FS BANCORP, INC.
2021 Annual Report

CORPORATE AND SHAREHOLDER INFORMATION

Transfer Agent
Equiniti Trust Company
EQ Shareowner Services
PO Box 64874
St Paul, MN 55164-0874
www.shareowneronline.com
Shareholder Services: (800) 468-9716

Independent Auditors
Moss Adams, LLP
Rimland Drive, Suite 300
Bellingham, WA 98226

SEC Counsel
Breyer & Associates PC
8180 Greensboro Drive, Suite 785
McLean, VA 22102

Common Stock
The Company's common stock is traded on the NASDAQ Stock Market LLC's Capital Market under the symbol "FSBW"

Investor Relations
6920 220th Street SW
Mountlake Terrace, WA 98043
investorrelations.fsbwa.com

FS BANCORP, INC. CONTACT INFORMATION

Joseph C. Adams
Chief Executive Officer
joea@fsbwa.com
(425) 697-8048

Matthew D. Mullet
Chief Financial Officer
mattm@fsbwa.com
(425) 697-8026

DIRECTORS AND OFFICERS

Directors
FS Bancorp, Inc. and 1st Security Bank of Washington
Ted A. Leech, Chairman
Joseph C. Adams, Chief Executive Officer
Pamela M. Andrews
Marina Cofer-Wildsmith
Michael J. Mansfield
Margaret R. Piesik
Mark H. Tueffers
Joseph P. Zavaglia

Executive Management
1st Security Bank of Washington
Joseph C. Adams, Chief Executive Officer
Erin Burr, EVP, Chief Risk Officer and CRA Officer
Lisa Cleary, EVP, Chief Operating Officer
Donn Costa, EVP, Home Lending
Rob Fuller, EVP, Chief Credit Officer
Vickie Jarman, EVP, Chief Human Resources/WOW! Officer
Matt Mullet, EVP, Chief Financial Officer
Kelli Nielsen, EVP, Retail Banking and Marketing
Dennis O'Leary, EVP, Chief Lending Officer

ANNUAL MEETING

Annual Meeting of Shareholders:
2:00 pm Thursday May 26, 2022
Administrative Center
6920 220th Street SW
Mountlake Terrace, WA 98043

CORPORATE WEBSITE

fsbwa.com

"Welcome to 1st Security Bank where our Smart, Driven, Nice® employees are building 'a truly great place to work and bank.'

We sincerely appreciate your support and will do everything we can to provide our clients with an exceptional banking experience. Thank you again for your trust in our team."

All the best,
Joe Adams, CEO

FS BANCORP, INC.

April 4, 2022

To our Shareholders:

Before I dive into the Bank's financials for 2021, I want to congratulate one of our Northwest owned and operated clients, Kenmore Air, on celebrating 75 years in business. Kenmore Air is a third-generation family run business that is probably the best known and most respected seaplane operation in the world. Not only do they repair and restore de Havilland Otters and Beavers, but they also fly passengers all over the Northwest including to the San Juan and Gulf Islands. If you ever find yourself in the Puget Sound region, by all means, check out Kenmore Air's flights. And if you're a nervous flyer, Todd Banks, Kenmore's CEO reminds passengers, "we fly low, you can see what's happening, and we are over our runway (water) 90% of the time." Based on my experience with Todd and team, you will love it!

Thanks to clients like Kenmore Air, the Bank had a tremendous 2021. It was our second-best year since the Bank's opening in 1936, exceeded only by the phenomenal year that was 2020. We continue to be thankful we are an "essential service." It really is hard to believe COVID-19 is still with us 2+ years later, but our teams have repeatedly risen to the COVID-19 challenge demonstrating their commitment to our customers and the communities we serve.

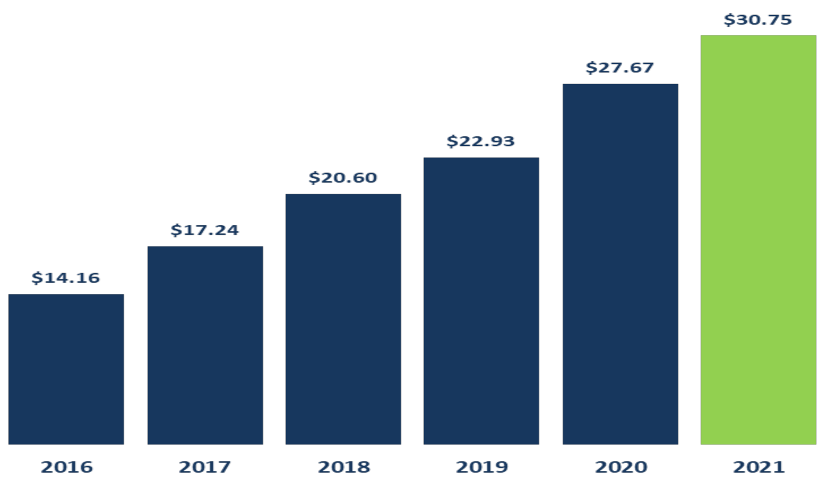
As I mentioned in the last two shareholder letters, we at 1st Security continue to operate under a modified business model to address the issues brought on by COVID-19. We still have approximately 75% of our non-customer facing employees working remotely. Unlike some of our larger competitors who have locked their branch doors, our customer facing teams remain accessible to our clients, while also being focused on protecting client and team health and safety. We owe a huge Thank You to our Retail teammates for keeping our doors open. They have been the face of the Bank during these difficult times and are a huge reason our customers are so loyal. The Bank's continued customer-driven focus resulted in outstanding 2021 financial results as shown below:

Financial results included the following:

- Gross Loans increased 11.7% in 2021 to $1.8 billion on December 31, 2021, reflecting strong loan growth in our four lending pillars.
  - Commercial real estate growth of 20.1% to $686.2 million,
  - Portfolio home lending growth including home equity of 14.9% to $406.9 million,
  - Consumer lending growth of 13.0% to $423.8 million, and
  - Business lending growth, excluding PPP loans, of 3.0% to $217.9 million;
- Our fifth pillar, deposits, increased 14.4% in 2021 to $1.9 billion on December 31, 2021. The increase was primarily driven by organic growth in customer relationships including a 27.2% growth in non interest bearing demand deposits to $443.1 million
- Provision expense of $500,000 in 2021 was a 96.2% decrease compared to 2020 which reflects improved credit performance and economic factors
- Return on average assets (ROAA) was 1.71%
- Return on average equity (ROAE) was 15.74%
- Diluted earnings per share (EPS) was $4.32
- Repurchased 524,353 split adjusted shares in 2021 representing 6.4% of common shares outstanding as of December 31, 2021
- Increased dividends paid to shareholders by 54% year over year

- Book value per share also increased to $30.75 in 2021 from $27.67 in 2020, and as shown in the six year table below. Book value remains our focus as this is one key variable we can control: (refer to table below)

Book Value



Our stock price increased 22.7% in 2021 beginning the year at $27.40 and closing 2021 at $33.63. This equates to a $6.23 per share increase for the year.

Our organization continues to be "culture" based and "people centric." As most shareholders know, the Vision Statement we created over ten years ago was, and still is: "To Build a Truly Great Place to Work and Bank." Key 2021 strategic and human capital achievements include the following:

- Ranked #1 by Bank Director Magazine as Best Community Bank and Best Leadership Team for 2022
- Recognized by Puget Sound Business Journal as one of Washington's Best Workplaces, and one of the *Top 100 Banks to Work For* by American Banker Magazine
- Created a Bank-wide "Livable Wage" of $20.00 per hour regardless of position
- Continued *"Operation Safe & Secure"* in response to COVID-19, the objective of which is to protect the health and financial security of our employees and customers
- Maintained a remote work environment, with 75% of non-customer facing employees having access to work from home
- Grew our employee base during the pandemic by 20%, adding 91 full-time jobs in our communities, since March 2020, with no furloughs or layoffs
- Donated over $155,000 to local food banks during our annual food drive

It was both an honor and a surprise to hear we won the Bank Director Magazine's Ranking Banking award for the Best Community Bank and Best Leadership Team, which was announced in December 2021. Emily McCormick, Vice President of Research, had reached out to us earlier in the year to discuss the topic of "culture" for an article that she was purportedly writing for the magazine. We had no idea we were in the running for an award. When she emailed Matt Mullet, our CFO, and me, we thought it might be a joke. After calling Emily, she assured us it was no joke. Not only had we been named Best Community Bank in the country (banks under $5 Billion in Assets), but Bank Director Magazine also ranked our Leadership Team #1 of all banks reviewed, regardless of size. Emily told us the Leadership Team award reflected our outstanding financial performance combined with our commitment to building a positive culture.

The Bank Director recognition is a great reminder that building an organization full of Smart, Driven, Nice® people is, in fact, a winning strategy. These awards would not have been possible without our teammates' and Board of Directors' ongoing commitment to our Bank's culture and core values. This commitment is at the heart of everything we do at 1st Security Bank.

Thanks again for your continued support. From everyone at 1st Security Bank and FSBW please stay safe and healthy. Take care and all the best in 2022.

Joe Adams

Joe Adams, CEO

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

FORM 10-K

(Mark one)

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

For the fiscal year ended December 31, 2021 **OR**

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

Commission File Number: 001-35589

FS BANCORP, INC.
(Exact name of registrant as specified in its charter)

Washington	45-4585178
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
6920 220th Street SW, Mountlake Terrace, Washington	**98043**
(Address of principal executive offices)	(Zip Code)
Registrant's telephone number, including area code:	(425) 771-5299

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, $0.01 par value per share	FSBW	The NASDAQ Stock Market LLC

Securities Registered Pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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

Indicate by check mark whether the registrant has submitted electronically, every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

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

Large accelerated filer ☐	Accelerated filer ☒
Non-accelerated filer ☐	Smaller reporting company ☒
Emerging growth company ☐	

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

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☒

Indicate by check mark whether the Registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes ☐ No ☒

As of March 11, 2022, there were 8,092,327 shares of the Registrant's common stock outstanding. The aggregate market value of the common stock held by non-affiliates of the Registrant was $261,908,698 based on the closing sales price of $35.64 per share of the Registrant's common stock as quoted on the NASDAQ Stock Market LLC on June 30, 2021. For purposes of this calculation, common stock held by executive officers and directors of the Registrant is considered to be held by affiliates.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the definitive Proxy Statement for the 2022 Annual Meeting of Shareholders ("Proxy Statement") are incorporated by reference into Part III.

FS Bancorp, Inc.
Table of Contents

As used in this report, the terms “we,” “our,” “us,” “Company”, and “FS Bancorp” refer to FS Bancorp, Inc. and its consolidated subsidiary, 1st Security Bank of Washington, unless the context indicates otherwise. When we refer to “Bank” in this report, we are referring to 1st Security Bank of Washington, the wholly owned subsidiary of FS Bancorp.

Forward-Looking Statements

This Form 10-K contains forward-looking statements, which can be identified by the use of words such as "believes," "expects," "anticipates," "estimates" or similar expressions. Forward-looking statements include, but are not limited to:

- statements of our goals, intentions and expectations;
- statements regarding our business plans, prospects, growth, and operating strategies;
- statements regarding the quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are subject to significant risks and uncertainties. Actual results may differ materially from those contemplated by the forward-looking statements due to, among others, the following factors:

- potential adverse impacts to economic conditions in our local market areas, other markets where the Company has lending relationships, or other aspects of the Company's business operations or financial markets, generally, resulting from the ongoing novel coronavirus of 2019 ("COVID-19") and any governmental or societal responses thereto;
- general economic conditions, either nationally or in our market area, that are worse than expected;
- the credit risks of lending activities, including changes in the level and trend of loan delinquencies, write offs, changes in our allowance for loan losses, and provision for loan losses that may be impacted by deterioration in the housing and commercial real estate markets;
- secondary market conditions and our ability to originate loans for sale and sell loans in the secondary market;
- fluctuations in the demand for loans, the number of unsold homes, land and other properties, and fluctuations in real estate values in our market area;
- staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our workforce and potential associated charges;
- 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;
- changes in the interest rate environment that reduce our interest margins or reduce the fair value of financial instruments;
- uncertainty regarding the future of the London Interbank Offered Rate ("LIBOR"), and the potential transition away from LIBOR toward new interest rate benchmarks;
- increased competitive pressures among financial services companies;
- our ability to execute our plans to grow our residential construction lending, our home lending operations, our warehouse lending, and the geographic expansion of our indirect home improvement lending;
- our ability to attract and retain deposits;
- our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we may in the future acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto;

- our ability to control operating costs and expenses;
- our ability to retain key members of our senior management team;
- changes in consumer spending, borrowing, and savings habits;
- our ability to successfully manage our growth;
- legislative or regulatory changes that adversely affect our business, including the effect of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, changes in regulation policies and principles, an increase in regulatory capital requirements or change in the interpretation of regulatory capital or other rules, including as a result of Basel III;
- adverse changes in the securities markets;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Public Company Accounting Oversight Board, or the Financial Accounting Standards Board ("FASB"), including as a result of the Coronavirus Aid, Relief, and Economic Security Act of 2020 ("CARES Act") and the Consolidated Appropriations Act, 2021 ("CAA 2021");
- costs and effects of litigation, including settlements and judgments;
- disruptions, security breaches, or other adverse events, failures, or interruptions in, or attacks on, our information technology systems or on the third-party vendors who perform several of our critical processing functions;
- inability of key third-party vendors to perform their obligations to us; and
- other economic, competitive, governmental, regulatory, and technical factors affecting our operations, pricing, products, and services, and other risks described elsewhere in this Form 10-K and our other reports filed with the U.S. Securities and Exchange Commission ("SEC").

Any of the forward-looking statements made in this Form 10-K and in other public statements may turn out to be wrong because of inaccurate assumptions we might make, because of the factors illustrated above or because of other factors that we cannot foresee. Forward-looking statements are based upon management's beliefs and assumptions at the time they are made. The Company undertakes no obligation to update or revise any forward-looking statement included in this report or to update the reasons why actual results could differ from those contained in such statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking statements discussed in this report might not occur and you should not put undue reliance on any forward-looking statements.

Available Information

The Company provides a link on its investor information page at www.fsbwa.com to filings with the SEC for purposes of providing copies of its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports, as soon as reasonably practicable after we have electronically filed such material with, or furnished such material to the SEC. Other than an investor's own internet access charges, these filings are free of charge and available through the SEC's website at www.sec.gov. The information contained on the Company's website is not included as part of, or incorporated by reference into, this Annual Report on Form 10-K.

PART 1

Item 1. Business

General

FS Bancorp, Inc. ("FS Bancorp" or the "Company"), a Washington corporation, was organized in September 2011 for the purpose of becoming the holding company of 1st Security Bank of Washington ("1st Security Bank of Washington" or the "Bank") upon the Bank's conversion from a mutual to a stock savings bank ("Conversion"). The Conversion was completed on July 9, 2012. At December 31, 2021, the Company had consolidated total assets of $2.29 billion, total deposits of $1.92 billion, and stockholders' equity of $247.5 million. The Company has not engaged in significant activity other than holding the stock of and providing capital to the Bank. Accordingly, the information set forth in this Annual Report on Form 10-K ("Form 10-K"), including the consolidated financial statements and related data, relates primarily to the Bank.

1st Security Bank of Washington is a relationship-driven community bank. The Bank delivers banking and financial services to local families, local and regional businesses and industry niches within distinct Puget Sound area communities. The Bank emphasizes long-term relationships with families and businesses within the communities served, working with them to meet their financial needs. The Bank is also actively involved in community activities and events within these market areas, which further strengthens these relationships. The Bank has been serving the Puget Sound area since 1907. Originally chartered as a credit union, and known as Washington's Credit Union, the Bank served various select employment groups. On April 1, 2004, the Bank converted from a credit union to a Washington state-chartered mutual savings bank. Upon completion of the Conversion in July 2012, 1st Security Bank of Washington became a Washington state-chartered stock savings bank and the wholly owned subsidiary of the Company.

At December 31, 2021, the Bank maintained the headquarters office that produces loans and accepts deposits located in Mountlake Terrace, Washington, and an administrative office in Aberdeen, Washington, as well as 21 full-service bank branches and 10 home loan production offices in suburban communities in the greater Puget Sound area. The Bank also has one home loan production office in the Tri-Cities, Washington.

The Company is a diversified lender with a focus on the origination of one-to-four-family, commercial real estate, consumer, including indirect home improvement ("fixture secured loans"), solar and marine lending, commercial business and second mortgage or home equity loans. Historically, consumer loans, in particular fixture secured loans, represented the largest portion of the Company's loan portfolio and the mainstay of the Company's lending strategy. In recent years, the Company has placed more of an emphasis on real estate lending products, such as one-to-four-family, commercial real estate, including speculative residential construction, as well as commercial business loans, while growing the current size of the consumer loan portfolio. The Company reintroduced in-house originations of residential mortgage loans in 2012, primarily for sale into the secondary market, through a mortgage banking program. The Company's lending strategies are intended to take advantage of: (1) the Company's historical strength in indirect consumer lending, (2) recent market consolidation that has created new lending opportunities, and (3) relationship lending. Retail deposits will continue to serve as an important funding source. For more information regarding the business and operations of 1st Security Bank of Washington, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Form 10-K.

1st Security Bank of Washington is examined and regulated by the Washington State Department of Financial Institutions ("DFI"), its primary regulator, and by the Federal Deposit Insurance Corporation ("FDIC"). 1st Security Bank of Washington is required to have certain reserves set by the Federal Reserve and is a member of the Federal Home Loan Bank of Des Moines ("FHLB" or "FHLB of Des Moines"), which is one of the 11 regional banks in the Federal Home Loan Bank System.

During the last two years, the Bank participated in the U.S. Small Business Administration ("SBA") Paycheck Protection Program ("PPP"), a guaranteed unsecured loan program enacted under the CARES Act to provide near-term relief to help small businesses impacted by COVID-19 sustain operations. The PPP ended on May 31, 2021. Under this program, we began processing applications for loan forgiveness in the fourth quarter of 2020. At December 31, 2021, there were 107 PPP loans outstanding totaling $24.2 million, as compared to 423 PPP loans totaling $62.1 million at December 31, 2020.

The principal executive offices of the Company are located at 6920 220th Street SW, Mountlake Terrace, Washington 98043 and the main telephone number is (425) 771-5299.

Market Area

The Company conducts operations, including loan and/or deposit services out of its headquarters, 10 loan production offices (six of which stand alone), 21 full-service bank branches in the Puget Sound region of Washington, and one stand-alone loan production office in Eastern Washington. The headquarters is located in Mountlake Terrace, in Snohomish County, Washington. The five stand-alone loan production offices in the Puget Sound region are located in Puyallup and Tacoma, in Pierce County, Bellevue, in King County, Port Orchard, in Kitsap County, Everett, in Snohomish County, and the one in Eastern Washington located in the Tri-Cities (Kennewick), in Benton County, Washington. The 21 full-service bank branches are located in the following counties: three in Snohomish, two in King, two in Clallam, two in Jefferson, two in Pierce, five in Grays Harbor, two in Thurston, one in Lewis, and two in Kitsap County.

The primary market area for business operations is the Seattle-Tacoma-Bellevue, Washington Metropolitan Statistical Area (the "Seattle MSA"). Kitsap, Clallam, Jefferson, Thurston, Lewis, and Grays Harbor counties, though not in the Seattle MSA, are also part of the Company's market area. This overall region is typically known as the Puget Sound region. The population of the Puget Sound region as estimated by Puget Sound Regional Council was 4.3 million in 2021, over half of the state's population, representing a large population base for potential business. The region has a well-developed urban area in the western portion along Puget Sound, with the north, central and eastern portions containing a mixture of developed residential and commercial neighborhoods and undeveloped, rural neighborhoods.

The Puget Sound region is the largest business center in both the State of Washington and the Pacific Northwest. Currently, key elements of the economy are aerospace, military bases, clean technology, biotechnology, education, information technology, logistics, international trade and tourism. The region is well known for the long presence of The Boeing Corporation and Microsoft, two major industry leaders, and for its leadership in technology. Amazon.com has expanded significantly in the Seattle downtown area. The workforce in general is well-educated and strong in technology. Washington State's location with regard to the Pacific Rim, along with a deep-water port has made international trade a significant part of the regional economy. Tourism has also developed into a major industry for the area, due to the scenic beauty, temperate climate and easy accessibility.

King County, which includes the city of Seattle, has the largest employment base and overall level of economic activity. Six of the largest employers in the state are headquartered in King County including Microsoft Corporation, University of Washington, Amazon.com, King County Government, Starbucks, and Swedish Health Services. Pierce County is the second most populous county in the state and its economy is also well diversified with the presence of military related government employment (Joint Base Lewis-McChord), along with health care (the MultiCare Health System and the Franciscan Health System). In addition, there is a large employment base in the economic sectors of shipping (the Port of Tacoma) and aerospace employment (Boeing). Snohomish County to the north has an economy based on aerospace employment (Boeing), health care (Providence Regional Medical Center), and military (the Everett Naval Station) along with additional employment concentrations in biotechnology, electronics/computers, and wood products.

According to 2021 economic research estimates, the median household income for King County was $103,000, compared to $79,000 for the State of Washington, and $66,000 for the United States.

The United States Navy is a key element for Kitsap County's economy. The United States Navy is the largest employer in the county, with installations at Puget Sound Naval Shipyard, Naval Undersea Warfare Center Keyport and Naval Base Kitsap (which comprises former Naval Submarine Base Bangor, and Naval Station Bremerton). The largest private employers in the county are the Harrison Medical Center and Port Madison Enterprises. Clallam County depends on agriculture, forestry, fishing, outdoor recreation and tourism. Jefferson County's largest private employer is Port Townsend Paper Mill and the largest employer overall (private and public) is Jefferson Healthcare.

Thurston County includes Olympia, home of Washington State's capital and its economic base is largely driven by state government related employment. According to 2021 economic research estimates, the median household income for Thurston County was $82,000.

Lewis County is supported by manufacturing, retail trade, local government and industrial services. Grays Harbor County has been historically dependent on the timber and fishing industries, but also relies on tourism, manufacturing, agriculture, shipping, transportation, and technology.

Unemployment in Washington was an estimated 4.5% at December 31, 2021, closely paralleling national trends as disclosed in the U.S. Bureau of Labor Statistics reflecting the impact of COVID-19 over the prior year. King County's estimated unemployment rate was 3.2%, a decrease from 6.8% in the prior year. The estimated unemployment rate in Snohomish County at year end 2021 was 3.8%, a decrease from 7.8% at year end 2020. Kitsap County's estimated unemployment rate was 3.3% at December 31, 2021, compared to 7.8% at December 31, 2020. At December 31, 2021, the estimated unemployment rate in Pierce County was 4.1%, down from 7.6% at December 31, 2020. Grays Harbor County's, Thurston County's, and Lewis County's estimated unemployment rates dropped to 5.5%, 3.5%, and 4.5%, respectively at December 31, 2021, compared to 10.1%, 6.5%, and 7.4% at year end 2020, respectively. Outside of the Puget Sound area, the Tri-Cities market includes two counties, Benton and Franklin, and we have two full-service branches in Clallam County and two in Jefferson County. The estimated unemployment rate in Benton County at year end 2021 was 4.2%, down from 6.4% at year end 2020. At December 31, 2021, the estimated unemployment rate in Franklin County was down to 5.5%, from 7.4% at December 31, 2020. For Clallam and Jefferson counties, the estimated unemployment rates at December 31, 2021 decreased to 4.5% and 4.1%, respectively, compared to 8.4% and 8.2%, respectively at December 31, 2020.

For a discussion regarding the competition in the Company's primary market area, see "Competition."

Lending Activities

General. Historically, the Company's primary emphasis was the origination of consumer loans (primarily indirect home improvement loans), one-to-four-family residential first mortgages, and second mortgage/home equity loan products. As a result of the Company's initial public offering in 2012, while maintaining the active indirect consumer lending program, the Company shifted its lending focus to include non-mortgage commercial business loans, as well as commercial real estate which includes construction and development loans. The Company reintroduced in-house originations of residential mortgage loans in 2012, primarily for sale in the secondary market. While maintaining the Company's historical strength in consumer lending, the Company has added management and personnel in the commercial and home lending areas to take advantage of the relatively favorable long-term business and economic environments prevailing in the markets.

The following table sets forth the amount of total loans with fixed or adjustable interest rates maturing subsequent to December 31, 2022:

(Dollars in thousands)	Year Ended December 31, 2021		
Real estate loans:	Fixed	Adjustable	Total
Commercial	$ 105,362	$ 143,805	$ 249,167
Construction	1,950	62,650	64,600
Home equity	13,093	26,642	39,735
One-to-four-family	213,181	137,573	350,754
Multi-family	83,991	94,662	178,653
Consumer	421,328	822	422,150
Commercial Business	76,600	59,718	136,318
Total	$ 915,505	$ 525,872	$ 1,441,377

Loan Maturity. The following table sets forth certain information at December 31, 2021, regarding the dollar amount for the loans maturing in the portfolio based on their contractual terms to maturity but does not include scheduled payments or potential prepayments. Loan balances do not include undisbursed loan proceeds, unearned discounts, unearned income, and allowance for loan losses.

	Real Estate							
(Dollars in thousands)	Commercial	Construction and Development	Home Equity	One-to-Four-Family [(2)]	Multi-family	Consumer	Commercial Business	Total
	Amount	Amount	Amount	Amount	Amount	Amount	Amount	Amount
In one year or less [(1)]	$ 15,871	$ 177,833	$ 823	$ 15,634	$ 41	$ 1,662	$ 105,785	$ 317,649
After one year through five years	99,752	19,894	733	14,852	20,720	21,817	61,423	239,191
After five years through fifteen years	149,211	44,706	2,234	76,458	155,170	329,652	65,870	823,301
More than fifteen years	204	—	36,768	259,444	2,763	70,681	9,025	378,885
Total	$ 265,038	$ 242,433	$ 40,558	$ 366,388	$ 178,694	$ 423,812	$ 242,103	$ 1,759,026

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

Lending Authority. The Chief Credit Officer has the authority to approve multiple loans to one borrower up to $15.0 million in aggregate. Loans in excess of $15.0 million and up to $30.0 million require additional approval from management's senior loan committee. All loans that are approved over $5.0 million are reported to the asset quality committee ("AQC") at each AQC meeting. Loans in excess of $30.0 million require AQC approval. The Chief Credit Officer may delegate lending authority to other individuals at levels consistent with their responsibilities.

The Board of Directors has implemented a lending limit policy that it believes matches the Washington State legal lending limit, 20% of Bank Tier 1 Capital, or $54.2 million at December 31, 2021. The Bank's largest lending relationship at December 31, 2021, consisted of a mix of permanent real estate loans, a multi-family construction loan, and a commercial line of credit. The permanent real estate loans were secured by seven residential real estate properties and had total commitments of $4.5 million, the multi-family construction loan had a total commitment of $17.0 million, and the commercial line of credit has a total available commitment of $25.0 million, with the Bank's total potential commitment of $16.0 million, and two other banks participating in the remaining $9.0 million. This line of credit is secured by notes for 12 properties. The total potential commitment of these loans to the Bank was $37.5 million at December 31, 2021, and the outstanding balance of these loans at December 31, 2021 was $13.5 million. The second largest lending relationship consisted of two commercial lines of credit secured by residential real estate with the Bank's total potential commitment of $22.8 million, of which $12.2 million was drawn at December 31, 2021, and one permanent one-to-four-family loan having combined commitments of $7.2 million. The outstanding balance of these three loans at December 31, 2021 was $19.4 million. The third largest lending relationship consisted of a mix of permanent real estate secured loans having combined commitments of $27.7 million, to four related limited liability companies. The outstanding balance of these loans at December 31, 2021 was $27.4 million. At December 31, 2021, all of the borrowers listed above were in compliance with the original repayment terms of their respective loans.

At December 31, 2021, the Company had $63.0 million in approved commercial construction warehouse lending lines for four companies, with the Bank's total potential commitment of $54.0 million, and two other banks participating in the remaining $9.0 million. The commitments individually range from $8.0 million to $25.0 million for the Bank with $27.1 million outstanding at December 31, 2021. At December 31, 2020, the Bank had $66.0 million approved in commercial construction warehouse lending lines for four companies with $33.0 million outstanding. In addition, at December 31, 2021, the Company had $43.5 million approved in mortgage warehouse lending lines for five companies. The commitments individually ranged from $5.0 million to $15.0 million. At December 31, 2021, there was $6.3 million in mortgage warehouse lending lines outstanding, compared to $36.0 million approved in mortgage warehouse lending lines with $16.1 million outstanding at December 31, 2020. At December 31, 2021, all of these warehouse lines were in compliance with the original repayment terms of their respective lending lines.

Commercial Real Estate Lending. The Company offers a variety of commercial real estate loans. Most of these loans are secured by income producing properties, including multi-family residences, retail centers, warehouses and office buildings located in the market areas. At December 31, 2021, commercial real estate loans (including $178.7 million of multi-family residential loans) totaled $443.7 million, or 25.2%, of the gross loan portfolio.

The Company's loans secured by commercial real estate are originated with a fixed or variable interest rate for up to a 15-year maturity and a 30-year amortization. The variable rate loans are indexed to the prime rate of interest or a short-term LIBOR rate, or five or seven-year FHLB rate, with rates equal to the prevailing index rate to 5.0% above the prevailing rate. Loan-to-value ratios on the Company's commercial real estate loans typically do not exceed 80% of the appraised value of the property securing the loan. In addition, personal guarantees are typically obtained from a principal of the borrower on substantially all credits.

Loans secured by commercial real estate are generally underwritten based on the net operating income of the property and the financial strength of the borrower. 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. The Company generally requires an assignment of rents or leases in order to be assured that the cash flow from the project will be sufficient to repay the debt. Appraisals on properties securing commercial real estate loans are performed by independent state certified or licensed fee appraisers. The Company does not generally maintain insurance or tax escrows for loans secured by commercial real estate. In order to monitor the adequacy of cash flows on income-producing properties, the borrower is required to provide financial information on at least an annual basis.

Loans secured by commercial real estate properties generally involve a greater degree of credit risk than one-to-four-family residential mortgage loans. These loans typically involve large balances to single borrowers or groups of related borrowers. Because payments on loans secured by commercial and multi-family real estate 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 multi-family 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 multi-family loans are not fully amortizing and include balloon payments upon maturity. Balloon payments may require the borrower to either sell or refinance the underlying property in order to make the payment, which may increase the risk of default or non-payment. The largest single commercial or multi-family real estate loan at December 31, 2021 was a performing $17.0 million loan secured by a 105-unit apartment building built in 2017 (which includes two retail spaces totaling 12,200 square feet) located in Seattle, Washington.

The Company intends to continue to emphasize commercial real estate lending and has hired experienced commercial loan officers to support the Company's commercial real estate lending objectives. As the commercial real estate loan portfolio expands, the Company intends to bring in additional experienced personnel in the areas of loan analysis and commercial deposit relationship management.

Construction and Development Lending. The Company expanded its residential construction lending team in 2011 with a focus on vertical, in-city one-to-four-family development in our market area. This team has over 60 years of combined experience and expertise in acquisition, development and construction ("ADC") lending in the Puget Sound market area. The Company has implemented this strategy to take advantage of what is believed to be a strong demand for construction and ADC loans to experienced, successful and relationship driven builders in our market area after many other banks abandoned this segment because of previous overexposure. At December 31, 2021, outstanding construction and development loans totaled $242.4 million, or 13.8%, of the gross loan portfolio and consisted of 308 loans, compared to $217.0 million and 253 loans at December 31, 2020. The construction and development loans at December 31, 2021, consisted of loans for residential and commercial construction projects primarily for vertical construction and $6.3 million of land acquisition and development loans for finished lots. Total committed, including unfunded construction and development loans at December 31, 2021, was $424.7 million. At December 31, 2021, $120.0 million, or 50.0% of our outstanding construction and development loan portfolio was comprised of speculative one-to-four-family construction loans. Approximately $27.1 million of our residential construction loans at December 31, 2021 were made to finance the custom construction of owner-occupied homes and are structured to be converted to permanent loans at the end of the construction phase. Approximately 71.0% of these custom home loans consisted of custom manufactured homes. In addition, included in commercial business loans, the Company had four commercial secured lines of credit, secured by notes to residential construction borrowers with guarantees from principals with experience in the construction re-lending market. These loans had combined bank-owned commitments of $54.0 million, and an outstanding balance of $27.1 million at December 31, 2021.

The Company's residential construction lending program includes loans for the purpose of constructing both speculative and pre-sold one-to-four-family residences, the acquisition of in-city lots with and without existing improvements for later development of one-to-four-family residences, the acquisition of land to be developed, and loans for the acquisition and development of land for future development of single-family residences. The Company generally limits these types of loans to known builders and developers in the market area. Construction loans generally provide for the payment of interest-only during the construction phase, which is typically up to 12 months. At the end of the construction phase, the construction loan is generally paid off through the sale of the newly constructed home and a permanent loan from another lender, although commitments to convert to a permanent loan may be made by us. Construction loans are generally made with a maximum loan amount of the lower of 95% of cost or 75% of appraised value at completion. During the term of construction, the accumulated interest on the loan is typically added to the principal balance of the loan through an interest reserve of 3% to 5.5% of the loan commitment amount.

Commitments to fund construction loans generally are made subject to an appraisal of the property by an independent licensed appraiser. The Company also reviews and has a licensed third-party inspect each property before disbursement of funds during the term of the construction loan. Loan proceeds are disbursed after inspection by a third-party inspector based on the percentage of completion method.

The Company may also make land acquisition and development loans to builders or residential lot developers on a limited basis. These loans involve a higher degree of credit risk, similar to commercial construction loans. At December 31, 2021, included in the $242.4 million of construction and development loans, were seven residential land acquisition and development loans for finished lots totaling $6.3 million, with total commitments of $13.1 million. These land loans also involve additional risks because the loan amount is based on the projected value of the lots after development. Loans are made for up to 75% of the estimated value with a term of up to two years. These loans are required to be paid on an accelerated basis as the lots are sold, so that the Company is repaid before all the lots are sold.

Construction financing is generally considered to involve a higher degree of credit risk than longer-term financing on improved, owner-occupied real estate. Construction and development lending contains the inherent difficulty in estimating both a property's value at completion of the project and the estimated cost (including interest) of the project. Changes in the demand, such as for new housing and higher than anticipated building costs may cause actual results to vary significantly from those estimated. If the estimate of construction cost proves to be inaccurate, we may be required to advance funds beyond the amount originally committed to permit completion of the project. This type of lending also typically involves higher loan principal amounts and is often concentrated with a small number of builders. In addition, during the term of most of our construction loans, an interest reserve is created at origination and is added to the principal of the loan through the construction phase. If the estimate of value upon completion proves to be inaccurate, we may be confronted at, or prior to, the maturity of the loan with a project, the value of which is insufficient to assure full repayment. Because construction loans require active monitoring of the building process, including cost comparisons and on-site inspections, these loans are more difficult and costly to monitor.

Increases in market rates of interest may have a more pronounced effect on construction loans by rapidly increasing the end-purchasers' borrowing costs, thereby reducing the overall demand for the project. Properties under construction are often difficult to sell and typically must be completed in order to be successfully sold which also complicates the process of working out problem construction loans. This may require us to advance additional funds and/or contract with another builder to complete construction. Furthermore, speculative construction loans to a builder are often associated with homes that are not pre-sold, and thus pose a greater potential risk than construction loans to individuals on their personal residences as there is the added risk associated with identifying an end-purchaser for the finished project. Loans on land under development or held for future construction pose additional risk because of the lack of income being produced by the property and the potential illiquid nature of the collateral. These risks can be significantly impacted by supply and demand. As a result, this type of lending often involves the disbursement of substantial funds with repayment dependent on the success of the ultimate project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor themselves to repay principal and interest.

The Company seeks to address the forgoing risks associated with construction development lending by developing and adhering to underwriting policies, disbursement procedures, and monitoring practices. Specifically, the Company (i) seeks to diversify the number of loans and projects in the market area, (ii) evaluate and document the creditworthiness of the borrower and the viability of the proposed project, (iii) limit loan-to-value ratios to specified levels, (iv) control disbursements on construction loans on the basis of on-site inspections by a licensed third-party, (v) monitor economic conditions and the housing inventory in each market, and (iv) typically obtains personal guarantees from a principal of the borrower on substantially all credits. No assurances, however, can be given that these practices will be successful in mitigating the risks of construction development lending.

Home Equity Lending. The Company has been active in second lien mortgage and home equity lending, with the focus of this lending being conducted in the Company's primary market area. The home equity lines of credit generally have adjustable rates tied to the prime rate of interest with a draw term of 10 years plus and a term to maturity of 15 years. Monthly payments are based on 1.0% of the outstanding balance with a maximum combined loan-to-value ratio of up to 90%, including any underlying first mortgage. Fixed second lien mortgage home equity loans are typically amortizing loans with terms of up to 30 years. Total second lien mortgage/home equity loans totaled $40.6 million, or 2.3% of the gross loan portfolio, at December 31, 2021, $27.4 million of which were adjustable-rate home equity lines of credit. Unfunded commitments on home equity lines of credit at December 31, 2021, was $67.6 million.

Residential. The Company originates loans secured by first mortgages on one-to-four-family residences primarily in the market area. The Company originates one-to-four-family residential mortgage loans through referrals from real estate agents, financial planners, builders, and from existing customers. Retail banking customers are also important referral sources of the Company's loan originations. The Company originated $1.55 billion of one-to-four-family mortgages (including $10.0 million of loans brokered to other institutions) and sold $1.42 billion to investors in 2021. Of the loans sold to investors, $1.10 billion were sold to the Federal National Mortgage Association ("Fannie Mae"), the Government National Mortgage Association ("Ginnie Mae"), the FHLB, and/or the Federal Home Loan Mortgage Corporation ("Freddie Mac") with servicing rights retained in order to further build the relationship with the customer. At December 31, 2021, one-to-four-family residential mortgage loans totaled $366.4 million, or 20.8%, of the gross loan portfolio, excluding loans held for sale of $125.8 million. In addition, the Company originates residential loans through its commercial lending channel, secured by single family rental homes in Washington, with an outstanding balance of $102.6 million at December 31, 2021.

The Company generally underwrites the one-to-four-family loans based on the applicant's ability to repay. This includes employment and credit history and the appraised value of the subject property. The Company will lend up to 100% of the lesser of the appraised value or purchase price for one-to-four-family first mortgage loans. For first mortgage loans with a loan-to-value ratio in excess of 80%, the Company generally requires either private mortgage insurance or government sponsored insurance in order to mitigate the higher risk level associated with higher loan-to-value loans. Fixed-rate loans secured by one-to-four-family residences have contractual maturities of up to 30 years and are generally fully amortizing, with payments due monthly. Adjustable-rate mortgage loans generally pose different credit risks than fixed-rate loans, primarily because as interest rates rise the borrower's payments rise, increasing the potential for default. Properties securing the one-to-four-family loans are appraised by independent fee appraisers who are selected in accordance with industry and regulatory standards. The Company requires borrowers to obtain title and hazard insurance, and flood insurance, if necessary. Loans are generally underwritten to the secondary market guidelines with overlays as determined by the internal underwriting department.

Consumer Lending. Consumer lending represents a significant and important historical activity for the Company, primarily reflecting the indirect lending through home improvement contractors and dealers. At December 31, 2021, consumer loans totaled $423.8 million, or 24.1% of the gross loan portfolio.

The Company's indirect home improvement loans, also referred to as fixture secured loans, represent the largest portion of the consumer loan portfolio and have traditionally been the mainstay of the Company's consumer lending strategy. These loans totaled $340.3 million, or 19.3% of the gross loan portfolio, and 80.3% of total consumer loans, at December 31, 2021. Indirect home improvement loans are originated through a network of 147 home improvement contractors and dealers located in Washington, Oregon, California, Idaho, Colorado, Arizona, Nevada, and Minnesota. Five dealers are responsible for 49.5% of the loan volume. These fixture secured loans consist of loans for a wide variety of products, such as replacement windows, siding, roofs, HVAC systems, pools, and other home fixture installations, including solar related home improvement projects.

In connection with fixture secured loans, the Company receives loan applications from the dealers, and originates the loans based on pre-defined lending criteria. These loans are processed through the loan origination software, with approximately 40.0% of the loan applications receiving an automated approval based on the information provided. All loan applications are evaluated by the Company's credit analysts who use the automated data to expedite the loan approval process. The Company follows the internal underwriting guidelines in evaluating loans obtained through the indirect dealer program, including using a Fair Isaac and Company, Incorporated ("FICO") credit score to approve loans. A FICO score is a principal measure of credit quality and is one of the significant criteria we rely upon in our underwriting in addition to the borrower's debt to income.

The Company's fixture secured loans generally range in amounts from $2,500 to $100,000, and generally carry terms of 12 to 20 years with fixed rates of amortizing payments and interest. In some instances, the participating dealer may pay a fee to buy down the borrower's interest rate to a rate below the Company's published rate. Fixture secured loans are secured by the personal property installed in, on or at the borrower's real property, and may be perfected with a financing statement under the Uniform Commercial Code ("UCC") filed in the county of the borrower's residence. The Company generally files a UCC financing statement to perfect the security interest in the personal property in situations where the borrower's credit score is below 720 or the home improvement loan is for an amount in excess of $5,000. Perfection gives the Company a claim to the collateral that is superior to someone that obtains a lien through the judicial process subsequent to the perfection of a security interest. The failure to perfect a security interest does not render the security interest unenforceable against the borrower. However, failure to perfect a security interest risks avoidance of the security interest in bankruptcy or subordination to the claims of third parties.

The Company also offers consumer marine loans secured by boats. At December 31, 2021, the marine loan portfolio totaled $80.6 million, or 4.6% of total loans. Marine loans are originated with borrowers on both a direct and indirect basis, and generally carry terms of up to 20 years with fixed rates of interest. The Company generally requires a 10% down payment, and the loan amount may be up to the lesser of 120% of factory invoice or 90% of the purchase price.

The Company originates other consumer loans which totaled $2.9 million at December 31, 2021. These loans primarily include personal lines of credit, credit cards, automobile, direct home improvement, loans on deposit, and recreational loans.

In evaluating any consumer loan application, a borrower's FICO score is utilized as an important indicator of credit risk. The FICO score represents the creditworthiness of a borrower based on the borrower's credit history, as reported by an independent third party. A higher FICO score typically indicates a greater degree of creditworthiness. Over the last several years the Company has emphasized originations of loans to consumers with higher credit scores. This has resulted in a lower level of loan charge-offs in recent periods. At December 31, 2021, 80.6% of the consumer loan portfolio was originated with borrowers having a FICO score over 720 at the time of origination, and 17.8% was originated with borrowers having a FICO score between 660 and 720 at the time of origination. Generally, a FICO score of 660 or higher indicates the borrower has an acceptable credit reputation. A consumer credit score at the time of loan origination of less than 660 is associated as "subprime" by federal banking regulators and these loans comprised just 1.6% of our consumer loan portfolio at December 31, 2021. Consideration for loans with FICO scores below 660 require additional management oversight and approval.

Consumer loans generally have shorter average lives with faster prepayment, which reduces the Company's exposure to changes in interest rates. In addition, management believes that offering consumer loan products helps to expand and create stronger ties to existing customer base by increasing the number of customer relationships and providing cross-marketing opportunities.

Consumer and other 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 boats, automobiles and other 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. In the case of fixture secured loans, it is very difficult to repossess the personal property securing these loans as they are typically attached to the borrower's personal residence. Accordingly, if a borrower defaults on a fixture secured loan the only practical recourse is to wait until the borrower wants to sell or refinance the home, at which time if there is a perfected security interest the Company generally will be able to collect a portion of the loan previously charged off.

Commercial Business Lending. The Company originates commercial business loans and lines of credit to local small- and mid-sized businesses in the Puget Sound market area that are secured by accounts receivable, inventory, or personal/business property, plant and equipment. Consistent with management's objectives to expand commercial business lending, in 2009, the Company commenced a mortgage warehouse lending program through which the Company funds third-party residential mortgage bankers. Under this program the Company provides short-term funding to the mortgage banking companies for the purpose of originating residential mortgage loans for sale into the secondary market. The Company's warehouse lending lines are secured by the underlying notes associated with one-to-four-family mortgage loans made to borrowers by the mortgage banking company and generally require guarantees from the principal shareholder(s) of the mortgage banking company. These loans are repaid when the note is sold by the mortgage bank into the secondary market, with the proceeds from the sale used to pay down the outstanding loan before being dispersed to the mortgage bank. The Company had $43.5 million approved in residential mortgage warehouse lending lines for five companies at December 31, 2021. The commitments ranged from $5.0 million to $15.0 million. At December 31, 2021, there was $6.3 million in residential warehouse lines outstanding, compared to $36.0 million in approved residential warehouse lending lines with $16.1 million outstanding at December 31, 2020. During the year ended December 31, 2021, we processed approximately 750 loans and funded approximately $306.5 million in total under our mortgage warehouse lending program.

The Company also has commercial construction warehouse lending lines secured by notes on construction loans and typically guaranteed by principals with experience in construction lending. In April 2013, we commenced an expansion of our mortgage warehouse lending program to include construction re-lending warehouse lines. These lines are secured by notes provided to construction lenders and are typically guaranteed by a principal of the borrower with experience in construction lending. Terms for the underlying notes can be up to 18 months and the Bank will lend a percentage (typically 70 - 80%) of the underlying note which may have a loan-to-value ratio up to 75%. Combined, the loan-to-value ratio on the underlying note would be up to 60% with additional credit support provided by the guarantor. At December 31, 2021, the Company had $63.0 million in approved commercial construction warehouse lending lines for four companies, with the Bank's total potential commitment of $54.0 million, and two other banks participating in the remaining $9.0 million. The individual commitments range from $8.0 million to $25.0 million. At December 31, 2021, there was $27.1 million outstanding, compared to $66.0 million approved in commercial warehouse lending lines for four companies with $33.0 million outstanding at December 31, 2020.

As a result of the COVID-19 pandemic, the CARES Act was enacted and authorized the SBA to temporarily guarantee loans under a new loan program called the Paycheck Protection Program. The CAA, 2021, which was signed into law on December 27, 2020, renewed and extended the PPP until May 31, 2021, the final expiration date for PPP lending. Beginning in the second quarter of 2020, the Bank began to offer PPP loans which are fully guaranteed by the SBA, to existing and new customers as a result of the COVID-19 pandemic. The entire principal amount of the borrower's PPP loan, including any accrued interest, is eligible to be forgiven and repaid by the SBA if the borrower meets the PPP conditions. The Bank earns 1% interest on PPP loans as well as a fee from the SBA to cover processing costs, which is amortized over the life of the loan and recognized fully at payoff or forgiveness. The maturity date of the PPP loan is either two or five years from the date of loan origination. The great majority of our PPP loans have been forgiven by the SBA in accordance with the terms of the program. The Bank expects that the great majority of its remaining PPP borrowers will also seek full or partial forgiveness of their loan obligations. Under this program, at December 31, 2021, there were 107 PPP loans outstanding totaling $24.2 million. For additional information regarding these loans, see "Item 1A. Risk Factors - "Risks Related to Our Lending - Loans originated under the SBA Paycheck Protection Program subject us to credit, forgiveness and guarantee risk" of this Form 10-K.

Commercial business loans may be fixed-rate but are usually adjustable-rate loans indexed to the prime rate of interest, plus a margin. Some of these commercial business loans, such as those made pursuant to the warehouse lending program, are structured as lines of credit with terms of 12 months and interest-only payments required during the term, while other loans may reprice on an annual basis and amortize over a two-to-five-year period. Due to the current interest rate environment, these loans and lines of credit are generally originated with a floor, which is set between 3.75% and 4.50%. Loan fees are generally charged at origination depending on the credit quality and account relationships of the borrower. Advance rates on these types of lines are generally limited to 80% of accounts receivable and 50% of inventory. The Company also generally requires the borrower to establish a deposit relationship as part of the loan approval process. At December 31, 2021, the commercial business loan portfolio totaled $242.1 million, or 13.8%, of the gross loan portfolio including warehouse lending loans and PPP loans.

At December 31, 2021, most of the commercial business loans were secured. The Company's 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 credit analysis. The Company generally requires personal guarantees on these commercial business loans. Nonetheless, commercial business loans are believed to carry higher credit risk than residential mortgage loans. The largest commercial business lending relationships at December 31, 2021, consisted of a participating commercial line of credit having a commitment of $11.0 million from the Bank, a commercial line of credit having a commitment of $6.0 million, and a commercial term loan with a commitment of $1.4 million. These loans are secured by a mix of assets of the borrower and guarantor. The outstanding balance of these loans at December 31, 2021 was $12.7 million. The next largest commercial business lending relationship totaled $17.0 million and consisted of two commercial lines of credit of up to $3.5 million, of which the Bank has disbursed none as of December 31, 2021, and a commercial term loan of $13.5 million. These loans are secured by a mix of assets of the borrower and guarantor.

Unlike residential mortgage loans, commercial business loans, particularly unsecured loans, are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business and, therefore, are of higher risk. The Company makes commercial business loans secured by business assets, such as accounts receivable, inventory, equipment, real estate and cash as collateral with loan-to-value ratios in most cases up to 80%, based on the type of collateral. This collateral depreciates over time, may be difficult to appraise 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, Servicing, Purchases and Sales

The Company originates both fixed-rate and adjustable-rate loans. The ability to originate loans, however, is dependent upon customer demand for loans in the market areas. From time to time to supplement our loan originations and based on our asset/liability objectives we will also purchase bulk loans or pools of loans from other financial institutions.

Over the past few years, the Company has continued to originate consumer loans, and increased emphasis on commercial real estate loans, including construction and development lending, as well as commercial business loans. Demand is affected by competition and the interest rate environment. In periods of economic uncertainty, the ability of financial institutions, including the Bank, to originate large dollar volumes of commercial business and real estate loans may be substantially reduced or restricted, with a resultant decrease in interest income. In addition to interest earned on loans and loan origination fees, the Company receives fees for loan commitments, late payments, and other miscellaneous services. The fees vary from time to time, generally depending on the supply of funds and other competitive conditions in the market. In addition to the 1.0% interest earned on PPP loans, the SBA pays processing fees for PPP loans of either 1%, 3%, or 5%, based on the size of the loan. Banks may not collect any fees from the PPP loan applicants.

The Company will sell long-term, conforming fixed-rate residential real estate loans in the secondary market to mitigate credit and interest rate risk. Gains and losses from the sale of these loans are recognized based on the difference between the sales proceeds and carrying value of the loans at the time of the sale. Some residential real estate loans originated as Federal Housing Administration or FHA, U.S. Department of Veterans Affairs or VA, or United States Department of Agriculture or USDA Rural Housing loans were sold by the Company as servicing released loans to other companies. A majority of residential real estate loans sold by the Company were sold with servicing retained at a specified servicing fee. The Company earned gross mortgage servicing fees of $6.3 million for the year ended December 31, 2021. The Company was servicing $2.61 billion of one-to-four-family loans at December 31, 2021, for Fannie Mae, Freddie Mac, Ginnie Mae, the FHLB, and another financial institution. These mortgage servicing rights ("MSRs") constituted a $17.0 million asset on our books on that date, which is amortized in proportion to and over the period of the net servicing income. These MSRs are periodically evaluated for impairment based on their fair value, which takes into account the rates and potential prepayments of those sold loans being serviced. The fair value of our MSRs at December 31, 2021 was $26.1 million. See "Note 4 - Servicing Rights" and "Note 15 - Fair Value Measurements" of the Notes to Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data" of this Form 10-K.

The following table presents the notional balance activity during the year ended December 31, 2021, related to loans serviced for others.

	(In thousands)
Beginning balance at January 1, 2021	
One-to-four-family	$ 2,172,501
Consumer	366
Subtotal	2,172,867
Additions	
One-to-four-family	1,097,273
Repayments	
One-to-four-family	(659,998)
Consumer	(158)
Subtotal	(660,156)
Ending balance at December 31, 2021	
One-to-four-family	2,609,776
Consumer	208
Total	$ 2,609,984

The following table shows total loans originated, purchased, sold and repaid during the years indicated.

(In thousands)	Year Ended December 31, 2021	2020
Originations by type:		
Fixed-rate:		
Commercial real estate	$ 42,328	$ 36,307
Construction and development	64,280	17,886
Home equity	8,446	13,522
One-to-four-family (1)	124,756	66,796
Loans held for sale (one-to-four-family)	1,338,609	1,723,884
Multi-family	40,383	17,118
Consumer	249,199	188,587
Commercial business (2)	78,043	98,646
Total fixed-rate	1,946,044	2,162,746
Adjustable-rate:		
Commercial real estate	36,068	25,218
Construction and development	273,097	297,883
Home equity	24,244	18,079
One-to-four-family (1)	37,490	59,188
Loans held for sale (one-to-four-family)	15,027	6,781
Multi-family	25,695	14,074
Consumer	1,924	1,176
Commercial business (2) (5)	94,746	113,546
Warehouse lines, net	(15,753)	(12,020)
Total adjustable-rate	492,538	523,925
Total loans originated	2,438,582	2,686,671
Purchases by type		
Fixed-rate:		
Commercial real estate	—	—
Home equity	—	—
One-to-four-family (1) (4)	1,618	272
Multi-family	—	—
Consumer	—	—
Construction and development	—	—
Commercial business (2)	—	—
Adjustable-rate:		
Commercial real estate	—	—
Home equity	—	—
One-to-four-family (1)	—	28,057
Multi-family	—	—
Consumer	—	—
Construction and development	—	—
Commercial business (2) (3)	—	3,727
Total loans purchased	1,618	32,056
Sales and repayments:		
One-to-four-family (1)	—	—
Loans held for sale (one-to-four-family)	(1,394,274)	(1,641,880)
Commercial business (2)	(2,452)	—
Total loans sold	(1,396,726)	(1,641,880)
Total principal repayments	(899,313)	(757,764)
Total reductions	(2,296,039)	(2,399,644)
Net increase	$ 144,161	$ 319,083

(1) One-to-four-family portfolio loans.
(2) Excludes warehouse lines.
(3) Includes USDA/ SBA guaranteed loans purchased at a premium.
(4) Loan repurchased, previously sold.
(5) Includes $52.8 million and $75.8 million of PPP loans at December 31, 2021 and 2020, respectively.

Sales of whole and participations in real estate loans can be beneficial to the Bank since these sales systematically 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.

From time to time we also sell whole consumer loans, specifically long-term consumer loans, which can be beneficial to us since these sales generate income at the time of sale, can potentially create future servicing income where servicing is retained, and provide a mitigation of interest rate risk associated with holding longer maturity consumer loans.

Asset Quality

When a borrower fails to make a required payment on a residential real estate loan, the Company attempts to cure the delinquency by contacting the borrower. In the case of loans secured by residential real estate, a late notice typically is sent 16 days after the due date, and the borrower is contacted by phone within 16 to 25 days after the due date. When the loan is 30 days past due, an action plan is formulated for the credit under the direction of the mortgage loan control manager. Generally, a delinquency letter is mailed to the borrower. All delinquent accounts are reviewed by a loan control representative 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, a Loan Control representative will 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. Between 90 - 120 days past due, a value is obtained for the loan collateral. At that time, a mortgage analysis is completed to determine the loan-to-value ratio and any collateral deficiency. If foreclosed, the Company customarily takes title to the property and sells it directly through a real estate broker.

Delinquent consumer loans are handled in a similar manner. Appropriate action is taken in the form of phone calls and notices to collect any loan payment that is delinquent more than 16 days. Once the loan is 90 days past due, it is classified as nonaccrual. Generally, credits are charged off if past due 120 days, unless the collections department provides support for a customer repayment plan. Bank 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 commercial business loans and loans secured by commercial real estate are handled by the loan officer in charge of the loan, who is responsible for contacting the borrower. The loan officer works with outside counsel and, in the case of real estate loans, a third-party consultant to resolve problem loans. In addition, management meets as needed 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 AQC and the board on a monthly basis. If an acceptable workout of a delinquent commercial loan cannot be agreed upon, the Company customarily will initiate foreclosure or repossession proceedings on any collateral securing the loan.

Other Real Estate Owned. Real estate acquired by the Company as a result of foreclosure or by deed-in-lieu of foreclosure is classified as real estate owned until it is sold. When the property is acquired, it is recorded at the lower of its cost, which is the unpaid principal balance of the related loan plus foreclosure costs, or the fair market value of the property less selling costs. The Company did not have any other real estate owned as of December 31, 2021.

Restructured Loans. According to generally accepted accounting principles in the United States of America ("U.S. GAAP"), the Company is required to account for certain loan modifications or restructuring as a "troubled debt restructuring" or "TDR". In general, the modification or restructuring of a debt is considered a TDR if the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrowers that would not otherwise be considered. The Company had no TDRs at December 31, 2021. In late March 2020, the Bank announced loan modification programs to support and provide relief for its borrowers during the COVID-19 pandemic. The Company has followed the CARES Act and interagency guidance from the federal banking agencies when determining if a borrower's modification is subject to TDR classification. As of December 31, 2021, the amount of loans remaining under interest-only payment/relief agreements due to COVID-19 included commercial real estate loans of $6.9 million and commercial business loans of $2.1 million. These loans were classified as current and accruing interest, with the exception of $1.2 million in commercial business loans which were classified as nonaccrual, yet current on contractual payments. These modifications were not classified as TDRs pursuant to the guidance in effect at the time of modification. For a discussion on loans that qualified for deferral or forbearance agreements under the CARES Act and related guidance, see "Note 3 - Loans Receivable and Allowance for Loan Losses." of the Notes to Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data" of this Form 10-K.

Classified Assets. Federal regulations provide for the classification of lower quality loans and other assets (such as other real estate owned and repossessed property), debt and equity securities, as substandard, doubtful or loss. An asset is considered substandard if it is inadequately protected by the current net worth and pay capacity of the borrower or of any collateral pledged. Substandard assets include those characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions, and values. 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 the Company classifies problem assets as either substandard or doubtful, a specific allowance may be established in an amount deemed 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 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. The Company's determination as to the classification of assets and the amount of valuation allowances is subject to review by the FDIC and the DFI, which can order the establishment of additional loss allowances. Assets which do not currently expose the Company to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are required to be designated as special mention.

In connection with the filing of periodic reports with the FDIC and in accordance with the Company's classification of assets policy, the Company regularly reviews the problem assets in the portfolio to determine whether any assets require classification in accordance with applicable regulations. On the basis of the review of the Company's assets, at December 31, 2021, the Company had classified $18.1 million of assets as substandard. The $18.1 million of classified assets represented 7.31% of equity and 0.79% of total assets at December 31, 2021. The Company had $7.6 million of assets classified as special mention at December 31, 2021, not included in classified assets reported above.

Allowance for Loan Losses

The Company maintains an allowance for loan losses to absorb probable incurred credit losses in the loan portfolio. The allowance is based on ongoing monthly assessments of the estimated probable incurred losses in the loan portfolio. Ultimate losses may vary from these estimates. 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. The Company also considers qualitative factors such as changes in the lending policies and procedures, changes in the local/national economy, changes in volume or type of credits, changes in volume/severity of problem loans, quality of loan review and board of director oversight and concentrations of credit. The qualitative factors have been established based on certain assumptions made as a result of the current economic conditions and are adjusted as conditions change to be directionally consistent with these changes. Large groups of smaller balance homogeneous loans, such as residential real estate, small commercial real estate, 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 real estate loans and commercial business loans, are evaluated individually for impairment, primarily through the evaluation of net operating income and available cash flow and their possible impact on collateral values.

When determining the appropriate allowance for loan losses during 2021, management took into consideration the impact of the COVID-19 pandemic on such additional qualitative factors as the national and state unemployment rates and related trends, national and state unemployment benefit claim levels and related trends, the amount of and timing of financial assistance provided by the government, consumer spending levels and trends, industries significantly impacted by the COVID-19 pandemic, a review of the Bank's largest commercial loan relationships, and the Bank's COVID-19 loan modification program.

Management decreased qualitative factors during 2021 due to improving of economic conditions as a result of the COVD-19 pandemic. The decrease in the factors resulted in a significant decrease in the allowance for loan losses during the current year. Management will continue to closely monitor economic conditions and will work with borrowers as necessary to assist them through this challenging economic climate. If economic conditions worsen, it is possible the Bank's allowance for loan losses will need to increase in future periods. Uncertainties relating to our allowance for loan losses are heightened as a result of the risks surrounding the COVID-19 pandemic as described in further detail in Item 1A. Risk Factors - "Risks Related to Macroeconomic Conditions-The COVID-19 pandemic has impacted the way we conduct business which may adversely impact our financial results and those of our customers. The ultimate impact will depend on future developments, which are highly uncertain and cannot be predicted, including the scope and duration of the pandemic and actions taken by governmental authorities in response to the pandemic."

The allowance for loan losses is increased by the provision for loan losses, which is charged against current period earnings and decreased by the amount of actual loan charge-offs, net of recoveries.

The provision for loan losses was $500,000 for the year ended December 31, 2021, compared to $13.0 million for the year ended December 31, 2020. The reduction of the provision for loan losses from the previous year reflects improved economic qualitative factors on credit-deterioration related to the COVID-19 pandemic utilized to calculate the allowance for loan losses and also reflects loan-level improvements in "watch" classified loans that were downgraded based on the COVID-19 pandemic at December 31, 2021, compared to the same time last year. The $24.2 million balance of remaining PPP loans was omitted from the calculation of the allowance for loan losses at December 31, 2021 as these loans are fully guaranteed by the SBA and management expects that the great majority of remaining PPP borrowers will seek full or partial forgiveness of their loan obligations from the SBA within a short time frame, which will in turn reimburse the Bank for the amount forgiven.

The allowance for loan losses was $25.6 million, or 1.46% of gross loans receivable at December 31, 2021, as compared to $26.2 million, or 1.66% of gross loans receivable outstanding at December 31, 2020. In accordance with acquisition accounting, loans acquired in the Anchor Bank acquisition in November 2018 ("Anchor Acquisition") were recorded at their estimated fair value, which resulted in a net discount to the contractual amounts of the loans, of which a portion reflects a discount for possible credit losses. Credit discounts are included in the determination of fair value and as a result, no allowance for loan losses is recorded for acquired loans at the acquisition date. Although the discount recorded on the acquired loans is not reflected in the allowance for loan losses, or related allowance coverage ratios, we believe it should be considered when comparing the current ratios to similar ratios in periods prior to the acquisition. The remaining fair value discount on loans purchased in the Anchor Acquisition was $751,000, on $84.3 million of gross loans at December 31, 2021. Management will continue to review the adequacy of the allowance for loan losses and make adjustments to the provision for loan losses based on loan growth, economic conditions, charge-offs and portfolio composition. A decline in national and local economic conditions, as a result of the COVID-19 pandemic or other factors, could result in a material increase in the allowance for loan losses and may adversely affect the Company's financial condition and results of operations.

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, reflects probable incurred loan losses in the loan portfolio. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations - Comparison of Results of Operations for the Years Ended December 31, 2021 and 2020 - Provision for Loan Losses” and “Notes 1- Basis of Presentation and Summary of Significant Accounting Policies” and “Note 3 - Loans Receivable and Allowance for Loan Losses” of the Notes to Consolidated Financial Statements included in “Item 8. Financial Statements and Supplementary Data” of this Form 10-K. In June 2016, FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments, referred to as Current Expected Credit Loss, or CECL.

The Company elected to early adopt the new standards, using a modified retrospective approach, effective January 1, 2022. For additional information on CECL see “Note 1 - Basis of Presentation and Summary of Significant Accounting Policies - Recent Accounting Pronouncements” of the Notes to Consolidated Financial Statements included in “Item 8. Financial Statements and Supplementary Data” of this Form 10-K. For additional information concerning our allowance for loan losses, see “Item 7. Management’s Discussion and Analysis of Financial Condition - Comparison of Results of Operations for the Years Ended December 31, 2021 and 2020 - Provision for Loan Losses” of this Form 10-K.

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The following table summarizes the distribution of the allowance for loan losses by loan category.

	December 31,														
	2021			2020			2019			2018			2017		
(Dollars in thousands)	Loan balance	Percent of loan balance in each category to total loans	Allowance for loan losses by loan category	Loan balance	Percent of loan balance in each category to total loans	Allowance for loan losses by loan category	Loan balance	Percent of loan balance in each category to total loans	Allowance for loan losses by loan category	Loan balance	Percent of loan balance in each category to total loans	Allowance for loan losses by loan category	Loan balance	Percent of loan balance in each category to total loans	Allowance for loan losses by loan category
Allocated at end of year to:															
Real estate loans															
Commercial	$ 210,306	11.94 %	$ 4,612	$ 152,131	9.66 %	$ 3,366	$ 114,015	8.43 %	$ 1,524	$ 74,039	5.58 %	$ 985	$ 63,611	8.22 %	$ 868
Construction and development	242,429	13.78	4,448	215,962	13.72	3,528	175,567	12.99	1,988	196,815	14.84	2,677	143,068	18.50	2,146
Home equity	38,476	2.19	262	37,096	2.36	691	29,606	2.19	343	27,295	2.06	320	25,289	3.27	263
One-to-four-family	355,942	20.24	1,424	290,036	18.42	3,494	224,967	16.64	1,349	194,343	14.65	1,288	163,655	21.16	1,004
Multi-family	163,464	9.29	2,861	102,894	6.54	1,276	91,975	6.80	987	49,125	3.71	491	44,451	5.75	489
Total real estate loans	1,010,617	57.44	13,607	798,119	50.70	12,355	636,130	47.05	6,191	541,617	40.84	5,761	440,074	56.90	4,770
Consumer loans															
Indirect home improvement	340,285	19.35	3,540	286,020	18.17	5,271	254,616	18.84	3,073	212,226	16.00	2,731	171,225	22.14	2,374
Marine	80,627	4.58	702	85,740	5.45	1,356	67,179	4.97	663	57,822	4.36	586	35,397	4.58	405
Other consumer	2,566	0.15	35	1,913	0.12	41	2,038	0.15	30	2,012	0.15	34	2,046	0.26	35
Total consumer loans	423,478	24.08	4,277	373,673	23.74	6,668	323,833	23.96	3,766	272,060	20.51	3,351	208,668	26.98	2,814
Commercial business loans															
Commercial and industrial	207,760	11.81	5,899	220,978	14.04	4,123	135,565	10.03	2,503	119,910	9.04	2,435	83,306	10.77	1,531
Warehouse lending	33,339	1.90	583	49,092	3.12	712	61,112	4.52	751	65,756	4.96	756	41,397	5.35	483
Total commercial business loans	241,099	13.71	6,482	270,070	17.16	4,835	196,677	14.55	3,254	185,666	14.00	3,191	124,703	16.12	2,014
Anchor Acquisition loans at fair value	83,832	4.77	1,248	132,365	8.40	1,623	195,253	14.44	15	326,895	24.65	—	—	—	—
Unallocated reserve	—	—	21	—	—	691	—	—	3	—	—	46	—	—	1,158
Total	$ 1,759,026	100.00 %	$ 25,635	$ 1,574,227	100.00 %	$ 26,172	$ 1,351,893	100.00 %	$ 13,229	$ 1,326,238	100.00 %	$ 12,349	$ 773,445	100.00 %	$ 10,756

The following table sets forth an analysis of the allowance for loan losses at the dates and or the years indicated. For additional information concerning our allowance for loan losses, see “Item 7. Management’s Discussion and Analysis of Financial Condition - Comparison of Results of Operations for the Years Ended December 31, 2021 and 2020 - Provision for Loan Losses” of this Form 10-K.

(Dollars in thousands)	Year Ended December 31, 2021	2020
Net charge offs	$ 1,037	$ 93
Average loans outstanding	$ 1,762,832	$1,576,975
Allowance for loan losses	$ 25,635	$ 26,172
Total gross loans	$1,759,026	$1,574,227
Nonperforming loans	$ 5,823	$ 7,761
Net charge-offs to average loans outstanding	0.06 %	0.01 %
Allowance for loan losses to total gross loans	1.46 %	1.66 %
Nonperforming loans to total gross loans	0.33 %	0.49 %
Allowance for loan losses to nonperforming loans	440.24 %	337.22 %

While management believes that the estimates and assumptions used in its determination of the adequacy of the allowance for loan losses are reasonable, there can be no assurance that such estimates and assumptions will not be proven incorrect in the future, or that the actual amount of future provisions will not exceed the amount of past provisions or that any increased provisions that may be required will not adversely impact the Company’s financial condition and results of operations. In addition, the determination of the amount of the Bank’s allowance for loan losses is subject to review by bank regulators as part of the routine examination process, which may result in the adjustment of reserves based upon their judgment of information available to them at the time of their examination.

Investment Activities

General. Under Washington law, savings banks are permitted to invest in various types of liquid assets, including U.S. Treasury obligations, securities of various federal agencies, certain certificates of deposit of insured banks and savings institutions, banker’s acceptances, repurchase agreements, federal funds (“Fed Funds”), commercial paper, investment grade corporate debt securities, and obligations of states and their political subdivisions.

The Chief Financial Officer has the responsibility for the management of the Company’s investment portfolio, subject to consultation with the Chief Executive Officer, and the direction and guidance of the Board of Directors. Various factors are considered when making investment 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 the Company’s 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. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations - Asset and Liability Management and Market Risk” of this Form 10-K.

As a member of the FHLB of Des Moines, the Bank had $4.8 million in stock at December 31, 2021. For the year ended December 31, 2021, the Bank received $256,000 in dividends.

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The composition and contractual maturities of the investment portfolio at December 31, 2021, excluding FHLB stock, are indicated in the following table. The yields on tax exempt municipal bonds have not been computed on a tax equivalent basis. During the year end December 31, 2021, the Company purchased $65.9 million in tax exempt securities. At December 31, 2021, the Company held tax exempt securities with an amortized cost of $127.2 million, as compared to $66.4 million at December 31, 2020.

	December 31, 2021										
	1 year or less		Over 1 year to 5 years		Over 5 to 10 years		Over 10 years		Total Securities		
(Dollars in thousands)	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Fair Value
Securities available-for-sale											
U.S. agency securities	$ —	— %	$ 959	2.79 %	$ 6,920	1.57 %	$ 13,276	1.75 %	$ 21,155	1.73 %	$ 20,970
Corporate securities	—	—	3,495	1.44	4,000	3.25	2,000	2.05	9,495	2.33	9,002
Municipal bonds	—	—	3,724	2.72	6,857	2.46	125,796	1.77	136,377	1.83	135,433
Mortgage-backed securities:											
Federal National Mortgage Association	—	—	5,377	3.04	38,552	1.91	31,242	2.31	75,171	2.15	75,737
Federal Home Loan Mortgage Corporation	—	—	—	—	1,390	1.83	8,216	1.94	9,606	1.93	9,768
Government National Mortgage Association	—	—	—	—	1,031	2.94	2,833	2.63	3,864	2.71	3,897
U.S. Small Business Administration securities	—	—	2,485	2.09	4,420	2.20	9,478	1.66	16,383	1.87	16,552
Total securities available-for-sale	—	—	16,040	2.46	63,170	2.05	192,841	1.87	272,051	1.95	271,359
Securities held-to-maturity											
Corporate securities	—	—	—	—	7,500	5.06	—	—	7,500	5.06	8,128
Total securities	$ —	— %	$ 16,040	2.46 %	$ 70,670	2.37 %	$ 192,841	1.87 %	$ 279,551	2.03 %	$ 279,487

Deposit Activities and Other Sources of Funds

General. Deposits, borrowings, and loan repayments are the major sources of funds for lending and other investment purposes. Scheduled loan repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are influenced significantly by general interest rates and market conditions. Borrowings from the FHLB of Des Moines are used to supplement the availability of funds from other sources and also as a source of term funds to assist in the management of interest rate risk.

The Company's deposit composition reflects a mixture with certificates of deposit (including brokered) accounting for 18.8% of the total deposits at December 31, 2021, and interest and noninterest-bearing checking, savings and money market accounts comprising the balance of total deposits. The Company relies on marketing activities, convenience, customer service and the availability of a broad range of deposit products and services to attract and retain customer deposits. The Company had $192.9 million of brokered deposits, or 10.1% of total deposits at December 31, 2021. As a wholesale funding alternative, brokered deposits have competitive rates that are comparable to FHLB borrowings and local certificates of deposit.

Deposits. Deposits are attracted from within the market area through the offering of a broad selection of deposit instruments, including checking accounts, money market deposit accounts, savings accounts, and certificates of deposit with a variety of rates. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit, and the interest rate, among other factors. In determining the terms of the Company's deposit accounts, the Company considers the development of long-term profitable customer relationships, current market interest rates, current maturity structure and deposit mix, customer preferences, and the profitability of acquiring customer deposits compared to alternative sources.

The following table sets forth total deposit activities for the years indicated.

	Year Ended December 31,		
(Dollars in thousands)	2021	2020	2019
Beginning balance	$ 1,674,071 (1)(2)	$ 1,392,408 (1)(2)	$ 1,274,219 (1)(2)
Net deposits before interest credited	234,744	269,683	102,027
Interest credited	6,929	11,980	16,162
Ending balance	$ 1,915,744	$ 1,674,071	$ 1,392,408
Net increase in deposits	$ 241,673	$ 281,663	$ 118,189
Percent increase	14.44 %	20.23 %	9.28 %

(1) On January 22, 2016, the Company purchased four retail bank branches from Bank of America, N.A (the "Branch Purchase") and acquired approximately $186.4 million in deposits. At December 31, 2021, 2020, and 2019, approximately $150.7 million, $129.5 million, and $117.1 million of the acquired deposits, respectively, remained with the Bank. These branches also attracted new deposits. At December 31, 2021, they had an aggregated total of $405.4 million in deposits, including public funds.

(2) On November 15, 2018, the Company completed the Anchor Acquisition and acquired approximately $357.9 million in deposits. At December 31, 2021, 2020, and 2019, approximately $281.8 million, $286.5 million, and $299.0 million of the acquired deposits remained with the Bank, respectively.

The following table sets forth the dollar amount of deposits in the various types of deposit programs the Company offered at the dates indicated.

	December 31,			
	2021		2020	
(Dollars in thousands)	Amount	Percent of Total	Amount	Percent of Total
Transactions and Savings Deposits				
Noninterest-bearing checking	$ 443,133	23.13 %	$ 348,421	20.81 %
Interest-bearing checking	349,251	18.23	226,282	13.52
Savings	193,922	10.12	152,842	9.13
Money market	552,357	28.83	429,548	25.66
Escrow accounts related to mortgages serviced	16,389	0.86	14,432	0.86
Total transaction and savings deposits	1,555,052	81.17	1,171,525	69.98
Certificates				
0.00 - 1.99%	310,189	16.19	406,551	24.29
2.00 - 3.99%	50,503	2.64	95,995	5.73
Total certificates	360,692	18.83	502,546	30.02
Total deposits	$ 1,915,744	100.00 %	$ 1,674,071	100.00 %

Total deposits in excess of the FDIC insurance limit were $569.3 million, or 29.72% and $430.9 million, or 25.74% for December 31, 2021 and 2020, respectively.

The following table sets forth the rate and maturity information of time deposit certificates at December 31, 2021.

	Rate			
(Dollars in thousands)	0.00 - 1.99%	2.00 - 3.99%	Total	Percent of Total
Certificate accounts maturing in quarter ending:				
March 31, 2022	$ 40,829	$ 7,822	$ 48,651	13.49 %
June 30, 2022	47,560	15,934	63,494	17.60
September 30, 2022	49,990	4,247	54,237	15.04
December 31, 2022	40,752	4,701	45,453	12.60
March 31, 2023	11,527	2,899	14,426	4.00
June 30, 2023	13,300	1,117	14,417	4.00
September 30, 2023	7,391	1,720	9,111	2.53
December 31, 2023	4,646	2,582	7,228	2.00
March 31, 2024	3,821	1,989	5,810	1.61
June 30, 2024	4,794	5,513	10,307	2.86
September 30, 2024	11,269	870	12,139	3.36
December 31, 2024	2,852	1,082	3,934	1.09
Thereafter	71,458	27	71,485	19.82
Total	$ 310,189	$ 50,503	$ 360,692	100.00
Percent of total	86.00 %	14.00 %	100.00 %	

The following table indicates the amount of jumbo certificates of deposit by time remaining until maturity at December 31, 2021. Jumbo certificates of deposit are certificates in amounts of $100,000 or more. Total deposits include uninsured certificates of deposit of $57.5 million at December 31, 2021, calculated in accordance with FDIC guidelines.

The Bank does not hold any foreign deposits. The following table provides certificates of deposit at December 31, 2021, by account, with a maturity of:

	Maturity				
(In thousands)	3 Months or Less	Over 3 to 6 Months	Over 6 to 12 Months	Over 12 Months	Total
Certificates of deposit of less than $100,000[1]	$ 17,164	$ 26,959	$ 45,086	$ 97,765	$ 186,974
Certificates of deposit of $100,000 to less than $250,000	22,698	22,661	32,727	38,120	116,206
Certificates of deposit in excess of the FDIC insurance limit	8,789	13,874	21,877	12,972	57,512
Total certificates of deposit	$ 48,651	$ 63,494	$ 99,690	$ 148,857	$ 360,692

(1) Includes $97.6 million of brokered deposits at December 31, 2021.

The estimate of uninsured non-time deposits is $569.3 million as of December 31, 2021.

The Federal Reserve requires the Bank to maintain reserves on transaction accounts or non-personal time deposits. These reserves may be in the form of cash or noninterest-bearing deposits with the Federal Reserve Bank of San Francisco (“FRB”). Negotiable order of withdrawal (“NOW”) accounts and other types of accounts that permit payments or transfers to third parties fall within the definition of transaction accounts and are subject to the reserve requirements, as are any non-personal time deposits at a savings bank. Effective March 26, 2020, the Federal Reserve lowered the reserve requirement to zero percent. There was no required reserve balance at December 31, 2021.

Debt. Although customer deposits are the primary source of funds for lending and investment activities, the Company uses various borrowings such as advances and warehouse lines of credit from the FHLB of Des Moines, and to a lesser extent Fed Funds purchased to supplement the supply of lendable funds, to meet short-term deposit withdrawal requirements and also to provide longer term funding to better match the duration of selected loan and investment maturities.

As one of the Company’s capital management strategies, the Company has used advances from the FHLB of Des Moines to fund loan originations in order to increase net interest income. Depending upon the retail banking activity, the Company will consider and may undertake additional leverage strategies within applicable regulatory requirements or restrictions. These borrowings would be expected to primarily consist of FHLB of Des Moines advances.

As a member of the FHLB of Des Moines, the Bank is required to own capital stock in the FHLB of Des Moines and authorized to apply for advances on the security of that stock and certain mortgage loans and other assets (principally securities which are obligations of, or guaranteed by, the U.S. Government) provided certain creditworthiness standards have been met. Advances are individually made under various terms pursuant to several different credit programs, each with its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based on the financial condition of the member institution and the adequacy of collateral pledged to secure the credit. The Bank maintains a committed credit facility with the FHLB of Des Moines that provides for immediately available advances up to an aggregate of $527.2 million at December 31, 2021. Outstanding advances from the FHLB of Des Moines totaled $42.5 million at December 31, 2021.

As of December 31, 2021, the Company had $200.1 million of additional short-term borrowing capacity with the FRB. The Bank also had an aggregate of $101.0 million in unsecured Fed Funds lines of credit with other correspondent financial institutions of which none was outstanding at December 31, 2021.

On February 10, 2021, FS Bancorp, Inc. completed the private placement of $50.0 million of its 3.75% fixed-to-floating rate subordinated notes due 2031 (the “Notes”) at an offering price equal to 100% of the aggregate principal amount of the Notes, of which $50.0 million have been exchanged for subordinated notes registered under the Securities Act of 1933. Net proceeds, after placement agent fees and offering expenses, was approximately $49.3 million. The Notes were issued under an Indenture, dated February 10, 2021(the “Indenture”), by and between the Company and U.S. Bank National Association, as trustee. From and including the original issue date to, but excluding, February 15, 2026 or the date of earlier redemption, FS Bancorp pays interest on the Notes semi-annually in arrears on February 15 and August 15 of each year, commencing on August 15, 2021, at a fixed annual interest rate equal to 3.75%. From and including February

15, 2026 to but excluding the maturity date or the date of earlier redemption, the floating interest rate per annum will be equal to a benchmark rate, which is expected to be Three-Month Term SOFR (as defined in the Indenture) plus a spread of 337 basis points, payable quarterly in arrears on February 15, May 15, August 15 and November 15 of each year, commencing on May 15, 2026. Notwithstanding the foregoing, in the event that the benchmark rate is less than zero, the benchmark rate shall be deemed to be zero. The Notes will mature on February 15, 2031.

On or after February 15, 2026, FS Bancorp may redeem the Notes, in whole or in part, at an amount equal to 100% of the outstanding principal amount being redeemed plus accrued interest. The Notes are not redeemable by FS Bancorp prior to February 15, 2026 except in the event that (i) the Notes no longer qualify as Tier 2 capital, (ii) the interest on the Notes is determined by law to be not deductible for Federal Income Tax reporting or (iii) FS Bancorp is considered an investment company pursuant to the Investment Company Act of 1940. The Notes are not subject to redemption by the noteholder.

The Notes are unsecured obligations and are subordinated in right of payment to all existing and future indebtedness, deposits and other liabilities of the Company's current and future subsidiaries, including the Banks' deposits as well as the Company's subsidiaries' liabilities to general creditors and liabilities arising during the ordinary course of business. The Notes may be included in Tier 2 capital for the Company under current regulatory guidelines and interpretations.

For additional information related to borrowings, see "Note 9 - Debt" of the Notes to Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data" of this Form 10-K.

Subsidiary and Other Activities

The Company has one active subsidiary, which is the Bank, and the Bank has one inactive subsidiary. The Bank had no capital investment in its inactive subsidiary at December 31, 2021.

Competition

The Company faces strong competition in attracting deposits. Competition in originating real estate loans comes primarily from other savings institutions, commercial banks, credit unions, life insurance companies, mortgage bankers, and more recently, financial technology (or "FinTech") companies. Other savings institutions, commercial banks, credit unions, finance, and FinTech companies provide vigorous competition in consumer lending, including indirect lending. Commercial business competition is primarily from local commercial banks. The Company competes by delivering high-quality, personal service to customers that result in a high level of customer satisfaction.

The Company's market areas have a high concentration of financial institutions, many of which are branches of large money centers and regional banks that have resulted from the consolidation of the banking industry in Washington and other western states. These include such large national lenders as Wells Fargo, Bank of America, Chase, and others in the Company's market area that have greater resources and offer services that the Bank does not provide. For example, the Bank does not offer trust services. Customers who seek "one-stop shopping" may be drawn to institutions that offer services that the Bank does not.

The Company attracts deposits through the branch office system. Competition for those deposits is principally from other savings institutions, commercial banks and credit unions located in the same community, as well as mutual funds, FinTech companies, and other alternative investments. The Bank competes for these deposits by offering superior service and a variety of deposit accounts at competitive rates. Based on the most recent branch deposit data provided by the FDIC, at June 30, 2021, 1st Security Bank of Washington's share of aggregate deposits in the market area consisting of the eleven counties where the Company has branches was less than one percent.

Executive Officers

Set forth below is certain information regarding the executive officers of the Company and the Bank. There are no family relationships among or between the executive officers.

Name	Age [1]	Position with FS Bancorp, Inc.	Position with 1st Security Bank of Washington
Joseph C. Adams	62	Director and Chief Executive Officer	Director and Chief Executive Officer
Matthew D. Mullet	43	Chief Financial Officer, Treasurer and Secretary	Executive Vice President, Chief Financial Officer
Robert B. Fuller	62	Chief Credit Officer	Executive Vice President, Chief Credit Officer
Dennis V. O'Leary	54		Executive Vice President, Chief Lending Officer
Lisa A. Cleary	40		Executive Vice President, Chief Operating Officer
Erin M. Burr	44		Executive Vice President, Chief Risk Officer and CRA Officer
Vickie A. Jarman	44		Executive Vice President, Chief Human Resources Officer/WOW! Officer
Donn C. Costa	60		Executive Vice President, Home Lending Production
Kelli B. Nielsen	50		Executive Vice President, Retail Banking and Marketing

(1) At December 31, 2021.

Joseph C. Adams, age 62, is a director and has been the Chief Executive Officer of 1st Security Bank of Washington since July 2004. He has also served in those capacities for FS Bancorp since its formation in September 2011. He joined 1st Security Bank of Washington in April 2003 as its Chief Financial Officer. Mr. Adams served as Supervisory Committee Chairperson from 1993 to 1999 when the Bank was Washington's Credit Union. Mr. Adams is a lawyer, having worked for Deloitte as a tax consultant, K&L Gates as a lawyer and then at Univar USA as a lawyer and Director of Regulatory Affairs. As the Director of Regulatory Affairs for Univar USA, the largest chemical distribution company in the United States, Mr. Adams used his environmental law expertise to ensure Univar stayed in compliance with all relevant local, state and federal environmental laws, rules and regulations. He is a member of the Washington State Bar Association, a Board member of the Central Washington University Foundation and a Board member of the Community Bankers of Washington. Mr. Adams graduated with distinction from the University of Hawaii with a Bachelor of Business Administration in Finance. He also graduated cum laude with a Juris Doctor from the University of Puget Sound School of Law. In addition, Mr. Adams graduated with honors from the Pacific Coast Banking School in 2007, a master's level program held at the University of Washington. Mr. Adams' legal and accounting backgrounds, as well as his duties as Chief Executive Officer of 1st Security Bank of Washington, bring a special knowledge of the financial, economic and regulatory challenges faced by the Bank, which makes him well-suited to educating the Board on these matters .

Matthew D. Mullet, age 43, joined 1st Security Bank of Washington in July 2011 and was appointed Chief Financial Officer in September 2011. He began his banking career in June 2000 as a financial examiner with the Washington State, Department of Financial Institutions, Division of Banks. In 2004, Matthew accepted a position at Golf Savings Bank in Seattle. He served in a variety of capacities at Golf and was appointed Chief Financial Officer in 2007. After the Golf Savings Bank merger with Sterling Savings Bank, he held the position of Senior Vice President of the Home Loan Division at Sterling until resigning in 2011 to join 1st Security Bank of Washington. Matthew is inspired by the Bank's commitment to its customers and to the communities it serves. Matthew serves on the Government Relations

Committee with Washington Bankers Association and volunteers with The IF Project, teaching Financial Literacy at the Washington Corrections Center for Women. He also works with a nonprofit school as its treasurer and is passionate about youth education.

Robert B. Fuller, age 62, joined 1st Security Bank of Washington as an Executive Vice President and Chief Credit Officer in 2013. His current areas of oversight include loan approval and loan administration for the Bank's entire commercial and consumer lending departments. He brings over three decades of experience in the banking industry to his role at the Bank. During his career, he has served as Chief Credit Officer for several private lenders and local community banks. Rob holds a Bachelor of Arts from Washington State University with a major in economics, and minor in mathematics and a Master of Business Administration degree from the University of Oregon in Finance and Accounting. Prior to his role at 1st Security, Rob worked at Golf Savings Bank in various roles, culminating in serving as Chief Financial Officer and Chief Operating Officer, and as a board member for five years. Rob served on the board of Seattle King County Habitat for Humanity from 2017 – 2019 and volunteers in his free time with that organization. He also volunteers with The IF Project, teaching Financial Literacy to women who are in the Washington Corrections Center for Women.

Dennis V. O'Leary, age 54, brings decades of banking experience to his position at 1st Security Bank of Washington. He joined the Bank in 2011 as Executive Vice President and manager of the newly formed construction lending division. In 2013, he was promoted to his current position as Chief Lending Officer. His responsibilities include oversight of the loan production for the commercial, consumer, and commercial real estate lending groups of the Bank. In 2006, following Sterling Savings Bank's purchase of Golf Savings Bank, Dennis served as the Senior Vice President and Puget Sound Regional Director of the residential construction lending division. A twenty-year veteran at Golf Savings Bank, he served as Executive Vice President of the residential construction department and held the position of board member for five years. Dennis holds a Bachelor of Business Administration degree with a focus on Finance and Economics from Central Washington University. Dennis volunteers with The IF Project, teaching Financial Literacy at the Washington Corrections Center for Women.

Lisa A. Cleary, age 40, joined 1st Security Bank of Washington in October 2020 as Chief Operating Officer. After beginning her career in branch banking, Lisa has held a variety of key positions in bank management to round out her two decades of diverse financial industry experience. These positions included AVP and Loan Operations Manager, VP and Small Business Administration Assistant Manager, and SVP and Credit Administrator at banks in the Puget Sound region. Prior to joining the Bank, Lisa was Executive Vice President and Chief Credit Officer at First Sound Bank. Lisa holds a Bachelor of Business Administration degree from the University of Alaska Fairbanks, with a specialty in management and organizations. Her other educational milestones include graduating top of her class in the 2009-2010 Washington Bankers Executive Development Program and graduating with honors from the Pacific Coast Banking School in 2013. She has been an active member of the American Bankers Association Emerging Leaders Committee since 2018, and the Washington Bankers Emerging Leaders Committee since 2017.

Erin M. Burr, age 44, holds a Bachelor of Business Administration degree from Western Washington University. She began her career in 1999 as a financial examiner for the Washington State, Department of Financial Institutions, Division of Banks. In 2006, Erin joined Builders Capital Mortgage in Seattle as their senior underwriter. She joined 1st Security Bank of Washington in January 2009 and became the Community Reinvestment Act (CRA) Officer in January 2010. She took on the Enterprise Risk Manager role in May 2012 and was promoted to Chief Risk Officer in April 2018. As the Bank's CRA Officer, Erin enjoys building relationships with nonprofit groups that support the communities the Bank serves. She coordinates the Bank's community outreach volunteer programs. Erin is a member of the Housing Consortium of Everett and Snohomish County and is dedicated to addressing affordable housing issues. She volunteers with The IF Project, teaching Financial Literacy to women who are in the Washington Corrections Center and she works with YWCA BankWork$ and the Teach Children to Save Program. She has volunteered in various roles with Domestic Violence Services of Snohomish County. As the Chief Risk Officer, Erin uses her regulatory background to help promote and build risk awareness throughout the Bank.

Vickie A. Jarman, age 44, holds a Bachelor of Arts in Communications from Seattle Pacific University. She joined 1st Security Bank of Washington in 2002, after working with the Ballard Boys and Girls Club. Vickie was promoted to Chief Human Resources Officer in 2018. Prior to becoming the Director of WOW and Chief Human Resources Officer, Vickie worked with our Consumer Lending team. Vickie oversees the onboarding and orientation of new hires, sharing the Bank's Vision, Mission, Core Values, and unique company culture. She also ensures that the Bank's Core Values continue to reflect the personal principles that support all the employees as the organization evolves. She has always been passionate and dedicated to volunteering and giving back to our communities and nonprofits. She volunteers with The IF Project, teaching Financial Literacy at the Washington Corrections Center for Women, YWCA BankWork$, and for the Teach Children to Save Program.

Donn C. Costa, age 60, is a cum laude graduate from Washington State University with a Bachelor of Business Administration degree. He began his career in mortgage lending over three decades ago and joined the Bank as the EVP of Home Lending in 2012, overseeing home lending sales and operations. Donn previously held the position of Executive Vice President at Sterling Savings Bank after its merger with Golf Savings Bank in 2009. Prior to the merger, Donn was President of Golf Savings Bank and a member of the Board of Directors, serving on the Asset and Liability, Personnel and Lending Committees and held the position of Executive Vice President of Mortgage Lending. Donn's achievements include serving as President of the Washington Mortgage Lenders and the Seattle Mortgage Bankers, as well as on the Advisory Boards of Fannie Mae and Freddie Mac. His goal for the team at 1st Security Bank of Washington is to provide "best in class" customer service and loan programs that help people achieve the dream of homeownership.

Kelli B. Nielsen, age 50, has worked in the financial services industry for three decades and brought a wealth of retail banking and leadership experience to her role when she joined 1st Security Bank of Washington in 2016. Previously, she was VP, Sales and Service Manager of Retail Banking at Cascade Bank before she moved to Sound Community Bank as the SVP of Retail Banking and Marketing. In 2016, Kelli graduated from the American Bankers Association (ABA), Stonier Graduate School of Banking, and holds a Certificate of Leadership from the University of Pennsylvania, The Wharton School. She serves on the ABA Stonier Advisory Board and is a representative on the Diversity, Equity, and Inclusion (DEI) Committee. She is also an Advocate for Women, serves on the Alumni Committee, and is Capstone Advisor for year-three students with Stonier. Passionate about building relationships and helping others, Kelli serves on the Washington Bankers Association (WBA) Retail Banking Committee, the Government Relations Committee and is on the WBA Pros Board. Kelli is also a published children's book author and certified life coach. She has a deep commitment to causes that improve the lives of children. She volunteers with Long Way Home, a nonprofit in Guatemala focused on building schools from sustainable material, is a former board member for Victim Support Services, a nonprofit that is the oldest victim-assistance organization in Washington State, and serves on the corporate advisory board for the Greater Seattle Business Association (GSBA) the largest LGBTQ+ Chamber in North America. She also volunteers with The IF Project, teaching Financial Literacy and serving as a mentor to female residents of the Washington Corrections Center for Women.

Human Capital

FS Bancorp, Inc, and its primary subsidiary 1st Security Bank of Washington, have developed a Vision Statement that guides our ongoing and future strategies. Our Vision Statement is: To build a truly great place to work and bank. The Vision Statement is aspirational and dynamic meaning we are aware of our responsibilities to our employees to continue to evolve in order to achieve these values. The order is purposeful in that we believe building a great place to work will naturally develop a great place to bank.

<u>Employee Compensation and Benefits</u>

Management remains focused on ensuring employees are provided a livable wage in addition to a commitment to a balanced work/life schedule. Besides a competitive salary, the following benefits are available to all full-time employees:

- Employee health benefits that have not increased in employee contribution cost since 2014;
- Life, AD&D, short-term disability and long-term disability;
- 401k match of up to the first 5% of contribution for up to 4% of total salary;
- An Employee Stock Ownership Plan ("ESOP") that contributed 51,842 shares in 2021 to employees that have met a minimum threshold of hours worked;
- Vacation and sick leave benefits;

- Family leave benefits including paid time off for a new child/adopted child;
- Education reimbursement of up to $5,000 per year for any accredited program;
- Paid volunteer hours (16 hours each year);
- Opportunities to participate in development programs through the Washington Bankers Association;
- Regular Company provided lunches and treats; and
- A pet friendly workplace at the administrative offices.

Management works with employees to provide these benefits whenever possible including a flexible schedule for employees to be able to enjoy full-time benefits with a reduced hour schedule when appropriate.

Diversity and Inclusion

One of our core values is diversity. We celebrate diversity and support equality for all. The Board and management consider diverse viewpoints, backgrounds, and experiences, as well as gender, age, race, and ethnicity. We are an inclusive community; all are welcome. Of the independent directors, 43% are women (three of seven) and 44% of the executives that report to our Chief Executive Officer are women (four of nine). As of December 31, 2021, our workforce was 69% female and 31% male, and women held 58% of the Bank's management roles (includes executives). The average tenure of management was seven years. The ethnicity of our workforce was 9% Asian, 2% Black, 6% Hispanic/Latino, 78% White, 2% Other, 3% Two or More Races.

The following table outlines gender diversity:

Level	Female %	Male %
Individual Contributor	71%	29%
Manager	66%	34%
Independent Director*	43%	57%
Executive	44%	56%

*FS Bancorp, Inc's board of directors is comprised of the Company's Chief Executive Officer, who is male, and seven independent directors.

Talent Acquisition

FS Bancorp, Inc. and 1st Security Bank of Washington have been a growing organization since 2011 and are regularly looking to fill positions in the markets we serve. We have an interview process that includes both the manager and teammates when interviewing potential candidates. The Human Resource team is an advocate for the employee and remains focused on providing a culture of "Wow". The head of our human resources team is the EVP of WOW and is focused on hiring employees to build careers that will thrive in our culture. In 2021, for additional positions and replacements, we hired 132 new employees bringing our total employee count to 538 employees as of December 31, 2021.

Operation Safe and Secure 2021

Starting with the pandemic in March 2020, management implemented "Operation Safe and Secure 2020" to provide regular, ongoing updates to employees about how the organization is functioning during the pandemic. One of the first items to be implemented from our Pandemic Plan was the adjustment to a remote work force. Based on our plan, 75% of our employees are capable of working remotely. For those essential employees that were required to be in the retail locations or admin office, we provided safety measures including enhanced cleaning, required mask wearing in open areas, plexiglass screens between cubicles and flexible hours where appropriate. In retail branch locations, we relied upon the feedback from the community to determine the appropriate level of customer access and safety for employees. Employee safety remains a top priority with mandatory quarantine requirements post vacation, a negative test required for anyone that may have been exposed or had COVID-19, and paid sick leave for all employees that may have been impacted by COVID-19.

Regarding job security, employees during the pandemic often expressed concern about whether their jobs were secure. During the pandemic, 1st Security Bank of Washington continued to hire and build out our infrastructure. We are proud to report there were no furloughs and that zero jobs were reduced or eliminated during the pandemic.

Volunteerism

Our organization has a long history of giving and volunteering in the communities we serve. While the pandemic has made volunteering difficult in recent years, our volunteer hours increased significantly from 2,200 hours in 2020 to 4,000 hours in 2021 in our communities.

Human Capital Metrics

As of December 31, 2021, FS Bancorp, Inc., and its subsidiary bank employed 538 employees. Of those numbers, 99.63% are full time employees and 0.37% are part time including our college internship program. Our employees are not represented by a collective bargaining agreement. As of December 31, 2021, 98.69% of our employees reside in Washington State, 0.74% in Oregon, 0.19% in Arizona, 0.19% in Colorado, and 0.19% in Idaho. Turnover for employees as measured by terminated/replaced employees was 17.14% in 2021, up from 14.99% in 2020.

HOW WE ARE REGULATED

The following is a brief description of certain laws and regulations applicable to FS Bancorp and 1st Security Bank of Washington. Descriptions of laws and regulations here and elsewhere in this Form 10-K do not purport to be complete and are qualified in their entirety by reference to the actual laws and regulations. Legislation is introduced from time to time in the United States Congress or in the Washington State Legislature that may affect the operations of FS Bancorp and 1st Security Bank of Washington. In addition, the regulations governing the Company and the Bank may be amended from time to time by the FDIC, DFI, Federal Reserve and the Consumer Financial Protection Bureau ("CFPB"). Any such legislation or regulatory changes in the future could adversely affect our operations and financial condition. We cannot predict whether any such changes may occur.

Regulation of 1st Security Bank of Washington

General. 1st Security Bank of Washington, as a state-chartered savings bank, is subject to applicable provisions of Washington law and to regulations and examinations of the DFI. As an insured institution, it also is subject to examination and regulation by the FDIC, which insures the deposits of 1st Security Bank of Washington to the maximum permitted by law. During these state or federal regulatory examinations, the examiners may require 1st Security Bank of Washington to provide for higher general or specific loan loss reserves, which can impact capital and earnings. This regulation of 1st Security Bank of Washington is intended for the protection of depositors and the Deposit Insurance Fund ("DIF") of the FDIC and not for the purpose of protecting shareholders of 1st Security Bank of Washington or FS Bancorp. 1st Security Bank of Washington is required to maintain minimum levels of regulatory capital and is subject to some limitations on the payment of dividends to FS Bancorp. See below "Regulatory Capital Requirements" and "Restrictions on Dividends and Stock Repurchases."

Federal and State Enforcement Authority and Actions. As part of its supervisory authority over Washington-chartered savings banks, the DFI may initiate enforcement proceedings to obtain a consent order to cease-and-desist against an institution believed to have engaged in unsafe and unsound practices or to have violated a law, regulation, or other regulatory limit, including a written agreement. The FDIC also has the authority to initiate enforcement actions against insured institutions under its jurisdiction for similar reasons and may terminate the deposit insurance if it determines that an institution has engaged in unsafe or unsound practices or is in an unsafe or unsound condition. Both these agencies may also utilize less formal supervisory tools to address their concerns about the condition, operations or compliance status of a savings bank.

Regulation by the Washington State Department of Financial Institutions. State law and regulations govern 1st Security Bank of Washington's ability to take deposits and pay interest, to make loans on or invest in residential and other real estate, to make consumer loans, to invest in securities, to offer various banking services to its customers, and to establish branch offices. As a state savings bank, 1st Security Bank of Washington must pay semi-annual assessments, examination costs and certain other charges to the DFI.

Washington law generally provides the same powers for Washington savings banks as federally and other-state chartered savings institutions and banks with branches in Washington, subject to the approval of the DFI. Washington law allows Washington savings banks to charge the maximum interest rates on loans and other extensions of credit to Washington residents which are allowable for a national bank in another state if higher than Washington limits. In addition, the DFI may approve applications by Washington savings banks to engage in an otherwise unauthorized activity, if the DFI determines that the activity is closely related to banking, and 1st Security Bank of Washington is otherwise qualified under the statute. This additional authority, however, is subject to review and approval by the FDIC if the activity is not permissible for national banks.

Insurance of Accounts and Regulation by the FDIC. Through the DIF, the FDIC insures deposit accounts in 1st Security Bank of Washington up to $250,000 per separately insured deposit ownership right or category. As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of and to require reporting by FDIC-insured institutions.

The FDIC assesses deposit insurance premiums quarterly on each FDIC-insured institution applied to its deposit base, which is its average consolidated total assets minus its Tier 1 capital. No institution may pay a dividend if it is in default on its federal deposit insurance assessment. Total base assessment rates currently range from three to 30 basis points subject to certain adjustments. The FDIC has authority to increase insurance assessments, and any significant increases may have an adverse effect on the operating expenses and results of operations of the Company. Management cannot predict what assessment rates will be in the future. In a banking industry emergency, the FDIC may also impose a special assessment. The Bank’s deposit insurance premiums for the year ended December 31, 2021, were $636,000.

The FDIC conducts examinations of and requires reporting by state non-member banks, such as 1st Security Bank of Washington. The FDIC also may prohibit any insured institution from engaging in any activity determined by regulation or order to pose a serious risk to the DIF. No institution may pay a dividend if it is in default on its federal deposit insurance assessment. Management is not aware of any existing circumstances which would result in termination of the Bank's deposit insurance.

Capital Requirements. In September 2019, the regulatory agencies, including the FDIC and Federal Reserve adopted a final rule, effective January 1, 2020, creating a community bank leverage ratio ("CBLR") for institutions with total consolidated assets of less than $10 billion, and that meet other qualifying criteria related to off-balance sheet exposures and trading assets and liabilities. The CBLR provides for a simple measure of capital adequacy for qualifying institutions. Management has elected to use the CBLR framework for the Bank. Consolidated regulatory capital requirements identical to those applicable to subsidiary banks generally apply to bank holding companies. However, the Federal Reserve Board has provided a “Small Bank Holding Company” exception to its consolidated capital requirements, and bank holding companies with less than $3.0 billion of consolidated assets are not subject to the consolidated holding company capital requirements unless otherwise directed by the Federal Reserve Board.

The CBLR is calculated as Tier 1 Capital to average consolidated assets as reported on an institution's regulatory reports. Tier 1 Capital, for the Company and the Bank, generally consists of common stock plus related surplus and retained earnings, adjusted for goodwill and other intangible assets and accumulated and other comprehensive amounts (“AOCI”) related amounts. Qualifying institutions that elect to use the CBLR framework and that maintain a leverage ratio of greater than 9% will be considered to have satisfied the generally applicable risk-based and leverage capital requirements in the regulatory agencies' capital rules, and to have met the well-capitalized ratio requirements. As required by the CARES Act, the FDIC temporarily lowered the CBLR to 8% beginning in the second quarter of 2020 through the end of that year. Beginning in 2021, the CBLR was increased to 8.5% for that calendar year. The CBLR returned to 9% on January 1, 2022. A qualifying institution utilizing the CBLR framework whose leverage ratio does not fall more than one percent below the required percentage is allowed a two-quarter grace period in which to increase its leverage ratio back above the required percentage. During the grace period, a qualifying institution will still be considered well capitalized so long as its leverage ratio does not fall more than one percent below the required percentage. If an institution either fails to meet all the qualifying criteria within the grace period or has a leverage ratio that falls more than one percent below the required percentage, it becomes ineligible to use the CBLR framework and must instead comply with generally applicable capital rules, sometimes referred to as Basel III rules. A bank may also opt out of the framework at any time, without restriction, by reverting to the generally applicable capital rules.

At December 31, 2021, 1st Security Bank of Washington was categorized as well capitalized under the prompt corrective action regulations of the FDIC. For a complete description of the Bank's required and actual capital levels on December 31, 2021, see "Note 14 - Regulatory Capital" of the Notes to Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data," of this Form 10-K.

The FASB has adopted a new accounting standard, referred to as Current Expected Credit Loss, or CECL. The Company elected to early adopt the new standards effective January 1, 2022. Upon adoption of CECL, a banking organization must record a one-time adjustment to its credit loss allowances as of the beginning of the fiscal year of adoption equal to the difference, if any, between the amount of credit loss allowances under the current methodology and the amount required under CECL. The federal banking regulators (the Federal Reserve, the Office of the Comptroller of the Currency and the FDIC) have adopted a rule that gives a banking organization the option to phase in over a three-year period the day-one adverse effects of CECL on its regulatory capital. For more on this new accounting standard, see "Note 1 - Basis of Presentation and Summary of Significant Accounting Policies - Recent Accounting Pronouncements" of the Notes to Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data" of this Form 10-K.

The FDIC also has authority to establish individual minimum capital requirements in appropriate cases upon a determination that an institution's capital level is or may become inadequate in light of particular risks or circumstances. Management of 1st Security Bank of Washington believes that, under the current regulations, 1st Security Bank of Washington will continue to meet its minimum capital requirements in the foreseeable future.

FS Bancorp, Inc. is a bank holding company registered with the Federal Reserve. Bank holding companies are subject to capital adequacy requirements of the Federal Reserve under the Bank Holding Company Act of 1956, as amended, and the regulations of the Federal Reserve. Bank holding companies with less than $3.0 billion in assets are generally not subject to compliance with the Federal Reserve's capital regulations, which are generally the same as the capital regulations applicable to the Bank. The Federal Reserve has a policy that a bank holding company is required to serve as a source of financial and managerial strength to the holding company's subsidiary bank and expects the holding company's subsidiary bank to be well capitalized under the prompt corrective action regulations. If FS Bancorp, Inc. was subject to regulatory guidelines for bank holding companies with $3.0 billion or more in assets at December 31, 2021, FS Bancorp, Inc. would have exceeded all regulatory capital requirements

Prompt Corrective Action. Federal statutes establish a supervisory framework for FDIC-insured institutions based on five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. An institution's category generally depends upon where its capital levels are in relation to relevant capital measures, which include risk-based capital measures, a leverage ratio capital measure, and certain other factors. An institution that is not well capitalized is subject to certain restrictions on brokered deposits, including restrictions on the rates it can offer on its deposits generally. Any institution which is neither well capitalized nor adequately capitalized is considered undercapitalized. The previously referenced final rule establishing an elective "community bank leverage ratio" regulatory capital framework provides that a qualifying institution whose capital exceeds the community bank leverage ratio and opts to use that framework will be considered "well capitalized" for purposes of prompt corrective action.

Undercapitalized institutions are subject to certain prompt corrective action requirements, regulatory controls and restrictions which become more extensive as an institution becomes more severely undercapitalized. Failure by 1st Security Bank of Washington to comply with applicable capital requirements would, if unremedied, result in progressively more severe restrictions on its activities and lead to enforcement actions, including, but not limited to, the issuance of a capital directive to ensure the maintenance of required capital levels and, ultimately, the appointment of the FDIC as receiver or conservator. Banking regulators will take prompt corrective action with respect to depository institutions that do not meet minimum capital requirements. Additionally, approval of any regulatory application filed for their review may be dependent on compliance with capital requirements.

At December 31, 2021, 1st Security Bank of Washington was categorized as well capitalized under the prompt corrective action regulations of the FDIC. For additional information, see "Note 14 - Regulatory Capital" of the Notes to Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data," of this Form 10-K.

Standards for Safety and Soundness. Each federal banking agency, including the FDIC, has adopted guidelines establishing general standards relating to internal controls, information and internal audit systems; loan documentation; credit underwriting; interest rate risk exposure; asset growth; asset quality; earnings; and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal shareholder. If the FDIC determines that an institution fails to meet any of these guidelines, it may require an institution to submit to the FDIC an acceptable plan to achieve compliance. Management of the Bank is not aware of any conditions relating to these safety and soundness standards which would require submission of a plan of compliance.

Federal Home Loan Bank System. The FHLB of Des Moines is one of 11 regional Federal Home Loan Banks that administer the home financing credit function of savings institutions. The Federal Home Loan Banks are subject to the oversight of the Federal Housing Finance Agency and each Federal Home Loan Bank serves as a reserve or central bank for its members within its assigned region. The Federal Home Loan Banks are funded primarily from proceeds derived from the sale of consolidated obligations of the Federal Home Loan Bank System and make loans or advances to members in accordance with policies and procedures established by the Board of Directors of the Federal Home Loan Bank, which are subject to the oversight of the Federal Housing Finance Agency. All advances are required to be fully secured by sufficient collateral as determined by the Federal Home Loan Bank. As a member, the Bank is required to purchase and maintain stock in the FHLB of Des Moines based on the Bank's asset size and level of borrowings from the FHLB of Des Moines. See "Business - Deposit Activities and Other Sources of Funds - Debt." At December 31, 2021, 1st Security Bank of Washington had $4.8 million in FHLB of Des Moines stock, which was in compliance with this requirement.

The FHLB pays dividends quarterly, and 1st Security Bank of Washington received $256,000 in dividends during the year ended December 31, 2021.

The Federal Home Loan Banks continue to contribute to low- and moderately-priced housing programs through direct loans or interest subsidies on advances targeted for community investment and low- and moderate-income housing projects. These contributions have adversely affected the level of Federal Home Loan Bank dividends paid and could continue to do so in the future. These contributions could also have an adverse effect on the value of Federal Home Loan Bank stock in the future. A reduction in value of 1st Security Bank of Washington's FHLB stock may result in a decrease in net income.

Commercial Real Estate Lending Concentrations. The federal banking agencies have issued guidance on sound risk management practices for concentrations in commercial real estate lending. The particular focus is on exposure to commercial real estate loans that are dependent on the cash flow from the real estate held as collateral and that are likely to be sensitive to conditions in the commercial real estate market (as opposed to real estate collateral held as a secondary source of repayment or as an abundance of caution). The purpose of the guidance is not to limit a bank's commercial real estate lending but to guide banks in developing risk management practices and capital levels commensurate with the level and nature of real estate concentrations. The guidance directs the FDIC and other federal bank regulatory agencies to focus their supervisory resources on institutions that may have significant commercial real estate loan concentration risk. A bank that has experienced rapid growth in commercial real estate lending, has notable exposure to a specific type of commercial real estate loan, or is approaching or exceeding the following supervisory criteria may be identified for further supervisory analysis with respect to real estate concentration risk:

- Total reported loans for construction, land development and other land represent 100% or more of the Bank's total regulatory capital; or

- Total commercial real estate loans (as defined in the guidance) represent 300% or more of the Bank's total regulatory capital and the outstanding balance of the Bank's commercial real estate loan portfolio has increased 50% or more during the prior 36 months.

The guidance provides that the strength of an institution's lending and risk management practices with respect to such concentrations will be taken into account in supervisory guidance on evaluation of capital adequacy. At December 31, 2021, 1st Security Bank of Washington's aggregate recorded loan balances for construction, land development and land loans were 81.8% of regulatory capital. In addition, at December 31, 2021, 1st Security Bank of Washington's loans on all commercial real estate, including construction, owner and non-owner occupied commercial real estate, and multi-family lending, as defined by the FDIC, were 248.1% of regulatory capital.

Activities and Investments of Insured State-Chartered Financial Institutions. Federal law generally limits the activities and equity investments of FDIC insured, state-chartered banks to those that are permissible for national banks. An insured state bank is not prohibited from, among other things, (1) acquiring or retaining a majority interest in a subsidiary, (2) investing as a limited partner in a partnership the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such limited partnership investments may not exceed 2% of the bank's total assets, (3) acquiring up to 10% of the voting stock of a company that solely provides or reinsures directors' and officers' liability insurance coverage or bankers' blanket bond group insurance coverage for insured depository institutions, and (4) acquiring or retaining the voting shares of a depository institution if certain requirements are met.

Dividends. Dividends from 1st Security Bank of Washington constitute a major source of funds for dividends in future periods that may be paid by FS Bancorp to shareholders. The amount of dividends payable by 1st Security Bank of Washington to FS Bancorp depends upon the Bank's earnings and capital position, and is limited by federal and state laws, regulations and policies. According to Washington law, 1st Security Bank of Washington may not declare or pay a cash dividend on its capital stock if it would cause its net worth to be reduced below (1) the amount required for liquidation accounts or (2) the net worth requirements, if any, imposed by the Director of the DFI. Dividends on 1st Security Bank of Washington's capital stock may not be paid in an aggregate amount greater than the aggregate retained earnings of 1st Security Bank of Washington, without the approval of the Director of the DFI. The Bank paid $9.8 million in dividends to the holding company in 2021.

The amount of dividends actually paid during any one period will be strongly affected by 1st Security Bank of Washington's policy of maintaining a strong capital position. Federal law further limits and can prohibit dividends when an institution does not meet the capital conservation buffer requirement and provides that no insured depository institution may pay a cash dividend if it would cause the institution to be "undercapitalized," as defined in the prompt corrective action regulations. Moreover, the federal bank regulatory agencies also have the general authority to limit the dividends paid by insured banks if such payments are deemed to constitute an unsafe and unsound practice.

Affiliate Transactions. FS Bancorp and 1st Security Bank of Washington are separate and distinct legal entities. FS Bancorp (and any non-bank subsidiary of FS Bancorp) is an affiliate of 1st Security Bank of Washington. Federal laws strictly limit the ability of banks to engage in certain transactions with their affiliates. Transactions deemed to be "covered transactions" under Section 23A of the Federal Reserve Act and between a bank and an affiliate are limited to 10% of the bank subsidiary's capital and surplus and, with respect to all affiliates, to an aggregate of 20% of the bank's capital and surplus. Further, covered transactions that are loans and extensions of credit generally are required to be secured by eligible collateral in specified amounts. Federal law also requires that covered transactions and certain other transactions listed in Section 23B of the Federal Reserve Act between a bank and its affiliates be on terms as favorable to the bank as transactions with non-affiliates.

Community Reinvestment Act. 1st Security Bank of Washington is also subject to the provisions of the Community Reinvestment Act of 1977 ("CRA"), which requires the appropriate federal bank regulatory agency to assess a bank's performance under the CRA in meeting the credit needs of the community serviced by the Bank, including low- and moderate-income neighborhoods. The regulatory agency's assessment of a bank's record is made available to the public. Further, a bank's CRA performance rating must be considered in connection with a bank's application to, among other things, establish a new branch office that will accept deposits, relocate an existing office or merge or consolidate with, or acquire the assets or assume the liabilities of, a federally regulated financial institution, and in connection with certain applications by a bank holding company, such as bank acquisitions. An unsatisfactory rating may be the basis for denial of certain applications. 1st Security Bank of Washington received a "satisfactory" rating during its most recent CRA examination.

Privacy Standards and Cybersecurity. The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 modernized the financial services industry by establishing a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms, and other financial service providers. Federal banking agencies, including the FDIC, have adopted guidelines for establishing information security standards and cybersecurity programs for implementing safeguards under the supervision of the board of directors. These guidelines, along with related regulatory materials, increasingly focus on risk management and processes related to information technology and the use of third parties in the provision of financial services. These regulations require 1st Security Bank of Washington to disclose its privacy policy, including informing consumers of its information sharing practices and informing consumers of their rights to opt out of certain practices. In addition, other federal and state cybersecurity and data privacy laws and regulations may expose 1st Security Bank of Washington to risk and result in certain risk management costs. In addition, on November 18, 2021, the federal banking agencies announced the adoption of a final rule providing for new notification requirements for banking organizations and their service providers for significant cybersecurity incidents. Specifically, the new rule requires a banking organization to notify its primary federal regulator as soon as possible, and no later than 36 hours after the banking organization determines that a "computer-security incident" rising to the level of a "notification incident" has occurred. Notification is required for incidents that have materially affected or are reasonably likely to materially affect the viability of a banking organization's operations, its ability to deliver banking products and services, or the stability of the financial sector. Service providers are required under the rule to notify affected banking organization customers as soon as possible when the provider determines that it has experienced a computer-security incident that has materially affected or is reasonably likely to materially affect the banking organization's customers for four or more hours. Compliance with the new rule is required by May 1, 2022. Noncompliance with federal or similar state privacy and cybersecurity laws and regulations could lead to substantial regulatory imposed fines and penalties, damages from private causes of action and/or reputational harm.

Environmental Issues Associated with Real Estate Lending. The Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") is a federal statute that generally imposes strict liability on, all prior and present "owners and operators" of sites containing hazardous waste. However, Congress asked to protect secured creditors by providing that the term "owner and operator" excludes a person whose ownership is limited to protecting its security interest in the site. Since the enactment of the CERCLA, this "secured creditor exemption" has been the subject of judicial interpretations which have left open the possibility that lenders could be liable for cleanup costs on contaminated property that they hold as collateral for a loan. To the extent that legal uncertainty exists in this area, all creditors, including 1st Security Bank of Washington, that have made loans secured by properties with potentially hazardous waste contamination (such as petroleum contamination) could be subject to liability for cleanup costs, which costs often substantially exceed the value of the collateral property.

Federal Reserve System. The Federal Reserve requires all depository institutions to maintain reserves at specified levels against their transaction accounts, primarily checking accounts. In response to the COVID-19 pandemic, the Federal Reserve reduced reserve requirement ratios to zero percent effective March 26, 2020, to support lending to households and businesses. At December 31, 2021, the Bank was in compliance with the reserve requirements in place at the time.

Other Consumer Protection Laws and Regulations. The Dodd-Frank Act established the CFPB and empowered it to exercise broad regulatory, supervisory and enforcement authority with respect to both new and existing consumer financial protection laws. 1st Security Bank of Washington is subject to consumer protection regulations issued by the CFPB, but as a financial institution with assets of less than $10 billion, 1st Security Bank of Washington is generally subject to supervision and enforcement by the FDIC and the DFI with respect to compliance with federal and state consumer financial protection laws and regulations.

1st Security Bank of Washington is subject to a broad array of federal and state consumer protection laws and regulations that govern almost every aspect of its business relationships with consumers. While the list set forth below is not exhaustive, these include the Truth in Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Home Mortgage Disclosure Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, the Right to Financial Privacy Act, the Home Ownership and Equity Protection Act, the Consumer Leasing Act, the Fair Credit Billing Act, the Homeowners Protection Act, the Check Clearing for the 21st Century Act, laws governing flood insurance, laws governing consumer protections in connection with the sale of insurance, federal and state laws prohibiting unfair and deceptive business practices, and various regulations that implement the foregoing. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans, collecting loans, and providing other services. In addition, The USA PATRIOT Act, requires banks to, among other things, establish broadened anti-money laundering compliance programs, and due diligence policies and controls to ensure the detection and reporting of money laundering. Such required compliance programs are intended to supplement existing compliance requirements that also apply to financial institutions under the Bank Secrecy Act and the Office of Foreign Assets Control regulations. Failure to comply with these laws and regulations can subject 1st Security Bank of Washington to various penalties, including but not limited to, enforcement actions, injunctions, fines, civil liability, criminal penalties, punitive damages, and the loss of certain contractual rights.

Regulation and Supervision of FS Bancorp

General. FS Bancorp is a bank holding company registered with the Federal Reserve and is the sole shareholder of 1st Security Bank of Washington. Bank holding companies are subject to comprehensive regulation by the Federal Reserve under the Bank Holding Company Act of 1956, as amended ("BHCA"), and the regulations promulgated there under. This regulation and oversight is generally intended to ensure that FS Bancorp limits its activities to those allowed by law and that it operates in a safe and sound manner without endangering the financial health of 1st Security Bank of Washington.

As a bank holding company, FS Bancorp is required to file quarterly and annual reports with the Federal Reserve and any additional information required by the Federal Reserve and is subject to regular examinations by the Federal Reserve. The Federal Reserve also has extensive enforcement authority over bank holding companies, including the ability to assess civil money penalties, to issue cease and desist or removal orders, and to require that a holding company divest subsidiaries (including its bank subsidiaries). In general, enforcement actions may be initiated for violations of law and regulations and unsafe or unsound practices.

The Bank Holding Company Act. Under the BHCA, FS Bancorp is supervised by the Federal Reserve. The Federal Reserve has a policy that a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, the Dodd-Frank Act provides that a bank holding company should serve as a source of strength to its subsidiary banks by having the ability to provide financial assistance to its subsidiary banks during periods of financial stress to the bank. A bank holding company's failure to meet its obligation to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve to be an unsafe and unsound banking practice or a violation of the Federal Reserve's regulations or both. No regulations have yet been proposed by the Federal Reserve to implement the source of strength doctrine required by the Dodd-Frank Act. FS Bancorp and any subsidiaries that it may control are considered "affiliates" of 1st Security Bank of Washington within the meaning of the Federal Reserve Act, and transactions between 1st Security Bank of Washington and its affiliates are subject to numerous restrictions. With some exceptions, FS Bancorp and its subsidiaries are prohibited from tying the provision of various services, such as extensions of credit, to other services offered by FS Bancorp or its subsidiaries.

Acquisitions. The BHCA prohibits a bank holding company, with certain exceptions, from acquiring ownership or control of more than 5% of the voting shares of any company that is not a bank or bank holding company and from engaging in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. Under the BHCA, the Federal Reserve may approve the ownership of shares by a bank holding company in any company, the activities of which the Federal Reserve has determined to be so closely related to the business of banking or managing or controlling banks as to be a proper incident thereto. These activities include: operating a savings institution, mortgage company, finance company, credit card company or factoring company; performing certain data processing operations; providing certain investment and financial advice; underwriting and acting as an insurance agent for certain types of credit-related insurance; leasing property on a full-payout, non-operating basis; selling money orders, travelers' checks, and U.S. Savings Bonds; real estate and personal property appraising; providing tax planning and preparation services; and, subject to certain limitations, providing securities brokerage services for customers. The Federal Reserve must approve the acquisition (or acquisition of control) of a bank or other FDIC-insured depository institution by a bank holding company, and the appropriate federal banking regulator must approve a bank's acquisition (or acquisition of control) of another bank or other FDIC-insured institution.

Regulatory Capital Requirements. As discussed above, pursuant to the "Small Bank Holding Company" exception, effective August 30, 2018, bank holding companies with less than $3 billion in consolidated assets were generally no longer subject to the Federal Reserve's capital regulations, which are generally the same as the capital regulations applicable to 1st Security Bank of Washington. At the time of this change, FS Bancorp was considered "well capitalized" (as defined for a bank holding company), and was not subject to an individualized order, directive or agreement under which the Federal Reserve requires it to maintain a specific capital level.

For additional information, see "Note 14 - Regulatory Capital" of the Notes to the Consolidated Financial Statements contained in "Item 8. Financial Statements and Supplementary Data" of this Form 10-K.

Restrictions on Dividends and Stock Repurchases. FS Bancorp's ability to declare and pay dividends is subject to the Federal Reserve limits and Washington law, and may depend on its ability to receive dividends from 1st Security Bank of Washington.

Federal Reserve policy limits the payment of a cash dividend by a bank holding company if the holding company's net income for the past year is not sufficient to cover both the cash dividend and a rate of earnings retention that is consistent with capital needs, asset quality and overall financial condition. A bank holding company that does not meet any applicable capital standard would not be able to pay any cash dividends under this policy. A bank holding company not subject to consolidated capital requirements is expected not to pay dividends unless its debt-to-equity ratio is less than 1:1, and it meets certain additional criteria. The Federal Reserve also has indicated that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends.

Except for a company that meets the applicable standard to be considered a well capitalized and well-managed bank holding company and is not subject to any unresolved supervisory issues, a bank holding company is required to give the Federal Reserve prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of the company's consolidated net worth. The Federal Reserve may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe or unsound practice or would violate any law, regulation or regulatory order, condition, or written agreement.

Under Washington corporate law, FS Bancorp generally may not pay dividends if after that payment it would not be able to pay its liabilities as they become due in the usual course of business, or its total assets would be less than the sum of its total liabilities.

Federal Securities Law. The stock of FS Bancorp is registered with the SEC under the Securities Exchange Act of 1934, as amended. As a result, FS Bancorp is subject to the information, proxy solicitation, insider trading restrictions, and other requirements under the Securities Exchange Act of 1934.

FS Bancorp stock held by persons who are affiliates of FS Bancorp may not be resold without registration unless sold in accordance with certain resale restrictions. Affiliates are generally considered to be officers, directors, and principal shareholders. If FS Bancorp meets specified current public information requirements, each affiliate of FS Bancorp will be able to sell in the public market, without registration, a limited number of shares in any three-month period.

COVID-19 Legislation. In response to the COVID-19 pandemic, Congress, through the enactment of the CARES Act and CAA, 2021, and the federal banking agencies, though rulemaking, interpretive guidance and modifications to agency policies and procedures, have taken a series of actions to provide national emergency economic relief measures including, among others, the CARES Act and CAA, 2021. As the ongoing COVID-19 pandemic evolves, federal and state regulatory authorities continue to issue additional guidance with respect to COVID-19. In addition, it is possible that Congress will enact additional COVID-19 response legislation. We will continue to assess the impact of the CARES Act, CAA, 2021, and other statutes, regulations and supervisory guidance related to the COVID-19 pandemic.

TAXATION

Federal Taxation

General. FS Bancorp and 1st Security Bank of Washington are subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to FS Bancorp. 1st Security Bank of Washington is no longer subject to U.S. federal income tax examinations by tax authorities for years ended before 2018, and income tax returns have not been audited for the past eight years, 2014 to 2021.

FS Bancorp files a consolidated federal income tax return with 1st Security Bank of Washington. Accordingly, any cash distributions made by FS Bancorp to its shareholders would be considered to be taxable dividends and not as a non-taxable return of capital to shareholders for federal and state tax purposes. For additional information, see "Note 11-Income Taxes" of the Notes to Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data" of this Form 10-K.

Method of Accounting. For federal income tax purposes, FS Bancorp currently reports its income and expenses on the accrual method of accounting and uses a fiscal year ending on December 31 for filing its federal income tax return.

Net Operating Loss Carryovers. The Company may carryforward net operating losses indefinitely. At December 31, 2021, the Company had remaining net operating losses of approximately $880,000, which begin to expire in 2035.

Corporate Dividends-Received Deduction. FS Bancorp may eliminate from its income dividends received from 1st Security Bank of Washington as a wholly-owned subsidiary of FS Bancorp if it elects to file a consolidated return with 1st Security Bank of Washington. The corporate dividends-received deduction is 100%, or 80%, in the case of dividends received from corporations with which a corporate recipient does not file a consolidated tax return, depending on the level of stock ownership of the payor of the dividend. Corporations which own less than 20% of the stock of a corporation distributing a dividend may deduct 70% of dividends received or accrued on their behalf.

Washington Taxation

The Company and the Bank are subject to a business and occupation tax which is imposed under Washington law at the rate of 1.75% of gross receipts. Interest received on loans secured by mortgages or deeds of trust on residential properties, residential mortgage-backed securities, and certain U.S. Government and agency securities are not subject to this tax.

Item 1A. Risk Factors

An investment in our common stock is subject to risks inherent in our business. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included in this report and our other filings with the SEC. In addition to the risks and uncertainties described below, other risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition, capital levels, cash flows, liquidity, results of operations, and prospects. The market price of our common stock could decline significantly due to any of these identified or other risks, and you could lose some or all of your investment. The risks discussed below also include forward-looking statements, and our actual results may differ substantially from those discussed in these forward-looking statements. This report is qualified in its entirety by these risk factors.

Risks Related to Macroeconomic Conditions

The COVID-19 pandemic has adversely impacted our ability to conduct business and is expected to adversely impact our financial results and those of our customers. The ultimate impact will depend on future developments, which are highly uncertain and cannot be predicted, including the scope and duration of the pandemic and actions taken by governmental authorities in response to the pandemic.

The COVID-19 pandemic continues to negatively impact economic and commercial activity and financial markets, both globally and within the United States. In our market areas, stay-at-home orders, travel restrictions and closure of non-essential businesses and similar orders imposed across the United States to restrict the spread of COVID-19 in 2020 resulted in significant business and operational disruptions, including business closures, supply chain disruptions, and significant layoffs and furloughs. Although local jurisdictions have subsequently lifted stay-at-home orders and moved to the opening of businesses, worker shortages, vaccine and testing requirements, new variants of COVID-19 and other health and safety recommendations have impacted the ability of businesses to return to pre-pandemic levels of activity and employment. While the overall economy has improved, disruptions to supply chains continue and significant inflation has been seen in the market. If these effects continue for a prolonged period or result in sustained economic stress or recession, many of the risk factors identified in our Form 10-K could be exacerbated, including the following risks of COVID-19, any of which could have a material, adverse effect on our business, financial condition, liquidity, and results of operations of the Company:

- effects on key employees, including operational management personnel and those charged with preparing, monitoring, and evaluating our financial reporting and internal controls;

- declines in demand for loans and other banking services and products, as well as a decline in the credit quality of our loan portfolio, owing to the effects of COVID-19 in the markets we serve;

- if the economy is unable to remain open in an efficient manner, loan delinquencies, problem assets, and foreclosures may increase, resulting in increased charges and reduced income;

- collateral for loans, especially real estate, may decline in value, which could cause loan losses to increase;

- allowance for loan losses may increase if borrowers experience financial difficulties, which will adversely affect net income;

- the net worth and liquidity of loan guarantors may decline, impairing their ability to honor commitments;

- as long as the Federal Reserve Board’s target federal funds rate remains near 0%, the yield on assets may decline to a greater extent than the decline in cost of interest-bearing liabilities, reducing net interest margin and spread and reducing net income;

- higher operating costs, increased cybersecurity risks and potential loss of productivity as the result of an increase in the number of employees working remotely;

- increasing or protracted volatility in the price of the Company’s common stock, which may also impair our goodwill; and

- risks to capital markets that may impact the performance of our investment securities portfolio, as well as limit our access to capital markets and other funding sources.

Because there have been no comparable recent global pandemics that resulted in similar global impact, we do not yet know the full extent of COVID-19’s effects on our business, operations, or the global economy as a whole. Any future development will be highly uncertain and cannot be predicted, including the scope and duration of the pandemic, possible future virus variants, the effectiveness of our work-from-home arrangements, third party providers’ ability to support our operations, and any actions taken by governmental authorities and other third parties in response to the pandemic. The uncertain future development of this crisis could materially and adversely affect our business, operations, operating results, financial condition, liquidity or capital levels.

Our business may be adversely affected by downturns in the national economy and in the economies in our market areas.

Our primary market areas are in the Puget Sound region of Washington and Kitsap, Clallam, Jefferson, Grays Harbor, Thurston, Lewis, and Benton counties. Our business is directly affected by market conditions, trends in industry and finance, legislative and regulatory changes, and changes in governmental monetary and fiscal policies, and inflation, all of which are beyond our control. General economic conditions, including inflation, unemployment and money supply fluctuations, also may affect our profitability adversely. Weakness in the global economy has adversely affected many businesses operating in our markets that are dependent upon international trade and it is not known how changes in tariffs being imposed on international trade may also affect these businesses. Changes in agreements or relationships between the United States and other countries may also affect these businesses.

A deterioration in economic conditions in the market areas we serve as a result of COVID-19 or other factors could result in the following consequences, any of which could have a material adverse effect on the business, financial condition, and results of operations:

- demand for our products and services may decline, possibly resulting in a decrease in our total loans or assets;
- loan delinquencies, problem assets and foreclosures may increase;
- we may increase our allowance for loan losses;
- collateral for our loans may further decline in value, in turn reducing customer's borrowing power, reducing the value of assets and collateral associated with existing loans;
- the net worth and liquidity of loan guarantors may decline, impairing their ability to honor commitments to us; and
- the amount of our low-cost or noninterest-bearing deposits may decrease.

A decline in local economic conditions may have a greater effect on our earnings and capital than on the earnings and capital of larger financial institutions whose real estate loan portfolios are geographically diverse. Many of the loans in our portfolio are secured by real estate or fixtures attached to real estate. Deterioration in the real estate markets where collateral for a mortgage loan is located could negatively affect the borrower's ability to repay the loan and the value of the collateral securing the loan. Real estate values are affected by various other factors, including changes in general or regional economic conditions, governmental rules or policies, and natural disasters such as earthquakes. If we are required to liquidate a significant amount of collateral during a period of reduced real estate values, our financial condition and profitability could be adversely affected.

Adverse changes in the regional and general economy could reduce our growth rate, impair our ability to collect loans, and generally have a negative effect on our financial condition and results of operations.

Risks Related to our Lending Activities

Our loan portfolio possesses increased risk due to a large percentage of consumer loans.

Our consumer loans accounted for $423.8 million, or 24.1% of our total gross loan portfolio as of December 31, 2021, of which $340.3 million (80.3% of total consumer loans) consisted of indirect home improvement loans (some of which were not secured by a lien on the real property), $80.6 million (19.0% of total consumer loans) consisted of marine loans secured by boats, and $2.9 million (0.7% of total consumer loans) consisted of other consumer loans, which includes personal lines of credit, credit cards, automobile, direct home improvement, loans on deposit, and recreational loans. Generally, we consider these types of loans to involve a higher degree of risk compared to first mortgage loans on owner-occupied, one-to-four-family residential properties. As a result of our large portfolio of consumer loans, it may become necessary to increase the level of provision for our loan losses, which would reduce profits. Consumer loans generally entail greater risk than do one-to-four-family residential mortgage loans, particularly in the case of loans that are secured by rapidly depreciable assets, such as automobiles and boats. In these cases, any repossessed collateral for a defaulted loan may not provide an adequate source of repayment of the outstanding loan balance.

Most of our consumer loans are originated indirectly by or through third parties, which presents greater risk than our direct lending products which involves direct contact between us and the borrower. Unlike a direct loan where the borrower makes an application directly to us, in these loans the dealer, who has a direct financial interest in the loan transaction, assists the borrower in preparing the loan application. Although we disburse the loan proceeds directly to the dealer upon receipt of a "completion certificate" signed by the borrower, because we do not have direct contact with the borrower, these loans may be more susceptible to a material misstatement on the loan application or having the loan proceeds being misused by the borrower or the dealer. In addition, if the work is not properly performed, the borrower may cease payment on the loan until the problem is rectified. Although we file a UCC-2 financing statement to perfect the security interest in the personal property collateral for most fixture loans, there are no guarantees on our ability to collect on that security interest or that the repossessed collateral for a defaulted fixture loan will provide an adequate source of repayment for the outstanding loan given the limited stand-alone value of the collateral.

Indirect home improvement and marine loans totaled $420.9 million, or 23.9% of our total gross loan portfolio at December 31, 2021, and are originated through a network of 147 home improvement contractors and dealers located in Washington, Oregon, California, Idaho, Colorado, Arizona, Nevada, and Minnesota. In addition, we rely on five dealers for 49.5% of our loan volume so the loss of one of these dealers can have a significant effect on our loan origination volume. See "Item 1. Business - Lending Activities - Consumer Lending" and "- Asset Quality."

Our business could suffer if we are unsuccessful in making, continuing, and growing relationships with home improvement contractors and dealers.

Our indirect home improvement lending, which is the largest component of our consumer loan portfolio, is reliant on our relationships with home improvement contractors and dealers. In particular, our indirect home improvement loan operations depend in large part upon our ability to establish and maintain relationships with reputable contractors and dealers who originate loans at the point of sale. Our indirect home improvement contractor/dealer network is currently comprised of 147 active contractors and dealers with businesses located throughout Washington, Oregon, California, Idaho, Colorado, Arizona, Nevada, and Minnesota with approximately ten contractors/dealers responsible for more than half of this loan volume. Indirect home improvement totaled $340.3 million, or 19.3% of our total gross loan portfolio, at December 31, 2021, reflecting approximately 21,000 loans with an average balance of approximately $16,000.

We have relationships with home improvement contractors/dealers, however, the relationships generally are not exclusive, some of them are newly established and they may be terminated at any time. If there is another economic downturn and contraction of credit to both contractors/dealers and their customers, there could be an increase in business closures and our existing contractor/dealer base could experience decreased sales and loan volume, which may have an adverse effect on our business, results of operations and financial condition. In addition, if a competitor were to offer better service or more attractive loan products to our contractor/dealer partners, it is possible that our partners would terminate their relationships with us or recommend customers to our competitors. If we are unable to continue to grow our existing relationships and develop new relationships, our results of operations and financial condition could be adversely affected.

A significant portion of our business involves commercial real estate lending which is subject to various risks that could adversely impact our results of operations and financial condition.

At December 31, 2021, our loan portfolio included $443.7 million of commercial real estate loans, including $160.5 million secured by non-owner occupied commercial real estate properties, and $178.7 million of multi-family real estate loans, or 25.2% of our total gross loan portfolio, compared to $354.3 million, or 22.5%, at December 31, 2020. We have been increasing and intend to continue to increase, subject to market demand, the origination of commercial and multi-family real estate loans. The credit risk related to these types of loans is considered to be greater than the risk related to one-to-four-family residential loans because the repayment of commercial and multi-family real estate loans typically is dependent on the successful operation and income stream of the property securing the loan and the value of the real estate securing the loan as collateral, which can be significantly affected by economic conditions.

Our focus on these types of loans will increase the risk profile relative to traditional one-to-four-family lenders as we continue to implement our business strategy. Although commercial and multi-family real estate loans are intended to enhance the average yield of the earning assets, they do involve a different, and possibly higher, level of risk of delinquency or collection than generally associated with one-to-four-family loans for a number of reasons. Among other factors, these loans involve larger balances to a single borrower or groups of related borrowers. Since commercial real estate and multi-family real estate loans generally have large balances, if we make any errors in judgment in the collectability of these loans, we may need to significantly increase the provision for loan losses since any resulting charge-offs will be larger on a per loan basis. Consequently, this could materially adversely affect our future earnings.

Collateral evaluation for these types of loans also requires a more detailed analysis at the time of loan underwriting and on an ongoing basis. In addition, most of our commercial and multi-family loans are not fully amortizing and include balloon payments upon maturity. Balloon payments may require the borrower to either sell or refinance the underlying property in order to make the payment, which may increase the risk of default or non-payment. Finally, if foreclosure occurs on a commercial real estate loan, the holding period for the collateral, if any, typically is longer than for a one-to-four-family residence because the secondary market for most types of commercial and multi-family real estate is not readily liquid, so we have less opportunity to mitigate credit risk by selling part or all of our interest in these assets. See "Item 1. Business - Lending Activities - Commercial Real Estate Lending" of this Form 10-K.

Repayment of our commercial business loans is often dependent on the cash flows of the borrower, which may be unpredictable, and the collateral securing these loans may fluctuate in value.

At December 31, 2021, our commercial business loan portfolio included commercial and industrial loans of $208.8 million, or 11.9%, and warehouse lending of $33.3 million, or 1.9%, of our total gross loan portfolio compared to commercial and industrial loans of $224.5 million, or 14.3%, and warehouse lending of $49.1 million, or 3.1% at December 31, 2020. Commercial business lending involves risks that are different from those associated with residential and commercial real estate lending. Real estate lending is generally considered to be collateral-based lending with loan amounts based on predetermined loan to collateral values and liquidation of the underlying real estate collateral being viewed as the primary source of repayment in the event of borrower default. Our commercial and industrial 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. This collateral may consist of equipment, inventory, accounts receivable, or other business assets. 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 these loans may depreciate over time, may be difficult to appraise, may be illiquid, and may fluctuate in value based on the specific type of business and equipment. As a result, the availability of funds for the repayment of commercial and industrial 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 and secondarily on the underlying collateral provided by the borrower. For additional information related to the risks of warehouse lending, see "Our residential mortgage warehouse lending and construction warehouse lending programs are subject to various risks that could adversely impact our results of operations and financial condition."

We continue to focus on residential construction lending which is subject to various risks that could adversely impact our results of operations and financial condition.

We make real estate construction loans to individuals and builders, primarily for the construction of residential properties. We originate these loans whether or not the collateral property underlying the loan is under contract for sale. At December 31, 2021, construction and development loans totaled $242.4 million, or 13.8% of our total gross loan portfolio (excluding $182.3 million of unfunded construction loan commitments), of which $173.6 million were for residential real estate projects. This compares to construction and development loans of $217.0 million, or 13.8% of our total loan portfolio at December 31, 2020, or an increase of 11.7% during the past year. In addition to these construction and development loans, the Company had four commercial note-secured lines of credit to residential construction re-lenders with combined commitments of $54.0 million, and an outstanding balance of $27.1 million at December 31, 2021. The underlying collateral risks associated with our commercial construction warehouse lines are similar to the risks related to our residential construction and development loans.

Construction financing is generally considered to involve a higher degree of credit risk than longer term financing on improved, owner-occupied real estate. Construction lending involves additional risks when compared with permanent residential lending because funds are advanced upon the collateral for the project based on an estimate of costs that will produce a future value at completion. Because of the uncertainties inherent in estimating construction costs, as well as the market value of the complete project and the effects of governmental regulation on real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the completed project loan-to-value ratio. Changes in demand for new housing and higher than anticipated building costs may cause actual results to vary significantly from those estimated. For these reasons, this type of lending also typically involves higher loan principal amounts and may be concentrated with a small number of builders. A downturn in housing, or the real estate market, could increase delinquencies, defaults and foreclosures, and significantly impair the value of our collateral and our ability to sell the collateral upon foreclosure. Some of the builders we deal with have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss. In addition, during the term of most of our construction loans, no payment from the borrower is required since the accumulated interest is added to the principal of the loan through an interest reserve. As a result, these loans often involve the disbursement of funds with repayment substantially dependent on the success of the ultimate project and the ability of the borrower to sell or lease the property or obtain permanent take-out financing, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of a completed project proves to be overstated, we may have inadequate security for the repayment of the loan upon completion of construction of the project and may incur a loss. Because construction loans require active monitoring of the building process, including cost comparisons and on-site inspections, these loans are more difficult and costly to monitor.

Increases in market rates of interest may have a more pronounced effect on construction loans by rapidly increasing the end-purchaser’s borrowing costs, thereby possibly reducing the homeowner's ability to finance the home upon completion or the overall demand for the project. Properties under construction are often difficult to sell and typically must be completed in order to be successfully sold which also complicates the process of working out problem construction loans. This may require us to advance additional funds and/or contract with another builder to complete construction and assume the market risk of selling the project at a future market price, which may or may not enable us to fully recover unpaid loan funds and associated construction and liquidation costs. Furthermore, in the case of speculative construction loans, there is the added risk associated with identifying an end-purchaser for the finished project. At December 31, 2021, outstanding construction and development loans totaled $242.4 million of which $120.0 million was comprised of speculative one-to-four-family construction loans and $6.3 million of land acquisition and development loans. Total committed, including unfunded construction and development loans at December 31, 2021 was $182.3 million. Loans on land under development or held for future construction pose additional risks because of the lack of income being produced by the property and the potential illiquid nature of the collateral. These risks can be significantly impacted by supply and demand. As a result, this type of lending often involves the disbursement of substantial funds with repayment dependent on the success of the ultimate project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor themselves to repay principal and interest. No real estate construction and development loans were nonperforming at December 31, 2021. A material increase in our nonperforming construction and development loans could have a material adverse effect on our financial condition and results of operation.

Our residential mortgage warehouse lending program is subject to various risks that could adversely impact our results of operations and financial condition.

The Company has a residential mortgage warehouse lending program that focuses on five Pacific Northwest mortgage banking companies. Short-term funding is provided to the mortgage banking companies for the purpose of originating residential mortgage loans for sale into the secondary market. Our warehouse lending lines are secured by the underlying notes associated with mortgage loans made to borrowers by the mortgage banking company and we generally require guarantees from the principal shareholder(s) of the mortgage banking company. Because these loans are repaid when the note is sold by the mortgage bank into the secondary market, with the proceeds from the sale used to pay down our outstanding loan before being dispersed to the mortgage bank, interest rate fluctuation is also a key risk factor affecting repayment. At December 31, 2021, we had approved residential warehouse lending lines in varying amounts from $5.0 million to $15.0 million with each of the five companies, for an aggregate amount of $43.5 million. At December 31, 2021, there was $6.3 million in residential warehouse lines outstanding, compared to $16.1 million outstanding at December 31, 2020.

There are numerous risks associated with residential mortgage warehouse lending, which include, without limitation, (i) credit risks relating to the mortgage bankers that borrow from us, (ii) the risk of intentional misrepresentation or fraud by any of these mortgage bankers, (iii) changes in the market value of mortgage loans originated by the mortgage banker, the sale of which is the expected source of repayment of the borrowings under the warehouse line of credit, due to changes in interest rates during the time in warehouse, (iv) unsalable or impaired mortgage loans originated, which could lead to decreased collateral value and the failure of a purchaser of the mortgage loan to purchase the loan from the mortgage banker, and (v) the volatility of mortgage loan originations.

The underlying collateral risks associated with our residential mortgage warehouse lines are similar to the risks related to our one-to-four-family residential mortgage loans. Additionally, the impact of interest rates on our residential mortgage warehouse lending business is similar to the impact on our mortgage banking operations as discussed below under "Revenue from mortgage banking operations is sensitive to changes in economic conditions, decreased economic activity, a slowdown in the housing market, higher interest rates or new legislation and may adversely impact our financial condition and results of operations."

Loans originated under the SBA Paycheck Protection Program subject us to forgiveness and guarantee risk.

As of December 31, 2021, we hold and service a portfolio of 107 loans originated under the PPP with a balance of $24.2 million. The PPP loans are subject to the provisions of the CARES Act and CAA 2021 and to complex and evolving rules and guidance issued by the SBA and other government agencies. Most of our PPP borrowers have already qualified for or will seek full or partial forgiveness of their loan obligations, however, if a PPP borrower fails to qualify for loan forgiveness, we face a heightened risk of holding these loans at unfavorable interest rates for an extended period of time. We could face additional risks in our administrative capabilities to service our PPP loans, and risk with respect to the determination of loan forgiveness. In the event of a loss resulting from a default on a PPP loan and a determination by the SBA that there was a deficiency in the manner in which we originated, funded or serviced a PPP loan, the SBA may deny its liability under the guaranty, reduce the amount of the guaranty or, if the SBA has already paid under the guaranty, seek recovery of any loss related to the deficiency from us.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings could be reduced.

Our business depends on the creditworthiness of our customers. As with most financial institutions, we maintain an allowance for loan losses to reflect potential defaults and nonperformance, which represents management's best estimate of probable loans losses inherent in the loan portfolio. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we review loans and our historical loss and delinquency experience and evaluate economic conditions. Management also recognizes that significant new growth in loan portfolios, new loan products, and the refinancing of existing loans can result in portfolios comprised of unseasoned loans that may not perform in a historical or projected manner and will increase the risk that our allowance may be insufficient to absorb losses without significant additional provisions. If our assumptions are incorrect, our allowance for loan losses may not be sufficient to cover actual losses, resulting in additional provisions for loan losses to replenish the allowance for loan losses. Deterioration in economic conditions, new information regarding existing loans, identification of additional problem loans or relationships, and other factors, both within and outside of our control, may increase our loan charge-offs and/or otherwise require an increase in our provision for loan losses.

In addition, the FASB has adopted a new accounting standard referred to as Current Expected Credit Loss, or CECL, which will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans, and recognize the expected credit losses as allowances for credit losses. This will change the current method of providing allowances for credit losses only when they have been incurred and are probable, which may require us to increase our allowance for loan losses, and may greatly increase the types of data we would need to collect and review to determine the appropriate level of the allowance for credit losses. The Company elected to early adopt the new standards, using a modified retrospective approach, effective January 1, 2022. We currently estimate that the adoption of this ASU will result in a combined decrease to our allowance for credit losses and reserve for unfunded loan commitments of 1% to 5%.

The federal banking regulators, including the Federal Reserve and the FDIC, have adopted a rule that gives a banking organization the option to phase in over a three-year period the day-one adverse effects of CECL on its regulatory capital. For more on this new accounting standard, see “Note 1 - Basis of Presentation and Summary of Significant Accounting Policies - Recent Accounting Pronouncements” of the Notes to Consolidated Financial Statements included in “Item 8. Financial Statements and Supplementary Data” of this Form 10-K.

In addition, bank regulatory agencies periodically review our allowance for loan losses and may require an increase in the provision for possible loan losses or the recognition of further loan charge-offs based on their judgment about information available to them at the time of their examination. Any increases in the provision for loan losses will result in a decrease in net income and may have a material adverse effect on our financial condition, results of operations, and capital.

Our business may be adversely affected by credit risk associated with residential property.

At December 31, 2021, $366.4 million, excluding loans held for sale of $125.8 million, or 20.8% of our total loan portfolio was secured by first liens on one-to-four-family residential loans and our home equity lines of credit totaled $40.6 million, or 2.3% of our total loan portfolio. These types of loans are generally sensitive to regional and local economic conditions that significantly impact the ability of borrowers to meet their loan payment obligations, making loss levels difficult to predict. A decline in residential real estate values resulting from a downturn in the Washington housing markets in which our loans are concentrated may reduce the value of the real estate collateral securing these types of loans and increase our risk of loss if borrowers default on their loans. A decline in economic conditions or in the volume of real estate sales and/or the sales prices coupled with elevated unemployment rates may result in higher than expected loan delinquencies or problem assets, and a decline in demand for our products and services. In addition, residential loans with high combined loan-to-value ratios will be more sensitive to the fluctuation of property values than those with lower combined loan-to-value ratios and therefore may experience a higher incidence of default and severity of losses. Further, the majority of our home equity lines of credit consist of second mortgage loans. For those home equity lines secured by a second mortgage, it is unlikely that we will be successful in recovering all or a portion of our loan proceeds in the event of default unless we are prepared to repay the first mortgage loan and such repayment and the costs associated with a foreclosure are justified by the value of the property. For these reasons, we may experience higher rates of delinquencies, defaults and losses which would adversely affect our net income.

Risk Related to Changes in Market Interest Rates

Changes in interest rates may reduce our net interest income and may result in higher defaults in a rising rate environment.

Our earnings and cash flows are largely dependent upon our net interest income. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Federal Reserve Board. In March 2020, in response to the COVID-19 pandemic, the Federal Open Market Committee (“FOMC”) of the Federal Reserve System, lowered the target range for the federal funds rate 150 basis points to a range of 0.00% to 0.25%. However, the FOMC has recently indicated it expects to increase rates starting in 2022, by implementing three one quarter point increases. Future increases in the targeted federal funds rate, may negatively impact both the housing markets by reducing refinancing activity and new home purchases and the U.S. economy. In addition, deflationary pressures, while possibly lowering our operating costs, could have a significant negative effect on our borrowers, especially our business borrowers, and the values of collateral securing loans, which could negatively affect our financial performance.

We principally manage interest rate risk by managing our volume and mix of our earning assets and funding liabilities. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and investments and the amount of interest we pay on deposits and borrowings, but these changes could also affect (i) our ability to originate and/or sell loans and obtain deposits, (ii) the fair value of our financial assets and liabilities, which could negatively impact shareholders’ equity, and our ability to realize gains from the sale of such assets, (iii) our ability to obtain and retain deposits in competition with other available investment alternatives, (iv) the ability of our borrowers to repay adjustable or variable rate loans, and (v) the average duration of our investment securities portfolio and other interest-earning assets. If the interest rates paid on deposits and borrowings increase at a faster rate than the interest rates received on loans and other investments, our net interest income, and therefore earnings, could be adversely affected. In a changing interest rate environment, we may not be able to manage this risk effectively. If we are unable to manage interest rate risk effectively, our business, financial condition, and results of operations could be materially affected.

Changes in interest rates could also have a negative impact on our results of operations by reducing the ability of borrowers to repay their current loan obligations or by reducing our margins and profitability. Our net interest margin is the difference between the yield we earn on our assets and the interest rate we pay for deposits and our other sources of funding. Changes in interest rates-up or down-could adversely affect our net interest margin and, as a result, our net interest income. Although the yield we earn on our assets and our funding costs tend to move in the same direction in response to changes in interest rates, one can rise or fall faster than the other, causing our net interest margin to expand or contract. Our liabilities tend to be shorter in duration than our assets, so they may adjust faster in response to changes in interest rates. As a result, when interest rates rise, our funding costs may rise faster than the yield we earn on our assets, causing our net interest margin to contract until the yields on interest-earning assets catch up.

Changes in the slope of the “yield curve”, or the spread between short-term and long-term interest rates could also reduce our net interest margin. Normally, the yield curve is upward sloping, meaning short-term rates are lower than long-term rates. Because our liabilities tend to be shorter in duration than our assets, when the yield curve flattens or even inverts, we could experience pressure on our net interest margin as our cost of funds increases relative to the yield we can earn on our assets. Also, interest rate decreases can lead to increased prepayments of loans and mortgage-backed securities as borrowers refinance their loans to reduce borrowing costs. Under these circumstances, we are subject to reinvestment risk as we may have to redeploy such repayment proceeds into lower yielding investments, which would likely hurt our income.

A sustained increase in market interest rates could adversely affect our earnings. As is the case with many financial institutions, our emphasis on increasing the development of core deposits, those deposits bearing no or a relatively low rate of interest with no stated maturity date, has resulted in an increasing percentage of our deposits being comprised of deposits bearing no or a relatively low rate of interest and having a shorter duration than our assets. At December 31, 2021, we had $211.8 million in certificates of deposit that mature within one year and $1.56 billion in noninterest bearing, NOW checking, savings and money market accounts. We would incur a higher cost of funds to retain these deposits in a rising interest rate environment. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, our net interest income, and therefore earnings, could be adversely affected. In addition, a substantial amount of our residential mortgage loans and home equity lines of credit have adjustable interest rates. As a result, these loans may experience a higher rate of default in a rising interest rate environment.

Our net income can also be reduced by the impact that changes in interest rates can have on the fair value of our capitalized mortgage servicing rights (“MSRs”). At December 31, 2021, we serviced $2.61 billion of loans sold to third parties, and the servicing rights associated with such loans had an amortized cost of $17.0 million and an estimated fair value, at that date, of $26.1 million. Because the estimated life and estimated income to be derived from servicing the underlying loans generally increase with rising interest rates and decrease with falling interest rates, the value of MSRs generally increases as interest rates rise and decreases as interest rates fall. For example, a decrease in mortgage interest rates typically increases the prepayment speeds of MSRs and therefore decreases the fair value of the MSRs. Future decreases in mortgage interest rates could decrease the fair value of our MSRs below their recorded amount, which would decrease our earnings. Changes in interest rates also affect the value of our interest-earning assets and in particular, our investment securities portfolio. Generally, the fair value of fixed-rate securities fluctuates inversely with changes in interest rates. Unrealized gains and losses on securities available for sale are reported as a separate component of equity, net of tax. Decreases in the fair value of securities available for sale resulting from increases in interest rates could have an adverse effect on stockholders’ equity.

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on our results of operations, any substantial, unexpected, or prolonged change in market interest rates could have a material adverse effect on our financial condition and results of operations. Also, our interest rate risk modeling techniques and assumptions likely may not fully predict or capture the impact of actual interest rate changes on our balance sheet or projected operating results. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations - Asset and Liability Management and Market Risk” of this Form 10-K.

Revenue from mortgage banking operations is sensitive to changes in economic conditions, decreased economic activity, a slowdown in the housing market, higher interest rates or new legislation and may adversely impact our financial condition and results of operations.

Our mortgage banking operations provide a significant portion of our noninterest income. We generate mortgage banking revenues primarily from gains on the sale of one-to-four-family mortgage loans. The one-to-four-family mortgage loans are sold pursuant to programs currently offered by Fannie Mae, Freddie Mac, Ginnie Mae, FHA, VA, USDA Rural Housing, the FHLB, and non-Government Sponsored Enterprise ("GSE") investors. These entities account for a substantial portion of the secondary market in residential one-to-four-family mortgage loans. Any future changes in the one-to-four-family programs, our eligibility to participate in these programs, the criteria for loans to be accepted or laws that significantly affect the activity of such entities, could, in turn, materially adversely affect our results of operations. Mortgage banking is generally considered a volatile source of income because it depends largely on the level of loan volume which, in turn, depends largely on prevailing market interest rates. In a rising or higher interest rate environment, our originations of mortgage loans may decrease, resulting in fewer loans that are available to be sold to investors. This would result in a decrease in mortgage banking revenues and a corresponding decrease in noninterest income. In addition, our results of operations are affected by the amount of noninterest expense associated with mortgage banking activities, such as salaries and employee benefits, occupancy, equipment and data processing expense, and other operating costs. During periods of reduced loan demand, our results of operations may be adversely affected to the extent that we are unable to reduce expenses commensurate with the decline in loan originations. In addition, although we sell loans into the secondary market without recourse, we are required to give customary representations and warranties about the loans to the buyers. If we breach those representations and warranties, the buyers may require us to repurchase the loans and we may incur a loss on the repurchase.

Our securities portfolio may be negatively impacted by fluctuations in market value, changes in the tax code, and interest rates.

Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of these securities. These factors include, but are not limited to, rating agency actions in respect of the securities, defaults by, or other adverse events affecting, the issuer or with respect to the underlying securities, and changes in market interest rates and continued instability in the capital markets. Any of these factors, among others, could cause other-than-temporary impairments ("OTTI") and realized and/or unrealized losses in future periods and declines in other comprehensive income, which could have a material effect on our business, financial condition and results of operations. The process for determining whether impairment of a security is other-than-temporary usually requires complex, subjective judgments about the future financial performance and liquidity of the issuer and any collateral underlying the security to assess the probability of receiving all contractual principal and interest payments on the security. There can be no assurance that the declines in market value will not result in other-than-temporary impairments of these assets and would lead to accounting charges that could have a material adverse effect on our net income and capital levels. For the year ended December 31, 2021, we did not incur any other-than-temporary impairments on our securities portfolio.

If our hedging against interest rate exposure is ineffective, it could result in volatility in our operating results, including potential losses, which could have a material adverse effect on our results of operations and cash flows.

We employ techniques that limit, or "hedge," the adverse effects of rising interest rates on our loans held for sale, and originated interest rate locks to customers. Our hedging activity varies based on the level and volatility of interest rates and other changing market conditions. These techniques may include purchasing or selling forward contracts, purchasing put and call options on securities or securities underlying futures contracts, or entering into other mortgage-backed derivatives. There are, however, no perfect hedging strategies, and interest rate hedging may fail to protect us from loss. Moreover, hedging activities could result in losses if the event against which we hedge does not materialize. Additionally, interest rate hedging could fail to protect us or adversely affect us because, among other things:

- available interest rate hedging may not correspond directly with the interest rate risk for which protection is sought;
- the duration of the hedge may not match the duration of the related liability;

- the party owing money in the hedging transaction may default on its obligation to pay;
- the credit quality of the party owing money on the hedge may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction;
- the value of derivatives used for hedging may be adjusted from time to time in accordance with accounting rules to reflect changes in fair value; and
- downward adjustments, or "mark-to-market losses," could reduce our stockholders' equity.

We may enter into derivative financial instruments such as interest rate swaps in order to mitigate our interest rate risk on a related financial instrument.

Our interest rate contracts expose us to:

- basis or spread risk, which is the risk of loss associated with variations in the spread between the interest rate contract and the hedged item;
- the credit or counter-party risk which is the risk of the insolvency or other inability of another party to the transaction to perform its obligations;
- interest rate risk;
- volatility risk which is the risk that the expected uncertainty relating to the price of the underlying asset differs from what is anticipated; and
- liquidity risk.

If we suffer losses on our interest rate hedging derivatives, our business, financial condition and prospects may be negatively affected, and our net income will decline.

We record our interest rate swaps at fair value and designate them as an effective cash flow hedge under the ASC 815, Derivatives and Hedging. Each quarter, we measure hedge effectiveness using the "hypothetical derivative method" and record in earnings any gains or losses resulting from hedge ineffectiveness. The hedge provided by our interest rate swaps could prove to be ineffective for a number of reasons, including early retirement of the debt, as is allowed under the debt, or in the event the counterparty to the interest rate swaps were determined to not be creditworthy. Any determination that the hedge created by the interest rate swaps was ineffective could have a material adverse effect on our results of operations and cash flows and result in volatility in our operating results. In addition, any changes in relevant accounting standards relating to the interest rate swaps, especially ASC 815, Derivatives and Hedging, could materially increase earnings volatility.

Risks Related to Accounting Matters

We may experience future goodwill impairment, which could reduce our earnings.

We performed our test for goodwill impairment for fiscal year 2021 and the test concluded that recorded goodwill of $2.3 million was not impaired. Our test of goodwill for potential impairment is based on a qualitative assessment by management that takes into consideration macroeconomic conditions, industry and market conditions, cost or margin factors, financial performance and share price. Our evaluation of the fair value of goodwill involves a substantial amount of judgment. If our judgment was incorrect, or if events or circumstances change, and an impairment of goodwill was deemed to exist, we would be required to write down our goodwill resulting in a charge against operations, which would adversely affect our results of operations, perhaps materially; however, it would have no impact on our liquidity, operations, or regulatory capital.

Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition and could result in further losses in the future.

At December 31, 2021, our nonperforming assets (which consisted of nonaccruing loans, other real estate owned ("OREO"), and other repossessed assets) were $5.8 million or 0.3% of total assets. Nonperforming assets adversely affect our earnings in various ways. We do not record interest income on nonaccrual loans or foreclosed assets, thereby adversely affecting our income and increasing our loan administration costs. Upon foreclosure or similar proceedings, we record the repossessed asset at the estimated fair value, less costs to sell, which may result in a write down or loss. If we experience increases in nonperforming loans and nonperforming assets, our losses and troubled assets could increase significantly, which could have a material adverse effect on our financial condition and results of operations, as our loan administration costs could increase, each of which could have an adverse effect on our net income and related ratios, such as return on assets and equity. A significant increase in the level of nonperforming assets from current levels would also increase our risk profile and may impact the capital levels our regulators believe are appropriate in light of the increased risk profile. While we reduce problem assets through collection efforts, asset sales, workouts and restructurings, decreases in the value of the underlying collateral, or in these borrowers' performance or financial condition, whether or not due to economic and market conditions beyond our control, could adversely affect our business, results of operations, and financial condition. In addition, the resolution of nonperforming assets requires significant commitments of time from management and our directors, which can be detrimental to the performance of their other responsibilities.

Risk Related to Regulatory and Compliance Matters

The level of our commercial real estate loan portfolio may subject us to additional regulatory scrutiny.

The FDIC, the Federal Reserve and the Office of the Comptroller of the Currency have promulgated joint guidance on sound risk management practices for financial institutions with concentrations in commercial real estate lending. Under this guidance, a financial institution that, like us, is actively involved in commercial real estate lending should perform a risk assessment to identify concentrations. A financial institution may have a concentration in commercial real estate lending if, among other factors (i) total reported loans for construction, land development and other land represent 100% or more of total capital, or (ii) total reported loans secured by multi-family and non-farm non-residential properties, loans for construction, land development and other land, and loans otherwise sensitive to the general commercial real estate market, including loans to commercial real estate related entities, represent 300% or more of total capital. The particular focus of the guidance is on exposure to commercial real estate loans that are dependent on the cash flow from the real estate held as collateral and that are likely to be at greater risk to conditions in the commercial real estate market (as opposed to real estate collateral held as a secondary source of repayment or as an abundance of caution). The purpose of the guidance is to guide banks in developing risk management practices and capital levels commensurate with the level and nature of real estate concentrations. The guidance states that management should employ heightened risk management practices including board and management oversight and strategic planning, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing.

While we believe we have implemented policies and procedures with respect to our commercial real estate loan portfolio consistent with this guidance, bank regulators could require us to implement additional policies and procedures consistent with their interpretation of the guidance that may result in additional costs to us.

Non-compliance with the USA PATRIOT Act, Bank Secrecy Act, or other laws and regulations could result in fines or sanctions.

The USA PATRIOT and Bank Secrecy Acts and related regulations require financial institutions to develop programs to prevent financial institutions from being used for money laundering and terrorist activities. Failure to comply with these regulations could result in fines or sanctions. During the last few years, several banking institutions have received large fines for non-compliance with these laws and regulations. While we have developed policies and procedures designed to assist in compliance with these laws and regulations, no assurance can be given that these policies and procedures will be effective in preventing violations of these laws and regulations. If our policies and procedures are deemed deficient, we would be subject to liability, including fines and regulatory actions, which may include restrictions on our ability to pay dividends and the denial of regulatory approvals to proceed with certain aspects of our business plan.

Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us. Any of these results could have a material adverse effect on our business, financial condition, results of operations, and growth prospects.

Risks Related to Cybersecurity, Third Parties and Technology

We rely on other companies to provide key components of our business infrastructure.

We rely on numerous external vendors to provide us with products and services necessary to maintain our day-to-day operations. Accordingly, our operations are exposed to risk that these vendors will not perform in accordance with the contracted arrangements under service level agreements. The failure of an external vendor to perform in accordance with the contracted arrangements under service level agreements because of changes in the vendor's organizational structure, financial condition, support for existing products and services or strategic focus or for any other reason, could be disruptive to our operations, which in turn could have a material negative impact on our financial condition and results of operations. We also could be adversely affected to the extent such an agreement is not renewed by the third-party vendor or is renewed on terms less favorable to us. Additionally, the bank regulatory agencies expect financial institutions to be responsible for all aspects of our vendors' performance, including aspects which they delegate to third parties. Disruptions or failures in the physical infrastructure or operating systems that support our business and customers, or cyber-attacks or security breaches of the networks, systems or devices that our customers use to access our products and services could result in client attrition, regulatory fines, penalties or intervention, reputational damage, reimbursement or other compensation costs, and/or additional compliance costs, any of which could materially adversely affect our results of operations or financial condition.

We are subject to certain risks in connection with our use of technology.

Our security measures may not be sufficient to mitigate the risk of a cyber attack. Communications and information systems are essential to the conduct of our business, as we use such systems to manage our customer relationships, our general ledger, and virtually all other aspects of our business. Our operations rely on the secure processing, storage, and transmission of confidential and other information in our computer systems and networks. Although we take protective measures and endeavor to modify them as circumstances warrant, the security of our computer systems, software, and networks may be vulnerable to breaches, fraudulent or unauthorized access, denial or degradation of service, attacks, misuse, computer viruses, malware, or other malicious code and cyber attacks that could have a security impact. If one or more of these events occur, this could jeopardize our or our customers' confidential and other information processed and stored in, and transmitted through, our computer systems and networks, or otherwise cause interruptions or malfunctions in our operations or the operations of our customers or counterparties. We may be required to expend significant additional resources to modify our protective measures or to investigate and remediate vulnerabilities or other exposures, and we may be subject to litigation and financial losses that are either not insured against or not fully covered through any insurance maintained by us. We could also suffer significant reputational damage.

Security breaches in our internet banking activities could further expose us to possible liability and damage our reputation. Increases in criminal activity levels and sophistication, advances in computer capabilities, new discoveries, vulnerabilities in third party technologies (including browsers and operating systems), or other developments could result in a compromise or breach of the technology, processes and controls that we use to prevent fraudulent transactions, and to protect data about us, our customers, and underlying transactions. Any compromise of our security could deter customers from using our internet banking services that involve the transmission of confidential information. We rely on standard internet security systems to provide the security and authentication necessary to effect secure transmission of data. Although we have developed and continue to invest in systems and processes that are designed to detect and prevent security breaches and cyber attacks and periodically test our security, these precautions may not protect our systems from compromises or breaches of our security measures, and could result in losses to us or our customers, our loss of business and/or customers, damage to our reputation, the incurrence of additional expenses, disruption to our business, our inability to grow our online services, or other businesses, additional regulatory scrutiny or penalties, or our exposure to civil litigation and possible financial liability, any of which could have a material adverse effect on our business, financial condition and results of operations.

Our security measures may not protect us from system failures or interruptions. While we have established policies and procedures to prevent or limit the impact of systems failures and interruptions, there can be no assurance that such events will not occur or that they will be adequately addressed if they do. In addition, we outsource certain aspects of our data processing and other operational functions to certain third-party providers. While we select third-party vendors carefully, we do not control their actions. If our third-party providers encounter difficulties including those resulting from breakdowns or other disruptions in communication services provided by a vendor, failure of a vendor to handle current or higher transaction volumes, cyber attacks and security breaches or if we otherwise have difficulty in communicating with them, our ability to adequately process and account for transactions could be affected, and our ability to deliver products and services to our customers and otherwise conduct business operations could be adversely impacted. Replacing these third-party vendors could also entail significant delay and expense. Threats to information security also exist in the processing of customer information through various other vendors and their personnel.

We cannot assure you that such breaches, failures or interruptions will not occur or, if they do occur, that they will be adequately addressed by us or the third parties on which we rely. We may not be insured against all types of losses as a result of third-party failures and insurance coverage may be inadequate to cover all losses resulting from breaches, system failures, or other disruptions. If any of our third-party service providers experience financial, operational, or technological difficulties, or if there is any other disruption in our relationships with them, we may be required to identify alternative sources of such services, and we cannot assure you that we could negotiate terms that are as favorable to us, or could obtain services with similar functionality as found in our existing systems without the need to expend substantial resources, if at all. Further, the occurrence of any systems failure or interruption could damage our reputation and result in a loss of customers and business, could subject us to additional regulatory scrutiny, or could expose us to legal liability. Any of these occurrences could have a material adverse effect on our financial condition and results of operations.

The Board of Directors oversees the risk management process, including the risk of cybersecurity.

We are subject to certain risks in connection with our data management or aggregation.

We are reliant on our ability to manage data and our ability to aggregate data in an accurate and timely manner to ensure effective risk reporting and management. Our ability to manage data and aggregate data may be limited by the effectiveness of our policies, programs, processes, and practices that govern how data is acquired, validated, stored, protected, and processed. While we continuously update our policies, programs, processes, and practices, many of our data management and aggregation processes are manual and subject to human error or system failure. Failure to manage data effectively and to aggregate data in an accurate and timely manner may limit our ability to manage current and emerging risks, as well as to manage changing business needs.

Risks Related to Our Business and Industry Generally

We will be required to transition from the use of the London Interbank Offered Rate ("LIBOR") in the future.

We have certain FHLB advances, brokered deposits, loans and investment securities indexed to LIBOR to calculate the loan interest rate. The continued availability of the LIBOR index is not guaranteed after 2023. We cannot predict whether and to what extent banks will continue to provide LIBOR submissions to the administrator of LIBOR or whether any additional reforms to LIBOR may be enacted. At this time, no consensus exists as to what rate or rates may become acceptable alternatives to LIBOR (with the exception of overnight repurchase agreements, which are expected to be based on the Secured Overnight Financing Rate, or SOFR). The language in our LIBOR-based contracts and financial instruments has developed over time and may have various events that trigger when a successor rate to the designated rate would be selected. If a trigger is satisfied, contracts and financial instruments may give the calculation agent discretion over the substitute index or indices for the calculation of interest rates to be selected. The implementation of a substitute index or indices for the calculation of interest rates under our loan agreements with our borrowers may result in our incurring significant expenses in effecting the transition, may result in reduced loan balances if borrowers do not accept the substitute index or indices, and may result in disputes or litigation with customers over the appropriateness or comparability to LIBOR of the substitute index or indices, which could have an adverse effect on our results of operations.

Ineffective liquidity management could adversely affect our financial results and condition.

Effective liquidity management is essential for the operation of our business. We require sufficient liquidity to meet customer loan requests, customer deposit maturities/withdrawals, payments on our debt obligations as they come due, and other cash commitments under both normal operating conditions and other unpredictable circumstances causing industry or general financial market stress. Our access to funding sources in amounts adequate to finance our activities on terms that are acceptable to us could be impaired by factors that affect us specifically, or the financial services industry or economy generally. Factors that could detrimentally impact our access to liquidity sources include a downturn in the geographic markets in which our loans and operations are concentrated or difficult credit markets. Our access to deposits may also be affected by the liquidity needs of our depositors. In particular, a majority of our liabilities are checking accounts and other liquid deposits, which are payable on demand or upon several days' notice, while by comparison, a substantial majority of our assets are loans, which cannot be called or sold in the same time frame. Although we have historically been able to replace maturing deposits and advances as necessary, we might not be able to replace such funds in the future, especially if a large number of our depositors seek to withdraw their accounts, regardless of the reason. A failure to maintain adequate liquidity could materially and adversely affect our business, results of operations, or financial condition. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity" of this Form 10-K.

Our growth or future losses may require us to raise additional capital in the future, but that capital may not be available when it is needed or the cost of that capital may be very high.

We are required by federal regulatory authorities to maintain adequate levels of capital to support our operations. At some point, we may need to raise additional capital or issue additional debt to support our growth or replenish future losses. Our ability to raise additional capital or issue additional debt depends on conditions in the capital markets, economic conditions, and a number of other factors, including investor perceptions regarding the banking industry, market conditions, and governmental activities, and on our financial condition and performance. Such borrowings or additional capital, if sought, may not be available to us or, if available, may not be on favorable terms.

Accordingly, we cannot make assurances that we will be able to raise additional capital or issue additional debt if needed on terms that are acceptable to us, or at all. If we cannot raise additional capital or issue additional debt when needed, our ability to further expand our operations could be materially impaired and our financial condition and liquidity could be materially and adversely affected. In addition, any additional capital we obtain may result in the dilution of the interests of existing holders of our common stock. Further, if we are unable to raise additional capital when required by our bank regulators, we may be subject to adverse regulatory action.

The Company's ability to pay dividends and make subordinated debt payments is subject to the ability of the Bank to make capital distributions to the Company.

The Company is a separate legal entity from its subsidiary and does not have significant operations of its own. The long-term ability of the Company to pay dividends to its stockholders and debt payments is based primarily upon the ability of the Bank to make capital distributions to the Company, and also on the availability of cash at the holding company level. The availability of dividends from the Bank is limited by the Bank's earnings and capital, as well as various statutes and regulations. In the event, the Bank is unable to pay dividends to the Company, the Company may not be able to pay dividends on its common stock or make payments on its outstanding debt. Consequently, the inability to receive dividends from the Bank could adversely affect the Company's financial condition, results of operations, and future prospects. At December 31, 2021, FS Bancorp, Inc. had $19.9 million in unrestricted cash to support dividend and debt payments.

The markets in which the Company operates are subject to the risk of flooding, mudslides, and other natural disasters.

The Company's offices are located in Washington. Also, most of the real and personal properties securing the Company's loans are located in Washington. Washington is prone to flooding, mudslides, brush fires, earthquakes, and other natural disasters. In addition to possibly sustaining damage to its own properties, if there is a major flood, mudslide, brush fire, earthquake or other natural disaster, the Company faces the risk that many of the Company's borrowers may experience uninsured property losses, or sustained job interruption and/or loss which may materially impair their ability to meet the terms of their loan obligations. Therefore, a major flood, mudslide, brush fire, earthquake or other natural disaster in Washington could have a material adverse effect on the Company's business, financial condition, results of operations, and cash flows.

Climate change may materially adversely affect the Company's business and results of operation.

Concerns over the long-term impacts of climate change have led and will continue to lead to governmental efforts around the world to mitigate those impacts. Consumers and businesses also may change their behavior on their own as a result of these concerns. We and our customers will need to respond to new laws and regulations as well as consumer and business preferences resulting from climate change concerns. We and our customers may face cost increases, asset value reductions, and operating process changes. The impact on our customers will likely vary depending on their specific attributes, including reliance on or role in carbon intensive activities. Among the impacts to us could be a drop in demand for our products and services, particularly in certain industry sectors. In addition, we could face reductions in creditworthiness on the part of some customers or in the value of assets securing loans. Our efforts to take these risks into account in making lending and other decisions, including by increasing our business with climate-friendly companies, may not be effective in protecting us from the negative impact of new laws and regulations or changes in consumer or business behavior.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

At December 31, 2021, the Company had one headquarter office and one administrative office which are owned by the Company, one free-standing leased ATM, 21 full-service bank branches and six stand-alone loan production offices, with an aggregate net book value of $26.6 million. The headquarters is located in Mountlake Terrace, in Snohomish County, Washington. The administrative office is located in Aberdeen, in Grays Harbor County, Washington. The 21 full-service bank branches are located in the following counties: three in Snohomish, two in King, two in Clallam, two in Jefferson, two in Pierce, five in Grays Harbor, two in Thurston, one in Lewis, and two in Kitsap County. Of these branch locations, 13 are owned and eight are leased facilities. Our six stand-alone loan production offices are located in Puyallup and Tacoma, in Pierce County, Bellevue, in King County, Port Orchard, in Kitsap County, and Everett, in Snohomish County in the Puget Sound region and in the Tri-Cities (Kennewick), in Benton County in Eastern Washington. The stand-alone loan production offices are leased facilities. The lease terms for our branch and loan production offices are not individually material. The Company's leases have remaining lease terms of four months to eight years, some of which include options to extend the leases for up to five years. In the opinion of management, all properties are adequately covered by insurance, are in a good state of repair and are suitable for the Company's needs. For additional information see "Note 5 - Premises and Equipment" of the Notes to Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data" of this Form 10-K.

The Company maintains depositor and borrower customer files on an on-line basis, utilizing a telecommunications network, portions of which are leased. The book value of all data processing and computer equipment utilized by the Company at December 31, 2021 was $993,000. Management has a business continuity plan in place with respect to the data processing system, as well as the Company's operations as a whole.

Item 3. Legal Proceedings

Because of the nature of our activities, the Company is subject to various pending and threatened legal actions, which arise in the ordinary course of business. From time to time, subordination liens may create litigation which requires us to defend our lien rights. In the opinion of management, liabilities arising from these claims, if any, will not have a material effect on our financial position.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's common stock is traded on The NASDAQ Stock Market LLC's Global Market, under the symbol "FSBW." At December 31, 2021, there were 8,169,887 shares of common stock issued and outstanding and approximately 214 shareholders of record based upon securities position listings furnished to us by our transfer agent. This total does not reflect the number of persons or entities who hold stock in nominee or "street name" accounts with brokers.

1st Security Bank of Washington is a wholly-owned subsidiary of FS Bancorp. Under federal regulations, the dollar amount of dividends 1st Security Bank of Washington may pay to FS Bancorp depends upon its capital position and recent net income. Generally, if 1st Security Bank of Washington satisfies its regulatory capital requirements, it may make dividend payments up to the limits prescribed by state law and FDIC regulations. See "Item 1. Business - How We Are Regulated - Regulation of 1st Security Bank of Washington - Dividends" and "Regulation and Supervision of FS Bancorp - Restrictions on Dividends and Stock Repurchases."

Our cash dividend policy is reviewed by management and the Board of Directors. Any dividends declared and paid in the future would depend upon a number of factors including capital requirements, the Company's financial condition and results of operations, tax considerations, statutory and regulatory limitations, and general economic conditions. No assurances can be given that any dividends will be paid or that, if paid, will not be reduced or eliminated in future periods. Our future payment of dividends may depend, in part, upon receipt of dividends from the Bank, which are restricted by federal regulations. Management's projections show an expectation that cash dividends will continue for the foreseeable future.

Issuer Purchases of Equity Securities.

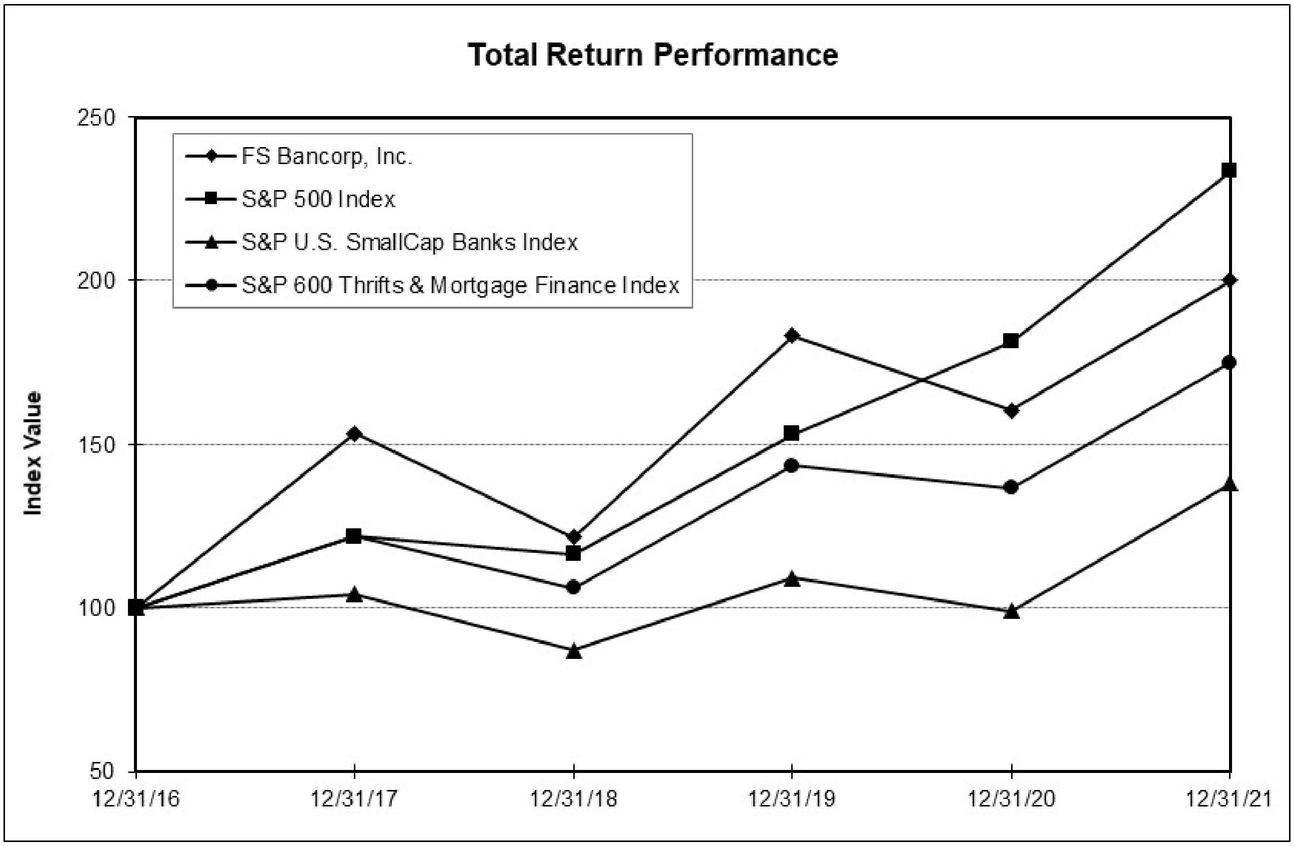
The following table summarizes common stock repurchases during the quarter ended December 31, 2021:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Repurchased as Part of Publicly Announced Plan	Maximum Dollar Value of Shares that May Yet Be Repurchased Under the Plan
October 1, 2021 - October 31, 2021	20,662	$ 34.80	20,662	$ 7,950,393
November 1, 2021 - November 30, 2021	600	33.68	600	7,930,188
December 1, 2021 - December 31, 2021	16,896	33.05	16,896	7,371,741
Total for the quarter	38,158	$ 34.01	38,158	$ 7,371,741

On August 30, 2021, the Company announced that its Board of Directors approved a share repurchase program of up to $10.0 million of the Company's common shares authorized and outstanding in addition to the $900,000 remaining common shares authorized and available for repurchase under the previous share repurchase plan. The repurchase program permits shares to be repurchased in open market or private transactions, through block trades, from time to time, to be repurchased through June 30, 2022, depending on market conditions and other factors, and pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities and Exchange Commission.

Equity Compensation Plan Information. The equity compensation plan information presented under subparagraph (d) in Part III, Item 12 of this report is incorporated herein by reference.

Performance Graph. The following graph compares the cumulative total shareholder return on the Company's common stock with the cumulative total return on the NASDAQ S&P 500 Index (U.S. Stock), SNL U.S. Bank NASDAQ Index, and the SNL Thrift Index. Total return assumes the reinvestment of all dividends and that the value of common stock and bank index was $100 on December 31, 2016.



Source: SNL Financial LC, Charlottesville, VA

Index	12/31/16	12/31/17	12/31/18	12/31/19	12/31/20	12/31/21
FS Bancorp, Inc.	100.00	153.26	121.60	183.21	160.46	200.22
S&P 500 Index	100.00	121.83	116.49	153.17	181.35	233.41
SNL Bank $1B-$5B	100.00	104.33	87.06	109.22	99.19	138.09
SNL Thrift $1B-$5B	100.00	121.80	106.22	143.50	136.75	175.02

Item 6. Reserved

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This discussion and analysis reviews our consolidated financial statements and other relevant statistical data and is intended to enhance your understanding of our financial condition and results of operations. The information in this section has been derived from the Consolidated Financial Statements and footnotes thereto that appear in Item 8. of this Form 10-K. The information contained in this section should be read in conjunction with these Consolidated Financial Statements and footnotes and the business and financial information provided in this Form 10-K.

Overview

FS Bancorp, Inc. and its subsidiary bank, 1st Security Bank of Washington have been serving the Puget Sound area since 1936. Originally chartered as a credit union, known as Washington's Credit Union, the credit union served various select employment groups. On April 1, 2004, the credit union converted to a Washington state-chartered mutual savings bank. On July 9, 2012, the Bank converted from mutual to stock ownership and became the wholly owned subsidiary of FS Bancorp, Inc.

The Company is relationship-driven, delivering banking and financial services to local families, local and regional businesses and industry niches within distinct Western Washington communities, predominately, the Puget Sound area, and one loan production office located in the Tri-Cities, Washington.

The Company also maintains its long-standing indirect consumer lending platform which operates primarily throughout the West Coast. The Company emphasizes long-term relationships with families and businesses within the communities served, working with them to meet their financial needs. The Company is also actively involved in community activities and events within these market areas, which further strengthens our relationships within those markets.

The Company focuses on diversifying revenues, expanding lending channels, and growing the banking franchise. Management remains focused on building diversified revenue streams based upon credit, interest rate, and concentration risks. Our business plan remains as follows:

- Growing and diversifying our loan portfolio;
- Maintaining strong asset quality;
- Emphasizing lower cost core deposits to reduce the costs of funding our loan growth;
- Capturing our customers' full relationship by offering a wide range of products and services by leveraging our well-established involvement in our communities and by selectively emphasizing products and services designed to meet our customers' banking needs; and
- Expanding the Company's markets.

The Company is a diversified lender with a focus on the origination of one-to-four-family loans, commercial real estate mortgage loans, second mortgage or home equity loan products, consumer loans, including indirect home improvement ("fixture secured") loans which also include solar-related home improvement loans, marine lending, and commercial business loans. As part of our expanding lending products, the Company experienced growth in residential mortgage and commercial construction warehouse lending consistent with our business plan to further diversify revenues. Historically, consumer loans, in particular, fixture secured loans had represented the largest portion of the Company's loan portfolio and had traditionally been the mainstay of the Company's lending strategy. At December 31, 2021, consumer loans represented 24.1% of the Company's total gross loan portfolio, up slightly from 23.8% at December 31, 2020. In recent years, the Company has placed more of an emphasis on real estate lending products, such as one-to-four-family loans, commercial real estate loans, including speculative residential construction loans, as well as commercial business loans, while maintaining the proportional size of the consumer loan portfolio.

Fixture secured loans to finance window, gutter, siding replacement, solar panels, pools, and other improvement renovations are a large and regionally expanding segment of the consumer loan portfolio. These fixture secured consumer loans are dependent on the Bank's contractor/dealer network of 147 active dealers located throughout Washington, Oregon, California, Idaho, Colorado, Arizona, Nevada, and Minnesota with five contractor/dealers responsible for 49.5% of the funded loans dollar volume for the year ended December 31, 2021. The Company funded $247.4 million, or approximately 11,000 loans during the year ended December 31, 2021.

The following table details fixture secured loan originations by state for the periods indicated:

	For the Twelve Months Ended December 31, 2021		For the Twelve Months Ended December 31, 2020	
State	Amount	Percent	Amount	Percent
Washington	$ 103,970	42.0 %	$ 79,063	42.6 %
Oregon	54,301	22.0	48,272	26.0
California	49,053	19.8	37,835	20.4
Idaho	19,790	8.0	10,681	5.7
Colorado	7,957	3.2	5,005	2.7
Arizona	4,294	1.7	2,728	1.5
Nevada	3,664	1.5	1,222	0.6
Minnesota	4,418	1.8	918	0.5
Total consumer loans	$ 247,447	100.0 %	$ 185,724	100.0 %

The Company originates one-to-four-family residential mortgage loans through referrals from real estate agents, financial planners, builders, and from existing customers. Retail banking customers are also an important source of the Company's loan originations. The Company originated $1.55 billion of one-to-four-family loans which includes loans held for sale, loans held for investment, and fixed seconds in addition to loans brokered to other institutions of $10.0 million through the home lending segment during the year ended December 31, 2021, of which $1.42 billion were sold to investors. Of the loans sold to investors, $1.10 billion were sold to the FNMA, FHLMC, FHLB, and/or GNMA with servicing rights retained for the purpose of further developing these customer relationships. At December 31, 2021, one-to-four-family residential mortgage loans held for investment, which excludes loans held for sale of $125.8 million, totaled $366.4 million, or 20.8%, of the total gross loan portfolio.

For the year ended December 31, 2021, there were more one-to-four-family loans originated to finance home purchases, reflecting increased sales of one-to-four-family homes, and decreased refinance activity, compared to the same period in the prior year as refinances surged due to the lowering of market interest rates in response to COVID-19. Residential construction and development lending, while not as common as other options like one-to-four-family loans, will continue to be an important element in our total loan portfolio, and we will continue to take a disciplined approach by concentrating our efforts on loans to builders and developers in our market areas known to us. These short-term loans typically mature in six to twelve months. In addition, the funding is usually not fully disbursed at origination, thereby reducing our net loans receivable in the short-term.

The Company is significantly affected by prevailing economic conditions, as well as government policies and regulations concerning, among other things, monetary and fiscal affairs. Deposit flows are influenced by a number of factors, including interest rates paid on time deposits, other investments, account maturities, and the overall level of personal income and savings. Lending activities are influenced by the demand for funds, the number and quality of lenders, and regional economic cycles. Sources of funds for lending activities include primarily deposits, including brokered deposits, borrowings, payments on loans, and income provided from operations.

The Company's earnings are primarily dependent upon net interest income, the difference between interest income and interest expense. Interest income is a function of the balances of loans and investments outstanding during a given period and the yield earned on these loans and investments. Interest expense is a function of the amount of deposits and borrowings outstanding during the same period and interest rates paid on these deposits and borrowings. The continuing low interest rate environment is expected to continue to put downward pressure on loan yields and the yields on other floating rate interest earning assets as well, which may adversely affect our net interest income and net interest margin in 2022.

Another significant influence on the Company's earnings is fee income from mortgage banking activities. The Company's earnings are also affected by the provision for loan losses, service charges and fees, gains from sales of assets, operating expenses and income taxes. The Company recorded a provision of $500,000 for the year ended December 31, 2021, compared to $13.0 million for the same period one year ago, reflecting improved economic factors at December 31, 2021, the increase in the loan portfolio due to organic growth, and net loan charge-offs. The reduction of the provision for loan losses also reflects improvements in "watch" classified loans that were downgraded due to the COVID-19 pandemic which have shown loan-level improvements at December 31, 2021.

Summary of Critical Accounting Policies and Estimates

Certain of the Company's accounting policies are important to the portrayal of the Company's financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Estimates associated with these policies are susceptible to material changes as a result of changes in facts and circumstances. Facts and circumstances which could affect these judgments include, but are not limited to, changes in interest rates, changes in the performance of the economy, and changes in the financial condition of borrowers. Management believes that its critical accounting policies and estimates include the following:

Allowance for Loan and Lease Losses ("ALLL"). The ALLL is the amount estimated by management as necessary to cover probable losses inherent in the loan portfolio at the balance sheet date. The ALLL is established through the provision for loan losses, which is charged to income. A high degree of judgment is necessary when determining the amount of the ALLL. Among the material estimates required to establish the ALLL are: loss exposure at default; the amount and timing of future cash flows on impacted loans; value of collateral; and determination of loss factors to be applied to the various elements of the portfolio. All of these estimates are susceptible to significant change. Management reviews the level of the ALLL at least quarterly and establishes the provision for loan losses based upon an evaluation of the portfolio, past loss experience, current economic conditions, and other factors related to the collectability of the loan portfolio. Although the Company believes that the best information available currently is used to establish the ALLL, future adjustments to the ALLL may be necessary if economic conditions differ substantially from the assumptions used in making the evaluation. As the Company adds new products to the loan portfolio and expands the Company's market area, management intends to enhance and adapt the methodology to keep pace with the size and complexity of the loan portfolio. Changes in any of the above factors could have a significant effect on the calculation of the ALLL in any given period. Management believes that its systematic methodology continues to be appropriate. In June 2016, the Financial Accounting Standards Board issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments, referred to as the Current Expected Credit Loss ("CECL") model, which was early adopted by the Company and effective January 1, 2022. For additional information on CECL see "Note 1 - Basis of Presentation and Summary of Significant Accounting Policies - Recent Accounting Pronouncements" of the Notes to the Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data" of this Form 10-K.

Servicing Rights. Servicing assets are recognized as separate assets when rights are acquired through the purchase or through the sale of financial assets. Generally, purchased servicing rights are capitalized at the cost to acquire the rights. For sales of mortgage loans, the value of servicing is capitalized during the month of sale. Fair value is based on market prices for comparable mortgage contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds, and default rates and losses. A significant change in prepayments of the loans in the servicing portfolio could result in significant changes in the valuation adjustments, thus creating potential volatility in the carrying amount of servicing rights. Refer to Note 4, Servicing Rights of the Notes to the Consolidated Financial Statements for further information.

Servicing assets are evaluated quarterly for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights into tranches based on predominant characteristics, such as interest rate, loan type, and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranches. If the Company later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as a recovery and an increase to income. Capitalized servicing rights are stated separately on the Consolidated Balance Sheets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

Derivative and Hedging Activity. Accounting Standards Codification ("ASC") 815, *"Derivatives and Hedging,"* requires that derivatives of the Company be recorded in the consolidated financial statements at fair value. Management considers its accounting policy for derivatives to be a critical accounting policy because these instruments have certain interest rate risk characteristics that change in value based upon changes in the capital markets. Fair values for derivative assets and liabilities are measured on a recurring basis. The Company's primary use of derivative instruments are related to the mortgage banking activities in the form of commitments to extend credit, commitments to sell loans, To-Be-Announced ("TBA") mortgage-backed securities trades and option contracts to mitigate the risk of the commitments to extend credit. Estimates of the percentage of commitments to extend credit on loans to be held for sale that may not fund are based upon historical data and current market trends. The fair value adjustments of the derivatives are recorded in the Consolidated Statements of Income with offsets to other assets or other liabilities on the Consolidated Balance Sheets.

Derivative instruments not related to mortgage banking activities primarily relate to interest rate swap agreements accounted for as cash flow hedges. To qualify for hedge accounting, derivatives must be highly effective at reducing the risk associated with the exposure being hedged and must be designated as a hedge at the inception of the derivative contract. If derivative instruments are designated as cash flow hedges, fair value adjustments related to the effective portion are recorded in other comprehensive income and are reclassified to earnings when the hedged transaction is reflected in earnings. Ineffective portions of cash flow hedges are reflected in earnings as they occur. Actual cash receipts and/or payments and related accruals on derivatives related to hedges are recorded as adjustments to the interest income or interest expense associated with the hedged item. During the life of the hedge, the Company formally assesses whether derivatives designated as hedging instruments continue to be highly effective in offsetting changes in the fair value or cash flows of hedged items. If it is determined that a hedge has ceased to be highly effective, the Company will discontinue hedge accounting prospectively. At such time, previous adjustments to the carrying value of the hedged item are reversed into current earnings and the derivative instrument is reclassified to a trading position recorded at fair value. For derivatives not designated as hedges, changes in fair value are recognized in earnings, in noninterest income.

Fair Value. ASC 820, *"Fair Value Measurements and Disclosures*," establishes a hierarchical disclosure framework associated with the level of pricing observability utilized in measuring financial instruments at fair value. The degree of judgment utilized in measuring the fair value of financial instruments generally correlates to the level of pricing observability. Financial instruments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of pricing observability and a lesser degree of judgment utilized in measuring fair value. Conversely, financial instruments rarely traded or not quoted will generally have little or no pricing observability and a higher degree of judgment utilized in measuring fair value. Pricing observability is impacted by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established and the characteristics specific to the transaction. The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (that is, an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability). For additional details, see "Note 15 - Fair Value Measurement" of the Notes to Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data" of this Form 10-K for additional information about the level of pricing transparency associated with financial instruments carried at fair value.

Income Taxes. Income taxes are reflected in the Company's consolidated financial statements to show the tax effects of the operations and transactions reported in the consolidated financial statements and consist of taxes currently payable plus deferred taxes. ASC 740, "*Accounting for Income Taxes*," requires the asset and liability approach for financial accounting and reporting for deferred income taxes. Deferred tax assets and liabilities result from temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities. They are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled and are determined using the assets and liability method of accounting. The deferred income provision represents the difference between net deferred tax asset/liability at the beginning and end of the reported period. In formulating the deferred tax asset, the Company is required to estimate income and taxes in the jurisdiction in which the Company operates. This process involves estimating the actual current tax exposure for the reported period together with assessing temporary differences resulting from differing treatment of items, such as depreciation and the provision for loan losses, for tax and financial reporting purposes.

Deferred tax assets and liabilities occur when taxable income is larger or smaller than reported income on the income statements due to accounting valuation methods that differ from tax, as well as tax rate estimates and payments made quarterly and adjusted to actual at the end of the year. Deferred tax assets and liabilities are temporary differences deductible or payable in future periods. The Company had net deferred tax liabilities of $1.2 million and $58,000 at December 31, 2021 and 2020, respectively.

The Company's accounting policies are discussed in detail in "Note 1 - Basis of Presentation and Summary" of the Notes to Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data" of this Form 10-K.

Our Business and Operating Strategy and Goals

The Company's primary objective is to operate 1st Security Bank of Washington as a well capitalized, profitable, independent, community-oriented financial institution, serving customers in its primary market area defined generally as the greater Puget Sound market area. The Company's strategy is to provide innovative products and superior customer service to small businesses, industry and geographic niches, and individuals located in its primary market area. Services are currently provided to communities through the main office and 21 full-service bank branches and are supported with 24/7 access to on-line banking and participation in a worldwide ATM network.

The Company focuses on diversifying revenues, expanding lending channels, and growing the banking franchise. Management remains focused on building diversified revenue streams based upon credit, interest rate, and concentration risks. The Board of Directors seeks to accomplish the Company's objectives through the adoption of a strategy designed to improve profitability and maintain a strong capital position and high asset quality. This strategy primarily involves:

Growing and diversifying the loan portfolio and revenue streams. The Company is transitioning lending activities from a predominantly consumer-driven model to a more diversified consumer and business model by emphasizing three key lending initiatives: expansion of commercial business lending programs, increasing in-house originations of residential mortgage loans primarily for sale into the secondary market through the mortgage banking program; and commercial real estate lending. Additionally, the Company seeks to diversify the loan portfolio by increasing lending to small businesses in the market area, as well as residential construction lending.

Maintaining strong asset quality. The Company believes that strong asset quality is a key to long-term financial success. The percentage of nonperforming loans to total gross loans were 0.33% and 0.49% at December 31, 2021 and 2020, respectively. The percentage of nonperforming assets to total assets were 0.25% and 0.37% at December 31, 2021 and 2020, respectively. The Company has actively managed the delinquent loans and nonperforming assets by aggressively pursuing the collection of consumer debts and marketing saleable properties upon which were foreclosed or repossessed, work-outs of classified assets and loan charge-offs. In the past several years, the Company also began emphasizing consumer loan originations to borrowers with higher credit scores, generally, credit scores over 720 (although the policy allows us to go lower). Although the Company plans to place more emphasis on certain lending products, such as commercial and multi-family real estate loans, construction and development loans, including speculative residential construction loans, and commercial business loans, while growing the current size of the one-to-four-family residential mortgage loans and the consumer loan portfolios, the Company continues to manage its credit exposures through the use of experienced bankers and an overall conservative approach to lending.

Emphasizing lower cost core deposits to reduce the costs of funding loan growth. The Company offers personal and business checking accounts, NOW accounts and savings and money market accounts, which generally are lower-cost sources of funds than certificates of deposit, and are less sensitive to withdrawal when interest rates fluctuate. In order to build a core deposit base, the Company is pursuing a number of strategies. First, a diligent attempt to recruit all commercial loan customers to maintain a deposit relationship with the Company, generally a business checking account relationship to the extent practicable, for the term of their loan. Second, interest rate promotions are provided on savings and checking accounts from time to time to encourage the growth of these types of deposits. Third, by hiring experienced personnel with relationships in the communities we serve.

Capturing customers' full relationship. The Company offers a wide range of products and services that provide diversification of revenue sources and solidify the relationship with the Bank's customers. The Company focuses on core retail and business deposits, including savings and checking accounts, that lead to long-term customer retention. As part of the commercial lending process, cross-selling the entire business banking relationship, including deposit relationships and business banking products, such as online cash management, treasury management, wires, direct deposit, payment processing and remote deposit capture. The Company's mortgage banking program also provides opportunities to cross-sell products to new customers.

Expanding the Company's markets. In addition to deepening relationships with existing customers, the Company intends to expand business to new customers by leveraging the Company's well-established involvement in the community and by selectively emphasizing products and services designed to meet their banking needs. The Company also intends to pursue expansion in other market areas through selective growth of the home lending network.

Selected Financial Data

The following table sets forth certain information concerning the Company's consolidated financial position and results of operations at and for the dates indicated and have been derived from the audited consolidated financial statements. The information below is qualified in its entirety by the detailed information included elsewhere herein and in the Company's Form 10-K for the years ended December 31, 2021 and 2020, and should be read along with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Item 8. Financial Statements and Supplementary Data."

	At December 31,	
(In thousands)	2021	2020
Selected Financial Condition Data:		
Total assets	$ 2,286,391	$ 2,113,241
Loans receivable, net[(1)]	1,728,540	1,544,981
Loans held for sale, at fair value	125,810	166,448
Securities available-for-sale, at fair value	271,359	178,018
Securities held-to-maturity	7,500	7,500
FHLB stock, at cost	4,778	7,439
Deposits	1,915,744	1,674,071
Borrowings	42,528	165,809
Subordinated note, net	49,394	10,000
Total stockholders' equity	247,507	230,007

(In thousands)	Year Ended December 31, 2021	2020
Selected Operations Data:		
Total interest and dividend income	$ 96,374	$ 88,837
Total interest expense	9,725	14,717
Net interest income	86,649	74,120
Provision for loan losses	500	13,036
Net interest income after provision for loan losses	86,149	61,084
Service charges and fee income	4,349	2,373
Bargain purchase gain	—	—
Gain on sale of loans	31,083	48,842
Loss on disposed fixed assets	—	—
Gain on sale of investment securities	—	300
Gain on sale of mortgage servicing rights	—	—
Earnings on cash surrender value of Bank Owned Life Insurance	866	870
Other noninterest income	1,215	2,974
Total noninterest income	37,513	55,359
Total noninterest expense	76,242	66,593
Income before provision for income taxes	47,420	49,850
Provision for income taxes	10,008	10,586
Net income	$ 37,412	$ 39,264

(1) Net of allowances for loan losses, loans in process and deferred loan costs, fees, premiums, and discounts.

Selected Financial Ratios and Other Data	At or For the Year Ended December 31, 2021	2020
Performance ratios:		
Return on assets (ratio of net income to average total assets)	1.71 %	2.02 %
Return on equity (ratio of net income to average equity)	15.74	18.74
Yield on average interest-earning assets	4.59	4.82
Rate paid on average interest-bearing liabilities	0.65	1.07
Net interest rate spread	3.94	3.75
Net interest margin[(1)]	4.13	4.02
Operating expense to average total assets	3.48	3.43
Average interest-earning assets to average interest-bearing liabilities	139.74	133.62
Efficiency ratio[(2)]	61.41	51.43
Margin on loans sold [(3)]	2.69	2.48
Asset quality ratios:		
Non-performing assets to total assets at end of period[(4)]	0.25 %	0.37 %
Non-performing loans to total gross loans[(5)]	0.33	0.49
Allowance for loan losses to non-performing loans[(5)]	440.24	337.22
Allowance for loan losses to gross loans receivable	1.46	1.66
Capital ratios:		
Equity to total assets at end of period	10.83 %	10.88 %
Average equity to average assets	10.86	10.80
Other data:		
Number of full-service offices	21	21
Full-time equivalent employees	536	506
Net income per common share:		
Basic	$ 4.42	$ 4.57
Diluted	$ 4.32	$ 4.49
Book values:		
Book value per common share	$ 30.75 [(7)]	$ 27.67 [(6)]

Share and per share data has been adjusted for all periods to reflect a two-for-one- stock split effective July 14, 2021.

(1) Net interest income divided by average interest-earning assets.
(2) Total noninterest expense as a percentage of net interest income and total other noninterest income.
(3) Cash margins on loans sold net of deferred fees/costs.
(4) Nonperforming assets consists of nonperforming loans (which include nonaccruing loans and accruing loans more than 90 days past due), foreclosed real estate and other repossessed assets.
(5) Nonperforming loans consists of nonaccruing loans and accruing loans more than 90 days past due.
(6) Book value per common share was calculated using shares outstanding of 8,475,912 at December 31, 2020, less 110,184 shares of unvested restricted stock, and unallocated ESOP shares of 51,842.
(7) Book value per common share was calculated using shares outstanding of 8,169,887 at December 31, 2021, less 121,672 shares of unvested restricted stock.

Comparison of Financial Condition at December 31, 2021 and December 31, 2020

Assets. Total assets increased $173.2 million, to $2.29 billion at December 31, 2021, from $2.11 billion at December 31, 2020, primarily due to increases in loans receivable, net of $183.6 million, securities available-for-sale of $93.3 million, servicing rights of $4.4 million, and other assets of $2.5 million, partially offset by decreases in total cash and cash equivalents of $65.1 million, loans held for sale of $40.6 million, Federal Home Loan Bank ("FHLB") stock of $2.7 million, and certificates of deposit at other financial institutions of $1.7 million. The increase in total assets were primarily funded by deposit growth and net proceeds from the issuance of subordinated notes during the year ended December 31, 2021.

Loans receivable, net, increased $183.6 million, to $1.73 billion at December 31, 2021, from $1.54 billion at December 31, 2020. Total real estate loans increased $167.6 million, including increases in one-to-four-family portfolio loans of $55.3 million, multi-family loans of $47.1 million, commercial real estate loans of $42.3 million, and construction and development loans of $25.5 million, partially offset by a decrease in home equity loans of $2.5 million. Undisbursed construction and development loan commitments increased $38.6 million, or 26.9%, to $182.3 million at December 31, 2021, as compared to $143.7 million at December 31, 2020. Consumer loans increased $48.6 million, primarily due to increases of $54.3 million in indirect home improvement loans, partially offset by a decrease of $5.1 million in marine loans. Commercial business loans decreased $31.5 million, due to a decrease in warehouse lending of $15.8 million reflecting the recent increase in residential mortgage interest rates and reduced refinance activity and commercial and industrial loans decreasing $15.7 million, including a net decrease in PPP loans of $37.9 million. The focused increase in commercial and industrial loans is tied to the Bank's investment in our business lending platform, including employees to service business lending customers and cash management teams to support business deposits.

Loans held for sale, consisting of one-to-four-family loans, decreased by $40.6 million, or 24.4%, to $125.8 million at December 31, 2021, compared to $166.4 million at December 31, 2020. Purchase activity was driven by a strong housing market in the Pacific Northwest while slightly higher market rates in 2021 reduced refinance activity. The Company continues to invest in its home lending operations and strategically adds production staff in the markets we serve.

One-to-four-family loan originations for the year ended December 31, 2021, included $1.35 billion of loans originated for sale, $190.2 million of portfolio loans including first and second liens, and $10.0 million of loans brokered to other institutions.

Originations of one-to-four-family loans to purchase and to refinance a home for the periods indicated were as follows:

	For the Year Ended December 31, 2021		For the Year Ended December 31, 2020		Year over Year	Year over Year
	Amount	Percent	Amount	Percent	$ Change	% Change
Purchase	$ 869,108	55.9 %	$ 731,820	39.1 %	$ 137,288	18.8
Refinance	685,727	44.1	1,141,277	60.9	(455,550)	(39.9)
Total	$ 1,554,835	100.0 %	$ 1,873,097	100.0 %	$ (318,262)	(17.0)

During the year ended December 31, 2021, the Company sold $1.42 billion of one-to-four-family loans, compared to sales of $1.64 billion one year ago. In addition, the cash margin on loans sold, net of deferred fees and capitalized expenses, increased to 2.69% for the year ended December 31, 2021, compared to 2.48% for the year ended December 31, 2020. Margin reported is based on actual loans sold into the secondary market and the related value of capitalized servicing, partially offset by recognized deferred loans fees and capitalized expenses. The gross cash margins on loans sold, were 3.97% and 4.25% for the year ended December 31, 2021 and 2020, respectively. Gross cash margins on loans sold is defined as the margin on loans sold without the impact of deferred loan fees and costs.

The ALLL was $25.6 million, or 1.46% of gross loans receivable, excluding loans held for sale at December 31, 2021, compared to $26.2 million, or 1.66% of gross loans receivable, excluding loans held for sale, at December 31, 2020. Substandard loans increased to $18.1 million at December 31, 2021, compared to $17.6 million at December 31, 2020. This increase in substandard loans was primarily due to increases of $5.7 million in commercial and industrial loans, partially offset by a $4.7 million decrease in one-to-four-family. Nonperforming loans, consisting solely of nonaccruing loans 90-days or more past due, decreased to $5.8 million at December 31, 2021, from $7.8 million at December 31, 2020. At December 31, 2021, nonperforming loans consisted of $4.4 million in commercial business loans, $551,000 of indirect home improvement loans, $480,000 in one-to-four-family loans, and $301,000 of home equity loans. The ratio of nonperforming loans to total gross loans was 0.33% at December 31, 2021, compared to 0.49% at December 31, 2020. There were no OREO properties at December 31, 2021, and one OREO property totaling $90,000 at December 31, 2020. As of December 31, 2021, the amount of loans remaining under interest-only payment/relief agreements due to COVID-19 included commercial real estate loans of $6.9 million and commercial business loans of $2.1 million. These loans were classified as current and accruing interest, with the exception of $1.2 million in commercial business loans which were classified as nonaccrual, yet current on contractual payments. These modifications were not classified as troubled debt restructurings pursuant to guidance in effect at the time of modification. At December 31, 2021 the Company had no

TDRs. See “Item 1. Business - Lending Activities - Asset Quality” of this Form 10-K for additional information regarding the Company’s nonperforming loans.

In accordance with acquisition accounting, the ALLL does not include the recorded discount on loans acquired in the Anchor Acquisition of $751,000 and $1.5 million on $84.3 million and $132.6 million of gross loans at December 31, 2021 and December 31, 2020, respectively.

Liabilities. Total liabilities increased $155.7 million to $2.04 billion at December 31, 2021, from $1.88 billion at December 31, 2020, primarily due to increases of $241.7 million in deposits and $40.0 million in subordinated notes, partially offset by a decrease of $123.3 million in borrowings and $2.9 million in other liabilities.

Total deposits increased $241.7 million to $1.92 billion at December 31, 2021, from $1.67 billion at December 31, 2020. The increase in deposits was primarily driven by organic growth in customer relationships, proceeds from PPP loans and government stimulus checks deposited directly into customer accounts, and reduced withdrawals from deposit accounts due to a change in spending habits as a result of COVID-19. Transactional accounts (noninterest-bearing checking, interest-bearing checking, and escrow accounts) increased $219.6 million to $808.8 million at December 31, 2021, from $589.1 million at December 31, 2020, primarily due to a $94.7 million increase in noninterest-bearing checking, and a $123.0 million increase in interest-bearing checking. Money market and savings accounts increased $163.9 million, or 28.1%, to $746.3 million at December 31, 2021, from $582.4 million at December 31, 2020. Time deposits decreased $141.9 million to $360.7 million at December 31, 2021, from $502.5 million at December 31, 2020. Nonretail CDs which include brokered CDs, online CDs, and public funds decreased $82.4 million to $114.2 million, at December 31, 2021, compared to $196.6 million at December 31, 2020, primarily due to an $88.9 million decrease in brokered CDs. The reduction in non-retail CDs is directly tied to the Company replacing these non-retail CDs with brokered interest-bearing checking deposits of $90.0 million. The bulk of our wholesale funding activity has been tied to liability interest rate swap arrangements of $90.0 million that are funded with 90-day liabilities, as discussed below. Escrow accounts related to mortgages serviced increased $2.0 million to $16.4 million at December 31, 2021, reflecting an increase in the servicing portfolio.

Deposits are summarized as follows at the years indicated:

	December 31, 2021 (1)(2)	December 31, 2020(1)(2)
Noninterest-bearing checking	$ 443,133	$ 348,421
Interest-bearing checking (6)	349,251	226,282
Savings	193,922	152,842
Money market (3)	552,357	429,548
Certificates of deposit less than $100,000(4)	186,974	299,157
Certificates of deposit of $100,000 through $250,000	116,206	135,901
Certificates of deposit of $250,000 and over(5)	57,512	67,488
Escrow accounts related to mortgages serviced	16,389	14,432
Total	$ 1,915,744	$ 1,674,071

(1) Includes $150.7 million of deposits at December 31, 2021 from the Branch Purchase and $129.5 million at December 31, 2020.
(2) Includes $281.8 million and $286.5 million of deposits at December 31, 2021 and December 31, 2020, respectively, from the Anchor Acquisition.
(3) Includes $5.0 million and $15.0 million of brokered deposits at December 31, 2021 and December 31, 2020, respectively.
(4) Includes $97.6 million and $186.4 million of brokered certificates of deposit at December 31, 2021 and December 31, 2020, respectively.
(5) Time deposits that meet or exceed the FDIC insurance limit.
(6) Includes $90.0 million and $0 of brokered deposits at December 31, 2021 and December 31, 2020, respectively.

As a result, primarily due to the COVID-19 pandemic and the resulting availability of PPP loan funds and stimulus funds made available during the first half of 2021, the table above reflects year over year increases as well as changes in the composition of deposits, reflecting customers transferring funds from CDs to more liquid interest-bearing accounts, such as money market and interest-bearing checking.

Borrowings comprised of FHLB advances, decreased $123.3 million to $42.5 million at December 31, 2021, from $165.8 million at December 31, 2020, primarily related to the repayment of $63.3 million of Paycheck Protection Program Liquidity Facility ("PPPLF") borrowings, due in part to SBA forgiveness of the underlying PPP loans and the maturity of $60.0 million of FHLB advances utilizing funds attributable to deposit growth.

During the year ended December 31, 2021, the Company repaid $10.0 million in subordinated notes with an interest rate fixed at 6.5% and issued $50.0 million in aggregate principal amount of its 3.75% fixed-to-floating rate subordinated notes in a private placement transaction announced on February 10, 2021, at an offering price equal to 100% of the aggregate principal amount of the Notes, of which $50.0 million have been exchanged for subordinated notes registered under the Securities Act of 1933. Net proceeds, after placement agent fees and offering expenses, was approximately $49.3 million. The subordinated notes qualify as Tier 2 capital for regulatory capital purposes. For additional information related to our subordinated notes see Note 9, Debt of the Notes to Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data" of this Form 10 K.

Management entered into two liability interest rate swap arrangements designated as cash flow hedges in the first quarter of 2020 and one liability interest rate swap arrangement in the third quarter of 2020 to lock the expense costs associated with $90.0 million in brokered deposits. The average cost of these $90 million in notional pay fixed interest rate swap agreements was 73 basis points for which the Bank pays a fixed rate of 73 basis points to the interest rate swap counterparty, compared to the quarterly reset of three-month LIBOR that will adjust quarterly. Management will continue to implement processes to match balance sheet funding duration and minimize interest rate risk and costs.

Stockholders' Equity. Total stockholders' equity increased $17.5 million, to $247.5 million at December 31, 2021, from $230.0 million at December 31, 2020. The increase in stockholders' equity during the year ended December 31, 2021, was primarily due to net income of $37.4 million, partially offset by common stock repurchases of $18.0 million, and cash dividends of $4.6 million. The Company repurchased 524,353 shares of its common stock during the year ended December 31, 2021, at an average price of $34.40 per share. Book value per common share was $30.75 at December 31, 2021, compared to $27.67 at December 31, 2020.

We calculated book value based on common shares outstanding of 8,169,887 at December 31, 2021, less 121,672 unvested restricted stock shares for the reported common shares outstanding of 8,048,215. Common shares outstanding was calculated using 8,475,912 shares at December 31, 2020, less 110,184 unvested restricted stock shares, and 51,842 of unallocated ESOP shares for the reported common shares outstanding of 8,313,886.

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Average Balances, Interest and Average Yields/Cost

The following table sets forth for the periods indicated, information regarding average balances of assets and liabilities, as well as the total dollar amounts of interest income from average interest-earning assets and interest expense on average interest-bearing liabilities, resultant yields, interest rate spread, net interest margin (otherwise known as net yield on interest-earning assets), and the ratio of average interest-earning assets to average interest-bearing liabilities. Also presented is the weighted average yield on interest-earning assets, rates paid on interest-bearing liabilities and the resultant spread at December 31, 2021. Income and all average balances are monthly average balances. Nonaccruing loans have been included in the table as loans carrying a zero yield. The yields on tax-exempt municipal bonds have not been computed on a tax equivalent basis.

	Year Ended December 31,								
	2021			2020			2019		
(Dollars in thousands)	Average Balance Outstanding	Interest Earned Paid	Yield/ Rate	Average Balance Outstanding	Interest Earned Paid	Yield/ Rate	Average Balance Outstanding	Interest Earned Paid	Yield/ Rate
Interest-earning assets:									
Loans receivable, net and loans held for sale [(1)] [(2)]	$ 1,762,832	$ 90,737	5.15 %	$ 1,576,975	$ 84,128	5.33 %	$ 1,361,616	$ 84,706	6.22 %
Taxable mortgage-backed securities	75,493	1,773	2.35	68,739	1,593	2.32	49,422	1,340	2.71
Taxable AFS investment securities	56,063	1,002	1.79	47,344	1,105	2.33	41,686	1,177	2.82
Tax-exempt AFS investment securities	97,471	1,800	1.85	39,721	795	2.00	11,441	300	2.63
Taxable HTM Investment securities	7,500	380	5.07	2,441	123	5.04	—	—	—
FHLB stock	5,494	256	4.66	8,079	394	4.88	8,500	454	5.34
Interest-bearing deposits at other financial institutions	93,435	426	0.46	100,783	699	0.69	79,749	1,648	2.07
Total interest-earning assets	2,098,288	96,374	4.59 %	1,844,082	88,837	4.82 %	1,552,414	89,625	5.77 %
Interest-bearing liabilities:									
Savings and money market	661,199	1,604	0.24 %	476,589	2,457	0.52 %	380,474	3,098	0.81 %
Interest-bearing checking	268,203	282	0.11	210,759	388	0.18	181,852	1,414	0.78
Certificates of deposit	464,921	5,043	1.08	535,047	9,135	1.71	515,634	11,650	2.26
Borrowings	63,128	1,074	1.70	147,836	1,961	1.33	93,405	2,476	2.65
Subordinated note	44,160	1,722	3.90	9,899	776	7.84	9,874	679	6.88
Total interest-bearing liabilities	1,501,611	9,725	0.65 %	1,380,130	14,717	1.07 %	1,181,239	19,317	1.64 %
Net interest income		$ 86,649			$ 74,120			$ 70,308	
Net interest rate spread			3.94 %			3.75 %			4.13 %
Net earning assets	$ 596,677			$ 463,952			$ 371,175		
Net interest margin			4.13 %			4.02 %			4.53 %
Average interest-earning assets to average interest-bearing liabilities	139.74 %			133.62 %			131.42 %		

(1) The average loans receivable, net balances include nonaccruing loans.
(2) Includes net deferred fee recognition of $9.4 million, $5.4 million, and $4.1 million for the years ended December 31, 2021, December 31, 2020, and December 31, 2019, respectively.

Rate/Volume Analysis

The following table presents the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. It distinguishes between the changes related to outstanding balances and that due to the changes in interest rates. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (i.e., changes in volume multiplied by old rate) and (ii) changes in rate (i.e., changes in rate multiplied by old volume). For purposes of this table, changes attributable to both rate and volume, which cannot be segregated, have been allocated proportionately to the change due to volume and the change due to rate.

	Year Ended December 31, 2021 vs. 2020			Year Ended December 31, 2020 vs. 2019		
	Increase (Decrease) Due to		Total Increase	Increase (Decrease) Due to		Total Increase
(In thousands)	Volume	Rate	(Decrease)	Volume	Rate	(Decrease)
Interest-earning assets:						
Loans receivable, net and loans held for sale[1]	$ 9,915	$ (3,306)	$ 6,609	$ 13,397	$ (13,975)	$ (578)
Taxable mortgage-backed securities	157	23	180	524	(271)	253
Taxable AFS Investment securities	204	(307)	(103)	160	(232)	(72)
Tax-exempt AFS investment securities	1,152	(147)	1,005	744	(249)	495
Taxable HTM Investment securities	255	2	257	123	—	123
FHLB stock	(126)	(12)	(138)	(22)	(38)	(60)
Interest-bearing deposits at other financial institutions	(51)	(222)	(273)	435	(1,384)	(949)
Total interest-earning assets	$ 11,506	$ (3,969)	$ 7,537	$ 15,361	$ (16,149)	$ (788)
Interest-bearing liabilities:						
Savings and money market	$ 952	$ (1,805)	$ (853)	$ 783	$ (1,424)	$ (641)
Interest-bearing checking	106	(212)	(106)	225	(1,251)	(1,026)
Certificates of deposit	(1,197)	(2,895)	(4,092)	439	(2,954)	(2,515)
Borrowings	(1,124)	237	(887)	1,443	(1,958)	(515)
Subordinated note	2,686	(1,740)	946	2	95	97
Total interest-bearing liabilities	$ 1,423	$ (6,415)	$ (4,992)	$ 2,892	$ (7,492)	$ (4,600)
Net change in net interest income			$ 12,529			$ 3,812

(1) The average loans receivable, net balances include nonaccruing loans.

Comparison of Results of Operations for the Years Ended December 31, 2021 and 2020

General. Net income was $37.4 million for the year ended December 31, 2021, and $39.3 million for the year ended December 31, 2020. The decrease in net income was primarily impacted by a $17.8 million, or 32.2% reduction in noninterest income and a $9.6 million, or 14.5% increase in noninterest expense, partially offset by a $12.5 million, or 96.2% decrease in the provision for loan losses, and a $12.5 million, or 16.9% increase in net interest income.

Net Interest Income. Net interest income increased $12.5 million, to $86.6 million for the year ended December 31, 2021, from $74.1 million for the year ended December 31, 2020. This increase was primarily the result of an improved mix of loans versus other interest-earning assets and increased balances in higher yielding loans funded by lower cost deposits. Interest income increased $7.5 million, primarily due to an increase of $6.6 million in interest income on loans receivable, including fees, impacted primarily by organic loan growth and net deferred fees recognized upon SBA forgiveness of PPP loans. Interest expense decreased $5.0 million, primarily as a result of repricing deposit rates and a reduction in higher cost borrowings. For the year ended December 31, 2021, the total recognition of net deferred fees on forgiven and amortizing PPP loans was $2.3 million.

The net interest margin ("NIM") increased 11 basis points to 4.13% for the year ended December 31, 2021, from 4.02% for the same period in the prior year. The increase in NIM reflects an improved mix of interest-bearing assets, including a higher balance of higher yielding portfolio loans and investment securities and a significant decrease of interest-bearing cash balances, earning a nominal yield combined with the reduction in our deposit and borrowing costs. Management remains focused on matching deposit/liability duration with the duration of loans/assets where appropriate.

Interest Income. Interest income for the year ended December 31, 2021, increased $7.5 million, to $96.4 million, from $88.8 million for the year ended December 31, 2020. The increase during the year was primarily attributable to an increase in the average balance of total interest-earning assets, partially offset by the decline in the average loan yield. The decrease in average yield on interest-earning assets compared to a year earlier primarily reflects decreases in the average yield for almost all interest earning assets, in particular, loan yields impacted by refinances of one-to-four-family loans and loan repricing to a lower market interest rate, and the origination last year of low-yielding PPP loans. The impact of PPP loans on loan yields will change during any period based on the volume of prepayments or amounts forgiven by the SBA as certain criteria are met, but is expected to cease completely after the maturity of the loans. Unamortized net deferred fees on PPP loans were $447,000 at December 31, 2021.

The following table compares average earning asset balances, associated yields, and resulting changes in interest income for the years ended December 31, 2021 and 2020:

	Year Ended December 31,				
	2021		2020		Increase/ (Decrease) in Interest Income
(Dollars in thousands)	Average Balance Outstanding	Yield/ Rate	Average Balance Outstanding	Yield/ Rate	
Loans receivable, net and loans held for sale	$ 1,762,832	5.15 %	$ 1,576,975	5.33 %	$ 6,609
Mortgage-backed securities	75,493	2.35	68,739	2.32	180
Investment securities available-for-sale	153,534	1.83	87,065	2.18	902
Investment securities held-to-maturity	7,500	5.07	2,441	5.04	257
FHLB stock	5,494	4.66	8,079	4.88	(138)
Interest-bearing deposits at other financial institutions	93,435	0.46	100,783	0.69	(273)
Total interest-earning assets	$ 2,098,288	4.59 %	$ 1,844,082	4.82 %	$ 7,537

(1) The average loans receivable, net balances include nonaccruing loans.

Interest Expense. Interest expense decreased $5.0 million, to $9.7 million for the year ended December 31, 2021, from $14.7 million for the prior year, primarily due to decreased interest expense on deposits of $5.1 million and a reduction in higher cost borrowings. The average cost of funds for total interest-bearing liabilities decreased 42 basis points to 0.65% for the year ended December 31, 2021, compared to 1.07% for the year ended December 31, 2020. This decrease was predominantly due to the decline in cost for market rate deposits and borrowings as well as managed runoff of higher cost CD funding. The average cost of interest-bearing deposits decreased 48 basis points to 0.50% for the year ended December 31, 2021, compared to 0.98% for the year ended December 31, 2020, reflecting lower market interest rates.

The following table details average balances for cost of funds on interest-bearing liabilities and the change in interest expense for the years ended December 31, 2021 and 2020:

	Year Ended December 31,				
	2021		2020		(Decrease)/
(Dollars in thousands)	Average Balance Outstanding	Yield/ Rate	Average Balance Outstanding	Yield/ Rate	Increase in Interest Expense
Savings and money market	$ 661,199	0.24 %	$ 476,589	0.52 %	$ (853)
Interest-bearing checking	268,203	0.11	210,759	0.18	(106)
Certificates of deposit	464,921	1.08	535,047	1.71	(4,092)
Borrowings	63,128	1.70	147,836	1.33	(887)
Subordinated note	44,160	3.90	9,899	7.84	946
Total interest-bearing liabilities	$ 1,501,611	0.65 %	$ 1,380,130	1.07 %	$ (4,992)

Provision for Loan Losses. For the year ended December 30, 2021, the provision for loan losses was $500,000, compared to $13.0 million for the year ended December 31, 2020. The reduction of the provision for loan losses reflects improved economic factors on credit deterioration related to the COVID-19 pandemic utilized to calculate the allowance for loan losses and also reflects loan-level improvements for previously downgraded loans due to the COVID-19 pandemic at December 31, 2021, compared to the same time last year. During the year ended December 31, 2021, net charge-offs totaled $1.0 million compared to $93,000 during the year ended December 31, 2020, primarily due to increased consumer loan charge-offs.

The following table details activity and information related to the allowance for loan losses for the years ended December 31, 2021 and 2020:

	At or For the Year Ended December 31,	
(Dollars in thousands)	2021	2020
Provision for loan losses	$ 500	$ 13,036
Net charge-offs	$ 1,037	$ 93
Allowance for loan losses	$ 25,635	$ 26,172
Allowance for loan losses as a percentage of total gross loans receivable at the end of the year	1.46 %	1.66 %
Non-accrual and 90 days or more past due loans	$ 5,823	$ 7,761
Allowance for loan losses as a percentage of nonperforming loans at end of year	440.2 %	337.2 %
Nonaccrual and 90 days or more past due loans as a percentage of gross loans receivable at the end of the year	0.33 %	0.49 %
Total gross loans	$ 1,759,026	$ 1,574,227

Management considers the ALLL at December 31, 2021, to be adequate to cover estimated losses inherent in the loan portfolio based on the assessment of the above-mentioned factors affecting the loan portfolio. While management believes the estimates and assumptions used in its determination of the adequacy of the allowance are reasonable, there can be no assurance that such estimates and assumptions will not be proven incorrect in the future, or that the actual amount of future provisions will not exceed the amount of past provisions or that any increased provisions that may be required will not adversely impact the Company's financial condition and results of operations. In addition, the determination of the amount of allowance for loan losses is subject to review by bank regulators, as part of the routine examination process, which may result in the establishment of additional reserves based upon their judgment of information available to them at the time of their examination.

Noninterest Income. Noninterest income decreased $17.8 million, to $37.5 million for the year ended December 31, 2021, from $55.4 million for the year ended December 31, 2020. The following table provides a detailed analysis of the changes in the components of noninterest income:

(Dollars in thousands)	Year Ended December 31, 2021	2020	Increase/(Decrease) Amount	Percent
Service charges and fee income	$ 4,349	$ 2,373	$ 1,976	83.3 %
Gain on sale of loans	31,083	48,842	(17,759)	(36.4)
Gain on sale of investment securities	—	300	(300)	(100.0)
Earnings on cash surrender value of BOLI	866	870	(4)	(0.5)
Other noninterest income	1,215	2,974	(1,759)	(59.1)
Total noninterest income	$ 37,513	$ 55,359	$ (17,846)	(32.2)%

The year over year decreases include a $17.8 million, or 36.4% decrease in gain on sale of loans, primarily due to a reduction in the amount of originated and sold refinance loans, and a $1.8 million, or 59.1% decrease in other noninterest income mostly due to the net gain from a one-time sale of Class B Visa stock shares of $1.5 million during the last year, partially offset by a $2.0 million, or 83.3% increase in net service charges and fee income. The Company recorded net losses of $1.1 million and $3.7 million on gross contractually specified servicing fees, late fees, and other ancillary fees, net of mortgage servicing rights amortization, resulting from servicing of loans for the years ended December 31, 2021 and 2020, respectively. The net losses were included in service charges and fee income.

Noninterest Expense. Noninterest expense increased $9.6 million, or 14.5%, to $76.2 million for the year ended December 31, 2021, from $66.6 million for the year ended December 31, 2020. The following table provides an analysis of the changes in the components of noninterest expense:

(Dollars in thousands)	Year Ended December 31, 2021	2020	Increase/(Decrease) Amount	Percent
Salaries and benefits	$ 49,721	$ 38,095	$ 11,626	30.5 %
Operations	10,791	10,471	320	3.1
Occupancy	4,892	4,736	156	3.3
Data processing	4,951	4,388	563	12.8
Loss on sale of OREO	9	2	7	350.0
OREO expenses	—	4	(4)	(100.0)
Loan costs	2,795	2,066	729	35.3
Professional and board fees	3,181	2,797	384	13.7
FDIC insurance	636	829	(193)	(23.3)
Marketing and advertising	634	530	104	19.6
Amortization of core deposit intangible	691	706	(15)	(2.1)
(Recovery) impairment of servicing rights	(2,059)	1,969	(4,028)	(204.6)
Total noninterest expense	$ 76,242	$ 66,593	$ 9,649	14.5 %

The increase in noninterest expense was primarily due a $11.6 million increase in salaries and benefits, primarily attributable to a reduction in recognized deferred costs on direct loan origination activities of $9.7 million and increases in compensation of $4.2 million and medical expenses of $2.0 million, partially offset by a decrease in incentives and commissions of $5.3 million. Compensation increased due to increased staffing as full-time employees increased by 30 and upward market pressure on salaries and wages. The primary offset to the increase in noninterest expense was due to the $4.0 million net change in the value of servicing rights resulting in a $2.1 million recovery of servicing rights, from a $2.0 million impairment recognized last year due to the low interest rate environment from the government's response to the COVID-19 pandemic.

The efficiency ratio, which is noninterest expense as a percentage of net interest income and noninterest income, rose to, 61.41% for the year ended December 31, 2021, compared to 51.43% for the year ended December 31, 2020, primarily representing the decrease in noninterest income and the increase in noninterest expense noted above.

Provision for Income Tax. For the year ended December 31, 2021, the Company recorded a provision for income tax expense of $10.0 million on pre-tax income of $47.4 million, as compared to a provision of income tax expense of $10.6 million on pre-tax income of $49.9 million for the year ended December 31, 2020. There was a net deferred tax liability of $1.2 million and $58,000 at December 31, 2021 and 2020, respectively. The effective corporate income tax rates for the years ended December 31, 2021 and 2020 were 21.1% and 21.2%, respectively. For additional information regarding income taxes, see “Note 11 - Income Taxes” of the Notes to Consolidated Financial Statements included in “Item 8. Financial Statements and Supplementary Data” of this Form 10-K.

Asset and Liability Management and Market Risk

Risk When Interest Rates Change. The rates of interest the Company earns on assets and pays on liabilities generally is established contractually for a period of time. Market rates change over time. Like other financial institutions, the Company’s results of operations are impacted by changes in interest rates and the interest rate sensitivity of the Company’s assets and liabilities. The risk associated with changes in interest rates and the Company’s ability to adapt to these changes is known as interest rate risk and is the most significant market risk.

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. Consequently, the fair value of the Company’s consolidated financial instruments will change when interest rate levels change, and that change may either be favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed interest rate obligations are less likely to prepay in a rising interest rate environment and more likely to prepay in a falling interest rate environment. Conversely, depositors who are receiving fixed interest rates are more likely to withdraw funds before maturity in a rising interest rate environment and less likely to do so in a falling interest rate environment. Management monitors interest rates and maturities of assets and liabilities, and attempts to minimize interest rate risk by adjusting terms of new loans, and deposits, and by investing in securities with terms that mitigate the Company’s overall interest rate risk.

How The Company Measures Risk of Interest Rate Changes. As part of an attempt to manage exposure to changes in interest rates and comply with applicable regulations, the Company monitors interest rate risk. In doing so, the Company analyzes and manages assets and liabilities based on their interest rates and payment streams, timing of maturities, repricing opportunities, and sensitivity to actual or potential changes in market interest rates.

The Company is subject to interest rate risk to the extent that its interest-bearing liabilities, primarily deposits, subordinated notes, and FHLB advances, reprice more rapidly or at different rates than the interest-earning assets. In order to minimize the potential for adverse effects of material prolonged increases or decreases in interest rates on the Company’s results of operations, the Company has adopted an Asset and Liability Management Policy. The Board of Directors sets the Asset and Liability Management Policy for the Bank, which is implemented by the Asset/Liability Committee (“ALCO”), an internal management committee. The board-level oversight for ALCO is performed by the Audit Committee of the Board of Directors.

The purpose of the ALCO is to communicate, coordinate, and control asset/liability management consistent with the business plan and board-approved policies. The committee establishes and monitors the volume and mix of assets and funding sources, taking into account relative costs and spreads, interest rate sensitivity and liquidity needs. The objectives are to manage assets and funding sources to produce results that are consistent with liquidity, capital adequacy, growth, risk, and profitability goals.

The committee generally meets monthly to, among other things, protect capital through earnings stability over the interest rate cycle; maintain the Bank’s well capitalized status; and provide a reasonable return on investment. The committee recommends appropriate strategy changes based on this review. The committee is responsible for reviewing and reporting the effects of the policy implementations and strategies to the Board of Directors at least quarterly. The Chief Financial Officer oversees the process on a daily basis.

A key element of the Bank’s asset/liability management plan is to protect net earnings by managing the maturity or repricing mismatch between interest-earning assets and rate-sensitive liabilities. The Company seeks to accomplish this by extending funding maturities through wholesale funding sources, including the use of FHLB advances and brokered certificates of deposit, and through asset management, including the use of adjustable-rate loans and selling certain fixed-rate loans in the secondary market. Management is also focused on matching deposit duration with the duration of earning assets as appropriate.

As part of the efforts to monitor and manage interest rate risk, a number of indicators are used to monitor overall risk. Among the measurements are:

Market Risk. Market risk is the potential change in the value of investment securities if interest rates change. This change in value impacts the value of the Company and the liquidity of the securities. Market risk is controlled by setting a maximum average maturity/average life of the securities portfolio to 10 years.

Economic Risk. Economic risk is the risk that the underlying value of a bank will change when rates change. This can be caused by a change in value of the existing assets and liabilities (this is called Economic Value of Equity or EVE), or a change in the earnings stream (this is caused by interest rate risk). The Company takes economic risk primarily when fixed rate loans are made, or purchase fixed-rate investments, or issue long term certificates of deposit or take fixed-rate FHLB advances. It is the risk that interest rates will change and these fixed-rate assets and liabilities will change in value. This change in value usually is not recognized in the earnings, or equity (other than marking to market securities available-for-sale or fair value adjustments on loans held for sale). The change is recognized only when the assets and liabilities are liquidated. Although the change in market value is usually not recognized in earnings or in capital, the impact is real to the long-term value of 1st Security Bank of Washington. Therefore, the Company will control the level of economic risk by limiting the amount of long-term, fixed-rate assets the Company will have and by setting a limit on concentrations and maturities of securities.

Interest Rate Risk. If the Federal Reserve Board changes the Fed Funds rate 100, 200 or 300 basis points, the Bank policy dictates that a change in net interest income should not change more that 15%, 25% and 40%, respectively.

The table presented below, as of December 31, 2021, is an analysis prepared for 1st Security Bank of Washington by a third-party consultant utilizing various market and actual experience-based assumptions. The table represents a static shock to the net interest income using instantaneous and sustained shifts in the yield curve, in 100 basis point increments, up and down 100 basis points. No rates in the model are allowed to go below zero. Given that the current targeted Fed Funds rate is a range of 0.00% to 0.25%, a 100, 200 or 300 basis point reduction in rates is not reported. The results reflect a projected income statement with minimal exposure to instantaneous changes in interest rates. These results are primarily based upon historical prepayment speeds within the consumer lending portfolio in combination with the above average yields associated with the consumer portfolio if those prepayments do not occur. The table illustrates the estimated change in our net interest income over the next 12 months from December 31, 2021.

Change in Interest Rates in Basis Points	Net Interest Income Amount	Net Interest Income Change	Net Interest Income Change
		(Dollars in thousands)	
300bp	$ 102,054	$ 3,808	3.88 %
200bp	100,264	2,018	2.05
100bp	99,173	927	0.94
0bp	98,246	—	—

In managing the assets/liability mix the Company typically places an equal emphasis on maximizing net interest margin and matching the interest rate sensitivity of the assets and liabilities. From time to time, however, depending on the relationship between long- and short-term interest rates, market conditions and consumer preference, the Company may place somewhat greater emphasis on maximizing net interest margin than on strict dollar for dollar categories matching the interest rate sensitivity of the assets and liabilities. Management also believes that the increased net income which may result from a prepayment assumption mismatch in the actual maturity or repricing of the asset and liability portfolios can, during periods of changing interest rates, provide sufficient returns to justify the increased exposure to sudden and unexpected increases in interest rates which may result from such a mismatch. Management believes that 1st Security Bank of Washington's level of interest rate risk is acceptable under this approach.

In evaluating 1st Security Bank of Washington's exposure to interest rate movements, certain shortcomings inherent in the method of analysis presented in the foregoing table must be considered. For example, although certain assets and liabilities may have similar maturities or repricing periods, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in interest rates. Additionally, certain assets, such as adjustable-rate mortgages, have features which restrict changes in interest rates on a short-term basis and over the life of the asset. Further, in the event of a significant change in interest rates, prepayment and early withdrawal levels would likely deviate significantly from those assumed above. Finally, the ability of many borrowers to service their debt may decrease in the event of an interest rate increase. 1st Security Bank of Washington considers all of these factors in monitoring its exposure to interest rate risk.

Liquidity and Capital Resources

Management maintains a liquidity position that it believes will adequately provide funding for loan demand and deposit runoff that may occur in the normal course of business. The Company relies on a number of different sources in order to meet potential liquidity demands. The primary sources are increases in deposit accounts, FHLB advances, purchases of federal funds, sale of securities available-for-sale, cash flows from loan payments, sales of one-to-four-family loans held for sale, and maturing securities. While the maturities and the scheduled amortization of loans are a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

The Bank must maintain an adequate level of liquidity to ensure the availability of sufficient funds to fund its operations. The Bank generally maintains sufficient cash and short-term investments to meet short-term liquidity needs. At December 31, 2021, the Bank's total borrowing capacity was $527.2 million with the FHLB of Des Moines, with unused borrowing capacity of $483.9 million. The FHLB borrowing limit is based on certain categories of loans, primarily real estate loans that qualify as collateral for FHLB advances. At December 31, 2021, the Bank held approximately $761.6 million in loans that qualify as collateral for FHLB advances.

In addition to the availability of liquidity from the FHLB of Des Moines, the Bank maintained a short-term borrowing line of credit with the FRB, with a current limit of $200.1 million, and a combined credit limit of $101.0 million in written federal funds lines of credit through correspondent banking relationships as of December 31, 2021. The FRB borrowing limit is based on certain categories of loans, primarily consumer loans that qualify as collateral for the FRB's line of credit. At December 31, 2021, the Bank held approximately $428.7 million in loans that qualify as collateral for the FRB line of credit. Subject to market conditions, we expect to utilize these borrowing facilities from time to time in the future to fund loan originations and deposit withdrawals, to satisfy other financial commitments, repay maturing debt and to take advantage of investment opportunities to the extent feasible.

Liquidity management is both a daily and long-term function of the Company's management. Excess liquidity is generally invested in short-term investments, such as overnight deposits and federal funds. On a longer-term basis, a strategy is maintained of investing in various lending products and investment securities, including U.S. Government obligations and U.S. agency securities. The Company uses sources of funds primarily to meet ongoing commitments, pay maturing deposits and fund withdrawals, and to fund loan commitments. At December 31, 2021, the approved outstanding loan commitments, including unused lines of credit, of $376.3 million and $182.3 million of undisbursed construction and development loan commitments, amounted to $558.6 million. For information regarding our commitments and off-balance sheet arrangements, see "Note 12 - Commitments and Contingencies" of the Notes to Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data" of this Form 10-K. Securities purchased during the years ended December 31, 2021 and 2020 totaled $130.1 million and $106.9 million, respectively, and securities repayments, maturities and sales in those periods were $29.9 million and $49.9 million, respectively.

The Bank's liquidity is also affected by the volume of loans sold and loan principal payments. During the years ended December 31, 2021 and 2020, the Bank sold $1.40 billion and $1.64 billion in loans and loan participation interests, respectively. During the years ended December 31, 2021 and 2020, the Bank received $899.3 million and $757.8 million in principal repayments, respectively.

The Bank's liquidity has been positively impacted by increases in deposit levels. During the years ended December 31, 2021 and 2020, deposits increased by $241.5 million and $281.7 million, respectively. As a result, our liquid assets in the form of cash and cash equivalents, CDs at other financial institutions and investment securities increased to $315.9 million at December 31, 2021 from $289.4 million at December 31, 2020. Certificates of deposit scheduled to mature in one year or less at December 31, 2021, totaled $211.8 million. It is management's policy to offer deposit rates that are competitive with other local financial institutions. Based on this management strategy, the Company believes that a majority of maturing relationship deposits will remain with the Bank.

We incur capital expenditures on an ongoing basis to expand and improve our product offerings, enhance and modernize our technology infrastructure, and to introduce new technology-based products to compete effectively in our markets. We evaluate capital expenditure projects based on a variety of factors, including expected strategic impacts (such as forecasted impact on revenue growth, productivity, expenses, service levels and customer retention) and our expected return on investment. The amount of capital investment is influenced by, among other things, current and projected demand for our services and products, cash flow generated by operating activities, cash required for other purposes and regulatory considerations. Based on current capital allocation objectives, there are no projects scheduled for capital investments in premises and equipment during the year ending December 31, 2022 that would materially impact liquidity. We also have purchase obligations, generally with remaining terms of less than three years and contracts with various vendors to provide services, including information processing, for periods generally ranging from one to five years, for which our financial obligations are dependent upon acceptable performance by the vendor.

For the year ending December 31, 2022, we project that fixed commitments will include $1.4 million of operating lease payments. There are $15.0 million of scheduled payments and maturities of FHLB borrowings during the year ending December 31, 2022. For information regarding our operating leases, see "Note 6 - Leases" of the Notes to Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data" of this Form 10-K.

The Bank's management believes that the liquid assets combined with the available lines of credit provide adequate liquidity to meet current financial obligations for at least the next 12 months.

As a separate legal entity from the Bank, FS Bancorp, Inc. must provide for its own liquidity. Sources of capital and liquidity for FS Bancorp, Inc. include distributions from the Bank and the issuance of debt or equity securities. During the year ended December 31, 2021, the Company repaid $10.0 million in subordinated notes with an interest rate fixed at 6.5% and issued $50.0 million in aggregate principal amount of its 3.75% fixed-to-floating rate subordinated notes in a private placement transaction announced on February 10, 2021, at an offering price equal to 100% of the aggregate principal amount of the Notes, of which $50.0 million have been exchanged for subordinated notes registered under the Securities Act of 1933. Net proceeds, after placement agent fees and offering expenses, was approximately $49.3 million. The Notes will mature on February 15, 2031. For regulatory capital purposes, the subordinated notes have been structured to qualify initially as Tier 2 Capital for the Company. Dividends and other capital distributions from the Bank are subject to regulatory notice. If our capital deteriorates such that our Bank is unable to pay dividends to us for an extended period of time, we may not be able to service our debt. At December 31, 2021, FS Bancorp, Inc. had $19.9 million in unrestricted cash to meet liquidity needs.

The Company currently expects to continue the current practice of paying quarterly cash dividends on common stock subject to the Board of Directors' discretion to modify or terminate this practice at any time and for any reason without prior notice. Our current quarterly common stock dividend rate is $0.20 per share, as approved by our Board of Directors, which we believe is a dividend rate per share which enables us to balance our multiple objectives of managing and investing in the Bank, and returning a substantial portion of our cash to our shareholders. Assuming continued payment during 2022 at this rate of $0.20 per share, our average total dividend paid each quarter would be approximately $1.1 million based on the number of our current outstanding shares (which assumes no increases or decreases in the number of shares, except in connection with the anticipated vesting of currently outstanding equity awards).

The Bank is subject to minimum capital requirements imposed by the FDIC. Based on its capital levels at December 31, 2021, the Bank exceeded these requirements as of that date. Consistent with our goals to operate a sound and profitable organization, our policy is for the Bank to maintain a well capitalized status under the capital categories of the FDIC. Based on capital levels at December 31, 2021, the Bank was considered to be well capitalized. Effective January 1, 2020, a bank that elects to use the Community Bank Leverage Ratio ("CBLR") will generally be considered well capitalized and to have met the risk-based and leverage capital requirements of the capital regulations if it has a leverage ratio greater than 9.0%. At December 31, 2021, the Bank qualified and elected to use the CBLR to measure capital adequacy. The CBLR calculated for the Bank at December 31, 2021 was 12.2%, compared to 10.9% at December 31, 2020.

As a bank holding company registered with the Federal Reserve, the Company is subject to the capital adequacy requirements of the Federal Reserve. Bank holding companies with less than $3.0 billion in assets are generally not subject to compliance with the Federal Reserve's capital regulations, which are generally the same as the capital regulations applicable to the Bank. The Federal Reserve has a policy that a bank holding company is required to serve as a source of financial and managerial strength to the holding company's subsidiary bank and the Federal Reserve expects the holding company's subsidiary bank to be well capitalized under the prompt corrective action regulations. If FS Bancorp, Inc. were subject to regulatory capital guidelines for bank holding companies with $3.0 billion or more in assets at December 31, 2021, FS Bancorp would have exceeded all regulatory capital requirements. The Tier 1 leverage-based capital ratio calculated for FS Bancorp, Inc. at December 31, 2021 was 10.8%. For additional information regarding regulatory capital compliance, see the discussion included in "Note 14 - Regulatory Capital" of the Notes to Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data" of this Form 10-K.

Recent Accounting Pronouncements

For a discussion of recent accounting standards, please see "Note 1- Basis of Presentation and Summary of Significant Accounting Policies" of the Notes to Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data" of this Form 10-K.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the risk of loss from adverse changes in market prices and rates. The Company's market risk arises principally from interest rate risk inherent in lending, investing, deposit and borrowings activities. Management actively monitors and manages its interest rate risk exposure. In addition to other risks that are managed in the normal course of business, such as credit quality and liquidity, management considers interest rate risk to be a significant market risk that could potentially have a material effect on the Company's financial condition and result of operations. The information contained in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Asset and Liability Management" of this Form 10-K is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data

FS BANCORP, INC. AND SUBSIDIARY
INDEX TO FINANCIAL STATEMENTS

Index to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of
FS Bancorp, Inc.

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of FS Bancorp, Inc. and subsidiary (the "Company") as of December 31, 2021 and 2020, the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2021, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2021 and 2020, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2021, based on criteria established in Internal Control - Integrated Framework (2013) issued by COSO.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control over Financial Reporting included in Item 9A. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures to respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Allowance for Loan Losses

As described in Notes 1 and 3 to the consolidated financial statements, the Company's consolidated allowance for loan losses balance was $25.6 million at December 31, 2021. The allowance for loan losses is maintained to provide for probable losses on existing loans based on evaluating risks in the loan portfolio and is based upon the Company's analysis of the factors underlying the quality of the loan portfolio. These factors include, among others, changes in the size and composition of the loan portfolio, the estimated value of any underlying collateral, actual loan loss experience, current economic conditions, and detailed analysis of individual loans for which full collectability may not be assured. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information is available.

We identified management's risk ratings of loans and the estimation of qualitative factors, both of which are used in the allowance for loan losses calculation, as a critical audit matter. The Company uses internally determined risk ratings to classify loans into pools and to estimate loss rates for each of the loan pools, which are used in the calculation of the allowance for loan losses. Determination of the risk grades involves significant management judgement. The qualitative factors are used to estimate probable losses incurred related to factors that are not captured in the past loss experience, are based on management's evaluation of available internal and external data, and involve significant management judgement. Auditing management's judgments regarding the determination of risk grades and qualitative factors applied to the allowance for loan losses involved a high degree of subjectivity.

The primary procedures we performed to address this critical audit matter included:

- Testing the design, implementation, and operating effectiveness of controls relating to management's calculation of the allowance for loan losses, including controls over the accuracy of risk ratings of loans and the determination of the reasonableness of the qualitative factors used.

- Testing a risk-based, targeted selection of loans to gain substantive evidence that the Company is appropriately rating these loans in accordance with its policies, and that the risk grades for the loans are reasonable based on current information available.

- Obtaining management's analysis and supporting documentation related to the qualitative factors, and testing whether the qualitative factors used in the calculation of the allowance for loan losses are supported by the analysis provided by management.

- Testing the completeness and accuracy of the data used in the calculation, application of the loan risk grades determined by management and used in the calculation, application of the qualitative factors determined by management and used in the calculation, and recalculation of the allowance for loan losses balance.

- Analytically reviewing historical asset quality trends and the overall characteristics of the loan portfolio including times past due, charge-off activity, and concentration of loan types for areas of directional consistency or bias.

/s/ Moss Adams LLP

Everett, Washington
March 16, 2022

We have served as the Company's auditor since 2006.

FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2021 AND 2020
(Dollars in thousands, except share data)

	December 31, 2021	December 31, 2020
ASSETS		
Cash and due from banks	$ 12,043	$ 11,554
Interest-bearing deposits at other financial institutions	14,448	80,022
Total cash and cash equivalents	26,491	91,576
Certificates of deposit at other financial institutions	10,542	12,278
Securities available-for-sale, at fair value	271,359	178,018
Securities held-to-maturity (fair value of $8,128 and $7,556, respectively)	7,500	7,500
Loans held for sale, at fair value	125,810	166,448
Loans receivable, net	1,728,540	1,544,981
Accrued interest receivable	7,594	7,030
Premises and equipment, net	26,591	27,343
Operating lease right-of-use ("ROU") assets	4,557	4,949
Federal Home Loan Bank ("FHLB") stock, at cost	4,778	7,439
Other real estate owned ("OREO")	—	90
Bank owned life insurance ("BOLI"), net	37,092	36,226
Servicing rights, held at the lower of cost or fair value	16,970	12,595
Goodwill	2,312	2,312
Core deposit intangible, net	4,060	4,751
Other assets	12,195	9,705
TOTAL ASSETS	$ 2,286,391	$ 2,113,241
LIABILITIES		
Deposits:		
Noninterest-bearing accounts	$ 459,522	$ 362,853
Interest-bearing accounts	1,456,222	1,311,218
Total deposits	1,915,744	1,674,071
Borrowings	42,528	165,809
Subordinated notes:		
Principal amount	50,000	10,000
Unamortized debt issuance costs	(606)	—
Total subordinated notes less unamortized debt issuance costs	49,394	10,000
Operating lease liabilities	4,792	5,176
Deferred tax liability, net	1,183	58
Other liabilities	25,243	28,120
Total liabilities	2,038,884	1,883,234
COMMITMENTS AND CONTINGENCIES (NOTE 12)		
STOCKHOLDERS' EQUITY		
Preferred stock, $.01 par value; 5,000,000 shares authorized; none issued or outstanding	—	—
Common stock, $.01 par value; 45,000,000 shares authorized; 8,169,887 and 8,475,912 shares issued and outstanding at December 31, 2021 and December 31, 2020, respectively	82	85
Additional paid-in capital	67,958	81,275
Retained earnings	179,215	146,405
Accumulated other comprehensive income, net of tax	252	2,533
Unearned shares – Employee Stock Ownership Plan ("ESOP")	—	(291)
Total stockholders' equity	247,507	230,007
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 2,286,391	$ 2,113,241

Share and per share data has been adjusted for all periods to reflect a two-for-one stock split effective July 14, 2021.

See accompanying notes to these consolidated financial statements.

FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2021 and 2020
(Dollars in thousands, except earnings per share data)

	Year Ended December 31,	
	2021	2020
INTEREST INCOME		
Loans receivable, including fees	$ 90,737	$ 84,128
Interest and dividends on investment securities, cash and cash equivalents, and certificates of deposit at other financial institutions	5,637	4,709
Total interest and dividend income	96,374	88,837
INTEREST EXPENSE		
Deposits	6,929	11,980
Borrowings	1,074	1,961
Subordinated notes	1,722	776
Total interest expense	9,725	14,717
NET INTEREST INCOME	86,649	74,120
PROVISION FOR LOAN LOSSES	500	13,036
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	86,149	61,084
NONINTEREST INCOME		
Service charges and fee income	4,349	2,373
Gain on sale of loans	31,083	48,842
Gain on sale of investment securities	—	300
Earnings on cash surrender value of BOLI	866	870
Other noninterest income	1,215	2,974
Total noninterest income	37,513	55,359
NONINTEREST EXPENSE		
Salaries and benefits	49,721	38,095
Operations	10,791	10,471
Occupancy	4,892	4,736
Data processing	4,951	4,388
Loss on sale of OREO	9	2
OREO expenses	—	4
Loan costs	2,795	2,066
Professional and board fees	3,181	2,797
Federal Deposit Insurance Corporation (“FDIC”) insurance	636	829
Marketing and advertising	634	530
Amortization of core deposit intangible	691	706
(Recovery) impairment of servicing rights	(2,059)	1,969
Total noninterest expense	76,242	66,593
INCOME BEFORE PROVISION FOR INCOME TAXES	47,420	49,850
PROVISION FOR INCOME TAXES	10,008	10,586
NET INCOME	$ 37,412	$ 39,264
Basic earnings per share	$ 4.42	$ 4.57
Diluted earnings per share	$ 4.32	$ 4.49

Share and per share data has been adjusted for all periods to reflect a two-for-one stock split effective July 14, 2021.

See accompanying notes to these consolidated financial statements.

FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2021 and 2020

(In thousands)

	Year Ended December 31, 2021	Year Ended December 31, 2020
Net income	$ 37,412	$ 39,264
Other comprehensive (loss) income:		
Securities available-for-sale:		
Unrealized holding (loss) gain during period	(5,150)	3,754
Income tax benefit (provision) related to unrealized holding (loss) gain	1,108	(807)
Reclassification adjustment for realized gains, net included in net income	—	(300)
Income tax provision related to reclassification for realized gains, net	—	65
Cash flow hedges:		
Unrealized derivative gains (losses) during period	1,706	(1,429)
Income tax (provision) benefit related to unrealized derivative gains (losses)	(367)	307
Reclassification adjustment for realized loss, net included in net income	538	198
Income tax benefit related to reclassification, net	(116)	(43)
Other comprehensive (loss) income, net of tax	(2,281)	1,745
COMPREHENSIVE INCOME	$ 35,131	$ 41,009

See accompanying notes to these consolidated financial statements.

FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2021 and 2020

(Dollars in thousands, except share amounts)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net of Tax	Unearned ESOP Shares	Total Stockholders' Equity
	Shares	Amount					
BALANCE, January 1, 2020	8,918,082	$ 89	$ 89,223	$ 110,715	$ 788	$ (573)	$ 200,242
Net income	—	$ —	—	39,264	—	—	$ 39,264
Dividends paid ($0.42 per share)	—	$ —	—	(3,574)	—	—	$ (3,574)
Share-based compensation	—	$ —	1,020	—	—	—	$ 1,020
Restricted stock awards	49,760	$ 1	—	—	—	—	$ 1
Common stock repurchased - repurchase plan	(519,086)	$ (5)	(9,797)	—	—	—	$ (9,802)
Common stock repurchased for employee/director taxes paid on restricted stock awards	(1,640)	$ —	(35)	—	—	—	$ (35)
Stock options exercised	28,796	$ —	(161)	—	—	—	$ (161)
Other comprehensive income, net of tax	—	$ —	—	—	1,745	—	$ 1,745
ESOP shares allocated	—	$ —	1,025	—	—	282	$ 1,307
BALANCE, December 31, 2020	8,475,912	$ 85	$ 81,275	$ 146,405	$ 2,533	$ (291)	$ 230,007
BALANCE, January 1, 2021	8,475,912	$ 85	$ 81,275	$ 146,405	$ 2,533	$ (291)	$ 230,007
Net income	—	$ —	—	37,412	—	—	$ 37,412
Dividends paid ($0.56 per share)	—	$ —	—	(4,602)	—	—	$ (4,602)
Share-based compensation	—	$ —	1,446	—	—	—	$ 1,446
Restricted stock awards	41,350	$ —	—	—	—	—	$ —
Common stock repurchased	(518,383)	$ (4)	(13,957)	—	—	—	$ (13,961)
Common stock repurchased for employee/director taxes paid on restricted stock awards	(5,970)	$ —	(211)	—	—	—	$ (211)
Stock options exercised, net	176,978	$ 1	(2,077)	—	—	—	$ (2,076)
Other comprehensive loss, net of tax	—	$ —	—	—	(2,281)	—	$ (2,281)
ESOP shares allocated	—	$ —	1,482	—	—	291	$ 1,773
BALANCE, December 31, 2021	8,169,887	$ 82	$ 67,958	$ 179,215	$ 252	$ —	$ 247,507

Share and per share data has been adjusted for all periods to reflect a two-for-one stock split effective July 14, 2021.

See accompanying notes to these consolidated financial statements.

FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2021 and 2020

(In thousands)

	Year Ended December 31,	
CASH FLOWS FROM (USED BY) OPERATING ACTIVITIES	2021	2020
Net income	$ 37,412	$ 39,264
Adjustments to reconcile net income to net cash from (used by) operating activities		
Provision for loan losses	500	13,036
Depreciation, amortization and accretion	15,183	13,618
Compensation expense related to stock options and restricted stock awards	1,446	1,020
ESOP compensation expense for allocated shares	1,773	1,307
Provision (benefit) for deferred income taxes	1,750	(2,390)
Increase in cash surrender value of BOLI	(866)	(870)
Gain on sale of loans held for sale	(30,977)	(48,842)
Gain on sale of portfolio loans	(106)	—
Gain on sale of investment securities	—	(300)
Origination of loans held for sale	(1,353,636)	(1,730,665)
Proceeds from sale of loans held for sale	1,444,305	1,670,431
(Recovery) impairment of servicing rights	(2,059)	1,969
Loss on sale of OREO	9	2
Changes in operating assets and liabilities		
Accrued interest receivable	(564)	(1,122)
Other assets	(3,670)	5,511
Other liabilities	(1,491)	5,714
Net cash from (used by) operating activities	109,009	(32,317)
CASH FLOWS USED BY INVESTING ACTIVITIES		
Activity in securities available-for-sale:		
Proceeds from sale of investment securities	—	12,214
Maturities, prepayments, and calls	29,863	37,964
Purchases	(130,138)	(99,390)
Maturities of certificates of deposit at other financial institutions	1,736	8,624
Activity in securities held-to-maturity:		
Purchases	—	(7,500)
Portfolio loan originations and principal collections, net	(214,133)	(189,162)
Purchase of portfolio loans	(1,618)	(32,743)
Proceeds from sale of portfolio loans	2,699	—
Proceeds from sale of OREO	81	76
Purchase of premises and equipment	(1,984)	(1,379)
Change in FHLB stock, net	2,661	606
Net cash used by investing activities	(310,833)	(270,690)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	241,537	281,431
Proceeds from borrowings	148,907	601,158
Repayments of borrowings	(272,188)	(520,213)
Dividends paid on common stock	(4,602)	(3,574)
Net proceeds from issuance of subordinated notes	49,333	—
Repayment of subordinated notes	(10,000)	—
Disbursements from stock options exercised, net	(2,076)	(161)
Restricted stock awards	(211)	(34)
Common stock repurchased	(13,961)	(9,802)
Net cash from financing activities	136,739	348,805
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(65,085)	45,798

FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2021 and 2020 (Continued)

CASH AND CASH EQUIVALENTS, beginning of year		91,576		45,778
CASH AND CASH EQUIVALENTS, end of year	$	26,491	$	91,576
SUPPLEMENTARY DISCLOSURES OF CASH FLOW INFORMATION				
Cash paid during the year for:				
Interest on deposits and borrowings	$	8,174	$	14,584
Income taxes		11,083		11,685
SUPPLEMENTARY DISCLOSURES OF NONCASH OPERATING, INVESTING AND FINANCING ACTIVITIES				
Change in unrealized (loss) gain on investment securities	$	(5,150)	$	3,454
Change in unrealized gain (loss) on cash flow hedges		2,244		(1,231)
Retention in gross mortgage servicing rights from loan sales		9,760		11,139
Right-of-use assets in exchange for lease liabilities		979		1,202

See accompanying notes to these consolidated financial statements.

NOTE 1 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations - FS Bancorp, Inc. (the "Company") was incorporated in September 2011 as the holding company for 1st Security Bank of Washington (the "Bank" or "1st Security Bank") in connection with the Bank's conversion from the mutual to stock form of ownership which was completed on July 9, 2012. The Bank is a community-based savings bank with 21 full-service bank branches, a headquarters that also originates loans and accepts deposits, and 10 loan production offices in suburban communities in the greater Puget Sound area which includes Snohomish, King, Pierce, Jefferson, Kitsap, Clallam, Grays Harbor, Thurston, and Lewis counties, and one loan production office in the market area of the Tri-Cities, Washington. The Bank provides loan and deposit services to customers who are predominantly small- and middle-market businesses and individuals. The Company and its subsidiary are subject to regulation by certain federal and state agencies and undergo periodic examination by these regulatory agencies.

Financial Statement Presentation - The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") and with prevailing practices within the banking and securities industries. In preparing such financial statements, management is required to make certain estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheet and the reported amounts of revenues and expenses for the reporting period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan and lease losses, fair value of financial instruments, the valuation of servicing rights, deferred income taxes, and if needed, a deferred tax asset valuation allowance.

Amounts presented in the consolidated financial statements and footnote tables are rounded and presented to the nearest thousands of dollars except per share amounts. If the amounts are above $1.0 million, they are rounded one decimal point, and if they are above $1.0 billion, they are rounded two decimal points.

Principles of Consolidation - The consolidated financial statements include the accounts of FS Bancorp, Inc. and its wholly owned subsidiary, 1st Security Bank of Washington. All material intercompany accounts have been eliminated in consolidation.

Segment Reporting - The Company operates in two business segments through the Bank: commercial and consumer banking and home lending. The Company's business segments are determined based on the products and services provided, as well as the nature of the related business activities, and they reflect the manner in which financial information is regularly reviewed for the purpose of allocating resources and evaluating performance of the Company's businesses. The results for these business segments are based on management's accounting process, which assigns income statement items and assets to each responsible operating segment. This process is dynamic and is based on management's view of the Company's operations. See "Note 20 - Business Segments."

Subsequent Events - The Company has evaluated events and transactions subsequent to December 31, 2021 for potential recognition or disclosure.

Cash and Cash Equivalents - Cash and cash equivalents include cash and due from banks, and interest-bearing balances due from other banks and the Federal Reserve Bank of San Francisco ("FRB") and have an original maturity of 90 days or less at the time of purchase. At times, cash balances may exceed Federal Deposit Insurance Corporation ("FDIC") insured limits. At December 31, 2021 and 2020, the Company had $327,000 and $17.0 million, respectively, of cash and due from banks and interest-bearing deposits at other financial institutions in excess of FDIC insured limits.

Securities - Securities are classified as held-to-maturity when the Company has the ability and positive intent to hold them to maturity. Securities classified as held-to-maturity are carried at cost, adjusted for amortization of premiums to the earliest callable date and accretion of discounts to the maturity date and, if appropriate, any other-than-temporary impairment losses. Securities available-for-sale consist of debt securities that the Company has the intent and ability to hold for an indefinite period, but not necessarily to maturity. Such securities may be sold to implement the Company's asset/liability management strategies and in response to changes in interest rates and similar factors. Securities available-for-sale are reported at fair value. Realized gains and losses on securities available-for-sale, determined using the specific identification method, are included in results of operations. Amortization of premiums and accretion of discounts are recognized as adjustments to yield over the contractual lives of the related securities with the exception of premiums for non-contingently callable debt securities which are amortized to the earliest call date, rather than the contractual maturity date.

Unrealized holding gains and losses, net of the related deferred tax effect on available-for-sale securities, are reported as a net amount in a separate component of equity entitled accumulated other comprehensive income (loss). Any declines in the values of these securities that are considered to be other-than-temporary-impairment ("OTTI") and credit-related are recognized in earnings. Noncredit-related unrealized losses on securities not expected to be sold is recognized in other comprehensive income (loss). The review for OTTI is conducted on an ongoing basis and takes into account the severity and duration of the impairment, recent events specific to the issuer or industry, fair value in relationship to cost, extent and nature of change in fair value, creditworthiness of the issuer including external credit ratings and recent downgrades, trends and volatility of earnings, current analysts' evaluations, and other key measures. In addition, the Company does not intend to sell the securities and it is more likely than not that we will not be required to sell the securities before recovery of their amortized cost basis. In doing this, we take into account our balance sheet management strategy and consideration of current and future market conditions. Dividends and interest income are recognized when earned.

Federal Home Loan Bank Stock - The Bank's investment in FHLB stock is carried at cost, which approximates fair value. As a member of the FHLB system, the Bank is required to maintain an investment in capital stock of the FHLB in an amount of $2.5 million and 4.0% of advances from the FHLB. The Bank's required minimum level of investment in FHLB stock is based on specific percentages of its outstanding mortgages, total assets, or FHLB advances. At December 31, 2021 and 2020, the Bank's minimum level of investment requirement in FHLB stock was $4.8 million and $7.4 million, respectively. The Bank was in compliance with the FHLB minimum investment requirement at December 31, 2021 and 2020.

Management evaluates FHLB stock for impairment as needed. Management's determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared with the capital stock amount for the FHLB and the length of time this situation has persisted; (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB; (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB; and (4) the liquidity position of the FHLB. Based on its evaluation, management determined that there was no impairment of FHLB stock at December 31, 2021 and 2020, respectively.

Loans Held for Sale - The Bank records all mortgage loans held for sale at fair value. Fair value is determined by outstanding commitments from investors or current investor yield requirements calculated on the aggregate loan basis. Gains and losses on fair value changes of loans held for sale are recorded in the gain on sale of loans component of noninterest income. Origination fees and costs are recognized in earnings at the time of origination. Mortgage loans held for sale are sold with the mortgage service rights either released or retained by the Bank. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold. All sales are made with limited recourse against the Company.

Other Real Estate Owned - Other real estate owned ("OREO") consists of properties or assets acquired through or in lieu of foreclosure, and are recorded initially at fair value less selling costs, with the initial charge made to the allowance for loan losses. Costs relating to development and improvement of the properties or assets are capitalized while costs relating to holding the properties or assets are expensed. Valuations are periodically performed by management, and a charge to earnings is recorded if the recorded value of a property exceeds its estimated net realizable value.

Derivatives - Commitments to fund mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of these mortgage loans are accounted for as free-standing derivatives. The fair value of the interest rate lock is recorded at the time the commitment to fund the mortgage loan is executed and is adjusted for the expected exercise of the commitments to fund the loans, the Company enters into forward commitments for the future delivery of mortgage loans when interest rate locks are entered. Fair values of these mortgage derivatives are estimated based on changes in mortgage interest rates from the date the interest on the loan is locked. Changes in the fair values of these derivatives are reported in "Gain on sale of loans" on the Consolidated Statements of Income.

The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and resulting designation. The Company's hedging policies permit the use of various derivative financial instruments to manage interest rate risk or to hedge specified assets and liabilities. To qualify for hedge accounting, derivatives must be highly effective at reducing the risk associated with the exposure being hedged and must be designated as a hedge at the inception of the derivative contract. If derivative instruments are designated as fair value hedges, and such hedges are highly effective, both the change in the fair value of the hedge and the hedged item are included in current earnings. If derivative instruments are designated as cash flow hedges, fair value adjustments related to the effective portion are recorded in other comprehensive income and are reclassified to earnings when the hedged transaction is reflected in earnings. Ineffective portions of cash flow hedges are reflected in earnings as they occur. Actual cash receipts and/or payments and related accruals on derivatives related to hedges are recorded as adjustments to the interest income or interest expense associated with the hedged item. During the life of the hedge, the Company formally assesses whether derivatives designated as hedging instruments continue to be highly effective in offsetting changes in the fair value or cash flows of hedged items. If it is determined that a hedge has ceased to be highly effective, the Company will discontinue hedge accounting prospectively. At such time, previous adjustments to the carrying value of the hedged item are reversed into current earnings and the derivative instrument is reclassified to a trading position recorded at fair value. For derivatives not designated as hedges, changes in fair value are recognized in earnings, in noninterest income.

Loans Receivable - Loans receivable, are stated at the amount of unpaid principal reduced by an allowance for loan losses and net deferred fees or costs. Interest on loans is calculated using the simple interest method based on the daily balance of the principal amount outstanding and is credited to income as earned. Loan fees, net of direct origination costs, are deferred and amortized over the life of the loan using the effective yield method. If the loan is repaid prior to maturity, the remaining unamortized net deferred loan origination fee is recognized in income at the time of repayment.

Interest on loans is accrued daily based on the principal amount outstanding. Generally, the accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due or when they are past due 90 days as to either principal or interest (based on contractual terms), unless they are well secured and in the process of collection. All interest accrued but not collected for loans that are placed on nonaccrual status or charged off are reversed against interest income. Subsequent collections on a cash basis are applied proportionately to past due principal and interest, unless collectability of principal is in doubt, in which case all payments are applied to principal. Loans are returned to accrual status when the loan is performing according to its contractual terms for at least six months and the collectability of principal and interest is no longer doubtful.

Impaired Loans - A loan is considered impaired when it is probable the Company will be unable to collect all contractual principal and interest payments due in accordance with the original or modified terms of the loan agreement. Impaired loans are measured on a loan-by-loan basis based on the estimated fair value of the collateral less estimated cost to sell if the loan is considered collateral dependent. Impaired loans not considered to be collateral dependent are measured based on the present value of expected future cash flows. Regular credit reviews of the portfolio also identify loans that are considered potentially impaired except for the smaller groups of homogeneous consumer loans.

The categories of nonaccrual loans and impaired loans overlap, although they are not coextensive. The Company considers all circumstances regarding the loan and borrower on an individual basis when determining whether an impaired loan should be placed on nonaccrual status, such as the financial strength of the borrower, the collateral value, reasons for delay, payment record, the amount of past due and the number of days past due. Loans that experience insignificant payment delays and payment shortfalls are generally not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of shortfall in relation to the principal and interest owed.

Troubled Debt Restructured Loans - Troubled debt restructured ("TDR") loans are loans for which the Company, for economic or legal reasons related to the borrower's financial condition, has granted a significant concession to the borrower that it would otherwise not consider. The loan terms which have been modified or restructured due to a borrower's financial difficulty may include, but are not limited to: a reduction in the stated interest rate; an extension of the maturity at an interest rate below current market; a reduction in the face amount of the debt; a reduction in the accrued interest; or re-aging, extensions, deferrals and renewals. TDR loans are considered impaired loans and are individually evaluated for impairment and can be classified as either accrual or nonaccrual. TDR loans are classified as nonperforming loans unless they have been performing in accordance with their modified terms for a period of at least six months in which case they are placed on accrual status. The Coronavirus Aid, Relief, and Economic Security Act of 2020 ("CARES Act") and the Consolidated Appropriations Act, 2021 ("CAA") provided guidance around the modification of loans as a result of the COVID-19 pandemic, which outlined, among other criteria, that short-term modifications made on a good faith basis to borrowers who were current as defined under the CARES Act prior to any relief, are not TDRs. This includes short-term (e.g. six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. Borrowers are considered current under the CARES Act and regulatory guidance if they are less than 30 days past due on their contractual payments at the time a modification program is implemented. The CAA extended relief offered under the CARES Act related to TDRs as a result of COVID-19 through January 1, 2022.

Allowance for Loan and Lease Losses ("ALLL") - The ALLL is maintained at a level considered adequate to provide for probable losses on existing loans based on evaluating known and inherent risks in the loan portfolio. The allowance is reduced by loans charged off and increased by provisions charged to earnings and recoveries on loans previously charged-off. The allowance is based on management's periodic, and systematic evaluation of factors underlying the quality of the loan portfolio including changes in the size and composition of the loan portfolio, the estimated value of any underlying collateral, actual loan loss experience, current economic conditions, and detailed analysis of individual loans for which full collectability may not be assured. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. While management uses the best information available to make its estimates, future adjustments to the allowance may be necessary if there is a significant change in economic and other conditions. The appropriateness of the ALLL is estimated based on these factors and trends identified by management at the time the financial statements are prepared.

When available information confirms that specific loans or portions thereof are uncollectible, these amounts are charged-off against the ALLL. The existence of some or all of the following criteria will generally confirm that a loss has been incurred: the loan is significantly delinquent and the borrower has not evidenced the ability or intent to bring the loan current; the Company has no recourse to the borrower, or if it does, the borrower has insufficient assets to pay the debt; the estimated fair value of the loan collateral is significantly below the current loan balance, and there is little or no near-term prospect for improvement.

A provision for loan losses is charged against income and added to the ALLL based on regular assessment of the loan portfolio. The ALLL is allocated to certain loan categories based on the relative risk characteristics, asset classifications, and actual loss experience within the loan portfolio. Although management has allocated the ALLL to various loan portfolio segments, the allowance is general in nature and is available for the loan portfolio in its entirety.

The ultimate recovery of all loans is susceptible to future market factors beyond the Company's control. These factors may result in losses or recoveries differing significantly from those provided for in the financial statements. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's ALLL, and may require the Company to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

In addition, as of January 1, 2022, the Company adopted Accounting Standards Update No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which is commonly referred to as "CECL." This accounting change will have a significant impact on how our allowance for credit losses is calculated, as well as the related disclosures. For additional information on CECL see below, "Recent Accounting Pronouncements."

Reserve for Unfunded Loan Commitments - The reserve for unfunded loan commitments is maintained at a level believed by management to be sufficient to absorb estimated probable losses related to these unfunded credit facilities. The determination of the adequacy of the reserve is based on periodic evaluations of the unfunded credit facilities including an assessment of the probability of commitment usage, credit risk factors for loans outstanding to these same customers, and the terms and expiration dates of the unfunded credit facilities. The reserve for unfunded loan commitments is included in other liabilities on the Consolidated Balance Sheets, with changes to the balance charged against noninterest expense.

Premises and Equipment, Net - Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The estimated useful lives used to compute depreciation include building and building improvements from 25 to 40 years and furniture, fixtures, and equipment from three to 10 years. Leasehold and tenant improvements are amortized using the straight-line method over the lesser of useful life or the life of the related lease. Gains or losses on dispositions are reflected in Consolidated Statements of Income.

Management reviews buildings, improvements and equipment for impairment on an annual basis or whenever events or changes in the circumstances indicate that the undiscounted cash flows for the property are less than its carrying value. If identified, an impairment loss is recognized through a charge to earnings based on the fair value of the property.

Right of Use Lease Asset & Lease Liability - The Company leases retail space, office space, storage space, and equipment under operating leases. Most leases require the Company to pay real estate taxes, maintenance, insurance and other similar costs in addition to the base rent. Certain leases also contain lease incentives, such as tenant improvement allowances and rent abatement. Variable lease payments are recognized as lease expense as they are incurred. The Company records an operating lease right of use (ROU) asset and an operating lease liability (lease liability) for operating leases with a lease term greater than 12 months. The ROU asset and lease liability are recorded in other assets and other liabilities, respectively, on the Consolidated Balance Sheets.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. ROU assets and lease liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of the Company's leases do not provide an implicit rate, the Company generally uses its incremental borrowing rate based on the estimated rate of interest for collateralized borrowing over a similar term of the lease payments at commencement date. Many of the Company's leases contain various provisions for increases in rental rates, based either on changes in the published Consumer Price Index or a predetermined escalation schedule, which are factored into our determination of lease payments when appropriate. Substantially all of the leases provide the Company with the option to extend the lease term one or more times following expiration of the initial term. The ROU asset and lease liability terms may include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

Transfers of Financial Assets - Transfers of an entire financial asset, a group of entire financial assets, or participating interest in an entire financial asset are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Servicing Rights - Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Generally, purchased servicing rights are capitalized at the cost to acquire the rights. For sales of mortgage, commercial and consumer loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage, commercial, or consumer servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds, and default rates and losses.

Servicing assets are evaluated quarterly for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights into tranches based on predominant characteristics, such as interest rate, loan type, and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the Company later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income. Capitalized servicing rights are stated separately on the Consolidated Balance Sheets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

Income Taxes - The Company files a consolidated federal income tax return. Deferred federal income taxes result from temporary differences between the tax basis of assets and liabilities, and their reported amounts in the financial statements.

These will result in differences between income for tax purposes and income for financial reporting purposes in future years. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Valuation allowances are established to reduce the net recorded amount of deferred tax assets if it is determined to be more likely than not, that all or some portion of the potential deferred tax asset will not be realized.

The Company follows the authoritative guidance issued related to accounting for uncertainty in income taxes. The guidance prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. It is the Company's policy to record any penalties or interest arising from federal or state taxes as a component of income tax expense.

Employee Stock Ownership Plan - Compensation expense recognized for the Company's ESOP equals the fair value of shares that have been allocated or committed to be released for allocation to participants. Any difference between the fair value of the shares at the time and the ESOP's original acquisition cost is charged or credited to stockholders' equity (additional paid-in capital). The cost of ESOP shares that have not yet been allocated or committed to be released is deducted from stockholders' equity.

Earnings Per Share ("EPS") – Basic and diluted EPS are computed using the two-class method, which is an earnings allocation method for computing earnings per share that treats a participating security as having rights to earnings that would otherwise have been available to common shareholders. Basic earnings per share are computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Unvested share-based awards containing non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are included in the computation of earnings per share pursuant to the two-class method. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. For earnings per share calculations, the ESOP shares committed to be released are included as outstanding shares for both basic and diluted earnings per share.

Comprehensive Income (Loss) - Comprehensive income (loss) is comprised of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized holding gains and losses on securities available-for-sale, net of tax and unrealized holding gains (losses) on derivatives designated as cash flow hedges, net of tax recorded directly to equity.

Financial Instruments - In the ordinary course of business, the Company has entered into agreements for off-balance-sheet financial instruments consisting of commitments to extend credit and stand-by letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

Restricted Assets - Regulations of the Board of Governors of the Federal Reserve System ("Federal Reserve") require that the Bank maintain reserves in the form of cash on hand and deposit balances with the FRB, based on a percentage of deposits. At December 31, 2021 and December 31, 2020, the Bank had no reserve requirement.

Marketing and Advertising Costs - The Company records marketing and advertising costs as expenses as they are incurred. Total marketing and advertising expense was $634,000 and $530,000 for the years ended December 31, 2021 and 2020, respectively.

Stock-Based Compensation - Compensation cost is recognized for stock options and restricted stock awards, based on the fair value of these awards at the grant date. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the grant date is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Goodwill - Goodwill is recorded upon completion of a business combination as the difference between the purchase price and the fair value of net identifiable assets acquired. The Company completes its annual review of goodwill during the fourth quarter of each fiscal year. An assessment of qualitative factors is completed to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the qualitative analysis concludes that further analysis is required, then a quantitative impairment test would be completed. The quantitative goodwill impairment test is used to identify the existence of impairment and the amount of impairment loss and compares the reporting unit's estimated fair value, including goodwill, to its carrying amount. If the fair value exceeds the carrying amount then goodwill is not considered impaired. If the carrying amount exceeds its fair value, an impairment loss would be recognized equal to the amount of excess, limited to the amount of total goodwill allocated to that reporting unit. There was no goodwill impairment at December 31, 2021 or 2020.

Business Combinations - The Company accounts for business combinations using the acquisition method of accounting. The accounts of an acquired entity are included as of the date of acquisition, and any excess of purchase price over the fair value of the net assets acquired is capitalized as goodwill. In the event that the fair value of net assets acquired exceeds the purchase price, including fair value of liabilities assumed, a bargain purchase gain is recorded on that acquisition. Under this method, all identifiable assets acquired, including purchased loans, and liabilities assumed are recorded at fair value. The Company typically issues common stock and/or pays cash for an acquisition, depending on the terms of the acquisition agreement. The value of shares of common stock issued is determined based on the market price of the stock as of the closing of the acquisition.

Acquired Loans - Acquired loans are recorded at their initial fair value and adjusted for subsequent advances, pay downs, amortization or accretion of any premium or discount on purchase, charge-offs and additional provisioning that may be required.

Application of New Accounting Guidance in 2021

In October 2020, the FASB issued ASU 2020-08, *Codification Improvements to Subtopic 310-20: Receivables – Nonrefundable Fees and Other Costs*. The ASU clarifies that the Company should reevaluate whether a callable debt security is within the scope of paragraph 310-20-35-33 for each reporting period. This ASU is effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. The Company adopted this ASU effective January 1, 2021. The adoption of ASU 2020-08 did not have a material impact on the consolidated financial statements.

In December 2019, the FASB issued ASU No. 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes.* The amendments in this ASU simplify the accounting for income taxes by removing certain exceptions to the general principles in Topic 740, Income Taxes. The amendments also improve consistent application of and simplify GAAP for other areas of Topic 740 by clarifying and amending existing guidance. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. The Company adopted this ASU effective January 1, 2021. The adoption of ASU 2019-12 did not have a material impact on the consolidated financial statements.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, as amended by ASU 2018-19, ASU 2019-10, and ASU 2019-11.* The ASU is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The ASU requires the recognition and measurement of all current expected credit losses ("CECL") for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the approach under CECL. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The Company engaged a third-party vendor to assist in the CECL calculation and has developed and implemented an internal governance framework. The Company elected to early adopt the new standards, using a modified retrospective approach, effective January 1, 2022. We currently estimate that the adoption of the ASU will result in a combined decrease to our allowance for credit losses and reserve for unfunded loan commitments of 1% to 5%.

In March 2020, the FASB issued ASU No. 2020-04, *"Reference Rate Reform" ("Topic 848")*. This ASU applies to contracts, hedging relationships and other transactions that reference LIBOR or other rate references expected to be discontinued because of reference rate reform. The ASU permits an entity to make necessary modifications to eligible contracts or transactions without requiring contract re-measurement or reassessment of a previous accounting determination. In January 2021, ASU 2021-01 clarifies that certain optional expedients and exceptions in Topic 848 for contract modifications and hedge accounting apply to derivatives that are affected by the discounting transition. A portion of the Bank's commercial real estate loans and its interest rate swap-related transactions are the majority of the Company's LIBOR exposure. Effective January 25, 2021, the Company adhered to the Interbank Offered Rate Fallbacks Protocol as published by the International Swaps and Derivatives Association, Inc. and recommended by the Alternative Reference Rates Committee. This ASU is effective for all entities as of March 12, 2020 through December 31, 2022. The Company does not expect the adoption of ASU 2020-04 to have a material impact on its consolidated financial statements.

NOTE 2 - INVESTMENTS

The following tables present the amortized costs, unrealized gains, unrealized losses, and estimated fair values of securities available-for-sale and held-to-maturity at December 31, 2021 and 2020:

	December 31, 2021			
SECURITIES AVAILABLE-FOR-SALE	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Values
U.S. agency securities	$ 21,155	$ 133	$ (318)	$ 20,970
Corporate securities	9,495	31	(524)	9,002
Municipal bonds	136,377	1,577	(2,521)	135,433
Mortgage-backed securities	88,641	1,457	(696)	89,402
U.S. Small Business Administration securities	16,383	235	(66)	16,552
Total securities available-for-sale	272,051	3,433	(4,125)	271,359
SECURITIES HELD-TO-MATURITY				
Corporate securities	7,500	628	—	8,128
Total securities held-to-maturity	7,500	628	—	8,128
Total securities	$ 279,551	$ 4,061	$ (4,125)	$ 279,487

SECURITIES AVAILABLE-FOR-SALE	December 31, 2020 Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Values
U.S. agency securities	$ 7,940	$ 166	$ (1)	$ 8,105
Corporate securities	11,885	54	(939)	11,000
Municipal bonds	69,572	2,435	(150)	71,857
Mortgage-backed securities	65,722	2,541	(76)	68,187
U.S. Small Business Administration securities	18,441	443	(15)	18,869
Total securities available-for-sale	173,560	5,639	(1,181)	178,018
SECURITIES HELD-TO-MATURITY				
Corporate securities	7,500	77	(21)	7,556
Total securities held-to-maturity	7,500	77	(21)	7,556
Total securities	$ 181,060	$ 5,716	$ (1,202)	$ 185,574

At December 31, 2021, the Bank pledged seven securities held at the FHLB of Des Moines with a carrying value of $8.1 million to secure Washington State public deposits of $13.9 million with a $5.6 million collateral requirement by the Washington Public Deposit Protection Commission. At December 31, 2020, the Bank pledged seven securities held at the FHLB of Des Moines with a carrying value of $8.8 million to secure Washington State public deposits of $13.2 million with a $5.3 million collateral requirement by the Washington Public Deposit Protection Commission. At December 31, 2021, the Bank pledged two securities with a total carrying value of $3.3 million to secure interest rate swaps designated as cash flow hedges. See "Note 17- Derivatives", for detail on the Bank's interest rate swaps.

Investment securities that were in an unrealized loss position at December 31, 2021 and 2020 are presented in the following tables, based on the length of time individual securities have been in an unrealized loss position. Management believes that these securities are only temporarily impaired due to changes in market interest rates or the widening of market spreads subsequent to the initial purchase of the securities, and not due to concerns regarding the underlying credit of the issuers or the underlying collateral.

	December 31, 2021					
	Less than 12 Months		12 Months or Longer		Total	
SECURITIES AVAILABLE-FOR-SALE	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. agency securities	$ 13,125	$ (105)	$ 3,752	$ (213)	$ 16,877	$ (318)
Corporate securities	—	—	5,476	(524)	5,476	(524)
Municipal bonds	72,098	(1,961)	14,116	(560)	86,214	(2,521)
Mortgage-backed securities	33,291	(620)	3,825	(76)	37,116	(696)
U.S. Small Business Administration securities	2,988	(66)	—	—	2,988	(66)
Total securities available-for-sale	$ 121,502	$ (2,752)	$ 27,169	$ (1,373)	$ 148,671	$ (4,125)

	December 31, 2020					
	Less than 12 Months		12 Months or Longer		Total	
SECURITIES AVAILABLE-FOR-SALE	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. agency securities	$ 1,986	$ (1)	$ —	$ —	$ 1,986	$ (1)
Corporate securities	7,059	(939)	—	—	7,059	(939)
Municipal bonds	8,377	(150)	—	—	8,377	(150)
Mortgage-backed securities	6,903	(65)	3,002	(11)	9,905	(76)
U.S. Small Business Administration securities	2,314	(15)	—	—	2,314	(15)
Total securities available-for-sale	26,639	(1,170)	3,002	(11)	29,641	(1,181)
SECURITIES HELD-TO-MATURITY						
Corporate securities	4,979	(21)	—	—	4,979	(21)
Total securities held-to-maturity	4,979	(21)	—	—	4,979	(21)
Total	$ 31,618	$ (1,191)	$ 3,002	$ (11)	$ 34,620	$ (1,202)

There were 75 investments with unrealized losses of less than one year and 17 investments with unrealized losses of more than one year at December 31, 2021. There were 21 investments with unrealized losses of less than one year and one investment with unrealized losses of more than one year at December 31, 2020. The unrealized losses associated with these investments are believed to be caused by changing market conditions that are considered to be temporary and the Company does not intend to sell the securities, and it is not likely to be required to sell these securities prior to maturity. Based on the Company's evaluation of these securities, no OTTI was recorded for the years ended December 31, 2021 and 2020. Additional deterioration in market and economic conditions, may have an adverse impact on credit quality in the future and result in other-than-temporary impairment charges.

The contractual maturities of securities available-for-sale and held-to-maturity at December 31, 2021 and 2020 are listed below. Expected maturities of mortgage-backed securities may differ from contractual maturities because borrowers may have the right to call or prepay the obligations; therefore, these securities are classified separately with no specific maturity date.

	December 31, 2021		December 31, 2020	
SECURITIES AVAILABLE-FOR-SALE	Amortized	Fair	Amortized	Fair
U.S. agency securities	Cost	Value	Cost	Value
Due after one year through five years	$ 959	$ 1,004	$ 978	$ 1,060
Due after five years through ten years	6,920	6,850	1,000	1,036
Due after ten years	13,276	13,116	5,962	6,009
Subtotal	21,155	20,970	7,940	8,105
Corporate securities				
Due in one year or less	—	—	2,392	2,433
Due after one year through five years	3,495	3,526	3,493	3,491
Due after five years through ten years	4,000	3,627	4,000	3,676
Due after ten years	2,000	1,849	2,000	1,400
Subtotal	9,495	9,002	11,885	11,000
Municipal bonds				
Due in one year or less	—	—	101	101
Due after one year through five years	3,724	3,850	3,749	3,980
Due after five years through ten years	6,857	7,035	7,994	8,321
Due after ten years	125,796	124,548	57,728	59,455
Subtotal	136,377	135,433	69,572	71,857
Mortgage-backed securities				
Federal National Mortgage Association (“FNMA”)	75,171	75,737	47,675	50,005
Federal Home Loan Mortgage Corporation (“FHLMC”)	9,606	9,768	11,825	11,913
Government National Mortgage Association (“GNMA”)	3,864	3,897	6,222	6,269
Subtotal	88,641	89,402	65,722	68,187
U.S. Small Business Administration securities				
Due after one year through five years	2,485	2,507	2,266	2,353
Due after five years through ten years	4,420	4,515	8,097	8,333
Due after ten years	9,478	9,530	8,078	8,183
Subtotal	16,383	16,552	18,441	18,869
Total securities available-for-sale	272,051	271,359	173,560	178,018
SECURITIES HELD-TO-MATURITY				
Corporate securities				
Due after five years through ten years	7,500	8,128	7,500	7,556
Total securities held-to-maturity	7,500	8,128	7,500	7,556
Total securities	$ 279,551	$ 279,487	$ 181,060	$ 185,574

The proceeds and resulting gains and losses, computed using specific identification from sales of securities available-for-sale for the years ended December 31, 2021 and 2020 were as follows:

	December 31, 2021		
	Proceeds	Gross Gains	Gross Losses
Securities available-for-sale	$ —	$ —	$ —

	December 31, 2020		
	Proceeds	Gross Gains	Gross Losses
Securities available-for-sale	$ 12,214	$ 300	$ —

NOTE 3 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

The composition of the loan portfolio was as follows at the dates indicated:

REAL ESTATE LOANS	December 31, 2021	December 31, 2020
Commercial	$ 265,038	$ 222,719
Construction and development	242,433	216,975
Home equity	40,558	43,093
One-to-four-family (excludes loans held for sale)	366,388	311,093
Multi-family	178,694	131,601
Total real estate loans	1,093,111	925,481
CONSUMER LOANS		
Indirect home improvement	340,285	286,020
Marine	80,627	85,740
Other consumer	2,900	3,418
Total consumer loans	423,812	375,178
COMMERCIAL BUSINESS LOANS		
Commercial and industrial (1)	208,764	224,476
Warehouse lending	33,339	49,092
Total commercial business loans	242,103	273,568
Total loans receivable, gross	1,759,026	1,574,227
Allowance for loan and lease losses	(25,635)	(26,172)
Deferred costs and fees, net	(5,061)	(4,017)
Premiums on purchased loans, net	210	943
Total loans receivable, net	$ 1,728,540	$ 1,544,981

(1) Includes Paycheck Protection Program (“PPP”) loans.

At December 31, 2021, the Bank held approximately $761.6 million in loans that are pledged as collateral for FHLB advances, compared to approximately $774.8 million at December 31, 2020. The Bank held approximately $428.7 million in loans that are pledged as collateral for the FRB line of credit at December 31, 2021, compared to approximately $369.2 million at December 31, 2020.

Included in the carrying value of gross loans are net discounts on loans purchased in the Anchor Bank acquisition in November 2018. The remaining net discount on loans acquired was $751,000 and $1.5 million, on $84.3 million and $132.6 million of gross loans at December 31, 2021 and December 31, 2020, respectively.

The Company has defined its loan portfolio into three segments that reflect the structure of the lending function, the Company’s strategic plan and the manner in which management monitors performance and credit quality. The three loan portfolio segments are: (a) Real Estate Loans, (b) Consumer Loans and (c) Commercial Business Loans. Each of these segments is disaggregated into classes based on the risk characteristics of the borrower and/or the collateral type securing the loan. The following is a summary of each of the Company’s loan portfolio segments and classes:

Real Estate Loans

Commercial Lending. Loans originated by the Company primarily secured by income producing properties, including retail centers, warehouses, and office buildings located in our market areas.

Construction and Development Lending. Loans originated by the Company for the construction of, and secured by, commercial real estate, one-to-four-family, and multi-family residences and tracts of land for development that are not pre-sold. A portion of the one-to-four-family construction portfolio is custom construction loans to the intended occupant of the residence.

Home Equity Lending. Loans originated by the Company secured by second mortgages on one-to-four-family residences, including home equity lines of credit in our market areas.

One-to-Four-Family Real Estate Lending. One-to-four-family residential loans include owner-occupied properties (including second homes), and non-owner-occupied properties with four or less units. These loans originated by the Company or periodically purchased from banks are secured by first mortgages on one-to-four-family residences in our market areas that the Company intends to hold (excludes loans held for sale).

Multi-family Lending. Apartment term lending (five or more units) to current banking customers and community reinvestment loans for low to moderate income individuals in the Company's footprint.

Consumer Loans

Indirect Home Improvement. Fixture secured loans for home improvement are originated by the Company through its network of home improvement contractors and dealers and are secured by the personal property installed in, on, or at the borrower's real property, and may be perfected with a UCC-2 financing statement filed in the county of the borrower's residence. These indirect home improvement loans include replacement windows, siding, roofing, pools, and other home fixture installations, including solar related home improvement projects.

Marine. Loans originated by the Company, secured by boats, to borrowers primarily located in the states the Company originates consumer loans.

Other Consumer. Loans originated by the Company to consumers in our retail branch footprint, including automobiles, recreational vehicles, direct home improvement loans, loans on deposits, and other consumer loans, primarily consisting of personal lines of credit and credit cards.

Commercial Business Loans

Commercial and Industrial Lending ("C&I"). Loans originated by the Company to local small- and mid-sized businesses in our Puget Sound market area are secured primarily by accounts receivable, inventory, or personal property, plant and equipment. Some of the C&I loans purchased by the Company are outside of the Greater Puget Sound market area. C&I loans are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. The Bank began originating U.S. Small Business Administration ("SBA") Paycheck Protection Program ("PPP") loans following the enactment of the CARES Act in April 2020. PPP loans originated by the Company are also included in this loan class. PPP loans are fully guaranteed by the SBA, intended for businesses impacted by the COVID-19 pandemic and designed to provide near term relief to help small businesses sustain operations. These loans have either a two-year or five-year maturity date and earn interest at 1%. The Bank also earns a fee based on the size of the loan, which is recognized over the life of the loan.

Warehouse Lending. Loans originated to non-depository financial institutions and secured by notes originated by the non-depository financial institution. The Company has two distinct warehouse lending divisions: commercial warehouse re-lending secured by notes on construction loans and mortgage warehouse re-lending secured by notes on one-to-four-family loans. The Company's commercial construction warehouse lines are secured by notes on construction loans and typically guaranteed by principals with experience in construction lending. Mortgage warehouse lending loans are funded through third-party residential mortgage bankers. Under this program, the Company provides short-term funding to the mortgage banking companies for the purpose of originating residential mortgage loans for sale into the secondary market.

The following tables detail activity in the allowance for loan losses by loan categories for the years shown:

	At or For the Year Ended December 31, 2021				
ALLOWANCE FOR LOAN LOSSES	Real Estate	Consumer	Commercial Business	Unallocated	Total
Beginning balance	$ 13,846	$ 6,696	$ 4,939	$ 691	$ 26,172
Provision (recapture) for loan losses	952	(1,417)	1,635	(670)	500
Charge-offs	—	(1,755)	(38)	—	(1,793)
Recoveries	—	756	—	—	756
Net charge-offs	—	(999)	(38)	—	(1,037)
Ending balance	$ 14,798	$ 4,280	$ 6,536	$ 21	$ 25,635
Period end amount allocated to:					
Loans individually evaluated for impairment	$ 23	$ 219	$ 921	$ —	$ 1,163
Loans collectively evaluated for impairment	14,775	4,061	5,615	21	24,472
Ending balance	$ 14,798	$ 4,280	$ 6,536	$ 21	$ 25,635
LOANS RECEIVABLE					
Loans individually evaluated for impairment	$ 781	$ 625	$ 4,417	$ —	$ 5,823
Loans collectively evaluated for impairment	1,092,330	423,187	237,686	—	1,753,203
Ending balance	$ 1,093,111	$ 423,812	$ 242,103	$ —	$ 1,759,026

	At or For the Year Ended December 31, 2020				
ALLOWANCE FOR LOAN LOSSES	Real Estate	Consumer	Commercial Business	Unallocated	Total
Beginning balance	$ 6,206	$ 3,766	$ 3,254	$ 3	$ 13,229
Provision for loan losses	7,622	3,372	1,354	688	13,036
Charge-offs	—	(1,101)	(22)	—	(1,123)
Recoveries	18	659	353	—	1,030
Net recoveries (charge-offs)	18	(442)	331	—	(93)
Ending balance	$ 13,846	$ 6,696	$ 4,939	$ 691	$ 26,172
Period end amount allocated to:					
Loans individually evaluated for impairment	$ 15	$ 305	$ 990	$ —	$ 1,310
Loans collectively evaluated for impairment	13,831	6,391	3,949	691	24,862
Ending balance	$ 13,846	$ 6,696	$ 4,939	$ 691	$ 26,172
LOANS RECEIVABLE					
Loans individually evaluated for impairment	$ 1,280	$ 871	$ 5,610	$ —	$ 7,761
Loans collectively evaluated for impairment	924,201	374,307	267,958	—	1,566,466
Ending balance	$ 925,481	$ 375,178	$ 273,568	$ —	$ 1,574,227

Nonaccrual and Past Due Loans. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are automatically placed on nonaccrual once the loan is 90 days past due or sooner if, in management's opinion, the borrower may be unable to meet payment obligations as they become due, or as required by regulatory authorities. The exception is the legacy Anchor Bank credit card portfolio acquired in the November 2018 merger ("Anchor Acquisition") which is serviced externally and loans are manually placed on nonaccrual once the credit card payment is 90 days past due.

As a result of the COVID-19 pandemic, the Company has and will continue to assist customers with an array of payment programs during periods of financial hardship, including forbearance. Forbearance allows a borrower to temporarily not make scheduled payments or to make smaller than scheduled payments, in each case for a specified period of time. Forbearance does not grant any reduction in the total principal or interest repayment obligation. While a loan is in forbearance status, interest continues to accrue and is repaid over a specified time period when the loan re-enters repayment status.

As of December 31, 2021, the amount of loans remaining under interest-only payment/relief agreements due to COVID-19 included commercial real estate loans of $6.9 million and commercial business loans of $2.1 million. These loans were classified as current and accruing interest, with the exception of $1.2 million in commercial business loans which were classified as nonaccrual, yet current on contractual payments. These modifications were not classified as TDRs pursuant to the guidance in effect at the time of modification. At December 31, 2021 and December 31, 2020, the Company had no TDRs.

There were no TDRs which incurred a payment default within twelve months of the restructure date during the years ended December 31, 2021 and 2020.

The following tables provide information pertaining to the aging analysis of contractually past due loans and nonaccrual loans for the years ended December 31, 2021 and 2020:

	December 31, 2021						
REAL ESTATE LOANS	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans Receivable	Non-Accrual
Commercial	$ —	$ —	$ —	$ —	$ 265,038	$ 265,038	$ —
Construction and development	—	—	—	—	242,433	242,433	—
Home equity	—	—	179	179	40,379	40,558	301
One-to-four-family	593	267	480	1,340	365,048	366,388	480
Multi-family	—	—	—	—	178,694	178,694	—
Total real estate loans	593	267	659	1,519	1,091,592	1,093,111	781
CONSUMER LOANS							
Indirect home improvement	1,060	281	294	1,635	338,650	340,285	551
Marine	117	—	—	117	80,510	80,627	56
Other consumer	14	4	18	36	2,864	2,900	18
Total consumer loans	1,191	285	312	1,788	422,024	423,812	625
COMMERCIAL BUSINESS LOANS							
Commercial and industrial	793	—	—	793	207,971	208,764	4,417
Warehouse lending	—	—	—	—	33,339	33,339	—
Total commercial business loans	793	—	—	793	241,310	242,103	4,417
Total loans	$ 2,577	$ 552	$ 971	$ 4,100	$ 1,754,926	$ 1,759,026	$ 5,823

	December 31, 2020						
REAL ESTATE LOANS	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans Receivable	Non-Accrual
Commercial	$ —	$ —	$ —	$ —	$ 222,719	$ 222,719	$ —
Construction and development	1,850	—	—	1,850	215,125	216,975	—
Home equity	127	137	219	483	42,610	43,093	636
One-to-four-family	389	404	512	1,305	309,788	311,093	644
Multi-family	—	—	—	—	131,601	131,601	—
Total real estate loans	2,366	541	731	3,638	921,843	925,481	1,280
CONSUMER LOANS							
Indirect home improvement	683	331	325	1,339	284,681	286,020	826
Marine	28	77	22	127	85,613	85,740	44
Other consumer	73	22	—	95	3,323	3,418	1
Total consumer loans	784	430	347	1,561	373,617	375,178	871
COMMERCIAL BUSINESS LOANS							
Commercial and industrial	—	1,204	—	1,204	223,272	224,476	5,610
Warehouse lending	—	—	—	—	49,092	49,092	—
Total commercial business loans	—	1,204	—	1,204	272,364	273,568	5,610
Total loans	$ 3,150	$ 2,175	$ 1,078	$ 6,403	$ 1,567,824	$ 1,574,227	$ 7,761

There were no loans 90 days or more past due and still accruing interest at both December 31, 2021 and December 31, 2020.

The following tables provide additional information about our impaired loans that have been segregated to reflect loans for which no allowance for loan losses has been provided and loans for which an allowance was provided for the years ended December 31, 2021 and 2020:

	December 31, 2021		
WITH NO RELATED ALLOWANCE RECORDED	Unpaid Principal Balance	Recorded Investment	Related Allowance
Real estate loans:			
Home equity	$ 259	$ 227	$ —
One-to-four-family	497	480	—
	756	707	—
WITH RELATED ALLOWANCE RECORDED			
Real estate loans:			
Home equity	92	74	23
Consumer loans:			
Indirect	551	551	193
Marine	56	56	20
Other consumer	18	18	6
Commercial business loans:			
Commercial and industrial	4,417	4,417	921
	5,134	5,116	1,163
Total	$ 5,890	$ 5,823	$ 1,163

	December 31, 2020		
WITH NO RELATED ALLOWANCE RECORDED Real estate loans:	Unpaid Principal Balance	Recorded Investment	Related Allowance
Home equity	687	636	—
One-to-four-family	645	584	—
Commercial business loans:			
Commercial and industrial	1,203	1,203	—
	2,535	2,423	—
WITH RELATED ALLOWANCE RECORDED			
Real estate loans:			
One-to-four-family	61	60	15
Consumer loans:			
Indirect	826	826	289
Marine	44	44	15
Other consumer	1	1	1
Commercial business loans:			
Commercial and industrial	4,407	4,407	990
	5,339	5,338	1,310
Total	$ 7,874	$ 7,761	$ 1,310

The following table presents the average recorded investment in loans individually evaluated for impairment and the interest income recognized and received for the years ended December 31, 2021 and 2020:

	At or For the Year Ended			
	December 31, 2021		December 31, 2020	
WITH NO RELATED ALLOWANCE RECORDED Real estate loans:	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Commercial	$ —	$ —	$ 996	$ —
Construction and development	771	—	—	—
Home equity	427	15	485	25
One-to-four-family	513	15	954	17
Consumer loans:				
Other consumer	—	—	3	—
Commercial business loans:				
Commercial and industrial	—	—	100	37
	1,711	30	2,538	79
WITH RELATED ALLOWANCE RECORDED				
Real estate loans:				
Home equity	57	—	—	—
One-to-four-family	20	—	60	—
Consumer loans:				
Indirect	643	38	675	60
Marine	77	6	40	3
Other consumer	8	1	1	—
Commercial business loans:				
Commercial and industrial	4,779	276	2,531	162
	5,584	321	3,307	225
Total	$ 7,295	$ 351	$ 5,845	$ 304

Credit Quality Indicators

As part of the Company's on-going monitoring of credit quality of the loan portfolio, management tracks certain credit quality indicators including trends related to (i) the risk grading of loans, (ii) the level of classified loans, (iii) net charge-offs, (iv) nonperforming loans and (v) the general economic conditions in the Company's markets. All loans modified due to COVID-19 are separately monitored and any request for continuation of relief beyond the initial modification will be reassessed at that time to determine if a further modification should be granted and if a downgrade in risk grading is appropriate.

The Company utilizes a risk grading matrix to assign a risk grade to its real estate and commercial business loans. Loans are graded on a scale of 1 to 10, with loans in risk grades 1 to 6 considered "Pass" and loans in risk grades 7 to 10 are reported as classified loans in the Company's allowance for loan loss analysis.

A description of the 10 risk grades is as follows:

- *Grades 1 and 2* - These grades include loans to very high quality borrowers with excellent or desirable business credit.
- *Grade 3* - This grade includes loans to borrowers of good business credit with moderate risk.
- *Grades 4 and 5* - These grades include "Pass" grade loans to borrowers of average credit quality and risk.
- *Grade 6* - This grade includes loans on management's "Watch" list and is intended to be utilized on a temporary basis for "Pass" grade borrowers where frequent and thorough monitoring is required due to credit weaknesses and where significant risk-modifying action is anticipated in the near term.
- *Grade 7* - This grade is for "Other Assets Especially Mentioned (OAEM)" in accordance with regulatory guidelines and includes borrowers where performance is poor or significantly less than expected.
- *Grade 8* - This grade includes "Substandard" loans in accordance with regulatory guidelines which represent an unacceptable business credit where a loss is possible if loan weakness is not corrected.
- *Grade 9* - This grade includes "Doubtful" loans in accordance with regulatory guidelines where a loss is highly probable.
- *Grade 10* - This grade includes "Loss" loans in accordance with regulatory guidelines for which total loss is expected and when identified are charged off.

Consumer, Home Equity, and One-to-Four-Family Real Estate Loans

Homogeneous loans are risk rated based upon the Federal Financial Institutions Examination Council's Uniform Retail Credit Classification and Account Management Policy. Loans classified under this policy at the Company are consumer loans which include indirect home improvement, solar, marine, other consumer, and one-to-four-family first and second liens. Under the Uniform Retail Credit Classification Policy, loans that are current or less than 90 days past due are graded "Pass" and risk graded "4" or "5" internally. Loans that are past due more than 90 days are classified "Substandard" risk graded "8" internally until the loan has demonstrated consistent performance, typically six months of contractual payments. Closed-end loans that are 120 days past due and open-end loans that are 180 days past due are charged off based on the value of the collateral less cost to sell. Management may more conservatively risk rate credits even if paying in accordance with the loan's repayment terms.

Commercial real estate, construction and development, multi-family and commercial business loans are evaluated individually for their risk classification and may be classified as "Substandard" even if current on their loan payment obligations.

The following tables summarize risk rated loan balances by category at the dates indicated:

	December 31, 2021						
REAL ESTATE LOANS	Pass (1 - 5)	Watch (6)	Special Mention (7)	Substandard (8)	Doubtful (9)	Loss (10)	Total
Commercial	$ 253,697	$ 4,652	$ 5,772	$ 917	$ —	$ —	$ 265,038
Construction and development	242,433	—	—	—	—	—	242,433
Home equity	40,257	—	—	301	—	—	40,558
One-to-four-family	363,911	—	—	2,477	—	—	366,388
Multi-family	178,694	—	—	—	—	—	178,694
Total real estate loans	1,078,992	4,652	5,772	3,695	—	—	1,093,111
CONSUMER LOANS							
Indirect home improvement	339,734	—	—	551	—	—	340,285
Marine	80,571	—	—	56	—	—	80,627
Other consumer	2,882	—	—	18	—	—	2,900
Total consumer loans	423,187	—	—	625	—	—	423,812
COMMERCIAL BUSINESS LOANS							
Commercial and industrial	188,970	4,204	1,822	13,768	—	—	208,764
Warehouse lending	33,339	—	—	—	—	—	33,339
Total commercial business loans	222,309	4,204	1,822	13,768	—	—	242,103
Total loans receivable, gross	$ 1,724,488	$ 8,856	$ 7,594	$ 18,088	$ —	$ —	$ 1,759,026

	December 31, 2020						
REAL ESTATE LOANS	Pass (1 - 5)	Watch (6)	Special Mention (7)	Substandard (8)	Doubtful (9)	Loss (10)	Total
Commercial	$ 157,932	$ 60,834	$ 3,013	$ 940	$ —	$ —	$ 222,719
Construction and development	212,209	2,917	1,849	—	—	—	216,975
Home equity	42,457	—	—	636	—	—	43,093
One-to-four-family	303,610	162	187	7,134	—	—	311,093
Multi-family	131,601	—	—	—	—	—	131,601
Total real estate loans	847,809	63,913	5,049	8,710	—	—	925,481
CONSUMER LOANS							
Indirect home improvement	285,194	—	—	826	—	—	286,020
Marine	85,696	—	—	44	—	—	85,740
Other consumer	3,417	—	—	1	—	—	3,418
Total consumer loans	374,307	—	—	871	—	—	375,178
COMMERCIAL BUSINESS LOANS							
Commercial and industrial	190,392	23,945	2,073	8,066	—	—	224,476
Warehouse lending	49,092	—	—	—	—	—	49,092
Total commercial business loans	239,484	23,945	2,073	8,066	—	—	273,568
Total loans receivable, gross	$ 1,461,600	$ 87,858	$ 7,122	$ 17,647	$ —	$ —	$ 1,574,227

Related Party Loans

Certain directors and executive officers or their related affiliates are customers of and have had banking transactions with the Company. Total loans to directors, executive officers, and their affiliates are subject to regulatory limitations.

Outstanding loan balances of related party loans were as follows and were within regulatory limitations:

	At December 31,	
	2021	2020
Beginning balance	$ 3,797	$ 3,249
Additions	647	581
Repayments	(237)	(33)
Ending balance	$ 4,207	$ 3,797

The aggregate maximum loan balance of extended credit was $4.3 million and $4.2 million at December 31, 2021 and 2020, respectively, and includes the ending balances from the tables above. These loans and lines of credit were made in compliance with applicable laws on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons and do not involve more than the normal risk of collectability.

NOTE 4 - SERVICING RIGHTS

Loans serviced for others are not included on the Consolidated Balance Sheets. The unpaid principal balances of permanent loans serviced for others were $2.61 billion and $2.17 billion at December 31, 2021 and 2020, respectively.

The following table summarizes servicing rights activity for the years ended December 31, 2021 and 2020:

	At or For the Year Ended December 31,	
	2021	2020
Beginning balance, at the lower of cost or fair value	$ 12,595	$ 11,560
Additions	9,760	11,139
Servicing rights amortized	(7,444)	(8,135)
Recovery (impairment) of servicing rights	2,059	(1,969)
Ending balance, at the lower of cost or fair value	$ 16,970	$ 12,595

The fair market value of the servicing rights' assets was $26.1 million and $12.8 million at December 31, 2021 and December 31, 2020, respectively. Fair value adjustments to servicing rights are mainly due to market-based assumptions associated with discounted cash flows, loan prepayment speeds, and changes in interest rates. A significant change in prepayments of the loans in the servicing portfolio could result in significant changes in the valuation adjustments, thus creating potential volatility in the carrying amount of servicing rights.

The following provides valuation assumptions used in determining the fair value of mortgage servicing rights ("MSR") at the dates indicated:

Key assumptions:	At December 31, 2021	At December 31, 2020
Weighted average discount rate	9.1 %	9.1 %
Conditional prepayment rate ("CPR")	13.8 %	32.6 %
Weighted average life in years	5.9	3.0

Key economic assumptions of the current fair value for single family MSR are presented in the table below. Also presented is the sensitivity to market rate changes for the par rate coupon for a conventional one-to-four-family FNMA, FHLMC, GNMA, or FHLB serviced home loan. The table below references a 50 basis point and 100 basis point adverse rate change and the impact on prepayment speeds and discount rates at December 31, 2021 and December 31, 2020:

		December 31, 2021	December 31, 2020 (1)
Aggregate portfolio principal balance		$ 2,609,776	$ 2,133,473
Weighted average rate of note		3.2 %	3.5 %
At December 31, 2021	Base	0.5% Adverse Rate Change	1.0% Adverse Rate Change
Conditional prepayment rate	13.8 %	20.0 %	31.5 %
Fair value MSR	$ 26,070	$ 21,188	$ 15,348
Percentage of MSR	1.0 %	0.8 %	0.6 %
Discount rate	9.1 %	9.6 %	10.1 %
Fair value MSR	$ 26,070	$ 25,586	$ 25,119
Percentage of MSR	1.0 %	1.0 %	1.0 %
At December 31, 2020	Base	0.5% Adverse Rate Change	1.0% Adverse Rate Change
Conditional prepayment rate	32.6 %	40.6 %	59.6 %
Fair value MSR	$ 12,833	$ 10,922	$ 8,286
Percentage of MSR	0.6 %	0.5 %	0.4 %
Discount rate	9.1 %	9.6 %	10.1 %
Fair value MSR	$ 12,833	$ 12,696	$ 12,562
Percentage of MSR	0.6 %	0.6 %	0.6 %

(1) Excludes nonperforming serviced loans in forbearance.

These sensitivities are hypothetical and should be used with caution as the tables above demonstrate the Company's methodology for estimating the fair value of MSR which is highly sensitive to changes in key assumptions. For example, actual prepayment experience may differ and any difference may have a material effect on MSR fair value. Changes in fair value resulting from changes in assumptions generally cannot be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear. Also, in these tables, the effects of a variation in a particular assumption on the fair value of the MSR is calculated without changing any other assumption; in reality, changes in one factor may be associated with changes in another (for example, decreases in market interest rates may provide an incentive to refinance; however, this may also indicate a slowing economy and an increase in the unemployment rate, which reduces the number of borrowers who qualify for refinancing), which may magnify or counteract the sensitivities. Thus, any measurement of MSR fair value is limited by the conditions existing and assumptions made at a particular point in time. Those assumptions may not be appropriate if they are applied to a different point in time.

The Company recorded $6.3 million and $4.4 million of gross contractually specified servicing fees, late fees, and other ancillary fees resulting from servicing of loans for the years ended December 31, 2021 and 2020, respectively. The income, net of MSR amortization, is reported in noninterest income on the Consolidated Statements of Income.

NOTE 5 - PREMISES AND EQUIPMENT

Premises and equipment at December 31, 2021 and 2020 were as follows:

	2021	2020
Land	$ 6,008	$ 5,227
Buildings	17,290	16,769
Furniture, fixtures, and equipment	15,307	14,724
Leasehold improvements	2,461	2,859
Building improvements	7,558	6,830
Projects in process	67	355
Subtotal	48,691	46,764
Less accumulated depreciation and amortization	(22,100)	(19,421)
Total	$ 26,591	$ 27,343

Depreciation and amortization expense for these assets totaled $2.7 million and $2.8 million for the years ended December 31, 2021 and 2020, respectively.

NOTE 6 - LEASES

The Company has operating leases for retail bank and home lending branches, and certain equipment. The Company's leases have remaining lease terms of 11 months to eight years and six months, some of which include options to extend the leases for up to five years.

The components of lease cost (included in occupancy expense on the Consolidated Statements of Income) are as follows for the years ended December 31, 2021 and 2020:

Lease cost:	Year Ended December 31, 2021	Year Ended December 31, 2020
Operating lease cost	$ 1,433	$ 1,393
Short-term lease cost	5	11
Total lease cost	$ 1,438	$ 1,404

The following table provides supplemental information related to operating leases at or for the years ended December 31, 2021 and 2020:

Cash paid for amounts included in the measurement of lease liabilities:	At or For the Twelve Months Ended December 31, 2021	At or For the Twelve Months Ended December 31, 2020
Operating cash flows from operating leases	$ 1,402	$ 1,365
Weighted average remaining lease term- operating leases	4.8 years	5.4 years
Weighted average discount rate- operating leases	2.17 %	2.48 %

The Company's leases typically do not contain a discount rate implicit in the lease contract. As an alternative, the discount rate used in determining the lease liability for each individual lease was the FHLB of Des Moines' fixed advance rate.

Maturities of operating lease liabilities at December 31, 2021 for future periods are as follows:

2022	$ 1,398
2023	1,027
2024	968
2025	650
2026	520
Thereafter	539
Total lease payments	5,102
Less imputed interest	(310)
Total	$ 4,792

NOTE 7 - OTHER REAL ESTATE OWNED

The following table presents the activity related to OREO at and for the years ended December 31:

	At or For the Year Ended December 31,	
	2021	2020
Beginning balance	$ 90	$ 168
Additions	—	—
Gross proceeds from sale of OREO	(81)	(76)
Loss on sale of OREO	(9)	(2)
Ending balance	$ —	$ 90

There were no OREO properties at December 31, 2021, compared to one OREO property totaling $90,000 at December 31, 2020. OREO holding costs were none and $4,000 for the years ended December 31, 2021 and 2020, respectively.

There were $710,000 and $662,000 in mortgage loans collateralized by residential real estate property in the process of foreclosure at December 31, 2021 and 2020, respectively.

NOTE 8 - DEPOSITS

Deposits are summarized as follows at December 31:

	December 31, 2021	December 31, 2020
Noninterest-bearing checking	$ 443,133	$ 348,421
Interest-bearing checking (1)	349,251	226,282
Savings	193,922	152,842
Money market (2)	552,357	429,548
Certificates of deposit less than $100,000 (3)	186,974	299,157
Certificates of deposit of $100,000 through $250,000	116,206	135,901
Certificates of deposit of $250,000 and over	57,512	67,488
Escrow accounts related to mortgages serviced	16,389	14,432
Total	$ 1,915,744	$ 1,674,071

(1) Includes $90.0 million and $0.0 of brokered deposits at December 31, 2021 and 2020, respectively.
(2) Includes $5.0 million and $15.0 million of brokered deposits at December 31, 2021 and 2020, respectively.
(3) Includes $97.6 million and $186.4 million of brokered deposits at December 31, 2021 and 2020, respectively.

Scheduled maturities of time deposits at December 31, 2021 for future years ending are as follows:

	At December 31, 2021
Maturing in 2022	$ 211,835
Maturing in 2023	45,181
Maturing in 2024	32,191
Maturing in 2025	56,953
Maturing in 2026	14,419
Thereafter	113
Total	$ 360,692

Interest expense by deposit category for the years ended December 31, 2021 and 2020 is as follows:

	Year Ended December 31,	
	2021	2020
Interest-bearing checking	$ 282	$ 388
Savings and money market	1,604	2,458
Certificates of deposit	5,043	9,134
Total	$ 6,929	$ 11,980

The Company had related party deposits of approximately $3.9 million and $4.0 million at December 31, 2021 and 2020, respectively, which includes deposits held for directors and executive officers.

NOTE 9 - DEBT

Borrowings

The Bank is a member of the FHLB of Des Moines, which entitles it to certain benefits including a variety of borrowing options consisting of a secured credit line that allows both fixed and variable rate advances. The FHLB borrowings at December 31, 2021 and 2020, consisted of a warehouse securities credit line ("securities line"), which allows advances with interest rates fixed at the time of borrowing and a warehouse federal funds ("Fed Funds") advance, which allows daily advances at variable interest rates. Credit capacity is primarily determined by the value of assets collateralized at the FHLB, funds on deposit at the FHLB, and stock owned by the Bank.

Credit is limited to 45% of the Company's total assets and available pledged assets. The Bank entered into an Advances, Pledges and Security Agreement with the FHLB for which specific loans are pledged to secure these credit lines. At December 31, 2021, loans of approximately $761.6 million were pledged to the FHLB. At December 31, 2021, the Bank's total borrowing capacity was $527.2 million with the FHLB of Des Moines, with unused borrowing capacity of $483.9 million. In addition, all FHLB stock owned by the Company is collateral for credit lines.

The Bank maintains a short-term borrowing line with the FRB with total credit based on eligible collateral. The Bank can borrow under the Term Auction or Term Facility at rates published by the San Francisco FRB. At December 31, 2021 and 2020, the Bank had approximately $428.7 million and $369.2 million, respectively, in pledged consumer loans with a Term Auction or Term Facility borrowing capacity of $200.1 million and $179.6 million, respectively, of which none was outstanding at either date. The Bank also had $101.0 million unsecured Fed Funds lines of credit with other financial institutions of which none was outstanding at December 31, 2021.

Advances on these lines at December 31, 2021 and 2020 were as follows:

	2021	2020
Federal Home Loan Bank - (interest rates ranging from 0.30% to 2.87% at both December 31, 2021 and 2020)	$ 42,528	$ 102,528
Paycheck Protection Program Liquidity Facility - (interest rate 0.35% at December 31, 2021 and 2020)	—	63,281
Total	$ 42,528	$ 165,809

Subordinated Notes

On February 10, 2021, FS Bancorp, Inc. completed the private placement of $50.0 million of its 3.75% fixed-to-floating rate subordinated notes due 2031 (the "Notes") at an offering price equal to 100% of the aggregate principal amount of the Notes, resulting in net proceeds, after placement agent fees and offering expenses, of approximately $49.3 million. The interest rate on the Notes remains fixed equal to 3.75% for the first five years. After five years the interest rate changes to a floating interest rate tied to a benchmark rate, which is expected to be Three-Month Term SOFR, plus a spread of 337 basis points. The Notes will mature on February 15, 2031. On or after February 15, 2026, the Company may redeem the Notes, in whole or in part.

The Notes are unsecured obligations and are subordinated in right of payment to all existing and future indebtedness, deposits and other liabilities of the Company's current and future subsidiaries, including the Bank's deposits as well as the Company's subsidiaries' liabilities to general creditors and liabilities arising during the ordinary course of business. The Notes may be included in Tier 2 capital for the Company under current regulatory guidelines and interpretations.

The maximum and average balances and weighted average interest rates on debt during the years ended December 31, 2021 and 2020 were as follows:

	2021	2020
Maximum balance:		
Federal Home Loan Bank advances and Fed Funds	$ 102,528	$ 159,114
Federal Reserve Bank	$ 22,000	$ 40,000
Fed Funds lines of credit	$ 3,907	$ 865
Subordinated note	$ 50,000	$ 10,000
Paycheck Protection Program Liquidity Facility	$ 63,281	$ 74,112
Average balance:		
Federal Home Loan Bank advances and Fed Funds	$ 55,602	$ 99,773
Federal Reserve Bank	$ 205	$ 1,096
Fed Funds lines of credit	$ 11	$ 3
Subordinated note	$ 44,699	$ 10,000
Paycheck Protection Program Liquidity Facility	$ 7,310	$ 46,965
Weighted average interest rates		
Federal Home Loan Bank advances and Fed Funds	1.88 %	1.80 %
Fed Funds	0.25 %	0.25 %
Fed Funds lines of credit	0.49 %	0.36 %
Subordinated note	3.75 %	6.50 %
Paycheck Protection Program Liquidity Facility	0.35 %	0.35 %

Scheduled maturities of Federal Home Loan Bank advances were as follows:

Years Ending December 31,	Balances	Interest Rates
2022	$ 15,000	0.30 %
2023	13,633	2.03 %
2024	13,895	1.77 %
Total	$ 42,528	

NOTE 10 - EMPLOYEE BENEFITS

Employee Stock Ownership Plan

On January 1, 2012, the Company established an ESOP for eligible employees of the Company and the Bank. Employees of the Company and the Bank are eligible to participate in the ESOP if they have been credited with at least 1,000 hours of service during the employees' first 12-month period and based on the employee's anniversary date will be vested in the ESOP. The employee will be 100% vested in the ESOP after two years of working at least 1,000 hours in each of those two years.

The ESOP borrowed $2.6 million from FS Bancorp, Inc. and used those funds to acquire 518,420 shares of FS Bancorp, Inc. common stock in the open market at an average price of $5.09 per share during the second half of 2012. It is anticipated that the Bank will make contributions to the ESOP in amounts necessary to amortize the ESOP loan payable to FS Bancorp, Inc. over a period of 10 years, bearing interest at 2.30%. Intercompany expenses associated with the ESOP are eliminated in consolidation. Shares purchased by the ESOP with the loan proceeds are held in a suspense account and allocated to ESOP participants on a pro rata basis as principal and interest payments are made by the ESOP to FS Bancorp, Inc. The loan is secured by shares purchased with the loan proceeds and will be repaid by the ESOP with funds from the Bank's discretionary contributions to the ESOP and earnings on the ESOP assets. Payments of principal and interest are due annually on December 31, the Company's fiscal year end. On December 31, 2021, the ESOP paid the tenth annual and final installment of principal in the amount of $288,000, plus accrued interest of $7,000 pursuant to the ESOP loan agreement.

As shares are committed to be released from collateral, the Company reports compensation expense equal to the average daily market prices of the shares at December 31, 2021 for the prior 90 days. These shares become outstanding for earnings per share computations. The compensation expense is accrued monthly throughout the year. Dividends on allocated ESOP shares are recorded as a reduction of retained earnings; dividends on unallocated ESOP shares are recorded as a reduction of debt and accrued interest.

Compensation expense related to the ESOP for the years ended December 31, 2021 and 2020, was $1.8 million, and $1.3 million, respectively.

Shares held by the ESOP at December 31, 2021 and December 31, 2020, were as follows (shown as actual, post stock split):

	Balances at December 31, 2021	Balances at December 31, 2020
Allocated shares	—	427,488
Committed to be released shares	—	—
Unallocated shares	—	51,842
Total ESOP shares	—	479,330
Fair value of unallocated shares (in thousands)	$ —	$ 1,307

401(k) Plan

The Company has a salary deferral 401(k) Plan covering substantially all of its employees. Employees are eligible to participate in the 401(k) plan at the date of hire if they are 18 years of age. Eligible employees may contribute through payroll deductions and are 100% vested at all times in their deferral contributions account. The Company matches 100% for contributions of 1% to 3%, and 50% for contributions of 4% to 5%. There was a $1.7 million and $1.5 million matching contribution for the years ended December 31, 2021 and 2020, respectively.

NOTE 11 - INCOME TAXES

The components of income tax expense for the years ended December 31, 2021 and 2020, were as follows:

	2021	2020
Provision for income taxes		
Current	$ 8,258	$ 12,976
Deferred	1,750	(2,390)
Total provision for income taxes	$ 10,008	$ 10,586

A reconciliation of the effective income tax rate with the federal statutory tax rates at December 31, 2021 and 2020 was as follows:

	2021		2020	
	Amount	Rate	Amount	Rate
Income tax provision at statutory rate	$ 9,958	21.0 %	$ 10,469	21.0 %
Tax exempt income	(492)	(1.0)	(292)	(0.6)
Nondeductible items resulting in increase in tax	28	—	57	0.1
Increase in tax resulting from other items	100	0.2	175	0.4
Equity compensation	(883)	(1.9)	(46)	(0.1)
Executive compensation	979	2.1	8	—
ESOP	318	0.7	215	0.4
Total	$ 10,008	21.1 %	$ 10,586	21.2 %

Total deferred tax assets and liabilities at December 31, 2021 and 2020 were as follows:

Deferred Tax Assets	2021	2020
Net operating loss carryforward	$ 189	$ 527
Allowance for loan losses	5,673	5,775
Other real estate owned	—	126
Non-accrued loan interest	—	6
Restricted stock awards	121	97
Non-qualified stock options	265	251
Interest rate swaps designated as cash flow hedge	—	265
Lease liability	1,030	1,113
Securities available-for-sale	149	—
Accrued compensation	—	430
Other	152	224
Total deferred tax assets	7,579	8,814
Deferred Tax Liabilities		
Loan origination costs	(1,982)	(2,134)
Servicing rights	(3,649)	(2,708)
Stock dividend - FHLB stock	(35)	(55)
Property, plant, and equipment	(1,036)	(1,097)
Purchase accounting adjustments	(863)	(830)
Securities available-for-sale	—	(958)
Lease right-of-use assets	(979)	(1,090)
Interest rate swaps designated as cash flow hedge	(218)	—
Total deferred tax liabilities	(8,762)	(8,872)
Net deferred tax liabilities	$ (1,183)	$ (58)

The Company files a U.S. Federal income tax return and Oregon and Idaho state returns, which are subject to examination by tax authorities for years 2018 and later. At December 31, 2021 and 2020, the Company had no uncertain tax positions. The Company recognizes interest and penalties in tax expense and at December 31, 2021 and 2020, the Company recognized no interest and penalties.

In response to the COVID-19 pandemic, the CARES Act, among other things, permits net operating loss ("NOL") carryforwards and carrybacks to offset 100% of taxable income for taxable years beginning before 2020. In addition, the CARES Act allows NOLs incurred in 2018, 2019, and 2020 to be carried back to each of the five preceding taxable years to generate a refund of previously paid income taxes, and it provides options for accelerating refunds associated with previously paid alternative minimum taxes. The Company benefited from the alternative minimum tax refund provisions of the CARES Act and submitted accelerated refund claims during the year ended December 31, 2020. At December 31, 2021, the Company had a remaining NOL of approximately $880,000, which begins to expire in 2035.

On December 27, 2020, the CAA was signed into law and extends several provisions of the CARES Act. As of December 31, 2020 and 2021, the Company has determined that neither this act nor changes to income tax laws or regulations in other jurisdictions have a significant impact on its effective tax rate.

NOTE 12 - COMMITMENTS AND CONTINGENCIES

Commitments - The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized on the Consolidated Balance Sheets.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

The following table provides a summary of the Company's commitments at December 31, 2021 and 2020:

COMMITMENTS TO EXTEND CREDIT **REAL ESTATE LOANS**	December 31, 2021	December 31, 2020
Commercial	$ 787	$ 1,293
Construction and development	182,297	143,666
One-to-four-family (includes locks for saleable loans)	78,264	147,712
Home equity	67,596	52,457
Multi-family	3,434	658
Total real estate loans	332,378	345,786
CONSUMER LOANS	35,873	23,365
COMMERCIAL BUSINESS LOANS		
Commercial and industrial	126,220	106,171
Warehouse lending	64,160	52,909
Total commercial business loans	190,380	159,080
Total commitments to extend credit	$ 558,631	$ 528,231

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the amount of the total commitments does not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the party. Collateral held varies, but may include accounts receivable, inventory, property and equipment, residential real estate, and income-producing commercial properties.

Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are uncollateralized and usually do not contain a specified maturity date and ultimately may not be drawn upon to the total extent to which the Company is committed. The Company has established reserves for estimated losses from unfunded commitments of $499,000 and $407,000 at December 31, 2021 and 2020, respectively. One-to-four-family commitments included in the table above are accounted for as fair value derivatives and do not carry an associated holdback. The Company's derivative positions are presented with discussion in "Note 17 - Derivatives."

The Company also sells one-to-four-family loans to the FHLB of Des Moines that require a limited level of recourse if the loans default and exceed a certain loss exposure. Specific to that recourse, the FHLB of Des Moines established a first loss account ("FLA") related to the loans and required a credit enhancement ("CE") obligation by the Bank to be utilized after the FLA is used. Based on loans sold through December 31, 2021, the total loans sold to the FHLB were $13.1 million with the FLA being $938,000 and the CE obligation at $811,000 or 6.2% of the loans outstanding. Management has established a holdback of 10% of the outstanding CE obligation, or $81,000, which is a part of the off-balance sheet holdback for loans sold. At December 31, 2021, there were no loans sold to the FHLB of Des Moines greater than 30 days past their contractual payment due date, compared to $498,000 at December 31, 2020.

Contingent liabilities for loans held for sale - In the ordinary course of business, loans are sold with limited recourse against the Company and may have to subsequently be repurchased due to defects that occurred during the origination of the loan. The defects are categorized as documentation errors, underwriting errors, early payoff, early payment defaults, breach of representation or warranty, servicing errors, and/or fraud. When a loan sold to an investor without recourse fails to perform according to its contractual terms, the investor will typically review the loan file to determine whether defects in the origination process occurred. If a defect is identified, the Company may be required to either repurchase the loan or indemnify the investor for losses sustained. If there are no such defects, the Company has no commitment to repurchase the loan. The Company has recorded a holdback reserve of $2.7 million and $2.0 million to cover loss exposure related to these guarantees for one-to-four-family loans sold into the secondary market at December 31, 2021 and 2020, respectively, which is included in other liabilities in the Consolidated Balance Sheets.

The Company has entered into a severance agreement with its Chief Executive Officer ("CEO"). The severance agreement, subject to certain requirements, generally includes a lump sum payment to the CEO equal to 24 months of base compensation in the event their employment is involuntarily terminated, other than for cause or the executive terminates his employment with good reason, as defined in the severance agreement.

The Company has entered into change of control agreements with its Chief Financial Officer, Chief Operating Officer, Chief Lending Officer, Chief Credit Officer, Chief Risk Officer, Chief Human Resources Officer, Senior Vice President Compliance Officer, Executive Vice President of Retail Banking and Marketing, and the Executive Vice President of Home Lending. The change of control agreements, subject to certain requirements, generally remain in effect until canceled by either party upon at least 24 months prior written notice. Under the change of control agreements, the executive generally will be entitled to a change of control payment from the Company if the executive is involuntarily terminated within six months preceding or 12 months after a change in control (as defined in the change of control agreements). In such an event, the executives would each be entitled to receive a cash payment in an amount equal to 12 months of their then current salary, subject to certain requirements in the change of control agreements.

As a result of the nature of our activities, the Company is subject to various pending and threatened legal actions, which arise in the ordinary course of business. From time to time, subordination liens may create litigation which requires us to defend our lien rights. In the opinion of management, liabilities arising from these claims, if any, will not have a material effect on our financial position. The Company had no material pending legal actions at December 31, 2021.

NOTE 13 - SIGNIFICANT CONCENTRATION OF CREDIT RISK

Most of the Company's commercial and multi-family real estate, construction, residential, and/or commercial business lending activities are with customers located in Western Washington and near the one loan production office located in the Tri-Cities, Washington. The Company originates real estate, consumer, and commercial business loans and has concentrations in these areas, however, indirect home improvement loans, including solar-related home improvement loans are originated through a network of home improvement contractors and dealers located throughout Washington, Oregon, California, Idaho, Colorado, Arizona, Minnesota, and Nevada. Loans are generally secured by collateral and rights to collateral vary and are legally documented to the extent practicable. Local economic conditions may affect borrowers' ability to meet the stated repayment terms. The concentration on commercial real estate remains below the 300% of Risk Based Capital regulatory threshold and the subset of construction concentration, excluding owner-occupied loans is within Board approved limits. The construction, land development, and other land concentration represents less than 100% of the

Bank's total regulatory capital at 81.8% and is focused on in city, in fill vertical construction financing in King and Snohomish counties. Local economic conditions may affect borrowers' ability to meet the stated repayment terms.

NOTE 14 - REGULATORY CAPITAL

The Bank is subject to various regulatory capital requirements administered by the Federal Reserve and the FDIC. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines of the regulatory framework for prompt corrective action, the Bank must meet specific capital adequacy guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital classification is also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The federal banking agencies jointly issued a final rule that provides for an optional, simplified measure of capital adequacy, the community bank leverage ratio framework, for qualifying community banking organizations, consistent with Section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act. This final rule is applicable to all non-advanced approaches FDIC-supervised institutions with less than $10 billion in total consolidated assets. The community bank leverage ratio ("CBLR") final rule was effective on January 1, 2020, and allows qualifying community banking organizations to calculate a leverage ratio to measure capital adequacy. Banks opting into the CBLR framework are not required to calculate or report risk-based capital. A qualifying community banking organization is defined as having less than $10 billion in total consolidated assets, a leverage ratio greater than 9%, off-balance sheet exposures of 25% or less of total consolidated assets, and trading assets and liabilities of 5% or less of total consolidated assets. The final rule adopted Tier 1 capital and the existing leverage ratio into the community bank leverage ratio framework. A bank electing the framework is not subject to other capital and leverage requirements. Under the CBLR framework, a bank will generally be considered well-capitalized and to have met the risk-based and leverage capital requirements of the capital regulations if it has a leverage ratio greater than 9.0%. As required by the CARES Act, the FDIC temporarily lowered the CBLR to 8% beginning in the second quarter of 2020 through the end of that year. Beginning in 2021, the CBLR was increased to 8.5% for that calendar year. The CBLR returned to 9% on January 1, 2022. A bank electing the framework that ceases to meet any qualifying criteria in a future period and that has a leverage ratio greater than 8% will be allowed a grace period of two reporting periods to satisfy the CBLR qualifying criteria or comply with the generally applicable capital requirements. A bank may opt out of the framework at any time, without restriction, by reverting to the generally applicable risk-based capital rule.

The Bank qualified for and elected the CBLR framework as of March 31, 2020. The CBLR calculated for the Bank at December 31, 2021 was 12.2%, compared to 10.9% at December 31, 2020. At December 31, 2021, the Bank had Tier 1 capital of $270.8 million and a minimum Tier 1 capital requirement of $189.3 million to be considered well capitalized under the CBLR framework. At December 31, 2020, the Bank had Tier 1 capital of $215.9 million and a minimum Tier 1 capital requirement of $159.1 million to be considered well capitalized for the CBLR framework. At both December 31, 2021 and December 31, 2020, the Bank was categorized as well capitalized under applicable regulatory requirements. There are no conditions or events since that notification that management believes have changed the Bank's category. Management believes, at December 31, 2021, that the Bank met all capital adequacy requirements.

FS Bancorp, Inc. is a bank holding company registered with the Federal Reserve. Bank holding companies are subject to capital adequacy requirements of the Federal Reserve under the Bank Holding Company Act of 1956, as amended, and the regulations of the Federal Reserve. Bank holding companies with less than $3.0 billion in assets are generally not subject to compliance with the Federal Reserve's capital regulations, which are generally the same as the capital regulations applicable to the Bank. The Federal Reserve has a policy that a bank holding company is required to serve as a source of financial and managerial strength to the holding company's subsidiary bank and expects the holding company's subsidiary bank to be well capitalized under the prompt corrective action regulations. If FS Bancorp, Inc. was subject to regulatory guidelines for bank holding companies with $3.0 billion or more in assets at December 31, 2021, FS Bancorp, Inc. would have exceeded all regulatory capital requirements. The Tier 1 leverage-based capital ratio calculated for FS Bancorp, Inc. at December 31, 2021 was 10.8%, compared to 11.1% at December 31, 2020.

NOTE 15 - FAIR VALUE MEASUREMENTS

The Company determines fair value based on the requirements established in Accounting Standards Codification ("ASC") Topic 820, *Fair Value Measurements,* which provides a framework for measuring fair value in accordance with U.S. GAAP and requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. ASC 820 defines fair value as the exit price, or the price that would be received for an asset or paid to transfer a liability, in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date under current market conditions. ASU 2016-01, *Financial Instruments - Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Financial Liabilities,* requires us to use the exit price notion when measuring the fair value of instruments for disclosure purposes.

The following definitions describe the levels of inputs that may be used to measure fair value:

Level 1 - Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 - Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The following methods were used to estimate the fair value of certain assets and liabilities on a recurring and nonrecurring basis.

Securities - The fair value of securities available-for-sale and held-to-maturity are recorded on a recurring basis. The fair value of investments and mortgage-backed securities are provided by a third-party pricing service. These valuations are based on market data using pricing models that vary by asset class and incorporate available current trade, bid and other market information, and for structured securities, cash flow, and loan performance data. The pricing processes utilize benchmark curves, benchmarking of similar securities, sector groupings, and matrix pricing. Option adjusted spread models are also used to assess the impact of changes in interest rates and to develop prepayment scenarios (Level 2). Certain other corporate securities and municipal bonds are generally measured at fair value based on discounted cash flow models (Level 3). Transfers between the fair value hierarchy are determined through the third-party service provider which, from time to time will transfer between levels based on market conditions per the related security. All models and processes used take into account market convention.

Mortgage Loans Held for Sale - The fair value of loans held for sale reflects the value of commitments with investors and/or the relative price as delivered into a To-Be-Announced ("TBA") mortgage-backed security (Level 2).

Derivative Instruments - Fair values for derivative assets and liabilities are measured on a recurring basis. The primary use of a derivative instrument is related to the mortgage banking activities of the Company. The fair value of the interest rate lock commitments and forward sales commitments are estimated using quoted or published market prices for similar instruments, adjusted for factors such as pull-through rate assumptions based on historical information, where appropriate. TBA mortgage-backed securities are fair valued on similar contracts in active markets (Level 2) while locks and forwards with customers and investors are fair valued using similar contracts in the market and changes in the market interest rates (Level 2 and 3). Derivative instruments not related to mortgage banking activities include interest rate swap agreements. The fair values of interest rate swap agreements are based on valuation models using observable market data as of the measurement date (Level 2). The Company's derivatives are traded in an over-the-counter market where quoted market prices are not always available. Therefore, the fair values of derivatives are determined using quantitative models that utilize multiple market inputs. The inputs will vary based on the type of derivative, but could include interest rates, prices and indices to generate continuous yield or pricing curves, prepayment rates, and volatility factors to value the position. The majority of market inputs are actively quoted and can be validated through external sources, including market transactions and third-party pricing services. The fair values of all interest rate swaps are determined from third-party pricing services without adjustment.

Impaired Loans - Fair value adjustments to impaired collateral dependent loans are recorded to reflect partial write-downs based on the current appraised value of the collateral or internally developed models, which contain management's assumptions. Management will utilize discounted cashflow impairment for TDRs when the change in terms results in a discount to the overall cashflows to be received (Level 3).

Other Real Estate Owned - Fair value adjustments to OREO are recorded at the lower of carrying amount of the loan or fair value of the collateral less selling costs. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, management periodically performs valuations such that the real estate is carried at the lower of its new cost basis or fair value, net of estimated costs to sell (Level 3).

Servicing Rights - The fair value of mortgage servicing rights is estimated using net present value of expected cash flows using a third-party model that incorporates assumptions used in the industry to value such rights, adjusted for factors such as weighted average prepayments speeds based on historical information where appropriate (Level 3).

The following table presents securities available-for-sale, mortgage loans held for sale, and derivative assets and liabilities measured at fair value on a recurring basis at the dates indicated:

Financial Assets	At December 31, 2021			
Securities available-for-sale:	Level 1	Level 2	Level 3	Total
U.S. agency securities	$ —	$ 20,970	$ —	$ 20,970
Corporate securities	—	7,995	1,007	9,002
Municipal bonds	—	135,302	131	135,433
Mortgage-backed securities	—	89,402	—	89,402
U.S. Small Business Administration securities	—	16,552	—	16,552
Mortgage loans held for sale, at fair value	—	125,810	—	125,810
Derivatives:				
Mandatory and best effort forward commitments with investors	—	—	808	808
Forward TBA mortgage-backed securities	—	53	—	53
Interest rate swaps	—	1,168	—	1,168
Interest rate lock commitments with customers	—	—	757	757
Total assets measured at fair value	$ —	$ 397,252	$ 2,703	$ 399,955
Financial Liabilities				
Derivatives:				
Interest rate swaps	—	(155)	—	(155)
Total liabilities measured at fair value	$ —	$ (155)	$ —	$ (155)

Financial Assets	At December 31, 2020			
Securities available-for-sale:	Level 1	Level 2	Level 3	Total
U.S. agency securities	$ —	$ 8,105	$ —	$ 8,105
Corporate securities	—	10,016	984	11,000
Municipal bonds	—	71,730	127	71,857
Mortgage-backed securities	—	68,187	—	68,187
U.S. Small Business Administration securities	—	18,869	—	18,869
Mortgage loans held for sale, at fair value	—	166,448	—	166,448
Derivatives:				
Interest rate swaps	—	21	—	21
Interest rate lock commitments with customers	—	—	4,024	4,024
Total assets measured at fair value	$ —	$ 343,376	$ 5,135	$ 348,511
Financial Liabilities				
Derivatives:				
Mandatory and best effort forward commitments with investors	$ —	$ —	$ (67)	$ (67)
Forward TBA mortgage-backed securities	—	(1,602)	—	(1,602)
Interest rate swaps	—	(1,252)	—	(1,252)
Total liabilities measured at fair value	$ —	$ (2,854)	$ (67)	$ (2,921)

The following table presents impaired loans, OREO, and servicing rights measured at fair value on a nonrecurring basis for which a nonrecurring change in fair value has been recorded during the reporting periods indicated. The amounts disclosed below represent the fair values at the time the nonrecurring fair value measurements were evaluated.

	December 31, 2021			
	Level 1	Level 2	Level 3	Total
Impaired loans	$ —	$ —	$ 5,823	$ 5,823
Servicing rights	—	—	26,070	26,070

	December 31, 2020			
	Level 1	Level 2	Level 3	Total
Impaired loans	$ —	$ —	$ 7,761	$ 7,761
OREO	—	—	90	90
Servicing rights	—	—	12,833	12,833

Quantitative Information about Level 3 Fair Value Measurements - Shown in the table below is the fair value of financial instruments measured under a Level 3 unobservable input on a recurring and nonrecurring basis at December 31, 2021 and 2020:

Level 3 Fair Value Instruments	Valuation Techniques	Significant Unobservable Inputs	Range	Weighted Average December 31, 2021	Weighted Average December 31, 2020
RECURRING					
Interest rate lock commitments with customers	Quoted market prices	Pull-through expectations	80% - 99%	93.3 %	91.6 %
Individual forward sale commitments with investors	Quoted market prices	Pull-through expectations	80% - 99%	93.3 %	91.6 %
Corporate securities	Discounted cash flows	Discount rate	2.2% - 2.5%	2.2 %	2.5 %
Municipal bonds	Discounted cash flows	Discount rate	6.0% - 6.4%	6.0 %	6.4 %
NONRECURRING					
Impaired loans	Fair value of underlying collateral	Discount applied to the obtained appraisal	10.0%	10.0 %	10.0 %
OREO	Fair value of collateral	Discount applied to the obtained appraisal	10.0%	N/A	10.0 %
Servicing rights	Industry sources	Pre-payment speeds	0% - 50%	13.8 %	32.6 %

An increase in the pull-through rate utilized in the fair value measurement of the interest rate lock commitments with customers and forward sale commitments with investors will result in positive fair value adjustments (and an increase in the fair value measurement). Conversely, a decrease in the pull-through rate will result in a negative fair value adjustment (and a decrease in the fair value measurement).

The following table provides a reconciliation of assets and liabilities measured at fair value using significant unobservable inputs (Level 3) on a recurring basis during the years ended December 31, 2021 and 2020.

2021	Beginning Balance	Purchases and Issuances	Sales and Settlements	Ending Balance	Net change in fair value for gains/(losses) (1)	Net change in fair value for gains/(losses) (2)
Interest rate lock commitments with customers	$ 4,024	$ 23,164	$ (26,431)	$ 757	$ (3,267)	$ —
Individual forward sale commitments with investors	(67)	2,526	(1,651)	808	875	—
Securities available-for-sale, at fair value	1,111	40	(13)	1,138	—	27
2020						
Interest rate lock commitments with customers	$ 557	$ 53,281	$ (49,814)	$ 4,024	$ 3,467	$ —
Individual forward sale commitments with investors	(195)	(4,857)	4,985	(67)	128	—
Securities available-for-sale, at fair value	1,162	—	(51)	1,111	—	(40)

(1) Relating to items held at end of period included in income.
(2) Relating to items held at end of period included in other comprehensive income.

Gains (losses) on interest rate lock commitments carried at fair value are recorded in other noninterest income. Gains (losses) on forward sale commitments with investors carried at fair value are recorded in noninterest income. Unrealized gains (losses) on securities available-for-sale, at fair value are recorded in accumulated other comprehensive income.

The following table provides estimated fair values of the Company's financial instruments at December 31, 2021 and 2020, whether or not recognized at fair value on the Consolidated Balance Sheets:

	December 31, 2021		December 31, 2020	
Financial Assets	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Level 1 inputs:				
Cash and cash equivalents	$ 26,491	$ 26,491	$ 91,576	$ 91,576
Certificates of deposit at other financial institutions	10,542	10,542	12,278	12,278
Level 2 inputs:				
Securities available-for-sale, at fair value	270,221	270,221	176,907	176,907
Securities held-to-maturity	7,500	8,128	7,500	7,556
Loans held for sale, at fair value	125,810	125,810	166,448	166,448
FHLB stock, at cost	4,778	4,778	7,439	7,439
Forward TBA mortgage-backed securities	53	53	—	—
Interest rate swaps	1,168	1,168	21	21
Accrued interest receivable	7,594	7,594	7,030	7,030
Level 3 inputs:				
Securities available-for-sale, at fair value	1,138	1,138	1,111	1,111
Loans receivable, gross	1,759,026	1,746,585	1,574,227	1,580,360
Servicing rights, held at lower of cost or fair value	16,970	26,070	12,595	12,833
Fair value interest rate locks with customers	757	757	4,024	4,024
Mandatory and best effort forward commitments with investors	808	808	—	—
Financial Liabilities				
Level 2 inputs:				
Deposits	1,915,744	1,912,498	1,674,071	1,674,328
Borrowings	42,528	43,365	165,809	167,680
Subordinated notes, excluding unamortized debt issuance costs	50,000	51,688	10,000	11,083
Accrued interest payable	766	766	406	406
Interest rate swaps	155	155	1,252	1,252
Forward TBA mortgage-backed securities	—	—	1,602	1,602
Level 3 inputs:				
Mandatory and best effort forward commitments with investors	—	—	67	67

NOTE 16 - EARNINGS PER SHARE

The Company computes earnings per share using the two-class method, which is an earnings allocation method for computing earnings per share that treats a participating security as having rights to earnings that would otherwise have been available to common shareholders. Basic earnings per share are computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Unvested share-based awards containing non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are included in the computation of earnings per share pursuant to the two-class method. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. For earnings per share calculations, the ESOP shares committed to be released are included as outstanding shares for both basic and diluted earnings per share.

The following table presents a reconciliation of the components used to compute basic and diluted earnings per share for the years ended December 31, 2021 and 2020:

	At or For the Year Ended December 31,	
Numerator (in thousands):	2021	2020
Net income	$ 37,412	$ 39,264
Dividends and undistributed earnings allocated to participating securities	(613)	(192)
Net income available to common shareholders	$ 36,799	$ 39,072
Denominator (shown as actual):		
Basic weighted average common shares outstanding	8,326,165	8,546,700
Dilutive shares	200,580	162,038
Diluted weighted average common shares outstanding	8,526,745	8,708,738
Basic earnings per share	$ 4.42	$ 4.57
Diluted earnings per share	$ 4.32	$ 4.49
Potentially dilutive weighted average share options that were not included in the computation of diluted earnings per share because to do so would be anti-dilutive	16,466	133,238

Share and per share data has been adjusted for all periods to reflect the two-for-one stock split effective July 14, 2021.

NOTE 17 - DERIVATIVES

The Bank regularly enters into commitments to originate and sell loans held for sale. The Bank has established a hedging strategy to protect itself against the risk of loss associated with interest rate movements on loan commitments. The Bank enters into contracts to sell forward TBA mortgage-backed securities. These commitments and contracts are considered derivatives but have not been designated as hedging instruments for reporting purposes under U.S. GAAP. Rather, they are accounted for as free-standing derivatives, or economic hedges, with changes in the fair value of the derivatives reported in noninterest income or noninterest expense. The Bank recognizes all derivative instruments as either other assets or other liabilities on the Consolidated Balance Sheets and measures those instruments at fair value.

Derivative instruments not related to mortgage banking activities primarily relate to interest rate swap agreements. The Bank's objectives in using certain interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Bank uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for the Bank making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

The Bank has entered into interest rate swaps to reduce the exposure to variability in interest-related cash outflows attributable to changes in forecasted LIBOR-based borrowings and brokered deposits. These derivative instruments are designated as cash flow hedges. The hedged item is the LIBOR portion of the series of future adjustable-rate borrowings and deposits over the term of the interest rate swap. Accordingly, changes to the amount of interest payment cash flows for the hedged transactions attributable to a change in credit risk are excluded from management's assessment of hedge effectiveness. The Bank tests for hedging effectiveness on a quarterly basis. The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The Bank has not recorded any hedge ineffectiveness since inception. The Company has master netting agreements with derivative dealers with which it does business, but reflects gross assets and liabilities as other assets and other liabilities, respectively, on the Consolidated Balance Sheets.

The Bank reclassified realized losses of $538,000 and $198,000 from accumulated other comprehensive income to interest expense related to these cash flow hedges for the year ended December 31, 2021 and 2020, respectively. The Bank expects that approximately $242,000 will be reclassified from accumulated other comprehensive income as a net increase to interest expense over the next twelve months related to these cash flow hedges.

The following tables summarize the Company's derivative instruments at the dates indicated:

	December 31, 2021		
		Fair Value	
Cash flow hedges:	Notional	Asset	Liability
Interest rate swaps	$ 90,000	$ 1,168	$ 155
Non-hedging derivatives:			
Fallout adjusted interest rate lock commitments with customers	71,890	757	—
Mandatory and best effort forward commitments with investors	74,375	808	—
Forward TBA mortgage-backed securities	111,000	53	—

	December 31, 2020		
		Fair Value	
Cash flow hedges:	Notional	Asset	Liability
Interest rate swaps	$ 90,000	$ 21	$ 1,252
Non-hedging derivatives:			
Fallout adjusted interest rate lock commitments with customers	136,739	4,024	—
Mandatory and best effort forward commitments with investors	25,027	—	67
Forward TBA mortgage-backed securities	232,000	—	1,602

At December 31, 2021 and 2020, the Bank had $111.0 million and $232.0 million of TBA trades with counterparties that held margin collateral of $305,000 and $3.3 million, respectively. At December 31, 2021, the Bank had pledged two securities with a carrying value of $3.3 million to secure interest rate swaps designated as cash flow hedges.

Changes in the fair value of the non-hedging derivatives recognized in noninterest income on the Consolidated Statements of Income and included in gain on sale of loans resulted in a net loss of $5.1 million and net gain of $6.3 million for the years ended December 31, 2021 and 2020, respectively.

NOTE 18 - ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following were changes in accumulated other comprehensive income (loss) by component, net of tax, for the years ended December 31, 2021 and 2020:

Year Ended December 31, 2021	Gains and (Losses) on Cash Flow Hedges	Unrealized Gains and (Losses) on Available for Sale Securities	Total
Beginning balance	$ (967)	$ 3,500	$ 2,533
Other comprehensive income (loss) before reclassification, net of tax	1,339	(4,042)	(2,703)
Amounts reclassified from accumulated other comprehensive income, net of tax	422	—	422
Net current period other comprehensive income (loss)	1,761	(4,042)	(2,281)
Ending balance	$ 794	$ (542)	$ 252

Year Ended December 31, 2020	Gains and (Losses) on Cash Flow Hedges	Unrealized Gains and (Losses) on Available for Sale Securities	Total
Beginning balance	$ —	$ 788	$ 788
Other comprehensive (loss) income before reclassification, net of tax	(1,122)	2,947	1,825
Amounts reclassified from accumulated other comprehensive income (loss), net of tax	155	(235)	(80)
Net current period other comprehensive (loss) income	(967)	2,712	1,745
Ending balance	$ (967)	$ 3,500	$ 2,533

NOTE 19 - STOCK-BASED COMPENSATION

Stock Options and Restricted Stock

On May 17, 2018, the shareholders of FS Bancorp, Inc. approved the 2018 Equity Incentive Plan (the "2018 Plan") that authorizes 1.3 million shares of the Company's common stock to be awarded. The 2018 Plan provides for the grant of incentive stock options, non-qualified stock options, and up to 326,000 restricted stock awards ("RSAs") to directors, emeritus directors, officers, employees or advisory directors of the Company. At December 31, 2021, there were 441,296 stock option awards and 144,460 RSAs available to be granted under the 2018 Plan. Share and per share data has been adjusted for all periods to reflect the two-for-one stock split effective July 14, 2021.

In September 2013, the shareholders of FS Bancorp, Inc. approved the FS Bancorp, Inc. 2013 Equity Incentive Plan (the "2013 Plan"). The Plan provides for the grant of stock options and RSAs. The 2013 Plan authorizes the grant of stock options totaling 648,026 shares of common stock to Company directors and employees of which 644,000 stock options were granted with an exercise price equal to the market price of FS Bancorp's common stock at the grant date of May 8, 2014, of $8.45 per share. The 2013 Plan authorized the grant of RSAs totaling 259,210 shares to Company directors, advisory directors, emeritus directors, officers, and employees, all of which have been granted. All options and RSAs previously granted have vested at December 31, 2021. At December 31, 2021, there were no stock options available to be granted under the 2013 Plan. Share and per share data has been adjusted for all periods to reflect the two-for-one stock split effective July 14, 2021.

Total share-based compensation expense was $1.4 million for the year ended December 31, 2021, and $1.0 million for the year ended December 31, 2020. The related income tax benefit was $304,000 and $214,000 for the years ended December 31, 2021 and 2020, respectively.

Stock Options

The 2018 plan consists of stock option awards that may be granted as incentive stock options or non-qualified stock options. Stock option awards generally vest at one year for independent directors or over a five-year period for employees and officers with 20% vesting on the anniversary date of each grant date as long as the award recipient remains in service to the Company. The options are exercisable after vesting for up to the remaining term of the original grant. The maximum term of the options granted is 10 years. Any unexercised stock options will expire 10 years after the grant date or sooner in the event of the award recipient's termination of service with the Company or the Bank. The fair value of each stock option award is estimated on the grant date using a Black-Scholes Option pricing model that uses the following assumptions. The dividend yield is based on the current quarterly dividend in effect at the time of the grant. Historical employment data is used to estimate the forfeiture rate. The Company elected to use Staff Accounting Bulletin 107, simplified expected term calculation for the "Share-Based Payments" method permitted by the SEC to calculate the expected term. This method uses the vesting term of an option along with the contractual term, setting the expected life at 5.5 years for one-year vesting, 6.0 years for three-year vesting, and 6.5 years for five-year vesting.

The fair value of options granted was determined using the following weighted-average assumptions as of the grant date for the years ended December 31, 2021 and 2020.

	Year Ended December 31, 2021	Year Ended December 31, 2020
Dividend yield	1.58%	1.97%
Expected volatility	37.10%	26.79%
Risk-free interest rate	1.01%	0.42%
Expected term in years	6.5	6.5
Weighted-average grant date fair value per option granted	$ 10.67	$ 8.00

The following table presents a summary of the Company's stock option plan awards during the year ended December 31, 2021 (shown as actual):

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term In Years	Aggregate Intrinsic Value
Outstanding at January 1, 2021	671,754	$ 19.45	6.58	$ 5,721,159
Granted	118,850	35.46	6.41	—
Less exercised	176,978	$ 12.73	—	$ 4,265,369
Forfeited or expired	—	—	—	—
Outstanding at December 31, 2021	613,626	$ 25.24	7.17	$ 5,362,902
Expected to vest, assuming a 0.31% annual forfeiture rate (1)	611,614	$ 25.23	7.17	$ 5,351,462
Exercisable at December 31, 2021	261,822	$ 20.98	5.60	$ 3,313,103

Share and per share data has been adjusted for all periods to reflect a two-for-one stock split effective July 14, 2021.

(1) Forfeiture rate has been calculated and estimated to assume a forfeiture of 3.1% of the options forfeited over 10 years.

At December 31, 2021, there was $2.1 million of total unrecognized compensation cost related to nonvested stock options granted under the 2018 plan. The cost is expected to be recognized over the remaining weighted-average vesting period of 3.5 years.

Restricted Stock Awards

The RSAs fair value is equal to the value of the market price of FS Bancorp's common stock on the grant date and compensation expense is recognized over the vesting period of the awards based on the fair value of the restricted stock. Shares for the 2018 Plan generally vest at one or three years for independent directors or over a five-year period for employees and officers beginning on the grant date. Any unvested RSAs will expire after vesting or sooner in the event of the award recipient's termination of service with the Company or the Bank.

The following table presents a summary of the Company's nonvested awards during the year ended December 31, 2021 (shown as actual):

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value Per Share	
Nonvested at January 1, 2021	110,184	$	24.35
Granted	41,350		35.46
Less vested	29,862		24.78
Forfeited or expired	—		—
Nonvested at December 31, 2021	121,672	$	28.02

Share and per share data has been adjusted to reflect the two-for-one stock split effective July 14, 2021.

At December 31, 2021, there was $3.0 million of total unrecognized compensation costs related to nonvested shares granted under the 2018 plan as RSAs. The cost is expected to be recognized over the remaining weighted-average vesting period of 3.5 years.

NOTE 20 - BUSINESS SEGMENTS

The Company's business segments are determined based on the products and services provided, as well as the nature of the related business activities, and they reflect the manner in which financial information is currently evaluated by management. This process is dynamic and is based on management's current view of the Company's operations and is not necessarily comparable with similar information for other financial institutions. The Company defines its business segments by product type and customer segment which it has organized into two lines of business: commercial and consumer banking and home lending.

The Company uses various management accounting methodologies to assign certain income statement items to the responsible operating segment, including:

- a funds transfer pricing ("FTP") system, which allocates interest income credits and funding charges between the segments, assigning to each segment a funding credit for its liabilities, such as deposits, and a charge to fund its assets;

- a cost per loan serviced allocation based on the number of loans being serviced on the balance sheet and the number of loans serviced for third parties;

- an allocation based upon the approximate square footage utilized by the home lending segment in Company owned locations;

- an allocation of charges for services rendered to the segments by centralized functions, such as corporate overhead, which are generally based on the number of full-time employees ("FTEs") in each segment; and

- an allocation of the Company's consolidated income taxes which are based on the effective tax rate applied to the segment's pretax income or loss.

The FTP methodology is based on management's estimated cost of originating funds including the cost of overhead for deposit generation.

A description of the Company's business segments and the products and services that they provide is as follows:

Commercial and Consumer Banking Segment

The commercial and consumer banking segment provides diversified financial products and services to our commercial and consumer customers through Bank branches, automated teller machines ("ATM"), online banking platforms, mobile banking apps, and telephone banking. These products and services include deposit products; residential, consumer, business and commercial real estate lending portfolios and cash management services. The Company originates consumer loans, commercial and multi-family real estate loans, construction loans for residential and multi-family construction, and commercial business loans. At December 31, 2021, the Company's retail deposit branch network consisted of 21 branches in the Pacific Northwest. This segment is also responsible for the management of the investment portfolio and other assets of the Bank.

Home Lending Segment

The home lending segment originates one-to-four-family residential mortgage loans primarily for sale in the secondary markets as well as loans held for investment. The majority of mortgage loans are sold to or securitized by FNMA, FHLMC, GNMA or the FHLB of Des Moines, while the Company generally retains the right to service these loans. Loans originated under the guidelines of the Federal Housing Administration or FHA, US Department of Veterans Affairs or VA, and United States Department of Agriculture or USDA are generally sold servicing released to a correspondent bank or mortgage company. The Company has the option to sell loans on a servicing-released or servicing-retained basis to securitizers and correspondent lenders. A small percentage of its loans are brokered to other lenders. On occasion, the Company may sell a portion of its MSR portfolio and may sell small pools of loans initially originated to be held in the loan portfolio. The Company manages the loan funding and the interest rate risk associated with the secondary market loan sales and the retained one-to-four-family mortgage servicing rights within this business segment. One-to-four-family loans originated for investment and held in this segment are allocated to the home lending segment with a corresponding provision expense and FTP for cost of funds.

Segment Financial Results

The tables below summarize the financial results for each segment based on the factors mentioned above within each segment for the years ended December 31, 2021 and 2020:

	At or For the Year Ended December 31, 2021		
Condensed income statement:	Home Lending	Commercial and Consumer Banking	Total
Net interest income [(1)]	$ 8,343	$ 78,306	$ 86,649
Provision for loan losses [(2)]	2,113	(2,613)	(500)
Noninterest income	28,968	8,545	37,513
Noninterest expense	(19,685)	(56,557)	(76,242)
Income before provision for income taxes	19,739	27,681	47,420
Provision for income taxes	(4,166)	(5,842)	(10,008)
Net income	$ 15,573	$ 21,839	$ 37,412
Total average assets for period ended	$ 409,363	$ 1,779,850	$ 2,189,213
FTEs	152	384	536

	At or For the Year Ended December 31, 2020		
Condensed income statement:	Home Lending	Commercial and Consumer Banking	Total
Net interest income (1)	$ 5,123	$ 68,997	$ 74,120
Provision for loan losses (2)	(2,758)	(10,278)	(13,036)
Noninterest income	44,808	10,551	55,359
Noninterest expense	(17,351)	(49,242)	(66,593)
Income before provision for income taxes	29,822	20,028	49,850
Provision for income taxes	(6,333)	(4,253)	(10,586)
Net income	$ 23,489	$ 15,775	$ 39,264
Total assets	$ 460,409	$ 1,652,832	$ 2,113,241
Total average assets for period ended	$ 396,367	$ 1,543,681	$ 1,940,048
FTEs	152	354	506

(1) Net interest income is the difference between interest earned on assets and the cost of liabilities to fund those assets. Interest earned includes actual interest earned on segment assets and, if the segment has excess liabilities, interest credits for providing funding to the other segment. The cost of liabilities includes interest expense on segment liabilities and, if the segment does not have enough liabilities to fund its assets, a funding charge based on the cost of assigned liabilities to fund segment assets.

(2) Provision for loan losses includes shifts in allocation between segments due to various changes, to include adjustments to qualitative factors, changes in loan balances, and charge-off and recovery activity.

NOTE 21 - REVENUE FROM CONTRACTS WITH CUSTOMERS

Revenue Recognition

In accordance with Topic 606, revenues are recognized when control of promised goods or services is transferred to customers in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the Company performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the Company satisfies a performance obligation. The Company only applies the five-step model to contracts when it is probable that the entity will collect the consideration it is entitled to in exchange for the goods or services it transfers to the customer. At contract inception, once the contract is determined to be within the scope of Topic 606, the Company assesses the goods or services that are promised within each contract and identifies those that contain performance obligations, and assesses whether each promised good or service is distinct. The Company then recognizes as revenue the amount of the transaction price that is allocated to the respective performance obligation when (or as) the performance obligation is satisfied.

All of the Company's revenue from contracts with customers in-scope of ASC 606 is recognized in noninterest income and included in our commercial and consumer banking segment. The following table presents noninterest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the years ended December 31, 2021 and 2020:

(Dollars in thousands):	At or For the Year Ended December 31,	
Noninterest income	2021	2020
In-scope of Topic 606:		
Debit card interchange fees	$ 2,252	$ 1,879
Deposit service and account maintenance fees	757	786
Noninterest income (in-scope of Topic 606)	3,009	2,665
Noninterest income (out-of-scope of Topic 606)	34,504	52,694
Total noninterest income	$ 37,513	$ 55,359

Deposit Fees

The Bank earns fees from its deposit customers for account maintenance, transaction-based services and overdraft charges. Account maintenance fees consist primarily of account fees and analyzed account fees charged on deposit accounts on a monthly basis. The performance obligation is satisfied and the fees are recognized on a monthly basis as the service period is completed. Transaction-based fees on deposits accounts are charged to deposit customers for specific services provided to the customer, such as wire fees, as well as charges against the account, such as fees for non-sufficient funds and overdrafts. The performance obligation is completed as the transaction occurs and the fees are recognized at the time each specific service is provided to the customer.

Debit Interchange Income

Debit and ATM interchange income represent fees earned when a debit card issued by the Bank is used. The Bank earns interchange fees from debit cardholder transactions through the Visa payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. The performance obligation is satisfied and the fees are earned when the cost of the transaction is charged to the cardholders' debit card.

NOTE 22 - GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and certain other intangibles generally arise from business combinations accounted for under the acquisition method of accounting. Goodwill totaled $2.3 million at December 31, 2021 and 2020, and represents the excess of the total acquisition price paid over the fair value of the assets acquired, net of the fair values of liabilities assumed as a result of the Branch Purchase in 2016. Goodwill is not amortized but is evaluated for impairment on an annual basis at December 31 of each year or whenever events or changes in circumstances indicate the carrying value may not be recoverable. The Company performed an impairment analysis at December 31, 2021 and determined that no impairment of goodwill existed. However, if adverse economic conditions or the decrease in the Company's stock price and market capitalization as a result of the COVID-19 pandemic were to be deemed sustained rather than temporary, it may significantly affect the fair value of our goodwill. Accordingly, no assurances can be given that the Company will not record an impairment loss on goodwill in the future.

Core deposit intangible ("CDI") is evaluated for impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable, with any changes in estimated useful life accounted for prospectively over the revised remaining life. As of December 31, 2021, management believes that there have been no events or changes in the circumstances that would indicate a potential impairment of CDI.

The following table summarizes the changes in the Company's other intangible assets comprised solely of CDI for the years ended December 31, 2021, and December 31, 2020.

	Other Intangible Assets		
	Gross CDI	Accumulated Amortization	Net CDI
Balance, December 31, 2019	$ 7,490	$ (2,033)	$ 5,457
Amortization	—	(706)	(706)
Balance, December 31, 2020	7,490	(2,739)	4,751
Amortization	—	(691)	(691)
Balance, December 31, 2021	$ 7,490	$ (3,430)	$ 4,060

The CDI represents the fair value of the intangible core deposit base acquired in business combinations. The CDI will be amortized on a straight-line basis over 10 years for the CDI related to the Anchor Acquisition and on an accelerated basis over approximately nine years for the CDI related to the Branch Purchase. Total amortization expense was $691,000 for the year ended December 31, 2021, and $706,000 for the year ended December 31, 2020.

Amortization expense for CDI is expected to be as follows for the years ended December 31:

2022	$ 691
2023	691
2024	621
2025	525
2026	525
Thereafter	1,007
Total	$ 4,060

NOTE 23 - PARENT COMPANY ONLY FINANCIAL INFORMATION

The Condensed Balance Sheets, Statements of Income, and Statements of Cash Flows for FS Bancorp, Inc. (Parent Only) are presented below:

Condensed Balance Sheets	December 31,	
Assets	2021	2020
Cash and due from banks	$ 19,883	$ 14,531
Investment in subsidiary	277,390	225,484
Other assets	407	202
Total assets	$ 297,680	$ 240,217
Liabilities and Stockholders' Equity		
Subordinated notes, net	49,394	10,000
Other liabilities	779	210
Total liabilities	50,173	10,210
Stockholders' equity	247,507	230,007
Total liabilities and stockholders' equity	$ 297,680	$ 240,217

Condensed Statements of Income	Year Ended December 31, 2021	2020
Interest expense on subordinated note	$ (1,722)	$ (776)
Dividends received from subsidiary	9,800	20,862
Other expenses	(272)	(195)
Income before income tax benefit and equity in undistributed net income of subsidiary	7,806	19,891
Income tax benefit	419	204
Equity in undistributed earnings of subsidiary	29,187	19,169
Net income	$ 37,412	$ 39,264

Condensed Statements of Cash Flows	Year Ended December 31, 2021	2020
Cash flows from operating activities:		
Net income	$ 37,412	$ 39,264
Equity in undistributed net income of subsidiary	(29,187)	(19,169)
Amortization	61	115
ESOP compensation expense for allocated shares	1,482	1,025
Share-based compensation expense related to stock options and restricted stock	1,446	1,020
Other assets	(205)	(30)
Other liabilities	569	27
Net cash from operating activities	11,578	22,252
Cash flows (used by) from investing activities:		
Net proceeds from ESOP	291	282
Investment in subsidiary	(25,000)	—
Net cash (used by) from investing activities	(24,709)	282
Cash flows from (used by) financing activities:		
Net proceeds from issuance of subordinated notes	49,333	—
Repayment of subordinated notes	(10,000)	—
(Disbursements) proceeds from stock options exercised	(2,076)	(161)
Common stock repurchased for employee/director taxes paid on restricted stock awards	(211)	(34)
Common stock repurchased	(13,961)	(9,802)
Dividends paid on common stock	(4,602)	(3,574)
Net cash from (used by) financing activities	18,483	(13,571)
Net increase in cash and cash equivalents	5,352	8,963
Cash and cash equivalents, beginning of year	14,531	5,568
Cash and cash equivalents, end of year	$ 19,883	$ 14,531

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

(i) Evaluation of Disclosure Controls and Procedures.

An evaluation of the disclosure controls and procedures as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") was carried out as of December 31, 2021 under the supervision and with the participation of the Company's Chief Executive Officer ("CEO"), Chief Financial Officer ("CFO"), and several other members of the Company's senior management. In designing and evaluating the Company's disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

The Company's CEO and CFO concluded that based on their evaluation at December 31, 2021, the Company's disclosure controls and procedures were effective in ensuring that information we are required to disclose in the reports we file or submit under the Exchange Act is (1) recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and (2) accumulated and communicated to FS Bancorp management, including its CEO and CFO, as appropriate to allow timely decisions regarding required disclosure, specified in the SEC's rules and forms.

a) Management's Report on internal control over financial reporting.

FS Bancorp's management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) of the Exchange Act. FS Bancorp's internal control system is designed to provide reasonable assurance to our management and the Board of Directors regarding the preparation and fair presentation of published financial statements for external purposes in accordance with generally accepted accounting principles.

This process includes policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions of FS Bancorp; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of FS Bancorp are being made only in accordance with authorizations of management and directors of FS Bancorp; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of FS Bancorp's assets that could have a material effect on the financial statements. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Also, because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Additionally, in designing disclosure controls and procedures, FS Bancorp's management was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. As a result of these inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Furthermore, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

FS Bancorp's management assessed the effectiveness of FS Bancorp's internal control over financial reporting as of December 31, 2021. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework (2013 Framework). Based on management's assessment, it was concluded that, as of December 31, 2021, FS Bancorp's internal control over financial reporting was effective based on those criteria. Moss Adams LLP, an independent registered public accounting firm, has audited FS Bancorp's consolidated financial statements and the effectiveness of its internal control over financial reporting as of December 31, 2021, which is included in "Item 8. Financial Statements and Supplementary Data" of this Annual Report on Form 10 K.

b) Attestation report of the registered public accounting firm.

The "Report of Independent Registered Public Accounting Firm" included in "Item 8. Financial Statements and Supplementary Data" of this Annual Report on Form 10-K is incorporated herein by reference.

c) Changes in internal control over financial reporting.

There were no significant changes in FS Bancorp's internal control over financial reporting during FS Bancorp's most recent fiscal quarter that have materially affected or are reasonably likely to materially affect, FS Bancorp's internal control over financial reporting.

Item 9B. Other Information

None.

Item 9C. Disclosure Regarding Foreign Jurisdictions that Prevent Inspections

Not applicable.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this item regarding the Company's Board of Directors is incorporated herein by reference from the section captioned "Proposal I - Election of Directors" in the Company's Proxy Statement, a copy of which will be filed with the SEC no later than 120 days after the Company's fiscal year end.

The executive officers of the Company and the Bank are elected annually and hold office until their respective successors have been elected and qualified or until death, resignation or removal by the Board of Directors. For information regarding the Company's executive officers, see "Item 1. Business - Executive Officers" included in this Form 10-K.

Code of Ethics for Senior Financial Officers

The Board of Directors has adopted a Code of Ethics for the Company's officers (including its senior financial officers), directors and employees. The Code is applicable to the Company's principal executive officer and senior financial officers. The Company's Code of Ethics is posted on its website at www.fsbwa.com under the Investor Relations tab.

Audit Committee Financial Expert

The Audit Committee of the Company is composed of Directors Leech (Chairperson), Mansfield and Cofer-Wildsmith. Each member of the Audit Committee is "independent" as defined in the Nasdaq Stock Market listing standards. The Board of Directors has determined that Mr. Leech and Mr. Mansfield meet the definition of "audit committee financial expert," as defined by the SEC.

Item 11. Executive Compensation

The information required by this item is incorporated herein by reference from the sections captioned "Executive Compensation" and "Directors' Compensation" in the Proxy Statement, a copy of which will be filed with the SEC no later than 120 days after the Company's fiscal year end.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

(a) Security Ownership of Certain Beneficial Owners.

The information required by this item is incorporated herein by reference from the section captioned "Security Ownership of Certain Beneficial Owners and Management" in the Company's Proxy Statement, a copy of which will be filed with the SEC no later than 120 days after the Company's fiscal year end.

(b) Security Ownership of Management.

The information required by this item is incorporated herein by reference from the sections captioned "Security Ownership of Certain Beneficial Owners and Management" and "Proposal I - Election of Directors" in the Company's Proxy Statement, a copy of which will be filed with the SEC no later than 120 days after the Company's fiscal year end.

(c) Changes in Control.

The Company is not aware of any arrangements, including any pledge by any person of securities of the Company, the operation of which may at a subsequent date result in a change in control of the Company.

d) Equity Compensation Plans Information. The following table summarizes share and exercise price information about FS Bancorp's equity compensation plans as of December 31, 2021:

Plan category	**Number of securities to be issued upon exercise of outstanding options, warrants, and rights (3)**		**Weighted-average exercise price of outstanding options, warrants, and rights (3)**	**Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))**
	(a)		(b)	(c)
Equity compensation plans (stock options) approved by security holders:				
2013 Equity Incentive Plan(1)	96,826	$	10.52	N/A
2018 Equity Incentive Plan(2)	516,800	$	27.86	585,756
Equity compensation plans not approved by security holders	N/A		N/A	N/A
Total	613,626	$	25.24	585,756

Share and per share data has been adjusted to reflect a two-for-one stock split effective July 14, 2021.

(1) The restricted shares granted under the 2013 Equity Incentive Plan were purchased by FS Bancorp in open market transactions and subsequently issued to the Company's directors and certain employees. At December 31, 2021, there were 259,210 restricted shares granted pursuant to the 2013 Equity Incentive Plan and no shares were available for future grants of restricted stock.

(2) The restricted shares granted under the 2018 Equity Incentive Plan were purchased by FS Bancorp in open market transactions and subsequently issued to the Company's directors and certain employees. At December 31, 2021, there were 181,540 restricted shares granted pursuant to the 2018 Equity Incentive Plan and 144,460 shares were available for future grants of restricted stock.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item is incorporated herein by reference from the section captioned "Transactions with Management" in the Company's Proxy Statement, a copy of which will be filed with the SEC no later than 120 days after the Company's fiscal year end.

Item 14. Principal Accounting Fees and Services

The information required by this item is incorporated herein by reference from the section captioned "Proposal 3 - Ratification of Appointment of Independent Auditor" in the Company's Proxy Statement, a copy of which will be filed with the SEC no later than 120 days after the Company's fiscal year end.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) 1. Financial Statements

For a list of the financial statements filed as part of this report see "Part II - Item 8. Financial Statements and Supplementary Data."

2. Financial Statement Schedules

Schedules to the Consolidated Financial Statements have been omitted as the required information is inapplicable.

(b) Exhibits

Exhibits are available from the Company by written request

3.1	Articles of Incorporation for FS Bancorp, Inc. (1)
3.2	Bylaws for FS Bancorp, Inc. (2)
4.1	Form of Common Stock Certificate of FS Bancorp, Inc. (1)
4.2	Description of Capital Stock of FS Bancorp, Inc. (8)
4.3	Indenture dated February 10, 2021, by and between FS Bancorp, Inc. and U.S. Bank National Association, as trustee. (3)
4.4	Forms of 3.75 Fixed-to-Floating Rate Subordinated Notes due 2031 (included as Exhibit A-1 and Exhibit A-2 to the Indenture filed as Exhibit 4.2 hereto) (3)
10.1	Severance Agreement between 1st Security Bank of Washington and Joseph C. Adams (1)
10.2	Form of Change of Control Agreement between 1st Security Bank of Washington and Matthew D. Mullet (1)
10.3	FS Bancorp, Inc. 2013 Equity Incentive Plan (the "2013 Plan") (4)
10.4	Form of Incentive Stock Option Agreement under the 2013 Plan (4)
10.5	Form of Non-Qualified Stock Option Agreement under the 2013 Plan (4)
10.6	Form of Restricted Stock Agreement under the 2013 Plan (4)
10.9	Form of Change of Control Agreement with Donn C. Costa, Dennis O'Leary, Rob Fuller, Lisa Cleary, Erin Burr, Victoria Jarman, Kelli Nielsen, and May-Ling Sowell (5)
10.10	FS Bancorp, Inc. 2018 Equity Incentive Plan (7)
10.11	Form of Incentive Stock Option Award Agreement under the 2018 Equity Incentive Plan (7)
10.12	Form of Non-Qualified Stock Option Award Agreement under the 2018 Equity Incentive Plan (7)
10.13	Form of Restricted Stock Award Agreement under the 2018 Equity Incentive Plan (7)
14	Code of Ethics and Conduct Policy (6)
21	Subsidiaries of Registrant
23	Consent of Independent Registered Public Accounting Firm
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following materials from the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2021, formatted in Inline Extensible Business Reporting Language (iXBRL): (1) Consolidated Balance Sheets; (2) Consolidated Statements of Income; (3) Consolidated Statements of Comprehensive Income; (4) Consolidated Statements of Stockholders' Equity; (5) Consolidated Statements of Cash Flows; and (6) Notes to Consolidated Financial Statements.
104	Cover Page Interactive Data file (formatted as Inline XBRL and contained in Exhibit 101)

(1) Filed as an exhibit to the Registrant's Registration Statement on Form S-1 (333-177125) filed on October 3, 2011, and incorporated by reference.
(2) Filed as an exhibit to the Registrant's Current Report on Form 8-K filed on July 10, 2013 (File No. 001-355589).
(3) Filed as an exhibit to the Registrant's Current Report on Form 8-K filed on February 11, 2021 (File No. 001-35589).
(4) Filed as an exhibit to the Registrant's Registration Statement on Form S-8 (333-192990) filed on December 20, 2013 and incorporated by reference.
(5) Filed as an exhibit to the Registrant's Current Report on Form 8-K filed on February 1, 2016 (File No. 001-35589)
(6) Registrant elects to satisfy Regulation S-K §229.406(c) by posting its Code of Ethics on its website at www.fsbwa.com in the section titled Investor Relations: Corporate Governance.
(7) Filed as an exhibit to the Registrant's Registration Statement on Form S-8 (333-22513) filed on May 23,2018.
(8) Filed as an exhibit to the Registrant's Registration Statement on Form 424b5 (333-22513) filed on September 11,2017.

Item 16. Form 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 16, 2022

FS Bancorp, Inc.

/s/Joseph C. Adams
Joseph C. Adams
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURES	TITLE	DATE
/s/Joseph C. Adams Joseph C. Adams	Director and Chief Executive Officer (Principal Executive Officer)	March 16, 2022
/s/Matthew D. Mullet Matthew D. Mullet	Chief Financial Officer, Treasurer and Secretary (Principal Financial and Accounting Officer)	March 16, 2022
/s/Ted A. Leech Ted A. Leech	Chairman of the Board	March 16, 2022
/s/Margaret R. Piesik Margaret R. Piesik	Director	March 16, 2022
/s/Joseph P. Zavaglia Joseph P. Zavaglia	Director	March 16, 2022
/s/Michael J. Mansfield Michael J. Mansfield	Director	March 16, 2022
/s/Marina Cofer-Wildsmith Marina Cofer-Wildsmith	Director	March 16, 2022
/s/Mark H. Tueffers Mark H. Tueffers	Director	March 16, 2022
/s/Pamela M. Andrews Pamela M. Andrews	Director	March 16, 2022

FS BANCORP, INC.

Administrative Center
6920 220th Street SW
Mountlake Terrace, WA 98043

1ST SECURITY BANK BRANCHES

Aberdeen, Capitol Hill, Centralia, Edmonds, Elma, Hadlock, Lacey, Lynnwood, Mill Creek, Montesano, Ocean Shores, Olympia, Overlake, Port Angeles, Port Townsend, Poulsbo, Puyallup, Puyallup South Hill, Sequim, Silverdale, Westport

HOME LENDING

Aberdeen, Bellevue, Everett, Lacey, Mill Creek, Mountlake Terrace, Olympic Peninsula, Port Orchard, Poulsbo, Puyallup, Tri-Cities, Vancouver

COMMERCIAL LENDING OFFICES

Mountlake Terrace, Tacoma

ADMINISTRATIVE CENTER

Mountlake Terrace

FS Bancorp, Inc.

6920 220th Street SW
Mountlake Terrace, WA 98043

fsbwa.com