Sound Financial Bancorp, Inc.
Form 10-Q
August 13, 2014
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2014
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

COMMISSION FILE NUMBER 001-35633

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

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

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

None
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

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

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the latest practicable date.

As of August 12, 2014, there were 2,515,920 shares of the registrant's common stock outstanding.

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SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Condensed Consolidated Balance Sheets (unaudited)
(In thousands, except share amounts)

	June 30, 2014	December 31, 2013
ASSETS		
Cash and cash equivalents	$28,866	$15,334
Available-for-sale securities, at fair value	14,082	15,421
Loans held for sale	1,921	130
Loans	403,938	390,926
Allowance for loan losses	(4,191)	(4,177)
Total Loans, net	399,747	386,749
Accrued interest receivable	1,391	1,366
Bank-owned life insurance ("BOLI"), net	11,235	11,068
Other real estate owned ("OREO") and repossessed assets, net	319	1,178
Mortgage servicing rights, at fair value	2,993	2,984
Federal Home Loan Bank ("FHLB") stock, at cost	2,270	2,314
Premises and equipment, net	2,006	2,138
Other assets	4,110	3,929
Total assets	468,940	442,611
LIABILITIES		
Deposits		
Interest-bearing	328,984	313,745
Noninterest-bearing demand	44,928	34,594
Total deposits	373,912	348,339
Borrowings	39,899	43,221
Accrued interest payable	71	82
Other liabilities	6,497	4,103
Advance payments from borrowers for taxes and insurance	374	362
Total liabilities	420,753	396,107
COMMITMENTS AND CONTINGENCIES (NOTE 7)	-	-
STOCKHOLDERS' EQUITY		
Preferred stock, $0.01 par value, 1,000,000 shares authorized, none issued or outstanding	-	-
Common stock, $0.01 par value, 40,000,000 shares authorized, 2,515,920 and 2,510,810 shares issued and outstanding as of June 30, 2014 and December 31, 2013, respectively	25	25
Additional paid-in capital	23,169	23,829
Unearned shares - Employee Stock Ownership Plan ("ESOP")	(1,369)	(1,369)
Retained earnings	26,239	24,288
Accumulated other comprehensive income (loss), net of tax	123	(269)
Total stockholders' equity	48,187	46,504
Total liabilities and stockholders' equity	$468,940	$442,611

See notes to condensed consolidated financial statements

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Income (unaudited)
(In thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
INTEREST INCOME				
Loans, including fees	$5,179	$4,838	$10,348	$9,342
Interest and dividends on investments, cash and cash equivalents	61	48	95	180
Total interest income	5,240	4,886	10,443	9,522
INTEREST EXPENSE				
Deposits	552	498	1,112	999
Borrowings	44	46	94	114
Total interest expense	596	544	1,206	1,113
Net interest income	4,644	4,342	9,237	8,409
PROVISION FOR LOAN LOSSES	200	450	400	700
Net interest income after provision for loan losses	4,444	3,892	8,837	7,709
NONINTEREST INCOME				
Service charges and fee income	700	551	1,234	1,150
Earnings on cash surrender value of bank-owned life insurance	86	74	167	152
Mortgage servicing income	80	184	33	311
Fair value adjustment on mortgage servicing rights	144	250	284	385
Other-than-temporary impairment losses on securities	-	(11)	-	(30)
Net gain on sale of loans	110	310	187	756
Total noninterest income	1,120	1,358	1,905	2,724
NONINTEREST EXPENSE				
Salaries and benefits	1,958	1,705	4,025	3,392
Operations	1,009	991	1,901	1,958
Regulatory assessments	75	82	135	182
Occupancy	327	309	613	608
Data processing	328	318	672	606
Net loss on OREO and repossessed assets	78	164	161	838
Total noninterest expense	3,775	3,569	7,507	7,584
Income before provision for income taxes	1,789	1,681	3,235	2,849
Provision for income taxes	573	539	1,032	910
Net income	$1,216	$1,142	$2,203	$1,939
Earnings per common share:				
Basic	$0.48	$0.44	$0.88	$0.75
Diluted	$0.47	$0.43	$0.85	$0.74
Weighted average number of common shares outstanding:				
Basic	2,510	2,587	2,508	2,587
Diluted	2,601	2,638	2,602	2,636

See notes to condensed consolidated financial statements

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Comprehensive Income (unaudited)
(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income	$1,216	$1,142	$2,203	$1,939
Available for sale securities:				
Unrealized gains arising during the period, net of taxes of $135, $48, $202 and $65, respectively	261	94	392	126
Reclassification adjustments for other-than-temporary impairment, net of taxes of $0, $4, $0 and $10, respectively	-	7	-	20
Other comprehensive income, net of tax	261	101	392	146
Comprehensive income	$1,477	$1,243	$2,595	$2,085

See notes to condensed consolidated financial statements

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Stockholders' Equity
For the Six Months Ended June 30, 2014 and 2013 (unaudited)
(In thousands, except number of shares)

	Shares	Common Stock	Additional Paid-in Capital	Unearned ESOP Shares	Retained Earnings	Accumulated Other Comprehensive Loss, net of tax	Total Stockholders' Equity
Balances at December 31, 2012	2,587,544	$ 26	$ 24,789	$ (1,598)	$ 20,736	$ (496)	$ 43,457
Net income					1,939		1,939
Other comprehensive income, net of tax						146	146
Share-based compensation			84				84
Restricted stock forfeited and retired	(734)						
Cash dividends on common stock ($0.05 per share)					(129)		(129)
Balances at June 30, 2013	2,586,810	$ 26	$ 24,873	$ (1,598)	$ 22,546	$ (350)	$ 45,497

	Shares	Common Stock	Additional Paid-in Capital	Unearned ESOP Shares	Retained Earnings	Accumulated Other Comprehensive Loss, net of tax	Total Stockholders' Equity
Balances at December 31, 2013	2,510,810	$ 25	$ 23,829	$ (1,369)	$ 24,288	$ (269)	$ 46,504
Net income					2,203		2,203
Other comprehensive income, net of tax						392	392
Share-based compensation			244				244
Cash dividends on common stock ($0.05 per share)					(252)		(252)
Restricted stock awards issued	45,565						
Common stock repurchased	(53,340)		(904)				(904)
Exercise of options	12,885						
Balances at June 30, 2014	2,515,920	$ 25	$ 23,169	$ (1,369)	$ 26,239	$ 123	$ 48,187

See notes to condensed consolidated financial statements

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Condensed Consolidated Statements of Cash Flows (unaudited)
(In thousands)

	Six Months Ended June 30, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$2,203	$1,939
Adjustments to reconcile net income to net cash from operating activities		
Accretion of net premium on investments	232	279
Other-than-temporary impairment losses on securities	-	30
Provision for loan losses	400	700
Depreciation and amortization	246	223
Compensation expense related to stock options and restricted stock	244	84
Fair value adjustment on mortgage servicing rights	(284)	(385)
Additions to mortgage servicing rights	(185)	(495)
Amortization of mortgage servicing rights	460	516
Increase in cash surrender value of BOLI	(167)	(152)
Gain on sale of loans	(187)	(756)
Proceeds from sale of loans	18,992	74,937
Originations of loans held for sale	(20,596)	(74,534)
Loss on sale and write-downs of OREO and repossessed assets	52	776
Change in operating assets and liabilities		
Accrued interest receivable	(25)	(53)
Other assets	(383)	(422)
Accrued interest payable	(11)	(11)
Other liabilities	2,394	437
Net cash from operating activities	3,385	3,113
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from principal payments, maturities and sales of available for sale securities	1,701	5,847
FHLB stock redeemed	44	44
Net increase in loans	(13,709)	(33,999)
Improvements to OREO and other repossessed assets	(12)	(33)
Proceeds from sale of OREO and other repossessed assets	1,130	1,835
Purchases of premises and equipment, net	(114)	(200)
Purchases of BOLI	-	(3,500)
Net cash used by investing activities	(10,960)	(30,006)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	25,573	7,431
Proceeds from borrowings	88,500	160,000
Repayment of borrowings	(91,822)	(141,322)
Dividends paid on common stock	(252)	(129)
Net change in advances from borrowers for taxes and insurance	12	(54)
Repurchase of common stock	(904)	-
Net cash from financing activities	21,107	25,926
Net decrease in cash and cash equivalents	13,532	(967)
Cash and cash equivalents, beginning of period	15,334	12,727
Cash and cash equivalents, end of period	$28,866	$11,760
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid for income taxes	$375	$730
Interest paid on deposits and borrowings	$1,217	$1,124

Noncash net transfer from loans to OREO and repossessed assets	$311	$1,265

See notes to condensed consolidated financial statements

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements (unaudited)

Note 1 – Basis of Presentation

The accompanying financial information is unaudited and has been prepared from the consolidated financial statements of Sound Financial Bancorp, Inc., and its wholly owned subsidiary, Sound Community Bank. References in this document to Sound Financial Bancorp refer to Sound Financial Bancorp, Inc. and its predecessor, Sound Financial, Inc., a federal corporation, and references to the "Bank" refer to Sound Community Bank. References to "we," "us," and "our" or the "Company" means Sound Financial Bancorp and its wholly-owned subsidiary, Sound Community Bank unless the context otherwise requires.

These unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the Securities and Exchange Commission ("SEC"). In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the financial position and results of operations for the periods presented have been included. Certain information and disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC. These unaudited financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the SEC on March 31, 2014 ("2013 Form 10-K"). The results for the interim periods are not necessarily indicative of results for a full year. For further information, refer to the consolidated financial statements and footnotes for the year ended December 31, 2013, included in the 2013 Form 10-K. Certain amounts in the prior quarters' consolidated financial statements have been reclassified to conform to the current presentation. These classifications do not have an impact on previously reported consolidated net income, retained earnings, stockholders' equity or earnings per share.

Note 2 – Accounting Pronouncements Recently Issued or Adopted

In July 2013, the Financial Accounting Standards Board "FASB" issued ASU No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. ASU No. 2013-11 requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except to the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. No new recurring disclosures are required. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2013 and are to be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. The adoption of ASU No. 2013-11 did not have a material impact on the Company's consolidated financial statements.

In January 2014, the FASB issued ASU No. 2014-01, Accounting for Investments in Qualified Affordable Housing Projects. ASU 2014-04 permits an entity to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognize the net investment performance in the income statement as a component of income tax expense (benefit). The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2014 and should be applied prospectively. The Company is currently reviewing the requirements of ASU No. 2014-01, but does not expect the ASU to have a material impact on the Company's consolidated financial statements.

In January 2014, the FASB issued ASU No. 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon foreclosure. ASU 2014-04 clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2)
the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2014 and can be applied with a modified retrospective transition method or prospectively. The adoption of ASU No. 2014-04 is not expected to have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which creates Topic 606 and supersedes Topic 605, Revenue Recognition. The core principle of Topic 606 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In general, the new guidance requires companies to use more judgment and make more estimates than under current guidance, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The standard is effective for public entities for interim and annual periods beginning after December 15, 2016; early adoption is not permitted. For financial reporting purposes, the standard allows for either full retrospective adoption, meaning the standard is applied to all of the periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements with the cumulative effect of initially applying the standard recognized at the date of initial application. The Company is currently evaluating the provisions of ASU No. 2014-09 to determine the potential impact the new standard will have on the Company's consolidated financial statements.

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements (unaudited)

In June 2014, the FASB issued ASU No. 2014-11, Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures, which changes the accounting for repurchase-to-maturity transactions and repurchase financing arrangements. It also requires additional disclosures about repurchase agreements and other similar transactions. The new guidance aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. Going forward, these transactions would all be accounted for as secured borrowings. The ASU also requires new and expanded disclosures. This ASU is effective for the first interim or annual period beginning after December 15, 2014. The adoption of ASU No. 2014-11 is not expected to have a material impact on the Company's consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. The ASU requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718, Compensation – Stock Compensation, as it relates to awards with performance conditions that affect vesting to account for such awards. The performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. The amendments in this ASU can be applied prospectively or retrospectively and are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015 with early adoption permitted. The Company is currently reviewing the requirements of ASU No. 2014-12, but does not expect the ASU to have a material impact on the Company's consolidated financial statements.

Note 3 – Investments

The amortized cost and fair value of our available-for-sale ("AFS") securities and the corresponding amounts of gross unrealized gains and losses at the dates indicated were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
June 30, 2014				
Municipal bonds	$ 1,911	$ 136	$ -	$ 2,047
Agency mortgage-backed securities	9,442	91	(82)	9,451
Non-agency mortgage-backed securities	2,542	103	(61)	2,584
Total	$ 13,895	$ 330	$ (143)	$ 14,082
December 31, 2013				
Municipal bonds	$ 1,911	$ 20	$ -	$ 1,931
Agency mortgage-backed securities	11,228	38	(195)	11,071
Non-agency mortgage-backed securities	2,689	78	(348)	2,419
Total	$ 15,828	$ 136	$ (543)	$ 15,421

The amortized cost and fair value of AFS securities at June 30, 2014, by contractual maturity, are shown below (in thousands). Expected maturities of AFS securities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	At June 30, 2014	
	Amortized Cost	Fair Value
Due in five to ten years	$1,911	$2,047
Due after ten years	11,984	12,035
Total	$13,895	$14,082

No securities were pledged to secure Washington State Public Funds as of June 30, 2014. The Company has letters of credit with a notional amount of $36.5 million to secure public deposits which exceeded the collateral requirements established by the Washington Public Deposit Protection Commission.

There were no sales of AFS securities during the three or six months ended June 30, 2014 and 2013.

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements (unaudited)

The following tables summarize at the dates indicated the aggregate fair value and gross unrealized loss by length of time of those investments that have been continuously in an unrealized loss position (in thousands):

	June 30, 2014					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Agency mortgage-backed securities	$651	$ (9)	$3,643	$ (73)	$4,294	$ (82)
Non-agency mortgage-backed securities	-	-	548	(61)	548	(61)
Total	$651	$ (9)	$4,191	$ (134)	$4,842	$ (143)

	December 31, 2013					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Agency mortgage-backed securities	$1,123	$ (29)	$7,145	$ (166)	$8,268	$ (195)
Non-agency mortgage-backed securities	-	-	636	(348)	636	(348)
Total	$1,123	$ (29)	$7,781	$ (514)	$8,904	$ (543)

The following table presents the cumulative roll forward of credit losses recognized in earnings during the three and six months ended June 30, 2014 and 2013 relating to the Company's non- agency mortgage backed securities (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Estimated credit losses, beginning balance	$450	$439	$450	$420
Additions for credit losses not previously recognized	-	11	-	30
Reduction for increases in cash flows	-	-	-	-
Reduction for realized losses	-	-	-	-
Estimated credit losses, ending balance	$450	$450	$450	$450

At June 30, 2014, our securities portfolio consisted of 15 agency mortgage-backed securities, five non-agency mortgage-backed securities and five municipal securities with a fair value of $14.1 million. At December 31, 2013, our securities portfolio consisted of 17 agency mortgage-backed securities, five non-agency mortgage-backed securities and five municipal bonds with a fair value of $15.4 million. At June 30, 2014, five of the 15 agency mortgage-backed securities were in an unrealized loss position compared to 11 of the 17 agency mortgage-backed securities at December 31, 2013. All of the agency mortgage-backed securities in an unrealized loss position at June 30, 2014 and December 31, 2013 were issued or guaranteed by U.S. governmental agencies. The unrealized losses were caused by changes in market interest rates or the widening of market spreads subsequent to the initial purchase of these securities, and not related to the underlying credit of the issuers or the underlying collateral. It is expected that these securities will not be settled at a price less than the amortized cost of each investment. Because the decline in fair value is attributable to changes in interest rates or widening market spreads and not credit quality, and because we do not intend to sell the securities in this class and it is not likely that we will be required to sell these securities before recovery of their amortized cost basis, which may include holding each security until contractual maturity, the unrealized losses on these investments are not considered an other-than-temporary impairment ("OTTI").

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements (unaudited)

As of June 30, 2014, one of the five non-agency mortgage-backed securities was in an unrealized loss position compared to two of the five non-agency mortgage-backed securities in an unrealized loss position at December 31, 2013. The unrealized loss was caused by changes in interest rates and market illiquidity causing a decline in the fair value subsequent to the purchase. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than par. While management does not intend to sell the non-agency mortgage-backed securities, and it is unlikely that the Company will be required to sell these securities before recovery of its amortized cost basis, management's impairment evaluation indicates that certain securities possess qualitative and quantitative factors that suggest an OTTI. These factors include, but are not limited to: the length of time and extent of the fair value declines, ratings agency down grades, the potential for an increased level of actual defaults, and the extension in duration of the securities. In addition to the qualitative factors, management's evaluation includes an assessment of quantitative evidence that involves the use of cash flow modeling and present value calculations as determined by considering the applicable OTTI accounting guidance. The Company compares the present value of the current estimated cash flows to the present value of the previously estimated cash flows. Accordingly, if the present value of the current estimated cash flows is less than the present value of the previous period's present value, an adverse change is considered to exist and the security is considered OTTI. The associated "credit loss" is the amount by which the security's amortized cost exceeds the present value of the current estimated cash flows. Based upon the results of the cash flow modeling, no security reflected OTTI during the three and six months ended June 30, 2014. Estimating the expected cash flows and determining the present values of the cash flows involves the use of a variety of assumptions and complex modeling. In developing its assumptions, the Company considers all available information relevant to the collectability of the applicable security, including information about past events, current conditions, and reasonable and supportable forecasts. Furthermore, the Company asserts that the cash flows used in the determination of OTTI are its "best estimate" of cash flows.

Note 4 – Loans

The composition of the loan portfolio at the dates indicated, excluding loans held for sale, was as follows (in thousands):

	At June 30, 2014	At December 31, 2013
Real estate loans:		
One- to four- family	$121,690	$117,739
Home equity	35,222	35,155
Commercial and multifamily	154,017	157,516
Construction and land	47,172	44,300
Total real estate loans	$358,101	354,710
Consumer loans:		
Manufactured homes	13,025	13,496
Other consumer	11,764	10,284
Total consumer loans	24,789	23,780
Commercial business loans	22,346	13,668
Total loans	405,236	392,158
Deferred fees	(1,298)	(1,232)
Total loans, gross	403,938	390,926
Allowance for loan losses	(4,191)	(4,177)

Total loans, net	$399,747	$386,749

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements (unaudited)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of June 30, 2014 (in thousands):

	One- to four-family	Home equity	Commercial and multifamily	Construction and land	Manufactured homes	Other consumer	Commercial business	Unallocated	Total
Allowance for loan losses:									
Individually evaluated for impairment	$280	$133	$ -	$ 26	$ 72	$ 1	$ -	$ -	$512
Collectively evaluated for impairment	592	313	1,790	234	65	86	137	462	3,679
Ending balance	$872	$446	$ 1,790	$ 260	$ 137	$ 87	$ 137	$ 462	$4,191
Loans receivable:									
Individually evaluated for impairment	$4,553	$1,624	$ 2,987	$ 204	$ 534	$ 21	$ 128	$ -	$10,051
Collectively evaluated for impairment	117,137	33,598	151,030	46,968					