

FS Bancorp, Inc.
Form 10-K
March 15, 2019
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10 K

(Mark one)

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

For the fiscal year ended December 31, 2018 OR

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

Commission File Number: 001 35589

FS BANCORP, INC.

(Exact name of registrant as specified in its charter)

Washington 45 4585178
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification Number)

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

Registrant's telephone number, including area code: (425) 771 5299

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value \$0.01 per share
(Title of Each Class)

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

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

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

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

Indicate by check mark whether disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or other information statements incorporated by reference in Part III of this Form 10 K or any amendments to this Form 10 K.

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

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

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

Indicate by check mark whether the Registrant is a shell company (as defined in Exchange Act Rule 12b 2). YES NO

As of March 8, 2019, there were 4,495,078 shares of the Registrant's common stock outstanding. The Registrant's common stock is listed on the NASDAQ Capital Market under the symbol "FSBW." The aggregate market value of the common stock held by non-affiliates of the Registrant was \$217,380,383, based on the closing sales price of \$63.25 per share of the Registrant's common stock as quoted on the NASDAQ Capital Market on June 30, 2018. For purposes of this calculation, common stock held by executive officers and directors of the Registrant is considered to be held by affiliates.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the definitive Proxy Statement for the 2019 Annual Meeting of Shareholders ("Proxy Statement") are incorporated by reference into Part III.

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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.

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Forward-Looking Statements

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

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

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

- the expected cost savings, synergies and other financial benefits from our recent merger with Anchor Bancorp (“Anchor”) might not be realized within the expected time frames or at all and costs or difficulties relating to integration matters, including but not limited to customer and employee retention, might be greater than expected;
- the combined company might not perform as well as expected;
- 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 control operating costs and expenses;
- our ability to retain key members of our senior management team;
- changes in consumer spending, borrowing, and savings habits;

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- 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 (the “Dodd Frank Act”), changes in regulation policies and principles, an increase in regulatory capital requirements or change in the interpretation of regulatory capital or other rules, including as a result of Basel III;
- adverse changes in the securities markets;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Public Company Accounting Oversight Board, or the Financial Accounting Standards Board (“FASB”);
- costs and effects of litigation, including settlements and judgments;
- disruptions, security breaches, or other adverse events, failures or interruptions in, or attacks on, our information technology systems or on the third-party vendors who perform several of our critical processing functions;
- inability of key third-party vendors to perform their obligations to us; and
- other economic, competitive, governmental, regulatory, and technical factors affecting our operations, pricing, products, and services, and other risks described elsewhere in this Form 10 K and our other reports filed with the U.S. Securities and Exchange Commission (“SEC”).

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

Available Information

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

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PART 1

Item 1. Business

General

FS Bancorp, Inc. (“FS Bancorp” or the “Company”), a Washington corporation, was organized in September 2011 for the purpose of becoming the holding company of 1st Security Bank of Washington (“1st Security Bank of Washington” or the “Bank”) upon the Bank’s conversion from a mutual to a stock savings bank (“Conversion”). The Conversion was completed on July 9, 2012. At December 31, 2018, the Company had consolidated total assets of \$1.62 billion, total deposits of \$1.27 billion, and stockholders’ equity of \$180.0 million. The Company has not engaged in any significant activity other than holding the stock of the Bank. Accordingly, the information set forth in this Annual Report on Form 10 K (“Form 10 K”), including the consolidated financial statements and related data, relates primarily to the Bank.

1st Security Bank of Washington is a relationship-driven community bank. The Bank delivers banking and financial services to local families, local and regional businesses and industry niches within distinct Puget Sound area communities. The Bank emphasizes long-term relationships with families and businesses within the communities served, working with them to meet their financial needs. The Bank is also actively involved in community activities and events within these market areas, which further strengthens relationships within these markets. The Bank has been serving the Puget Sound area since 1936. Originally chartered as a credit union, and known as Washington’s Credit Union, the Bank served various select employment groups. On April 1, 2004, the Bank converted from a credit union to a Washington state-chartered mutual savings bank. Upon completion of the Conversion in July 2012, 1st Security Bank of Washington became a Washington state-chartered stock savings bank and the wholly owned subsidiary of the Company.

At December 31, 2018, the Bank maintained its main administrative office that also accepts deposits, 21 full-service bank branches and eight home loan production offices in suburban communities in the greater Puget Sound area. The Bank also has one home loan production office in the Tri-Cities, Washington. On November 15, 2018, the Company completed the acquisition of Anchor Bancorp which was merged with and into the Company, and immediately thereafter Anchor’s bank subsidiary, Anchor Bank was merged with and into 1st Security Bank of Washington (the “Anchor Acquisition”). The Anchor Acquisition added nine full-service bank branches within Grays Harbor, Thurston, Lewis, and Pierce counties, and one loan production office located in King County, Washington. The Anchor Acquisition expanded our Puget Sound-focused retail footprint and provided an opportunity to extend our unique brand of community banking into those communities. For additional information on the Anchor Acquisition, see Note 2 of the Notes to Consolidated Financial Statements included in “Item 8. Financial Statements and Supplementary Data” of this Form 10 K.

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

Analysis of Financial Condition and Results of Operations” of this Form 10 K.

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

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

Market Area

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

The primary market area for business operations is the Seattle-Tacoma-Bellevue, Washington Metropolitan Statistical Area (the "Seattle MSA"). Kitsap, Clallam, Jefferson, Thurston, Lewis, and Grays Harbor counties, though not in the Seattle MSA, are also part of the Company's market area. This overall region is typically known as the Puget Sound region. The population of the Puget Sound region as estimated by Puget Sound Regional Council was 4.1 million in 2018, over half of the state's population, representing a large population base for potential business. The region has a well-developed urban area in the western portion along Puget Sound, with the north, central and eastern portions containing a mixture of developed residential and commercial neighborhoods and undeveloped, rural neighborhoods.

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

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

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

From the Anchor Acquisition, we have entered three new counties, Thurston, Lewis, and Grays Harbor. Thurston County includes Olympia, home of Washington State's capital and its economic base is largely driven by state government related employment. Lewis County is supported by manufacturing, retail trade, local government and industrial services. Grays Harbor County has been historically dependent on the timber and fishing industries, but also relies on tourism, manufacturing, agriculture, shipping, transportation, and technology.

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In 2016, the median household income for King County was \$86,000, compared to \$67,000 for the State of Washington, and \$58,000 for the United States. Seattle has been listed in the top three most literate cities in the country every year since 2005 by an annual review conducted by Central Connecticut State University.

Unemployment in Washington was an estimated 4.3% at December 31, 2018, closely paralleling national trends as disclosed in the U.S. Bureau of Labor Statistics. King County had the lowest unemployment rate in the state at 3.3%, slightly decreased from 3.6% in the prior year, and much lower than the state average of 4.5% and national average of 4.1%, respectively. The estimated unemployment rate in Snohomish County at year end 2018 was 3.6%, slightly decreased from 4.0% at year end 2017. Kitsap County's unemployment rate improved slightly to 4.9% at December 31, 2018, compared to 5.0% at December 31, 2017. At December 31, 2018, the estimated unemployment rate in Pierce County was 5.3%, down from 5.4% at December 31, 2017. Grays Harbor County's, Thurston County's, and Lewis County's unemployment rate was 7.4%, 5.0%, and 6.9%, respectively at December 31, 2018, compared to 7.2%, 5.0%, and 6.7% at year end 2017, respectively. Outside of the Puget Sound area, the Tri-Cities market includes two counties, Benton and Franklin, and we have two full-service branches in Clallam County and two in Jefferson County. The estimated unemployment rate in Benton County at year end 2018 was 5.8%, down from 6.1% at year end 2017. At December 31, 2018, the estimated unemployment rate in Franklin County was down to 7.7%, from 8.0% at December 31, 2017. For Clallam and Jefferson counties, the estimated unemployment rates at December 31, 2018 decreased to 6.9% and 5.9%, respectively, compared to 7.0% and 6.2%, respectively at December 31, 2017.

According to the Washington Center for Real Estate Research, home values in the State of Washington continued to improve in 2018. For the quarter ended December 31, 2018, the average home value was \$657,000 in King County, \$473,000 in Snohomish County, \$387,000 in Jefferson County, \$345,000 in Kitsap County, \$342,000 in Pierce County, \$318,000 in Thurston County, \$296,000 in Clallam County, \$279,000 in both Benton and Franklin counties, \$227,000 in Lewis County, and \$200,000 in Grays Harbor County. Compared to the statewide average increase in home values of 1.1% in the fourth quarter of 2018, all counties: Benton, Franklin, Thurston, Jefferson, Pierce, Kitsap, Clallam, Snohomish, Grays Harbor, Lewis, and King counties outperformed the state average, with 10.9%, 10.9%, 10.3%, 8.4%, 8.4%, 7.8%, 7.4%, 7.0%, 6.0%, 4.6% and 2.5% increases in average home values, respectively.

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

Lending Activities

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

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Loan Portfolio Analysis. The following table sets forth the composition of the loan portfolio by type of loan at the dates indicated.

	December 31, 2018		December 31, 2017		December 31, 2016		December 31, 2015		December 31, 2014
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount
TE	\$ 204,699	15.43 %	\$ 63,611	8.22 %	\$ 55,871	9.23 %	\$ 50,034	9.78 %	\$ 42,970
and	247,306	18.65	143,068	18.50	94,462	15.60	80,806	15.80	57,813
family	40,258	3.04	25,289	3.27	20,081	3.32	16,540	3.24	15,737
(S)	249,397	18.80	163,655	21.16	124,009	20.48	102,921	20.13	46,801
ate	104,663	7.89	44,451	5.75	37,527	6.20	22,223	4.35	16,201
	846,323	63.81	440,074	56.90	331,950	54.83	272,524	53.30	179,522
	167,793	12.65	130,176	16.83	107,759	17.80	103,064	20.16	99,304
	44,433	3.35	41,049	5.31	36,503	6.03	29,226	5.72	18,162
er	57,822	4.36	35,397	4.58	28,549	4.71	23,851	4.66	16,713
er	5,425	0.41	2,046	0.26	1,915	0.32	2,181	0.43	2,628
	275,473	20.77	208,668	26.98	174,726	28.86	158,322	30.97	136,807
AL									
and	138,686	10.46	83,306	10.77	65,841	10.88	59,619	11.66	55,624
rcial	65,756	4.96	41,397	5.35	32,898	5.43	20,817	4.07	22,257
s	204,442	15.42	124,703	16.12	98,739	16.31	80,436	15.73	77,881
ross	1,326,238	100.00 %	773,445	100.00 %	605,415	100.00 %	511,282	100.00 %	394,210
r loan	(12,349)		(10,756)		(10,211)		(7,785)		(6,090)
s and	(2,907)		(2,708)		(1,887)		(962)		(946)
ns	1,537		1,577		—		—		—

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\$ 1,312,519

\$ 761,558

\$ 593,317

\$ 502,535

\$ 387,174

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The following table shows the composition of the loan portfolio by fixed- and adjustable-rate loans at the dates indicated.

December 31, 2018		2017		2016		2015		2014	
Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	
\$ 58,037	4.37 %	\$ 32,430	4.19 %	\$ 30,445	5.03 %	\$ 26,189	5.12 %	\$ 23,144	
25,613	1.93	286	0.04	—	—	315	0.06	322	
14,134	1.07	2,649	0.34	1,644	0.27	2,146	0.42	2,677	
45,126	3.40	11,804	1.53	10,267	1.69	9,305	1.82	8,108	
41,832	3.15	14,453	1.87	4,538	0.75	2,659	0.52	3,240	
184,742	13.92	61,622	7.97	46,894	7.74	40,614	7.94	37,491	
272,279	20.53	207,671	26.85	174,041	28.75	157,805	30.87	136,368	
59,195	4.46	32,835	4.24	26,901	4.45	17,440	3.41	16,197	
—	—	673	0.09	—	—	—	—	—	
59,195	4.46	33,508	4.33	26,901	4.45	17,440	3.41	16,197	
516,216	38.91	302,801	39.15	247,836	40.94	215,859	42.22	190,056	
146,662	11.06	31,181	4.03	25,426	4.20	23,845	4.66	19,826	
221,693	16.72	142,782	18.46	94,462	15.60	80,491	15.74	57,491	
26,124	1.97	22,640	2.93	18,437	3.05	14,394	2.82	13,060	
204,271	15.40	151,851	19.63	113,742	18.79	93,616	18.31	38,693	
62,831	4.74	29,998	3.88	32,989	5.45	19,564	3.83	12,961	
661,581	49.89	378,452	48.93	285,056	47.09	231,910	45.36	142,031	
3,194	0.24	997	0.13	685	0.11	517	0.10	439	
79,491	6.00	50,471	6.53	38,940	6.43	42,178	8.25	39,427	

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cial	65,756	4.96	40,724	5.26	32,898	5.43	20,818	4.07	22,257
	145,247	10.96	91,195	11.79	71,838	11.86	62,996	12.32	61,684
	810,022	61.09	470,644	60.85	357,579	59.06	295,423	57.78	204,154
oss	1,326,238	100.00 %	773,445	100.00 %	605,415	100.00 %	511,282	100.00 %	394,210
loan	(12,349)		(10,756)		(10,211)		(7,785)		(6,090)
and	(2,907)		(2,708)		(1,887)		(962)		(946)
ns	1,537		1,577		—		—		—
	\$ 1,312,519		\$ 761,558		\$ 593,317		\$ 502,535		\$ 387,174

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Loan Maturity and Repricing. The following table sets forth certain information at December 31, 2018, regarding the dollar amount and current note rates of interest for the loans maturing or repricing in the portfolio based on their contractual terms to maturity, but does not include scheduled payments or potential prepayments. Loan balances do not include undisbursed loan proceeds, unearned discounts, unearned income, and allowance for loan losses.

	Real Estate					
	Construction					
(Dollars in	and					Commercial
		Home	One-to-Four-Family			
thousands)	Commercial Development	Equity	(2)	Multi-family	Consumer	Business