**Risk Factors Comparison 2024-03-22 to 2023-03-14 Form: 10-K**

**Legend:** **New Text** ~~Removed Text~~ Unchanged Text Moved Text Section

We assume and manage a certain degree of risk in order to conduct our business strategy. In addition to the risk factors described below, other risks and uncertainties not specifically mentioned, or that are currently known to, or deemed to be immaterial by management, also may materially and adversely affect our financial condition, results of operations and cash flows. Before making an investment decision, you should carefully consider the risks described below together with all of the other information included in this Form 10- K and our other ~~filings~~ **documents filed** with **and furnished to** the SEC. If any of the circumstances described in the following risk factors ~~actually~~ occur to a significant degree, the value of our common stock could decline, and you could lose all or part of your investment. This report is qualified in its entirety by these risk factors. Risks Related to Macroeconomic Conditions A worsening of economic conditions in our market area could reduce demand for our products and services and result in increases in our level of nonperforming loans, which could adversely affect our operations, financial condition and earnings. Substantially all our loans are to businesses and individuals in the state of Washington. Accordingly, local economic conditions have a significant impact on the ability of our borrowers to repay loans and the value of the collateral securing loans. Further, as a result of a high concentration of our customer base in the Puget Sound area and eastern Washington state regions, the deterioration of businesses in these areas, or one or more businesses with a large employee base in these areas, could have a material adverse effect on our business, financial condition, liquidity, results of operations and prospects. A return of recessionary conditions or adverse economic conditions in our market areas may reduce our rate of growth, affect our customers' ability to repay loans and adversely impact our business, financial condition, and results of operations. Weakness in the global economy and global supply chain issues have adversely affected many businesses operating in our markets that are dependent upon international trade ~~, and it is not known how changes in tariffs being imposed on international trade may also affect these businesses~~. Changes in agreements or relationships between the United States and other countries may also affect these businesses. A deterioration in economic conditions in the markets we serve, in particular the Puget Sound area **and western region** of Washington State, could result in the following consequences, any of which could have a material adverse effect on our business, financial condition, liquidity and results of operations: • **Reduced** demand for our products and services ~~may~~ **, potentially leading to a** decline ~~;~~ **in our overall loans or assets.** • **Elevated instances of** loan delinquencies, ~~problem~~ **problematic** assets **,** and foreclosures ~~may~~ **. • An** increase **in** ~~; • we may increase~~ our allowance for ~~loan~~ **credit** losses ~~;~~ **on loans.** • **Depreciation in** collateral ~~for~~ **values linked to our** loans, ~~especially real estate, may decline in value,~~ thereby **diminishing** ~~reducing customers' future~~ borrowing **capacities** ~~power,~~ and ~~reducing the value of assets~~ - **asset values tied to** ~~and collateral associated with~~ existing loans ~~;~~ **.** • ~~the~~ **Reduced** net worth and liquidity of loan guarantors ~~may decline~~, **possibly** impairing their ability to ~~honor~~ **meet** commitments to us **.** ~~; and~~ • **Reduction in** ~~the amount of~~ our low- cost or noninterest- bearing deposits ~~may decrease~~. Moreover, a significant decline in local, regional or national economic conditions caused by inflation, recession, severe weather, natural disasters, widespread disease or pandemics, acts of terrorism, an outbreak of hostilities or other international or domestic calamities, unemployment or other factors beyond our control could negatively affect the financial results of our banking operations. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans and leases, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue or cause us to incur additional expenses. **External economic factors, such as changes in monetary policy and** ~~Inflationary~~ --- **inflation** ~~pressures~~ and ~~rising prices~~ **deflation,** may **have an adverse** ~~affect~~ **effect on** our **business,** ~~results of operations and~~ financial condition **and results of operations. Our financial condition and results of operations are affected by credit policies of monetary authorities, particularly the Federal Reserve. Actions by monetary and fiscal authorities, including the Federal Reserve, could lead to inflation, deflation, or other economic phenomena that could adversely affect our financial performance**. Inflation has risen sharply since the end of 2021 ~~to~~ **and throughout 2022 at** levels not seen **for over** ~~in more than~~ 40 years **. Inflationary pressures, while easing recently, remained elevated throughout the first half of 2023**. Small to medium- sized businesses may be impacted more during periods of high inflation, as they are not able to leverage economics of scale to mitigate cost pressures compared to larger businesses. Consequently, the ability of our business customers to repay their loans may deteriorate ~~, and in some cases this deterioration may occur~~ quickly, which would adversely impact our results of operations and financial condition. Furthermore, a prolonged period of inflation could cause wages and other costs to the Company to increase, which could adversely affect our results of operations and financial condition. **Virtually all** ~~The economic impact of the COVID- 19 pandemic could continue to affect~~ our **assets** ~~financial condition~~ and **liabilities are monetary** ~~results of operations. The COVID- 19 pandemic has adversely impacted the global and national economy and certain industries and geographies~~ in ~~which our clients operate. Given its ongoing and dynamic~~ nature ~~, it is difficult to predict the full impact of the COVID- 19 pandemic on the Company and its clients, employees and third- party service providers~~. **As** ~~The extent of this impact will depend on future developments, which are highly uncertain. Additionally, the responses of various governmental and nongovernmental authorities and consumers to the pandemic may have material long- term effects on the Company and its clients which are difficult to quantify in the near- term or long- term. We could be subject to~~ a ~~number of risks as the~~ result ~~of the COVID- 19 pandemic~~, ~~any of which could~~ **interest rates tend to** have a ~~material adverse effect~~ **more significant impact** on our **performance than general levels** ~~business, financial condition, liquidity, results~~ of **inflation** ~~operations, ability to execute our~~ - **or deflation** ~~growth strategy, and ability to pay dividends~~. **Interest rates do** ~~These risks include, but are~~ not **necessarily move** ~~limited to, changes~~ in ~~demand~~ **the same direction** ~~for~~ - **or** ~~our products~~ **by the same magnitude as the prices of goods** and services ~~; increased loan losses or other impairments in our loan portfolios and~~

~~increases in our allowance for loan losses; a decline in collateral for our loans, especially real estate; unanticipated unavailability of employees; increased cyber security risks as employees work remotely; a prolonged weakness in economic conditions resulting in a reduction of future projected earnings that could necessitate a valuation allowance against our current outstanding deferred tax assets; a triggering event leading to impairment testing on our intangible assets, which could result in an impairment charge; and increased costs as we and our regulators, customers and vendors adapt to evolving pandemic conditions~~ . Risks Related to Our Lending Our loan portfolio includes loans with a higher risk of loss. Our origination of commercial and multifamily real estate, construction and land, consumer and commercial business loans, typically present different risks to us than our one- to- four family residential loans for a number of reasons, including as follows: • Construction and Land Loans. **Construction** ~~This type of~~ lending **carries** ~~is subject to the~~ inherent ~~difficulties~~ **uncertainties** in estimating ~~both~~ a property ~~'~~ **'** s **future** value ~~at~~ **upon project** completion ~~of a~~ **and the overall cost, encompassing interest, for** project **fulfillment** ~~and the estimated cost (including interest) of the project~~ . ~~The~~ **These** uncertainties ~~inherent~~ **arise from challenges** in estimating construction costs, **assessing** ~~as well as~~ the market value **upon** ~~of a completed~~ project **completion,** and **considering** the ~~effects~~ **impact** of governmental ~~regulation~~ **regulations** on real property **. Consequently** , ~~make it difficult to evaluate~~ accurately **evaluating** the total funds required to complete a project and **determining** the ~~completed project's~~ loan- to- value ratio **for the completed project is often challenging** . We may ~~be required to~~ **encounter scenarios where** ~~advance~~ **advancing** funds beyond the **committed** amount ~~originally committed~~ **becomes necessary** to ensure **project** completion **due to inaccurate estimations** ~~of the project if our estimate of the value~~ of construction ~~cost~~ **costs , potentially resulting in** ~~proves to be inaccurate. We may have~~ inadequate security for ~~the~~ **loan** repayment ~~of the loan~~ upon **project** completion ~~of construction of the project~~ and **subsequent** ~~may incur a loss~~ **losses** ~~if our appraisal of the value of a completed project proves to be overstated~~ . ~~Disagreements~~ **Challenges such as disputes** between borrowers and builders **,** ~~and the failure of builders~~ - **builder failures** to pay subcontractors **, and the concentration** ~~may also jeopardize projects. This type~~ of ~~lending also typically involves~~ higher loan ~~principal~~ amounts **among** ~~and may be concentrated with~~ a ~~small~~ **limited** number of builders **further increase risk exposure** . A downturn in **the** housing or ~~the~~ real estate market could ~~increase~~ **escalate** delinquencies, defaults **,** and foreclosures, **substantially** ~~and significantly impair~~ **impairing** ~~the value of our~~ collateral **values** and **complicating** ~~our ability to sell~~ the ~~collateral upon~~ **process of selling** ~~foreclosure~~ -- **foreclosed properties** . **Multiple loans** ~~Some of the builders we deal~~ with ~~have more than~~ **a single builder amplify our risk exposure, wherein adverse developments in** one loan ~~outstanding with us. Consequently, an adverse development with respect to one loan~~ or ~~one~~ credit relationship ~~can expose~~ -- **pose** ~~us to a significantly~~ -- **significant** ~~greater risk of~~ loss **potential** . ~~In addition, during the term of some~~ **Some** ~~of our~~ construction loans **involve interest accumulation without** ~~, no payment from the~~ borrower ~~is required since the accumulated~~ **payments, impacting construction loan dynamics if market** interest ~~is added to the principal of the loan through an interest reserve. Increases in market~~ rates **rise, leading to increased** ~~of interest may have a more pronounced effect on construction loans by rapidly increasing the end- purchaser' s~~ borrowing costs ~~, thereby possibly~~ **for end purchasers and potentially** reducing **homebuyer** ~~the homeowner' s ability to finance~~ **financing capabilities** ~~the home upon completion~~ or ~~the~~ overall **project** demand ~~for the project~~ . Properties under construction are **challenging to sell and** often **necessitate completion before** ~~difficult to sell and typically must be completed in order to be successfully~~ -- **successful** ~~sold which also~~ **sale, further** ~~complicates~~ **complicating** the ~~process~~ **management** of ~~managing our problem~~ **problematic** construction loans. This ~~may~~ **could** require ~~us to advance~~ additional ~~funds~~ - **fund allocation** ~~and /~~ or ~~contract~~ **engagement** with ~~another~~ **alternate** ~~builder~~ **builders , adding** ~~to complete construction and assume the~~ market ~~risk~~ **risks** ~~of~~ **in** selling ~~the project~~ **projects** at ~~a~~ future market ~~price~~ **prices that** ~~, which may or~~ may not ~~enable us to fully recover~~ -- **cover** ~~unpaid~~ **outstanding** loan funds **,** ~~and associated~~ construction **,** and liquidation costs. **Our construction** ~~Loans~~ **loans** ~~on~~ **include those with finalized sales contracts or permanent loans for finished homes** ~~land~~ - **and** ~~under development~~ **speculative construction loans where purchasers may not be identified during or post- construction. Speculative construction loans to builders pose higher potential risks than loans** ~~or~~ **for** ~~held~~ **personal residences. We aim to mitigate these risks by actively monitoring unsold homes in our portfolio, local housing markets, and balancing home sales with new loan originations. We consider various factors, including builder financial capacity, market demand, and inventory ratios, while working with numerous small and mid- sized builders across geographic regions within our service area to diversify speculative construction lending risks. Land loans** for future **development entail** ~~construction also pose~~ additional ~~risk~~ **risks** ~~because of~~ **due to** the lack of income **generation from** ~~being produced by~~ the property and ~~the~~ potential ~~illiquid~~ **illiquidity** ~~nature~~ of ~~the~~ collateral **and are** ~~. These risks can be~~ significantly ~~impacted~~ **affected** by supply and demand **dynamics** . **Hence** ~~As a result~~ , **such** ~~this type of~~ lending ~~often~~ involves **disbursing** ~~the disbursement of~~ substantial funds **,** with repayment dependent on ~~the~~ **project** success ~~of the ultimate project~~ and the **borrower' s** ability ~~of the borrower~~ to sell or lease the property or obtain permanent ~~take- out~~ financing, rather than ~~the ability of the borrower or guarantor to independently~~ -- **independent repayment** ~~repay principal and interest. Construction loans made by us include those with a sales contract or permanent loan in place for the finished homes and those for which purchasers for the finished homes may not be identified either during or following the construction period, known as speculative construction loans. Speculative construction loans to a builder pose a greater potential risk to us than construction loans to individuals on their personal residences. We attempt to mitigate this risk by actively monitoring the number of unsold homes in our construction loan portfolio and local housing markets to attempt to maintain an appropriate balance between home sales and new loan originations. In addition, the maximum number of speculative construction loans (loans that are not pre- sold) approved for each builder is based on a combination of factors, including the financial capacity~~ **capability** ~~of the builder, the market demand for the finished product and the ratio of sold to unsold inventory the builder maintains. We have also attempted to diversify the risk associated with speculative construction lending by doing business with a large number of small and mid- sized builders spread over a relatively large geographic region representing numerous sub- markets within our service area~~ . • Commercial and Multifamily Real Estate Loans. ~~These~~ **Our commercial and multifamily real estate** loans ~~typically~~ **generally** involve higher principal amounts ~~than~~ **compared to** other **loan** types **,** ~~of loans~~ and some ~~of our~~ commercial borrowers **maintain multiple** ~~have more than one loan~~ **loans** ~~outstanding~~ with us. Consequently, an adverse development **in any single** ~~with respect to one~~ loan or ~~one~~ credit relationship can **significantly heighten our** ~~expose~~ **exposure** ~~us~~ to **potential losses, far more than the impact of** a **similar** ~~significantly greater risk of loss compared to an adverse~~ development **in** ~~with respect to~~ a one- to- four family residential mortgage loan. **The** ~~Repayment~~ **repayment** of these loans **relies on** ~~is dependent upon~~ income ~~being~~ generated from the property securing the loan ~~in amounts~~ **. This income must** ~~sufficient~~ **sufficiently** ~~to~~ cover ~~operating~~ **operational** expenses and debt service **. Economic fluctuations** ~~, which may be adversely affected by changes in the economy~~ or **shifts in** local market conditions ~~. In addition, many~~ - **may adversely affect the property' s income, posing potential repayment challenges. Moreover, a substantial portion** of our commercial and multifamily real estate loans ~~are~~ **do** not fully ~~amortizing~~ **amortize** and ~~contain large~~ **include substantial** balloon payments upon maturity. ~~Such~~ **These** balloon payments may require the borrower to either sell or refinance the ~~underlying~~ property ~~in order to make the payment~~ , **potentially heightening** ~~which may increase~~ the risk of default or non- payment. ~~If we~~ **In the event of a** ~~foreclose~~ **foreclosure** on a commercial or multifamily real estate loan, our holding period for the collateral ~~typically is longer than for~~ **tends to be more extended compared to** one- to- four family residential loans ~~because there are fewer~~ **. This elongated holding period results from a limited pool of** potential purchasers ~~of~~ **for** the collateral. ~~In recent~~ **Recent** years ~~,~~ **have witnessed substantial growth in** commercial real estate markets ~~have been experiencing substantial growth~~ , ~~and increased~~ **compounded by intensified** competitive pressures **that** have **led** ~~contributed significantly~~ to historically low capitalization rates and ~~rising~~ **surging** property ~~values~~ **valuations** . **The** ~~Furthermore, commercial real estate markets have been particularly impacted by the~~ economic disruption ~~resulting from~~ **spurred by** the ~~COVID- 19 pandemic. The~~ COVID- 19 pandemic has ~~also been a catalyst for~~ **particularly affected commercial real estate markets. Additionally,** the ~~evolution~~ **pandemic has accelerated the adoption** of ~~various~~ remote work options ~~which could impact~~ **, potentially influencing** the long- term performance of **certain office** ~~some types of~~ properties within our commercial real estate portfolio. ~~Accordingly~~ **Moreover** , the federal banking regulatory agencies have ~~expressed~~ **raised** concerns about ~~weaknesses in~~ **vulnerabilities within** the current commercial real estate market **, recognizing the risks associated with these assets** . Failures in our risk management policies, procedures **,** and controls could **impede** ~~adversely affect~~ our ability to **effectively** manage this portfolio **, potentially leading to** ~~and could result in an~~ increased ~~rate of~~ delinquencies ~~in,~~ and ~~increased~~ **higher** losses ~~from~~ , **thereby** ~~this portfolio, which could have a material~~ **materially impacting** ~~adverse effect on~~ our business, financial condition **,** and ~~results of operations~~ **operational performance** . • Commercial Business Loans. Our commercial business loans are primarily made based on the cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. A borrower ~~'~~ **’** s cash flow may prove to be unpredictable, and collateral securing these loans may fluctuate in value. Most often, this collateral includes accounts receivable, inventory, equipment or real estate. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. Other collateral securing **commercial business** loans may depreciate over time, may be difficult to appraise, may be illiquid and may fluctuate in value based on the success of the business. • Consumer Loans. Generally, we consider ~~these~~ **consumer** loans to involve a different degree of risk compared to first mortgage loans on one- to- four family residential properties. As a result of our large portfolio of ~~these~~ **consumer** loans, ~~it~~ **we** may **need** ~~become necessary~~ to increase the level of our ~~provision~~ **allowance** for ~~loan~~ **credit** losses **on loans** , which could decrease our profits. Consumer loans ~~generally entail greater risk than do one- to- four family residential mortgage loans~~ , particularly ~~in the~~ **those** ~~case of loans that are~~ secured by **assets that depreciate** rapidly **like** ~~depreciable assets, such as~~ manufactured homes, automobiles **,** and recreational vehicles ~~. In these cases~~ , ~~any~~ **generally carry a higher risk. Upon default,** repossessed collateral **from these** ~~for a defaulted loan~~ **loans** ~~may~~ **might** not ~~provide an adequate~~ **adequately cover** ~~source of repayment of~~ the outstanding loan balance. **In particular,** ~~Manufactured~~ **manufactured** ~~homes are a riskier form of collateral, though this risk is reduced if the owner also owns the land on which the~~ home ~~is located, because~~ **loans pose higher risks due to** ~~they~~ - **the** ~~are costly~~ -- **cost** and ~~difficult~~ **difficulty** ~~to~~ **of** ~~relocate~~ **relocating the manufactured home** when repossessed ~~,~~ and ~~difficult to sell due to~~ **the limited market for resale, especially with** the diminishing number of manufactured home parks in the Puget Sound area. **A significant** ~~Additionally, a good~~ portion of our manufactured home loan borrowers are first- time home buyers, **typically exhibiting** ~~who tend to be a~~ higher credit risk ~~than first- time home buyers of single- family residences,~~ due to ~~more~~ limited financial resources. **Consequently** ~~As a result~~ , these loans tend to **experience increased** ~~have a higher probability of~~ default **probabilities** , higher delinquency rates and greater servicing costs ~~than~~ **compared to** other ~~types of~~ consumer loans. ~~Our floating~~ **Floating** home, houseboat **,** and house barge loans are typically located on cooperative or condominium moorages. The primary risk **of these** ~~in floating home~~ loans ~~is~~ **stems from** the ~~unique~~ **distinctive** nature of the collateral and the ~~challenges of~~ **complexities involved in** relocating such ~~collateral~~ **property** to ~~a~~ **permissible** ~~location~~ **locations** ~~other than where such housing is permitted~~ . The process for securing ~~the deed~~ **deeds** ~~and /~~ or ~~the~~ **rights within** condominium or cooperative ~~dock~~ **docks** ~~is also unique compared to~~ **in this lending area differs significantly from our** other **loan** types **, potentially** ~~of lending we participate in. As a result~~ **resulting in** ~~, these loans may have~~ higher **costs associated with** collateral recovery **compared to** ~~costs than for~~ one- to- four family mortgage loans and other ~~types of~~ consumer loans. Our business may be adversely affected by credit risk associated with residential property and declining property values. Our first- lien one- to- four family real estate loans are primarily made based on the repayment ability of the borrower and the collateral securing these loans. Home equity lines of credit generally entail greater risk than do one- to- four family residential mortgage loans where we are in the first- lien position. For those home equity lines secured by a second mortgage, it is less likely that we will be successful in recovering all of our loan proceeds in the event of default. Our foreclosure on these loans requires that the value of the property be sufficient to cover the repayment of the first mortgage loan, as well as the costs associated with foreclosure. This type of lending is generally sensitive to regional and local economic conditions that significantly impact the ability of borrowers to meet their loan payment obligations, making loss levels difficult to predict. A downturn in the economy or the housing market in our market areas or a rapid increase in interest rates may reduce the value of the real estate collateral securing these types of loans and increase the risk that we would incur losses if borrowers default on their loans. Residential loans with high combined loan- to- value ratios generally will be more sensitive to declining property values than those with lower combined loan- to- value ratios and therefore may experience a higher incidence of default and severity of losses. In addition, if the borrowers sell their homes, the borrowers may be unable to repay their loans in full from the sale proceeds. As a result, these loans may experience higher rates of delinquencies, defaults and losses, which will in turn adversely affect our financial condition and results of operations. A majority of our residential loans are “ non- conforming ” because they are adjustable- rate mortgages which contain interest rate floors or do not satisfy credit or other requirements due to personal and financial reasons (i. e., divorce, bankruptcy, length of time employed, etc.), conforming loan limits (i. e., jumbo mortgages), and other requirements imposed by secondary market purchasers. Some of these borrowers have higher debt- to- income ratios, or the loans are secured by unique properties in rural markets for which there are no sales of comparable properties to support the value according to secondary market requirements. We may require additional collateral or lower loan- to- value ratios to reduce the risk of these loans. We believe that these loans satisfy a need in our local market areas. As a result, subject to market conditions, we intend to continue to originate these types of loans. Our allowance for ~~loan~~ **credit** losses **on loans** may prove inadequate or we may be negatively affected by credit risk exposures. Future additions to our allowance for ~~loan~~ **credit** losses **on loans** , as well as charge- offs in excess of reserves, will reduce our earnings. Our business ~~depends~~ **relies significantly** on the creditworthiness of our customers. ~~As with most financial institutions~~ **To account for potential defaults and nonperformance in our loan portfolio** , we maintain an allowance for ~~loan~~ **credit** losses ~~to reflect potential defaults and nonperformance, which~~ **on loans using the Current Expected Credit Loss (“ CECL ”) methodology. This allowance** represents management ~~'~~ **’** s best estimate of ~~probable incurred~~ **the lifetime expected credit** losses ~~inherent~~ in ~~the~~ **our** loan portfolio. ~~Management's estimate~~ **The amount of this allowance** is **determined by management through periodic reviews and consideration of several factors, including, but not limited to: • our collective loss reserve, for loans evaluated on a pool basis with similar risk characteristics** based on our **life** ~~continuing evaluation~~ of ~~specific credit risks and~~ loan **historical default and** loss experience, ~~current~~ **certain macroeconomic factors, reasonable and supportable forecasts, regulatory requirements, management’ s expectations of future events and certain qualitative factors; and • our individual loss reserve, based on our evaluation of individual** ~~loan~~ **loans** ~~portfolio quality,~~ **that do not share similar risk characteristics and the** present **value of** ~~economic, political and regulatory conditions, industry concentrations and other~~ -- **the expected** ~~factors that may indicate~~ future ~~loan losses~~ **cash flows or the fair value of the underlying collateral** . The determination of the appropriate ~~level of the~~ allowance for ~~loan~~ **credit** losses ~~inherently~~ involves a ~~high~~ **significant** degree of subjectivity **, relying on substantial** ~~and judgment and requires us to make~~ estimates of **both** current credit risks and future trends, all of which ~~may undergo~~ **are subject to potential** material changes. ~~There is no certainty that the~~ **Inaccuracies in our estimations could lead to an insufficient** allowance for ~~loan losses will be adequate over time to cover~~ credit losses ~~in~~ **, necessitating increases through provisions for credit losses, adversely impacting our recorded income. Additionally, as we acknowledge the potential impact of significant portfolio growth, new loan products, and refinancing activities,** ~~the~~ **these actions may result in portfolios consisting of unseasoned loans that may not perform as anticipated, elevating the risk of an inadequate allowance to absorb losses without additional provisions. A material decrease in the credit quality of our** loan portfolio **, significant** ~~because of unanticipated adverse~~ changes in ~~the economy, market conditions or events adversely affecting specific customers, industries or markets. If the credit quality of our loan portfolio materially decreases, if~~ the risk profile of ~~a market~~ **markets** , ~~industry~~ **industries ,** or ~~group of customers~~ - **customer groups** ~~changes materially~~ , or ~~if~~ **inadequacy in** the allowance for ~~loan~~ **credit** losses ~~is not adequate,~~ **could have a materially adverse impact on** our business, financial condition, liquidity, capital, and results of operations ~~could be materially adversely affected~~ . Risks Related to Market and Interest Rate Changes Fluctuating interest rates can adversely affect our profitability. ~~Net~~ **Our net** income is **primarily derived from** the **excess of** ~~amount by which~~ net interest income and **non-** ~~noninterest income exceed noninterest expense, the provision for loan losses and taxes. Net~~ interest income ~~makes up a majority~~ **over non- interest expenses, provisions for credit losses, and taxes. The core component** of our net income ~~and~~ is **net** ~~based on the difference between the~~ interest income ~~we earn~~ **, which centers** on **the variance between the interest income accrued from** interest- earning assets, such as loans and securities, and the interest expense **incurred** ~~we pay~~ on interest- bearing liabilities, **mainly** ~~such as~~ deposits and borrowings. The yields we earn on our **interest- earning** assets and the rates we pay on our **interest- bearing** liabilities are generally fixed for a contractual period of time. Like many financial institutions, our liabilities generally have shorter contractual maturities than our assets. This ~~imbalance can create~~ **mismatch exposes us to** significant earnings volatility ~~because~~ **as** market interest rates **fluctuate** ~~change over time~~ . **Shifts** ~~In addition, changes~~ in interest rates can ~~affect~~ **also impact** the average ~~life~~ **lifespan** of loans and mortgage- backed ~~and related~~ securities. In ~~a period~~ **periods** of rising interest rates, the **growth rate of** interest income ~~we earn~~ **from our interest- earning assets might lag behind the accelerating interest expenses** on our ~~assets may not increase as rapidly as the~~ interest **- bearing** ~~we pay on our~~ liabilities. ~~A~~ **Conversely,** ~~decline~~ **declining** ~~in~~ interest rates ~~results in~~ **can trigger** increased **loan** prepayments ~~of loans~~ and mortgage- backed ~~and related securities~~ **security redemptions** as borrowers **seek lower** ~~refinance their debt to reduce their~~ borrowing costs **through refinancing** . This ~~creates~~ **introduces** reinvestment risk, **where** ~~which is~~ the **challenge lies in** ~~risk that we may not be able to reinvest~~ **reinvesting** prepayments at rates ~~that are~~ comparable to ~~the~~ **those initially** ~~rates we~~ earned on the prepaid loans or securities. ~~Furthermore~~ **Moreover** , an inverted interest rate yield curve, ~~where~~ **wherein** short- term interest rates (which are usually the rates at which financial institutions borrow funds) **surpass** ~~are higher than~~ long- term ~~interest~~ rates (which are usually the rates at which financial institutions lend funds for fixed- rate loans) **,** can ~~reduce~~ **compress** a financial institution ~~'~~ **'** s net interest margin ~~and create~~ **. This occurrence poses** financial ~~risk~~ **risks , particularly** for ~~financial~~ institutions that originate longer- term, fixed- rate mortgage loans. ~~At~~ **As of** December 31, ~~2022~~ **2023** , ~~50~~ **approximately 52** . ~~7~~ **2** % of our loan portfolio consisted of fixed- rate loans ~~. In addition~~ , ~~at~~ **potentially exposing us to these risks. As is the case with many banks, we attempt to increase our**

**proportion of deposits comprising either no or relatively low- interest- bearing accounts, which has been challenging over the last couple years. As of** December 31, ~~2022~~ **2023** , ~~49. 3 % of our loans had floating or~~ **our** ~~variable~~ **deposit composition included $ 249. 5 million in certificates of deposit maturing within one year and $ 518. 6 million in** ~~interest~~ **noninterest - bearing** ~~rates. As a result~~ , ~~these loans may experience a higher rate of default in a rising~~ **NOW checking, savings, and money market accounts. In an increasing** interest rate environment ~~. Further~~ , **retaining** ~~approximately $ 294. 1 million or 68. 7 % of~~ these **deposits could lead to a higher cost of funds,** ~~floating or variable interest rate loans have interest rate floors below~~ which **has been** ~~the loan' s contractual interest rate may not adjust, of which $ 145. 6 million were at their~~ -- **the case over the last couple** ~~floors at December 31, 2022. The inability~~ of **years. Should** ~~our loans to adjust downward can contribute to increased income in periods of declining~~ interest rates ~~, although this is subject to the risk~~ **associated with our deposits and borrowings increase at a faster pace** ~~that~~ **than** ~~borrowers may refinance these~~ -- **the rates received from** loans **and** ~~during periods of declining interest rates. Also, when loans are at their~~ - **other** ~~floors~~ **investments** , ~~there is a further risk that~~ our **net** interest income **and overall earnings might be** ~~may not increase as rapidly as our cost of funds during periods of increasing interest rates, which could have a material adverse~~ **adversely affected** ~~effect on our results of operations. Any substantial prolonged change in market interest rates could have a material adverse effect on our financial condition, liquidity and results of operations~~ . Since March 2022, in response to inflationary pressures, the Federal Open Market Committee (" FOMC ") of the Federal Reserve has increased the target range for the federal funds rate by ~~425~~ **525** basis points, including ~~125~~ **100** basis points during ~~the fourth calendar quarter of 2022~~ **2023** , to a range of ~~4~~ **5** . 25 % to ~~4~~ **5** . 50 % as of December 31, ~~2022. As it seeks to control inflation without creating a recession, the FOMC increased the target range another 25 basis points, to a range of 4. 50 % to 4. 75 %, in February~~ 2023 ~~and has indicated further increases are expected during 2023~~ . **A sustained and substantial change in market** ~~If the FOMC further increases the targeted federal funds rate, overall~~ interest rates **could significantly** ~~will likely continue to rise, which should positively~~ impact our ~~net~~ **financial condition, liquidity, and operational results. Furthermore, fluctuations in** interest **rates could adversely affect** ~~income but may negatively impact both~~ the **valuation of our assets** ~~housing market, by reducing refinancing activity~~ and **liabilities** ~~new home purchases~~ , **ultimately affecting our earnings** ~~and the U. S. economy more broadly~~ . Changes in the valuation of our securities portfolio could hurt our profits and reduce our capital levels. Our securities portfolio may be impacted by fluctuations in market value, potentially reducing accumulated other comprehensive income and / or earnings. Fluctuations in market value may be caused by changes in market interest rates, lower market prices for securities and limited investor demand. Management evaluates securities for ~~OTTI~~ **credit losses** on a quarterly basis, with more frequent evaluation for selected issues. In analyzing a debt issuer' s financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred and industry analysts' reports. Changes in interest rates can also have an adverse effect on our financial condition, as our **AFS** ~~available- for- sale~~ securities are reported at their estimated fair value, and therefore are impacted by fluctuations in interest rates. We increase or decrease our stockholders' equity by the amount of change in the estimated fair value of the **AFS** ~~available- for- sale~~ securities, net of taxes. Declines in market value could result in ~~OTTI~~ **credit** losses on these assets, which would lead to accounting charges that could have a material adverse effect on our net income and capital levels. At December 31, ~~2022~~ **2023** , we had no **allowance for credit losses on** securities ~~that were deemed impaired~~ . An increase in interest rates, change in the programs offered by Fannie Mae or our ability to qualify for its programs may reduce our mortgage revenues, which would negatively impact our noninterest income. The sale of residential mortgage loans to Fannie Mae provides a significant portion of our non- interest income. ~~Any future~~ **Future** changes in ~~its~~ **Fannie Mae' s** program, **including** our eligibility to participate ~~in such program~~ , the criteria for loans to be accepted or laws that significantly affect the activity of Fannie Mae could ~~, in turn,~~ materially adversely affect our results of operations if we could not find other purchasers. Mortgage banking is generally considered a volatile source of income because it depends largely on the level of loan volume which, in turn, depends largely on prevailing market interest rates. In a rising or higher interest- rate environment, the demand for mortgage loans, particularly refinancing of existing mortgage loans, tends to fall and our originations of mortgage loans may decrease, resulting in fewer loans that are available to be sold. This would result in a decrease in mortgage revenues and a corresponding decrease in noninterest income. In addition, our results of operations are affected by the amount of noninterest expense associated with our loan sale activities, such as salaries and employee benefits, occupancy, equipment and data processing expense and other operating costs. During periods of reduced loan demand, our results of operations may be adversely affected to the extent that we are unable to reduce expenses commensurate with the decline in loan originations. In addition, although we sell loans to Fannie Mae or into the secondary market without recourse, we are required to give customary representations and warranties about the loans we sell. If we breach those representations and warranties, we may be required to repurchase the loans and we may incur a loss on the repurchase. We may incur losses in the fair value of our mortgage servicing rights due to changes in prepayment rates. Our mortgage servicing rights carry interest- rate risk because the total amount of servicing fees earned, as well as changes in fair market value, fluctuate based on expected loan prepayments (affecting the expected average life of a portfolio of residential mortgage servicing rights). The rate of prepayment of residential mortgage loans may be influenced by changing national and regional economic trends, such as recessions or stagnating real estate markets, as well as the difference between interest rates on existing residential mortgage loans relative to prevailing residential mortgage rates. During periods of declining interest rates, many residential borrowers refinance their mortgage loans. Changes in prepayment rates are therefore difficult for us to predict. The loan administration fee income (related to the residential mortgage loan servicing rights corresponding to a mortgage loan) decreases as mortgage loans are prepaid. Consequently, if prepayment rates increase, we would expect the fair value of portfolios of residential mortgage loan servicing rights to decrease along with the amount of loan administration income received. Risks Related to Cybersecurity, Data and Fraud A failure in or breach of our security systems or infrastructure, including breaches resulting from cyber- attacks, could disrupt our business, result in the disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs and cause losses. **The integrity of our security systems and infrastructure is crucial. Any failure or breach, including those arising from cyber- attacks, has the potential to disrupt our business operations, leading to the disclosure or misuse of confidential** ~~Information~~ **information , detrimental effects on our reputation, increased operational costs, and financial losses. The landscape of information** security risks for financial institutions **has expanded significantly due to** ~~have increased in recent years in part because of~~ the proliferation of new technologies, the **widespread** use of the Internet and telecommunications **for** ~~technologies to conduct~~ financial transactions, and the **escalating** ~~increased sophistication and~~ activities of organized crime, hackers, terrorists, activists, and other external **entities. These** parties ~~. Those parties also~~ may attempt to **deceive** ~~fraudulently induce~~ employees, customers, or ~~other~~ **system** users ~~of our systems~~ to ~~disclose~~ **extract** confidential information **, thereby gaining** ~~in order to gain~~ access to our data or that of our customers. Our operations **heavily** rely on the secure processing, transmission **,** and storage of confidential information ~~in~~ **within** our computer systems and networks, ~~either~~ managed directly by us or through ~~our~~ **third- party** data processing vendors. **Additionally** ~~In addition, to access our products and services~~ , our customers ~~may~~ use personal computers, smartphones, ~~tablet~~ **tablets** ~~PCs~~ , and other mobile devices ~~that~~ **to access our services, which** are beyond our **direct** control ~~systems~~ . **While** ~~Although we believe~~ we have robust information security procedures and controls **in place** , **our reliance** ~~we rely heavily~~ on ~~our~~ third **-** party vendors, technologies, systems, networks **,** and ~~our~~ customers ~~'~~ **'** devices **makes** ~~all of which may become the~~ **them** ~~target of~~ **susceptible to** cyber- attacks, ~~computer~~ viruses ~~, malicious code~~ , unauthorized access, hackers **,** or ~~information~~ security breaches ~~that~~ **. Such incidents** could **lead to** ~~result in the~~ unauthorized **data** ~~release~~ **releases** ~~, gathering~~ , monitoring, misuse, ~~loss,~~ theft **,** or destruction of ~~our~~ confidential ~~, proprietary and other~~ information **, disrupting** ~~or~~ **our** ~~that~~ **operations or those** of our customers **and** ~~, or disrupt our operations or those of our customers or~~ third parties. To date, we have not incurred **substantial** ~~any material~~ losses **from** ~~relating to~~ cyber- attacks or ~~other information~~ security breaches ~~, but there can be no assurance that we will not suffer such attacks, breaches and losses in the future~~ . **However** ~~Our risk and exposure to these matters remains heightened because of, among other things~~ , the evolving nature of ~~these~~ threats and our **ongoing** plans to **advance** ~~continue to evolve~~ our internet ~~banking~~ and mobile banking ~~channel~~ **channels heighten our exposure to these risks** . As a result, **continuously** ~~the continued development~~ **developing** and **enhancing** ~~enhancement of~~ our information security controls, processes **,** and practices ~~designed~~ to ~~protect~~ **safeguard** customer information, ~~our~~ systems, computers, software, data **,** and networks ~~from attack, damage or unauthorized access remain~~ **remains** a **management** priority ~~for our management~~ . ~~As~~ **With the evolving nature of** cyber threats ~~continue to evolve~~ , we may **need** ~~be required~~ to ~~expend~~ **allocate** significant additional resources to **bolster** ~~insure, modify or enhance~~ our protective measures or ~~to~~ investigate and ~~remediate important~~ **address crucial** information security vulnerabilities or exposures **. Despite** ~~; however,~~ our ~~measures may be insufficient to~~ **efforts, they might not** prevent all physical and electronic **intrusions** ~~break- ins~~ , denial of service **,** ~~and other~~ cyber- attacks **,** or security breaches. Disruptions or failures in the physical infrastructure or operating systems ~~that support~~ **supporting** our business and customers, or ~~cyber- attacks or security~~ breaches ~~of~~ **in** the networks, systems **,** or devices ~~that our~~ **used by** customers ~~use to access~~ **accessing** our ~~products and~~ services **,** could result in customer attrition, uninsured financial losses, ~~the inability of our customers~~ - **customer** ~~to transact~~ **transaction disruptions** ~~business with us~~ , ~~employee~~ productivity losses, technology replacement costs, incident response ~~costs~~ **expenses** , **legal** ~~violations of applicable privacy~~ and ~~other laws,~~ regulatory **repercussions** ~~fines, penalties or intervention, additional regulatory scrutiny~~ , reputational damage, litigation, reimbursement or ~~other~~ compensation costs, and ~~/ or~~ additional compliance ~~costs, any~~ **expenses. Any** of ~~which~~ **these outcomes** could ~~materially~~ **significantly** and adversely affect our ~~results of operations or~~ financial condition **or operational results** . The failure to protect our customers' confidential information and privacy could adversely affect our business. We are subject to federal and state privacy regulations and confidentiality obligations that, among other things **,** restrict the use and dissemination of, and access to, certain information that we produce, store or maintain in the course of our business. We also have contractual obligations to protect certain confidential information we obtain from our existing vendors and customers. These obligations generally include protecting such confidential information in the same manner and to the same extent as we protect our own confidential information, and in some instances may impose indemnity obligations on us relating to unlawful or unauthorized disclosure of any such information. If we do not comply with privacy regulations and contractual obligations that require us to protect confidential information, or if we experience a security breach or network compromise, we could experience adverse consequences, including regulatory sanctions, penalties or fines, increased compliance costs, remedial costs such as providing credit monitoring or other services to affected customers, litigation and damage to our reputation, which in turn could result in decreased revenues and loss of customers, all of which would have a material adverse effect on our business, financial condition and results of operations. Our operations rely on certain external vendors. We rely on certain external vendors to provide products and services necessary to maintain our day- to- day operations. These third- party vendors are sources of operational and informational security risks to us, including risks associated with operational errors, information system failures, interruptions or breaches and unauthorized disclosures of sensitive or confidential client or customer information. If these vendors encounter any of these issues, or if we have difficulty communicating with them, we could be exposed to disruption of operations, loss of service or connectivity to customers, reputational damage, and litigation risk that could have a material adverse effect on our business and, in turn, our financial condition and results of operations **. In July 2023, we publicly reported that one of our third party vendors had notified us that it uses MOVEit Transfer software (" MOVEit "), which was the subject of a widely reported cybersecurity event, to transfer information related to the Bank' s mobile and online banking customers. The Bank, as well as many other financial institutions, uses the vendor for certain regulatory compliance and operational support services, including account hosting and transaction processing. The Bank has been informed by the vendor that the vendor' s forensic investigation indicated that the Bank' s customer data was downloaded only one time in connection with a valid file transfer request by the Bank and, to date, there has been no indication that any personal data of the Bank' s customers has been compromised** . We continually encounter technological change, and we may have fewer resources than many of our competitors to invest in technological improvements. The financial services industry is undergoing rapid technological changes with frequent introductions of new technology- driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success will depend, in part, upon our ability to address the needs of our clients by using technology to provide products and services that will satisfy client demands for convenience, as well as to create additional efficiencies in our operations. Many national vendors provide turn- key services to community banks, such as internet banking and remote deposit capture that allow smaller banks to compete with institutions that have substantially greater resources to invest in technological improvements. We may not be able, however, to effectively implement new technology- driven products and services or be successful in marketing these products and services to our customers. Our business may be adversely affected by an increasing prevalence of fraud and other financial crimes. As a ~~bank~~ **financial institution** , we ~~are susceptible to~~ **face the risk of** fraudulent ~~activity~~ **activities perpetrated** ~~that may be committed~~ against us or our customers, **potentially** ~~which may result~~ **resulting** in financial losses ~~or~~ **,** increased **operational** costs ~~to us or our customers~~ , disclosure or misuse of ~~our~~ **sensitive** information ~~or our~~ **, misappropriation of assets, breaches of** customer ~~’ s information, misappropriation of assets,~~ privacy ~~breaches against our customers~~ , ~~litigation~~ **legal actions,** or damage to our reputation. ~~Such fraudulent~~ **Fraudulent** ~~activity~~ **activities** ~~may take many~~ **come in various** forms, including check fraud, electronic fraud, wire fraud, phishing, social engineering **,** and other ~~dishonest acts~~ **deceptive practices** . **There has been a notable** ~~Nationally~~ -- **national** ~~,~~ **increase in** reported incidents of fraud and other financial crimes ~~have increased~~ . ~~We have also experienced~~ **Our institution has encountered** losses due to apparent ~~fraud~~ **fraudulent activities** and other financial crimes. **Despite implementing policies and procedures aimed at preventing such losses, the dynamic nature of fraudulent activities presents ongoing challenges, and there is no guarantee against the occurrence of such losses.** While we ~~have~~ **remain committed to stringent** policies and procedures ~~designed~~ **to mitigate the risks associated with fraudulent activities, including investing in security measures and staff training, the evolving landscape of fraudulent tactics and the persistence of sophisticated schemes pose continual threats. Accordingly, there is inherent uncertainty regarding our ability** to prevent ~~such~~ losses ~~,~~ **resulting from fraudulent activities in** ~~there~~ -- **the future** ~~can be no assurance that such losses will not occur~~ . Regulatory and Accounting- Related Risks We operate in a highly regulated environment and may be adversely affected by changes in federal and state laws and regulations that could increase our costs of operations. The banking industry is extensively regulated. Federal banking regulations are designed primarily to protect the deposit insurance funds and customers, not to benefit a company ~~'~~ **’** s shareholders. These regulations may sometimes impose significant limitations on our operations. These regulations, along with the currently existing tax, accounting, securities, insurance, and monetary laws, regulations, rules, standards, policies and interpretations control the methods by which financial institutions conduct business, implement strategic initiatives and tax compliance, and govern financial reporting and disclosures. These laws, regulations, rules, standards, policies, and interpretations are constantly evolving and may change significantly over time. Any new regulations or legislation, change in existing regulation or oversight, whether a change in regulatory policy or a change in a regulator ~~'~~ **’** s interpretation of a law or regulation, could have a material impact on our operations, **impact the capital or liquidity requirements applicable to us,** increase our costs of regulatory compliance and of doing business and adversely affect our profitability. In this regard, the U. S. Department of the Treasury ~~'~~ **’** s Financial Crimes Enforcement Network ( ~~"~~ **“** FinCEN ~~"~~ **”** ), published guidelines in 2014 for financial institutions servicing cannabis businesses that are legal under state law. These guidelines generally allow us to work with cannabis- related businesses that are operating in accordance with state laws and regulations, so long as we comply with required regulatory oversight of their accounts with us. Legislation has previously been introduced in Congress that would allow banks and financial institutions to serve cannabis businesses in states where it is legal without any risk of federal prosecution but has yet to be enacted. At December 31, ~~2022~~ **2023** , approximately ~~2.~~ 3 **. 0** % of our total deposits and a portion of our service charges from deposits are from legal cannabis- related businesses. ~~An accounting change requiring that we calculate the allowance for loan and lease losses on the basis of the current expected credit losses over the lifetime of our loans, referred to as the CECL model, became applicable to us, as a smaller reporting company, on January 1, 2023. CECL adoption will have broad impact on our financial statements, which will affect key profitability and solvency measures, including, but not limited to higher loan loss reserve levels and related deferred tax assets. Increased reserve levels also may lead to a reduction in capital levels. Any such changes could have a material adverse effect on our business, financial condition and results of operations.~~ Any adverse change in the FinCEN guidance noted above, any new regulations or legislation, any change in existing regulations or oversight, whether a change in regulatory policy or a change in a regulator' s interpretation of a law or regulation, could have a negative impact on our non- interest income, as well as the cost of our operations, increasing our cost of regulatory compliance and of doing business and / or otherwise affect us, which may materially affect our profitability. ~~Our~~ **Moreover, our** failure to comply with laws, regulations or policies could result in civil or criminal sanctions and money penalties by state and federal agencies, and / or reputational damage, which could have a material adverse effect on our business, financial condition and results of operations. See “ Part I, Item 1. Business- How We Are Regulated ” in this Form 10- K for more information about the **laws and** regulations to which we are subject. The level of our commercial real estate loan portfolio may subject us to additional regulatory scrutiny. The FDIC, the Federal Reserve and the Office of the Comptroller of the Currency have promulgated joint guidance on sound risk management practices for financial institutions with concentrations in commercial real estate lending. Under this guidance, a financial institution that, like us, is actively involved in commercial real estate lending, should perform a risk assessment to identify concentrations. A financial institution may have a concentration in commercial real estate lending if, among other factors (i) total reported loans for construction, land development and other land represent 100 % or more of the bank’ s total regulatory capital (or in the case of a bank, such as the Bank, that has elected to follow the CBLR framework, CBLR Capital (Tier 1 capital plus the entire allowance for loan and lease losses), or (ii) total commercial real estate loans (as defined in the guidance) represent 300 % or more of the bank’ s total regulatory capital or CBLR Capital, as appropriate, and the outstanding balance of the bank’ s commercial real estate loan portfolio has increased 50 % or more during the prior 36 months. The particular focus of the guidance is on exposure to commercial real estate loans that are dependent on the cash flow from the real estate held as collateral and that are likely to be at greater risk to conditions in the commercial real estate market (as opposed to real estate collateral held as a secondary source of repayment or as an abundance of caution). The purpose of the guidance is to guide banks in developing risk management practices and capital levels commensurate with the level and nature of real estate concentrations. The guidance states that management should employ heightened risk management practices including board and management oversight and strategic planning, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing. At December 31, ~~2022~~ **2023**, Sound Community Bank' s aggregate recorded loan balances for construction, land development and land loans were ~~101~~ **106**. ~~5~~ **7** % of CBLR Capital. In addition, at December 31, ~~2022~~ **2023**, Sound Community Bank' s loans on all commercial real estate, including construction, owner and non- owner occupied commercial real estate, and multi- family lending, as defined by the FDIC, were ~~364~~ **352**. ~~2~~ **9** % of CBLR Capital. While we believe we have implemented policies and procedures with respect to our commercial real estate loan portfolio consistent with this guidance, bank regulators could require us to implement additional policies and procedures consistent with their interpretation of the guidance that may result in additional costs to us. Our accounting policies and methods are fundamental to how we report our financial condition and results of operations, and we use estimates in determining the fair value of certain of our assets, which estimates may prove to be imprecise and result in significant changes in valuation. A portion of our assets are carried on the balance sheet at fair value, including investment securities available for sale ~~,~~ **and** mortgage servicing rights related to single- family loans ~~, and single-family loans held for sale~~. Generally, for assets that are reported at fair value, we use quoted market prices or valuation models that use observable market data inputs to estimate their fair value. In certain cases, observable market prices and data may not be readily available, or their availability may be diminished due to market conditions. We use financial models to value certain of these assets. These models are complex and use asset- specific collateral data and market inputs for interest rates. Although we have processes and procedures in place governing valuation models and their review, such assumptions are complex, as we must make judgments about the effect of matters that are inherently uncertain. Different assumptions could result in significant changes in valuation, which in turn could affect earnings or result in significant changes in the dollar amount of assets reported on the balance sheet. **We are subject to an extensive body of accounting rules and best practices. Periodic changes to such rules may change the treatment and recognition of critical financial line items and affect our profitability. Our business operations are significantly influenced by the extensive body of accounting regulations in the United States. Regulatory bodies periodically issue new guidance, altering accounting rules and reporting requirements, which can substantially affect the preparation and reporting of our financial statements. These changes might necessitate retrospective application, potentially leading to restatements of prior period financial statements. One such significant change in 2023 was the implementation of the CECL model, which we adopted on January 1, 2023. Under the CECL model, financial assets carried at amortized cost, such as loans and HTM debt securities, are presented at the net amount expected to be collected. This forward- looking approach in estimating expected credit losses contrasts starkly with the prior, " incurred loss " model, which delays recognition until a loss is probable. CECL mandates considering historical experience, current conditions, and reasonable forecasts affecting collectability, leading to periodic adjustments of financial asset values. However, this forward- looking methodology, reliant on macroeconomic variables, introduces the potential for increased earnings volatility due to unexpected changes in these indicators between periods. An additional consequence of CECL is an accounting asymmetry between loan- related income, recognized periodically based on the effective interest method, and credit losses, recognized upfront at origination. This asymmetry might create the perception of reduced profitability during loan expansion periods due to the immediate recognition of expected credit losses. Conversely, periods with stable or declining loan levels might seem relatively more profitable as income accrues gradually for loans where losses had been previously recognized. As a result of the change in methodology from the incurred loss model to the CECL model, on January 1, 2023, the Company recorded a one- time upward adjustment to the ACL on loans of $ 760 thousand and an ACL on unfunded loan commitments of $ 695 thousand, and an after- tax decrease to opening retained earnings of $ 1. 1 million.** Risks Related to our Business and Industry Generally ~~We will be required to transition from the use of the London Interbank Offered Rate (" LIBOR ") in the future. We have certain FHLB advances, brokered deposits, loans and investment securities indexed to LIBOR to calculate the loan interest rate. ICE Benchmark Administration, the authorized and regulated administrator of LIBOR, ended publication of the one- week and two-month USD LIBOR tenors on December 31, 2021, and the remaining USD LIBOR tenors will end publication in June 2023. Financial services regulators and industry groups have collaborated to develop alternate reference rate indices or reference rates. The transition to a new reference rate requires changes to contracts, risk and pricing models, valuation tools, systems, product design and hedging strategies. At this time, no consensus exists as to what rate or rates may become acceptable alternatives to LIBOR (with the exception of overnight repurchase agreements, which are expected to be based on the Secured Overnight Financing Rate, or SOFR). The language in our LIBOR- based contracts and financial instruments has developed over time and may have various events that trigger when a successor rate to the designated rate would be selected. If a trigger is satisfied, contracts and financial instruments may give the calculation agent discretion over the substitute index or indices for the calculation of interest rates to be selected. The implementation of a substitute index or indices for the calculation of interest rates under our loan agreements with our borrowers may result in our incurring significant expenses in effecting the transition, may result in reduced loan balances if borrowers do not accept the substitute index or indices, and may result in disputes or litigation with customers over the appropriateness or comparability to LIBOR of the substitute index or indices, which could have an adverse effect on our results of operations. At December 31, 2022, we had variable rate loans indexed to LIBOR totaling $ 53. 9 million. We did not have any investments, brokered deposits or borrowings indexed to LIBOR as of December 31, 2022.~~ Ineffective liquidity management could adversely affect our financial results and condition. **Our business hinges on** ~~Effective~~

**effective** liquidity management ~~is essential to our business~~. We ~~require sufficient~~ **must maintain ample** liquidity to meet **various financial obligations, including: (i) fulfilling** customer loan requests ~~, customer~~ **and handling** deposit maturities and withdrawals ~~,~~ **; and (ii) making timely** payments on ~~our~~ debt obligations ~~as they come due~~ and other cash commitments under ~~both~~ normal ~~operating conditions~~ and ~~other~~ unpredictable circumstances, including ~~events causing~~ **times of** industry or ~~general~~ financial market stress. **Raising** ~~An inability to raise~~ funds through deposits, borrowings, ~~the sale of loans~~ - **loan sales,** or **sales of** investment securities **is essential for** ~~and other sources could have a substantial negative effect on~~ our liquidity. We **primarily** rely on customer deposits and **occasionally** ~~at times, borrowings~~ ---- **borrow** from **entities like** the FHLB of Des Moines ~~and~~ **,** the Federal Reserve **,** and ~~certain~~ other wholesale funding sources ~~to fund our operations~~. **Several factors influence our liquidity, including (i) interest rate trends and competition affecting** ~~Deposit~~ **deposit** flows and ~~the~~ **loan** ~~prepayment~~ **prepayments** ~~of loans~~ and **(ii) potential limitations arising from** ~~mortgage- related securities are strongly influenced by such external factors as the direction of interest rates, whether actual or perceived, and the competition for deposits and loans in the markets we serve. Further,~~ changes **in** ~~to the~~ FHLB of Des Moines **’** ~~' s~~ underwriting guidelines **, which could** ~~for wholesale borrowings or lending policies may limit or~~ restrict our ~~ability to borrow~~ **borrowing capacity** ~~and could therefore have a significant adverse impact on our liquidity~~. ~~Although~~ **While historically,** we have **successfully** ~~historically been able to replace~~ **replaced** maturing deposits and borrowings ~~if desired~~, ~~we~~ **future replacements** may ~~not~~ be **challenged by shifts** ~~able to replace such funds~~ in ~~the future if, among other things,~~ our financial condition, ~~the financial condition of the~~ FHLB of Des Moines **’ status** , or market conditions ~~change~~. Our access to **adequate** funding **, vital for** ~~sources in amounts adequate to finance~~ our activities **,** ~~or on terms which are acceptable~~ could be ~~impaired~~ **hindered** by ~~factors that affect~~ **specific issues impacting** us ~~specifically~~ or ~~the~~ **broader industry and economic concerns. Such limitations could arise due to** financial ~~services~~ **market disruptions, negative** industry **outlooks** ~~or economy in general~~, ~~such as a disruption in the~~ **credit market deterioration, reduced market activity, poor** financial **performance** ~~markets or negative views and expectations about the prospects for the financial services industry or deterioration in credit markets. Additional factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity as a result of a downturn in the markets in which our deposits and loans are concentrated, negative operating results~~, or adverse regulatory ~~action~~ **actions** ~~against us~~. Any decline in available funding **sufficient** ~~in amounts adequate~~ to **sustain** ~~finance our activities or~~ **our operations** ~~on terms which are acceptable~~ could ~~adversely~~ **severely** impact our ability to **lend** ~~originate loans~~, invest ~~in securities~~, meet ~~our~~ expenses, ~~or fulfill obligations such as repaying~~ --- **repay** ~~our~~ borrowings **,** or ~~meeting~~ **manage** deposit withdrawal demands **. Consequently** , **this** ~~any of which~~ could **significantly** ~~, in turn, have a material adverse effect~~ **affect** ~~on~~ our business, financial condition **,** and results of operations. Climate change and related legislative and regulatory initiatives may materially affect the Company' s business and results of operations. The effects of climate change continue to create an alarming level of concern for the state of the ~~global~~ environment. As a result, the global business community has increased its political and social awareness surrounding the issue, and the United States has entered into international agreements in an attempt to reduce global temperatures, such as reentering the Paris Agreement. Further, the U. S. Congress, state legislatures and federal and state regulatory agencies continue to propose ~~numerous~~ initiatives to supplement the global effort to combat climate change. Similar and even more expansive initiatives are expected under the current administration, including potentially increasing supervisory expectations with respect to banks’ risk management practices, accounting for the effects of climate change in stress testing scenarios and systemic risk assessments, revising expectations for credit portfolio concentrations based on climate-related factors and encouraging investment by banks in climate- related initiatives and lending to communities disproportionately impacted by the effects of climate change. The lack of empirical data surrounding the credit and other financial risks posed by climate change render it difficult, or even impossible, to predict how climate change may impact our financial condition and results of operations; however, the physical effects of climate change may also directly impact us. Specifically, unpredictable and more frequent weather disasters may adversely impact the real property, and / or the value of the real property, securing the loans in our ~~portfolios~~ - **portfolio** . Additionally, if insurance obtained by our borrowers is insufficient to cover any losses sustained to the collateral, or if insurance coverage is otherwise unavailable to our borrowers, the collateral securing our loans may be negatively impacted by climate change, natural disasters and related events, which could impact our financial condition and results of operations. Further, the effects of climate change may negatively impact regional and local economic activity, which could adversely affect our customers and the communities in which we operate. Overall, climate change, its effects and the resulting, unknown impact could have a material adverse effect on our financial condition and results of operations. If our enterprise risk management framework is not effective at mitigating risk and loss to us, we could suffer unexpected losses and our results of operations could be materially adversely affected. We maintain an enterprise risk management program that is designed to identify, quantify, monitor, report, and control the risks that we face. These risks include interest- rate, credit, liquidity, operations, reputation, compliance and litigation. We also maintain a compliance program to identify, measure, assess, and report on our adherence to applicable laws, policies and procedures. While we assess and improve these programs on an ongoing basis, there can be no assurance that our risk management or compliance programs, along with other related controls, will effectively mitigate all risk and limit losses in our business. As with any risk management framework, there are inherent limitations to our risk management strategies as there may exist, or develop in the future, risks that we have not appropriately anticipated or identified. If our risk management framework proves ineffective, we could suffer unexpected losses and our business, financial condition and results of operations could be materially adversely affected. We are subject to certain risks in connection with our data management or aggregation. We are reliant on our ability to manage data and our ability to aggregate data in an accurate and timely manner to ensure effective risk reporting and management. Our ability to manage and aggregate data may be limited by the effectiveness of our policies, programs, processes and practices that govern how data is acquired, validated, stored, protected and processed. While we continuously update our policies, programs, processes and practices, many of our data management and aggregation processes are manual and subject to human error or system failure. Failure to manage data effectively and to aggregate data in an accurate and timely manner may limit our ability to manage current and emerging risks, as well as to manage changing business needs. Our growth or future losses may require us to raise additional capital in the future, but that capital may not be available when it is needed, or the cost of that capital may be ~~very~~ **exceedingly** high. We are required by federal regulatory authorities to maintain adequate levels of capital to support our operations. At some point, we may need to raise additional capital to support our growth or replenish future losses. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial condition and performance. Accordingly, we cannot make assurances that we will be able to raise additional capital if needed on terms that are acceptable to us, or at all. If we cannot raise additional capital when needed, our ability to further expand our operations could be materially impaired and our financial condition and liquidity could be materially and adversely affected. In addition, any additional capital we obtain may **dilute** ~~result in the dilution~~ of the interests of existing holders of our common stock. Further, if we are unable to raise additional capital when required by our bank regulators, we may be subject to adverse regulatory action. As a community bank, maintaining our reputation in our market area is critical to the success of our business, and the failure to do so may materially adversely affect our performance. We are a community bank and our reputation is one of the most valuable components of our business. A key aspect of our business strategy is to rely on our reputation for customer service and knowledge of local markets to expand our presence by capturing new business opportunities from existing and prospective customers in our current market and contiguous areas. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior service to our customers and caring about our customers and associates. We provide many different financial products and rely on the ability of our employees and systems to process a significant number of transactions. If our reputation is negatively affected by the actions of our employees, by our inability to conduct our operations in a manner that is appealing to current or prospective customers, or otherwise, our business and, therefore, our operating results may be materially adversely affected. The Company may not attract and retain skilled employees. The Company' s success depends, in large part, on its ability to attract and retain key people. Competition for the best people can be intense, and the Company spends considerable time and resources attracting and hiring qualified people for its operations. The unexpected loss of the services of one or more of the Company' s key personnel could have a material adverse impact on the Company' s business because of their skills, knowledge of the Company' s market, and years of industry experience, as well as the difficulty of promptly finding qualified replacement personnel. The Company' s ability to pay dividends and make subordinated debt payments is subject to the ability of the Bank to make capital distributions to the Company. The Company is a separate legal entity from its subsidiary **bank** and does not have significant operations of its own. The long- term ability of the Company to pay dividends to its stockholders and debt payments is based primarily upon the ability of the Bank to make capital distributions to the Company, and also on the availability of cash at the holding company level. The availability of dividends from the Bank is limited by the Bank' s earnings and capital, as well as various statutes and regulations. Under certain circumstances, capital distributions from the Bank to the Company may be subject to regulatory approvals. If the Bank is unable to pay dividends to the Company, the Company may not be able to pay dividends on its common stock or make payments on its outstanding debt. Consequently, the inability to receive dividends from the Bank could adversely affect the Company' s financial condition, results of operations, and future prospects and the value of the Company' s common stock. At December 31, ~~2022~~ **2023** , Sound Financial Bancorp had $ **156 thousand** ~~2. 2 million~~ in unrestricted cash to support dividend and debt payments. See" Part I. Item 1. Business — How We Are Regulated — Regulation of Sound Community Bank — Capital Rules ” and “ — Regulation of Sound Financial Bancorp — Limitations on Dividends and Stock Repurchases" for additional information.