Section 1: 10-Q (10-Q)

Table of Contents

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended **June 30, 2019** **OR**

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

For the transition period from ________ to ________

Commission File Number: 001-35589

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

Washington	**45-4585178**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

6920 220th Street SW, Mountlake Terrace, Washington 98043
(Address of principal executive offices; Zip Code)

(425) 771-5299

(Registrant's telephone number, including area code)

None

(Former name, former address and former fiscal year, if changed since last report)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value $.01 per share	FSBW	The NASDAQ Stock Market LLC

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 [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes [X] No [ ]

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

Large accelerated filer [ ]	Accelerated filer [X]
Non-accelerated filer [ ]	Smaller reporting company [X]
Emerging growth company [ ]	

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of August 2, 2019, there were 4,477,864 outstanding shares of the registrant's common stock.

FS Bancorp, Inc.
Form 10-Q

Table of Contents

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

Item 1. Financial Statements

FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except share amounts) (Unaudited)

ASSETS	June 30, 2019	December 31, 2018
Cash and due from banks	$ 15,214	$ 9,408
Interest-bearing deposits at other financial institutions	44,380	23,371
Total cash and cash equivalents	59,594	32,779
Certificates of deposit at other financial institutions	24,297	22,074
Securities available-for-sale, at fair value	96,252	97,205
Loans held for sale, at fair value	66,508	51,195
Loans receivable, net	1,282,119	1,312,519
Accrued interest receivable	5,779	5,761
Premises and equipment, net	29,517	29,110
Operating lease right-of-use (“ROU”) assets	4,582	—
Federal Home Loan Bank (“FHLB”) stock, at cost	8,329	9,887
Other real estate owned (“OREO”)	254	689
Bank owned life insurance (“BOLI”), net	34,917	34,485
Servicing rights, held at the lower of cost or fair value	10,849	10,429
Goodwill	2,312	2,312
Core deposit intangible, net	5,837	6,217
Other assets	9,919	6,982
TOTAL ASSETS	$ 1,641,065	$ 1,621,644
LIABILITIES		
Deposits:		
Noninterest-bearing accounts	$ 279,221	$ 234,532
Interest-bearing accounts	1,054,996	1,039,687
Total deposits	1,334,217	1,274,219
Borrowings	83,211	137,149
Subordinated note:		
Principal amount	10,000	10,000
Unamortized debt issuance costs	(125)	(135)
Total subordinated note less unamortized debt issuance costs	9,875	9,865
Operating lease liabilities	4,721	—
Deferred tax liability, net	1,003	361
Other liabilities	18,612	20,012
Total liabilities	1,451,639	1,441,606
COMMITMENTS AND CONTINGENCIES (NOTE 10)		
STOCKHOLDERS’ EQUITY		
Preferred stock, $.01 par value; 5,000,000 shares authorized; none issued or outstanding	—	—
Common stock, $.01 par value; 45,000,000 shares authorized; 4,476,864 and 4,492,478 shares issued and outstanding at June 30, 2019 and December 31, 2018, respectively	45	45
Additional paid-in capital	90,418	91,466
Retained earnings	99,184	90,854
Accumulated other comprehensive gain (loss), net of tax	496	(1,479)
Unearned shares – Employee Stock Ownership Plan (“ESOP”)	(717)	(848)
Total stockholders’ equity	189,426	180,038
TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY	$ 1,641,065	$ 1,621,644

See accompanying notes to these consolidated financial statements.

FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands, except per share amounts) (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
INTEREST INCOME				
Loans receivable, including fees	$ 21,102	$ 13,135	$ 42,211	$ 25,391
Interest and dividends on investment securities, cash and cash equivalents, and certificates of deposit at other financial institutions	1,263	887	2,465	1,619
Total interest and dividend income	22,365	14,022	44,676	27,010
INTEREST EXPENSE				
Deposits	4,056	1,432	7,766	2,675
Borrowings	606	496	1,350	576
Subordinated note	169	169	337	337
Total interest expense	4,831	2,097	9,453	3,588
NET INTEREST INCOME	17,534	11,925	35,223	23,422
PROVISION FOR LOAN LOSSES	910	450	1,660	800
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	16,624	11,475	33,563	22,622
NONINTEREST INCOME				
Service charges and fee income	1,854	670	3,512	1,329
Gain on sale of loans	3,576	4,671	5,973	8,649
Gain on sale of investment securities	32	—	32	113
Earnings on cash surrender value of BOLI	217	88	432	170
Other noninterest income	404	185	689	377
Total noninterest income	6,083	5,614	10,638	10,638
NONINTEREST EXPENSE				
Salaries and benefits	8,649	7,671	16,892	14,719
Operations	2,658	1,541	4,702	2,901
Occupancy	1,230	704	2,342	1,353
Data processing	1,336	679	2,622	1,319
Gain on sale of OREO	—	—	(85)	—
OREO expenses	7	—	11	—
Loan costs	707	704	1,379	1,332
Professional and board fees	616	463	1,166	907
Federal Deposit Insurance Corporation (“FDIC”) insurance	139	90	387	131
Marketing and advertising	191	215	327	364
Acquisition costs	1,224	—	1,598	—
Amortization of core deposit intangible	190	77	380	153
Impairment of servicing rights	124	—	147	—
Total noninterest expense	17,071	12,144	31,868	23,179
INCOME BEFORE PROVISION FOR INCOME TAXES	5,636	4,945	12,333	10,081
PROVISION FOR INCOME TAXES	1,173	688	2,678	1,502
NET INCOME	$ 4,463	$ 4,257	$ 9,655	$ 8,579
Basic earnings per share	$ 1.00	$ 1.19	$ 2.17	$ 2.40
Diluted earnings per share	$ 0.98	$ 1.13	$ 2.12	$ 2.28

See accompanying notes to these consolidated financial statements.

FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands) (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Net Income	$ 4,463	$ 4,257	$ 9,655	$ 8,579
Other comprehensive income (loss), before tax:				
Securities available-for-sale:				
Unrealized holding gain (loss) during year	1,220	(524)	2,548	(1,991)
Income tax (provision) benefit related to unrealized holding gain (loss)	(263)	113	(548)	428
Reclassification adjustment for realized gain included in net income	(32)	—	(32)	(113)
Income tax provision related to reclassification for realized gain	7	—	7	24
Other comprehensive income (loss), net of tax	932	(411)	1,975	(1,652)
COMPREHENSIVE INCOME	$ 5,395	$ 3,846	$ 11,630	$ 6,927

See accompanying notes to these consolidated financial statements.

FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Dollars in thousands, except share amounts) (Unaudited)

Three Months Ended June 30, 2018 and 2019

	Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive (Loss) Income,	Unearned ESOP	Total Stockholders'
	Shares	Amount	Capital	Earnings	Net of Tax	Shares	Equity
BALANCE, April 1, 2018	3,695,552	$ 37	$ 55,823	$72,349	$ (1,716)	$ (1,051)	$ 125,442
Net income	—	$ —	—	4,257	—	—	$ 4,257
Dividends paid ($0.14 per share)	—	$ —	—	(504)	—	—	$ (504)
Share-based compensation	—	$ —	150	—	—	—	$ 150
Common stock repurchased	(4,325)	$ —	(250)	—	—	—	$ (250)
Stock options exercised	17,433	$ —	294	—	—	—	$ 294
Other comprehensive loss, net of tax	—	$ —	—	—	(411)	—	$ (411)
ESOP shares allocated	—	$ —	327	—	—	66	$ 393
BALANCE, June 30, 2018	3,708,660	$ 37	$ 56,344	$76,102	$ (2,127)	$ (985)	$ 129,371
BALANCE, April 1, 2019	4,489,042	$ 45	$ 91,742	$95,383	$ (436)	$ (782)	$ 185,952
Net income	—	$ —	—	4,463	—	—	$ 4,463
Dividends paid ($0.15 per share)	—	$ —	—	(662)	—	—	$ (662)
Share-based compensation	—	$ —	190	—	—	—	$ 190
Common stock repurchased	(49,978)	$ —	(2,413)	—	—	—	$ (2,413)
Stock options exercised	37,800	$ —	638	—	—	—	$ 638
Other comprehensive income, net of tax	—	$ —	—	—	932	—	$ 932
ESOP shares allocated	—	$ —	261	—	—	65	$ 326
BALANCE, June 30, 2019	4,476,864	$ 45	$ 90,418	$99,184	$ 496	$ (717)	$ 189,426

Six Months Ended June 30, 2018 and 2019

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income, Net of Tax	Unearned ESOP Shares	Total Stockholders' Equity
	Shares	Amount					
BALANCE, January 1, 2018	3,680,152	$ 37	$ 55,135	$68,422	$ (475)	$ (1,117)	$ 122,002
Net income	—	$ —	—	8,579	—	—	$ 8,579
Dividends paid ($0.25 per share)	—	$ —	—	(899)	—	—	$ (899)
Share-based compensation	—	$ —	285	—	—	—	$ 285
Common stock repurchased	(4,325)	$ —	(250)	—	—	—	$ (250)
Stock options exercised	32,833	$ —	554	—	—	—	$ 554
Other comprehensive loss, net of tax	—	$ —	—	—	(1,652)	—	$ (1,652)
ESOP shares allocated	—	$ —	620	—	—	132	$ 752
BALANCE, June 30, 2018	3,708,660	$ 37	$ 56,344	$76,102	$ (2,127)	$ (985)	$ 129,371
BALANCE, January 1, 2019	4,492,478	$ 45	$ 91,466	$90,854	$ (1,479)	$ (848)	$ 180,038
Net income	—	$ —	—	9,655	—	—	$ 9,655
Dividends paid ($0.30 per share)	—	$ —	—	(1,325)	—	—	$ (1,325)
Share-based compensation	—	$ —	452	—	—	—	$ 452
Common stock repurchased	(56,014)	$ —	(2,698)	—	—	—	$ (2,698)
Stock options exercised	40,400	$ —	682	—	—	—	$ 682
Other comprehensive income, net of tax	—	$ —	—	—	1,975	—	$ 1,975
ESOP shares allocated	—	$ —	516	—	—	131	$ 647
BALANCE, June 30, 2019	4,476,864	$ 45	$ 90,418	$99,184	$ 496	$ (717)	$ 189,426

See accompanying notes to these consolidated financial statements.

FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands) (Unaudited)

	Six Months Ended June 30,	
	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 9,655	$ 8,579
Adjustments to reconcile net income to net cash from operating activities		
Provision for loan losses	1,660	800
Depreciation, amortization and accretion	4,303	2,640
Compensation expense related to stock options and restricted stock awards	452	285
ESOP compensation expense for allocated shares	647	752
Increase in cash surrender value of BOLI	(432)	(170)
Gain on sale of loans held for sale	(5,973)	(8,567)
Gain on sale of portfolio loans	—	(82)
Gain on sale of investment securities	(32)	(113)
Origination of loans held for sale	(321,784)	(313,203)
Proceeds from sale of loans held for sale	310,730	317,431
Impairment of servicing rights	147	—
Gain on sale of OREO	(85)	—
Changes in operating assets and liabilities		
Accrued interest receivable	(18)	(468)
Other assets	(8,153)	(74)
Other liabilities	3,931	4,565
Net cash (used) from operating activities	(4,952)	12,375
CASH FLOWS USED BY INVESTING ACTIVITIES		
Activity in securities available-for-sale:		
Proceeds from sale of investment securities	10,554	5,305
Maturities, prepayments, and calls	8,343	4,315
Purchases	(15,599)	(27,845)
Maturities of certificates of deposit at other financial institutions	2,488	496
Purchase of certificates of deposit at other financial institutions	(4,712)	—
Loan originations and principal collections, net	27,982	(104,670)
Purchase of portfolio loans	(321)	(21,618)
Proceeds from sale of portfolio loans	—	5,551
Proceeds from sale of OREO, net	684	—
Purchase of premises and equipment	(1,741)	(1,649)
Purchase of BOLI	—	(3,000)
Change in FHLB stock, net	1,558	(4,871)
Net cash from (used) by investing activities	29,236	(147,986)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	59,998	40,271
Proceeds from borrowings	296,282	513,985
Repayments of borrowings	(350,408)	(414,988)
Dividends paid	(1,325)	(899)
Proceeds from stock options exercised	682	554
Common stock repurchased	(2,698)	(250)
Net cash from financing activities	2,531	138,673
NET INCREASE IN CASH AND CASH EQUIVALENTS	26,815	3,062
CASH AND CASH EQUIVALENTS, beginning of period	32,779	18,915
CASH AND CASH EQUIVALENTS, end of period	$ 59,594	$ 21,977

FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(In thousands) (Unaudited)

SUPPLEMENTARY DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest on deposits and borrowings	$ 9,529	$ 3,513
Income taxes	2,467	1,200
SUPPLEMENTARY DISCLOSURES OF NONCASH OPERATING, INVESTING AND FINANCING ACTIVITIES		
Change in unrealized gain (loss) on investment securities, net	2,517	(2,105)
Property taken in settlement of loans	179	—
Retention of gross mortgage servicing rights from loan sales	$ 2,059	$ 2,519

See accompanying notes to these consolidated financial statements

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

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

On November 15, 2018, the Company completed its acquisition of Anchor Bancorp ("Anchor"), pursuant to the Agreement and Plan of Merger dated as of July 17, 2018 (the "Merger Agreement") by and between FS Bancorp and Anchor. Under the terms of the Merger Agreement, Anchor merged with and into FS Bancorp ("Anchor Acquisition"), with FS Bancorp as the surviving corporation. Immediately after the Anchor Acquisition, FS Bancorp merged Anchor Bank, a wholly-owned subsidiary of Anchor, with and into 1st Security Bank of Washington, a wholly-owned subsidiary of FS Bancorp, with 1st Security Bank of Washington as the surviving bank. For additional information, see "Note 2 - Business Combination."

Financial Statement Presentation **-** The accompanying unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. 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"). It is recommended that these unaudited interim consolidated financial statements be read in conjunction with the Company's Annual Report on Form 10-K with all of the audited information and footnotes required by U.S. GAAP for complete financial statements for the year ended December 31, 2018, as filed with the SEC on March 15, 2019. In the opinion of management, all normal adjustments and recurring accruals considered necessary for a fair presentation of the financial position and results of operations for the periods presented have been included.

The results for the three and six months ended June 30, 2019 are not necessarily indicative of the results that may be expected for the year ending December 31, 2019, or any other future period. The preparation of financial statements, in conformity with U.S. GAAP, requires management to make estimates and assumptions that affect amounts reported in the financial statements. Actual results could differ from these estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan and lease losses, fair value of financial instruments, the valuation of servicing rights, deferred income taxes, and if needed, a deferred tax asset valuation allowance.

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

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

Segment Reporting **-** The Company operates in two business segments through the Bank: commercial and consumer banking and home lending. The Company's business segments are determined based on the products and services provided, as well as the nature of the related business activities, and they reflect the manner in which financial information is regularly reviewed for the purpose of allocating resources and evaluating performance of the Company's businesses. The results for these business segments are based on management's accounting process, which assigns income statement items and assets to each responsible operating segment. This process is dynamic and is based on management's view of the Company's operations. See "Note 16 - Business Segments."

Subsequent Events **-** The Company has evaluated events and transactions subsequent to June 30, 2019 for potential recognition or disclosure.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, as amended by ASU 2018-19, ASU 2019-04, and ASU 2019-05*. The ASU is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The ASU requires the measurement of all current expected credit losses ("CECL") for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of CECL. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, however, the FASB board proposed in July 2019 extending the adoption date for certain registrants, including the Company, to fiscal years beginning after December 15, 2022. Early application will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company is currently evaluating the impact of this ASU on the Company's consolidated financial statements. Once adopted, the Company anticipates the allowance for loan losses to increase through a one-time adjustment to retained earnings, however, until the evaluation is complete the magnitude of the increase will be unknown.

In April 2019, the FASB issued ASU 2019-04, *Codification Improvements to Topic 326, Financial Instruments-Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*. This ASU clarifies and improves areas of guidance related to the recently issued standards on credit losses, hedging, and recognition and measurement including improvements resulting from various FASB Transition Resource Group meetings. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the impact that ASU 2019-04 will have on its consolidated financial statements.

In May 2019, the FASB issued ASU 2019-05, *Financial Instruments-Credit Losses (Topic 326): Targeted Transition Relief*. The amendments in this ASU provide entities that have certain instruments within the scope of Subtopic 326-20 with an option to irrevocably elect the fair value option in Subtopic 825-10, applied on an instrument-by-instrument basis for eligible instruments, upon the adoption of Topic 326. The fair value option election does not apply to held-to-maturity debt securities. An entity that elects the fair value option should subsequently measure those instruments at fair value with changes in fair value flowing through earnings. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. The amendments should be applied on a modified-retrospective basis by means of a cumulative-effect adjustment to the opening balance of retained earnings balance in the balance sheet. Early adoption is permitted. The Company is currently assessing the impact that ASU 2019-05 will have on its consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. This ASU contains some technical adjustments related to the fair value disclosure requirements of public companies. Included in this ASU is the additional disclosure requirement of unrealized gains and losses for the period in recurring level 3 fair value disclosures and the range and weighted average of significant unobservable inputs, among other technical changes. ASU 2018-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted for any removed or modified disclosures. The adoption of ASU 2018-13 is not expected to have a material impact on the Company's consolidated financial statements.

In August 2018, FASB issued ASU 2018-15, *Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. The amendments in this ASU broaden the scope of ASC Subtopic 350-40 to include costs incurred to implement a hosting arrangement that is a service contract. The amendments align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the

requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The costs are capitalized or expensed depending on the nature of the costs and the project stage during which they are incurred, consistent with the accounting for costs for internal-use software. The amendments in this ASU result in consistent capitalization of implementation costs of a hosting arrangement that is a service contract and implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by the amendments in this ASU. This ASU is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. The amendments in this ASU should be applied retrospectively to all implementation costs incurred after the date of adoption. Adoption of ASU 2018-15 is not expected to have a material impact on the Company's Consolidated Financial Statements.

Application of New Accounting Guidance Adopted in 2019

On January 1, 2019, the Company adopted FASB ASU No. 2016-02, *Leases (Topic 842)*. ASU No. 2016-02 requires lessees to recognize on the balance sheet the assets and liabilities arising from operating leases. A lessee should recognize a liability to make lease payments and an ROU asset representing its right to use the underlying asset for the lease term. A lessee should include payments to be made in an optional period only if the lessee is reasonably certain to exercise an option to extend the lease or not to exercise an option to terminate the lease. For operating leases, the lease cost should be allocated over the lease term on a generally straight-line basis. In July 2018, the FASB issued ASU No, 2018-10, *Codification Improvements to Topic 842, Leases* and ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements.* These ASUs contain clarifications to ASU 2016-02, including providing a new transition method in addition to the existing transition method contained in ASU No. 2016-02 to allow entities to initially apply the new leases standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. These amendments have the same effective date as ASU 2016-02. In March 2019, FASB issued ASU 2019-01, *Leases (Topic 842), Codification Improvements*. The amendment in this ASU that is applicable to the Company clarifies interim disclosure requirements that allow omission of required transition disclosures. For financial reporting purposes, the Company applied the modified retrospective transition approach and elected to apply the transition option included in ASU 2018-11 on the effective date, January 1, 2019 which eliminates the requirement for reporting comparative periods presented in the financial statements prior to that date.

The new standard provides for a number of practical expedients in transition. The Company elected the package of practical expedients, which permits us to not reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs. The Company also elected the use-of-hindsight and elected the practical expedient to not separate lease and non-lease components on our real estate leases where we are the lessee. The Company did not elect the practical expedient pertaining to land easement as it is not applicable to us.

The new standard also provides practical expedients for an entity's ongoing accounting. The Company has elected the short-term lease recognition exemption for certain leases which are less than 12 months in duration or month-to-month. This means, for those leases that qualify, ROU assets or lease liabilities will not be recognized.

The adoption of this ASU on January 1, 2019 created ROU assets of $4.8 million and operating lease liabilities of $5.0 million, and the related impact to the Company's first quarter 2019 Consolidated Balance Sheet was approximately 0.3%. Additional disclosures required by the ASU have been included in "Note 7 - Leases."

NOTE 2 - BUSINESS COMBINATION

On November 15, 2018, the Company completed its acquisition of Anchor Bancorp, pursuant to the Agreement and Plan of Merger dated as of July 17, 2018 by and between FS Bancorp and Anchor. Under the terms of the Merger Agreement, Anchor merged with and into FS Bancorp, with FS Bancorp as the surviving corporation. Immediately after the Anchor Acquisition, FS Bancorp merged Anchor Bank, a wholly-owned subsidiary of Anchor, with and into 1st Security Bank of Washington, a wholly-owned subsidiary of FS Bancorp, with 1st Security Bank of Washington as the surviving bank. Anchor's principal business activities prior to the acquisition were attracting retail deposits from the general public and utilizing those deposits to originate loans including one-to-four-family residences, commercial real estate, and multi-family residences located in Western Washington. Anchor's principal lending activity had consisted of the origination of loans secured by first mortgages on owner-occupied, one-to-four-family residences and loans for the construction of one-to-four-family residences, as well as consumer loans, with an emphasis on home equity loans and lines of credit. The primary objective for the acquisition was to significantly expand FS Bancorp’s presence throughout Western Washington, increase nonmaturity deposits, and offer additional banking and lending products to former Anchor customers as well as new customers.

The Anchor Acquisition was accounted for under the acquisition method of accounting and accordingly, the assets and liabilities were recorded at their fair values on November 15, 2018, the date of acquisition. Determining the fair value of assets and liabilities is a complicated process involving significant judgment regarding methods and assumptions used to calculate estimated fair values. Fair values are preliminary and subject to refinement for up to one year after the closing date of the acquisition as information relative to the closing date fair values become available.

Anchor Bank’s operating system conversion into the Bank’s core system occurred on June 15, 2019, with related expenses in the second quarter of 2019 of $1.2 million.

The following table summarizes the estimated fair values of assets acquired and liabilities assumed at the date of acquisition:

November 15, 2018	Acquired Book Value	Fair Value Adjustments	Amount Recorded
Assets			
Cash and cash equivalents	$ 54,558	$ —	$ 54,558
Securities available-for-sale	19,609	(54)	19,555
Loans receivable, net	361,596	(5,321)[1]	356,275
Premises and equipment, net	8,411	3,354 [2]	11,765
Other real estate owned	689	—	689
Deferred tax asset	4,097	(3,358)	739
Mortgage servicing rights	218	564	782
Core deposit intangible ("CDI")	—	5,251 [3]	5,251
Other assets	25,231	18	25,249
Total assets acquired	$ 474,409	$ 454	$ 474,863
Liabilities			
Deposits	$ 357,863	$ (1,052)[4]	$ 356,811
Borrowings	37,000	(282)	36,718
Other liabilities	9,286	63	9,349
Total liabilities assumed	$ 404,149	$ (1,271)	$ 402,878

Explanation of Fair Value Adjustments

(1) The fair value discount for acquired loans from Anchor was $5.3 million and was determined by separate adjustments to reflect a credit risk and marketability component and a yield component reflecting the differential between portfolio and market yields. The discount on acquired loans will be accreted back into interest income over an estimated average life of 60 months.

(2) The fair value adjustment represents the difference between the fair value of the premises and the book value of those assets acquired. The Company utilized third-party valuations including appraisals, comparative market analysis, and tax-assessed values to assist in the determination of the fair value.

(3) The fair value adjustment of $5.3 million represents the value of the core deposit base assumed on a study performed. This amount was recorded by the Company as an identifiable intangible asset and will be amortized as an expense on a straight-line basis over an estimated 10 year life of the core deposit base and will be reviewed for impairment annually. See “Note 17 - Goodwill and Other Intangible Assets.”

(4) The fair value of transaction and savings accounts was determined to be equal to their carrying values. The fair value of time deposits was calculated using a discounted cash flow analysis that calculated the present value of the projected cash flows from the portfolio versus the present value of a similar portfolio with a similar maturity profile at current market

rates. As of the acquisition date, the portfolio of time deposits was valued at a pre-tax discount of $1.1 million, or 0.65% of certificates of deposit acquired in the Anchor Acquisition of $162.9 million. This adjustment represents a difference in interest rates from the time deposits acquired and the estimated wholesale funding rates used in the application of fair value accounting. The discounted amount will be accreted into expense as an increase in interest expense over the maturity profile of the acquired time deposits.

The following table summarizes the consideration paid, the aggregate amount recognized for each major class of assets acquired and liabilities assumed by 1st Security Bank in the Anchor Acquisition:

	At November 15, 2018	
Purchase price of Anchor		
Fair value of FS Bancorp common stock at $46.54 [(1)] per share for 725,518 shares		$ 33,766
Cash paid		30,805
Total purchase price		64,571
Fair value of assets acquired:		
Cash and cash equivalents	$ 54,558	
Securities available-for-sale	19,555	
Loans receivable, net	356,275	
Premises and equipment	11,765	
OREO	689	
Deferred tax asset	739	
Mortgage servicing rights	782	
Intangible assets – CDI	5,251	
Other assets	25,249	
Total assets and identifiable intangible assets acquired	$ 474,863	
Fair value of liabilities assumed:		
Deposits	$ 356,811	
Borrowings	36,718	
Other liabilities	9,349	
Total liabilities assumed	$ 402,878	
Fair value of net assets and identifiable intangible assets acquired		71,985
Bargain purchase gain		$ (7,414)

____

(1) Stock price is as of the closing date.

The application of the acquisition method of accounting resulted in a bargain purchase gain of $7.4 million for the year ended December 31, 2018 and was reported as a component of noninterest income on our Consolidated Statements of Income. The bargain purchase gain was primarily due to the decline in the value of the stock portion of the merger consideration between signing and closing the Anchor Acquisition which resulted in the purchase price for Anchor being less than the fair market value of the net assets acquired. In the merger, each Anchor shareholder received 0.291 of a share of FS Bancorp common stock for each share of Anchor common stock along with $12.40 in cash.

The Company determined that the disclosure requirements related to the amounts of revenues and earnings of Anchor included in the consolidated statements of operations since the November 15, 2018 acquisition date was impracticable. The financial activity and operating results of Anchor were commingled with the Company’s financial activity and operating results as of the acquisition date.

NOTE 3 - SECURITIES AVAILABLE-FOR-SALE

The following tables present the amortized costs, unrealized gains, unrealized losses, and estimated fair values of securities available-for-sale at June 30, 2019 and December 31, 2018:

	June 30, 2019			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Values
SECURITIES AVAILABLE-FOR-SALE				
U.S. agency securities	$ 11,000	$ 63	$ —	$ 11,063
Corporate securities	8,546	62	—	8,608
Municipal bonds	12,236	251	(5)	12,482
Mortgage-backed securities	44,602	207	(256)	44,553
U.S. Small Business Administration securities	19,235	352	(41)	19,546
Total securities available-for-sale	$ 95,619	$ 935	$ (302)	$ 96,252

	December 31, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Values
SECURITIES AVAILABLE-FOR-SALE				
U.S. agency securities	$ 16,052	$ 32	$ (197)	$ 15,887
Corporate securities	7,074	—	(209)	6,865
Municipal bonds	14,446	23	(275)	14,194
Mortgage-backed securities	45,827	83	(1,074)	44,836
U.S. Small Business Administration securities	15,690	—	(267)	15,423
Total securities available-for-sale	$ 99,089	$ 138	$ (2,022)	$ 97,205

At June 30, 2019, the Bank had pledged eight securities held at the FHLB of Des Moines with a carrying value of $10.9 million to secure Washington State public deposits of $10.5 million with a $3.9 million collateral requirement by the Washington Public Deposit Protection Commission. At December 31, 2018, the Bank pledged 11 securities held at the FHLB of Des Moines with a carrying value of $13.7 million to secure Washington State public deposits of $19.9 million with an $8.4 million minimum collateral requirement by the Washington Public Deposit Protection Commission.

Investment securities that were in an unrealized loss position at June 30, 2019 and December 31, 2018 are presented in the following tables, based on the length of time individual securities have been in an unrealized loss position. Management believes that these securities are only temporarily impaired due to changes in market interest rates or the widening of market spreads subsequent to the initial purchase of the securities, and not due to concerns regarding the underlying credit of the issuers or the underlying collateral.

	June 30, 2019					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
SECURITIES AVAILABLE-FOR-SALE						
U.S. agency securities	$ —	$ —	$ 2,998	$ —	$ 2,998	$ —
Corporate securities	—	—	—	—	—	—
Municipal bonds	—	—	531	(5)	531	(5)
Mortgage-backed securities	1,021	—	23,372	(256)	24,393	(256)
U.S. Small Business Administration securities	2,932	(5)	2,620	(36)	5,552	(41)
Total	$3,953	$ (5)	$29,521	$ (297)	$33,474	$ (302)

	December 31, 2018					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
SECURITIES AVAILABLE-FOR-SALE						
U.S. agency securities	$ 6,018	$ (25)	$ 4,822	$ (172)	$ 10,840	$ (197)
Corporate securities	975	(25)	5,890	(184)	6,865	(209)
Municipal bonds	2,098	(22)	8,787	(253)	10,885	(275)
Mortgage-backed securities	6,266	(40)	32,537	(1,034)	38,803	(1,074)
U.S. Small Business Administration securities	1,958	(11)	13,465	(256)	15,423	(267)
Total	$ 17,315	$ (123)	$ 65,501	$ (1,899)	$ 82,816	$ (2,022)

There were two investments with unrealized losses of less than one year, and 23 investments with unrealized losses of more than one year at June 30, 2019. There were 14 investments with unrealized losses of less than one year, and 48 investments with unrealized losses of more than one year at December 31, 2018. The unrealized losses associated with these investments are believed to be caused by changing market conditions that are considered to be temporary and the Company does not intend to sell the securities, and it is not likely to be required to sell these securities prior to maturity. Based on the Company's evaluation of these securities, no other-than-temporary impairment was recorded for the six months ended June 30, 2019, or for the year ended December 31, 2018.

The contractual maturities of securities available-for-sale at June 30, 2019 and December 31, 2018 are listed below. Expected maturities of mortgage-backed securities may differ from contractual maturities because borrowers may have the right to call or prepay the obligations; therefore, these securities are classified separately with no specific maturity date.

	June 30, 2019		December 31, 2018	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
U.S. agency securities				
Due after one year through five years	$ 1,005	$ 1,037	$ 1,043	$ 1,040
Due after five years through ten years	4,997	5,026	10,011	9,941
Due after ten years	4,998	5,000	4,998	4,906
Subtotal	11,000	11,063	16,052	15,887
Corporate securities				
Due after one year or less	1,000	1,006	6,077	5,947
Due after one year through five years	7,546	7,602	997	918
Subtotal	8,546	8,608	7,074	6,865
Municipal bonds				
Due after one year through five years	2,659	2,663	2,659	2,570
Due after five years through ten years	2,003	2,092	2,610	2,592
Due after ten years	7,574	7,727	9,177	9,032
Subtotal	12,236	12,482	14,446	14,194
Mortgage-backed securities				
Federal National Mortgage Association (“FNMA”)	29,791	29,862	30,554	30,026
Federal Home Loan Mortgage Corporation (“FHLMC”)	7,461	7,368	10,301	9,961
Government National Mortgage Association (“GNMA”)	7,350	7,323	4,972	4,849
Subtotal	44,602	44,553	45,827	44,836
U.S. Small Business Administration securities				
Due after one year through five years	860	843	—	—
Due after five years through ten years	11,667	11,967	13,828	13,581
Due after ten years	6,708	6,736	1,862	1,842
Subtotal	19,235	19,546	15,690	15,423
Total	$ 95,619	$ 96,252	$ 99,089	$ 97,205

The proceeds and resulting gains and losses, computed using specific identification from sales of securities available-for-sale for the three and six months ended June 30, 2019 and 2018 shown below:

	Three Months Ended June 30, 2019			Six Months Ended June 30, 2019		
	Proceeds	Gross Gains	Gross (Losses)	Proceeds	Gross Gains	Gross (Losses)
Securities available-for-sale	$ 10,554	$ 91	$ (59)	$ 10,554	$ 91	$ (59)

	Three Months Ended June 30, 2018			Six Months Ended June 30, 2018		
	Proceeds	Gross Gains	Gross (Losses)	Proceeds	Gross Gains	Gross (Losses)
Securities available-for-sale	$ —	$ —	$ —	$ 5,305	$ 113	$ —

NOTE 4 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

The composition of the loan portfolio was as follows at June 30, 2019 and December 31, 2018:

	June 30, 2019	December 31, 2018
REAL ESTATE LOANS		
Commercial	$ 206,834	$ 204,699
Construction and development	214,140	247,306
Home equity	36,860	40,258
One-to-four-family (excludes loans held for sale)	248,921	249,397
Multi-family	103,219	104,663
Total real estate loans	809,974	846,323
CONSUMER LOANS		
Indirect home improvement	188,336	167,793
Solar	44,508	44,433
Marine	66,064	57,822
Other consumer	4,875	5,425
Total consumer loans	303,783	275,473
COMMERCIAL BUSINESS LOANS		
Commercial and industrial	135,336	138,686
Warehouse lending	47,028	65,756
Total commercial business loans	182,364	204,442
Total loans receivable, gross	1,296,121	1,326,238
Allowance for loan losses	(12,340)	(12,349)
Deferred costs and fees, net	(2,940)	(2,907)
Premiums on purchased loans, net	1,278	1,537
Total loans receivable, net	$ 1,282,119	$ 1,312,519

Most of the Company's commercial and multi-family real estate, construction, residential, and/or commercial business lending activities are with customers located in Western Washington and near the loan production office located in the Tri-Cities, Washington. The Company originates real estate, consumer, and commercial business loans and has concentrations in these areas, however, indirect home improvement loans and solar loans are originated through a network of home improvement contractors and dealers located throughout Washington, Oregon, California, Idaho, Colorado, and Arizona. Loans are generally secured by collateral and rights to collateral vary and are legally documented to the extent practicable. Local economic conditions may affect borrowers' ability to meet the stated repayment terms.

At June 30, 2019, the Bank held approximately $655.3 million in loans that qualify as collateral for FHLB advances, compared to approximately $355.5 million at December 31, 2018. The Bank pledged loans acquired in the Anchor Acquisition during the first quarter of 2019, after determining which loans qualify as collateral for FHLB advances. The Bank held approximately $295.7 million in loans that qualify as collateral for the Federal Reserve Bank line of credit at June 30, 2019, compared to approximately $265.2 million at December 31, 2018.

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

Real Estate Loans

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

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

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

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

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

Consumer Loans

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

Solar. Fixture secured loans for solar related home improvement projects are originated by the Company through its network of contractors and dealers, and are secured by the personal property installed in, on, or at the borrower's real property, and which may be perfected with a UCC-2 financing statement filed in the county of the borrower's residence.

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

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

Commercial Business Loans

Commercial and Industrial Lending ("C&I"). Loans originated by the Company to local small- and mid-sized businesses in our Puget Sound market area are secured primarily by accounts receivable, inventory, or personal property, plant and equipment. Some of the C&I loans purchased by the Company are outside of the Greater Puget Sound market area. C&I loans are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business.

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

The following tables detail activity in the allowance for loan losses by loan categories at or for the three and six months ended June 30, 2019 and 2018:

	At or For the Three Months Ended June 30, 2019				
	Real Estate	Consumer	Commercial Business	Unallocated	Total
ALLOWANCE FOR LOAN LOSSES					
Beginning balance	$ 5,785	$ 3,363	$ 2,730	$ (33)	$ 11,845
Provision for loan losses	(5)	196	419	300	910
Charge-offs	—	(217)	(431)	—	(648)
Recoveries	—	233	—	—	233
Net recoveries (charge-offs)	—	16	(431)	—	(415)
Ending balance	$ 5,780	$ 3,575	$ 2,718	$ 267	$ 12,340
Period end amount allocated to:					
Loans individually evaluated for impairment	$ —	$ 156	$ —	$ —	$ 156
Loans collectively evaluated for impairment	5,780	3,419	2,718	267	12,184
Ending balance	$ 5,780	$ 3,575	$ 2,718	$ 267	$ 12,340
LOANS RECEIVABLE					
Loans individually evaluated for impairment	$ 322	$ 445	$ —	$ —	$ 767
Loans collectively evaluated for impairment	809,652	303,338	182,364	—	1,295,354
Ending balance	$ 809,974	$ 303,783	$ 182,364	$ —	$ 1,296,121

	At or For the Three Months Ended June 30, 2018				
	Real Estate	Consumer	Commercial Business	Unallocated	Total
ALLOWANCE FOR LOAN LOSSES					
Beginning balance	$ 4,780	$ 2,934	$ 2,311	$ 1,115	$ 11,140
Provision for loan losses	330	285	255	(420)	450
Charge-offs	(1)	(223)	—	—	(224)
Recoveries	16	188	1	—	205
Net recoveries (charge-offs)	15	(35)	1	—	(19)
Ending balance	$ 5,125	$ 3,184	$ 2,567	$ 695	$ 11,571
Period end amount allocated to:					
Loans individually evaluated for impairment	$ 21	$ 109	$ —	$ —	$ 130
Loans collectively evaluated for impairment	5,104	3,075	2,567	695	11,441
Ending balance	$ 5,125	$ 3,184	$ 2,567	$ 695	$ 11,571
LOANS RECEIVABLE					
Loans individually evaluated for impairment	$ 317	$ 310	$ —	$ —	$ 627
Loans collectively evaluated for impairment	475,946	239,564	177,643	—	893,153
Ending balance	$ 476,263	$ 239,874	$ 177,643	$ —	$ 893,780

	At or For the Six Months Ended June 30, 2019				
	Real Estate	Consumer	Commercial Business	Unallocated	Total
ALLOWANCE FOR LOAN LOSSES					
Beginning balance	$ 5,761	$ 3,351	$ 3,191	$ 46	$ 12,349
Provision for loan losses	18	310	1,111	221	1,660
Charge-offs	—	(466)	(1,584)	—	(2,050)
Recoveries	1	380	—	—	381
Net recoveries (charge-offs)	1	(86)	(1,584)	—	(1,669)
Ending balance	$ 5,780	$ 3,575	$ 2,718	$ 267	$ 12,340
Period end amount allocated to:					
Loans individually evaluated for impairment	$ —	$ 156	$ —	$ —	$ 156
Loans collectively evaluated for impairment	5,780	3,419	2,718	267	12,184
Ending balance	$ 5,780	$ 3,575	$ 2,718	$ 267	$ 12,340
LOANS RECEIVABLE					
Loans individually evaluated for impairment	$ 322	$ 445	$ —	$ —	$ 767
Loans collectively evaluated for impairment	809,652	303,338	182,364	—	1,295,354
Ending balance	$ 809,974	$ 303,783	$ 182,364	$ —	$ 1,296,121

	At or For the Six Months Ended June 30, 2018				
	Real Estate	Consumer	Commercial Business	Unallocated	Total
ALLOWANCE FOR LOAN LOSSES					
Beginning balance	$ 4,770	$ 2,814	$ 2,014	$ 1,158	$ 10,756
Provision for loan losses	343	370	550	(463)	800
Charge-offs	(4)	(451)	—	—	(455)
Recoveries	16	451	3	—	470
Net recoveries	12	—	3	—	15
Ending balance	$ 5,125	$ 3,184	$ 2,567	$ 695	$ 11,571
Period end amount allocated to:					
Loans individually evaluated for impairment	$ 21	$ 109	$ —	$ —	$ 130
Loans collectively evaluated for impairment	5,104	3,075	2,567	695	11,441
Ending balance	$ 5,125	$ 3,184	$ 2,567	$ 695	$ 11,571
LOANS RECEIVABLE					
Loans individually evaluated for impairment	$ 317	$ 310	$ —	$ —	$ 627
Loans collectively evaluated for impairment	475,946	239,564	177,643	—	893,153
Ending balance	$ 476,263	$ 239,874	$ 177,643	$ —	$ 893,780

Non-accrual 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 non-accrual once the loan is 90 days past due or sooner if, in management's opinion, the borrower may be unable to meet payment obligations as they become due, or as required by regulatory authorities. The exception is the legacy Anchor credit card portfolio which is serviced externally.

The following tables provide information pertaining to the aging analysis of contractually past due loans and non-accrual loans at June 30, 2019 and December 31, 2018:

	June 30, 2019						
	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans Receivable	Non-Accrual
REAL ESTATE LOANS							
Commercial	$ —	$ —	$ —	$ —	$ 206,834	$ 206,834	$ —
Construction and development	—	—	—	—	214,140	214,140	—
Home equity	38	5	186	229	36,631	36,860	190
One-to-four-family	117	99	572	788	248,133	248,921	958
Multi-family	—	—	—	—	103,219	103,219	—
Total real estate loans	155	104	758	1,017	808,957	809,974	1,148
CONSUMER LOANS							
Indirect home improvement	382	122	155	659	187,677	188,336	401
Solar	73	—	—	73	44,435	44,508	33
Marine	65	—	—	65	65,999	66,064	—
Other consumer	12	28	14	54	4,821	4,875	11
Total consumer loans	532	150	169	851	302,932	303,783	445
COMMERCIAL BUSINESS LOANS							
Commercial and industrial	—	—	—	—	135,336	135,336	—
Warehouse lending	—	—	—	—	47,028	47,028	—
Total commercial business loans	—	—	—	—	182,364	182,364	—
Total loans	$687	$254	$ 927	$1,868	$ 1,294,253	$ 1,296,121	$1,593

	December 31, 2018						
	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans Receivable	Non-Accrual
REAL ESTATE LOANS							
Commercial	$ —	$ —	$ —	$ —	$ 204,699	$ 204,699	$ —
Construction and development	—	—	—	—	247,306	247,306	—
Home equity	158	40	229	427	39,831	40,258	229
One-to-four-family	1,274	164	1,358	2,796	246,601	249,397	1,552
Multi-family	—	—	—	—	104,663	104,663	—
Total real estate loans	1,432	204	1,587	3,223	843,100	846,323	1,781
CONSUMER LOANS							
Indirect home improvement	438	196	113	747	167,046	167,793	367
Solar	62	43	41	146	44,287	44,433	41
Marine	50	—	—	50	57,772	57,822	18
Other consumer	69	24	11	104	5,321	5,425	2
Total consumer loans	619	263	165	1,047	274,426	275,473	428
COMMERCIAL BUSINESS LOANS							
Commercial and industrial	—	431	—	431	138,255	138,686	1,685
Warehouse lending	—	—	—	—	65,756	65,756	—
Total commercial business loans	—	431	—	431	204,011	204,442	1,685
Total loans	$2,051	$898	$ 1,752	$4,701	$ 1,321,537	$ 1,326,238	$3,894

There were five other consumer loans and two other consumer loans 90 days or more past due and still accruing interest of $8,000 and $11,000 at June 30, 2019 and at December 31, 2018, respectively.

The following tables provide additional information about our impaired loans that have been segregated to reflect loans for which an allowance for loan losses has been provided and loans for which no allowance was provided at June 30, 2019 and December 31, 2018:

	June 30, 2019		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
WITH NO RELATED ALLOWANCE RECORDED			
Home equity	$ 190	$ 190	$ —
One-to-four-family	958	958	—
Total real estate loans	1,148	1,148	—
WITH RELATED ALLOWANCE RECORDED			
Consumer loans	445	445	156
	445	445	156
Total	$ 1,593	$ 1,593	$ 156

	December 31, 2018		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
WITH NO RELATED ALLOWANCE RECORDED			
Home equity	$ 229	$ 229	$ —
WITH RELATED ALLOWANCE RECORDED			
One-to-four-family	1,552	1,552	125
Consumer loans	428	428	150
Commercial business loans	1,685	1,685	700
	3,665	3,665	975
Total	$ 3,894	$ 3,894	$ 975

The following tables present the average recorded investment in loans individually evaluated for impairment and the interest income recognized and received for the three and six months ended June 30, 2019 and 2018:

	At or For the Three Months Ended			
	June 30, 2019		June 30, 2018	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
WITH NO RELATED ALLOWANCE RECORDED				
Home equity	$ 190	$ —	$ 148	$ 1
One-to-four-family	1,606	49	—	—
Total real estate loans	1,796	49	148	1
Commercial business loans	288	—	—	—
	2,084	49	148	1
WITH RELATED ALLOWANCE RECORDED				
One-to-four-family	—	—	271	1
Consumer loans	442	7	292	6
	442	7	563	7
Total	$ 2,526	$ 56	$ 711	$ 8

	At or For the Six Months Ended			
	June 30, 2019		June 30, 2018	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
WITH NO RELATED ALLOWANCE RECORDED				
Home equity	$ 267	$ —	$ 182	$ 3
One-to-four-family	1,857	66	—	—
Total real estate loans	2,124	66	182	3
Commercial business loans	359	—	—	—
	2,483	66	182	3
WITH AN ALLOWANCE RECORDED				
One-to-four-family	—	—	271	3
Consumer loans	451	17	276	11
Commercial business loans	1,152	7	—	—
	1,603	24	547	14
Total	$ 4,086	$ 90	$ 729	$ 17

Credit Quality Indicators

As part of the Company's on-going monitoring of credit quality of the loan portfolio, management tracks certain credit quality indicators including trends related to (i) the risk grading of loans, (ii) the level of classified loans, (iii) net charge-offs, (iv) non-performing loans, and (v) the general economic conditions in the Company's markets.

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

A description of the 10 risk grades is as follows:

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

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

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

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

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

	June 30, 2019						
	Pass (1 - 5)	Watch (6)	Special Mention (7)	Substandard (8)	Doubtful (9)	Loss (10)	Total
REAL ESTATE LOANS							
Commercial	$ 204,267	$ 1,501	$ —	$ 1,066	$ —	$ —	$ 206,834
Construction and development	208,294	5,846	—	—	—	—	214,140
Home equity	36,635	—	35	190	—	—	36,860
One-to-four-family	247,702	200	61	958	—	—	248,921
Multi-family	102,025	1,194	—	—	—	—	103,219
Total real estate loans	798,923	8,741	96	2,214	—	—	809,974
CONSUMER LOANS							
Indirect home improvement	187,935	—	—	401	—	—	188,336
Solar	44,475	—	—	33	—	—	44,508
Marine	66,064	—	—	—	—	—	66,064
Other consumer	4,859	—	5	11	—	—	4,875
Total consumer loans	303,333	—	5	445	—	—	303,783
COMMERCIAL BUSINESS LOANS							
Commercial and industrial	123,752	7,663	120	3,801	—	—	135,336
Warehouse lending	47,028	—	—	—	—	—	47,028
Total commercial business loans	170,780	7,663	120	3,801	—	—	182,364
Total loans receivable, gross	$ 1,273,036	$16,404	$ 221	$ 6,460	$ —	$ —	$ 1,296,121

[redacted]

	December 31, 2018						
	Pass (1 - 5)	Watch (6)	Special Mention (7)	Substandard (8)	Doubtful (9)	Loss (10)	Total
REAL ESTATE LOANS							
Commercial	$ 203,557	$ 1,142	$ —	$ —	$ —	$ —	$ 204,699
Construction and development	244,577	2,729	—	—	—	—	247,306
Home equity	39,846	—	183	229	—	—	40,258
One-to-four-family	247,575	207	63	1,552	—	—	249,397
Multi-family	103,447	1,216	—	—	—	—	104,663
Total real estate loans	839,002	5,294	246	1,781	—	—	846,323
CONSUMER LOANS							
Indirect home improvement	167,426	—	—	367	—	—	167,793
Solar	44,392	—	—	41	—	—	44,433
Marine	57,804	—	—	18	—	—	57,822
Other consumer	5,415	—	8	2	—	—	5,425
Total consumer loans	275,037	—	8	428	—	—	275,473
COMMERCIAL BUSINESS LOANS							
Commercial and industrial	124,089	8,813	—	5,784	—	—	138,686
Warehouse lending	65,756	—	—	—	—	—	65,756
Total commercial business loans	189,845	8,813	—	5,784	—	—	204,442
Total loans receivable, gross	$ 1,303,884	$14,107	$ 254	$ 7,993	$ —	$ —	$ 1,326,238

NOTE 5 - SERVICING RIGHTS

Loans serviced for others are not included on the Consolidated Balance Sheets. The unpaid principal balances of permanent loans serviced for others were $1.30 billion and $1.19 billion at June 30, 2019 and December 31, 2018, respectively.

The following tables summarizes servicing rights activity for the three and six months ended June 30, 2019 and 2018:

	At or For the Three Months Ended June 30,	
	2019	2018
Beginning balance	$ 10,611	$ 7,515
Additions	1,215	1,381
Servicing rights amortized	(853)	(544)
Impairment of servicing rights	(124)	—
Ending balance	$ 10,849	$ 8,352

	At or For the Six Months Ended June 30,	
	2019	2018
Beginning balance	$ 10,429	$ 6,795
Additions	2,059	2,519
Servicing rights amortized	(1,492)	(962)
Impairment of servicing rights	(147)	—
Ending balance	$ 10,849	$ 8,352

The fair market value of the servicing rights' assets was $11.2 million and $14.6 million at June 30, 2019 and December 31, 2018, respectively. Fair value adjustments to servicing rights are mainly due to market-based assumptions associated with

discounted cash flows, loan prepayment speeds, and changes in interest rates. A significant change in prepayments of the loans in the servicing portfolio could result in significant changes in the valuation adjustments, thus creating potential volatility in the carrying amount of servicing rights.

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

	At June 30, 2019	At December 31, 2018
Key assumptions:		
Weighted average discount rate	9.5 %	9.5 %
Conditional prepayment rate ("CPR")	19.4 %	9.4 %
Weighted average life in years	4.8	7.7

Key economic assumptions and the sensitivity of the current fair value for single family MSR to immediate adverse changes in those assumptions at June 30, 2019 and December 31, 2018 were as follows:

	June 30, 2019	December 31, 2018
Aggregate portfolio principal balance	$ 1,302,598	$ 1,186,858
Weighted average rate of note	4.3 %	4.3 %

At June 30, 2019	Base	0.5% Adverse Rate Change	1.0% Adverse Rate Change
Conditional prepayment rate	19.4 %	27.4 %	35.6 %
Fair value MSR	$11,209	$ 9,001	$ 7,369
Percentage of MSR	0.9 %	0.7 %	0.6 %
Discount rate	9.7 %	10.2 %	10.7 %
Fair value MSR	$11,209	$ 11,033	$ 10,863
Percentage of MSR	0.9 %	0.8 %	0.8 %

At December 31, 2018	Base	0.5% Adverse Rate Change	1.0% Adverse Rate Change
Conditional prepayment rate	8.8 %	11.6 %	17.7 %
Fair value MSR	$14,218	$ 12,723	$ 10,358
Percentage of MSR	1.2 %	1.1 %	0.9 %
Discount rate	9.6 %	10.1 %	10.6 %
Fair value MSR	$14,218	$ 13,912	$ 13,617
Percentage of MSR	1.2 %	1.2 %	1.2 %

The above table shows the sensitivity to market rate changes for the par rate coupon for a conventional one-to-four-family FNMA, FHLMC, GNMA, or FHLB serviced home loan. The above tables reference a 50 basis point and 100 basis point decrease in market note rates.

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

[redacted]

The Company recorded $834,000 and $573,000 of gross contractually specified servicing fees, late fees, and other ancillary fees resulting from servicing of loans for the three months ended June 30, 2019 and 2018, respectively, and $1.6 million and $1.1 million for the six months ended June 30, 2019 and 2018, respectively. The income, net of amortization, is reported in noninterest income on the Consolidated Statements of Income.

NOTE 6 - DERIVATIVES

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

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

	June 30, 2019		
		Fair Value	
	Notional	Asset	Liability
Fallout adjusted interest rate lock commitments with customers	$ 74,370	$ 1,047	$ —
Mandatory and best effort forward commitments with investors	35,442	—	—
Forward TBA mortgage-backed securities	132,000	—	411

	December 31, 2018		
		Fair Value	
	Notional	Asset	Liability
Fallout adjusted interest rate lock commitments with customers	$ 29,432	$ 503	$ —
Mandatory and best effort forward commitments with investors	24,776	—	34
Forward TBA mortgage-backed securities	51,500	—	540

At June 30, 2019 and December 31, 2018, the Company had $132.0 million and $51.5 million of TBA trades with counterparties that required margin collateral of $910,000 and $460,000, respectively. This collateral is included in interest-bearing deposits at other financial institutions on the Consolidated Balance Sheets.

Changes in the fair value of the derivatives recognized in other noninterest income on the Consolidated Statements of Income and included in gain on sale of loans resulted in net losses of ($7,000) and net gains of $403,000 for the three months ended June 30, 2019 and 2018, respectively, and net gains of $292,000 and $484,000 for the six months ended June 30, 2019 and 2018, respectively.

NOTE 7 - LEASES

The Company has operating leases for retail bank and home lending branches, and certain equipment. The ROU assets obtained in exchange for operating lease obligations totaled $5.2 million at January 1, 2019. The Company's leases have remaining lease terms of five months to eight years, some of which include options to extend the leases for up to five years and are referenced in the December 31, 2018 Form 10-K, Part I. Item 2.

The components of lease cost (included in occupancy expense) are as follows for the six months ended June 30, 2019:

	Three Months Ended June 30, 2019	Six Months Ended June 30, 2019
Lease cost:		
Operating lease cost	$ 308	$ 616
Short-term lease cost	38	84
Total lease cost	$ 346	$ 700

The following table provides supplemental information related to operating leases:

	At or For the Three Months Ended June 30, 2019	At or For the Six Months Ended June 30, 2019
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	$ 334	$ 676
Weighted average remaining lease term- operating leases	5.7 years	5.7 years
Weighted average discount rate- operating leases	3.11 %	3.11 %

The Company's leases typically do not contain a discount rate implicit in the lease contract. As an alternative, the weighted average discount rate used to present value the future value of lease payments due in calculating the value of the ROU asset and lease liability was determined by utilizing the December 31, 2018 fixed-rate advances issued by the FHLB of Des Moines, for all leases entered into prior to the January 1, 2019 adoption date.

Maturities of operating lease liabilities at June 30, 2019 for future periods are as follows:

Remainder of 2019	$ 631
2020	1,082
2021	947
2022	841
2023	482
Thereafter	1,282
Total lease payments	5,265
Less imputed interest	(544)
Total	$ 4,721

The Company has secured two new leases commencing between July 1, 2019 and December 31, 2019. The initial lease terms range between 64 – 65 months and both include one option to extend for five years. These leases were not included in the ROU assets or operating lease liabilities at June 30, 2019.

NOTE 8 - OTHER REAL ESTATE OWNED ("OREO")

The following table presents the activity related to OREO at or for the three and six months ended June 30, 2019 and 2018:

	At or For the Three Months Ended June 30,		At or For the Six Months Ended June 30,	
	2019	2018	2019	2018
Beginning balance	$ 167	$ —	$ 689	$ —
Additions	87	—	164	—
Gross proceeds from sale of OREO	—	—	(684)	—
Gain on sale of OREO	—	—	85	—
Ending balance	$ 254	$ —	$ 254	$ —

At June 30, 2019, there were $254,000 in OREO properties and none at June 30, 2018. There were holding costs of $7,000 and $11,000 for the three and six months ended June 30, 2019, respectively, compared to no holding costs for both the three and six months ended June 30, 2018.

There were $225,000 in mortgage loans collateralized by residential real estate property in the process of foreclosure at June 30, 2019.

NOTE 9 - DEPOSITS

Deposits are summarized as follows at June 30, 2019 and December 31, 2018:

	June 30, 2019 (1)(2)	December 31, 2018(1)(2)
Noninterest-bearing checking	$ 268,113	$ 221,107
Interest-bearing checking	180,498	151,103
Savings	117,687	122,344
Money market	247,854	282,595
Certificates of deposit less than $100,000(3)	251,280	243,193
Certificates of deposit of $100,000 through $250,000	177,718	154,095
Certificates of deposit of $250,000 and over(4)	79,959	86,357
Escrow accounts related to mortgages serviced	11,108	13,425
Total	$ 1,334,217	$ 1,274,219

____

(1) Includes $113.9 million of deposits at June 30, 2019 from the purchase of four retail bank branches from Bank of America, National Association on January 22, 2016 ("Branch Purchase") and $120.0 million at December 31, 2018.
(2) Includes $345.1 million and $321.1 million of deposits at June 30, 2019 and December 31, 2018, respectively, from the Anchor Acquisition.
(3) Includes $114.6 million and $116.7 million of brokered deposits at June 30, 2019 and December 31, 2018, respectively.
(4) Time deposits that meet or exceed the FDIC insurance limit.

Federal Reserve regulations require that the Bank maintain reserves in the form of cash on hand when there are deposit balances with the Federal Reserve Bank based on a percentage of deposits. The amounts of such balances at June 30, 2019 and December 31, 2018 were none and $17.4 million, respectively, and are included in interest-bearing deposits at other financial institutions on the Consolidated Balance Sheets.

Scheduled maturities of time deposits at June 30, 2019 for future periods ending are as follows:

	At June 30, 2019
Maturing in 2019	$ 183,730
Maturing in 2020	220,783
Maturing in 2021	57,153
Maturing in 2022	30,327
Maturing in 2023	9,745
Thereafter	7,219
Total	$ 508,957

Interest expense by deposit category for the three and six months ended June 30, 2019 and 2018 is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Interest-bearing checking	$ 386	$ 63	$ 582	$ 130
Savings and money market	741	393	1,504	712
Certificates of deposit	2,929	976	5,680	1,833
Total	$4,056	$1,432	$7,766	$2,675

NOTE 10 - COMMITMENTS AND CONTINGENCIES

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

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

The following table provides a summary of the Company's commitments at June 30, 2019 and December 31, 2018:

	June 30, 2019	December 31, 2018
COMMITMENTS TO EXTEND CREDIT		
REAL ESTATE LOANS		
Commercial	$ 2,154	$ 5,836
Construction and development	70,506	76,889
One-to-four-family (includes locks for salable loans)	81,963	35,714
Home equity	43,049	41,204
Multi-family	510	515
Total real estate loans	198,182	160,158
CONSUMER LOANS	21,234	18,560
COMMERCIAL BUSINESS LOANS		
Commercial and industrial	75,304	72,880
Warehouse lending	45,472	44,243
Total commercial business loans	120,776	117,123
Total commitments to extend credit	$ 340,192	$ 295,841

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

Unfunded commitments under commercial lines of credit, revolving credit lines, and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are uncollateralized and usually do not contain a specified maturity date and ultimately may not be drawn upon to the total extent to which the Company is committed. The Company has established reserves for estimated losses from unfunded commitments of $285,000 at June 30, 2019 and $299,000 at December 31, 2018. One-to-four-family commitments included in the table above are accounted for as fair value derivatives and do not carry an associated holdback.

The Company also sells one-to-four-family loans to the FHLB of Des Moines that require a limited level of recourse if the loans default and exceed a certain loss exposure. Specific to that recourse, the FHLB of Des Moines established a first loss account ("FLA") related to the loans and required a credit enhancement ("CE") obligation by the Bank to be utilized after the FLA is used. Based on loans sold through June 30, 2019, the total loans sold to the FHLB were $74.6 million with the FLA totaling $875,000 and the CE obligation at $680,000 or 0.89% of the loans outstanding. Management has established a holdback of 10% of the outstanding CE, or $68,000, which is a part of the off-balance sheet holdback for loans sold. There were no outstanding delinquencies on the loans sold to the FHLB of Des Moines at both June 30, 2019 and December 31, 2018.

Contingent liabilities for loans held for sale **-** In the ordinary course of business, loans are sold with limited recourse against the Company and may have to subsequently be repurchased due to defects that occurred during the origination of the loan. The defects are categorized as documentation errors, underwriting errors, early payoff, early payment defaults, breach of representation or warranty, servicing errors, and/or fraud. When a loan sold to an investor without recourse fails to perform according to its contractual terms, the investor will typically review the loan file to determine whether defects in the origination process occurred. If a defect is identified, the Company may be required to either repurchase the loan or indemnify the investor for losses sustained. If there are no such defects, the Company has no commitment to repurchase the loan. The Company has recorded a holdback reserve of $1.2 million to cover loss exposure related to these guarantees for one-to-four-family loans sold into the secondary market at June 30, 2019, and $1.0 million at December 31, 2018, which is included in other liabilities on the Consolidated Balance Sheets.

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

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

The Bank received 7,158 shares of Class B common stock in Visa, Inc. as a result of the Visa initial public offering ("IPO") in March 2008. These Class B shares of stock held by the Bank could be converted to Class A shares at a conversion rate of 1.6298 when all litigation pending as of the date of the IPO is concluded. At June 30, 2019, the date that litigation will be concluded cannot be determined. Until such time, the stock cannot be redeemed or sold by the Bank; therefore, it is not readily marketable and has a current carrying value of $0. Visa, Inc. Class A stock's market value at June 30, 2019 and December 31, 2018 was $173.55 per share and $131.94 per share, respectively.

As a result of the nature of our activities, the Company is subject to various pending and threatened legal actions, which arise in the ordinary course of business. From time to time, subordination liens may create litigation which requires us to defend our lien rights. In the opinion of management, liabilities arising from these claims, if any, will not have a material effect on our financial position. The Company had no material pending legal actions at June 30, 2019.

NOTE 11 - FAIR VALUE MEASUREMENTS

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

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

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

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

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

The following methods were used to estimate the fair value of financial instruments on a recurring and nonrecurring basis:

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

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

Derivative Instruments - The fair value of the interest rate lock commitments and forward sales commitments are estimated using quoted or published market prices for similar instruments, adjusted for factors such as pull-through rate assumptions based on historical information, where appropriate. TBA mortgage-backed securities are fair valued on similar contracts in active markets (Level 2) while locks and forwards with customers and investors are fair valued using similar contracts in the market and changes in the market interest rates (Level 2 and 3).

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

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

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

The following tables present securities available-for-sale measured at fair value on a recurring basis at the dates indicated:

	Securities Available-for-Sale			
	Level 1	Level 2	Level 3	Total
At June 30, 2019				
U.S. agency securities	$ —	$11,063	$ —	$11,063
Corporate securities	—	8,608	—	8,608
Municipal bonds	—	12,482	—	12,482
Mortgage-backed securities	—	44,553	—	44,553
U.S. Small Business Administration securities	—	19,546	—	19,546
Total	$ —	$96,252	$ —	$96,252

	Securities Available-for-Sale			
	Level 1	Level 2	Level 3	Total
At December 31, 2018				
U.S. agency securities	$ —	$15,887	$ —	$15,887
Corporate securities	—	6,865	—	6,865
Municipal bonds	—	14,194	—	14,194
Mortgage-backed securities	—	44,836	—	44,836
U.S. Small Business Administration securities	—	15,423	—	15,423
Total	$ —	$97,205	$ —	$97,205

The following table presents mortgage loans held for sale measured at fair value on a recurring basis at the dates indicated:

	Mortgage Loans Held for Sale			
	Level 1	Level 2	Level 3	Total
June 30, 2019	$ —	$66,508	$ —	$66,508
December 31, 2018	$ —	$51,195	$ —	$51,195

The following tables present the fair value of interest rate lock commitments with customers and individual forward sale commitments with investors measured at their fair value on a recurring basis at the dates indicated:

	Interest Rate Lock Commitments with Customers			
	Level 1	Level 2	Level 3	Total
June 30, 2019	$ —	$ —	$1,047	$ 1,047
December 31, 2018	$ —	$ —	$ 503	$ 503

	Individual Forward Sale Commitments with Investors			
	Level 1	Level 2	Level 3	Total
June 30, 2019	$ —	$ (411)	—	$ (411)
December 31, 2018	$ —	$ (540)	$ (34)	$ (574)

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

	Impaired Loans			
	Level 1	Level 2	Level 3	Total
June 30, 2019	$ —	$ —	$1,593	$ 1,593
December 31, 2018	$ —	$ —	$3,894	$ 3,894

	OREO			
	Level 1	Level 2	Level 3	Total
June 30, 2019	$ —	$ —	$ 254	$ 254
December 31, 2018	$ —	$ —	$ 689	$ 689

	Servicing Rights			
	Level 1	Level 2	Level 3	Total
June 30, 2019	$ —	$ —	$11,209	$11,209
December 31, 2018	$ —	$ —	$14,593	$14,593

Quantitative Information about Level 3 Fair Value Measurements - Shown in the table below is the fair value of financial instruments measured under a Level 3 unobservable input on a recurring and nonrecurring basis at June 30, 2019 and December 31, 2018:

Level 3 Fair Value Instruments	Valuation Techniques	Significant Unobservable Inputs	Weighted Average Range	Weighted Average June 30, 2019	Weighted Average December 31, 2018
RECURRING					
Interest rate lock commitments with customers	Quoted market prices	Pull-through expectations	80% - 99%	94.9 %	95.2 %
Individual forward sale commitments with investors	Quoted market prices	Pull-through expectations	80% - 99%	94.9 %	95.2 %
NONRECURRING					
Impaired loans	Fair value of underlying collateral	Discount applied to the obtained appraisal	0% - 50%	9.8 %	25.0 %
OREO	Fair value of collateral	Discount applied to the obtained appraisal	0% - 75%	35.8 %	71.1 %
Servicing rights	Industry sources	Pre-payment speeds	0% - 50%	19.4 %	9.4 %

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

The following tables provides a reconciliation of assets and liabilities measured at fair value using significant unobservable inputs (Level 3) on a recurring basis during the three and six months ended June 30, 2019 and 2018:

Three Months Ended June 30,	Beginning Balance	Purchases and Issuances	Sales and Settlements	Ending Balance	Net change in fair value for gains/ (losses) relating to items held at end of period
2019					
Interest rate lock commitments with customers	$ 686	$ 3,163	$ (2,802)	$ 1,047	$ 361
Individual forward sale commitments with investors	(96)	(425)	521	—	96
2018					
Interest rate lock commitments with customers	$ 815	$ 3,140	$ (2,817)	$ 1,138	$ 323
Individual forward sale commitments with investors	4	84	(106)	(18)	(22)

Six Months Ended June 30,	Beginning Balance	Purchases and Issuances	Sales and Settlements	Ending Balance	Net change in fair value for gains/ (losses) relating to items held at end of period
2019					
Interest rate lock commitments with customers	$ 503	$ 5,095	$ (4,551)	$ 1,047	$ 544
Individual forward sale commitments with investors	(34)	(587)	621	—	34
2018					
Interest rate lock commitments with customers	$ 726	$ 5,575	$ (5,163)	$ 1,138	$ 412
Individual forward sale commitments with investors	51	656	(725)	(18)	(69)

Gains (losses) on interest rate lock commitments carried at fair value are recorded in other noninterest income. Gains (losses) on forward sale commitments with investors carried at fair value are recorded within other noninterest income.

Fair value estimates are based on existing balance sheet financial instruments without attempting to estimate the value of anticipated future business. The fair value has not been estimated for assets and liabilities that are not considered financial instruments.

Financial Instruments with Book Value Equal to Fair Value - The fair value of financial instruments that are short-term or reprice frequently and that have little or no risk are considered to have a fair value equal to book value. These instruments include cash and cash equivalents and certificates of deposit at other financial institutions, FHLB stock, BOLI, accrued interest, and off-balance sheet instruments.

Fair Value Estimates - The following methods and assumptions were used by the Company in estimating the fair values of financial instruments disclosed in following financial instruments table:

Loans Receivable, Net - Fair values for loans are estimated using an exit price assumption (Level 3).

Deposits - The fair value of deposits with no stated maturity date is included at the amount payable on demand. Fair values for fixed rate certificates of deposit are estimated using an exit price assumption (Level 2).

[redacted]

Borrowings - The carrying amounts of advances maturing within 90 days approximate their fair values. The fair values of long-term advances are estimated using discounted cash flow analyses based on the Bank's current incremental borrowing rates for similar types of borrowing arrangements (Level 2).

Subordinated Note - The fair value of the Subordinated Note is based upon the average yield of debt issuances for similarly sized issuances (Level 2).

The following table provides estimated fair values of the Company's financial instruments at June 30, 2019 and December 31, 2018, whether or not recognized at fair value on the Consolidated Balance Sheets:

	June 30, 2019		December 31, 2018	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets				
Level 1 inputs:				
Cash and cash equivalents	$ 59,594	$ 59,594	$ 32,779	$ 32,779
Certificates of deposit at other financial institutions	24,297	24,297	22,074	22,074
Level 2 inputs:				
Securities available-for-sale, at fair value	96,252	96,252	97,205	97,205
Loans held for sale, at fair value	66,508	66,508	51,195	51,195
FHLB stock, at cost	8,329	8,329	9,887	9,887
Accrued interest receivable	5,779	5,779	5,761	5,761
Level 3 inputs:				
Loans receivable, gross	1,296,121	1,298,097	1,326,238	1,320,341
Servicing rights, held at lower of cost or fair value	10,849	11,209	10,429	14,593
Fair value interest rate locks with customers	1,047	1,047	503	503
Financial Liabilities				
Level 2 inputs:				
Deposits	1,334,217	1,325,620	1,274,219	1,261,096
Borrowings	83,211	83,707	137,149	136,873
Subordinated note	9,875	10,242	9,865	10,242
Accrued interest payable	268	268	344	344
Paired off commitments with investors	518	518	64	64
Individual forward sale commitments with investors	411	411	540	540
Level 3 inputs:				
Individual forward sale commitments with investors	0	0	34	34

NOTE 12 - EMPLOYEE BENEFITS

Employee Stock Ownership Plan

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

The ESOP borrowed $2.6 million from FS Bancorp, Inc. and used those funds to acquire 259,210 shares of FS Bancorp, Inc. common stock in the open market at an average price of $10.17 per share during the second half of 2012. It is anticipated that the Bank will make contributions to the ESOP in amounts necessary to amortize the ESOP loan payable to FS Bancorp, Inc. over a period of 10 years, bearing interest at 2.30%. Intercompany expenses associated with the ESOP are eliminated in consolidation. Shares purchased by the ESOP with the loan proceeds are held in a suspense account and allocated to ESOP participants on a pro rata basis as principal and interest payments are made by the ESOP to FS Bancorp, Inc. The loan is secured by shares purchased with the loan proceeds and will be repaid by the ESOP with funds from the Bank's discretionary contributions to the ESOP and earnings on the ESOP assets. Payments of principal and interest are due annually on December 31, the Company's fiscal year end. On December 31, 2018, the ESOP paid the seventh annual installment of principal in the amount of $269,000, plus accrued interest of $26,000 pursuant to the ESOP loan agreement.

As shares are committed to be released from collateral, the Company reports compensation expense equal to the average daily market prices of the shares at June 30, 2019 for the prior 90 days. These shares become outstanding for earnings per share computations. The compensation expense is accrued monthly throughout the year. Dividends on allocated ESOP shares are recorded as a reduction of retained earnings; dividends on unallocated ESOP shares are recorded as a reduction of debt and accrued interest.

Compensation expense related to the ESOP for the three months ended June 30, 2019 and 2018 was $327,000 and $393,000, respectively, and $647,000 and $752,000 for the six months ended June 30, 2019 and 2018, respectively.

Shares held by the ESOP at June 30, 2019 and 2018 were as follows (shown as actual):

	Balances at June 30, 2019	Balances at June 30, 2018
Allocated shares	176,809	153,049
Committed to be released shares	12,960	12,960
Unallocated shares	64,803	90,724
Total ESOP shares	254,572	256,733
Fair value of unallocated shares (in thousands)	$ 3,241	$ 5,262

NOTE 13 - EARNINGS PER SHARE

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

The following table presents a reconciliation of the components used to compute basic and diluted earnings per share for the three and six months ended June 30, 2019 and 2018:

	At or For the Three Months Ended June 30,		At or For the Six Months Ended June 30,	
Numerator (in thousands):	2019	2018	2019	2018
Net income	$ 4,463	$ 4,257	$ 9,655	$ 8,579
Dividends and undistributed earnings allocated to participating securities	(29)	—	(62)	—
Net income available to common shareholders	$ 4,434	$ 4,257	$ 9,593	$ 8,579
Denominator (shown as actual):				
Basic weighted average common shares outstanding	4,418,397	3,583,927	4,415,111	3,573,560
Dilutive shares	112,472	181,797	117,873	188,519
Diluted weighted average common shares outstanding	4,530,869	3,765,724	4,532,984	3,762,079
Basic earnings per share	$ 1.00	$ 1.19	$ 2.17	$ 2.40
Diluted earnings per share	$ 0.98	$ 1.13	$ 2.12	$ 2.28
Potentially dilutive weighted average share options that were not included in the computation of diluted earnings per share because to do so would be anti-dilutive	39,668	—	41,195	—

NOTE 14 - STOCK-BASED COMPENSATION

Stock Options and Restricted Stock

On May 17, 2018, the shareholders of FS Bancorp, Inc. approved the 2018 Equity Incentive Plan (the "2018 Plan") that authorizes 650,000 shares of the Company's common stock to be awarded. The 2018 Plan provides for the grant of incentive stock options, non-qualified stock options, and up to 163,000 restricted stock awards ("RSAs") to directors, emeritus directors, officers, employees or advisory directors of the Company. On August 15, 2018, the Company awarded grants of 25,000 RSAs and 100,000 stock options with an exercise price equal to the market price of FS Bancorp's common stock at the grant date of $58.60 per share.

In September 2013, the shareholders of FS Bancorp, Inc. approved the FS Bancorp, Inc. 2013 Equity Incentive Plan (the "2013 Plan"). The Plan provides for the grant of stock options and RSAs. The 2013 Plan authorizes the grant of stock options totaling 324,013 shares of common stock to Company directors and employees of which 322,000 option share awards were granted with an exercise price equal to the market price of FS Bancorp's common stock at the grant date of May 8, 2014, of $16.89 per share. The 2013 Plan authorizes the grant of RSAs totaling 129,605 shares to Company directors, advisory directors, emeritus directors, officers, and employees, and 125,105 shares were granted on May 8, 2014 at a grant date fair value of $16.89 per share. The remaining 4,500 RSAs were granted January 1, 2016 at a grant date fair value of $26.00 per share.

Total share-based compensation expense for both plans was $190,000 and $452,000 for the three and six months ended June 30, 2019, respectively, and $150,000 and $285,000 for the 2013 Plan for the three and six months ended June 30, 2018, respectively.

Stock Options

Both plans consist of stock option awards that may be granted as incentive stock options or non-qualified stock options. Options typically vest over a period of five years with 20% vesting on the anniversary date of each grant date as long as the award recipient remains in service to the Company. The options are exercisable after vesting for up to the remaining term of the original grant. The maximum term of the options granted is 10 years. Any unexercised stock options will expire 10 years after the grant date or sooner in the event of the award recipient's termination of service with the Company or the Bank. At June 30, 2019, there were 387,000 and 6,013 option share awards available to be granted under the 2018 Plan and the 2013 Plan, respectively.

The fair value of each option award is estimated on the grant date using a Black-Scholes Option pricing model that uses the following assumptions. The dividend yield is based on the current quarterly dividend in effect at the time of the grant. Historical employment data is used to estimate the forfeiture rate. The Company elected to use Staff Accounting Bulletin 107, simplified expected term calculation for the “Share-Based Payments” method permitted by the SEC to calculate the expected term. This method uses the vesting term of an option along with the contractual term, setting the expected life at 6.5 years.

The following table presents a summary of the Company’s stock option awards during the six months ended June 30, 2019 (shown as actual):

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term In Years	Aggregate Intrinsic Value
Outstanding at January 1, 2019	290,104	$ 31.27	6.83	$ 4,940,803
Granted	—	—	—	—
Less exercised	40,400	$ 16.89	—	$ 1,289,224
Forfeited or expired	—	—	—	—
Outstanding at June 30, 2019	249,704	$ 33.59	6.57	$ 5,236,646
Expected to vest, assuming a 0.31% annual forfeiture rate (1)	249,046	$ 33.53	6.57	$ 5,236,646
Exercisable at June 30, 2019	149,704	$ 16.89	4.86	$ 5,236,646

____

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

At June 30, 2019, there was $1.1 million of total unrecognized compensation cost related to nonvested stock options granted under both plans. The cost is expected to be recognized over the remaining weighted-average vesting period of 4.1 years.

Restricted Stock Awards

The RSAs’ fair value is equal to the value on the grant date. Compensation expense is recognized over the vesting period of the awards based on the fair value of the restricted stock. Shares in the 2013 Plan awarded as restricted stock typically vested ratably over a three-year period for directors and a five-year period for employees, beginning at the grant date, and for the 2018 Plan, shares typically vest ratably over a five-year period for both directors and employees beginning at the grant date. Any unvested RSAs will expire after vesting or sooner in the event of the award recipient’s termination of service with the Company or the Bank.

The following table presents a summary of the Company’s nonvested awards during the six months ended June 30, 2019 (shown as actual):

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value Per Share
Nonvested at January 1, 2019	43,421	$ 41.22
Granted	—	—
Less vested	18,421	$ 17.63
Forfeited or expired	—	—
Nonvested at June 30, 2019	25,000	$ 58.60

At June 30, 2019, there was $1.2 million of total unrecognized compensation costs related to nonvested shares granted as RSAs. The cost is expected to be recognized over the remaining weighted-average vesting period of 4.1 years. The total fair value of shares vested for the six months ended June 30, 2019 and 2018 was $948,000 and $1.1 million, respectively.

NOTE 15 - REGULATORY CAPITAL

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of Tier 1 capital (as defined in the regulations) to total average assets (as defined), and minimum ratios of Tier 1 total capital (as defined) and common equity Tier 1 ("CET 1") capital to risk-weighted assets (as defined).

The Bank must maintain minimum total risk-based, Tier 1 risk-based, Tier 1 leverage, and CET 1 capital ratios as set forth in the table below to be categorized as well capitalized. At June 30, 2019 and December 31, 2018, the Bank was categorized as well capitalized under applicable regulatory requirements. There are no conditions or events since that notification that management believes have changed the Bank's category. Management believes, at June 30 2019, that the Bank met all capital adequacy requirements.

The following table compares the Bank's actual capital amounts and ratios at June 30, 2019 and December 31, 2018 to their minimum regulatory capital requirements and well capitalized regulatory capital at those dates (dollars in thousands):

	Actual		For Capital Adequacy Purposes		For Capital Adequacy with Capital Buffer		To be Well Capitalized Under Prompt Corrective Action Provisions	
Bank Only	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
At June 30, 2019								
Total risk-based capital (to risk-weighted assets)	$ 197,531	14.73 %	$ 107,314	8.00 %	$ 140,850	10.50 %	$ 134,143	10.00 %
Tier 1 risk-based capital (to risk-weighted assets)	$ 184,907	13.78 %	$ 80,486	6.00 %	$ 114,021	8.50 %	$ 107,314	8.00 %
Tier 1 leverage capital (to average assets)	$ 184,907	11.38 %	$ 64,979	4.00 %	$ N/A	N/A	$ 81,224	5.00 %
CET 1 capital (to risk-weighted assets)	$ 184,907	13.78 %	$ 60,364	4.50 %	$ 93,900	7.00 %	$ 87,193	6.50 %
At December 31, 2018								
Total risk-based capital (to risk-weighted assets)	$ 188,472	13.52 %	$ 111,493	8.00 %	$ 137,694	9.88 %	$ 139,366	10.00 %
Tier 1 risk-based capital (to risk-weighted assets)	$ 175,824	12.62 %	$ 83,620	6.00 %	$ 109,820	7.88 %	$ 111,493	8.00 %
Tier 1 leverage capital (to average assets)	$ 175,824	10.67 %	$ 65,884	4.00 %	$ N/A	N/A	$ 82,355	5.00 %
CET 1 capital (to risk-weighted assets)	$ 175,824	12.62 %	$ 62,715	4.50 %	$ 88,846	6.38 %	$ 90,588	6.50 %

In addition to the minimum CET 1, Tier 1, total capital, and leverage ratios, the Bank is required to maintain a capital conservation buffer consisting of additional CET 1 capital greater than 2.5% of risk-weighted assets above the required

minimum levels in order to avoid limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses based on percentages of eligible retained income that could be utilized for such actions. At June 30, 2019, the Bank’s capital conservation buffer was 6.7%.

FS Bancorp, Inc. is a bank holding company registered with the Federal Reserve. Bank holding companies are subject to capital adequacy requirements of the Federal Reserve under the Bank Holding Company Act of 1956, as amended, and the regulations of the Federal Reserve. For a bank holding company with less than $3.0 billion in assets, the capital guidelines apply on a bank only basis and the Federal Reserve expects the holding company’s subsidiary bank to be well capitalized under the prompt corrective action regulations. If FS Bancorp, Inc. was subject to regulatory guidelines for bank holding companies with $3.0 billion or more in assets at June 30, 2019, FS Bancorp, Inc. would have exceeded all regulatory capital requirements. The regulatory capital ratios calculated for FS Bancorp, Inc. at June 30, 2019 were 11.1% for Tier 1 leverage-based capital, 13.5% for Tier 1 risk-based capital, 14.4% for total risk-based capital, and 13.5% for CET 1 capital ratio, compared to 11.9%, 13.9%, 15.2%, and 13.9% at June 30, 2018, respectively.

NOTE 16 - BUSINESS SEGMENTS

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

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

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

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

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

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

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

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

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

Commercial and Consumer Banking Segment

The commercial and consumer banking segment provides diversified financial products and services to its commercial and consumer customers through Bank branches, automated teller machines (“ATM”), online banking platforms, mobile banking apps, and telephone banking. These products and services include deposit products; residential, consumer, business and commercial real estate lending portfolios and cash management services. The Company originates consumer loans, commercial and multi-family real estate loans, construction loans for residential and multi-family construction, and commercial business loans. At June 30, 2019, the Company’s retail deposit branch network consisted of 21 branches in the Pacific Northwest. At June 30, 2019 and December 31, 2018, deposits totaled $1.33 billion and $1.27 billion, respectively. This segment is also responsible for the management of its investment portfolio and other assets of the Bank.

Home Lending Segment

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

Segment Financial Results

The tables below summarize the financial results for each segment based primarily on the number of FTEs and assets within each segment for the three and six months ended June 30, 2019 and 2018:

	At or For the Three Months Ended June 30, 2019		
	Home Lending	Commercial and Consumer Banking	Total
Condensed income statement:			
Net interest income [1]	$ 1,141	$ 16,393	$ 17,534
Provision for loan losses [2]	(304)	(606)	(910)
Noninterest income	3,511	2,572	6,083
Noninterest expense	(3,944)	(13,127)	(17,071)
Income before provision for income taxes	404	5,232	5,636
Provision for income taxes	(86)	(1,087)	(1,173)
Net income	$ 318	$ 4,145	$ 4,463
Total average assets at period end	$ 253,394	$ 1,374,290	$ 1,627,684
FTEs	116	316	432

	At or For the Three Months Ended June 30, 2018		
	Home Lending	Commercial and Consumer Banking	Total
Condensed income statement:			
Net interest income [1]	$ 764	$ 11,161	$ 11,925
Provision for loan losses	(149)	(301)	(450)
Noninterest income	4,447	1,167	5,614
Noninterest expense	(4,508)	(7,636)	(12,144)
Income before provision for income taxes	554	4,391	4,945
Provision for income taxes	(78)	(610)	(688)
Net income	$ 476	$ 3,781	$ 4,257
Total average assets at period end	$ 222,687	$ 860,175	$ 1,082,862
FTEs	117	219	336

	At or For the Six Months Ended June 30, 2019		
	Home Lending	Commercial and Consumer Banking	Total
Condensed income statement:			
Net interest income [1]	$ 2,212	$ 33,011	$ 35,223
Provision for loan losses [2]	(363)	(1,297)	(1,660)
Noninterest income	5,930	4,708	10,638
Noninterest expense	(7,248)	(24,620)	(31,868)
Income before provision for income taxes	531	11,802	12,333
Provision for income taxes	(115)	(2,563)	(2,678)
Net income	$ 416	$ 9,239	$ 9,655
Total average assets at period end	$ 246,379	$ 1,374,929	$ 1,621,308
FTEs	116	316	432

	At or For the Six Months Ended June 30, 2018		
	Home Lending	Commercial and Consumer Banking	Total
Condensed income statement:			
Net interest income [1]	$ 1,479	$ 21,943	$ 23,422
Provision for loan losses	(145)	(655)	(800)
Noninterest income	8,213	2,425	10,638
Noninterest expense	(8,564)	(14,615)	(23,179)
Income before provision for income taxes	983	9,098	10,081
Provision for income taxes	(146)	(1,356)	(1,502)
Net income	$ 837	$ 7,742	$ 8,579
Total average assets at period end	$ 219,553	$ 830,419	$ 1,049,972
FTEs	117	219	336

____

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

(2) The allocated provision for loan losses is partially associated with the increase in Anchor Bank, one-to-four-family, and home equity loans of $59.7 million at June 30, 2019.

NOTE 17 - GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and certain other intangibles generally arise from business combinations accounted for under the acquisition method of accounting. Goodwill totaled $2.3 million at June 30, 2019 and December 31, 2018, and represents the excess of the total acquisition price paid over the fair value of the assets acquired, net of the fair values of liabilities assumed as a result of the Branch Purchase in 2016. Goodwill is not amortized but is evaluated for impairment on an annual basis at December 31 of each year or whenever events or changes in circumstances indicate the carrying value may not be recoverable. The Company performed an impairment analysis at December 31, 2018, and determined that no impairment of goodwill existed. No events or circumstances since the December 31, 2018 annual impairment test were noted that would indicate it was more likely than not a goodwill impairment existed at June 30, 2019.

The following table summarizes the changes in the Company's other intangible assets comprised solely of CDI for the year ended December 31, 2018, and the six months ended June 30, 2019.

	Other Intangible Assets		
	Gross CDI	Accumulated Amortization	Net CDI
Balance, December 31, 2017	$ 2,239	$ (922)	$1,317
Additions as a result of the Anchor Acquisition [(1)]	5,251	—	5,251
Amortization	—	(351)	(351)
Balance, December 31, 2018	7,490	(1,273)	6,217
Amortization	—	(380)	(380)
Balance, June 30, 2019	$ 7,490	$ (1,653)	$5,837

____

(1) See "Note 2 - Business Combination."

The CDI represents the fair value of the acquired core deposit base acquired in business combinations. The CDI will be amortized on a straight-line basis over 10 years for the CDI related to the Anchor Acquisition and on an accelerated basis over approximately nine years for the CDI related to the Branch Purchase. Total amortization expense was $190,000 and $380,000 for the three and six months ended June 30, 2019, and $77,000 and $153,000 for the same periods in 2018. Amortization expense for CDI is expected to be as follows at June 30, 2019:

Remainder of 2019	380
2020	706
2021	691
2022	691
2023	691
Thereafter	2,678
Total	$ 5,837

NOTE 18 - REVENUE FROM CONTRACTS WITH CUSTOMERS

Revenue Recognition

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

All of the Company's revenue from contracts with customers in scope of ASC 606 is recognized in noninterest income and included in our commercial and consumer banking segment. For the three months ended June 30, 2019, the Company recognized $1.2 million in total deposit fees, which included $469,000 of debit card interchange fees and $280,000 of fees from non-sufficient funds, both considered within the scope of ASC 606, and $5.3 million of noninterest income considered not within the scope of ASC 606, compared to $574,000 in total deposit fees including $280,000 of debit card interchange fees, $116,000 of fees from non-sufficient funds, and $5.2 million of noninterest income considered not within the scope of ASC 606 for the three months ended June 30, 2018. For the six months ended June 30, 2019, the Company recognized $2.3 million in total deposit fees, which included $892,000 of debit card interchange fees and $551,000 of fees from non-sufficient funds, both considered within the scope of ASC 606, and $9.2 million of noninterest income considered not within the scope of ASC 606, compared to $1.1 million in total deposit fees, which included $540,000 of debit card interchange fees and $236,000 of fees from non-sufficient funds, both considered within the scope of ASC 606, and $9.9 million of noninterest income considered not within the scope of ASC 606.

Deposit Fees

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

Debit Interchange Income

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

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

Forward-Looking Statements

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

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

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

- general economic conditions, either nationally or in our market area, that are worse than expected;
- the credit risks of lending activities, including changes in the level and trend of loan delinquencies, write offs, changes in our allowance for loan losses, and provision for loan losses that may be impacted by deterioration in the housing and commercial real estate markets;
- secondary market conditions and our ability to originate loans for sale and sell loans in the secondary market;
- fluctuations in the demand for loans, the number of unsold homes, land and other properties, and fluctuations in real estate values in our market area;
- staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our workforce and potential associated charges;
- the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation;
- changes in the interest rate environment that reduce our interest margins or reduce the fair value of financial instruments;
- increased competitive pressures among financial services companies;
- our ability to execute our plans to grow our residential construction lending, our home lending operations, our warehouse lending, and the geographic expansion of our indirect home improvement lending;
- our ability to attract and retain deposits;
- our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we may in the future acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto;
- our ability to control operating costs and expenses;
- our ability to retain key members of our senior management team;
- changes in consumer spending, borrowing, and savings habits;
- our ability to successfully manage our growth;
- legislative or regulatory changes that adversely affect our business, including the effect of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, changes in regulation policies and principles, an increase in regulatory capital requirements or change in the interpretation of regulatory capital or other rules, including as a result of Basel III;
- adverse changes in the securities markets;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Public Company Accounting Oversight Board or the Financial Accounting Standards Board;
- costs and effects of litigation, including settlements and judgments;
- disruptions, security breaches, or other adverse events, failures, or interruptions in, or attacks on, our information technology systems or on the third-party vendors who perform several of our critical processing functions;
- inability of key third-party vendors to perform their obligations to us; and
- other economic, competitive, governmental, regulatory, and technical factors affecting our operations, pricing, products, and services and other risks described elsewhere in this Form 10-Q and our other reports filed with the U.S.

Securities and Exchange Commission, including our Annual Report on Form 10-K for the year ended December 31, 2018.

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

Overview

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

The Company is relationship-driven, delivering banking and financial services to local families, local and regional businesses and industry niches within distinct Puget Sound area communities, and one loan production office located in the Tri-Cities, Washington. On November 15, 2018, the Company completed the Anchor Acquisition and acquired $361.6 million in loans, $357.9 million in deposits, and recorded a bargain purchase gain of $7.4 million based on financial information at that date. As a result of the Anchor Acquisition, Anchor's shareholders received 725,518 shares of FS Bancorp common stock and $30.8 million in cash for total consideration paid of $64.6 million. The Anchor Acquisition added nine full-service bank branches within the communities of Aberdeen, Centralia, Elma, Lacey, Montesano, Ocean Shores, Olympia, Puyallup, and Westport, Washington. The Anchor Acquisition expanded our Puget Sound-focused retail footprint and provided an opportunity to extend our unique brand of community banking into these communities. For additional details see "Note 2 - Business Combinations" of the Notes to Consolidated Financial Statements included in Part I. Item 1 of this report.

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

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

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

The Company is a diversified lender with a focus on the origination of one-to-four-family loans, commercial real estate mortgage loans, second mortgage or home equity loan products, consumer loans including home improvement ("fixture secured") loans, solar loans, marine lending, and commercial business loans. As part of our expanding lending products, the Company experienced growth in residential mortgage and commercial construction warehouse lending consistent with our business plan to further diversify revenues. Historically, consumer loans, in particular, fixture secured loans had represented the largest portion of the Company's loan portfolio and had traditionally been the mainstay of the Company's lending strategy. In recent years, the Company has placed more of an emphasis on real estate lending products, such as one-to-four-family loans, commercial real estate loans, including speculative residential construction loans, as well as commercial business loans, while growing the current size of the consumer loan portfolio.

Consumer loans, in particular indirect home improvement loans to finance window replacement, gutter replacement, siding replacement, solar panels, pools, and other improvement renovations is a large and regionally expanding segment of the loan portfolio. Consumer lending is dependent on the Bank's contractor/dealer network of 97 active dealers located throughout Washington, Oregon, California, Idaho, Colorado, and Arizona, with four contractor/dealers responsible for 49.2% of the funded loans dollar volume. The Company funded $37.9 million, or approximately 2,000 loans during the quarter ended June 30, 2019. The following table details consumer funded loan originations by state (excluding marine) for the periods indicated:

State	For the Six Months Ended June 30, 2019 Amount	Percent	For the Twelve Months Ended December 31, 2018 Amount	Percent
Washington	$ 25,750	39.4 %	$ 63,738	43.0 %
Oregon	17,340	26.5	45,848	30.9
California	15,854	24.2	29,850	20.1
Idaho	3,677	5.6	6,008	4.1
Colorado	1,538	2.4	2,609	1.8
Arizona	1,258	1.9	267	0.1
Total consumer loans	$ 65,417	100.0 %	$ 148,320	100.0 %

The Company originates one-to-four-family residential mortgage loans through referrals from real estate agents, financial planners, builders, and from existing customers. Retail banking customers are also an important source of the Company's loan originations. The Company originated $351.7 million of one-to-four-family loans which includes loans held for sale, loans held for investment, and fixed seconds in addition to loans brokered to other institutions of $3.9 million through the home lending segment during the six months ended June 30, 2019, of which $304.3 million were sold to investors. Of the loans sold to investors, $199.7 million were sold to the FNMA, FHLMC, FHLB, and/or GNMA with servicing rights retained for the purpose of further developing these customer relationships. At June 30, 2019, one-to-four-family residential mortgage loans held for investment, which excludes loans held for sale of $66.5 million, totaled $248.9 million, or 19.2%, of the total gross loan portfolio.

The Company expanded its residential construction and commercial real estate lending team in 2011 with a focus on vertical, in-city one-to-four-family development in our market area. This team has over 60 years of combined experience and expertise in commercial real estate and multi-family acquisition, development and construction ("ADC") lending in the Puget Sound market area and the related take-out financing as applicable. The Company has implemented this strategy to take advantage of what is believed to be a strong demand for construction and ADC loans to experienced, successful and relationship driven builders in our market areas.

The Company originates commercial business loans and lines of credit to local small- and mid-sized businesses in the Puget Sound market area that are secured by accounts receivable, inventory or property, plant and equipment. Consistent with management's objectives to expand commercial business lending, in 2009, the Company commenced a mortgage warehouse lending program through which the Company funds third-party residential mortgage bankers. Under this program the Company provides short-term funding to the mortgage banking companies for the purpose of originating residential mortgage loans for sale into the secondary market. In 2013, the Company expanded this program to include commercial construction warehouse lines along with residential construction lending.

Since 2012, the Company has had an emphasis on diversifying lending products by expanding commercial real estate, commercial business, and residential lending, while maintaining the current volume of production and historical growth of the consumer loan portfolio. The Company's lending strategies are intended to take advantage of: (1) historical strength in indirect consumer lending, (2) recent market consolidation that has created new lending opportunities and the availability of experienced bankers, and (3) strength in relationship lending. Retail deposits will continue to serve as an important funding source.

Recently, improvements in the economy, employment rates, and interest rates has resulted in higher volumes of refinances and sales of one-to-four-family homes during the six months ended June 30, 2019, compared to the prior years' surge in construction loans due to the lack of housing inventory. We anticipate that residential construction and development lending will continue to be a strong element of our total loan portfolio and we will continue to take a disciplined approach by concentrating our efforts on loans to builders and developers in our market areas known to us. These short-term loans typically mature in six to twelve months. In addition, the funding is usually not fully disbursed at origination, thereby reducing our net loans receivable in the short-term.

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

The Company's earnings are primarily dependent upon net interest income, the difference between interest income and interest expense. Interest income is a function of the balances of loans and investments outstanding during a given period and the yield earned on these loans and investments. Interest expense is a function of the amount of deposits and borrowings outstanding during the same period and interest rates paid on these deposits and borrowings. Another significant influence on the Company's earnings is fee income from mortgage banking activities. The Company's earnings are also affected by the provision for loan losses, service charges and fees, gains from sales of assets, operating expenses and income taxes.

Critical Accounting Policies and Estimates

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

Allowance for Loan and Lease Losses ("ALLL"). The ALLL is the amount estimated by management as necessary to cover probable losses inherent in the loan portfolio at the balance sheet date. The allowance is established through the provision for loan losses, which is charged to income. A high degree of judgment is necessary when determining the amount of the ALLL. Among the material estimates required to establish the allowance are: loss exposure at default; the amount and timing of future cash flows on impacted loans; value of collateral; and determination of loss factors to be applied to the various elements of the portfolio. All of these estimates are susceptible to significant change. Management reviews the level of the allowance at least quarterly and establishes the provision for loan losses based upon an evaluation of the portfolio, past loss experience, current economic conditions, and other factors related to the collectability of the loan portfolio. Although the Company believes that use of the best information available currently establishes the ALLL, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the evaluation. As the Company adds new products to the loan portfolio and expands the Company's market area, management intends to enhance and adapt the methodology to keep pace with the size and complexity of the loan portfolio. Changes in any of the above factors could have a significant effect on the calculation of the ALLL in any given period. Management believes that its systematic methodology continues to be appropriate given the Company's increased size and level of complexity.

Servicing Rights. Servicing assets are recognized as separate assets when rights are acquired through the purchase or through the sale of financial assets. Generally, purchased servicing rights are capitalized at the cost to acquire the rights. For sales of mortgage, commercial and consumer loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage, commercial, or consumer servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds, and default rates and losses. Servicing assets are evaluated quarterly for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights into tranches based on predominant characteristics, such as interest rate, loan type, and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranches. If the Company later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as a recovery and an increase to income. Capitalized servicing rights are stated separately on the consolidated balance sheets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

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

Fair Value. ASC 820, "*Fair Value Measurements and Disclosures,*" establishes a hierarchical disclosure framework associated with the level of pricing observability utilized in measuring financial instruments at fair value. The degree of judgment utilized in measuring the fair value of financial instruments generally correlates to the level of pricing observability. Financial instruments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of pricing observability and a lesser degree of judgment utilized in measuring fair value. Conversely, financial instruments rarely traded or not quoted will generally have little or no pricing observability and a higher degree of judgment utilized in measuring fair value. Pricing observability is impacted by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established and the characteristics specific to the transaction. The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (that is, an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability). For additional details, see "Note 11 - Fair Value Measurements" of the Notes to Consolidated Financial Statements included in Part I. Item 1 of this report.

Income Taxes**.** Income taxes are reflected in the Company's consolidated financial statements to show the tax effects of the operations and transactions reported in the consolidated financial statements and consist of taxes currently payable plus deferred taxes. ASC 740, "*Accounting for Income Taxes,*" requires the asset and liability approach for financial accounting and reporting for deferred income taxes. Deferred tax assets and liabilities result from temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities. They are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled and are determined using the assets and liability method of accounting. The deferred income provision represents the difference between net deferred tax asset/liability at the beginning and end of the reported period. In formulating the deferred tax asset, the Company is required to estimate income and taxes in the jurisdiction in which the Company operates. This process involves estimating the actual current tax exposure for the reported period together with assessing temporary differences resulting from differing treatment of items, such as depreciation and the provision for loan losses, for tax and financial reporting purposes. The Company had no net deferred tax assets and net deferred tax liabilities of $1.0 million and $361,000, at June 30, 2019 and December 31, 2018, respectively.

Comparison of Financial Condition at June 30, 2019 and December 31, 2018

Assets. Total assets increased $19.4 million, or 1.2%, to $1.64 billion at June 30, 2019, compared to $1.62 billion at December 31, 2018, primarily due to increases in total cash and cash equivalents of $26.8 million, loans held for sale of $15.3 million, operating lease ROU assets of $4.6 million, and other assets of $2.9 million, partially offset by a decrease in loans receivable, net of $30.4 million. The increases in total assets were primarily funded by deposit growth.

Loans receivable, net decreased $30.4 million, to $1.28 billion at June 30, 2019, from $1.31 billion at December 31, 2018. Total real estate loans decreased $36.3 million, including decreases in construction and development of $33.2 million, home equity of $3.4 million, and multi-family of $1.4 million, partially offset by an increase in commercial of $2.1 million. Undisbursed construction and development loan commitments decreased $6.4 million, or 8.3%, to $70.5 million at June 30, 2019, as compared to $76.9 million at December 31, 2018. Commercial business loans decreased $22.1 million, primarily due to a net decrease in warehouse lending of $18.7 million, consisting of a decrease of $21.3 million in commercial warehouse lending, offset by an increase of $2.6 million in residential mortgage warehouse lending, as well as a decrease in commercial and industrial loans of $3.4 million. These decreases were partially offset by consumer loans which increased $28.3 million, primarily due to increases of $20.5 million in indirect home improvement loans and $8.2 million in marine loans.

Loans held for sale, consisting of one-to-four-family loans, increased by $15.3 million, or 29.9%, to $66.5 million at June 30, 2019, from $51.2 million at December 31, 2018. The Company continues to build its home lending operations by developing additional lending niches and will continue selling one-to-four-family loans into the secondary market for asset/liability management purposes.

One-to-four-family loan originations, including $321.8 million of loans originated for sale, $26.0 million of portfolio loans including first and second liens, and $3.9 million of loans brokered to other institutions, decreased $10.6 million, or 2.9% to $351.7 million during the six months ended June 30, 2019, compared to $362.3 million during the six months ended June 30, 2018. Originations of one-to-four-family loans to purchase a home (purchase production) decreased by $27.0 million, or 9.8% with $247.7 million in loan purchase production closing during the six months ended June 30, 2019, down from $274.7 million during the six months ended June 30, 2018. One-to-four-family loan originations for refinance (refinance production) increased $17.3 million, or 20.0%, with $104.0 million in refinance production closing during the six months ended June 30, 2019, up from $86.7 million during the six months ended June 30, 2018. During the six months ended June 30, 2019, the Company sold $304.3 million of one-to-four-family loans, compared to sales of $315.6 million for the same period one year ago. In addition, the cash margin on loans sold decreased to 1.67% for the six months ended June 30, 2019, compared to 2.56% for the six months ended June 30, 2018.

The ALLL was $12.3 million at June 30, 2019 and December 31, 2018, or 1.0% and 0.9% of gross loans receivable, excluding loans held for sale, respectively. Substandard loans decreased to $6.5 million at June 30, 2019, compared to $8.0 million at December 31, 2018, primarily due to a $1.2 million charge-off of a commercial line of credit in the first quarter 2019. Non-performing loans, consisting of non-accruing and accruing loans 90 days or more past due, decreased to $1.6 million at June 30, 2019, from $3.9 million at December 31, 2018, primarily due to three charge-offs comprised of the $1.2 million mentioned above, a one-to-four-family loan in the amount of $834,000, and one commercial business relationship of $431,000. At June 30, 2019, non-performing loans consisted of $958,000 in one-to-four-family loans, $401,000 of indirect home improvement loans, $190,000 of home equity loans, $33,000 of solar loans, and $11,000 of other consumer loans. The ratio of non-performing loans to total gross loans was 0.1% at June 30, 2019, compared to 0.3% at December 31, 2018. There were three OREO properties totaling $254,000 at June 30, 2019, and two OREO properties totaling $689,000 at December 31, 2018.

The allowance does not include the recorded discount on loans acquired in the Anchor Acquisition of $3.7 million on $278.4 million of gross loans at June 30, 2019.

Liabilities. Total liabilities increased $10.0 million to $1.45 billion at June 30, 2019, from $1.44 billion at December 31, 2018, primarily due to a $60.0 million increase in deposits and a $642,000 increase in deferred tax liability, partially offset by a $53.9 million decrease in borrowings and a $1.4 million decrease in other liabilities.

Total deposits increased to $1.33 billion at June 30, 2019, from $1.27 billion at December 31, 2018. Relationship-based transactional accounts (noninterest-bearing checking, interest-bearing checking, and escrow accounts) increased $74.1 million to $459.7 million at June 30, 2019, from $385.6 million at December 31, 2018 primarily due to a $47.0 million increase in noninterest-bearing checking and a $29.4 million increase in interest-bearing checking. Money market and savings accounts decreased $39.4 million to $365.5 million at June 30, 2019, from $404.9 million at December 31, 2018. Time deposits increased $25.3 million to $509.0 million at June 30, 2019, from $483.6 million at December 31, 2018. Non-retail certificates of deposit ("CDs") which includes brokered CDs, online CDs, and public funds decreased $8.6 million to $118.9 million at June 30, 2019, compared to $127.5 million at December 31, 2018, primarily due to decreases in public funds of $9.4 million and in brokered CDs of $2.1 million, partially offset by an increase of $3.2 million in online CDs. Management remains focused on increasing its lower cost relationship-based deposits to fund long-term asset growth.

Borrowings decreased $53.9 million to $83.2 million at June 30, 2019, from $137.1 million at December 31, 2018, primarily related to the repayment of FHLB Fed Funds to take advantage of lower cost FHLB advances.

Stockholders' Equity. Total stockholders' equity increased $9.4 million to $189.4 million at June 30, 2019, from $180.0 million at December 31, 2018. The increase in stockholders' equity during the six months ended June 30, 2019, was primarily due to net income of $9.7 million, and a decrease in accumulated other comprehensive loss to a gain, net of tax of $2.0 million, partially offset by common stock repurchases of $2.5 million. The Company repurchased 52,622 shares of its common stock during the six months ended June 30, 2019, at an average price of $47.97 per share. At June 30, 2019, the number of shares that remained available for repurchase was 172,378 as authorized pursuant to our January 2019 Share Repurchase Plan. Book value per common share was $43.18 at June 30, 2019, compared to $41.19 at December 31, 2018.

We calculated book value based on common shares outstanding of 4,476,864 at June 30, 2019, less 25,000 unvested restricted stock shares, and 64,803 of unallocated ESOP shares for the reported common shares outstanding of 4,387,061. Common shares outstanding was calculated using 4,492,478 shares at December 31, 2018, less 43,421 unvested restricted stock shares, and 77,763 of unallocated ESOP shares for the reported common shares outstanding of 4,371,294.

Comparison of Results of Operations for the Three Months Ended June 30, 2019 and 2018

General. Net income for the three months ended June 30, 2019, increased $206,000, or 4.8%, to $4.5 million, from $4.3 million for the three months ended June 30, 2018. The primary reason for the increase in net income was a $5.1 million, or 44.9% increase in net interest income after provision for loan losses, partially offset by a $4.9 million, or 40.6% increase in noninterest expense, including $1.2 million of acquisition costs compared to none for the three months ended June 30, 2018.

The following table sets forth the average balances of all major categories of interest-earning assets and interest-bearing liabilities to calculate the comparison of results of operations for the three months ended June 30, 2019 and 2018:

Average Balances	For the Three Months Ended June 30, 2019 Average Balance Outstanding	Interest Earned/ Paid	Yield/ Rate	For the Three Months Ended June 30, 2018 Average Balance Outstanding	Interest Earned/ Paid	Yield/ Rate
ASSETS						
Loans receivable, net deferred loan fees (1)(3)	$ 1,338,411	$ 21,102	6.32%	$ 899,692	$ 13,135	5.86%
Mortgage-backed securities	47,682	318	2.68%	47,442	284	2.40%
Investment securities	51,489	372	2.90%	49,423	349	2.83%
Federal Home Loan Bank stock	8,188	105	5.14%	6,770	76	4.50%
Interest-bearing deposits at other financial institutions	83,805	468	2.24%	41,952	178	1.70%
Total interest-earning assets	1,529,575	22,365	5.86%	1,045,279	14,022	5.38%
Noninterest-earning assets (2)	98,109			37,583		
Total assets	$ 1,627,684			$ 1,082,862		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Savings and money market	$ 378,705	$ 741	0.78%	$ 287,354	$ 393	0.55%
Interest-bearing checking	187,049	386	0.83%	125,901	63	0.20%
Certificates of deposit (3)	511,539	2,929	2.30%	243,108	976	1.61%
Borrowings	86,714	606	2.80%	100,546	496	1.98%
Subordinated note	9,872	169	6.87%	9,852	169	6.88%
Total interest-bearing liabilities	1,173,879	4,831	1.65%	766,761	2,097	1.10%
Noninterest-bearing accounts	243,893			179,814		
Other noninterest-bearing liabilities	21,146			10,451		
Stockholders' equity	188,766			125,836		
Total liabilities and stockholders' equity	$ 1,627,684			$ 1,082,862		
Net interest income		$ 17,534			$ 11,925	
Net interest rate spread			4.21%			4.28%
Net earning assets	$ 355,696			$ 278,518		
Net interest margin			4.60%			4.58%
Average interest-earning assets to average interest-bearing liabilities	130.30%			136.32%		

____
(1) Includes loans held for sale.
(2) Includes fixed assets, BOLI, servicing rights, goodwill, and CDI.
(3) Includes fair value adjustments from the Anchor Acquisition.

Net Interest Income. Net interest income increased $5.6 million, or 47.0%, to $17.5 million for the three months ended June 30, 2019, from $11.9 million for the three months ended June 30, 2018. This increase was a result of an $8.0 million, or 60.7% increase in loans receivable interest income, due to a $438.7 million, or 48.8% increase in the average loans receivable, net balance, largely reflecting the loans acquired in the Anchor Acquisition, accompanied with a 46 basis point increase in the average loan yield, and a $376,000, or 42.4% increase in interest and dividends on investment securities, cash and cash equivalents and CDs at other financial institutions. These increases were partially offset by a $2.6 million, or 183.2% increase in deposit interest expense due to assumed deposits and continued organic growth in interest-bearing deposits with higher market interest rates, and a $110,000, or 22.2% increase in interest expense on borrowings mainly from the use of FHLB advances to support loan growth.

The net interest margin ("NIM") increased two basis points to 4.60% for the three months ended June 30, 2019, from 4.58% for the same period in the prior year. The increase in NIM for the comparable quarter, year over year, was driven primarily by a positive impact from incremental interest accretion on loans acquired in the Anchor Acquisition of 20 basis points, partially offset by higher cost market rate deposits and increased borrowing costs to fund loan growth. Management remains focused on matching deposit/liability duration with the duration of loans/assets where appropriate.

Interest Income. Interest income for the three months ended June 30, 2019, increased $8.3 million, or 59.5%, to $22.4 million, from $14.0 million for the three months ended June 30, 2018. The increase during the period was primarily attributable to the increase in the average balance of loans receivable to $1.34 billion for the three months ended June 30, 2019, compared to $899.7 million for the three months ended June 30, 2018, and a 48 basis point increase in the average yield on interest-earning assets to 5.86% for the three months ended June 30, 2019, compared to 5.38% for the three months ended June 30, 2018. The increase in average yield on interest-earning assets compared to the same period a year earlier primarily reflects the growth in the loan portfolio, and the proportionally larger level of loans in the average interest-earning asset mix as well as the 46 basis point increase in the average loan yield.

The following table compares average earning asset balances, associated yields, and resulting changes in interest income for the three months ended June 30, 2019 and 2018:

	Three Months Ended June 30,				
	2019		2018		
(Dollars in thousands)	Average Balance Outstanding	Yield/ Rate	Average Balance Outstanding	Yield/ Rate	Increase in Interest Income
Loans receivable, net and loans held for sale	$ 1,338,411	6.32 %	$ 899,692	5.86 %	$ 7,967
Mortgage-backed securities	47,682	2.68	47,442	2.40	34
Investment securities	51,489	2.90	49,423	2.83	23
FHLB stock	8,188	5.14	6,770	4.50	29
Interest-bearing deposits at other financial institutions	83,805	2.24	41,952	1.70	290
Total interest-earning assets	$ 1,529,575	5.86 %	$ 1,045,279	5.38 %	$ 8,343

Interest Expense. Interest expense increased $2.7 million, or 130.4%, to $4.8 million for the three months ended June 30, 2019, from $2.1 million for the same prior year period. The increase was attributable to an increase in interest expense on deposits of $2.6 million, and borrowings of $110,000. The average cost of funds increased 55 basis points to 1.65% for the three months ended June 30, 2019, from 1.10% for the three months ended June 30, 2018. The increase was predominantly due to growth in higher market rate deposits, primarily those acquired in the Anchor Acquisition along with organic deposit growth. The average cost of deposits increased 57 basis points to 1.22%, for the three months ended June 30, 2019, compared to 0.65%, for the three months ended June 30, 2018, reflecting rising market interest rates primarily in interest-bearing checking, brokered CDs, and CDs.

The following table details average balances for cost of funds on interest-bearing liabilities and the change in interest expense for the three months ended June 30, 2019 and 2018:

	Three Months Ended June 30,				
	2019		2018		
(Dollars in thousands)	Average Balance Outstanding	Yield/ Rate	Average Balance Outstanding	Yield/ Rate	Increase in Interest Expense
Savings and money market	$ 378,705	0.78 %	$ 287,354	0.55 %	$ 348
Interest-bearing checking	187,049	0.83	125,901	0.20	323
Certificates of deposit	511,539	2.30	243,108	1.61	1,953
Borrowings	86,714	2.80	100,546	1.98	110
Subordinated note	9,872	6.87	9,852	6.88	—
Total interest-bearing liabilities	$ 1,173,879	1.65 %	$ 766,761	1.10 %	$ 2,734

Provision for Loan Losses. For the three months ended June 30, 2019, the provision for loan losses was $910,000, compared to $450,000 for the three months ended June 30, 2018, due primarily to the increase in the loan portfolio and net loan charge-offs. Included in the loan portfolio increase was $30.0 million of Anchor Bank loans transferred to the ALLL in accordance to ASC 450-20 *Loss Contingencies* with a related provision of $360,000. During the three months ended June 30, 2019, net loan charge-offs totaled $415,000, compared to $19,000 during the three months ended June 30, 2018. The significant increase in net loan charge-offs compared to the prior year was primarily due to the charge-off of loans from one commercial business relationship totaling $431,000.

Noninterest Income. Noninterest income increased $469,000, or 8.4%, to $6.1 million for the three months ended June 30, 2019, from $5.6 million for the three months ended June 30, 2018. The increase between the periods primarily reflects a $1.2 million increase in service charges and fee income, primarily due to deposit accounts assumed in the Anchor Acquisition and deposit growth, partially offset by a $1.1 million decrease in gain on sale of loans.

Noninterest Expense. Noninterest expense increased $4.9 million, or 40.6%, to $17.1 million for the three months ended June 30, 2019, from $12.1 million for the three months ended June 30, 2018. The increase was primarily due to the Anchor Acquisition and growth in our operations with increases of $1.1 million in operations, $978,000 in salaries and benefits, $657,000 in data processing, and $526,000 in occupancy expense. Acquisition costs were $1.2 million for the three months ended June 30, 2019, compared to none for the three months ended June 30, 2018 and were primarily due to the integration of the Anchor Bank core processing platform.

The efficiency ratio, which is noninterest expense as a percentage of net interest income and noninterest income, increased slightly to 72.3% for the three months ended June 30, 2019, compared to 69.2% for the three months ended June 30, 2018, representing a greater increase in noninterest expense as compared to smaller increases in net interest income and noninterest income.

Provision for Income Tax. For the three months ended June 30, 2019, the Company recorded a provision for income tax expense of $1.2 million on pre-tax income as compared to $688,000 for the three months ended June 30, 2018. The effective corporate income tax rates for the three months ended June 30, 2019 and 2018 were 20.8% and 13.9%, respectively. The increase in the tax provision and related effective tax rate is primarily due to an increase in pre-tax income of $691,000 and acquisition costs of $1.2 million during the three months ended June 30, 2019, which are not allowable as a deduction for federal income tax purposes.

Comparison of Results of Operations for the Six Months Ended June 30, 2019 and 2018

General. Net income for the six months ended June 30, 2019, increased $1.1 million, or 12.5%, to $9.7 million, from $8.6 million for the six months ended June 30, 2018. The increase was mostly due to a $10.9 million, or 48.4% increase in net interest income, after provision for loan losses, partially offset by an $8.7 million, or 37.5% increase in noninterest expense, including $1.6 million of acquisition costs compared to none for the six months ended June 30, 2018. In addition there was a $1.2 million, or 78.3% increase in provision for income taxes.

The following table sets forth the average balances of all major categories of interest-earning assets and interest-bearing liabilities to calculate the comparison of results of operations for the six months ended June 30, 2019 and 2018:

	For the Six Months Ended June 30, 2019			For the Six Months Ended June 30, 2018		
Average Balances	Average Balance Outstanding	Interest Earned/ Paid	Yield/ Rate	Average Balance Outstanding	Interest Earned/ Paid	Yield/ Rate
ASSETS						
Loans receivable, net deferred loan fees [(1)]	$ 1,343,387	$ 42,211	6.34%	$ 872,394	$ 25,391	5.87%
Mortgage-backed securities	47,237	638	2.72%	45,979	529	2.32%
Investment securities	52,172	747	2.89%	47,737	643	2.72%
Federal Home Loan Bank stock	8,557	235	5.54%	5,097	111	4.39%
Interest-bearing deposits at other financial institutions	76,030	845	2.24%	41,346	336	1.64%
Total interest-earning assets	1,527,383	44,676	5.90%	1,012,553	27,010	5.38%
Noninterest-earning assets [(2)]	93,925			37,419		
Total assets	$ 1,621,308			$ 1,049,972		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Savings and money market	$ 386,964	$ 1,505	0.78%	$ 290,391	$ 712	0.49%
Interest-bearing checking	175,212	582	0.67%	124,666	130	0.21%
Certificates of deposit [(3)]	503,609	5,679	2.27%	248,116	1,833	1.49%
Borrowings	98,514	1,350	2.76%	61,294	576	1.90%
Subordinated note	9,869	337	6.89%	9,849	337	6.90%
Total interest-bearing liabilities	1,174,168	9,453	1.62%	734,316	3,588	0.99%
Noninterest-bearing accounts	241,758			180,158		
Other noninterest-bearing liabilities	19,125			11,181		
Stockholders' equity	186,257			124,317		
Total liabilities and stockholders' equity	$ 1,621,308			$ 1,049,972		
Net interest income		$ 35,223			$ 23,422	
Net interest rate spread			4.27%			4.39%
Net earning assets	$ 353,215			$ 278,237		
Net interest margin			4.65%			4.66%
Average interest-earning assets to average interest-bearing liabilities	130.08%			137.89%		

____

(1) Includes loans held for sale.
(2) Includes fixed assets, BOLI, servicing rights, goodwill, and CDI.
(3) Includes fair value adjustments from the Anchor Acquisition.

Net Interest Income. Net interest income increased $11.8 million, or 50.4%, to $35.2 million for the six months ended June 30, 2019, from $23.4 million for the six months ended June 30, 2018, mostly due to a $16.8 million, or 66.2% increase in loans receivable interest income, partially offset by a $5.1 million, or 190.3% increase in deposit interest expense and a $774,000, or 134.4% increase in borrowing interest expense.

The NIM decreased one basis point to 4.65% for the six months ended June 30, 2019, from 4.66% for the six months ended June 30, 2018. The decreased NIM was mostly driven by higher cost market rate deposits and increased borrowing costs, partially offset by a positive impact from incremental interest accretion on loans acquired in the Anchor Acquisition of 18 basis points.

Interest Income. Interest income for the six months ended June 30, 2019, increased $17.7 million, or 65.4%, to $44.7 million, from $27.0 million for the six months ended June 30, 2018. The increase during the period was primarily due to the increase in the average balance of loans receivable to $1.34 billion for the six months ended June 30, 2019, compared to $872.4 million for the six months ended June 30, 2018. The average yield on interest-earning assets increased 52 basis points to 5.90% for the six months ended June 30, 2019, compared to 5.38% for the six months ended June 30, 2018. The increase in average yield on interest-earning assets compared to the same period last year primarily reflects the growth in the loan portfolio previously discussed and the proportionally larger level of loans in the average interest-earning asset mix.

The following table compares average earning asset balances, associated yields, and resulting changes in interest income for the six months ended June 30, 2019 and 2018:

	Six Months Ended June 30,				
	2019		2018		
(Dollars in thousands)	Average Balance Outstanding	Yield/ Rate	Average Balance Outstanding	Yield/ Rate	Increase in Interest Income
Loans receivable, net and loans held for sale	$ 1,343,387	6.34 %	$ 872,394	5.87 %	$ 16,820
Mortgage-backed securities	47,237	2.72	45,979	2.32	109
Investment securities	52,172	2.89	47,737	2.72	104
FHLB stock	8,557	5.54	5,097	4.39	124
Interest-bearing deposits at other financial institutions	76,030	2.24	41,346	1.64	509
Total interest-earning assets	$ 1,527,383	5.90 %	$ 1,012,553	5.38 %	$ 17,666

Interest Expense. Interest expense increased $5.9 million, or 163.5%, to $9.5 million for the six months ended June 30, 2019, from $3.6 million for the same prior year period. The increase was attributable to an increase in interest expense on deposits of $5.1 million, and borrowings of $774,000. Deposit costs increased predominantly due to growth in higher market rate deposits, primarily those acquired in the Anchor Acquisition along with organic deposit growth. The average cost of funds increased 63 basis points to 1.62% for the six months ended June 30, 2019, compared to 0.99% for the six months ended June 30, 2018. The average cost of deposits increased 53 basis points to 1.17% for the six months ended June 30, 2019, compared to 0.64% for the six months ended June 30, 2018, mostly driven by rising market interest rates primarily in interest-bearing checking, brokered CDs, and CDs.

The following table details average balances for cost of funds on interest-bearing liabilities and the change in interest expense for the six months ended June 30, 2019 and 2018:

	Six Months Ended June 30,				
	2019		2018		
(Dollars in thousands)	Average Balance Outstanding	Yield/ Rate	Average Balance Outstanding	Yield/ Rate	Increase in Interest Expense
Savings and money market	$ 386,964	0.78 %	$ 290,391	0.49 %	$ 793
Interest-bearing checking	175,212	0.67	124,666	0.21	452
Certificates of deposit	503,609	2.27	248,116	1.49	3,846
Borrowings	98,514	2.76	61,294	1.90	774
Subordinated note	9,869	6.89	9,849	6.90	—
Total interest-bearing liabilities	$ 1,174,168	1.62 %	$ 734,316	0.99 %	$ 5,865

Provision for Loan Losses. For the six months ended June 30, 2019, the provision for loan losses was $1.7 million, due primarily to the increase in the loan portfolio and net loan charge-offs, compared to $800,000 for the six months ended June 30, 2018. Included in the loan portfolio increase was $30.0 million of Anchor Bank loans transferred to the ALLL in accordance to ASC 450-20 *Loss Contingencies* with a related provision of $360,000. Net loan charge-offs totaled $1.7 million during the six months ended June 30, 2019, compared to net recoveries of $15,000 during the six months ended June 30, 2018. The significant increase in net loan charge-offs was primarily due to a charge-off of a commercial line of credit of $1.2 million in the first quarter of 2019, and the charge-off of loans from one commercial business relationship of $431,000 in the second quarter of 2019 .

Noninterest Income. Noninterest income was unchanged at $10.6 million for both the six months ended June 30, 2019, June 30, 2018. Service charges and fee income increased $2.2 million, other noninterest income increased $312,000, and earnings on cash surrender value of BOLI increased $262,000, partially offset by a decrease of $2.7 million in gain on sale of loans, primarily due to an 89 basis point decrease in the average loan sale margin.

Noninterest Expense. Noninterest expense increased $8.7 million, or 37.5%, to $31.9 million for the six months ended June 30, 2019, from $23.2 million for the six months ended June 30, 2018. The increase was primarily due to the Anchor Acquisition and growth in our operations with increases of $2.2 million in salaries and benefits also associated with the hiring of additional employees to support lending and deposit growth, $1.8 million in operations, $1.3 million in data processing, $989,000 in occupancy expense, $259,000 in professional and board fees, $256,000 in FDIC insurance, and $227,000 in amortization of core deposit intangible. Acquisition costs were $1.6 million for the six months ended June 30, 2019, compared to none for the same period last year.

The efficiency ratio was 69.5% for the six months ended June 30, 2019, compared to 68.1% for the six months ended June 30, 2018.

Provision for Income Tax. For the six months ended June 30, 2019, the Company recorded a provision for income tax expense of $2.7 million on pre-tax income as compared to $1.5 million for the six months ended June 30, 2018. The effective tax rate for the six month period ended June 30, 2019 and 2018 was 21.7% and 14.9%, respectively. The increase in the tax provision and related effective tax rate is primarily due to an increase in pre-tax income of $2.3 million and acquisition costs of $1.6 million during the six months ended June 30, 2019, which are not allowable as a deduction for federal income tax purposes.

Liquidity

Management maintains a liquidity position that it believes will adequately provide funding for loan demand and deposit runoff that may occur in the normal course of business. The Company relies on a number of different sources in order to meet potential liquidity demands. The primary sources are increases in deposit accounts, FHLB advances, purchases of federal funds, sale of securities available-for-sale, cash flows from loan payments, sales of one-to-four-family loans held for sale, and maturing securities.

At June 30, 2019, the Bank's total borrowing capacity was $484.2 million with the FHLB of Des Moines, with unused borrowing capacity of $390.3 million. The FHLB borrowing limit is based on certain categories of loans, primarily real estate loans that qualify as collateral for FHLB advances. At June 30, 2019, the Bank held approximately $655.3 million in loans that qualify as collateral for FHLB advances.

In addition to the availability of liquidity from the FHLB of Des Moines, the Bank maintained a short-term borrowing line with the Federal Reserve Bank, with a current limit of $144.8 million, and a combined credit limit of $51.0 million in written federal funds lines of credit through correspondent banking relationships at June 30, 2019. The Federal Reserve Bank borrowing limit is based on certain categories of loans, primarily consumer loans that qualify as collateral for Federal Reserve Bank line of credit. At June 30, 2019, the Bank held approximately $295.7 million in loans that qualify as collateral for the Federal Reserve Bank line of credit.

At June 30, 2019, $83.2 million in FHLB advances were outstanding, and no advances were outstanding against the Federal Reserve Bank line of credit, or the federal funds lines of credit. The Bank's Asset and Liability Management Policy permits management to utilize brokered deposits up to 20% of deposits or $267.9 million at June 30, 2019. Total brokered deposits at June 30, 2019 were $114.6 million. Management utilizes brokered deposits to mitigate interest rate risk and liquidity risk exposure when appropriate.

Liquidity management is both a daily and long-term function of the Company's management. Excess liquidity is generally invested in short-term investments, such as overnight deposits and federal funds. On a longer term basis, a strategy is maintained of investing in various lending products and investment securities, including U.S. Government obligations and U.S. agency securities. The Company uses sources of funds primarily to meet ongoing commitments, pay maturing deposits, fund withdrawals, and to fund loan commitments. At June 30, 2019, the approved outstanding loan commitments, including unused lines of credit amounted to $340.2 million. Certificates of deposit scheduled to mature in three months or less at June 30, 2019, totaled $91.0 million. It is management's policy to offer deposit rates that are competitive with other local financial institutions. Based on this management strategy, the Company believes that a majority of maturing relationship deposits will remain with the Bank.

As a separate legal entity from the Bank, FS Bancorp, Inc. must provide for its own liquidity. Sources of capital and liquidity for FS Bancorp, Inc. include distributions from the Bank and the issuance of debt or equity securities. Dividends and other capital distributions from the Bank are subject to regulatory notice. At June 30, 2019, FS Bancorp, Inc. had $5.2 million in unrestricted cash to meet liquidity needs.

Commitments and Off-Balance Sheet Arrangements

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the financing needs of its customers. For information regarding our commitments and off-balance sheet arrangements, see "Note 10 - Commitments and Contingencies" of the Notes to Consolidated Financial Statements included in Part I. Item 1 of this report.

Capital Resources

The Bank is subject to minimum capital requirements imposed by the FDIC. Based on its capital levels at June 30, 2019, the Bank exceeded these requirements as of that date. Consistent with our goals to operate a sound and profitable organization, our policy is for the Bank to maintain a well capitalized status under the capital categories of the FDIC. Based on capital levels at June 30, 2019, the Bank was considered to be well capitalized. At June 30, 2019, the Bank exceeded all regulatory capital requirements with Tier 1 leverage-based capital, Tier 1 risk-based capital, total risk-based capital, and common equity Tier 1 capital ratios of 11.4%, 13.8%, 14.7%, and 13.8%, respectively.

As a bank holding company registered with the Federal Reserve, the Company is subject to the capital adequacy requirements of the Federal Reserve. For a bank holding company with less than $3.0 billion in assets, the capital guidelines apply on a bank only basis, and the Federal Reserve expects the holding company's subsidiary bank to be well capitalized under the prompt corrective action regulations. If FS Bancorp, Inc. were subject to regulatory capital guidelines for bank holding companies with $3.0 billion or more in assets at March 31, 2019, FS Bancorp, Inc. would have exceeded all regulatory capital requirements. The regulatory capital ratios calculated for FS Bancorp, Inc. at June 30, 2019 were 11.1% for Tier 1 leverage-based capital, 13.5% for Tier 1 risk-based capital, 14.4% for total risk-based capital, and 13.5% for CET 1 capital ratio. For additional information regarding regulatory capital compliance, see the discussion included in "Note 15 - Regulatory Capital" to the Notes to Consolidated Financial Statements included in Part I. Item 1 of this report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in the market risk disclosures contained in FS Bancorp's Annual Report on Form 10-K for the fiscal year ended December 31, 2018.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

An evaluation of the disclosure controls and procedures as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") was carried out as of June 30, 2019 under the supervision and with the participation of the Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") and several other members of the Company’s senior management. In designing and evaluating the Company’s disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

The Company’s CEO and CFO concluded that based on their evaluation at June 30, 2019, the Company’s disclosure controls and procedures were effective in ensuring that information we are required to disclose in the reports we file or submit under the Exchange Act is (1) recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms, and (2) accumulated and communicated to FS Bancorp management, including its CEO and CFO, as appropriate to allow timely decisions regarding required disclosure, specified in the SEC’s rules and forms.

(b) Changes in Internal Controls

There were no significant changes in the Company’s internal control over financial reporting that occurred during the three months ended June 30, 2019, that have materially affected or are reasonably likely to materially affect our internal control over financial reporting. The Company does not expect that its disclosure controls and procedures and internal control over financial reporting 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 may be circumvented by the individual acts of some persons, by collusion of two or more people, or by 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 or 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.

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

There have been no material changes to the risk factors set forth in Part I. Item 1A of the Company’s Annual Report on Form 10-K for the year ended December 31, 2018.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Not applicable

(b) Not applicable

(c) The following table summarizes common stock repurchases during the three months ended June 30, 2019:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Repurchased as Part of Publicly Announced Plan	Maximum Number of Shares that May Yet Be Repurchased Under the Plan
April 1, 2019 - April 30, 2019	—	$ —	—	219,564
May 1, 2019 - May 31, 2019	38,241 (1)	48.42	35,449	184,115
June 1, 2019 - June 30, 2019	11,737	47.78	11,737	172,378
Total for the quarter	49,978	$ 48.27	47,186	172,378

(1) There were 2,792 shares surrendered by participants included in the 2013 Equity Incentive Plan in satisfaction of payment for withholding taxes for vesting of restricted stock shares.

On January 28, 2019, the Company announced that its Board of Directors authorized the repurchase of up to 225,000 shares of the Company’s common stock, or 5% of the Company’s outstanding shares authorized and outstanding at December 31, 2018. The repurchase program permits shares to be repurchased in open market or private transactions, through block trades, from time to time over a 12-month period until January 31, 2020, depending on market conditions and other factors, and pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities and Exchange Commission.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

2.1	Agreement and Plan of Merger, dated as of July 17, 2018, by and between FS Bancorp, Inc. and Anchor Bancorp (1)
3.1	Articles of Incorporation of FS Bancorp, Inc. (2)
3.2	Bylaws of FS Bancorp, Inc. (3)
4.1	Form of Common Stock Certificate of FS Bancorp, Inc. (2)
10.1	Severance Agreement between 1st Security Bank of Washington and Joseph C. Adams (2)
10.2	Form of Change of Control Agreement between 1st Security Bank of Washington and Matthew D. Mullet (2)
10.3	FS Bancorp, Inc. 2013 Equity Incentive Plan (the “2013 Plan”) (4)
10.4	Form of Incentive Stock Option Agreement under the 2013 Plan (4)
10.5	Form of Non-Qualified Stock Option Agreement under the 2013 Plan (4)
10.6	Form of Restricted Stock Agreement under the 2013 Plan (4)
10.7	Purchase and Assumption Agreement between Bank of America, National Association and 1st Security Bank dated September 1, 2015 (5)
10.8	Subordinated Loan Agreement dated September 30, 2015 by and among Community Funding CLO, Ltd. and the Company (6)
10.9	Form of change of control agreement with Donn C. Costa, Dennis O’Leary, Rob Fuller, Erin Burr, Victoria Jarman, Kelli Nielsen, and May-Ling Sowell (7)
10.10	FS Bancorp, Inc. 2018 Equity Incentive Plan (8)
10.11	Form of Incentive Stock Option Award Agreement under the 2018 Equity Incentive Plan (8)
10.12	Form of Non-Qualified Stock Option Award Agreement under the 2018 Equity Incentive Plan (8)
10.13	Form of Restricted Stock Award Agreement under the 2018 Equity Incentive Plan (8)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following materials from the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2019 formatted in Extensible Business Reporting Language (XBRL): (1) Consolidated Balance Sheets; (2) Consolidated Statements of Income; (3) Consolidated Statements of Comprehensive Income; (4) Consolidated Statements of Changes in Stockholders’ Equity; (5) Consolidated Statements of Cash Flows; and (6) Notes to Consolidated Financial Statements.
(1)	Filed as an exhibit to the Registrant’s Current Report on Form 8-K filed on July 18, 2018 (File No. 001-35589) and incorporated by reference.
(2)	Filed as an exhibit to the Registrant’s Registration Statement on Form S-1 (333-177125) filed on October 3, 2011, and incorporated by reference.
(3)	Filed as an exhibit to the Registrant’s Current Report on Form 8-K filed on July 10, 2013 (File No. 001-35589) and incorporated by reference.
(4)	Filed as an exhibit to the Registrant’s Registration Statement on Form S-8 (333-192990) filed on December 20, 2013, and incorporated by reference.
(5)	Filed as an exhibit to the Registrant’s Current Report on Form 8-K filed on September 2, 2015 (File No. 001-35589) and incorporated by reference.
(6)	Filed as an exhibit to the Registrant’s Current Report on Form 8-K filed on October 19, 2015 (File No. 001-35589) and incorporated by reference.
(7)	Filed as an exhibit to the Registrant’s Current Report on Form 8-K filed on February 1, 2016 (File No. 001-35589) and incorporated by reference.
(8)	Filed as an exhibit to the Registrant’s Registration Statement on Form S-8 (333-225135) filed on May 23, 2018.

Exhibit Index

Exhibit No.	Description
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following materials from the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2019 formatted in Extensible Business Reporting Language (XBRL): (1) Consolidated Balance Sheets; (2) Consolidated Statements of Income; (3) Consolidated Statements of Comprehensive Income; (4) Consolidated Statements of Changes in Stockholders’ Equity; (5) Consolidated Statements of Cash Flows; and (6) Notes to Consolidated Financial Statements.

Table of Contents

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.

FS BANCORP, INC.

Date: August 9, 2019

By: /s/Joseph C. Adams
Joseph C. Adams,
Chief Executive Officer
(Duly Authorized Officer)

Date: August 9, 2019

By: /s/Matthew D. Mullet
Matthew D. Mullet
Secretary, Treasurer and
Chief Financial Officer
(Principal Financial and Accounting Officer)

(Back To Top)

Section 2: EX-31.1 (EX-31.1)

EXHIBIT 31.1

Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Joseph C. Adams, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of FS Bancorp, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15-(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2019

/s/Joseph C. Adams
Joseph C. Adams
Chief Executive Officer

(Back To Top)

Section 3: EX-31.2 (EX-31.2)

EXHIBIT 31.2

Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Matthew D. Mullet, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of FS Bancorp, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15-(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2019

/s/Matthew D. Mullet
Matthew D. Mullet
Chief Financial Officer

(Back To Top)

Section 4: EX-32.1 (EX-32.1)

EXHIBIT 32.1

Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the accompanying Quarterly Report on Form 10-Q of FS Bancorp, Inc. (the "Company") for the quarter ended June 30, 2019 (the "Report"), I, Joseph C. Adams, in my capacity as Chief Executive Officer of the Company, hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods presented in the financial statements included in the Report.

Date: August 9, 2019

/s/Joseph C. Adams
Joseph C. Adams
Chief Executive Officer

(Back To Top)

Section 5: EX-32.2 (EX-32.2)

EXHIBIT 32.2

Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the accompanying Quarterly Report on Form 10-Q of FS Bancorp, Inc. (the "Company") for the quarter ended June 30, 2019 (the "Report"), I, Matthew D. Mullet, in my capacity as Chief Financial Officer of the Company, hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods presented in the financial statements included in the Report.

Date: August 9, 2019	/s/Matthew D. Mullet
	Matthew D. Mullet
	Chief Financial Officer

(Back To Top)