

Risk Factors Comparison 2025-03-18 to 2024-03-22 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 documents filed with and furnished to the SEC. If any of the circumstances described in the following risk factors 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. **Broader** ~~A return of recessionary conditions or adverse economic conditions in our market areas~~ **factors such as inflation, unemployment and money supply fluctuations also** may ~~adversely reduce our rate of growth, affect our~~ **profitability. Trade wars, tariffs, customers' ability to repay loans and adversely impact our** ~~or shifts~~ **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 ~~policies~~. ~~Changes in agreements or relationships between the United States and other countries~~ **nations could disrupt supply chains, increase costs for businesses, and reduce export opportunities for our customers. These developments** may also affect, **in turn, negatively impact** these businesses **and, by extension, our operations and financial performance**. 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, potentially leading to a decline in our overall loans or assets.
- Elevated instances of loan delinquencies, ~~problematic~~ **problem** assets, and foreclosures.
- An increase in our allowance for credit losses on loans.
- ~~Depreciation~~ **Reduced values** in collateral **securing** values linked to our loans, thereby diminishing borrowing capacities and asset values tied to existing loans.
- Reduced net worth and liquidity of loan guarantors, possibly impairing their ability to meet commitments to us.
- Reduction in our low- cost or noninterest- bearing deposits.

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, **trade- related pressures that may affect construction costs or materials availability,** 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. **Monetary policy, inflation, deflation, and other** ~~External-external~~ economic factors **could**, ~~such as changes in monetary policy and inflation and deflation,~~ **may have an adverse- adversely impact** effect on our business, financial ~~condition~~ **performance** 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. **Higher U. S. tariffs on imported goods could exacerbate inflation- inflationary pressures by increasing** ~~has risen sharply since the end-~~ **cost of 2021- goods and materials throughout 2022 at levels not seen for over 40 years- businesses and consumers**. **This may particularly affect** ~~inflationary pressures, while easing recently, remained elevated throughout the first half of 2023.~~ ~~Small- small~~ to medium- sized businesses may be impacted more during periods of high inflation, as they are ~~not less~~ **able to leverage economies- economies** of scale to mitigate cost pressures compared to larger businesses. Consequently, **our business clients may experience increased financial strain, reducing the- their** ability of our business customers to repay ~~their loans~~ **and** may deteriorate quickly, which would adversely ~~impact- impacting~~ our results of operations and financial condition. Furthermore, a prolonged period of inflation could cause wages and other costs to ~~us the Company~~ to increase, which could adversely affect our results of operations and financial condition. Virtually all ~~of~~ our assets and liabilities are monetary in nature ~~As and, as~~ a result, **market** interest rates tend to have a more significant impact on our performance than general levels of inflation or deflation. **However, Interest- interest** rates do not necessarily move in the same direction or ~~by the same~~ magnitude as the prices of goods and services, **creating additional uncertainty in the economic environment**. 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 lending carries inherent uncertainties in estimating a property' s future value upon project completion and the overall cost, encompassing interest, for project fulfillment. These uncertainties arise from challenges in estimating construction costs, assessing the market value upon project completion, and

considering the impact of governmental regulations on real property. Consequently, accurately evaluating the total funds required to complete a project and determining the loan-to-value ratio for the completed project is often challenging. We may encounter scenarios where advancing funds beyond the committed amount becomes necessary to ensure project completion due to inaccurate estimations of construction costs, potentially resulting in inadequate security for loan repayment upon project completion and subsequent losses. Challenges such as disputes between borrowers and builders, builder failures to pay subcontractors, and the concentration of higher loan amounts among a limited number of builders further increase risk exposure. A downturn in the housing or real estate market could escalate delinquencies, defaults, and foreclosures, substantially impairing collateral values and complicating the process of selling foreclosed properties. Multiple loans with a single builder amplify our risk exposure, wherein adverse developments in one loan or credit relationship pose significant loss potential. Some construction loans involve interest accumulation without borrower payments, impacting construction loan dynamics if market interest rates rise, leading to increased borrowing costs for end purchasers and potentially reducing homebuyer financing capabilities or overall project demand. Properties under construction are challenging to sell and often necessitate completion before successful sale, further complicating the management of problematic construction loans. This could require additional fund allocation or engagement with alternate builders, adding market risks in selling projects at future market prices that may not cover outstanding loan funds, construction, and liquidation costs. Our construction loans include those with finalized sales contracts or permanent loans for finished homes and speculative construction loans where purchasers may not be identified during or post-construction. Speculative construction loans to builders pose higher potential risks than loans for personal residences. We aim to mitigate these risks by actively monitoring **unsold homes in our portfolio**, local housing markets **and unsold homes in our portfolio**, 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 additional risks due to the lack of income generation from the property and potential illiquidity of collateral and are significantly affected by supply and demand dynamics. Hence, such lending involves disbursing substantial funds, with repayment dependent on project success and the borrower's ability to sell or lease the property or obtain permanent financing, rather than independent repayment capability.

- Commercial and Multifamily Real Estate Loans. Our commercial and multifamily real estate loans generally involve higher principal amounts compared to other loan types, and some commercial borrowers maintain multiple loans with us. Consequently, an adverse development in any single loan or credit relationship can significantly heighten our exposure to potential losses, far more than the impact of a similar development in a one-to-four family residential mortgage loan. The repayment of these loans relies on income generated from the property securing the loan. This income must sufficiently cover operational expenses and debt service. Economic fluctuations or shifts in local market conditions may adversely affect the property's income, posing potential repayment challenges. Moreover, a substantial portion of our commercial and multifamily real estate loans do not fully amortize and include substantial balloon payments upon maturity. These balloon payments may require the borrower to either sell or refinance the property, potentially heightening the risk of default or non-payment. In the event of a foreclosure on a commercial or multifamily real estate loan, our holding period for the collateral tends to be more extended compared to one-to-four family residential loans. This elongated holding period results from a limited pool of potential purchasers for the collateral. **In recent years, the market has experienced substantial growth, with increased competition contributing to historically low capitalization rates and rising property values.** **However, the economic disruption caused by the COVID-19 pandemic significantly impacted this market. The pandemic also accelerated the adoption of remote work, which has particularly affected many companies to re-evaluate their long-term real estate needs. While some businesses are returning to traditional office environments, others are downsizing or shifting to hybrid models, creating uncertainty in demand for office space and other commercial properties. This trend could result in prolonged vacancies, declining rental income, and reduced property values, adversely affecting the performance of our commercial real estate markets.** Additionally, the pandemic has accelerated the adoption of remote work options, potentially influencing the long-term performance of certain office properties within our commercial real estate portfolio. Moreover, the federal **Federal** banking regulatory **regulators** agencies **also** have raised concerns about **vulnerabilities within weaknesses in** the current commercial real estate market, recognizing the risks associated with these assets. Failures in our risk management policies, procedures, and controls could **lead** **impede** our ability to **higher** effectively manage this portfolio, potentially leading to increased delinquencies and higher losses, **adversely affecting** thereby materially impacting our business, financial condition, and **results of operational operations** 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 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 consumer loans, we may need to increase the level of our allowance for credit losses on loans, which could decrease our profits. Consumer loans, particularly those secured by assets that depreciate rapidly like manufactured homes, automobiles, and recreational vehicles, generally carry a higher **degree of** risk. Upon default, repossessed collateral from these loans might not adequately cover the outstanding loan balance. In particular, manufactured home loans pose higher risks due to the cost and difficulty of relocating the manufactured home when repossessed and the limited market for resale, especially with the

diminishing number of manufactured home parks in the Puget Sound area. A significant portion of our manufactured home loan borrowers are first-time home buyers, typically exhibiting higher credit risk due to limited financial resources. Consequently, these loans tend to experience increased default probabilities, higher delinquency rates and greater servicing costs compared to other consumer loans. Floating home, houseboat, and house barge loans are typically located on cooperative or condominium moorages. The primary risk of these loans stems from the distinctive nature of the collateral and the complexities involved in relocating such property to permissible locations. The process for securing deeds or rights within condominium or cooperative docks in this lending area differs significantly from our other loan types, potentially resulting in higher costs associated with collateral recovery compared to one- to- four family mortgage loans and other 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 **the borrower’ s personal and financial reasons circumstances** (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 credit losses on loans may prove inadequate or we may be negatively affected by credit risk exposures. Future additions to our allowance for credit losses on loans, as well as charge- offs in excess of reserves, will reduce our earnings. Our business relies significantly on the creditworthiness of our customers. To account for potential defaults and nonperformance in our loan portfolio, we maintain an allowance for credit losses on loans using the Current Expected Credit Loss (“ CECL ”) methodology. This allowance represents management’ s best estimate of the lifetime expected credit losses in our loan portfolio. 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 of loan historical default and loss experience, 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 loans that do not share similar risk characteristics and the present value of the expected future cash flows or the fair value of the underlying collateral. The determination of the appropriate allowance for credit losses involves a significant degree of subjectivity, relying on substantial estimates of both current credit risks and future trends, all of which are subject to potential material changes. Inaccuracies in our estimations could lead to an insufficient allowance for credit losses, necessitating increases through provisions for credit losses, adversely impacting our ~~recorded net~~ income. Additionally, as we acknowledge the potential impact of significant portfolio growth, new loan products, and refinancing activities, 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. **Bank regulatory agencies also periodically review our allowance for credit losses on loans. Based on their assessment, they may require increased provisions or loan charge- offs**. A material decrease in the credit quality of our loan portfolio, significant changes in the risk profile of markets, industries, or customer groups, or inadequacy in the allowance for credit losses could have a materially adverse impact on our business, financial condition, liquidity, capital, and results of operations. Risks Related to Market and Interest Rate Changes Fluctuating interest rates can adversely affect our profitability. Our net income is primarily derived from the excess of net interest income and non- interest income over non- interest expenses, provisions for credit losses, and taxes. The core component of our net income is net interest income, which centers on the variance between the interest income accrued from interest- earning assets, such as loans and securities, and the interest expense incurred on interest- bearing liabilities, mainly 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 mismatch exposes us to significant earnings volatility as market interest rates fluctuate. Shifts in interest rates can also impact the average lifespan of loans and mortgage- backed securities. In periods of rising interest rates, the growth rate of interest income from our interest- earning assets might lag behind the accelerating interest expenses on our interest- bearing liabilities. Conversely, declining interest rates can trigger increased loan prepayments and mortgage- backed security redemptions as borrowers seek lower borrowing costs through refinancing. This introduces reinvestment risk, where the challenge lies in reinvesting prepayments at rates comparable to those initially earned on the prepaid loans or securities.

Moreover, an inverted interest rate yield curve, wherein short- term interest rates (which are usually the rates at which financial institutions borrow funds) surpass long- term rates (which are usually the rates at which financial institutions lend funds for fixed- rate loans), can compress a financial institution's net interest margin. This occurrence poses financial risks, particularly for institutions that originate longer- term, fixed- rate mortgage loans. As of December 31, 2023-2024, approximately 52.2-4% of our loan portfolio consisted of fixed- rate loans, 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, 2023-2024, our deposit composition included \$ 249-274.5-3 million in certificates of deposit maturing within one year and \$ 518-542.6-0 million in noninterest- bearing, NOW checking, savings, and money market accounts. In a rising an increasing interest- rate environment, retaining these deposits can become costlier could lead to a higher cost of funds, which has been the case over the last couple of years. Should interest- If deposit and borrowing rates rise associated with our deposits and borrowings increase at a faster pace than the rates received from loans- loan and other investments- investment yields, our net interest income and overall earnings could decline might be adversely affected. Additionally Since March 2022-, adjustable- rate residential mortgage loans and home equity lines in response to inflationary pressures, the Federal Open Market Committee ("FOMC") of credit may face the Federal Reserve has increased default risks in a rising the target range for the federal funds rate environment by 525 basis points, including 100 basis points during 2023, to a range of 5.25 % to 5.50 % as of December 31, 2023-. A sustained and substantial change in market interest rates could significantly impact our financial condition, liquidity, and operational results. Furthermore, fluctuations in interest rates could adversely affect the valuation of our assets and liabilities, ultimately affecting our earnings. 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 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 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 securities, net of taxes. Declines in market value could result in 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, 2023-2024, we had no allowance for credit losses on securities. An increase in interest rates, change- changes 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 contributes provides a significant significantly to portion of our non- interest income. Future changes in Fannie Mae's program, including our eligibility to participate, the criteria for loans- loan to be accepted- acceptance, or related laws that significantly affect the activity of Fannie Mae could 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 is influenced by -, 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. Our In addition, our results of operations are also affected by the amount of noninterest expense expenses associated with mortgage banking our loan sale activities, including such as salaries and employee benefits, occupancy, equipment and, data processing expense, and other operating costs. During periods of reduced loan demand, we may face challenges in reducing these expenses proportionately, which could adversely impact 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 Although we sell loans to Fannie Mae or into the secondary market without recourse, we provide are required to give customary representations and warranties to buyers about the loans we sell-. If we breach those these representations and warranties are breached, we may be required to repurchase the loans, potentially incurring 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, 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 the proliferation of new

technologies, the widespread use of the Internet and telecommunications for financial transactions, and the escalating activities of organized crime, hackers, terrorists, activists, and other external entities. These parties may attempt to deceive employees, customers, or system users to extract confidential information, thereby gaining access to our data or that of our customers. Our operations heavily rely on the secure processing, transmission, and storage of confidential information within our computer systems and networks, managed directly by us or through third- party data processing vendors. Additionally, our customers use personal computers, smartphones, tablets, and other mobile devices to access our services, which are beyond our direct control. While we have robust information security procedures and controls in place, our reliance on third- party vendors, technologies, systems, networks, and customers' devices makes them susceptible to cyber- attacks, viruses, unauthorized access, hackers, or security breaches. Such incidents could lead to unauthorized data releases, monitoring, misuse, theft, or destruction of confidential information, disrupting our operations or those of our customers and third parties. To date, we have not incurred substantial losses from cyber- attacks or security breaches. However, the evolving nature of threats and our ongoing plans to advance our internet and mobile banking channels heighten our exposure to these risks. As a result, continuously developing and enhancing our information security controls, processes, and practices to safeguard customer information, systems, computers, software, data, and networks remains a management priority. With the evolving nature of cyber threats, we may need to allocate significant additional resources to bolster our protective measures or investigate and address crucial information security vulnerabilities or exposures. Despite our efforts, they might not prevent all physical and electronic intrusions, denial of service, cyber- attacks, or security breaches. Disruptions or failures in the physical infrastructure or operating systems supporting our business and customers, or breaches in the networks, systems, or devices used by customers accessing our services, could result in customer attrition, uninsured financial losses, customer transaction disruptions, productivity losses, technology replacement costs, incident response expenses, legal and regulatory repercussions, reputational damage, litigation, reimbursement or compensation costs, and additional compliance expenses. Any of these outcomes could significantly and adversely affect our 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~~ **essential** to maintain our day- to- day operations. These third- party vendors ~~are sources of~~ **expose us to** operational and ~~informational~~ **information** security risks to us, including ~~risks associated with~~ operational errors, ~~information~~ system failures, interruptions or breaches, and unauthorized disclosures of sensitive or confidential ~~client~~ **information. Past incidents involving third- party vendors have demonstrated the potential** or for such risks to disrupt our operations, impair customer service, damage our reputation, or expose us to litigation. While we work closely with our vendors to implement appropriate security measures and monitoring processes to mitigate these risks, no system is entirely immune to breaches or other security events. Such incidents could materially and adversely affect our business, financial condition, and results of operations. Our current and future uses of Artificial Intelligence (AI) and other emerging technologies may create additional risks. The increasing adoption of AI in financial services presents significant opportunities but also introduces a range of risks that could impact our operations, regulatory compliance, and customer trust. AI introduces model risk, where flawed algorithms or biased data could result in inaccurate credit decisions, compliance violations, or discriminatory outcomes in lending or customer service. Cybersecurity threats, such as data breaches, adversarial attacks, and data poisoning, pose significant challenges, particularly as these systems handle large volumes of sensitive customer information. Additionally if these vendors encounter any of these issues, or if we have difficulty communicating with them- ~~the opaque nature~~, we could be exposed to disruption of operations ~~some AI models~~, often referred 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 **"black- box" systems**, raises uses the vendor for certain regulatory compliance concerns, as regulators increasingly require transparency and **explainability in AI- driven decision- making**. Operational risks also arise from potential system failures, over- reliance on AI, and integration challenges with existing infrastructure. Disruptions in AI systems could impact critical functions such as fraud detection, transaction monitoring, and customer support services. Ethical and **reputational risks**, including unintended consequences or perceived unfairness in AI- driven decisions, may erode 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 **trust and expose us to regulatory scrutiny. Mitigating these risks requires a robust governance framework, regularly testing and auditing of AI models, and strong human oversight. Investments in cybersecurity, data privacy protections** was downloaded only one time in connection with a valid file transfer request by the Bank and, **and employee training are critical** to **managing** date, there **these risks** 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 financial institution, we face the risk of fraudulent activities perpetrated against us or our customers, potentially resulting in financial losses, increased operational costs, disclosure or misuse of sensitive information, misappropriation of assets, breaches of customer privacy, legal actions, or damage to our reputation. Fraudulent activities come in various forms, including check fraud, electronic fraud, wire fraud, phishing, social engineering, and other deceptive practices. There has been a notable national increase in reported incidents of fraud and other financial crimes. Our institution has encountered losses due to apparent 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 remain committed to stringent policies and procedures 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 losses resulting from fraudulent activities in the future. 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, 2023-2024, approximately 3-5.0-1% of our total deposits and a portion of our service charges from deposits are from legal cannabis-related businesses. 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. 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-assist banks in developing risk management practices and capital levels commensurate with the level and nature of their 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, 2023-2024, Sound Community Bank's aggregate recorded loan balances for

construction, land development and land loans were ~~106.63~~ **7.9** % of CBLR Capital. In addition, at December 31, ~~2023~~ **2024**, 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 ~~352.348~~ **9.5** % 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. 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. **Increasing scrutiny and evolving expectations from customers, regulators, investors, and other stakeholders with respect to our environmental, social and governance practices may impose additional costs on us or expose us to new or additional risks. Companies are facing increasing scrutiny from customers, regulators, investors, and other stakeholders related to their environmental, social, and governance ("ESG") practices and disclosure. Investor advocacy groups, investment funds, and influential investors are also increasingly focused on these practices, especially as they relate to the environment, health and safety, diversity, labor conditions, and human rights. Increased ESG-related compliance costs could result in increases to our overall operational costs. Failure to adapt to or comply with regulatory requirements, or investor or stakeholder expectations and standards, could negatively impact our reputation, ability to do business with certain partners, and our stock price. Recent changes in the regulatory landscape under the new Trump administration have moved toward a reduction in emphasis on certain ESG priorities, particularly around climate change and diversity, equity, and inclusion ("DEI"). This shift is leading to the rollback of regulations that mandate specific disclosures and operational practices in these areas. However, some stakeholder groups continue to demand greater transparency and action, resulting in a complex and potentially conflicting environment for companies. If regulatory enforcement of ESG-related policies becomes less stringent, companies may face reputational risks if their practices are seen as insufficient or inconsistent with broader societal expectations, especially related to DEI and environmental stewardship.** As a result of the change in methodology from the incurred-loss model to the CECL model, **navigating this evolving regulatory** on January 1, 2023, the Company recorded a one-time upward adjustment to the ACL on loans of \$ 760 thousand and an **and** ACL on unfunded loan commitments of \$ 695 thousand **public opinion landscape may require us to balance compliance with regulatory requirements against maintaining investor, and customer, and stakeholder trust** after tax decrease to opening retained earnings of \$ 1.1 million. Risks Related to our Business and Industry Generally Ineffective liquidity management could adversely affect our financial results and condition. Our business hinges on effective liquidity management. We must maintain ample liquidity to meet various financial obligations, including: (i) fulfilling customer loan requests and handling deposit maturities and withdrawals; and (ii) making timely payments on debt obligations and other cash commitments under normal and unpredictable circumstances, including times of industry or financial market stress. Raising funds through deposits, borrowings, loan sales, or sales of investment securities is essential for our liquidity. We primarily rely on customer deposits and occasionally borrow from entities like the FHLB of Des Moines, the Federal Reserve, and other wholesale funding sources. Several factors influence our liquidity, including (i) interest rate trends and competition affecting deposit flows and loan prepayments and (ii) potential limitations arising from changes in FHLB of Des Moines' underwriting guidelines, which could restrict our borrowing capacity. While historically, we have successfully replaced maturing deposits and borrowings, future replacements may be challenged by shifts in our financial condition, FHLB of Des Moines' status, or market conditions. Our

access to adequate funding, vital for our activities, could be hindered by specific issues impacting us or broader industry and economic concerns. Such limitations could arise due to financial market disruptions, negative industry outlooks, credit market deterioration, reduced market activity, poor financial performance, or adverse regulatory actions. Any decline in available funding sufficient to sustain our operations could severely impact our ability to lend, invest, meet expenses, repay borrowings, or manage deposit withdrawal demands. Consequently, this could significantly affect 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 **raise significant** create an alarming level of concern **concerns** for about the state of the environment. **However** As a result, **under** the **new Trump administration** global business community has increased its political and social awareness surrounding the issue, and **federal policy may shift to reduce** the United States has entered into **emphasis on climate change initiatives and environmental regulations. This could include scaling back federal participation in** international agreements in an attempt to reduce global temperatures, such as reentering the Paris Agreement. **Further**, the U. S. Congress, state legislatures and **reducing** federal and state regulatory agencies continue **pressures on businesses, including banks, to address climate- related risks. Legislative and regulatory proposals aimed at** initiatives to supplement the global effort to combat **combating** climate change **may face greater scrutiny**. 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 **or diminished priority** 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 **regarding** the **financial and** credit and other financial risks posed by climate change **render makes** it difficult, **or even impossible**, to predict **how its specific impact on our financial condition and results of operations. However, the physical effects of climate change, such as more frequent and severe weather disasters, could directly affect us. For instance, such events may damage real property securing loans in our portfolio or reduce the value of that collateral. If our borrower's insurance is insufficient to cover these losses or if insurance becomes unavailable, the value of collateral securing our loans could be negatively affected, potentially impacting our financial condition and results of operations. Moreover,** 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 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- affect** of climate change may **negatively impact** regional and local economic activity, **harming** which could adversely affect our customers and the communities in which we operate. **Overall Regardless of changes in federal policy**, the effects of climate change ; its effects and **the their** resulting, unknown **long- term impact impacts** could **still** 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 **risks**. 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 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 **of** the interests of existing holders of our common stock. **Further, if we are unable to raise additional capital when required by our bank- banking** 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~~ **might** not **be able to** 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, **repurchase stock** 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, **repurchase its stock** and **make** 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, **repurchase 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, ~~2023~~ **2024**, Sound Financial Bancorp had \$ ~~156 thousand~~ **1.3 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. **44**