

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

Sound Financial Bancorp, Inc.

Form 10-Q

November 14, 2012

---

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2012

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-35633

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

Maryland  
(State or other jurisdiction of incorporation of  
organization)

45-5188530  
(IRS Employer Identification No.)

2005 5th Avenue, Second Floor, Seattle, Washington 98121  
(Address of principal executive offices)

(206) 448-0884  
(Registrant's telephone number)

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

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

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

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

Indicate by check mark 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 issuer's classes of common stock, as of the latest practicable date:

As of November 14, 2012, there were 2,587,544 shares of the registrant’s common stock outstanding.

---

SOUND FINANCIAL BANCORP, INC.  
 FORM 10-Q  
 TABLE OF CONTENTS

	Page Number
<b>PART I FINANCIAL INFORMATION</b>	
Item 1. Financial Statements	
Condensed Consolidated Balance Sheets as of September 30, 2012 (unaudited) and December 31, 2011	3
Condensed Consolidated Statements of Income for the Three and Nine Month Periods Ended September 30, 2012 and 2011 (unaudited)	4
Condensed Consolidated Statements of Comprehensive Income for the Three and Nine Month Periods Ended September 30, 2012 and 2011 (unaudited)	5
Condensed Consolidated Statement of Stockholders' Equity for the Nine Month Periods Ended September 30, 2012 and 2011(unaudited)	6
Condensed Consolidated Statements of Cash Flows for the Nine Month Periods Ended September 30, 2012 and 2011 (unaudited)	7
Selected Notes to Condensed Consolidated Financial Statements	8
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	36
Item 3. Quantitative and Qualitative Disclosures About Market Risk	48
Item 4. Controls and Procedures	48
<b>PART II OTHER INFORMATION</b>	
Item 1. Legal Proceedings	49
Item 1A Risk Factors	49
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	49
Item 3. Defaults Upon Senior Securities	49
Item 4. Mine Safety Disclosures	49
Item 5. Other Information	49
Item 6. Exhibits	50

SIGNATURES

EXHIBITS

---

## PART I FINANCIAL INFORMATION

## Financial Statements

SOUND FINANCIAL BANCORP, INC AND SUBSIDIARY  
Condensed Consolidated Balance Sheets (Unaudited)

	September 30, 2012	December 31, 2011
	(Dollars in thousands)	
<b>ASSETS</b>		
Cash and cash equivalents	\$15,655	\$17,031
Available-for-sale securities, at fair value	20,891	2,992
Federal Home Loan Bank stock, at cost	2,422	2,444
Loans held for sale	2,089	1,807
Loans	308,998	300,096
Less allowance for loan losses	(4,333 )	(4,455 )
Total loans, net	304,665	295,641
Accrued interest receivable	1,249	1,234
Bank-owned life insurance, net	7,160	6,981
Other real estate owned and repossessed assets, net	2,548	2,821
Mortgage servicing rights, at fair value	2,314	2,437
Premises and equipment, net	2,237	2,385
Other assets	5,268	3,967
Total assets	\$366,498	\$339,740
<b>LIABILITIES</b>		
Deposits		
Interest-bearing	279,737	269,421
Noninterest-bearing demand	33,307	30,576
Total deposits	313,044	299,997
Borrowings		
Accrued interest payable	8,024	8,506
Other liabilities	78	84
Advance payments from borrowers for taxes and insurance	2,514	2,149
Total liabilities	542	291
	324,202	311,027
<b>COMMITMENTS AND CONTINGENCIES (NOTE 7)</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Preferred stock, \$0.01 par value, 1,000,000 shares authorized, none outstanding	-	-
Common stock, \$0.01 par value, 40,000,000 shares authorized, 2,587,544 and 2,578,144 issued and outstanding as of September 30, 2012 and December 31, 2011,	26	30

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

respectively

Additional paid-in capital	24,722	11,939
Unearned shares - Employee Stock Ownership Plan (“ESOP”)	(1,827 )	(693 )
Retained earnings	19,848	18,096
Accumulated other comprehensive loss, net of tax	(473 )	(659 )
Total stockholders’ equity	42,296	28,713
Total liabilities and stockholders’ equity	\$366,498	\$339,740

See notes to condensed consolidated financial statements

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY  
Condensed Consolidated Statements of Income (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
(Dollars in thousands, except per share amounts)				
<b>INTEREST INCOME</b>				
Loans, including fees	\$4,437	\$4,556	\$13,459	\$13,787
Interest and dividends on investments, cash and cash equivalents	105	57	244	176
<b>Total interest income</b>	<b>4,542</b>	<b>4,613</b>	<b>13,703</b>	<b>13,963</b>
<b>INTEREST EXPENSE</b>				
Deposits	540	626	1,617	1,893
Borrowings	56	55	167	223
<b>Total interest expense</b>	<b>596</b>	<b>681</b>	<b>1,784</b>	<b>2,116</b>
<b>NET INTEREST INCOME</b>	<b>3,946</b>	<b>3,932</b>	<b>11,919</b>	<b>11,847</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>1,075</b>	<b>1,300</b>	<b>3,675</b>	<b>3,350</b>
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>2,871</b>	<b>2,632</b>	<b>8,244</b>	<b>8,497</b>
<b>NONINTEREST INCOME</b>				
Service charges and fee income	574	516	1,638	1,514
Earnings on cash surrender value of bank-owned life insurance	60	61	179	189
Mortgage servicing income	148	110	346	318
Fair value adjustment on mortgage servicing rights	(211 )	(491 )	97	(235 )
Loss on sale of securities	-	-	-	(33 )
Other-than-temporary impairment losses on securities	(32 )	(56 )	(156 )	(96 )
Loss on sale of assets	-	-	-	(80 )
Gain on sale of loans	668	126	1,226	263
<b>Total noninterest income</b>	<b>1,207</b>	<b>266</b>	<b>3,330</b>	<b>1,840</b>
<b>NONINTEREST EXPENSE</b>				
Salaries and benefits	1,537	1,189	4,242	3,942
Operations	697	602	2,007	1,869
Regulatory assessments	108	103	329	454
Occupancy	314	288	918	835
Data processing	264	218	769	685
Losses and expenses on other real estate owned and repossessed assets	265	274	757	958
<b>Total noninterest expense</b>	<b>3,185</b>	<b>2,674</b>	<b>9,022</b>	<b>8,743</b>
<b>INCOME BEFORE PROVISION FOR INCOME TAXES</b>	<b>893</b>	<b>224</b>	<b>2,552</b>	<b>1,594</b>
<b>PROVISION FOR INCOME TAXES</b>	<b>281</b>	<b>43</b>	<b>800</b>	<b>463</b>
<b>NET INCOME</b>	<b>\$612</b>	<b>\$181</b>	<b>\$1,752</b>	<b>\$1,131</b>
<b>Net income per share (see Note 9):</b>				
Basic	\$0.24	\$0.07	\$0.68	\$0.44
Diluted	\$0.23	\$0.07	\$0.67	\$0.43



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

Weighted average shares outstanding:

Basic	2,587,669	2,582,733	2,585,694	2,582,733
Diluted	2,627,820	2,609,137	2,616,070	2,609,852

See notes to condensed consolidated financial statements

---

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Net income	\$612	\$181	\$1,752	\$1,131
Other comprehensive income, net of tax				
Unrealized holding gain (loss) on available for sale securities, net of taxes (benefit) of \$22, \$(7), \$43 and \$37 respectively	42	(14 )	83	71
Reclassification adjustments for realized losses on sales of securities, net of taxes of \$0, \$0, \$0 and \$11, respectively	-	-	-	22
Reclassification adjustments for other-than-temporary impairment on securities, net of taxes of \$11, \$19, \$53 and \$32, respectively	21	37	103	63
Other comprehensive income	\$63	\$23	\$186	\$156
Comprehensive income	\$675	\$204	\$1,938	\$1,287

See notes to condensed consolidated financial statements

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY  
Condensed Consolidated Statement of Stockholders' Equity  
For the Nine Months Ended September 30, 2012 and 2011 (unaudited)

	Shares	Common Stock	Additional Paid-in Capital (in thousands, except number of shares)	Unearned ESOP Shares	Retained Earnings	Accumulated Other Comprehensive Loss, net of tax	Total Stockholders' Equity
BALANCE, December 31, 2011	2,949,045	\$30	\$11,939	\$(693 )	\$18,096	\$ (659 )	\$ 28,713
Net income					1,752		1,752
Other comprehensive income, net of tax						186	186
Restricted stock awards	11,000	-					
Cancel Sound Community Bank MHC shares	(1,621,435)	(16 )					(16 )
Exchange of common stock at 0.87423 shares per common share	(168,357 )	(2 )					(2 )
Fractional share distribution	(209 )	-					
Proceeds from stock offering, net of offering costs	1,417,500	14	12,658				12,672
Purchase of common stock by ESOP				(1,134 )			(1,134 )
Share-based compensation			125				125
	2,587,544	\$26	\$24,722	\$(1,827 )	\$19,848	\$ (473 )	\$ 42,296

BALANCE,  
September 30,  
2012

See notes to condensed consolidated financial statements

---

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

	Nine Months Ended September 30,	
	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$1,752	\$1,131
Adjustments to reconcile net income to net cash from operating activities		
Accretion of net premium on investments	69	-
Loss on sale of available for sale securities	-	33
Other-than-temporary impairment losses on securities	156	96
Provision for loan losses	3,675	3,350
Depreciation and amortization	284	286
Compensation expense related to stock options and restricted stock	125	99
Fair value adjustment on mortgage servicing rights	(97 )	235
Additions to mortgage servicing rights	(554 )	(329 )
Amortization of mortgage servicing rights	774	611
Increase in cash surrender value of bank owned life insurance	(179 )	(189 )
Proceeds from sale of loans	63,865	32,912
Originations of loans held for sale	(65,373 )	(32,876 )
Loss on sale of other real estate owned and repossessed assets	314	722
Loss on sale of fixed assets	-	80
Gain on sale of loans	(1,226 )	(263 )
Change in operating assets and liabilities		
Accrued interest receivable	(15 )	84
Other assets	(1,398 )	1,022
Accrued interest payable	(6 )	(45 )
Other liabilities	366	(1,683 )
Net cash provided by operating activities	4,984	5,276
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from principal payments, maturities and sales of available for sale securities	1,219	1,382
Purchase of available for sale securities	(19,056 )	-
Net increase in loans	(15,074 )	(11,209 )
Improvements to other real estate owned ("OREO") and other repossessed assets	(392 )	(30 )
Proceeds from sale of OREO and other repossessed assets	2,726	2,392
Purchases of premises and equipment	(136 )	698
Net cash used by investing activities	(30,713 )	(6,767 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase in deposits	13,046	21,352
Proceeds from borrowings	-	61,700
Repayment of borrowings	(482 )	(77,882 )
Net change in advances from borrowers for taxes and insurance	251	268
Common stock purchase by ESOP	(1,134 )	-
Proceeds from stock offering, net of offering costs	12,672	-
Net cash provided by financing activities	24,353	5,438

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

INCREASE IN CASH AND CASH EQUIVALENTS	(1,376 )	3,947
CASH AND CASH EQUIVALENTS, beginning of period	17,031	9,092
CASH AND CASH EQUIVALENTS, end of period	\$15,655	\$13,039
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>		
Cash paid for income taxes	\$750	\$1,185
Interest paid on deposits and borrowings	\$1,790	\$2,161
Net noncash transfer of loans to other real estate owned	\$2,375	\$3,730
See notes to condensed consolidated financial statements		

---

SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY  
Selected Notes to Condensed Consolidated Financial Statement (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. (“we,” “us,” “our,” “Sound Financial Bancorp,” or the “Company”) and its wholly owned subsidiary, Sound Community Bank (the “Bank”). 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, 2011, as filed with the SEC. 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, 2011, included in the Company’s Annual Report on Form 10-K.

Certain amounts in the prior quarters’ financial statements have been reclassified to conform to the current presentation. These classifications do not have an impact on previously reported net income, retained earnings or earnings per share.

On August 22, 2012, the Company completed its conversion from the mutual holding company structure and related public stock offering, so that it is now a stock holding company that is wholly owned by public shareholders. Please see Note 2 – Conversion and Stock Issuance for more information.

Note 2 – Conversion and Stock Issuance

The Company, a Maryland corporation, was organized by Sound Community MHC (“the MHC”), Sound Financial, Inc. and Sound Community Bank to facilitate the “second-step” conversion of Sound Community Bank from the mutual holding company structure to the stock holding company structure (the “Conversion”). Upon consummation of the Conversion, which occurred on August 22, 2012, the Company became the holding company for Sound Community Bank and now owns all of the issued and outstanding shares of Sound Community Bank’s common stock.

In connection with the Conversion, the Company sold a total of 1,417,500 shares of common stock in offering to certain depositors of Sound Community Bank and others, including 113,400 shares to the Sound Community Bank employee stock ownership plan (“ESOP”). All shares were sold at a purchase price of \$10.00 per share. Proceeds from the offering, net of \$1.5 million in expenses, totaled \$12.7 million. The Company used \$1.1 million of the proceeds to fund the ESOP and made a \$7.5 million dividend to the Bank. In addition, concurrent with the offering, shares of Sound Financial, Inc. common stock owned by public stockholders were exchanged for 0.87423 shares of the Company’s common stock, with cash being paid in lieu of issuing any fractional shares. As a result of the offering, exchange and cash in lieu of fractional shares, the Company now has 2,587,544 shares outstanding.

All share and per share information in this report for periods prior to the Conversion has been revised to reflect the 0.87423 Conversion exchange ratio.





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

Note 3 – Accounting Pronouncements Recently Issued or Adopted

In September 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2011-08, Testing Goodwill for Impairment. With the ASU, a company testing goodwill for impairment now has the option of performing a qualitative assessment before calculating the fair value of the reporting unit (the first step of goodwill impairment test). If, on the basis of qualitative factors, the fair value of the reporting unit is more likely than not greater than the carrying amount, a quantitative calculation would not be needed. Additionally, new examples of events and circumstances that an entity should consider in performing its qualitative assessment about whether to proceed to the first step of the goodwill impairment have been made to the guidance and replace the previous guidance for triggering events for interim impairment assessment. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The adoption of this ASU did not have a material impact on the Company’s consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-11, Disclosures about Offsetting Assets and Liabilities. The ASU requires an entity to offset, and present as a single net amount, a recognized eligible asset and a recognized eligible liability when it has an unconditional and legally enforceable right of setoff and intends either to settle the asset and liability on a net basis or to realize the asset and settle the liability simultaneously. The ASU requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The amendments are effective for annual and interim reporting periods beginning on or after January 1, 2013. The Company is currently in the process of evaluating the ASU but does not expect it will have a material impact on the Company’s consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-12, Deferral of the Effective Date for Amendments to Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update 2011-05 (“ASU 2011-12”). This ASU defers only those changes in ASU 2011-05 that relate to the presentation of reclassification adjustments. ASU 2011-12 was issued in order to allow the FASB time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. While the FASB is considering the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, the Company will continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before the issuance of ASU 2011-05. ASU 2011-12 was effective for the Company’s financial statements for annual and interim periods beginning after December 31, 2011, and was applied prospectively. The adoption of this standard did not have a material impact on the Company’s consolidated financial statements.

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

In July 2012, the FASB issued ASU No. 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment. With the ASU, a company testing indefinite-lived intangibles for impairment now has the option to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with current guidance. An entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after September 15, 2012. The Company is currently in the process of evaluating the ASU but does not expect it will have a material impact on the Company's consolidated financial statements.

In October 2012, the FASB issued ASU. 2012-06, Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution. The Update clarifies that when an entity recognizes an indemnification asset as a result of a government-assisted acquisition of a financial institution and subsequently, a change in the cash flows expected to be collected on the indemnification asset occurs, as a result of a change in cash flows expected to be collected on the assets subject to indemnification, the reporting entity should subsequently account for the change in the measurement of the indemnification asset on the same basis as the change in the assets subject to indemnification. Any amortization of changes in value should be limited to the contractual term of the indemnification agreement. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2012. The adoption of this ASU will not have a material impact on the Company's consolidated financial statements.

---

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

## Note 4 – Investments

The amortized cost and fair value of our available for sale securities and the corresponding amounts of gross unrealized gains and losses at September 30, 2012 and December 31, 2011 were as follows:

	Amortized Cost	Gains	Gross Unrealized Losses 1 Year or Less (in thousands)	Losses Greater Than 1 Year	Estimated Fair Value
September 30, 2012					
Agency mortgage-backed securities	\$18,208	\$33	\$(178)	\$-	\$18,063
Non-agency mortgage-backed securities	3,400	-	-	(572)	2,828
Total	\$21,608	\$33	\$(178)	\$(572)	\$20,891

	Amortized Cost	Gains	Gross Unrealized Losses 1 Year or Less (in thousands)	Losses Greater Than 1 Year	Estimated Fair Value
December 31, 2011					
Agency mortgage-backed securities	\$53	\$6	\$-	\$-	\$59
Non-agency mortgage-backed securities	3,939	-	-	(1,006)	2,933
Total	\$3,992	\$6	\$-	\$(1,006)	\$2,992

The amortized cost and fair value of mortgage-backed securities by contractual maturity, at September 30, 2012, are shown below. Expected maturities of mortgage-backed securities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, 2012 Amortized Cost      Fair Value (in thousands)	
Due after ten years	\$21,608	\$20,891

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

Securities with a carrying value of \$57,000 at September 30, 2012 were pledged to secure Washington State Public Funds. Additionally, at September 30, 2012, the Company had letters of credit with a notional amount of \$30.0 million to secure public deposits.

---

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

Sales of available for sale securities for the nine months ended September 30, 2012 and 2011 were as follows:

	Nine Months Ended September 30,	
	2012	2011
(in thousands)		
Proceeds	\$-	\$1,118
Gross gains	-	3
Gross losses	-	(36)

The following table summarizes at September 30, 2012 and December 31, 2011 the aggregate fair value and gross unrealized loss by length of time those investments have been continuously in an unrealized loss position:

	Less Than 12 Months		September 30, 2012 12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
(in thousands)						
Agency mortgage-backed securities	\$13,645	\$(178)	\$-	\$-	\$13,645	\$(178)
Non-agency mortgage-backed securities	-	-	2,828	(572)	2,828	(572)
Total	\$13,645	\$(178)	\$2,828	\$2,828	\$16,473	\$(750)

	Less Than 12 Months		December 31, 2011 12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
(in thousands)						
Non-agency mortgage-backed securities	\$-	\$-	\$2,933	\$(1,006)	\$2,933	\$(1,006)
Total	\$-	\$-	\$2,933	\$(1,006)	\$2,933	\$(1,006)

The following table presents the cumulative roll forward of credit losses recognized in earnings during the nine months ended September 30, 2012 and 2011 relating to the Company's non-U.S. agency mortgage backed securities:

	Nine Months Ended September 30,	
	2012	2011
	(in thousands)	
Estimated credit losses, beginning balance	\$256	\$160
Additions for credit losses not previously recognized	156	96
Reduction for increases in cash flows	-	-
Reduction for realized losses	-	-
Estimated losses, ending balance	\$412	\$256

---

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

As of September 30, 2012, our securities portfolio consisted of fourteen U.S. agency and five non-U.S. agency mortgage backed securities with a fair value of \$20.9 million, of which all five non-U.S. agency securities and nine U.S. agency securities were in an unrealized loss position. The unrealized losses were primarily caused by changes in interest rates and a lack of market liquidity 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 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 other-than-temporary impairment ("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 as of September 30, 2012, four securities reflected OTTI during the nine month period ended September 30, 2012. 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.

The Company engages a third party to assist management with modeling cash flows. The model includes each individual non-agency mortgage backed securities' structural features. The modeled cash flows are discounted and they incorporate additional projected defaults based upon risk analysis of the financial condition and performance. Utilizing the quantitative change in the net present value of the cash flows compared to the amortized cost of the security, the Company recognized additional credit losses of \$156,000 in non-cash pre-tax impairment charges for the nine months ended September 30, 2012. Cumulative at September 30, 2012, the Company has recognized a total of \$412,000 of OTTI on four of the five non-agency mortgage backed securities.

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

## Note 5 – Loans

The composition of the loan portfolio, including loans held for sale, at the dates indicated is as follows:

	September 30, 2012	December 31, 2011
	(in thousands)	
Real Estate Loans:		
One-to four- family	\$94,341	\$96,305
Home equity	35,883	39,656
Commercial and multifamily	119,938	106,016
Construction and land	20,694	17,805
Total real estate loans	270,856	259,782
Consumer loans:		
Manufactured homes	17,010	18,444
Other consumer	9,085	10,920
Total consumer loans	26,095	29,364
Commercial business loans	14,761	13,163
Total loans	311,712	302,309
Deferred fees	(625 )	(406 )
Loans held for sale	(2,089 )	(1,807 )
Total loans, gross	308,998	300,096
Allowance for loan losses	(4,333 )	(4,455 )
Total loans, net	\$304,665	\$295,641



SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY  
Selected 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 September 30, 2012:

	One- to four- family	Home equity	Commercial and multifamily	Construction and land	Manufactured homes	Other consumer	Commercial business	Unallocated	Total
(In thousands)									
Allowance for loan losses:									
Ending balance: individually evaluated for impairment	\$ 837	\$ 280	\$ 74	\$ 25	\$ 120	\$ 41	\$ 153	\$ -	\$ 1,530
Ending balance: collectively evaluated for impairment	938	786	566	135	152	133	82	11	2,803
Ending balance	\$ 1,775	\$ 1,066	\$ 640	\$ 160	\$ 272	\$ 174	\$ 235	\$ 11	\$ 4,333
Loans receivable:									
Ending balance: individually evaluated for impairment	\$ 6,766	\$ 1,794	\$ 2,148	\$ 653	\$ 663	\$ 97	\$ 1,236	\$ -	\$ 13,357
Ending balance: collectively evaluated for impairment	87,575	34,089	117,790	20,041	16,347	8,988	13,525	-	298,355
Ending balance	\$ 94,341	\$ 35,883	\$ 119,938	\$ 20,694	\$ 17,010	\$ 9,085	\$ 14,761	\$ -	\$ 311,712



SOUND FINANCIAL BANCORP, INC. AND SUBSIDIARY  
Selected 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 December 31, 2011:

	One- to four- family	Home equity	Commercial and multifamily	Commercial Construction and land	Manufactured homes	Other consumer	Commercial business	Unallocated	Total
	(In thousands)								
Allowance for loan losses:									
Ending balance: individually evaluated for impairment	\$541	\$447	\$ 38	\$ 37	\$ 11	\$48	\$ 132	\$ -	\$1,254
Ending balance: collectively evaluated for impairment	576	979	931	68	279	165	122	81	3,201
Ending balance	\$1,117	\$1,426	\$ 969	\$ 105	\$ 290	\$ 213	\$ 254	\$ 81	\$4,455
Loans receivable:									
Ending balance: individually evaluated for impairment	\$8,260	\$1,784	\$ 2,003	\$ 902	\$ 122	\$ 101	\$ 447	\$ -	\$13,619
Ending balance: collectively evaluated for impairment	88,045	37,872	104,013	16,903	18,322	10,819	12,716	-	288,690

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

Ending balance	\$96,305	\$39,656	\$ 106,016	\$ 17,805	\$ 18,444	\$ 10,920	\$ 13,163	\$ -	\$302,309
-------------------	----------	----------	------------	-----------	-----------	-----------	-----------	------	-----------

---

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

The following table summarizes the activity in loan losses for the three months ended September 30, 2012:

	Beginning Allowance	Charge-offs	Recoveries (in thousands)	Provision	Ending Allowance
One-to four- family	\$1,676	\$(609 )	\$-	\$708	\$1,775
Home equity	1,212	(216 )	-	70	1,066
Commercial and multifamily	647	-	-	(7 )	640
Construction and land	181	(162 )	-	141	160
Manufactured homes	336	(46 )	-	(18 )	272
Other consumer	173	(126 )	6	121	174
Commercial business	215	(38 )	-	58	235
Unallocated	9	-	-	2	11
	\$4,449	\$(1,197 )	\$6	\$1,075	\$4,333

The following table summarizes the activity in loan losses for the nine months ended September 30, 2012:

	Beginning Allowance	Charge-offs	Recoveries (in thousands)	Provision	Ending Allowance
One-to four- family	\$1,117	\$(2,008 )	\$4	\$2,662	\$1,775
Home equity	1,426	(951 )	132	459	1,066
Commercial and multifamily	969	(503 )	83	91	640
Construction and land	105	(203 )	-	258	160
Manufactured homes	290	(106 )	-	88	272
Other consumer	213	(232 )	22	171	174
Commercial business	254	(45 )	10	16	235
Unallocated	81	-	-	(70 )	11
	\$4,455	\$(4,048 )	\$251	\$3,675	\$4,333

The following table summarizes the activity in loan losses for the three months ended September 30, 2011:

	Beginning Allowance	Charge-offs	Recoveries (in thousands)	Provision	Ending Allowance
One-to four- family	\$827	\$(261 )	\$-	\$407	\$973
Home equity	1,605	(352 )	1	(211 )	1,043
Commercial and multifamily	1,213	(807 )	16	667	1,089
Manufactured	273	(82 )	-	148	339
Other consumer	208	(37 )	8	25	204
Commercial business	172	(180 )	38	191	221
Unallocated	65	-	-	73	138
	\$4,363	\$(1,719 )	\$63	\$1,300	\$4,007



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

The following table summarizes the activity in loan losses for the nine months ended September 30, 2011:

	Beginning Allowance	Charge-offs	Recoveries (in thousands)	Provision	Ending Allowance
One-to four- family	\$909	\$(794 )	\$12	\$846	\$973
Home equity	1,480	(1,144 )	7	700	1,043
Commercial and multifamily	664	(1,311 )	34	1,702	1,089
Manufactured	294	(283 )	-	328	339
Other consumer	309	(199 )	48	46	204
Commercial business	163	(188 )	39	207	221
Unallocated	617	-	-	(479 )	138
	\$4,436	\$(3,919 )	\$140	\$3,350	\$4,007

Credit Quality Indicators. Federal regulations provide for the classification of lower quality loans and other assets, such as 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 payment capacity of the borrower or of any collateral pledged. Substandard assets include those characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all the weaknesses 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 establishment of a specific loss reserve is not warranted.

When we classify problem assets as either substandard or doubtful, we may establish a specific allowance in an amount we deem prudent to address the risk specifically or we may allow the loss to be addressed in the general allowance. General allowances represent loss reserves which have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been specifically allocated to particular problem assets. When an insured institution classifies problem assets as a loss, it is required to charge off such assets in the period in which they are deemed uncollectible. Assets that do not currently expose us to sufficient risk to warrant classification as substandard or doubtful but possess identified weaknesses are required to be classified as either watch or special mention assets. Our determination as to the classification of our assets and the amount of our valuation allowances and related provision for loan losses is subject to review by the OCC, which can order the establishment of additional loss allowances.

Early indicator loan grades are used to identify and track potential problem loans which do not rise to the levels described for substandard, doubtful or loss. The grades for watch and special mention are assigned to loans which have been criticized based upon known characteristics such as periodic payment delinquency or stale financial information from the borrower and/or guarantors. Loans identified as criticized (watch and special mention) or classified (substandard, doubtful or loss) are subject to monthly problem loan reporting.

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

The following table represents the internally assigned grades as of September 30, 2012 by type of loan:

Grade:	One-to four- family	Home equity	Commercial and multifamily	Construction and land	Manufactured homes	Other consumer	Commercial Business	Total
	(in thousands)							
Pass	\$76,595	\$28,687	\$ 113,700	\$ 19,366	\$ 14,656	\$ 8,186	\$ 11,342	\$272,532
Watch	14,536	5,791	4,271	778	2,331	849	2,819	31,375
Special Mention	493	502	598	-	-	-	-	1,593
Substandard	2,717	903	1,369	550	23	50	600	6,212
Doubtful	-	-	-	-	-	-	-	-
Loss	-	-	-	-	-	-	-	-
Total	\$94,341	\$35,883	\$ 119,938	\$ 20,694	\$ 17,010	\$ 9,085	\$ 14,761	\$311,712

The following table represents the internally assigned grades as of December 31, 2011 by type of loan:

Grade:	One-to four- family	Home equity	Commercial and multifamily	Construction and land	Manufactured homes	Other consumer	Commercial Business	Total
	(in thousands)							
Pass	\$70,392	\$31,943	\$ 100,002	\$ 16,087	\$ 16,062	\$ 9,507	\$ 10,331	\$254,324
Watch	18,088	6,138	4,048	778	2,260	1,312	2,385	35,009
Special Mention	1,505	183	-	-	-	4	11	1,703
Substandard	6,320	1,392	1,966	940	122	97	436	11,273
Doubtful	-	-	-	-	-	-	-	-
Loss	-	-	-	-	-	-	-	-
Total	\$96,305	\$39,656	\$ 106,016	\$ 17,805	\$ 18,444	\$ 10,920	\$ 13,163	\$302,309

**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 if, in management's opinion, the borrower may be unable to meet payment of obligations as they become due, as well as when required by regulatory provisions.

The following table presents the recorded investment in nonaccrual loans as of September 30, 2012 and December 31, 2011 by type of loan:

	September 30, 2012	December 31, 2011
	(in thousands)	
One- to four- family	\$1,358	\$3,124



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

Home equity	404	731
Commercial and multifamily	1,124	1,299
Construction and land	550	-
Other consumer	3	64
Commercial business	91	-
Total	\$3,530	\$5,218

---

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

The following table represents the aging of the recorded investment in past due loans as of September 30, 2012 by type of loan:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Recorded Investment 90 Days or Greater and Accruing (in thousands)	Total Past Due	Current	Total Loans
One- to four- family	\$-	\$411	\$1,592	\$-	\$2,003	\$92,338	\$94,341
Home equity	324	108	358	-	790	35,093	35,883
Commercial and multifamily	-	-	-	-	-	119,938	119,938
Construction and land	-	-	551	-	551	20,143	20,694
Manufactured homes	76	-	-	-	76	16,934	17,010
Other consumer	113	2	3	-	118	8,967	9,085
Commercial business	30	-	90	-	120	14,641	14,761
Total	\$543	\$521	\$2,594	\$-	\$3,658	\$308,054	\$311,712

The following table represents the aging of the recorded investment in past due loans as of December 31, 2011 by type of loan:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Recorded Investment 90 Days or Greater and Accruing (in thousands)	Total Past Due	Current	Total Loans
One- to four- family	\$4,321	\$935	\$2,683	\$-	\$7,939	\$88,366	\$96,305
Home equity	583	176	683	-	1,442	38,214	39,656
Commercial and multifamily	-	-	-	-	-	106,016	106,016
	-	123	80	-	203	17,602	17,805

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

Construction and land

Manufactured homes	327	7	-	-	334	18,110	18,444
Other consumer	172	3	-	-	175	10,745	10,920
Commercial business	669	-	-	-	669	12,494	13,163
Total	\$6,072	\$1,244	\$3,446	\$-	\$10,762	\$291,547	\$302,309

Nonperforming Loans. Loans are considered nonperforming when they are 90 days past due, placed on nonaccrual, or when they are past due troubled debt restructurings (“TDRs”). The following table represents the credit risk profile based on payment activity as of September 30, 2012 by type of loan:

	One- to four- family	Home equity	Commercial and multifamily	Construction and land	Manufactured homes	Other consumer	Commercial business	Total
	(in thousands)							
Performing	\$92,934	\$35,093	\$ 118,572	\$ 20,144	\$ 16,991	\$ 9,082	\$ 14,552	\$307,368
Nonperforming	1,407	790	1,366	550	19	3	209	4,344
Total	\$94,341	\$35,883	\$ 119,938	\$ 20,694	\$ 17,010	\$ 9,085	\$ 14,761	\$311,712

The following table represents the credit risk profile based on payment activity as of December 31, 2011 by type of loan:

	One-to four- family	Home equity	Commercial and multifamily	Construction and land	Manufactured homes	Other consumer	Commercial business	Total
	(in thousands)							
Performing	\$91,904	\$38,783	\$ 104,797	\$ 17,725	\$ 18,444	\$ 10,856	\$ 13,163	\$295,672
Nonperforming	4,401	873	1,219	80	-	64	-	6,637
Total	\$96,305	\$39,656	\$ 106,016	\$ 17,805	\$ 18,444	\$ 10,920	\$ 13,163	\$302,309

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

Impaired Loans. A loan is considered impaired when we have determined that we may be unable to collect payments of principal or interest when due under the terms of the loan. In the process of identifying loans as impaired, we take into consideration factors which include payment history and status, collateral value, financial condition of the borrower, and the probability of collecting scheduled payments in the future. Minor payment delays and insignificant payment shortfalls typically do not result in a loan being classified as impaired. The significance of payment delays and shortfalls is considered on a case by case basis, after taking into consideration the totality of circumstances surrounding the loans and the borrowers, including payment history and amounts of any payment shortfall, length and reason for delay, and likelihood of return to stable performance. Impairment is measured on a loan by loan basis for all loans in the portfolio.

The following table presents loans individually evaluated for impairment as of September 30, 2012 by type of loan:

	Recorded Investment	Unpaid Principal Balance	Related Allowance
(in thousands)			
With no related allowance recorded:			
One-to four-family	\$2,172	\$2,329	\$-
Home equity	935	1,252	-
Commercial and multifamily	1,904	1,904	-
Construction and land	552	730	-
Manufactured homes	68	68	-
Other consumer	13	54	-
Commercial business	846	846	-
Total	\$6,490	\$7,183	\$-
With an allowance recorded:			
One-to four-family	\$4,594	\$4,611	\$837
Home equity	859	859	280
Commercial and multifamily	244	244	74
Construction and land	101	102	25
Manufactured homes	595	595	120
Other consumer	84	84	41
Commercial business	390	430	153
Total	\$6,867	\$6,925	\$1,530
Totals:			
One-to four- family	\$6,766	\$6,940	\$837
Home equity	1,794	2,111	280
Commercial and multifamily	2,148	2,148	74
Construction and land	653	832	25
Manufactured homes	663	663	120
Other consumer	97	138	41
Commercial business	1,236	1,276	153

Total	\$13,357	\$14,108	\$1,530
-------	----------	----------	---------

---

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

The following table presents loans individually evaluated for impairment as of December 31, 2011 by type of loan:

	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(in thousands)		
With no related allowance recorded:			
One-to four-family	\$3,104	\$3,104	\$-
Home equity	773	773	-
Commercial and multifamily	1,784	1,784	-
Construction and land	779	785	-
Manufactured homes	-	-	-
Other consumer	14	55	-
Commercial business	233	233	-
Total	\$6,687	\$6,734	\$-
With an allowance recorded:			
One-to four-family	\$5,156	\$5,280	\$541
Home equity	1,011	1,038	447
Commercial and multifamily	219	219	38
Construction and land	123	178	37
Manufactured homes	122	122	11
Other consumer	87	87	48
Commercial business	214	214	132
Total	\$6,932	\$7,138	\$1,254
Totals:			
One-to four-family	\$8,260	\$8,384	\$541
Home equity	1,784	1,811	447
Commercial and multifamily	2,003	2,003	38
Construction and land	902	963	37
Manufactured homes	122	122	11
Other consumer	101	142	48
Commercial Business	447	447	132
Total	\$13,619	\$13,872	\$1,254

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

The following table presents loans individually evaluated for impairment as of September 30, 2012 and 2011 by type of loan:

	Three Months Ended			
	September 30, 2012		September 30, 2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
One-to four-family	\$1,908	\$ 28	\$2,437	\$ 44
Home equity	783	9	623	5
Commercial and multifamily	1,938	26	1,915	20
Construction and land	574	-	-	-
Manufactured homes	70	1	13	1
Other consumer	8	1	39	1
Commercial business	847	3	82	-
Total	\$6,126	\$ 68	\$5,109	\$ 71
With an allowance recorded:				
One-to four-family	\$5,132	\$ 37	\$3,658	\$ 5
Home equity	1,141	9	865	3
Commercial and multifamily	245	4	1,227	2
Construction and land	161	1	-	-
Manufactured homes	648	10	145	2
Other consumer	127	2	46	2
Commercial business	255	4	163	1
Total	\$7,708	\$ 67	\$6,104	\$ 15
Totals:				
One-to four-family	\$7,040	\$ 65	\$6,095	\$ 49
Home equity	1,923	18	1,488	8
Commercial and multifamily	2,183	30	3,142	22
Construction and land	735	1	-	-
Manufactured homes	718	11	158	3
Other consumer	134	3	85	3
Commercial Business	1,101	7	245	1
Total	\$13,833	\$ 135	\$11,212	\$ 86

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

	Nine Months Ended			
	September 30, 2012		September 30, 2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
One-to four-family	\$2,694	\$ 84	\$2,307	\$ 111
Home equity	749	32	625	20
Commercial and multifamily	1,874	60	1,409	68
Construction and land	663	21	-	-
Manufactured homes	62	4	39	2
Other consumer	14	2	55	2
Commercial business	688	13	106	1
Total	\$6,743	\$ 216	\$4,541	\$ 204
With an allowance recorded:				
One-to four-family	\$5,268	\$ 129	\$3,441	\$ 35
Home equity	1,146	28	808	11
Commercial and multifamily	284	7	2,109	4
Construction and land	131	4	-	-
Manufactured homes	554	32	105	8
Other consumer	101	5	49	5
Commercial business	217	16	168	9
Total	\$7,700	\$ 221	\$6,680	\$ 72
Totals:				
One-to four-family	\$7,962	\$ 213	\$5,748	\$ 146
Home equity	1,895	60	1,433	31
Commercial and multifamily	2,157	67	3,518	72
Construction and land	794	25	-	-
Manufactured homes	615	36	144	10
Other consumer	115	7	104	7
Commercial Business	905	29	274	10
Total	\$14,443	\$ 437	\$11,222	\$ 276

Forgone interest on nonaccrual loans was \$191,000 and \$276,000 at September 30, 2012 and 2011, respectively. There were no commitments to lend additional funds to borrowers whose loans were classified as nonaccrual, TDR or impaired at September 30, 2012 and December 31, 2011.



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

Troubled debt restructurings. Loans classified as TDRs totaled \$7.3 million and \$6.9 million at September 30, 2012 and December 31, 2011, respectively and are included in impaired loans. A TDR is a loan to a borrower that is experiencing financial difficulty that has been modified from its original terms and conditions in such a way that the Company is granting the borrower a concession of some kind. The Company has granted a variety of concessions to borrowers in the form of loan modifications. The modifications granted can generally be described in the following categories:

**Rate Modification:** A modification in which the interest rate is changed.

**Term Modification:** A modification in which the maturity date, timing of payments, or frequency of payments is changed.

**Payment Modification:** A modification in which the dollar amount of the payment is changed. Interest only modifications in which a loan is converted to interest only payments for a period of time are included in this category.

**Combination Modification:** Any other type of modification, including the use of multiple categories above.

The following tables present newly restructured loans by type of modification for the three and nine month periods ended September 30, 2012:

Three Months Ended September 30, 2012

	Number of Contracts	Rate Modifications	Term Modifications	Payment Modifications	Combination Modifications	Total Modifications
(in thousands, except for number of contracts)						
One- to four- family	1	\$ -	\$ -	\$ -	\$ 197	\$ 197
Home equity	1	-	-	-	117	117
Commercial and multifamily	-	-	-	-	-	-
Construction and land	-	-	-	-	-	-
Manufactured homes	-	-	-	-	-	-
Other consumer	-	-	-	-	-	-
Commercial business	-	-	-	-	-	-
<b>Total</b>	<b>2</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 314</b>	<b>\$ 314</b>

Nine Months Ended September 30, 2012

	Number of Contracts	Rate Modifications	Term Modifications	Payment Modifications	Combination Modifications	Total Modifications
(in thousands, except for number of contracts)						
One- to four- family	5	\$ -	\$ -	\$ -	\$ 561	\$ 561
Home equity	2	-	-	-	166	166
Commercial and multifamily	2	-	-	-	426	426
Construction and land	2	-	-	-	26	26

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

Manufactured homes	-	-	-	-	-	-
Other consumer	2	-	-	-	14	14
Commercial business	3	121	-	-	186	307
Total	16	\$ 121	\$ -	\$ -	\$ 1,379	\$ 1,500

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

The following tables presents newly restructured loans by type of modification for the three and nine month periods ended September 30, 2011:

Three Months Ended September 30, 2011

	Number of Contracts	Rate Modifications	Term Modifications	Payment Modifications	Combination Modifications	Total Modifications
(in thousands, except for number of contracts)						
One- to four- family	-	\$ -	\$ -	\$ -	\$ -	\$ -
Home equity	-	-	-	-	-	-
Commercial and multifamily	1	-	-	-	997	997
Construction and land	-	-	-	-	-	-
Manufactured homes	-	-	-	-	-	-
Other consumer	-	-	-	-	-	-
Commercial business	-	-	-	-	-	-
<b>Total</b>	<b>1</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 997</b>	<b>\$ 997</b>

Nine Months Ended September 30, 2011

	Number of Contracts	Rate Modifications	Term Modifications	Payment Modifications	Combination Modifications	Total Modifications
(in thousands, except for number of contracts)						
One- to four- family	-	\$ -	\$ -	\$ -	\$ -	\$ -
Home equity	-	-	-	-	-	-
Commercial and multifamily	1	-	-	-	997	997
Construction and land	-	-	-	-	-	-
Manufactured homes	-	-	-	-	-	-
Other consumer	1	-	-	-	44	44
Commercial business	-	-	-	-	-	-
<b>Total</b>	<b>2</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 1,041</b>	<b>\$ 1,041</b>

There were no post-modification changes that were recorded as a result of the TDRs for the years ended September 30, 2012 and 2011.

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

The following is a summary of all loans modified as TDRs within the previous twelve months and for which there was a payment default during the periods shown below:

	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2012
	(in thousands)	
One-to four-family	\$1,246	\$1,246
Home equity	215	215
Commercial and multifamily	1,366	1,366
Manufactured homes	390	471
Other consumer	27	27
Commercial business	540	540
Total	\$3,784	\$3,865

For the preceding table, a loan is considered in default when a payment is 30 days or more past due. At September 30, 2012, there was one commercial and multifamily real estate TDR loan on nonaccrual.

The Company had no commitments to extend additional credit to borrowers owing receivables whose terms have been modified in troubled debt restructurings. All TDRs are also classified as impaired loans and are included in the loans individually evaluated for impairment in the calculation of the allowance for loan losses.

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

## Note 6 – Fair Value Measurements

The following table presents estimated fair values of the Company's financial instruments as of September 30, 2012 and December 31, 2011, whether or not recognized or recorded at fair value is summarized as follows:

Description	September 30, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(in thousands)				
Financial assets:				
Cash and cash equivalents	\$15,655	\$15,655	\$17,031	\$17,031
Available for sale securities	20,891	20,891	2,992	2,992
FHLB Stock	2,422	2,422	2,444	2,444
Loans held for sale	2,089	2,089	1,807	1,807
Loans, net	304,665	309,636	295,641	297,358
Accrued interest receivable	1,249	1,249	1,234	1,234
Bank owned life insurance, net	7,160	7,160	6,981	6,981
Mortgage servicing rights	2,314	2,314	2,437	2,437
Financial liabilities:				
Non-maturity deposits	176,569	176,569	170,029	170,029
Time deposits	136,475	137,918	129,968	130,672
Borrowings	8,024	7,827	8,506	8,451
Accrued interest payable	78	78	84	84
Advance payments from borrowers for taxes and insurance	542	542	291	291

The following table presents information about the level in the fair value hierarchy for the Company's financial assets and liabilities that are not measured at fair value as of September 30, 2012:

Description	Total	Fair Value at September 30, 2012		
		Level 1	Level 2	Level 3
(in thousands)				
Financial assets:				
Cash and cash equivalents	\$15,655	\$15,655	\$-	\$-
FHLB Stock	2,422	-	-	2,422
Loans held for sale	2,089	-	2,089	-
Loans, net	309,636	-	-	309,636
Accrued interest receivable	1,249	1,249	-	-
Bank owned life insurance, net	7,160	7,160	-	-
Financial liabilities:				
Non-maturity deposits	176,569	\$-	\$-	\$176,569
Time deposits	137,918	-	137,918	-
Accrued interest payable	78	78	-	-
Advance payments from borrowers for taxes and insurance	542	-	-	542



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

The following table presents information about the Company's assets measured at fair value on a recurring basis as of September 30, 2012 and December 31, 2011:

Description	Total	Fair Value at September 30, 2012		
		Level 1	Level 2	Level 3
		(in thousands)		
Agency Mortgage-backed Securities	\$18,063	\$-	\$18,063	\$-
Non-agency Mortgage-backed Securities	2,828	-	2,828	-
Mortgage Servicing Rights	2,314	-	-	2,314

Description	Total	Fair Value at December 31, 2011		
		Level 1	Level 2	Level 3
		(in thousands)		
Agency Mortgage-backed Securities	\$59	\$-	\$59	\$-
Non-agency Mortgage-backed Securities	2,933	-	2,933	-
Mortgage Servicing Rights	2,437	-	-	2,437

For the three and nine months ended September 30, 2012, there were no transfers between Level 1 and Level 2 or between Level 2 and Level 3.

The following table provides a description of the valuation technique, unobservable input, and qualitative information about the unobservable inputs for the Company's assets and liabilities classified as Level 3 and measured at fair value on a recurring basis at September 30, 2012:

Financial Instrument	Valuation Technique	Unobservable Input(s)	Weighted Average	
Mortgage Servicing Rights	Discounted cash flow	Prepayment Speed Assumption	372.0	%
		Discount rate	10.0	%

Generally, any significant increases in the constant prepayment rate and discount rate utilized in the fair value measurement of the mortgage servicing rights will result in a negative fair value adjustment (and decrease in the fair value measurement). Conversely, a decrease in the constant prepayment rate and discount rate will result in a positive fair value adjustment (and increase in the fair value measurement). An increase in the weighted average life assumptions will result in a decrease in the constant prepayment rate and conversely, a decrease in the weighted average life will result in an increase of the constant prepayment rate.

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

A description of the valuation methodologies used for impaired loans and OREO is as follows:

**Impaired Loans** - The fair value of collateral dependent loans is based on the current appraised value of the collateral or internally developed models utilizing a calculation of expected discounted cash flows which contain management's assumptions. These assets are classified as level 3 and are measured on a nonrecurring basis.

**Other Real Estate Owned ("OREO") and Repossessed Assets** - OREO and repossessed assets consist principally of properties acquired through foreclosure and are carried at the lower of cost or estimated market value less selling costs. The fair value is based on current appraised value or other sources of value.

The following methods and assumptions were used to estimate fair value of each class of financial instruments listed above:

**Cash and cash equivalents, accrued interest receivable and payable, and advance payments from borrowers for taxes and insurance** - The estimated fair value is equal to the carrying amount.

**AFS Securities** - AFS securities are recorded at fair value based on quoted market prices, if available. If quoted market prices are not available, management utilizes third-party pricing services or broker quotations from dealers in the specific instruments. Level 1 securities include those traded on an active exchange, as well as U.S. government and its agencies securities. Level 2 securities include private label mortgage-backed securities.

**Loans Held for Sale** - Residential mortgage loans held for sale are recorded at the lower of cost or fair value. The fair value of fixed-rate residential loans is based on whole loan forward prices obtained from government sponsored enterprises. At September 30, 2012 and December 31, 2011, loans held for sale were carried at cost.

**Loans** - The estimated fair value for all fixed rate loans is determined by discounting the estimated cash flows using the current rate at which similar loans would be made to borrowers with similar credit ratings and maturities. The estimated fair value for variable rate loans is the carrying amount. The fair value for all loans also takes into account projected loan losses as a part of the estimate.

**Mortgage Servicing Rights** - Mortgage servicing rights represent the value associated with servicing residential mortgage loans, when the mortgage loans have been sold into the secondary market and the related servicing has been retained by us. The value is determined through a discounted cash flow analysis, which uses interest rates, prepayment speeds and delinquency rate assumptions as inputs. All of these assumptions require a significant degree of management judgment. Servicing rights and the related mortgage loans are segregated into categories of homogeneous pools based upon common characteristics. Mortgage servicing rights are classified as Level 3.

**FHLB stock** - The estimated fair value is equal to the par value of the stock, which approximates fair value.

**Bank-owned Life Insurance** - The estimated fair value is equal to the cash surrender value of policies, net of surrender charges.

**Deposits** - The estimated fair value of deposit accounts (savings, demand deposit, and money market accounts) is the carrying amount. The fair value of fixed-maturity time certificates of deposit are estimated by discounting the



estimated cash flows using the current rate at which similar certificates would be issued.

---

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

**Borrowings** - The fair value of borrowings are estimated using discounted cash flow analyses, based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

**Off-balance-sheet financial instruments** - The fair value for the Company's off-balance-sheet loan commitments are estimated based on fees charged to others to enter into similar agreements taking into account the remaining terms of the agreements and credit standing of the Company's customers. The estimated fair value of these commitments is not significant.

We assume interest rate risk (the risk that general interest rate levels will change) as a result of our normal operations. As a result, the fair values of our financial instruments will change when interest rate levels change, which may be favorable or unfavorable to us. Management attempts to match maturities of assets and liabilities to the extent necessary or possible to minimize interest rate risk. However, borrowers with fixed-rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by establishing early withdrawal penalties for certificates of deposit, creating interest rate floors for certain variable rate loans, adjusting terms of new loans and deposits, by borrowing at fixed rates for fixed terms and investing in securities with terms that mitigate our overall interest rate risk.

The following table presents information about the Company's assets measured at fair value on a nonrecurring basis:

Description	Fair Value at September 30, 2012			
	Total	Level 1	Level 2	Level 3
	(in thousands)			
OREO and repossessed assets	\$2,548	\$-	\$-	\$2,548
Impaired loans	\$13,043	-	-	\$13,043

  

Description	Fair Value at December 31, 2011			
	Total	Level 1	Level 2	Level 3
	(in thousands)			
OREO and repossessed assets	\$2,821	\$-	\$-	\$2,821
Impaired loans	13,619	-	-	13,619

The following table presents the total losses resulting from fair value adjustments:

Description	Total Losses Three Months Ended September 30,		Total Losses Nine Months Ended September 30,	
	2012	2011	2012	2011
OREO and repossessed assets	\$ 145	\$ 274	\$ 314	\$ 958
Impaired loans	1,197	393	4,048	1,719

There were no liabilities carried at fair value, measured on a recurring or nonrecurring basis, at September 30, 2012 or December 31, 2011.

---

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

The following table provides a reconciliation of the assets and liabilities measured at fair value using significant unobservable inputs (Level 3) on a recurring basis during the three and nine months ended September 30, 2012 and 2011 (in thousands):

	Three Months Ended September 30,	
	2012	2011
Beginning balance, at fair value	\$2,558	\$3,273
Servicing rights that result from transfers of financial assets	226	113
Changes in Fair Value(1)	(259 )	(491 )
Other(2)	(211 )	(212 )
Ending balance, at fair value	\$2,314	\$2,683
	Nine Months Ended September 30,	
	2012	2011
Beginning balance, at fair value	\$2,437	\$3,200
Servicing rights that result from transfers of financial assets	554	329
Changes in Fair Value(1)	97	(235 )
Other(2)	(774 )	(611 )
Ending balance, at fair value	\$2,314	\$2,683

(1) Represents changes due to principal collections over time

(2) Primarily relates to changes in prepayment speeds, duration and discount rate

#### Note 7 – Commitments and Contingencies

In the normal course of operations, the Company engages in a variety of financial transactions that are not recorded in our financial statements. These transactions involve varying degrees of off-balance sheet credit, interest rate and liquidity risks. These transactions are used primarily to manage customers' requests for funding and take the form of loan commitments and lines of credit.

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

Note 8 – Borrowings

The Company utilizes a loan agreement with the FHLB of Seattle. The terms of the agreement call for a blanket pledge of a portion of the Company's mortgage and commercial and multifamily portfolio based on the outstanding balance. At September 30, 2012, the amount available to borrow under this agreement is approximately 35% of total assets, or up to \$128.3 million subject to the availability of eligible collateral. Based on eligible collateral, the total amount available under this agreement as of September 30, 2012 and December 31, 2011 was \$89.0 million and \$83.5 million, respectively. The Company had outstanding borrowings under this arrangement of \$8.0 million and \$8.5 million at September 30, 2012 and December 31, 2011, respectively. Additionally, the Company had outstanding letters of credit from the FHLB with a notional amount of \$30.0 million and \$24.0 million at September 30, 2012 and December 31, 2011, respectively, to secure public deposits. The net remaining amounts available as of September 30, 2012 and December 31, 2011, was \$51.0 million and \$51.0 million, respectively.

The Company participates in the Federal Reserve Bank's Borrower-in-Custody program, which gives the Company access to overnight borrowings from the discount window. The terms of the program call for a pledge of specific assets. The Company had unused borrowing capacity under this program of \$9.8 million and \$21.9 million at September 30, 2012 and December 31, 2011, respectively. There were no outstanding borrowings at September 30, 2012 or December 31, 2011.

The Company has access to an unsecured line of credit from the Pacific Coast Banker's Bank. The line has a maturity date of June 30, 2014 and is renewable. As of September 30, 2012, the amount available under this line of credit is \$2.0 million. There was no outstanding balance on this line of credit as of September 30, 2012 and December 31, 2011.

Note 9 – Earnings Per Share

Earnings per share are summarized in the following table (figures in thousands except earnings per share):

	Three Months		Nine Months	
	Ended September 30, 2012	2011	Ended September 30, 2012	2011
Net income	\$612	\$181	\$1,752	\$1,131
Less net income attributable to participating securities(1)	7	2	19	12
Net income available to common shareholders	\$605	\$179	\$1,733	1,119
Weighted average number of shares outstanding, basic	2,588	2,583	2,586	2,583
Weighted average number of shares outstanding, diluted	2,628	2,609	2,616	2,610
Earnings per share, basic	\$0.24	\$0.07	\$0.68	\$0.44
Earnings per share, diluted	\$0.23	\$0.07	\$0.67	\$0.43

(1) Represents dividends paid and undistributed earnings allocated to nonvested restricted stock awards.

All share and per share information in this report for periods prior to the Conversion has been revised to reflect the 0.87423 Conversion exchange ratio. (Please see Note 2 – Conversion and Stock Issuance for more information.) Treasury shares for 2011 and unallocated common shares held by the ESOP for 2012 and 2011 are not included in the weighted-average number of common share outstanding for either basic or diluted earnings per share calculations. Unvested restricted shares are included in the weighted-average number of common shares outstanding for basic earnings per share calculations. The Company's common stock equivalents relate solely to stock options granted and outstanding.

---

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

Note 10 – Stock-based Compensation

Stock Options and Restricted Stock

In 2008, the Board of Directors adopted and stockholders approved an Equity Incentive Plan (the “Plan”) which was assumed by the Company in connection with the Conversion. The Plan permits the grant of restricted stock, restricted stock units, stock options, and stock appreciation rights. Under the Plan, 126,287 shares of common stock were approved for awards for stock options and stock appreciation rights and 50,514 shares of common stock were approved for awards for restricted stock and restricted stock units, in each case, as adjusted for the Conversion exchange ratio.

As of September 30, 2012, on an adjusted basis, awards for stock options totaling 125,051 shares and awards for restricted stock totaling 24,747 shares of Company common stock have been granted, net of any forfeitures, to participants in the Plan. During the three and nine month periods ended September 30, 2012, share-based compensation expense totaled \$59,000 and \$125,000, respectively. During the three and nine month periods ended September 30, 2011, share-based compensation expense totaled \$33,000 and \$99,000, respectively for both stock options and restricted stock. All of the awards vest in 20 percent annual increments commencing one year from the grant date. The options are exercisable for a period of 10 years from the date of grant, subject to vesting.

The following is a summary of the Company’s stock option plan awards during the period ended September 30, 2012:

	Shares(1)	Weighted-Average Exercise Price(1)	Weighted-Average Remaining Contractual Term In Years	Aggregate Intrinsic Value
Outstanding at the beginning of the year	97,492	\$ 9.07	7.33	\$104,317
Granted	26,417	8.49	9.42	
Exercised	-	-		
Forfeited	(3 )	9.07	7.33	
Expired	-	-		
Outstanding at September 30, 2012	123,906	\$ 8.94	7.77	\$148,688
Exercisable	61,682	\$ 9.07	7.33	\$66,000
Expected to vest, assuming a 0% forfeiture rate over the vesting term	123,906	\$ 8.94	7.77	\$148,688

(1)As stated in Note 2, all share and per share information in this report for periods prior to the Conversion has been revised to reflect the 0.87423 Conversion exchange ratio.

As of September 30, 2012, there was \$195,000 of total unrecognized compensation cost related to non-vested stock options granted under the Plan. The cost is expected to be recognized over the remaining weighted-average vesting period of 2.64 years.

The fair value of each option award is estimated on the date of grant using a Black-Scholes model that uses the assumptions noted in the table below. The dividend yield is based on the current quarterly dividend in effect at the time of the grant.





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

The Company (including the predecessor entity) became a publicly held company in January 2008, so the amount of historical stock price information available is limited. As a result, the Company elected to use a weighted-average of its peers' historical stock prices, as well as the Company's own historical stock prices to estimate volatility. The Company bases the risk-free interest rate on the U.S. Treasury Constant Maturity Indices in effect on the date of the grant. The Company elected to use the Staff Accounting Bulletin No. 110, "Share-Based Payments" permitted by the Securities and Exchange Commission to calculate the expected term. This simplified method uses the vesting term of an option along with the contractual term, setting the expected life at a midpoint in between.

The fair value of options granted during 2012 were determined using the following weighted-average assumptions as of the grant date.

Annual dividend yield	0.00	%
Expected volatility	28.97	%
Risk-free interest rate	1.46	%
Expected term		7.5 years
Weighted-average grant date fair value per option granted	\$8.49	

The fair value of the restricted stock awards is equal to the fair value of the Company's stock at the date of grant. Compensation expense is recognized over the vesting period that the awards are based. Shares awarded as restricted stock vest ratably over a five-year period beginning at the grant date with 20% vesting on the anniversary date of each grant date.

The following is a summary of the Company's unvested restricted stock awards for the nine month period ended September 30, 2012:

Non-vested Shares	Shares(1)	Weighted-Average Grant-Date Fair Value Per Share(1)	Aggregate Intrinsic Value Per Share
Non-vested at January 1, 2012	22,706	\$ 6.43	
Granted	9,617	6.49	
Vested	(7,566 )	6.43	
Forfeited	(10 )	-	
Expired	-	-	
Non-vested at September 30, 2012	24,747	\$ 6.45	\$10.14
Expected to vest assuming a 0% forfeiture rate over the vesting term	24,747	\$ 6.45	\$10.14

(1)As stated in Note 2, all share and per share information in this report for periods prior to the Conversion has been revised to reflect the 0.87423 Conversion exchange ratio.

The aggregate intrinsic value of the unvested restricted stock awards as of September 30, 2012 was \$251,000.

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

As of September 30, 2012, there was \$193,000 of unrecognized compensation cost related to unvested restricted stock awards granted under the Plan remaining. The cost is expected to be recognized over the weighted-average vesting period of 2.45 years.

---

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

Employee Stock Ownership Plan

In January 2008, the ESOP borrowed \$1.2 million from the Company to purchase common stock of the Company. In August 2012, in conjunction with the Conversion, the ESOP borrowed \$1.1 million from the Company to purchase common stock of the Company. Both loans are being repaid principally by the Bank through contributions to the ESOP over a period of ten years. The interest rate on the loans are fixed at 4.0% and 2.5% per annum, respectively. As of September 30, 2012, the remaining balance of the ESOP loans were \$751,000 and \$1.1 million.

Neither the loan balances nor the related interest expense are reflected on the condensed consolidated financial statements.

At September 30, 2012, the ESOP was committed to release 19,553 shares of the Company's common stock to participants and held 194,221 unallocated shares remaining to be released in future years. The fair value of the 194,221 restricted shares held by the ESOP trust was \$2.0 million at September 30, 2012. ESOP compensation expense included in salaries and benefits was \$61,000 and \$114,000 for the three and nine month periods ended September 30, 2012.

---

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

On August 22, 2012, Sound Financial Bancorp, Inc. (the "Company") became the holding company for Sound Community Bank (the "Bank") and owner of all of the issued and outstanding shares of the Bank's common stock. The Company is a Maryland chartered stock holding company and is subject to regulation by the Board of Governors of the Federal Reserve System ("Federal Reserve"). See Note 2 – Conversion and Stock Issuance for additional information.

Substantially all of the Company's business is conducted through the Bank, which is a federal savings bank subject to extensive regulation by the Office of the Comptroller of the Currency ("OCC"). The Bank's deposits are insured up to applicable limits by the Federal Deposit Insurance Corporation ("FDIC"). At September 30, 2012, the Company had total consolidated assets of \$366.5 million, net loans of \$304.7 million, deposits of \$313.0 million and stockholders' equity of \$42.3 million. Shares of the Company's common stock are traded on the Nasdaq Capital Market under the symbol "SFBC." Our executive offices are located at 2005 5th Avenue – Suite 200, Seattle, Washington, 98121.

During October 2012, the Bank filed an application to convert from a federally chartered savings bank to a Washington state-chartered commercial bank. As a Washington commercial bank, the Bank's regulators will be the Washington State Department of Financial Institutions ("WDFI") and the FDIC. The Federal Reserve will remain as the primary federal regulator for the Company. While the proposed charter conversion requires regulatory approval, the Bank expects the new charter to become effective in December 2012. The change is intended to reduce regulatory examination costs and to move oversight of the Bank to the WDFI, which is focused on local community banks and financial institutions. The charter conversion will not affect our customers in any way, and they will continue to receive the same protection on deposits through the FDIC.

Our principal business consists of attracting retail deposits from the general public and investing those funds, along with borrowed funds, in loans secured by first and second mortgages on one- to four-family residences (including home equity loans and lines of credit), commercial and multifamily, consumer and commercial business loans and, to a lesser extent, construction and land loans. We offer a wide variety of secured and unsecured consumer loan products, including manufactured home loans, automobile loans, boat loans and recreational vehicle loans. As part of our business, we focus on residential mortgage loan originations, many of which we sell to Fannie Mae. We sell these loans with servicing retained to maintain the direct customer relationship and promote our emphasis on strong customer service.

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

Our noninterest expenses consist primarily of salaries and employee benefits, expenses for occupancy, marketing and computer services and FDIC deposit insurance premiums. Salaries and benefits consist primarily of the salaries and wages paid to our employees, payroll taxes, expenses for retirement and other employee benefits. Occupancy

expenses, which are the fixed and variable costs of buildings and equipment, consist primarily of lease payments, property taxes, depreciation charges, maintenance and costs of utilities.

#### Forward-Looking Statements

When used in this Form 10-Q the words or phrases “will likely result,” “are expected to,” “will continue,” “is anticipated,” “estimate,” “project,” “intends” or similar expressions are intended to identify “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, assumptions and statements about future performance. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from the results anticipated, including, among other things,

---

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

- changes in economic conditions, either nationally or in our market area;
  - fluctuations in interest rates;
- the risks of lending and investing activities, including changes in the level and direction of loan delinquencies and charge-offs and changes in estimates of the adequacy of our allowance for loan losses;
  - the possibility of other-than-temporary impairments of securities held in our securities portfolio;
    - our ability to access cost-effective funding;
- fluctuations in the demand for loans, the volume of unsold homes, land and other properties, and fluctuations in real estate values and both residential and commercial and multifamily real estate market conditions in our market area;
  - secondary market conditions for loans and our ability to sell loans in the secondary market;
    - our ability to attract and retain deposits;
- our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we may acquire into our operations and our ability to realize related revenue synergies and expected cost savings and other benefits within the anticipated time frames or at all;
- legislative or regulatory changes such as the Dodd-Frank Wall Street Reform and Consumer Protection Act and its implementing regulations that adversely affect our business, as well as changes in regulatory policies and principles, or the interpretation of regulatory capital or other rules, including changes related to Basel III;
- monetary and fiscal policies of the Federal Reserve and the U.S. Government and other governmental initiatives affecting the financial services industry;
- results of examinations of Sound Financial and Sound Community Bank by their regulators, including the possibility that the regulators may, among other things, require us to increase our allowance for loan losses or to write-down assets, change Sound Community Bank's regulatory capital position or affect our ability to borrow funds or maintain or increase deposits, which could adversely affect our liquidity and earnings;
  - increases in premiums for deposit insurance;
  - our ability to control operating costs and expenses;
- the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation;
  - difficulties in reducing risks associated with the loans on our balance sheet;
- staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our workforce and potential associated charges;
  - computer systems on which we depend could fail or experience a security breach;
    - our ability to retain key members of our senior management team;



- costs and effects of litigation, including settlements and judgments;
  - our ability to implement our business strategies;
- increased competitive pressures among financial services companies;
  - changes in consumer spending, borrowing and savings habits;
- the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions;
  - our ability to pay dividends on our common stock;
  - adverse changes in the securities markets;
- the inability of key third-party providers to perform their obligations to us;
- statements made with respect to our intentions regarding disclosure and other changes resulting from the Jumpstart Our Business Startups Act of 2012;
- changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; and
- other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services and the other risks described from time to time in our filings with the Securities and Exchange Commission (“SEC”).

We wish to advise readers not to place undue reliance on any forward-looking statements and that the factors listed above could materially affect our financial performance and could cause our actual results for future periods to differ materially from any such forward-looking statements expressed with respect to future periods and could negatively affect our stock price performance.

We do not undertake and specifically decline any obligation to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

References in this document to “we,” “us,” and “our” means Sound Financial Bancorp, Inc. and its wholly-owned subsidiary, Sound Community Bank, unless the context otherwise requires.

---



## Critical Accounting Policies

We consider accounting policies involving significant judgments and assumptions by management that have, or could have, a material impact on the carrying value of certain assets or on income to be critical accounting policies. Estimates associated with these policies are susceptible to material changes as a result of changes in facts and circumstances. Facts and circumstances that 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 include determining the allowance for loan losses, accounting for other-than-temporary impairment of securities, accounting for mortgage servicing rights, accounting for other real estate owned, and accounting for deferred income taxes. For additional information on our accounting policies see our Form 10-K Annual Report for the year ended December 31, 2011.

## Comparison of Financial Condition at September 30, 2012 and December 31, 2011

**General.** Total assets increased by \$26.8 million, or 7.9%, to \$366.5 million at September 30, 2012 from \$339.7 million at December 31, 2011. This increase was primarily the result of a \$9.0 million, or 3.1% increase in our net loan portfolio, and a \$17.9 million, or 598.2% increase in available-for-sale securities. Our total liabilities increased by \$13.2 million or 4.2% to \$324.2 million at September 30, 2012 from \$311.0 million at December 31, 2011 primarily as a result of a \$13.0 million, or 4.3% increase in deposits.

**Cash and Securities.** Cash, cash equivalents and our available-for-sale securities increased \$16.5 million, or 82.5%, to \$36.5 million at September 30, 2012. Cash and cash equivalents decreased by \$1.4 million, or 8.1%, to \$15.7 million at September 30, 2012, as excess cash balances were deployed to purchase agency mortgage-backed securities. Available-for-sale securities increased \$17.9 million, or 598.2%, to \$20.9 million at September 30, 2012. This increase reflects purchases of agency mortgage-backed securities made in the third quarter with the proceeds received from our stock offering completed in August 2012, slightly offset by investment pay-downs and other-than-temporary impairment charges on our non-agency mortgage-backed security portfolio.

At September 30, 2012, included in our available-for-sale securities portfolio, were \$2.8 million of non-agency mortgage-backed securities. These securities present a higher credit risk than U.S. agency mortgage-backed securities, of which we had \$18.1 million at September 30, 2012. In order to monitor the increased risk, management receives and reviews a quarterly credit surveillance report from a third party, which evaluates non-agency securities based on a number of factors, including credit scores, loan-to-value ratios, geographic locations, delinquencies and loss histories of the underlying mortgage loans. This analysis is prepared in order to project potential future losses based on various home price depreciation scenarios over a three-year horizon. Based on these reports, management ascertains the appropriate value for these securities and, in the nine months ended September 30, 2012, recorded an impairment charge of \$156,000 on four of these non-agency securities. The current market environment significantly limits our ability to mitigate our exposure to value changes in these more risky securities by selling them, and we do not anticipate these conditions to change significantly in the next 12 months. Accordingly, if the market and economic environment impacting the loans supporting these securities continues to deteriorate, we could determine that additional impairment must be recorded on these securities, as well as on any other securities in our portfolio. As a result, our future earnings, equity, regulatory capital and ongoing operations could be materially adversely affected.

**Loans.** Our total loan portfolio (including loans held for sale and excluding deferred fees) increased \$9.2 million, or 3.0%, to \$311.1 million at September 30, 2012. Loans held for sale increased from \$1.8 million at December 31, 2011, to \$2.1 million at September 30, 2012. The increase was primarily due to the timing difference between loan fundings and loan sale settlements.

The most significant changes in our loan portfolio during the year to date included an increase of \$13.9 million or 13.1% in our commercial and multifamily real estate, a \$2.9 million or 16.2% increase in our construction and land loans and a \$1.6 million or 12.1% increase in commercial business loans. Manufactured home loans decreased by \$1.4 million or 7.8% while other consumer loans decreased \$1.8 million or 16.8% between December 31, 2011 and September 30, 2012 primarily as a result of charge-offs, prepayments and lower demand from creditworthy borrowers in the current economic environment.

---

The following table reflects the changes in the types of loans in our loan portfolio at September 30, 2012 as compared to the end of 2011:

	September 30, 2012	December 31, 2011	Amount Change	Percent Change
	(Dollar amounts in thousands)			
One-to-four family loans	\$94,341	\$96,305	\$(1,964 )	(2.0 )%
Home equity	35,883	39,656	(3,773 )	(9.5 )
Commercial and multifamily	119,938	106,016	13,922	13.1
Construction and land	20,694	17,805	2,889	16.2
Manufactured homes	17,010	18,444	(1,434 )	(7.8 )
Other consumer	9,085	10,920	(1,835 )	(16.8 )
Commercial business	14,761	13,163	1,598	12.1
Total	\$311,712	\$302,309	\$9,403	3.1 %

**Mortgage Servicing Rights.** At September 30, 2012, we had \$2.3 million in mortgage servicing rights recorded at fair value compared to \$2.4 million at December 31, 2011. The decrease during the period was the result of a lower market valuation for our mortgage servicing rights which was offset somewhat by an increase in our originated servicing portfolio as of September 30, 2012 compared to December 31, 2011.

**Nonperforming Assets.** At September 30, 2012, our nonperforming assets totaled \$6.9 million, or 1.88% of total assets, compared to \$9.5 million, or 2.78% of total assets at December 31, 2011.

Nonperforming loans to total loans decreased to 1.41% of total loans at September 30, 2012 from 2.20% at December 31, 2011. The decrease reflects a \$2.3 million decrease in nonperforming loans in the nine month period although nonperforming loans remain elevated compared to historical levels due to the continuing weak economy in our market area. Our largest nonperforming loans at September 30, 2012 consisted of a \$1.1 million commercial real estate loan, a \$471,000 commercial land development loan and a \$338,000 home equity loan.

OREO and repossessed assets decreased by \$273,000 during the first nine months of 2012. We repossessed 17 one- to four- family residences, nine manufactured homes, two boats and one recreational vehicle in the nine months ended September 30, 2012. During the same period, we sold seven one- to four- family residences, two commercial properties, nine manufactured homes and a recreational vehicle at an aggregate loss of \$314,000. Our largest OREO at September 30, 2012, consisted of a mobile home park with a recorded value of \$1.1 million located in Spanaway, Washington. Our next two largest OREO properties were comprised of a \$490,000 one- to four- family property located in Carnation, Washington and a \$198,000 one- to four- family property located in Dayton, Washington.

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

The table below sets forth the amounts and categories of nonperforming assets in our loan portfolio at the dates indicated:

	Nonperforming Assets			
	September 30, 2012	December 31, 2011	Amount Change	Percent Change
(Dollars in thousands)				
Nonperforming loans(1):				
One-to four- family	\$1,407	\$4,401	\$(2,994 )	(68.0 )%
Home equity	790	873	(83 )	(9.5 )
Commercial and multifamily	1,366	1,219	147	12.1
Construction and land	550	80	470	587.5
Manufactured homes	19	-	19	NM
Other consumer	3	64	(61 )	(95.3 )
Commercial business	209	-	209	NM
Total	\$4,344	\$6,637	\$(2,293 )	(34.5 )%
OREO and repossessed assets:				
One-to four- family	\$1,360	\$478	\$882	184.5 %
Commercial and multifamily	1,073	2,225	(1,152 )	(51.8 )
Manufactured homes	46	118	(72 )	(61.0 )
Other consumer	69	-	69	NM
Total	\$2,548	\$2,821	\$(273 )	(9.7 )%
Total nonperforming assets	\$6,892	\$9,458	\$(2,566 )	(27.1 )%
Nonperforming assets as a percentage of total assets	1.88	% 2.78	%	
Performing restructured loans:				
One-to four- family	\$3,017	\$2,508	\$509	20.3 %
Home equity	239	812	(573 )	(70.6 )
Commercial and multifamily	780	785	(5 )	(0.6 )
Construction and land	102	-	102	NM
Manufactured homes	622	-	622	NM
Other consumer	47	4	43	1075.0
Commercial business	565	26	539	2073.1
Total	\$5,372	\$4,135	\$1,237	29.9 %

(1) Nonperforming loans include \$814,000 and \$2.8 million in nonperforming TDRs as of September 30, 2012 and December 31, 2011.

In addition to the non-performing assets set forth in the table above, as of September 30, 2012, there were \$3.3 million in loans with respect to which known information about possible credit problems of the borrowers have caused management to have doubts as to the abilities of the borrowers to comply with present loan repayment terms. This may result in the future inclusion of such loans in the nonperforming asset categories.

Allowance for Loan Losses. The allowance for loan losses is maintained to cover losses that are probable and can be estimated on the date of the evaluation in accordance with generally accepted accounting principles in the United States. It is our best estimate of probable incurred credit losses in our loan portfolio.

Our allowance for loan losses at September 30, 2012 was \$4.3 million, or 1.40% of total loans receivable, compared to \$4.5 million, or 1.47% of total loans receivable at December 31, 2011. The \$122,000, or 2.7% decrease in the allowance for loan losses reflects the \$3.7 million provision for loan losses established during the first nine months of 2012 as a result of an increase in our loan portfolio and net charge-offs of \$3.8 million during the period as well as the decline in nonperforming loans.

Specific loan loss reserves increased \$274,000, and general loan loss reserves decreased by \$396,000 at September 30, 2012 compared to December 31, 2011. Net charge-offs for the nine months ending September 30, 2012 were \$3.8 million, or 1.67% of average loans on an annualized basis, compared to \$3.8 million, or 1.69% of average loans for the same period in 2011. As of September 30, 2012, the allowance for loan losses as a percentage of loans receivable and nonperforming loans was 1.40% and 99.75%, respectively, compared to 1.47% and 67.12%, respectively, at December 31, 2011. The allowance for loan losses as a percentage of loans receivable decreased slightly due to an increase in loans receivable during the nine month period ended September 30, 2012. The allowance for loan losses as a percentage of nonperforming loans increased during this same period due to a decrease in nonperforming loans.

---

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

The following table shows the adjustments in our allowance during the first nine months of 2012 as compared to the same period in 2011:

	At and for the Nine Month Period Ended September 30,			
	2012		2011	
	(Dollars in thousands)			
Balance at beginning of period	\$4,455		\$4,436	
Charge-offs	(4,048	)	(3,919	)
Recoveries	251		140	
Net charge-offs	(3,797	)	(3,779	)
Provisions charged to operations	3,675		3,350	
Balance at end of period	\$4,333		\$4,007	
Ratio of net charge-offs during the period to average loans outstanding during the period	1.67	%	1.69	%
Allowance as a percentage of non-performing loans	99.75	%	62.1	%
Allowance as a percentage of total loans (end of period)	1.40	%	1.32	%

Deposits. Total deposits increased by \$13.0 million, or 4.3%, to \$313.0 million at September 30, 2012 from \$300.0 million at December 31, 2011. A summary of deposit accounts with the corresponding weighted average cost of funds is presented below:

	As of September 30, 2012		As of December 31, 2011	
	Amount	Wtd. Avg. Rate	Amount	Wtd. Avg. Rate
	(Dollars in thousands)			
Checking (noninterest)	\$29,895	0.00 %	\$26,907	0.00 %
NOW (interest)	25,331	0.08	22,332	0.09
Savings	25,046	0.06	22,092	0.10
Money Market	92,885	0.33	95,029	0.58
Certificates	136,475	1.33	129,968	1.53
Escrow	3,412	0.00	3,669	0.00
Total	\$313,044	0.69 %	\$299,997	0.87 %

During the first nine months of 2012, checking and NOW accounts increased \$6.0 million, or 12.2% to \$55.2 million. These increases were a result of our emphasis on attracting these and other low-cost deposits such as savings accounts, which increased \$3.0 million, or 13.4% in the first nine months of 2012. Although certificate balances increased \$6.5 million in the first nine months of 2012, this was a result of increases in our public fund certificates. Public fund certificates increased \$9.4 million while business and consumer certificates decreased \$2.9 million, or 2.7%. This is a result of the low interest rate environment and strategic decision to compete less aggressively on certificate interest rates

Borrowings. FHLB advances decreased \$482,000, or 5.7%, to \$8.0 million at September 30, 2012, with a weighted-average cost of 2.76%, from \$8.5 million at December 31, 2011, with a weighted-average cost of 2.17%. We continue to utilize FHLB advances to fund interest-earning asset growth and/or enhance our interest rate risk management despite our strong deposit growth.

Stockholders' Equity. Total stockholders' equity increased \$13.6 million, or 47.3%, to \$42.3 million at September 30, 2012, from \$28.7 million at December 31, 2011. This primarily reflects an increase in paid-in capital as a result of net proceeds from the Conversion of \$12.7 million as well as \$1.8 million in net income and a \$186,000 decrease in accumulated other comprehensive loss.

---

## Comparison of Results of Operation for the Three and Nine Months Ended September 30, 2012 and 2011

General. Net income increased \$431,000 to \$612,000 for the three months ended September 30, 2012, compared to \$181,000 for the three months ended September 30, 2011. The primary reasons for this improvement were increased gain on sales of loans, and a decrease in the provision for loan losses, partially offset by increased noninterest expenses. Net income increased \$621,000 to \$1.8 million for the nine months ended September 30, 2012, compared to \$1.1 million for the nine months ended September 30, 2011. The improvement in the nine month results were primarily attributable to decreased interest expense and increased noninterest income as a result of increased gain on sales of loans. These improvements were partially offset by increases in the provision for loan losses and noninterest expenses in the current nine month period compared to the nine month period in 2011.

Interest Income. Interest income decreased by \$71,000, or 1.5%, to \$4.5 million for the three months ended September 30, 2012 compared to the three months ended September 30, 2011. Interest income decreased by \$260,000, or 1.9%, to \$13.7 million for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011. The decrease in interest income primarily reflected lower interest rates realized on our loan portfolio despite an increase in our average loan balances during the 2012 periods as compared to the same periods last year. Our average balance of loans receivable increased \$9.7 million to \$307.4 million during the quarter ended September 30, 2012 from \$297.7 million during the same period last year. The average balance of loans receivable increased \$5.6 million to \$303.0 million during the nine months ended September 30, 2012 from \$297.4 million during the same period last year.

The weighted average yield on loans decreased from 6.12% for the three months ended September 30, 2011, to 5.77% for the three months ended September 30, 2012. The weighted average yield on loans decreased from 6.18% for the nine months ended September 30, 2011, to 5.92% for the nine months ended September 30, 2012. The decrease was primarily the result of the continued historically low interest rate environment and the competitive market for loans to well-qualified borrowers. The weighted average yield on investments, including OTTI, was 2.24% for the three months ended September 30, 2012 compared to 0.10% for the three months ended September 30, 2011. The weighted average yield on investments, including OTTI, was 1.42% for the nine months ended September 30, 2012 compared to 2.86% for the nine months ended September 30, 2011. The decrease reflects increased average balances of agency mortgage-backed securities in the 2012 period which currently carry a lower yield than non-agency mortgage-backed securities. Non-agency mortgage-backed securities made up a significant proportion of the investment portfolio in the 2011 period.

Interest Expense. Interest expense decreased \$85,000, or 12.5%, to \$596,000 for the three months ended September 30, 2012, from \$681,000 for the three months ended September 30, 2011. Interest expense decreased \$332,000, or 15.7%, to \$1.8 million for the nine months ended September 30, 2012, from \$2.1 million for the nine months ended September 30, 2011. This decrease reflects overall lower interest rates paid on deposits notwithstanding an increase in the average balances of deposits during both the three and nine months ended September 30, 2012 as compared to the same periods last year. Our average balance of deposits increased \$37.2 million to \$318.7 million during the quarter ended September 30, 2012 from \$281.5 million during the same period last year. The average balance of deposits increased \$30.8 million to \$309.6 million during the nine months ended September 30, 2012 from \$278.8 million during the same period last year. Our weighted average cost of interest-bearing liabilities was 0.83% for the three months ended September 30, 2012, compared to 1.00% for the three months ended September 30, 2011. Our weighted average cost of interest-bearing liabilities was 0.84% for the nine months ended September 30, 2012, compared to 0.87% for the nine months ended September 30, 2011.

Interest paid on deposits decreased \$86,000, or 13.7% to \$540,000 for the three months ended September 30, 2012, from \$626,000 for the same period in 2011. Interest paid on deposits decreased \$276,000, or 14.6% to \$1.6 million



for the nine months ended September 30, 2012, from \$1.9 million for the same period in 2011. These reductions were the result of decreases in the weighted average cost of deposits during the three and nine months ended September 30, 2012, respectively, compared to the same periods in 2011 as lower rates were paid on renewing certificates of deposit and existing savings, interest-bearing checking and money market accounts.

Interest expense on borrowings increased \$1,000, or 1.8%, to \$56,000 for the three months ended September 30, 2012 from \$55,000 for the three months ended September 30, 2011. Interest expense on borrowings decreased \$56,000, or 25.1% to \$167,000 for the nine months ended September 30, 2012, from \$223,000 for the same period in 2011. The decrease primarily resulted from a \$1.2 million and \$7.9 million decrease in the average balance of borrowings outstanding for the three and nine month periods ended September 30, 2012, respectively compared to the same period in 2011. The decrease in borrowings was a result of scheduled loan pay offs that were not replaced due to increased balances of deposits.

---

Net Interest Income. Net interest income was \$3.9 million for the three months ended September 30, 2012, and 2011, respectively. Net interest income increased \$72,000, or 0.6%, to \$11.9 million for the nine months ended September 30, 2012, from \$11.8 million for the nine months ended September 30, 2011. The increase in net interest income for the nine months ended September 30, 2012 primarily resulted from lower rates paid on deposits and lower outstanding borrowings compared to the same period last year. In addition, lower rates on loans were realized on our loan portfolio due to the historically low rate environment, especially for loans to well-qualified borrowers. Our net interest margin was 4.91% for the three months ended September 30, 2012, compared to 5.22% for the three months ended September 30, 2011. Our net interest margin was 5.12% for the nine months ended September 30, 2012, compared to 5.25% for the nine months ended September 30, 2011.

Provision for Loan Losses. A provision for loan losses of \$1.1 million was made during the three months ended September 30, 2012, compared to a provision for loan losses of \$1.3 million during the three months ended September 30, 2011. A provision for loan losses of \$3.7 million was made during the nine months ended September 30, 2012, compared to a provision for loan losses of \$3.4 million during the nine months ended September 30, 2011. The decrease in the provision for the three month comparison period was the result of both decreased net charge-offs and lower levels of nonperforming loans. The increase in provision expense for the nine month comparison period was a result of increases in net charge-offs and nonperforming loans during the nine month period ended September 30, 2012. The increase in net charge-offs occurred primarily in the first quarter of 2012. Overall we believe that higher than historical levels of nonperforming assets and charge-offs will continue until the housing market, unemployment, and general economic market conditions further recover in our market area.

For the three months ended September 30, 2012, the annualized percentage of net charge-offs to average loans decreased 17 basis points to 1.55% compared to 1.72% for the three months ended September 30, 2011. For the nine months ended September 30, 2012, the annualized percentage of net charge-offs to average loans decreased four basis points to 1.67% as compared to 1.71% for the nine months ended September 30, 2011. The ratio of nonperforming loans to total loans decreased to 1.41% at September 30, 2012 from 2.13% at September 30, 2011.

Noninterest Income. Noninterest income decreased \$941,000, or 353.8%, to \$1.2 million during the three months ended September 30, 2012, compared to \$266,000 during the three months ended September 30, 2011. A summary of the changes in noninterest income for the three month period is presented in the table below:

	Three Months Ended September 30,		Amount Change (Dollars in thousands)	Percent Change	
	2012	2011			
Service charges and fee income	\$574	\$516	\$58	11.2	%
Earnings on cash surrender value of bank owned life insurance	60	61	(1)	(1.6)	)
Mortgage servicing income	148	110	38	34.5	
Fair value adjustment on mortgage servicing rights	(211)	(491)	280	(57.0)	)
Other-than-temporary impairment losses	(32)	(56)	24	(42.9)	)
Gain on sale of loans	668	126	542	430.2	
Total	\$1,207	\$266	\$941	353.8	%

Service charges and fee income increased primarily due to higher loan fees from a greater volume of loan originations in the 2012 period versus the 2011 period. Higher mortgage servicing income was a result of increased volumes of loans sold in the secondary market and higher loan sale margins on the sale of loans to Fannie Mae. The fair value adjustment on mortgage servicing rights was impacted by the interest rate environment, as rates decreased during the 2012 period and prepayment speeds increased. The increased gain on sale of loans was a result of an increase in the

volume of loans originated for sale to Fannie Mae during the three months ended September 30, 2012 compared to the same 2011 period. The loan origination volumes were achieved as a result of a continuing high volume of activity resulting from relatively low mortgage interest rates.

---

Noninterest income increased \$1.5 million, or 81.0%, to \$3.3 million during the nine months ended September 30, 2012, compared to \$1.8 million during the nine months ended September 30, 2011. A summary of the changes in noninterest income for the nine month period is presented in the table below:

	Nine Months Ended September 30,		Amount Change	Percent Change	
	2012	2011			
	(Dollars in thousands)				
Service charges and fee income	\$1,638	\$1,514	\$124	8.2	%
Earnings on cash surrender value of bank owned life insurance	179	189	(10 )	(5.3 )	
Mortgage servicing income	346	318	28	8.8	
Fair value adjustment on mortgage servicing rights	97	(235 )	332	141.3	
Loss on sale of securities	-	(33 )	33	100.0	
Other-than-temporary impairment losses	(156 )	(96 )	(60 )	(62.5 )	
Loss on sale of fixed assets	-	(80 )	80	100.0	
Gain on sale of loans	1,226	263	963	366.2	
Total	\$3,330	\$1,840	\$1,490	81.0	%

Service charges and fee income increased \$124,000, or 8.2%, to \$1.6 million during the nine months ended September 30, 2012, compared to \$1.5 million during the three months ended September 30, 2011. This increase was primarily a result of increased volumes of loan originations in the 2012 period compared to the 2011 period. We also introduced new deposit offerings that had a favorable impact on debit card income and other deposit fees.

The fair value adjustment on mortgage servicing rights was primarily a result of an increase in the size of the overall servicing asset as rates have remained relatively steady along with prepayment speeds. The increased gain on sale of loans was a result of an increase in the volume of loans originated for sale and higher loan sale margins on the sale of loans to Fannie Mae during the nine months ended September 30, 2012 compared to the same 2011 period. The loan origination volumes were achieved as a result of a continuing high volume of activity resulting from relatively low mortgage interest rates.

Noninterest Expense. Noninterest expense increased \$511,000, or 19.1%, to \$3.2 million during the three months ended September 30, 2012, compared to \$2.7 million during the three months ended September 30, 2011. A summary of the changes in noninterest expense for the three month period is presented in the table below:

	Three Months Ended September 30,		Amount Change	Percent Change	
	2012	2011			
	(Dollars in thousands)				
Salaries and benefits	\$1,537	\$1,189	\$348	29.3	%
Operations	697	602	95	15.8	
Regulatory assessments	108	103	5	4.9	
Occupancy	314	288	26	9.0	
Data processing	264	218	46	21.1	
Losses and expenses on sale of OREO and repossessed assets	265	274	(9 )	(3.3 )	

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

Total	\$3,185	\$2,674	\$511	19.1	%
-------	---------	---------	-------	------	---

Salaries and benefits expense increased by \$348,000 for the three months ended September 30, 2012 compared to the three months ended September 30, 2011 due to increased lending staff and higher commission expenses due to increased loan production. Operations expense increased \$95,000 during the three months ended September 30, 2012 compared to the same period in 2011 as a result of higher marketing costs associated with the rollout of new deposit products and higher loan processing costs due to increased loan production. Data processing expenses increased primarily due to the rollout of the new deposit products and associated programming costs.

---

A summary of the changes in noninterest expense for the nine month period is presented in the table below:

	Nine Months Ended September 30,		Amount Change	Percent Change	
	2012	2011			
	(Dollar amounts in thousands)				
Salaries and benefits	\$4,242	\$3,942	\$300	7.6	%
Operations	2,007	1,869	138	7.4	
Regulatory assessments	329	454	(125)	(27.5)	)
Occupancy	918	835	83	9.9	
Data processing	769	685	84	12.3	
Losses and expenses on sale of OREO and repossessed assets	757	958	(201)	(21.0)	)
<b>Total</b>	<b>\$9,022</b>	<b>\$8,743</b>	<b>\$279</b>	<b>3.2</b>	<b>%</b>

Salaries and benefits expense increased by \$300,000 for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011 due to increased lending staff and higher commission expenses due to increased loan production. Operations expense increased as a result of higher marketing costs associated with the rollout of new deposit products and higher loan processing costs due to increased loan production. Regulatory assessments decreased during the nine months ended September 30, 2012 as compared to the same period in 2011 due to a decrease in the FDIC's assessment rate. Occupancy expenses increased primarily due to rent increases and other expenditures related to our main office. Losses and expenses on OREO and repossessed assets decreased by \$201,000 during the nine month 2012 period compared to same period in 2011 due to lower net losses and reduced expenses associated with OREO property sales as well as reflecting a decline in the amount of OREO.

**Income Tax Expense.** For the three months ended September 30, 2012, we had income tax expense of \$281,000 on our pre-tax income as compared to \$43,000 for the three months ended September 30, 2011. The effective tax rates for the quarters ended September 30, 2012 and 2011 were 31.5% and 19.2%, respectively.

### Liquidity

The Management Discussion and Analysis in Item 7 of the Company's Form 10-K Annual Report filed with the SEC on March 31, 2012 contains an overview of the Company's and the Bank's liquidity management, sources of liquidity and cash flows. This discussion updates that disclosure for the nine months ended September 30, 2012.

At September 30, 2012, the Bank had \$36.5 million in cash and investment securities available for sale and \$2.1 million in loans held for sale generally available for its cash needs. Also, based on existing collateral pledged, the Bank had the ability to borrow an additional \$51.0 million in Federal Home Loan Bank advances, \$9.8 million through the Federal Reserve's Discount Window and \$2.0 million through Pacific Coast Banker's Bank. The Bank uses these sources of funds primarily to meet ongoing commitments, pay maturing deposits and fund withdrawals, and to fund loan commitments. At September 30, 2012, outstanding loan commitments, including unused lines and letters of credit totaled \$57.4 million. Certificates of deposit scheduled to mature in one year or less at September 30, 2012, totaled \$70.3 million. Based on our competitive pricing, we believe that a majority of maturing deposits will remain with the Bank.

As a separate legal entity from the Bank, the Company must provide for its own liquidity. At September 30, 2012, the Company, on an unconsolidated basis, had \$4.2 million in cash, interest-bearing deposits and liquid investments generally available for its cash needs. The Company's principal source of liquidity is dividends from the Bank.

Except as set forth above, management is not aware of any trends, events, or uncertainties that will have, or that are reasonably likely to have a material impact on liquidity, capital resources or operations.

---

## Off-Balance Sheet Activities

In the normal course of operations, the Company engages in a variety of financial transactions that are not recorded in our financial statements. These transactions involve varying degrees of off-balance sheet credit, interest rate and liquidity risks. These transactions are used primarily to manage customers' requests for funding and take the form of loan commitments and lines of credit. During the nine months ended September 30, 2012, we engaged in no off-balance sheet transactions likely to have a material effect on our financial condition, results of operations or cash flows.

A summary of our off-balance sheet loan commitments at September 30, 2012, is as follows:

Off-balance sheet loan commitments (in thousands)	
Commitments to make loans	\$16,601
Undisbursed portion of loans closed	9,098
Unused lines of credit	31,133
Irrevocable letters of credit	578
<b>Total loan commitments</b>	<b>\$57,410</b>

## Capital

Sound Community Bank is subject to minimum capital requirements imposed by regulations of the OCC. Based on its capital levels at September 30, 2012, Sound Community Bank exceeded these requirements as of that date. Consistent with our goals to operate a sound and profitable organization, our policy is for Sound Community Bank to maintain a "well-capitalized" status under the regulatory capital categories of the OCC. Based on capital levels at September 30, 2012, Sound Community Bank was considered to be well-capitalized. Management monitors the capital levels to provide for current and future business opportunities and to maintain Sound Community Bank's "well-capitalized" status.

The following table shows the capital ratios of Sound Community Bank at September 30, 2012 (dollars in thousands):

	Actual		Minimum Capital Requirements				Minimum Required to Be Well-Capitalized Under Prompt Corrective Action Provisions		
	Amount	Ratio	Amount		Ratio	Amount		Ratio	
Tier 1 Capital to total adjusted assets(1)	\$37,568	10.27 %	\$14,636	≥	4.00 %	18,295	≥	5.00 %	
Tier 1 Capital to risk-weighted assets(2)	\$37,568	13.76 %	\$10,921	≥	4.00 % <sup>(3)</sup>	16,382	≥	6.00 %	
Total Capital to risk-weighted assets(2)	\$40,992	15.01 %	\$21,842	≥	8.00 %	27,303	≥	10.00 %	

(1) Based on total adjusted assets of \$365.9 million.

(2) Based on risk-weighted assets of \$273.0 million.

(3) The Tier 1 risk-based capital requirement for a well-capitalized institution is 6% of risk-weighted assets.





Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company is a smaller reporting company and is not required to provide this disclosure.

The Company provided information about market risk in Item 7A of its Form 10-K Annual Report filed with the SEC on March 31, 2012. There have been no material changes in our market risk since our December 31, 2011 Form 10-K.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures.

An evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a -15(e) under the Securities Exchange Act of 1934 (the "Act")), as of September 30, 2012, was carried out under the supervision and with the participation of the Company's Chief Executive Officer, Chief Financial Officer and several other members of the Company's senior management. The Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2012, the Company's disclosure controls and procedures were effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Act is: (i) accumulated and communicated to the Company's management (including the Chief Executive Officer and the Chief Financial Officer) in a timely manner, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

We intend to continually review and evaluate the design and effectiveness of the Company's disclosure controls and procedures and to improve the Company's controls and procedures over time and to correct any deficiencies that we may discover in the future. The goal is to ensure that senior management has timely access to all material financial and non-financial information concerning the Company's business. While we believe the present design of the disclosure controls and procedures is effective to achieve this goal, future events affecting our business may cause the Company to modify its disclosure controls and procedures.

The Company does not expect that its disclosure controls and procedures will prevent all error and all fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. 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. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure 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; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies and procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

(b) Changes in Internal Control over Financial Reporting.

There were no changes in our internal control over financial reporting (as defined in Rule 13a - 15(f) under the Act) that occurred during the quarter ended September 30, 2012, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



PART II OTHER INFORMATION

Item 1 Legal Proceedings

In the normal course of business, the Company occasionally becomes involved in various legal proceedings. In the opinion of management, any liability from such proceedings would not have a material adverse effect on the business or financial condition of the Company.

Item 1A Risk Factors

Not required; the Company is a smaller reporting company.

Item 2 Unregistered Sales of Equity Securities and use of Proceeds

Nothing to report.

Item 3 Defaults Upon Senior Securities

Nothing to report.

Item 4 Mine Safety Disclosures

Not Applicable

Item 5. Other Information

Nothing to report

---

EXHIBIT INDEX

Exhibits:

2.0	Plan of Conversion and Reorganization (incorporated herein by reference to the Current Report on Form 8-K filed with the SEC on January 30, 2012 (File No. 000-52889))
3.1	Charter of Sound Financial Bancorp, Inc. (incorporated herein by reference to the Registration Statement on Form S-1 filed with the SEC on March 27, 2012 (File No. 333-180385))
3.2	Bylaws of Sound Financial Bancorp, Inc. (incorporated herein by reference to the Registration Statement on Form S-1 filed with the SEC on March 27, 2012 (File No. 333-180385))
4.0	Form of Common Stock Certificate of Sound Financial Bancorp, Inc. (incorporated herein by reference to the Registration Statement on Form S-1 filed with the SEC on March 27, 2012 (File No. 333-180385))
10.1	Employment Agreement by and between Sound Community Bank and Laura Lee Stewart (incorporated herein by reference to the Registration Statement on Form SB-2 filed with the SEC on September 20, 2007 (File No. 333-146196))
10.2	Executive Long Term Compensation Agreement effective August 14, 2007 by and between Sound Community Bank and Laura Lee Stewart (incorporated herein by reference to the Registration Statement on Form SB-2 filed with the SEC on September 20, 2007 (File No. 333-146196))
10.3	Amendment to Freeze Benefit Accruals Under the Executive Long Term Compensation Agreement effective August 14, 2007, by and between Sound Community Bank (incorporated herein by reference to the Current Report on Form 8-K filed with the SEC on January 5, 2012 (File No. 000-52889))
10.4	Supplemental Executive Long Term Compensation Agreement effective December 31, 2011 by and between Sound Community Bank and Laura Lee Stewart (incorporated herein by reference to the Current Report on Form 8-K filed with the SEC on January 5, 2012 (File No. 000-52889))
10.5	Confidentiality, Non-Competition and Non-Solicitation Agreement by and between Sound Community Bank and Laura Lee Stewart (incorporated herein by reference to the Report on Form 8-K filed with the SEC on January 5, 2012 (File No. 000-52889))
10.6	Employment Agreement by and between Sound Community Bank and Matthew Deines (incorporated herein by reference to the Current Report on Form 8-K filed with the SEC on November 5, 2009 (File No. 000-52889))
10.7	Employment Agreement by and between Sound Community Bank and Matthew Moran (incorporated herein by reference to the Current Report on Form 8-K filed with the SEC on November 5, 2009 (File No. 000-52889))
10.8	Addendums to the Employment Agreements by and between Sound Community Bank and each of Matthew Deines and

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

	Matthew Moran (incorporated herein by reference to the Current Report on Form 8-K filed with the SEC on January 3, 2012 (File No. 000-52889))
10.9	Summary of Director Board Fee Arrangements (incorporated herein by reference to the Annual Report on Form 10-K filed with the SEC on March 31, 2011 (File No. 000-52889))
	Sound Financial Bancorp, Inc. 2008 Equity Incentive Plan (incorporated herein by reference to the Annual Report on Form 10-K filed with the SEC on March 31, 2009 (File No. 000-52889))
10.10	Forms of Incentive Stock Option Agreement, Non-Qualified Stock Option Agreement and Restricted Stock Agreements under the 2008 Equity Incentive Plan (incorporated herein by reference to the Current Report on Form 8-K filed with the SEC on January 29, 2009 (File No. 000-52889))
10.11	Summary of Annual Bonus Plan (incorporated herein by reference to the Registration Statement on Form SB-2 filed with the SEC on September 20, 2007 (File No. 333-146196))
10.12	Statement re computation of per share earnings (See Note 8 of the Notes to Condensed Consolidated Financial Statements contained in this Quarterly Report on Form 10-Q.)
11	Rule 13(a)-14(a) Certification (Chief Executive Officer)
31.1	Rule 13(a)-14(a) Certification (Chief Financial Officer)
31.2	Section 1350 Certification
32	Interactive Data Files*
101	

- In accordance with Rule 406T of Regulation S-T, these interactive data files are deemed not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are not deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those section.

SIGNATURES

Pursuant to the requirements 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.

Sound Financial Bancorp, Inc.

Date: November 14, 2012

By: /s/ Laura Lee Stewart  
Laura Lee Stewart  
President and Chief Executive Officer

Date: November 14, 2012

By: /s/ Matthew P. Deines  
Matthew P. Deines  
Executive Vice President and Chief Financial Officer

t;font-size:10pt;">

6,211

5,453

5,042

Other, net  
(10,142  
)

(5,697  
)

(6,236  
)

(5,008  
)

(1,217  
)

(706  
)

Total  
\$

84,341

\$  
76,859

\$  
75,932

\$  
69,117

\$  
61,048

\$  
61,584

Effective income tax rate

34.0  
%

35.4  
%

35.1  
%

35.6  
%

37.6  
%

37.7  
%

The Company's and the Utilities' effective tax rate decreased in 2013 compared to 2012 primarily due to \$3.5 million lower deferred taxes related to the tax gross-up of AFUDC-equity and a \$3.1 million (including \$2.7 million related to the Utilities) out-of-period income tax benefit (see "Out-of-period income tax benefit"). The Company's effective tax rate increased slightly from 2011 to 2012 due primarily to lower utility tax credit amortization and its lower relative impact on higher operating income in 2012, and tax-free bank-owned life insurance proceeds received in 2011.

The tax effects of book and tax basis differences that give rise to deferred tax assets and liabilities were as follows:

150

---



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

December 31 (in thousands)	HEI consolidated		Hawaiian Electric consolidated	
	2013	2012	2013	2012
Deferred tax assets				
Allowance for loan losses	\$ 16,172	\$ 17,254	\$—	\$—
Retirement benefits	—	266	—	—
Net operating loss	—	—	19,848	6,413
Other	41,067	34,354	17,295	13,986
Total deferred tax assets	57,239	51,874	37,143	20,399
Deferred tax liabilities				
Property, plant and equipment related	378,280	316,900	375,771	315,409
Goodwill	23,781	23,781	—	—
Regulatory assets, excluding amounts attributable to property, plant and equipment	33,251	33,071	33,251	33,071
FHLB stock dividend	18,847	20,062	—	—
Repairs deduction	75,127	69,514	75,127	69,514
Retirement benefits	29,280	—	23,851	8,688
Other	27,933	27,875	15,602	11,328
Total deferred tax liabilities	586,499	491,203	523,602	438,010
Net deferred income tax liability	\$ 529,260	\$ 439,329	\$ 486,459	\$ 417,611
Prepayments and other	\$—	\$—	\$ 20,702	\$—
Deferred income taxes	529,260	439,329	507,161	417,611
Net deferred income tax liability	\$ 529,260	\$ 439,329	\$ 486,459	\$ 417,611

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences are deductible. Based upon historical taxable income and projections for future taxable income, management believes it is more likely than not the Company and the Utilities will realize substantially all of the benefits of the deferred tax assets. As of December 31, 2013, the valuation allowance for deferred tax benefits is not significant. In 2013, the net deferred income tax liability continued to increase primarily as a result of accelerated tax deductions taken for bonus depreciation (resulting from the American Taxpayer Relief Act of 2012). The Utilities are included in the consolidated federal and Hawaii income tax returns of HEI and are subject to the provisions of HEI's tax sharing agreement, which determines each subsidiary's (or subgroup) income tax return liabilities and refunds on a standalone basis as if it filed a separate return (or subgroup consolidated return).

Consequently, although HEI consolidated does not expect any unutilized net operating loss (NOL) as of December 31, 2013, standalone Hawaiian Electric consolidated expects a \$55 million (pretax) NOL for federal tax purposes in accordance with the HEI tax sharing agreement. The deferred tax asset associated with this NOL is included in "Prepayments and other."

HEI consolidated. In 2013, 2012 and 2011, credit adjustments to interest expense on income taxes was reflected in "Interest expense – other than on deposit liabilities and other bank borrowings" in the amount of \$0.3 million, \$1.4 million and \$1.2 million, respectively. The credit adjustments to interest expense were primarily due to the resolution of tax issues with the Internal Revenue Service (IRS). As of December 31, 2013 and 2012, the total amount of accrued interest related to uncertain tax positions and recognized on the balance sheet in "Interest and dividends payable" was \$0.4 million and \$0.3 million, respectively.

As of December 31, 2013, the total amount of liability for uncertain tax positions was \$0.9 million and, of this amount, \$0.7 million, if recognized, would affect the Company's effective tax rate. The Company's unrecognized tax benefits are primarily the result of differences relating to the tax basis of property and equipment.

Hawaiian Electric consolidated. In 2013, 2012 and 2011, credit adjustments to interest expense on income taxes was reflected in "Interest and other charges" in the amount of \$0.3 million, \$0.5 million and \$1.0 million, respectively. The credit adjustments to interest expense were primarily due to the resolution of tax issues with the IRS. As of December 31, 2013 and 2012, the total amount of accrued interest related to uncertain tax positions and recognized on

the balance sheet in “Interest and preferred dividends payable” was de minimis.

151

---

As of December 31, 2013, the total amount of liability for uncertain tax positions was \$0.5 million and, if recognized, would affect the Utilities' effective tax rate. The Utilities' unrecognized tax benefits are primarily the result of differences relating to the tax basis of property and equipment.

The changes in total unrecognized tax benefits were as follows:

(in millions)	HEI consolidated			Hawaiian Electric consolidated		
	2013	2012	2011	2013	2012	2011
Unrecognized tax benefits, January 1	\$0.8	\$5.7	\$15.4	\$0.4	\$3.7	14.2
Additions based on tax positions taken during the year	—	0.3	—	—	0.3	—
Reductions based on tax positions taken during the year	—	—	(0.6 )	—	—	(0.6 )
Additions for tax positions of prior years	0.5	—	0.1	0.5	—	—
Reductions for tax positions of prior years	(0.4 )	(4.1 )	(8.1 )	(0.4 )	(3.6 )	(8.8 )
Settlements	—	—	—	—	—	—
Lapses of statute of limitations	—	(1.1 )	(1.1 )	—	—	(1.1 )
Unrecognized tax benefits, December 31	\$0.9	\$0.8	\$5.7	\$0.5	\$0.4	\$3.7

The 2012 reduction in unrecognized tax benefits was primarily due to the IRS's acceptance of the deductibility of costs of repairs to utility generation property for tax years 2007-2009. The 2011 reduction in unrecognized tax benefits was primarily due to the IRS's issuance of guidance (Revenue Procedure 2011-43, issued in August 2011) on the deductibility of costs of repairs to utility transmission and distribution (T&D) property, including a "safe harbor" method under which taxpayers could transition and minimize the uncertainty of the repairs expense deduction for T&D property. The Company elected the "safe harbor" method in its 2011 tax return, which resulted in the reduction of associated unrecognized tax benefits for 2011.

The IRS is currently auditing tax years 2010 and 2011. Tax years 2007 to 2012 remain subject to examination by the Department of Taxation of the State of Hawaii.

As of December 31, 2013, the disclosures above present the Company's and the Utilities' accruals for potential tax liabilities and related interest. Based on information currently available, the Company and the Utilities believe these accruals have adequately provided for potential income tax issues with federal and state tax authorities and related interest, and that the ultimate resolution of tax issues for all open tax periods will not have a material adverse effect on its results of operations, financial condition or liquidity.

**Out-of-period income tax benefit.** During 2013, the Company recorded a \$3.1 million (including \$2.7 million related to the Utilities) out-of-period income tax benefit, resulting primarily from the reversal of deferred tax liabilities due to errors in the amount of book over tax basis differences in plant and equipment. Management concluded that this out-of-period adjustment was not material to either the current or any prior period financial statements.

**Recent tax developments.** In September 2013, the IRS issued final regulations addressing the acquisition, production and improvement of tangible property, which are effective January 1, 2014. Management is currently evaluating the impact of these new regulations, but does not expect a material impact on the Utilities since specific guidance on network (i.e., transmission and distribution) assets and generation property has already been received. The IRS also proposed regulations addressing the disposition of property.

The Utilities adopted the safe harbor guidelines with respect to network assets in 2011 and in June 2013, the IRS released a revenue procedure relating to deductions for repairs of generation property, which provides some guidance (that is elective) for taxpayers that own steam or electric generation property. This guidance defines the relevant components of generation property to be used in determining whether such component expenditures should be deducted as repairs or capitalized and depreciated by taxpayers. The revenue procedure also provides an extrapolation methodology that could be used by taxpayers in determining deductions for prior years' repairs without going back to the specific documentation of those years. The guidance does not provide specific methods for determining the repairs amount. Management continues to evaluate the costs and benefits of adopting this guidance, in order to determine whether and when an election should be made.



## 13 · Cash flows

Years ended December 31 (in millions)	2013	2012	2011
Supplemental disclosures of cash flow information			
HEI consolidated			
Interest paid to non-affiliates	\$85	\$84	\$97
Income taxes paid (refunded)	14	(14)	(22)
Hawaiian Electric consolidated			
Interest paid to non-affiliates	59	57	58
Income taxes refunded	(26)	(3)	(23)
Supplemental disclosures of noncash activities			
HEI consolidated			
Common stock dividends reinvested in HEI common stock <sup>1</sup>	24	24	12
Increases in common stock related to director and officer compensatory plans	5	6	8
Loans transferred from held for investment to held for sale	25	—	6
Real estate acquired in settlement of loans	4	11	12
Hawaiian Electric consolidated			
Electric utility property, plant and equipment			
AFUDC-equity	6	7	6
Estimated fair value of noncash contributions in aid of construction	5	10	7
Unpaid invoices and other	24	37	45

<sup>1</sup> The amounts shown represents common stock dividends reinvested in HEI common stock under the HEI DRIP in noncash transactions.

## 14 · Regulatory restrictions on net assets

As of December 31, 2013, the Utilities could not transfer approximately \$674 million of net assets to HEI in the form of dividends, loans or advances without PUC approval.

ASB is required to notify the FRB and OCC prior to making any capital distribution (including dividends) to HEI (through ASHI). Generally, the FRB and OCC may disapprove or deny ASB's request to make a capital distribution if the proposed distribution will cause ASB to become undercapitalized, or the proposed distribution raises safety and soundness concerns, or the proposed distribution violates a prohibition contained in any statute, regulation, or agreement between ASB and the OCC. As of December 31, 2013, ASB could transfer approximately \$91 million of net assets to HEI in the form of dividends and still maintain its "well-capitalized" position.

HEI management expects that the regulatory restrictions will not materially affect the operations of the Company nor HEI's ability to pay common stock dividends.

## 15 · Significant group concentrations of credit risk

Most of the Company's business activity is with customers located in the State of Hawaii.

The Utilities are regulated operating electric public utilities engaged in the generation, purchase, transmission, distribution and sale of electricity on the islands of Oahu, Hawaii, Maui, Lanai and Molokai in the State of Hawaii. The Utilities provide the only electric public utility service on the islands they serve. The Utilities grant credit to customers, all of whom reside or conduct business in the State of Hawaii.

Most of ASB's financial instruments are based in the State of Hawaii, except for the investment and mortgage-related securities it owns. Substantially all real estate loans receivable are collateralized by real estate in Hawaii. ASB's policy is to require mortgage insurance on all real estate loans with a loan to appraisal ratio in excess of 80% at origination.

## 16 · Fair value measurements

Fair value estimates are estimates of the price that would be received to sell an asset, or paid upon the transfer of a liability, in an orderly transaction between market participants at the measurement date. The fair value estimates are generally determined based on assumptions that market participants would use in pricing the asset or liability and are based on market data obtained from independent sources. However, in certain cases, the Company and the Utilities use their own assumptions about market participant assumptions based on the best information available in the circumstances. These valuations are estimates at a specific point in time, based on relevant market information, information about the financial instrument and judgments regarding future expected loss experience, economic conditions, risk characteristics of various financial instruments and other factors. These estimates do not reflect any premium or discount that could result if the Company or the Utilities were to sell its entire holdings of a particular financial instrument at one time. Because no active trading market exists for a portion of the Company's and the Utilities' financial instruments, fair value estimates cannot be determined with precision. Changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the estimates. In addition, the tax ramifications related to the realization of the unrealized gains and losses could have a significant effect on fair value estimates, but have not been considered in making such estimates.

The Company and the Utilities group their financial assets measured at fair value in three levels outlined as follows:

- Level 1: Inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and is used to measure fair value whenever available.
- Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; inputs to the valuation methodology include quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs to the valuation methodology that are derived principally from or can be corroborated by observable market data by correlation or other means.
- Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using discounted cash flow methodologies, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The Company and/or the Utilities used the following methods and assumptions to estimate the fair value of each applicable class of financial instruments for which it is practicable to estimate that value:

Short-term borrowings—other than bank. The carrying amount approximated fair value because of the short maturity of these instruments.

Investment and mortgage-related securities. To determine the fair value of investment securities held in ASB's available-for-sale portfolio, independent third-party vendor or broker pricing is used on an unadjusted basis. Prices for investments and mortgage-related securities are based on observable inputs, including historical trading levels or sector yields, using market-based valuation techniques. The third party pricing service uses applications, models and pricing matrices that correlate security prices to benchmark securities which are adjusted for various inputs. Inputs include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark security bids and offers, TBA (to be announced) prices, monthly payment information, and reference data including market research. The pricing service may prioritize inputs differently on any given day for any security, and not all inputs are available for use in the evaluation process on any given day or for each security. The pricing vendor corroborates its finding on an on-going basis by monitoring market activity and events.

Third party pricing services provide security prices in good faith using rigorous methodologies; however, they do not warrant or guarantee the adequacy or accuracy of their information. Therefore, ASB utilizes a separate third party pricing vendor to corroborate security pricing of the first pricing vendor. If the pricing differential between the two pricing sources exceeds an established threshold, a pricing inquiry will be sent to both vendors or to an independent broker to determine a price that can be supported based on observable inputs found in the market. Such challenges to pricing are required infrequently and are generally resolved using additional security-specific information that was not available to a specific vendor.

Loans receivable. The estimated fair value of loans receivable is determined based on characteristics such as loan category, repricing features and remaining maturity, and includes prepayment estimates.

For residential real estate loans, fair values were estimated by discounting estimated cash flows using discount rates based on current industry pricing for loans with similar contractual characteristics and remaining maturity.

For other types of loans, fair values were estimated by discounting contractual cash flows using discount rates that reflect current industry pricing for loans with similar characteristics and remaining maturity. Where industry pricing is not available, discount rates are based on ASB's current pricing for loans with similar characteristics and remaining maturity.

The fair value of all loans was adjusted to reflect current assessments of loan collectability. Also see "Fair value measurements on a nonrecurring basis" below.

Deposit liabilities. The fair value of savings, negotiable orders of withdrawal, demand and money market deposits was the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit was estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities.

Other bank borrowings. Fair value was estimated by discounting the future cash flows using the current rates available for borrowings with similar credit terms and remaining maturities.

Long-term debt. Fair value was obtained from third-party financial services providers based on the current rates offered for debt of the same or similar remaining maturities and from discounting the future cash flows using the current rates offered for debt of the same or similar remaining maturities.

Derivative financial instruments. See "Fair value measurements on a recurring basis" below.

Off-balance sheet financial instruments. The fair value of loans serviced for others was calculated by discounting expected net income streams using discount rates that reflect industry pricing for similar assets. Expected net income streams were estimated based on industry assumptions regarding prepayment speeds and income and expenses associated with servicing residential mortgage loans for others. The fair value of commitments to originate loans was estimated based on the change in current primary market prices of new commitments. Since lines of credit can expire without being drawn and customers are under no obligation to utilize the lines, no fair value was assigned to unused lines of credit. The fair value of letters of credit was estimated based on the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements.



The estimated fair values of certain of the Company's and the Utilities' financial instruments were as follows:

(in thousands)	Carrying or notional amount	Quoted prices in active markets for identical assets (Level 1)	Estimated fair value Significant other Observable inputs (Level 2)	Significant Unobservable inputs (Level 3)	Total
December 31, 2013					
Financial assets					
Money market funds	\$10	\$—	\$10	\$—	\$10
Available-for-sale investment and mortgage-related securities	529,007	—	529,007	—	529,007
Investment in stock of Federal Home Loan Bank of Seattle	92,546	—	92,546	—	92,546
Loans receivable, net	4,115,415	—	—	4,211,290	4,211,290
Derivative assets	46,356	98	531	—	629
Financial liabilities					
Deposit liabilities	4,372,477	—	4,374,377	—	4,374,377
Short-term borrowings—other than bank	105,482	—	105,482	—	105,482
Other bank borrowings	244,514	—	256,029	—	256,029
Long-term debt, net—other than bank	1,492,945	—	1,508,425	—	1,508,425
The Utilities' long-term debt, net (included in amount above)	1,217,945	—	1,228,966	—	1,228,966
Derivative liabilities	4,732	—	26	—	26
December 31, 2012					
Financial assets					
Money market funds	\$10	\$—	\$10	\$—	\$10
Available-for-sale investment and mortgage-related securities	671,358	—	671,358	—	671,358
Investment in stock of Federal Home Loan Bank of Seattle	96,022	—	96,022	—	96,022
Loans receivable, net	3,763,238	—	—	3,957,752	3,957,752
Financial liabilities					
Deposit liabilities	4,229,916	—	4,235,527	—	4,235,527
Short-term borrowings—other than bank	83,693	—	83,693	—	83,693
Other bank borrowings	195,926	—	212,163	—	212,163
Long-term debt, net—other than bank	1,422,872	—	1,481,004	—	1,481,004
The Utilities' long-term debt, net (included in amount above)	1,147,872	—	1,181,631	—	1,181,631

As of December 31, 2013 and 2012, loan commitments and unused lines and letters of credit issued by ASB had notional amounts of \$1.6 billion and \$1.5 billion, respectively, and their estimated fair value on such dates were \$0.2 million and \$1.2 million, respectively. As of December 31, 2013 and 2012, loans serviced by ASB for others had notional amounts of \$1.4 billion and \$1.3 billion, respectively, and the estimated fair value of the servicing rights for such loans was \$15.7 million and \$11.9 million, respectively.

Fair value measurements on a recurring basis.

Securities. While securities held in ASB's investment portfolio trade in active markets, they do not trade on listed exchanges nor do the specific holdings trade in quoted markets by dealers or brokers. All holdings are valued using

market-based approaches that are based on exit prices that are taken from identical or similar market transactions, even in situations where trading volume may be low when compared with prior periods. Inputs to these valuation techniques reflect the assumptions that consider credit and nonperformance risk that market participants would use in pricing the asset based on

156

---

market data obtained from independent sources. Available-for-sale securities were comprised of federal agency obligations and mortgage-backed securities and municipal bonds.

Derivative financial instruments. ASB enters into interest rate lock commitments (IRLC) for residential mortgage loans, which commit ASB to lend funds to a potential borrower at a specific interest rate and within a specified period of time. The estimated fair value of commitments to originate residential mortgage loans for sale is based on quoted prices for similar loans in active markets. IRLCs are classified as Level 2 measurements.

ASB utilizes forward commitments as economic hedges against potential changes in the values of the IRLCs and loans held for sale. To reduce the impact of price fluctuations of IRLC and mortgage loans held for sale, ASB will purchase to be announced (TBA) mortgage-backed securities forward commitments, mandatory and best effort commitments. These commitments help protect ASB's loan sale profit margin from fluctuations in interest rates. The changes in the fair value of these commitments are recognized as part of mortgage banking income on the consolidated statements of income. TBA forward commitments are classified as Level 1, and consist of publicly-traded debt securities for which identical fair values can be obtained through quoted market prices in active exchange markets. The fair values of ASB's best efforts and mandatory delivery loan sale commitments are determined similarly to the IRLCs using quoted prices in the market place that are observable and are classified as Level 2 measurements.

Assets and liabilities measured at fair value on a recurring basis were as follows:

(in thousands)	December 31, 2013			December 31, 2012		
	Fair value measurements using Level 1	Level 2	Level 3	Fair value measurements using Level 1	Level 2	Level 3
Money market funds ("other" segment)	\$—	\$10	\$—	\$—	\$10	\$—
Available-for-sale securities (bank segment)						
Mortgage-related securities-FNMA, FHLMC and GNMA	\$—	\$369,444	\$—	\$—	\$417,383	\$—
Federal agency obligations	—	80,973	—	—	171,491	—
Municipal bonds	—	78,590	—	—	82,484	—
	\$—	\$529,007	\$—	\$—	\$671,358	\$—
Derivative assets <sup>1</sup>						
Interest rate lock commitments	\$—	\$488	\$—	\$—	\$—	\$—
Forward commitments	98	43	—	—	—	—
	\$98	\$531	\$—	\$—	\$—	\$—
Derivative liabilities <sup>1</sup>						
Interest rate lock commitments	\$—	\$24	\$—	\$—	\$—	\$—
Forward commitments	—	2	—	—	—	—
	\$—	\$26	\$—	\$—	\$—	\$—

<sup>1</sup> Derivatives are carried at fair value with changes in value reflected in the balance sheet in other assets or other liabilities and included in mortgage banking income.

Fair value measurements on a nonrecurring basis. From time to time, the Company may be required to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from the writedowns of individual assets. ASB does not record loans at fair value on a recurring basis.

However, from time to time, ASB records nonrecurring fair value adjustments based on the current appraised value of the collateral securing the loans or unobservable market assumptions. Unobservable assumptions reflect ASB's own estimate of the fair value of collateral used in valuing the loan. ASB may also be required to measure goodwill at fair value on a nonrecurring basis. See "Goodwill and other intangibles" in Note 1 for ASB's goodwill valuation methodology. During 2013 and 2012, goodwill was not measured at fair value.

From time to time, the Company may be required to measure certain liabilities at fair value on a nonrecurring basis in accordance with GAAP. The fair value of Hawaiian Electric's ARO (Level 3) was determined by discounting the expected future cash flows using market-observable risk-free rates as adjusted by Hawaiian Electric's credit spread (also see Note 3).



Assets measured at fair value on a nonrecurring basis were as follows:

(in millions)	Balance	Fair value measurements using		
		Level 1	Level 2	Level 3
Loans				
December 31, 2013	\$4	\$—	\$—	\$4
December 31, 2012	21	—	—	21
Real estate acquired in settlement of loans				
December 31, 2013	—	—	—	—
December 31, 2012	3	—	—	3

For 2013 and 2012, there were no adjustments to fair value for ASB's loans held for sale.

Residential loans. The fair value of ASB's residential loans that were written down due to impairment was determined based on third party appraisals, which include the appraisers' assumptions and judgment, and therefore, is classified as a Level 3 measurement.

Home equity lines of credit. The fair value of ASB's home equity lines of credit that were written down due to impairment was determined based on third party appraisals, which include the appraisers' assumptions and judgment, and therefore, is classified as a Level 3 measurement.

Commercial loans. The fair value of ASB's commercial loans that were written down due to impairment was determined based on the value placed on the assets of the business, and therefore, is classified as a Level 3 measurement.

Real estate acquired in settlement of loans. The fair value of ASB's real estate acquired in settlement of loans that were written down due to impairment was determined based on third party appraisals, which include the appraisers' assumptions and judgment, and therefore, is classified as a Level 3 measurement.

For loans and real estate acquired in settlement of loans classified as Level 3 as of December 31, 2013, the significant unobservable inputs used in the fair value measurement were as follows:

(\$ in thousands)	Fair value at December 31, 2013	Valuation technique	Significant unobservable input	Significant unobservable input value <sup>1</sup>	
				Range	Weighted Average
Residential loans	\$2,361	Fair value of property or collateral	Appraised value less 7% selling cost	44-96%	87%
Home equity lines of credit	170	Fair value of property or collateral	Appraised value less 7% selling cost	45-50%	50%
Commercial loans	217	Fair value of property or collateral	Fair value of business assets		19%
Commercial loans	1,668	Discounted cash flow	Present value of expected future cash flows		58%
			Discount rate		4.5%
Total loans	\$4,416				

<sup>1</sup> Represent percent of outstanding principal balance.

Significant increases (decreases) in any of those inputs in isolation would result in significantly higher (lower) fair value measurements.

Retirement benefit plans

Assets held in various trusts for the retirement benefit plans are measured at fair value on a recurring basis and were as follows:

(in millions)	Pension benefits				Other benefits			
	December 31	Fair value measurements using			December 31	Fair value measurements using		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	Level 3	
2013								
Equity securities	\$672	\$672	\$—	\$—	\$102	\$102	\$—	\$—
Equity index funds	127	127	—	—	19	19	—	—
Fixed income securities	350	122	228	—	46	40	6	—
Pooled and mutual funds and other	84	—	83	1	13	—	13	—
Total	\$1,233	\$921	\$311	\$1	\$180	\$161	\$19	\$—
Receivables and payables, net	(46	)			(1	)		
Fair value of plan assets	\$1,187				\$179			
2012								
Equity securities	\$513	\$513	\$—	\$—	\$83	\$83	\$—	\$—
Equity index funds	95	95	—	—	15	15	—	—
Fixed income securities	338	125	213	—	47	41	6	—
Pooled and mutual funds and other	78	1	76	1	13	—	13	—
Total	1,024	\$734	\$289	\$1	158	\$139	\$19	\$—
Receivables and payables, net	(53	)			(1	)		
Fair value of plan assets	\$971				\$157			

The fair values of the financial instruments shown in the table above represent the Company's best estimates of the amounts that would be received upon sale of those assets or that would be paid to transfer those liabilities in an orderly transaction between market participants at that date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the Company's judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Company based on the best information available in the circumstances.

In connection with the adoption of the fair value measurement standards, the Company adopted the provisions of ASU 2009-12, "Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent)," which allows for the estimation of the fair value of investments in investment companies for which the investment does not have a readily determinable fair value, using net asset value per share or its equivalent as a practical expedient.

The Company used the following valuation methodologies for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2013 and 2012.

Equity securities, equity index funds, U.S. Treasury fixed income securities and public mutual funds (Level 1).

Equity securities, equity index funds, U.S. Treasury fixed income securities and public mutual funds are valued at the closing price reported on the active market on which the individual securities or funds are traded.

Fixed income securities and pooled and mutual funds and other (Level 2). Fixed income securities, other than those issued by the U.S. Treasury, are valued based on yields currently available on comparable securities of issuers with similar credit ratings. Pooled and mutual funds include commingled equity funds and other closed funds, respectively, that are not open to public investment and are valued at the net asset value per share. Certain other investments are valued based on discounted cash flow analyses, using observable inputs.

Other (Level 3). Venture capital interest is valued at historical cost, modified by revaluation of financial assets and financial liabilities at fair value through profit or loss.

For 2013 and 2012, the changes in Level 3 assets were as follows:

(in thousands)	2013		2012	
	Pension	Other	Pension	Other

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

	benefits	benefits	benefits	benefits	
Balance, January 1	\$581	\$18	\$217	\$7	
Realized and unrealized losses	(1	) —	(24	) (1	)
Purchases and settlements, net	—	—	388	12	
Balance, December 31	\$580	\$18	\$581	\$18	

159

---

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

17 · Quarterly information (unaudited)

Selected quarterly information was as follows:

(in thousands, except per share amounts)	Quarters ended				Years ended December 31
	March 31	June 30	Sept. 30	Dec. 31	
HEI consolidated					
2013					
Revenues	\$784,064	\$796,730	\$831,229	\$826,447	\$3,238,470
Operating income	70,657	82,370	90,099	72,293	315,419
Net income	34,152	41,061	48,707	39,486	163,406
Net income for common stock	33,679	40,588	48,236	39,013	161,516
Basic earnings per common share <sup>1</sup>	0.34	0.41	0.49	0.39	1.63
Diluted earnings per common share <sup>2</sup>	0.34	0.41	0.48	0.39	1.62
Dividends per common share	0.31	0.31	0.31	0.31	1.24
Market price per common share <sup>3</sup>					
High	27.92	28.30	27.24	27.15	28.30
Low	25.50	23.84	24.12	24.51	23.84
2012					
Revenues	\$814,860	\$854,268	\$867,720	\$838,147	\$3,374,995
Operating income	75,816	79,406	91,702	37,272	284,196
Net income <sup>4</sup>	38,789	39,273	48,177	14,309	140,548
Net income for common stock <sup>4</sup>	38,316	38,800	47,706	13,836	138,658
Basic earnings per common share <sup>1</sup>	0.40	0.40	0.49	0.14	1.43
Diluted earnings per common share <sup>2</sup>	0.40	0.40	0.49	0.14	1.42
Dividends per common share	0.31	0.31	0.31	0.31	1.24
Market price per common share <sup>3</sup>					
High	26.79	28.87	29.24	26.75	29.24
Low	24.86	24.65	26.26	23.65	23.65
Hawaiian Electric consolidated					
2013					
Revenues	\$719,273	\$730,688	\$766,115	\$764,096	\$2,980,172
Operating income	52,953	61,138	71,914	59,508	245,513
Net income	24,928	29,192	38,315	32,489	124,924
Net income for common stock	24,429	28,693	37,817	31,990	122,929
2012					
Revenues	749,610	789,552	801,095	769,182	3,109,439
Operating income	57,254	61,496	74,819	19,443	213,012
Net income <sup>4</sup>	27,799	29,875	38,873	4,724	101,271
Net income for common stock <sup>4</sup>	27,300	29,376	38,375	4,225	99,276

Note: HEI owns all of Hawaiian Electric's common stock, therefore per share data for Hawaiian Electric is not meaningful.

<sup>1</sup> The quarterly basic earnings per common share are based upon the weighted-average number of shares of common stock outstanding in each quarter.

<sup>2</sup> The quarterly diluted earnings per common share are based upon the weighted-average number of shares of common stock outstanding in each quarter plus the dilutive incremental shares at quarter end.

<sup>3</sup> Market prices of HEI common stock (symbol HE) shown are as reported on the NYSE Composite Tape.

In the fourth quarter of 2012, as part of a settlement agreement with the Consumer Advocate, the Utilities recorded a

<sup>4</sup> writedown of \$24 million (net of taxes) of CIS project costs in lieu of conducting regulatory audits of the CIP CT-1 and CIS projects





ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

HEI and Hawaiian Electric: None

ITEM 9A. CONTROLS AND PROCEDURES

HEI:

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Constance H. Lau, HEI Chief Executive Officer, and James A. Ajello, HEI Chief Financial Officer, have evaluated the disclosure controls and procedures of HEI as of December 31, 2013. Based on their evaluations, as of December 31, 2013, they have concluded that the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective in ensuring that information required to be disclosed by HEI in reports HEI files or submits under the Securities Exchange Act of 1934:

- (1) is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and
- (2) is accumulated and communicated to HEI management, including HEI's principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Annual Report of Management on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) and Rule 15d-15(f) promulgated under the Securities Exchange Act of 1934, as amended. The Company's internal control over financial reporting was designed to provide reasonable assurance to management and the Board of Directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

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.

Management conducted an evaluation of the effectiveness of the Company's internal control over financial reporting as of December 31, 2013 based on criteria established in Internal Control - Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, management has concluded that the Company's internal control over financial reporting was effective as of December 31, 2013.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2013 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears on page 77.

Changes in Internal Control over Financial Reporting

There have been no changes in internal control over financial reporting during the quarter ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Hawaiian Electric:

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Richard M. Rosenblum, Hawaiian Electric Chief Executive Officer, and Tayne S. Y. Sekimura, Hawaiian Electric Chief Financial Officer, have evaluated the disclosure controls and procedures of Hawaiian Electric as of December 31, 2013. Based on their evaluations, as of December 31, 2013, they have concluded that the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective in ensuring that information required to be disclosed by Hawaiian Electric in reports Hawaiian Electric files or submits under the Securities Exchange Act of 1934:

- (1) is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and



- (2) is accumulated and communicated to Hawaiian Electric management, including Hawaiian Electric's principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

#### Annual Report of Management on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) and Rule 15d-15(f) promulgated under the Securities Exchange Act of 1934, as amended. Hawaiian Electric's internal control over financial reporting was designed to provide reasonable assurance to management and the Board of Directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

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.

Management conducted an evaluation of the effectiveness of Hawaiian Electric's internal control over financial reporting as of December 31, 2013 based on on criteria established in Internal Control - Integrated Framework (1992) issued by COSO. Based on this evaluation, management has concluded that the Company's internal control over financial reporting was effective as of December 31, 2013.

#### Changes in Internal Control over Financial Reporting

There have been no changes in internal control over financial reporting during the quarter ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, Hawaiian Electric's internal control over financial reporting.

#### ITEM 9B. OTHER INFORMATION

HEI and Hawaiian Electric: None

#### PART III

#### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

HEI:

Information regarding HEI's executive officers is provided in the "Executive Officers of the Registrant" section following Item 4 of this report.

The remaining information required by this Item 10 for HEI is incorporated herein by reference to the following sections in the HEI 2014 Proxy Statement:

• "Nominees for Class III directors whose terms expire at the 2017 Annual Meeting"

• "Continuing Class I directors whose terms expire at the 2015 Annual Meeting"

• "Continuing Class II directors whose terms expire at the 2016 Annual Meeting"

• "Committees of the Board" (portions regarding whether HEI has an audit committee and identifying its members; no other portion of the Committees of the Board section is incorporated herein by reference)

• "Audit Committee Report" (portion identifying audit committee financial experts who serve on the HEI Audit Committee only; no other portion of the Audit Committee Report is incorporated herein by reference)

Family relationships; director arrangements

There are no family relationships between any HEI director or director nominee and any other HEI director or director nominee or any HEI executive officer. There are no arrangements or understandings between any HEI director or director nominee and any other person pursuant to which such director or director nominee was selected.

#### Code of Conduct

The HEI Board has adopted a Corporate Code of Conduct that includes a code of ethics applicable to, among others, its principal executive officer, principal financial officer and principal accounting officer. The Corporate Code of Conduct is available on HEI's website at [www.hei.com](http://www.hei.com). HEI elects to disclose the information required by Form 8-K, Item 5.05, "Amendments to the Registrant's Code of Ethics, or Waiver of a Provision of the Code of Ethics," through this website and such information will remain available on this website for at least a 12-month period.

#### Section 16(a) beneficial ownership reporting compliance

Information required to be reported under this caption is incorporated herein by reference to the "Stock Ownership Information—Section 16(a) Beneficial Ownership Reporting Compliance" section in the HEI 2014 Proxy Statement.

#### Hawaiian Electric:

The information required by this Item 10 for Hawaiian Electric is incorporated herein by reference to pages 1 to 7 of Hawaiian Electric Exhibit 99.1.

#### ITEM 11. EXECUTIVE COMPENSATION

#### HEI:

The information required by this Item 11 for HEI is incorporated herein by reference to the information relating to executive and director compensation in the HEI 2014 Proxy Statement.

#### Hawaiian Electric:

The information required by this Item 11 for Hawaiian Electric is incorporated herein by reference to:

Pages 7 to 33 of Hawaiian Electric Exhibit 99.1;

The discussion of "What is Hawaiian Electric's 2012-2014 long-term incentive plan?" at pages 19-20 of Hawaiian Electric's Exhibit 99.3 to Annual Report on Form 10-K for the year ended December 31, 2012; and

Information concerning compensation paid to directors of Hawaiian Electric who are also directors of HEI under the section of the HEI 2014 Proxy Statement entitled, "Director Compensation."

#### Compensation Committee Interlocks and Insider Participation

#### HEI:

The information required to be reported under this caption for HEI is incorporated herein by reference to the "Compensation Committee Interlocks and Insider Participation" section in the HEI 2014 Proxy Statement.

#### Hawaiian Electric:

The information required to be reported under this caption for Hawaiian Electric is incorporated herein by reference to page 21 of Hawaiian Electric Exhibit 99.1.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

HEI:

Security Ownership of Certain Beneficial Owners

The information required by this Item 12 for HEI is incorporated herein by reference to the “Stock Ownership Information—Security Ownership of Certain Beneficial Owners” section in the HEI 2014 Proxy Statement.

Equity compensation plan information

Information as of December 31, 2013 about HEI Common Stock that may be issued under all of the Company’s equity compensation plans was as follows:

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights (1)	(b) Weighted-average exercise price of outstanding options, warrants and rights (2)	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (3)
Equity compensation plans approved by shareholders	1,304,255	\$26.02	1,581,169
Equity compensation plans not approved by shareholders	—	—	—
Total	1,304,255	\$26.02	1,581,169

(1) This column includes the number of shares of HEI Common Stock which may be issued under the HEI 2010 Equity Incentive Plan (EIP) and the 1987 Stock Option and Incentive Plan (SOIP) on account of awards outstanding as of December 31, 2013, including:

SOIP	EIP	TOTAL	
2,366	—	2,366	Stock appreciation rights plus accrued dividend equivalent rights
—	313,206	313,206	Restricted stock units plus estimated compounded dividend equivalents (if applicable) *
—	75,309	75,309	Shares issued in February 2014 under the 2011-2013 LTIP plus compounded dividend equivalents
—	913,374	913,374	Shares issuable at maximum payouts under the 2012-2014 and 2013-2015 LTIPs, including estimated compounded dividend equivalents
2,366	1,301,889	1,304,255	

Under the EIP as of December 31, 2013, RSUs count against the shares authorized for issuance as four shares for every share issued. Accordingly, the 313,206 RSU shares in the table are counted as 1,252,824 shares in determining the 1,581,169 shares available for future issuance under the EIP.

The weighted average exercise price in this column relates to the outstanding 62,000 stock appreciation rights which were granted in 2004. Excluded from the weighted average exercise price calculation are 102,000 stock appreciation rights whose exercise price was greater than the share price on December 31, 2013 and shares that may be issued without the payment of additional consideration (including the LTIP and restricted stock unit awards).

This represents the number of shares available as of December 31, 2013 for future awards, including 1,378,709 shares available for future awards under the EIP and 202,460 shares available for future awards under the 2011 Nonemployee Director Plan. As of May 11, 2010, no new awards may be granted under the SOIP.

Hawaiian Electric:

The information required by this Item 12 for Hawaiian Electric is incorporated herein by reference to pages 34 to 35 of Hawaiian Electric Exhibit 99.1.

164

---

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

HEI:

The information required by this Item 13 for HEI is incorporated herein by reference to the sections relating to related person transactions and director independence in the HEI 2014 Proxy Statement.

Hawaiian Electric:

The information required by this Item 13 for Hawaiian Electric is incorporated herein by reference to pages 35 to 36 of Hawaiian Electric Exhibit 99.1.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

HEI:

The information required by this Item 14 for HEI is incorporated herein by reference to the relevant information in the Audit Committee Report in the HEI 2014 Proxy Statement (but no other part of the "Audit Committee Report" is incorporated herein by reference).

Hawaiian Electric:

The information required by this Item 14 for Hawaiian Electric is incorporated herein by reference to page 37 of Hawaiian Electric Exhibit 99.1.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial statements

See Item 8 for the financial statements of HEI and Hawaiian Electric.

(a)(2) and (c) Financial statement schedules

The following financial statement schedules for HEI and Hawaiian Electric are included in this report on the pages indicated below:

		Page/s in Form 10-K	
		HEI	Hawaiian Electric
Schedule I	Condensed Financial Information of Registrant, Hawaiian Electric Industries, Inc. (Parent Company) as of December 31, 2013 and 2012 and Years ended December 31, 2013, 2012 and 2011	<u>166-168</u>	NA
Schedule II	Valuation and Qualifying Accounts, Hawaiian Electric Industries, Inc. and subsidiaries and Hawaiian Electric Company, Inc. and subsidiaries, Years ended December 31, 2013, 2012 and 2011	<u>169</u>	<u>169</u>

NA Not applicable.

Certain schedules, other than those listed, are omitted because they are not required, or are not applicable, or the required information is shown in the Consolidated Financial Statements.



Hawaiian Electric Industries, Inc.

## SCHEDULE I — CONDENSED FINANCIAL INFORMATION OF REGISTRANT

HAWAIIAN ELECTRIC INDUSTRIES, INC. (PARENT COMPANY)

## CONDENSED BALANCE SHEETS

December 31	2013	2012
(dollars in thousands)		
Assets		
Cash and cash equivalents	\$571	\$18,021
Accounts receivable	1,661	1,836
Property, plant and equipment, net	5,419	5,814
Deferred income tax assets	1,594	8,517
Other assets	23,679	8,390
Investments in subsidiaries, at equity	2,122,841	1,978,283
	\$2,155,765	\$2,020,861
Liabilities and shareholders' equity		
Liabilities		
Accounts payable	\$817	\$24,086
Interest payable	4,630	4,781
Notes payable to subsidiaries	7,936	7,722
Commercial paper	105,482	83,694
Long-term debt, net	275,000	275,000
Deferred income taxes	11,385	—
Retirement benefits liability	21,559	28,004
Other	1,886	3,709
	428,695	426,996
Shareholders' equity		
Preferred stock, no par value, authorized 10,000,000 shares; issued: none	—	—
Common stock, no par value, authorized 200,000,000 shares; issued and outstanding: 101,259,800 shares and 97,928,403 shares	1,488,126	1,403,484
Retained earnings	255,694	216,804
Accumulated other comprehensive loss	(16,750)	(26,423)
	1,727,070	1,593,865
	\$2,155,765	\$2,020,861
Note to Balance Sheets		
HEI medium-term note 5.25%, due 2013	\$—	\$50,000
HEI medium-term note 6.51%, due 2014	100,000	100,000
HEI senior note 4.41%, due 2016	75,000	75,000
HEI senior note 5.67%, due 2021	50,000	50,000
HEI senior note 3.99%, due 2023	50,000	—
	\$275,000	\$275,000

The aggregate payments of principal required subsequent to December 31, 2013 on long-term debt are \$100 million in 2014, nil in 2015, \$75 million in 2016 and nil in 2017 and 2018.

As of December 31, 2013, HEI has a General Agreement of Indemnity in favor of both Liberty Mutual Insurance Company (Liberty) and Travelers Casualty and Surety Company of America (Travelers) for losses in connection with any and all bonds, undertakings or instruments of guarantee and any renewals or extensions thereof executed by Liberty or Travelers, including, but not limited to, a \$0.2 million self-insured United States Longshore & Harbor bond and a \$0.5 million self-insured automobile bond.



Hawaiian Electric Industries, Inc.

## SCHEDULE I — CONDENSED FINANCIAL INFORMATION OF REGISTRANT (continued)

HAWAIIAN ELECTRIC INDUSTRIES, INC. (PARENT COMPANY)

## CONDENSED STATEMENTS OF INCOME

Years ended December 31 (in thousands)	2013	2012	2011
Revenues	\$288	\$221	\$253
Equity in net income of subsidiaries	180,359	157,883	158,722
Expenses:			
Operating, administrative and general	16,063	16,191	15,401
Depreciation of property, plant and equipment	596	672	227
Taxes, other than income taxes	497	421	409
Interest expense	16,207	16,695	22,013
Income before income tax benefits	147,284	124,125	120,925
Income tax benefits	14,232	14,533	17,305
Net income	\$161,516	\$138,658	\$138,230

The Company's financial reporting policy for income tax allocations is based upon a separate entity concept whereby each subsidiary provides income tax expense (or benefits) as if each were a separate taxable entity. The difference between the aggregate separate tax return income tax provisions and the consolidated financial reporting income tax provision is charged or credited to HEI's separate tax provision.

HAWAIIAN ELECTRIC INDUSTRIES, INC. (PARENT COMPANY)

## STATEMENTS OF COMPREHENSIVE INCOME

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Incorporated by reference are HEI and Subsidiaries' Statements of Consolidated Comprehensive Income and Consolidated Statements of Changes in Shareholders' Equity in Part II, Item 8.

Hawaiian Electric Industries, Inc.

## SCHEDULE I — CONDENSED FINANCIAL INFORMATION OF REGISTRANT (continued)

HAWAIIAN ELECTRIC INDUSTRIES, INC. (PARENT COMPANY)

## CONDENSED STATEMENTS OF CASH FLOWS

Years ended December 31, (in thousands)	2013	2012	2011
Cash flows from operating activities			
Net income	\$ 161,516	\$ 138,658	\$ 138,230
Adjustments to reconcile net income to net cash provided by operating activities			
Equity in net income	(180,359 )	(157,883 )	(158,722 )
Common stock dividends/distributions received from subsidiaries	121,578	118,044	128,558
Depreciation of property, plant and equipment	596	672	227
Other amortization	800	845	981
Increase in deferred income taxes	15,228	150	276
Excess tax benefits from share-based payment arrangements	(430 )	(61 )	—
Changes in assets and liabilities			
Decrease (increase) in accounts receivable	(2,167 )	(475 )	412
Increase (decrease) in accounts and interest payable	(23,420 )	19,995	1,324
Change in prepaid and accrued income taxes	(15,604 )	(4,861 )	3,550
Increase (decrease) in defined benefit pension and other postretirement benefit plans liability	(6,449 )	1,805	5,313
Changes in other assets and liabilities	10,985	10,229	(1,880 )
Net cash provided by operating activities	82,274	127,118	118,269
Cash flows from investing activities			
Capital expenditures	(201 )	(410 )	(110 )
Investments in subsidiaries	(78,500 )	(44,000 )	(40,000 )
Other	—	—	(4,206 )
Net cash used in investing activities	(78,701 )	(44,410 )	(44,316 )
Cash flows from financing activities			
Net decrease in notes payable to subsidiaries with original maturities of three months or less	56	(1,797 )	(1,757 )
Net increase in short-term borrowings with original maturities of three months or less	21,788	14,873	43,897
Proceeds from issuance of long-term debt	50,000	—	125,000
Repayment of long-term debt	(50,000 )	(7,000 )	(150,000 )
Excess tax benefits from share-based payment arrangements	430	61	—
Net proceeds from issuance of common stock	55,086	23,613	15,979
Common stock dividends	(98,383 )	(96,202 )	(106,812 )
Other	—	—	(35 )
Net cash used in financing activities	(21,023 )	(66,452 )	(73,728 )
Net increase (decrease) in cash and equivalents	(17,450 )	16,256	225
Cash and cash equivalents, January 1	18,021	1,765	1,540
Cash and cash equivalents, December 31	\$ 571	\$ 18,021	\$ 1,765

## Supplemental disclosures of noncash activities:

In 2013, 2012 and 2011, \$2.3 million, \$1.8 million and \$1.3 million, respectively, of HEI accounts receivable from ASHI were reduced with a corresponding reduction in HEI notes payable to ASHI in noncash transactions.

In 2013, 2012 and 2011, \$2.5 million, \$2.5 million and \$2.0 million, respectively, were contributed as equity by HEI into ASHI with a corresponding increase in HEI notes payable to ASHI in noncash transactions.

Under the HEI Dividend Reinvestment and Stock Purchase Plan (DRIP), common stock dividends reinvested by shareholders in HEI common stock in noncash transactions amounted to \$24 million, \$24 million and \$12 million in 2013, 2012 and 2011, respectively. HEI satisfied the requirements of the HEI DRIP, Hawaiian Electric Industries Retirement Savings Plan (HEIRSP) and ASB 401(k) Plan (from August 18, 2011 through January 8, 2012) by acquiring for cash its common shares through open market purchases rather than by issuing additional shares.

Note:

The “Notes to Consolidated Financial Statements” in Part II, Item 8 should be read in conjunction with the above HEI (Parent Company) financial statements.

Hawaiian Electric Industries, Inc. and subsidiaries  
and Hawaiian Electric Company, Inc. and subsidiaries  
SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS  
Years ended December 31, 2013, 2012 and 2011

Col. A (in thousands)	Col. B	Col. C Additions		Col. D	Col. E
Description	Balance at begin- ning of period	Charged to costs and expenses	Charged to other accounts	Deductions	Balance at end of period
2013					
Allowance for uncollectible accounts – electric utility	\$2,148	\$3,812	\$1,943	(a) \$5,574	(b) \$2,329
Allowance for uncollectible interest – bank	\$3,166	\$—	\$—	\$1,505	\$1,661
Allowance for losses for loans receivable – bank	\$41,985	\$1,507	\$4,826	(a) \$8,202	(b) \$40,116
Allowance for mortgage-servicing assets – bank	\$498	\$—	\$(60)	(a) \$187	\$251
Deferred tax valuation allowance – HEI	\$278	\$—	\$—	\$—	\$278
2012					
Allowance for uncollectible accounts – electric utility	\$2,221	\$3,230	\$1,180	(a) \$4,483	(b) \$2,148
Allowance for uncollectible interest – bank	\$4,825	\$—	\$—	\$1,659	\$3,166
Allowance for losses for loans receivable – bank	\$37,906	\$12,883	\$4,026	(a) \$12,830	(b) \$41,985
Allowance for mortgage-servicing assets – bank	\$175	\$504	\$—	\$181	\$498
Deferred tax valuation allowance – HEI	\$278	\$—	\$—	\$—	\$278
2011					
Allowance for uncollectible accounts – electric utility	\$1,278	\$4,419	\$1,857	(a) \$5,333	(b) \$2,221
Allowance for uncollectible interest – bank	\$4,397	\$—	\$428	\$—	\$4,825
Allowance for losses for loans receivable – bank	\$40,646	\$15,009	\$1,741	(a) \$19,490	(b) \$37,906
Allowance for mortgage-servicing assets – bank	\$128	\$121	\$—	\$74	\$175
Deferred tax valuation allowance – HEI	\$—	\$278	\$—	\$—	\$278

(a) Primarily recoveries.

(b) Bad debts charged off.

The Company has revised its previously issued "Schedule II - Valuation and Qualifying Accounts" to correct for an error that resulted from the exclusion of the following line items: (a) Allowance for mortgage servicing assets - bank and (b) Deferred tax valuation allowance - HEI. The amounts excluded from the schedule were not considered to be material to previously issued financial statement schedules and the revisions to the schedule had no impact on the Company's Consolidated Balance Sheets, Consolidated Statements of Income or Consolidated Statements of Cash Flows.



(a)(3) and (b) Exhibits

The Exhibit Index attached to this Form 10-K is incorporated herein by reference. The exhibits listed for HEI and Hawaiian Electric are listed in the index under the headings “HEI” and “Hawaiian Electric,” respectively, except that the exhibits listed under “Hawaiian Electric” are also exhibits for HEI.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrants have duly caused this report to be signed on their behalf by the undersigned, thereunto duly authorized. The execution of this report by registrant Hawaiian Electric Company, Inc. shall be deemed to relate only to matters having reference to such registrant and its subsidiaries.

HAWAIIAN ELECTRIC INDUSTRIES, INC.

HAWAIIAN ELECTRIC COMPANY, INC.

(Registrant)

(Registrant)

By /s/ James A. Ajello  
James A. Ajello  
Executive Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer of HEI)

By /s/ Tayne S. Y. Sekimura  
Tayne S. Y. Sekimura  
Senior Vice President and Chief Financial Officer  
(Principal Financial Officer of Hawaiian Electric)

Date: February 21, 2014

Date: February 21, 2014

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 registrants and in the capacities indicated on February 21, 2014. The execution of this report by each of the undersigned who signs this report solely in such person’s capacity as a director or officer of Hawaiian Electric Company, Inc. shall be deemed to relate only to matters having reference to such registrant and its subsidiaries.

Signature

Title

/s/ Constance H. Lau  
Constance H. Lau

President of HEI and Director of HEI  
Chairman of the Board of Directors of Hawaiian Electric  
(Chief Executive Officer of HEI)

/s/ Richard M. Rosenblum  
Richard M. Rosenblum

President and Director of Hawaiian Electric  
(Chief Executive Officer of Hawaiian Electric)

/s/ James A. Ajello  
James A. Ajello

Executive Vice President and Chief Financial Officer of HEI  
(Principal Financial and Accounting Officer of HEI)

/s/ Tayne S. Y. Sekimura  
Tayne S. Y. Sekimura

Senior Vice President and Chief Financial Officer of Hawaiian Electric  
(Principal Financial Officer of Hawaiian Electric)

/s/ Cathlynn L. Yoshida  
Cathlynn L. Yoshida

Controller of Hawaiian Electric  
(Principal Accounting Officer of Hawaiian Electric)





SIGNATURES (continued)

Signature	Title
/s/ Don E. Carroll Don E. Carroll	Director of Hawaiian Electric
/s/ Thomas B. Fargo Thomas B. Fargo	Director of HEI and Hawaiian Electric
/s/ Peggy Y. Fowler Peggy Y. Fowler	Director of HEI and Hawaiian Electric
/s/ Timothy E. Johns Timothy E. Johns	Director of Hawaiian Electric
/s/ Micah A. Kane Micah A. Kane	Director of Hawaiian Electric
/s/ Bert A. Kobayashi, Jr. Bert A. Kobayashi, Jr.	Director of Hawaiian Electric
/s/ A. Maurice Myers A. Maurice Myers	Director of HEI
/s/ Keith P. Russell Keith P. Russell	Director of HEI
/s/ James K. Scott James K. Scott	Director of HEI
/s/ Kelvin H. Taketa Kelvin H. Taketa	Director of HEI and Hawaiian Electric
/s/ Barry K. Taniguchi Barry K. Taniguchi	Director of HEI
/s/ Jeffrey N. Watanabe	Chairman of the Board of Directors of HEI

Jeffrey N. Watanabe

171

---

EXHIBIT INDEX

The exhibits designated by an asterisk (\*) are filed herewith. The exhibits not so designated are incorporated by reference to the indicated filing. A copy of any exhibit may be obtained upon written request for a \$0.20 per page charge from the HEI Shareholder Services Division, P.O. Box 730, Honolulu, Hawaii 96808-0730.

Exhibit no.	Description
HEI:	
3(i)	HEI's Amended and Restated Articles of Incorporation (Exhibit 3(i) to HEI's Current Report on Form 8-K, dated May 5, 2009, File No. 1-8503).
3(ii)	Amended and Restated Bylaws of HEI as last amended May 9, 2011 (Exhibit 3(ii) to HEI's Current Report on Form 8-K May 9, 2011, File No. 1-8503).
4.1	Agreement to provide the SEC with instruments which define the rights of holders of certain long-term debt of HEI and its subsidiaries (Exhibit 4.1 to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 1992, File No. 1-8503).
4.2	Indenture, dated as of October 15, 1988, between HEI and Citibank, N.A., as Trustee (Exhibit 4 to Registration Statement on Form S-3, Registration No. 33-25216).
4.3(a)	First Supplemental Indenture dated as of June 1, 1993 between HEI and Citibank, N.A., as Trustee, to Indenture dated as of October 15, 1988 between HEI and Citibank, N.A., as Trustee (Exhibit 4(a) to HEI's Quarterly Report on Form 10-Q for the quarter ended September 30, 1993, File No. 1-8503).
4.3(b)	Second Supplemental Indenture dated as of April 1, 1999 between HEI and Citibank, N.A., as Trustee, to Indenture dated as of October 15, 1988 between HEI and Citibank, N.A., as Trustee (Exhibit 4.1 to HEI's Quarterly Report on Form 10-Q for the quarter ended March 31, 1999, File No. 1-8503).
4.3(c)	Third Supplemental Indenture dated as of August 1, 2002 between HEI and Citibank, N.A., as Trustee, to Indenture dated as of October 15, 1988 between HEI and Citibank, N.A., as Trustee (Exhibit 4 to HEI's Current Report on Form 8-K, dated August 16, 2002, File No. 1-8503).
4.4(a)	Pricing Supplement No. 1 to Registration Statement on Form S-3 of HEI (Registration No. 333-73225) filed on May 3, 1999 in connection with the sale of Medium-Term Notes, Series C, 6.51% due May 5, 2014.
4.5	Master Note Purchase Agreement among HEI and the Purchasers thereto, dated March 24, 2011 (Exhibit 4(a) to HEI's Current Report on Form 8-K dated March 24, 2011, File No. 1-8503).
4.5(a)	First Supplement to Note Purchase Agreement among HEI and the Purchasers thereto, dated March 6, 2013 (Exhibit 4(a) to HEI's Current Report on Form 8-K dated March 6, 2013, File No. 1-8503).
4.6	Underwriting Agreement, dated March 19, 2013, among HEI, J.P. Morgan Securities LLC and Morgan Stanley & Co. LLC, individually and acting as representatives of each of the other Underwriters listed in Schedule 1 thereto and J.P. Morgan Securities LLC acting as forward seller (Exhibit 1.1 to HEI's Current Report on Form 8-K, dated March 19, 2013, File No. 1-8503).

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

- 4.7 Hawaiian Electric Industries Retirement Savings Plan, restatement effective January 1, 2013 (Exhibit 4.5 to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, File No. 1-8503).
- 4.8 Master Trust Agreement dated as of September 4, 2012 between HEI and ASB and Fidelity Management Trust Company, as Trustee (Exhibit 4 to HEI's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, File No. 1-8503).
- 4.8(a) Letter Amendment effective November 28, 2012 to Master Trust Agreement dated as of September 4, 2012 between HEI and ASB and Fidelity Management Trust Company (Exhibit 4.6(a) to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, File No. 1-8503).
- 4.9 Hawaiian Electric Industries, Inc. Dividend Reinvestment and Stock Purchase Plan, as amended and restated (Exhibit 4(a) to Registration Statement on Form S-3, Registration No. 333-180413).
- 4.10 American Savings Bank 401(k) Plan, restatement effective January 1, 2013 (Exhibit 4.8 to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, File No. 1-8503).
-

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

Exhibit no.	Description
10.1	Conditions for the Merger and Corporate Restructuring of Hawaiian Electric Company, Inc. dated September 23, 1982. (Exhibit 10.1 to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2006, File No. 1-8503).
10.2	Regulatory Capital Maintenance/Dividend Agreement dated May 26, 1988, between HEI, HEIDI and the Federal Savings and Loan Insurance Corporation (by the Federal Home Loan Bank of Seattle) (Exhibit (28)-2 to HEI's Current Report on Form 8-K dated May 26, 1988, File No. 1-8503).
10.3	OTS letter regarding release from Part II.B. of the Regulatory Capital Maintenance/Dividend Agreement dated May 26, 1988 (Exhibit 10.3(a) to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 1992, File No. 1-8503).

HEI Exhibits 10.4 through 10.21 are management contracts or compensatory plans or arrangements required to be filed as exhibits pursuant to Item 15(b) of this report. HEI Exhibits 10.4 through 10.19 are also management contracts or compensatory plans or arrangements with Hawaiian Electric participants.

10.4	HEI Executive Incentive Compensation Plan amended as of February 4, 2013 (Exhibit 10.4 to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, File No. 1-8503).
10.5	HEI Executives' Deferred Compensation Plan (Exhibit 10.2 to HEI's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, File No. 1-8503).
10.6	Hawaiian Electric Industries, Inc. 2010 Equity and Incentive Plan, as amended and restated November 16, 2010 (Exhibit 10.6 to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, File No. 1-8503).
10.6(a)	Form of Non-Qualified Stock Option Agreement pursuant to 2010 Equity and Incentive Plan (Exhibit 4.4 to Registration Statement filed on May 11, 2010 on Form S-8 Registration No. 333-166737).
10.6(b)	Form of Stock Appreciation Right Agreement pursuant to 2010 Equity and Incentive Plan (Exhibit 4.5 to Registration Statement filed on May 11, 2010 on Form S-8 Registration No. 333-166737).
10.6(c)	Form of Restricted Shares Agreement pursuant to 2010 Equity and Incentive Plan (Exhibit 4.6 to Registration Statement filed on May 11, 2010 on Form S-8 Registration No. 333-166737).
10.6(d)	Form of Performance Shares Agreement pursuant to 2010 Equity and Incentive Plan (Exhibit 4.7 to Registration Statement filed on May 11, 2010 on Form S-8 Registration No. 333-166737).
10.6(e)	Form of Restricted Stock Unit Agreement, amended as of February 4, 2013, pursuant to 2010 Equity and Incentive Plan (Exhibit 10.6(e) to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, File No. 1-8503).
10.7	1987 Stock Option and Incentive Plan of HEI (as amended and restated effective January 22, 2008) (Exhibit 10.3 to HEI's Quarterly Report on Form 10-Q for the quarter ended June 30, 2008,

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

File No. 1-8503).

- 10.7(a) Form of Hawaiian Electric Industries, Inc. Stock Option Agreement with Dividend Equivalents (Exhibit 10.7(b) to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2004, File No. 1-8503).
- 10.7(b) Form of Hawaiian Electric Industries, Inc. Stock Appreciation Right Agreement with Dividend Equivalents (Exhibit 10.2 to HEI's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004, File No. 1-8503).
- 10.7(c) Form of Hawaiian Electric Industries, Inc. Stock Appreciation Right Agreement with Dividend Equivalents (effective for April 7, 2005 stock appreciation rights grant) (Exhibit 10.1 to HEI's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005, File No. 1-8503).
- 10.7(d) Form of Restricted Stock Unit Agreement Pursuant to the 1987 Stock Option and Incentive Plan of HEI (Exhibit 10.7(f) to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2008, File No. 1-8503).
- 10.8 HEI Long-Term Incentive Plan amended as of February 4, 2013 (Exhibit 10.8 to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, File No. 1-8503).
- 10.9 HEI Supplemental Executive Retirement Plan amended and restated as of January 1, 2009 (Exhibit 10.3 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, File No. 1-8503).
-

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

Exhibit no.	Description
10.9(a)	Amendments to the HEI Supplemental Executive Retirement Plan Freezing Benefit Accruals Effective December 31, 2008 (Exhibit 10.9(a) to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2008, File No. 1-8503).
10.10	HEI Excess Pay Plan amended and restated as of January 1, 2009 (Exhibit 10.10 to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2008, File No. 1-8503).
10.10(a)	HEI Excess Pay Plan Addendum for Constance H. Lau (Exhibit 10.10(a) to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2008, File No. 1-8503).
10.10(b)	HEI Excess Pay Plan Addendum for Richard M. Rosenblum (Exhibit 10.10(c) to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2009, File No. 1-8503).
10.10(c)	Amendment No. 1 dated December 13, 2010 to January 1, 2009 Restatement of HEI Excess Pay Plan (Exhibit 10.10(c) to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, File No. 1-8503).
10.11	Form of Change in Control Agreement (Exhibit 10.11 to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2008, File No. 1-8503).
10.12	Nonemployee Director Retirement Plan, effective as of October 1, 1989 (Exhibit 10.15 to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 1989, File No. 1-8503).
10.13	HEI 2011 Nonemployee Director Stock Plan (Appendix A to HEI's Proxy Statement for 2011 Annual Meeting of Shareholders filed on March 21, 2011, File No. 1-8503).
10.14	Nonemployee Director's Compensation Schedule effective January 1, 2011 (Exhibit 10.14 to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, File No. 1-8503).
10.15	HEI Non-Employee Directors' Deferred Compensation Plan (Exhibit 10.5 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, File No. 1-8503).
10.16	Executive Death Benefit Plan of HEI and Participating Subsidiaries restatement effective as of January 1, 2009 (Exhibit 10.6 to HEI's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, File No. 1-8503).
10.16(a)	Resolution of the Compensation Committee of the Board of Directors of Hawaiian Electric Industries, Inc. Re: Adoption of Amendment No. 1 to January 1, 2009 Restatement of the Executive Death Benefit Plan (Exhibit 10.1 to HEI's Quarterly Report on Form 10-Q for the quarter ended September 30, 2009, File No. 1-8503).
10.17	Severance Pay Plan for Merit Employees of HEI and affiliates, restatement effective as of January 1, 2009 (Exhibit 10.17 to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2008, File No. 1-8503).
10.17(a)	Addendum A of Severance Pay Plan for Merit Employees of HEI and affiliates, restatement effective as of January 1, 2009 for James A. Ajello and Richard M. Rosenblum (Exhibit 10.17(a) to HEI's Annual Report on Form 10-K for the fiscal year ended December 31,



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

2008, File No. 1-8503).

- 10.18 Hawaiian Electric Industries Deferred Compensation Plan adopted on December 13, 2010 (Exhibit 10.18 to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, File No. 1-8503).
- 10.19 Form of Indemnity Agreement (HEI, Hawaiian Electric and ASB with their respective directors and HEI with certain of its senior officers) (Exhibit 10.1 to HEI's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, File No. 1-8503).
- 10.20 American Savings Bank Select Deferred Compensation Plan (Restatement Effective January 1, 2009) (Exhibit 10.7 to HEI's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, File No. 1-8503).
- 10.21 American Savings Bank Supplemental Executive Retirement, Disability, and Death Benefit Plan, effective January 1, 2009 (Exhibit 10.8 to HEI's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, File No. 1-8503).
- 10.21(a) Amendments to the American Savings Bank Supplemental Executive Retirement, Disability, and Death Benefit Plan Freezing Benefit Accruals Effective December 31, 2008 (Exhibit 10.19(b) to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2008, File No. 1-8503).
-

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

Exhibit no.	Description
10.22	Credit Agreement, dated as of May 7, 2010, among HEI, as Borrower, the Lenders Party Hereto and Bank of Hawaii, as Co-Syndication Agent, and U.S. Bank National Association, as Co-Syndication Agent, and Wells Fargo Bank, National Association, as Co-Syndication Agent, and Bank of America, N.A., as Co-Documentation Agent, and Union Bank, N.A., as Co-Documentation Agent, and JPMorgan Chase Bank, N.A., as Administrative Agent and Issuing Bank, and J.P. Morgan Securities Inc., as Sole Lead Arranger and Sole Book Runner (Exhibit 10.1 to HEI's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010, File No. 1-8503).
10.23	Amendment No. 1, dated as of December 5, 2011, to the Credit Agreement, dated as of May 7, 2010, among HEI, as Borrower, the Lenders Party Hereto and Bank of Hawaii, as Co-Syndication Agent, and U.S. Bank National Association, as Co-Syndication Agent, and Wells Fargo Bank, National Association, as Co-Syndication Agent, and Bank of America, N.A., as Co-Documentation Agent, and Union Bank, N.A., as Co-Documentation Agent, and JPMorgan Chase Bank, N.A., as Administrative Agent and Issuing Bank, and J.P. Morgan Securities Inc., as Sole Lead Arranger and Sole Book Runner (Exhibit 10.1 to HEI's Current Report on Form 8-K dated December 5, 2011, File No. 1-8503).
10.24	Confirmation of Forward Sale Transaction dated March 19, 2013 between HEI and JPMorgan Chase Bank, National Association, London Branch (Exhibit 10.1 to HEI's Current Report on Form 8-K dated March 19, 2013, File No. 1-8503).
10.25	Confirmation of Additional Forward Sale Transaction dated March 20, 2013 between HEI and JPMorgan Chase Bank, National Association, London Branch (Exhibit 10.2 to HEI's Current Report on Form 8-K dated March 19, 2013, File No. 1-8503).
*11	HEI - Computation of Earnings per Share of Common Stock.
*12.1	HEI - Computation of Ratio of Earnings to Fixed Charges.
*21.1	HEI - Subsidiaries of the Registrant.
*23.1	Consent of Independent Registered Public Accounting Firm.
*31.1	Certification Pursuant to Section 13a-14 of the Securities Exchange Act of 1934 of Constance H. Lau (HEI Chief Executive Officer).
*31.2	Certification Pursuant to Section 13a-14 of the Securities Exchange Act of 1934 of James A. Ajello (HEI Chief Financial Officer).
*32.1	HEI Certification Pursuant to 18 U.S.C. Section 1350.
*101.INS	XBRL Instance Document.
*101.SCH	XBRL Taxonomy Extension Schema Document.
*101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.

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

\*101.DEF XBRL Taxonomy Extension Definition Linkbase Document.

\*101.LAB XBRL Taxonomy Extension Label Linkbase Document.

\*101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

Hawaiian Electric:

3(i).1 Hawaiian Electric's Certificate of Amendment of Articles of Incorporation (Exhibit 3.1 to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 1988, File No. 1-4955).

3(i).2 Articles of Amendment to Hawaiian Electric's Amended Articles of Incorporation (Exhibit 3.1(b) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 1989, File No. 1-4955).

3(i).3 Articles of Amendment to Hawaiian Electric's Amended Articles of Incorporation (Exhibit 3(i).4 to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 1998, File No. 1-4955).

3(i).4 Articles of Amendment V of Hawaiian Electric's Amended Articles of Incorporation effective August 6, 2009 (Exhibit 3(i).4 to Quarterly Report on Form 10-Q for the quarter ended June 30, 2009, File No. 1-4955).

---

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

Exhibit no.	Description
3(ii)	Hawaiian Electric's Amended and Restated Bylaws (as last amended August 6, 2010) (Exhibit 3(ii) to Hawaiian Electric's Current Report on Form 8-K dated August 9, 2010, File No. 1-4955).
4.1	Agreement to provide the SEC with instruments which define the rights of holders of certain long-term debt of Hawaiian Electric, Hawaii Electric Light and Maui Electric (Exhibit 4.1 to HEI's Annual Report on Form 10-K for the fiscal year ended December 31, 2002, File No. 1-4955).
4.2	Certificate of Trust of HECO Capital Trust III (incorporated by reference to Exhibit 4(a) to Registration No. 333-111073).
4.3	Amended and Restated Trust Agreement of HECO Capital Trust III dated as of March 1, 2004 (Exhibit 4(c) to Hawaiian Electric's Current Report on Form 8-K dated March 16, 2004, File No. 1-4955).
4.4	Hawaiian Electric Junior Indenture with The Bank of New York, as Trustee, dated as of March 1, 2004 (Exhibit 4(f) to Hawaiian Electric's Current Report on Form 8-K dated March 16, 2004, File No. 1-4955).
4.5	6.500% Quarterly Income Trust Preferred Security issued by HECO Capital Trust III, dated March 18, 2004 (Exhibit 4(d) to Hawaiian Electric's Current Report on Form 8-K dated March 16, 2004, File No. 1-4955).
4.6	6.500% Junior Subordinated Deferrable Interest Debenture, Series 2004 issued by Hawaiian Electric, dated March 18, 2004 (Exhibit 4(g) to Hawaiian Electric's Current Report on Form 8-K dated March 16, 2004, File No. 1-4955).
4.7	Trust Guarantee Agreement between The Bank of New York, as Trust Guarantee Trustee, and Hawaiian Electric dated as of March 1, 2004 (Exhibit 4(l) to Hawaiian Electric's Current Report on Form 8-K dated March 16, 2004, File No. 1-4955).
4.8	Maui Electric Junior Indenture with The Bank of New York, as Trustee, including Hawaiian Electric Subsidiary Guarantee, dated as of March 1, 2004 (Exhibit 4(h) to Hawaiian Electric's Current Report on Form 8-K dated March 16, 2004, File No. 1-4955).
4.9	Hawaii Electric Light Junior Indenture with The Bank of New York, as Trustee, including Hawaiian Electric Subsidiary Guarantee, dated as of March 1, 2004 (Exhibit 4(j) to Hawaiian Electric's Current Report on Form 8-K dated March 16, 2004, File No. 1-4955).
4.10	6.500% Junior Subordinated Deferrable Interest Debenture, Series 2004 issued by Maui Electric, dated March 18, 2004 (Exhibit 4(i) to Hawaiian Electric's Current Report on Form 8-K dated March 16, 2004, File No. 1-4955).
4.11	6.500% Junior Subordinated Deferrable Interest Debenture, Series 2004 issued by Hawaii Electric Light, dated March 18, 2004 (Exhibit 4(k) to Hawaiian Electric's Current Report on Form 8-K dated March 16, 2004, File No. 1-4955).
4.12	

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

Expense Agreement, dated March 1, 2004, among HECO Capital Trust III, Hawaiian Electric, Maui Electric and Hawaii Electric Light (Exhibit 4(m) to Hawaiian Electric's Current Report on Form 8-K dated March 16, 2004, File No. 1-4955).

- 4.13 Note Purchase Agreement among Hawaiian Electric and the Purchasers that are parties thereto, dated April 19, 2012 (Exhibit 4(a) to Hawaiian Electric's Current Report on Form 8-K dated April 19, 2012, File No. 1-4955).
- 4.14 Note Purchase and Guaranty Agreement among Hawaiian Electric, Maui Electric and the Purchasers that are parties thereto, dated April 19, 2012 (Exhibit 4(b) to Hawaiian Electric's Current Report on Form 8-K dated April 19, 2012, File No. 1-4955).
- 4.15 Note Purchase and Guaranty Agreement among Hawaiian Electric, Hawaii Electric Light and the Purchasers that are parties thereto, dated April 19, 2012 (Exhibit 4(c) to Hawaiian Electric's Current Report on Form 8-K dated April 19, 2012, File No. 1-4955).
- 4.16 Note Purchase Agreement among Hawaiian Electric and the Purchasers that are parties thereto, dated September 13, 2012 (Exhibit 4 to Hawaiian Electric's Current Report on Form 8-K dated September 13, 2012, File No. 1-4955).
- 4.17 Note Purchase Agreement among Hawaiian Electric Company, Inc. and the Purchasers that are parties thereto, dated as of October 3, 2013. (Exhibit 4(a) to Hawaiian Electric's Current Report on Form 8-K dated October 3, 2013, File No. 1-4955).
-

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

Exhibit no.	Description
4.18	Note Purchase and Guaranty Agreement among Maui Electric Company, Limited and the Purchasers that are parties thereto, dated as of October 3, 2013. (Exhibit 4(b) to Hawaiian Electric's Current Report on Form 8-K dated October 3, 2013, File No. 1-4955).
4.19	Note Purchase and Guaranty Agreement among Hawaii Electric Light Company, Inc. and the Purchasers that are parties thereto, dated as of October 3, 2013. (Exhibit 4 to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended September 30, 2013, 2013, File No. 1-4955).
10.1(a)	Power Purchase Agreement between Kalaeloa Partners, L.P., and Hawaiian Electric dated October 14, 1988 (Exhibit 10(a) to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended September 30, 1988, File No. 1-4955).
10.1(b)	Amendment No. 1 to Power Purchase Agreement between Hawaiian Electric and Kalaeloa Partners, L.P., dated June 15, 1989 (Exhibit 10(c) to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended June 30, 1989, File No. 1-4955).
10.1(c)	Lease Agreement between Kalaeloa Partners, L.P., as Lessor, and Hawaiian Electric, as Lessee, dated February 27, 1989 (Exhibit 10(d) to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended June 30, 1989, File No. 1-4955).
10.1(d)	Restated and Amended Amendment No. 2 to Power Purchase Agreement between Hawaiian Electric and Kalaeloa Partners, L.P., dated February 9, 1990 (Exhibit 10.2(c) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 1989, File No. 1-4955).
10.1(e)	Amendment No. 3 to Power Purchase Agreement between Hawaiian Electric and Kalaeloa Partners, L.P., dated December 10, 1991 (Exhibit 10.2(e) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 1991, File No. 1-4955).
10.1(f)	Amendment No. 4 to Power Purchase Agreement between Hawaiian Electric and Kalaeloa Partners, L.P., dated October 1, 1999 (Exhibit 10.1 to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000, File No. 1-4955).
10.1(g)	Confirmation Agreement Concerning Section 5.2B(2) of Power Purchase Agreement and Amendment No. 5 to Power Purchase Agreement between Hawaiian Electric and Kalaeloa Partners, L.P., dated October 12, 2004 (Exhibit 10.3 to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004, File No. 1-4955).
10.1(h)	Agreement for Increment Two Capacity and Amendment No. 6 to Power Purchase Agreement between Hawaiian Electric and Kalaeloa Partners, L.P., dated October 12, 2004 (Exhibit 10.4 to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004, File No. 1-4955).
10.2(a)	Power Purchase Agreement between AES Barbers Point, Inc. and Hawaiian Electric, entered into on March 25, 1988 (Exhibit 10(a) to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended March 31, 1988, File No. 1-4955).

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

- 10.2(b) Agreement between Hawaiian Electric and AES Barbers Point, Inc., pursuant to letters dated May 10, 1988 and April 20, 1988 (Exhibit 10.4 to Hawaiian Electric's Annual Report on Form 10-K for fiscal year ended December 31, 1988, File No. 1-4955).
- 10.2(c) Amendment No. 1, entered into as of August 28, 1988, to Power Purchase Agreement between AES Barbers Point, Inc. and Hawaiian Electric (Exhibit 10 to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended September 30, 1989, File No. 1-4955).
- 10.2(d) Hawaiian Electric's Conditional Notice of Acceptance to AES Barbers Point, Inc. dated January 15, 1990 (Exhibit 10.3(c) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 1989, File No. 1-4955).
- 10.2(e) Amendment No. 2, entered into as of May 8, 2003, to Power Purchase Agreement between AES Hawaii, Inc. and Hawaiian Electric (Exhibit 10.2(e) to Hawaiian Electric's Annual Report on Form 10-K for fiscal year ended December 31, 2003, File No. 1-4955).
- 10.3(a) Agreement between Maui Electric and Hawaiian Commercial & Sugar Company pursuant to letters dated November 29, 1988 and November 1, 1988 (Exhibit 10.8 to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 1988, File No. 1-4955).
- 10.3(b) Amended and Restated Power Purchase Agreement by and between A&B-Hawaii, Inc., through its division, Hawaiian Commercial & Sugar Company, and Maui Electric, dated November 30, 1989 (Exhibit 10(e) to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended September 30, 1990, File No. 1-4955).
-

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

Exhibit no.	Description
10.3(c)	First Amendment to Amended and Restated Power Purchase Agreement by and between A&B-Hawaii, Inc., through its division, Hawaiian Commercial & Sugar Company, and Maui Electric, dated November 1, 1990, amending the Amended and Restated Power Purchase Agreement dated November 30, 1989 (Exhibit 10(f) to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended September 30, 1990, File No. 1-4955).
10.3(d)	Termination Notice dated December 27, 1999 for Amended and Restated Power Purchase Agreement by and between A&B Hawaii, Inc., through its division, Hawaiian Commercial & Sugar Company, and Maui Electric, dated November 30, 1989, as amended (Exhibit 10.2 to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000, File No. 1-4955).
10.3(e)	Rescission dated January 23, 2001 of Termination Notice for Amended and Restated Power Purchase Agreement by and between A&B Hawaii, Inc., through its division, Hawaiian Commercial & Sugar Company, and Maui Electric, dated November 30, 1989, as amended (Exhibit 10.4(f) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 2000, File No. 1-4955).
10.3(f)	Letter agreement dated July 2, 2007 to not issue a notice of termination of Amended and Restated Power Purchase Agreement Between A&B-Hawaii, Inc., through its division, Hawaiian Commercial & Sugar Company, and Maui Electric dated November 30, 1989, as Amended on November 1, 1990 (Exhibit 10.3(f) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, File No. 1-4955).
10.4(a)	Purchase Power Contract between Hawaii Electric Light and Thermal Power Company dated March 24, 1986 (Exhibit 10(a) to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended June 30, 1989, File No. 1-4955).
10.4(b)	Firm Capacity Amendment between Hawaii Electric Light and Puna Geothermal Venture (assignee of AMOR VIII, who is the assignee of Thermal Power Company) dated July 28, 1989 to Purchase Power Contract between Hawaii Electric Light and Thermal Power Company dated March 24, 1986 (Exhibit 10(b) to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended June 30, 1989, File No. 1-4955).
10.4(c)	Amendment made in October 1993 to Purchase Power Contract between Hawaii Electric Light and Puna Geothermal Venture dated March 24, 1986, as amended (Exhibit 10.5(b) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 1997, File No. 1-4955).
10.4(d)	Third Amendment dated March 7, 1995 to the Purchase Power Contract between Hawaii Electric Light and Puna Geothermal Venture dated March 24, 1986, as amended (Exhibit 10.5(c) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 1997, File No. 1-4955).
10.4(e)	Performance Agreement and Fourth Amendment dated February 12, 1996 to the Purchase Power Contract between Hawaii Electric Light and Puna Geothermal Venture dated March 24, 1986, as amended (Exhibit 10.5(b) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 1995, File No. 1-4955).



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

- 10.4(f) Fifth Amendment dated February 7, 2011 to the Purchase Power Contract between Hawaii Electric Light and Puna Geothermal Venture dated March 24, 1986, as amended (Exhibit 10.4(f) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 2011, File No. 1-4955).
- 10.4(g) Power Purchase Agreement between Puna Geothermal Venture and Hawaii Electric Light dated February 7, 2011 (Exhibit 10.4(g) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 2011, File No. 1-4955).
- 10.5(a) Power Purchase Agreement between Encogen Hawaii, L.P. and Hawaii Electric Light dated October 22, 1997 (but with the following attachments omitted: Attachment C, "Selected portions of the North American Electric Reliability Council Generating Availability Data System Data Reporting Instructions dated October 1996" and Attachment E, "Form of the Interconnection Agreement between Encogen Hawaii, L.P. and Hawaii Electric Light," which is provided in final form as Exhibit 10.6(b)) (Exhibit 10.7 to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 1997, File No. 1-4955).
- 10.5(b) Interconnection Agreement between Encogen Hawaii, L.P. and Hawaii Electric Light dated October 22, 1997 (Exhibit 10.7(a) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 1997, File No. 1-4955).
- 10.5(c) Amendment No. 1, executed on January 14, 1999, to Power Purchase Agreement between Encogen Hawaii, L.P. and Hawaii Electric Light dated October 22, 1997 (Exhibit 10.7(b) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 1998, File No. 1-4955).
-

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

Exhibit no.	Description
10.5(d)	Power Purchase Agreement Novation dated November 8, 1999 by and among Encogen Hawaii, L.P., Hamakua Energy Partners and Hawaii Electric Light (Exhibit 10.7(c) to Hawaiian Electric's Annual Report on Form 10-K for fiscal year ended December 31, 2001, File No. 1-4955).
10.5(e)	Consent and Agreement Concerning Certain Assets of Black River Energy, LLC By and Among Great Point Power Hamakua Holdings, LLC, Hamakua Energy Partners, L.P. and Hawaii Electric Light dated April 19, 2010 (Exhibit 10.6(e) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, File No. 1-4955).
10.5(f)	Guarantee Agreement between Great Point Power Hamakua Holdings, LLC and Hawaii Electric Light dated June 4, 2010 (Exhibit 10.6(f) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, File No. 1-4955).
10.6	Low Sulfur Fuel Oil Supply Contract by and between Chevron and Hawaiian Electric dated as of August 24, 2012 (confidential treatment has been requested for portions of this exhibit) (Exhibit 10.2 to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, File No. 1-4955).
10.7(a)	Inter-Island Industrial Fuel Oil and Diesel Fuel Supply Contract by and between Chevron and Hawaiian Electric, Maui Electric, Hawaii Electric Light, HTB and YB dated as of November 14, 1997 (confidential treatment has been requested for portions of this exhibit) (Exhibit 10.9 to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 1997, File No. 1-4955).
10.7(b)	Amendment to Inter-Island Industrial Fuel Oil and Diesel Fuel Supply Contract by and between Chevron and Hawaiian Electric, Maui Electric and Hawaii Electric Light entered into as of April 12, 2004 (confidential treatment has been requested for portions of this exhibit, which has been redacted accordingly) (Exhibit 10(d) to Hawaiian Electric's Current Report on Form 8-K, dated May 28, 2004, File No. 1-4955).
* 10.7(c)	Second Amendment dated December 17, 2013 to Inter-Island Industrial Fuel Oil and Diesel Fuel Supply Contract by and between Chevron and Hawaiian Electric, Maui Electric and Hawaii Electric Light entered into as of November 14, 1997, as amended by Amendment dated April 12, 2004 (confidential treatment has been requested for portions of this exhibit, which has been redacted accordingly).
10.8	Facilities and Operating Contract by and between Chevron and Hawaiian Electric dated as of November 14, 1997 (confidential treatment has been requested for portions of this exhibit, which has been redacted accordingly) (Exhibit 10.10 to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 1997, File No. 1-4955).
10.9	Low Sulfur Fuel Oil Supply Contract by and between Tesoro and Hawaiian Electric dated as of August 28, 2012 (confidential treatment has been requested for portions of this exhibit, which has been redacted accordingly) (Exhibit 10.3 to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, File No. 1-4955).
10.10(a)	Inter-Island Industrial Fuel Oil and Diesel Fuel Supply Contract by and between BHP Petroleum Americas Refining Inc. and Hawaiian Electric, Maui Electric and Hawaii Electric Light dated

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

November 14, 1997 (confidential treatment has been requested for portions of this exhibit, which has been redacted accordingly) (Exhibit 10.12 to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 1997, File No. 1-4955).

10.10(b) First Amendment to Inter-Island Industrial Fuel Oil and Diesel Fuel Supply Contract by and between Tesoro Hawaii Corporation, formerly known as BHP Petroleum Americas Refining Inc., and Hawaiian Electric, Maui Electric and Hawaii Electric Light dated March 29, 2004 (confidential treatment has been requested for portions of this exhibit, which has been redacted accordingly) (Exhibit 10(b) to Hawaiian Electric's Current Report on Form 8-K, dated May 28, 2004, File No. 1-4955).

10.10(c) Second Amendment to Inter-Island Industrial Fuel Oil and Diesel Fuel Supply Contract by and between Tesoro Hawaii Corporation, formerly known as BHP Petroleum Americas Refining Inc., and Hawaiian Electric, Maui Electric and Hawaii Electric Light dated January 31, 2012 (confidential treatment has been requested for portions of this exhibit, which has been redacted accordingly) (Exhibit 10.4 to Hawaiian Electric's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, File No. 1-4955).

\* 10.10(d) Letter agreement dated December 11, 2013 between Hawaiian Electric, Maui Electric and Hawaii Electric Light and Hawaiian Independent Energy LLC (formerly known as Tesoro Hawaii Corporation, formerly known as BHP Petroleum Americas Refining Inc.) Re: The Inter-Island Industrial Fuel Oil and Diesel Supply Contract dated November 14, 1997, as amended by First Amendment and Second Amendment.

---

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

Exhibit no.	Description
10.11(a)	Contract of private carriage by and between HITI and Hawaii Electric Light dated December 4, 2000 (Exhibit 10.13 to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 2000, File No. 1-4955).
10.11(b)	Consent to Change of Ownership/Control of Carrier by and between K-Sea Operating Partnership, L.P., and Hawaii Electric Light, dated July 1, 2011 (Exhibit 10.13(b) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, File No. 1-4955).
10.12(a)	Contract of private carriage by and between HITI and Maui Electric dated December 4, 2000 (Exhibit 10.14 to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 2000, File No. 1-4955).
10.12(b)	Consent to Change of Ownership/Control of Carrier by and between K-Sea Operating Partnership, L.P., and Maui Electric, dated July 1, 2011 (Exhibit 10.14(b) to Hawaiian Electric's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, File No. 1-4955).
10.13	Energy Agreement among the State of Hawaii, Division of Consumer Advocacy of the Department of Commerce and Consumer Affairs, and the Hawaiian Electric Companies (Exhibit 10.12 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, File No. 1-4955).
10.14	Stipulated Settlement Agreement between the Hawaiian Electric Companies and the Division of Consumer Advocacy regarding Certain Regulatory Matters (Exhibit 10 to Hawaiian Electric's Current Report on Form 8-K, dated January 28, 2013, File No. 1-4955).
10.15	Credit Agreement, dated as of May 7, 2010, among Hawaiian Electric, as Borrower, the Lenders Party Hereto and Bank of Hawaii, as Co-Syndication Agent, and U.S. Bank, National Association, as Co-Syndication Agent, and Wells Fargo Bank, National Association, as Co-Syndication Agent, and Bank of America, N.A., as Co-Documentation Agent, and Union Bank, N.A., as Co-Documentation Agent, and JPMorgan Chase Bank, N.A., as Administrative Agent and Issuing Bank, and J.P. Morgan Securities Inc., as Sole Lead Arranger and Sole Book Runner (Exhibit 10.3 to Quarterly Report on Form 10-Q for the quarter ended March 31, 2010, File No. 1-4955).
10.16	Amendment No. 1, dated as of December 5, 2011, to the Credit Agreement, dated as of May 7, 2010, among Hawaiian Electric, as Borrower, the Lenders Party Hereto and Bank of Hawaii, as Co-Syndication Agent, and U.S. Bank National Association, as Co-Syndication Agent, and Wells Fargo Bank, National Association, as Co-Syndication Agent, and Bank of America, N.A., as Co-Documentation Agent, and Union Bank, N.A., as Co-Documentation Agent, and JPMorgan Chase Bank, N.A., as Administrative Agent and Issuing Bank, and J.P. Morgan Securities Inc., as Sole Lead Arranger and Sole Book Runner (Exhibit 10.2 to Hawaiian Electric's Current Report on Form 8-K dated December 5, 2011, File No. 1-4955).
11	Computation of Earnings Per Share of Common Stock (See note on Hawaiian Electric's Item 6. Selected Financial Data).
*12.2	Hawaiian Electric - Computation of Ratio of Earnings to Fixed Charges.

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

- \*21.2 Hawaiian Electric - Subsidiaries of the Registrant
- \*31.3 Certification Pursuant to Section 13a-14 of the Securities Exchange Act of 1934 of Richard M. Rosenblum (Hawaiian Electric Chief Executive Officer).
- \*31.4 Certification Pursuant to Section 13a-14 of the Securities Exchange Act of 1934 of Tayne S. Y. Sekimura (Hawaiian Electric Chief Financial Officer).
- \*32.2 Hawaiian Electric Certification Pursuant to 18 U.S.C. Section 1350.
- \*99.1 Hawaiian Electric's Directors, Executive Officers and Corporate Governance; Hawaiian Electric's Executive Compensation; Hawaiian Electric's Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters; Hawaiian Electric's Certain Relationships and Related Transactions, and Director Independence; and Hawaiian Electric's Principal Accounting Fees and Services.