

NORTHRIM BANCORP INC  
Form 10-Q  
August 08, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549  
FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended June 30, 2016

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 000-33501

NORTHRIM BANCORP, INC.

(Exact name of registrant as specified in its charter)

Alaska

92-0175752

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

3111 C Street

Anchorage, Alaska 99503

(Address of principal executive offices) (Zip Code)

(907) 562-0062

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer  Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The number of shares of the issuer's Common Stock, par value \$1 per share, outstanding at August 8, 2016 was 6,882,482.

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PART I. FINANCIAL INFORMATION

These consolidated financial statements should be read in conjunction with the financial statements, accompanying notes and other relevant information included in Northrim BanCorp, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2015.

ITEM 1. FINANCIAL STATEMENTS

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## CONSOLIDATED FINANCIAL STATEMENTS

## NORTHRIM BANCORP, INC.

## Consolidated Balance Sheets

(Unaudited)

(In Thousands, Except Share Data)	June 30, 2016	December 31, 2015
<b>ASSETS</b>		
Cash and due from banks	\$30,095	\$30,989
Interest bearing deposits in other banks	44,661	27,684
Investment securities available for sale, at fair value	290,601	291,113
Investment securities held to maturity, at amortized cost	901	903
Total portfolio investments	291,502	292,016
Investment in Federal Home Loan Bank stock	1,966	1,816
Loans held for sale	60,360	50,553
Loans	967,346	980,787
Allowance for loan losses	(18,385)	(18,153)
Net loans	948,961	962,634
Purchased receivables, net	13,596	13,326
Other real estate owned, net	2,558	3,053
Premises and equipment, net	38,671	40,217
Mortgage servicing rights, at fair value	2,602	1,654
Goodwill	22,334	22,334
Other intangible assets, net	1,372	1,442
Other assets	59,692	51,774
Total assets	\$1,518,370	\$1,499,492
<b>LIABILITIES</b>		
Deposits:		
Demand	\$461,970	\$430,191
Interest-bearing demand	183,885	209,291
Savings	231,246	227,969
Money market	241,334	236,675
Certificates of deposit less than \$100,000	50,933	52,505
Certificates of deposit \$100,000 and greater	86,320	84,161
Total deposits	1,255,688	1,240,792
Securities sold under repurchase agreements	26,049	31,420
Borrowings	4,362	2,120
Junior subordinated debentures	18,558	18,558
Other liabilities	29,748	29,388
Total liabilities	1,334,405	1,322,278
<b>SHAREHOLDERS' EQUITY</b>		
Preferred stock, \$1 par value, 2,500,000 shares authorized, none issued or outstanding	—	—
Common stock, \$1 par value, 10,000,000 shares authorized, 6,877,140 shares issued and outstanding at June 30, 2016 and December 31, 2015	6,877	6,877
Additional paid-in capital	62,797	62,420
Retained earnings	113,238	108,150
Accumulated other comprehensive income (loss)	742	(412)

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Total Northrim BanCorp shareholders' equity	183,654	177,035
Noncontrolling interest	311	179
Total shareholders' equity	183,965	177,214
Total liabilities and shareholders' equity	\$1,518,370	\$1,499,492
See notes to consolidated financial statements		

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NORTHRIM BANCORP, INC.  
Consolidated Statements of Income  
(Unaudited)

(In Thousands, Except Per Share Data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Interest Income				
Interest and fees on loans and loans held for sale	\$13,710	\$14,135	\$27,488	\$27,602
Interest on investment securities available for sale	953	759	1,933	1,644
Interest on investment securities held to maturity	14	25	27	48
Interest on deposits in other banks	41	24	88	35
Total Interest Income	14,718	14,943	29,536	29,329
Interest Expense				
Interest expense on deposits, borrowings and junior subordinated debentures	639	748	1,283	1,502
Net Interest Income	14,079	14,195	28,253	27,827
Provision for loan losses	200	376	903	702
Net Interest Income After Provision for Loan Losses	13,879	13,819	27,350	27,125
Other Operating Income				
Mortgage banking income	8,510	7,859	14,206	15,165
Employee benefit plan income	936	931	1,900	1,708
Bankcard fees	675	669	1,308	1,258
Purchased receivable income	531	562	1,065	1,151
Service charges on deposit accounts	510	568	1,009	1,058
Gain (loss) on sale of securities, net	12	16	(11)	130
Other income	690	958	1,492	1,628
Total Other Operating Income	11,864	11,563	20,969	22,098
Other Operating Expense				
Salaries and other personnel expense	12,011	11,125	23,262	21,675
Occupancy expense	1,697	1,594	3,305	3,198
Data processing expense	1,146	1,104	2,230	2,200
Professional and outside services	785	791	1,492	1,542
Change in fair value, RML earn-out liability	687	587	817	2,089
Marketing expense	615	642	1,353	1,259
Loss on sale of premises and equipment	358	7	358	7
Insurance expense	263	345	578	669
OREO (income) expense, net rental income and gains on sale	127	(121)	101	176
Intangible asset amortization expense	35	72	70	145
Other operating expense	1,645	1,607	3,174	3,254
Total Other Operating Expense	19,369	17,753	36,740	36,214
Income Before Provision for Income Taxes	6,374	7,629	11,579	13,009
Provision for income taxes	1,868	2,686	3,567	4,433
Net Income	4,506	4,943	8,012	8,576
Less: Net income attributable to the noncontrolling interest	156	162	286	234
Net Income Attributable to Northrim BanCorp, Inc.	\$4,350	\$4,781	\$7,726	\$8,342
Earnings Per Share, Basic	\$0.63	\$0.70	\$1.12	\$1.22
Earnings Per Share, Diluted	\$0.63	\$0.69	\$1.11	\$1.20
Weighted Average Shares Outstanding, Basic	6,877,140	6,854,338	6,877,140	6,854,264
Weighted Average Shares Outstanding, Diluted	6,968,896	6,941,671	6,966,905	6,938,879
See notes to consolidated financial statements				



NORTHRIM BANCORP, INC.  
 Consolidated Statements of Comprehensive Income  
 (Unaudited)  
 2010

(In Thousands)	Three Months		Six Months	
	Ended June 30, 2016	2015	Ended June 30, 2016	2015
Net income	\$4,506	\$4,943	\$8,012	\$8,576
Other comprehensive income (loss), net of tax:				
Securities available for sale:				
Unrealized gains (losses) arising during the period	\$466	(\$152)	\$1,792	\$736
Reclassification of net (gains) losses included in net income (net of tax (benefit) expense of \$5 and \$7 for the second quarter of 2016 and 2015, respectively and (\$5) and \$53 for the six months ended June 30, 2016 and 2015, respectively)	(7)	(9)	6	(77)
Income tax expense (benefit) related to unrealized gains and losses	(174)	58	(644)	(263)
Other comprehensive income (loss), net of tax	285	(103)	1,154	396
Comprehensive income	4,791	4,840	9,166	8,972
Less: comprehensive income attributable to the noncontrolling interest	156	162	286	234
Comprehensive income attributable to Northrim BanCorp, Inc.	\$4,635	\$4,678	\$8,880	\$8,738

See notes to consolidated financial statements



## NORTHRIM BANCORP, INC.

Consolidated Statements of Changes in Shareholders' Equity  
(Unaudited)

(In Thousands)	Common Stock Number of Shares	Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Non-controlling Interest	Total
Balance as of January 1, 2015	6,854	\$6,854	\$61,729	\$95,493	\$247	\$118	\$164,441
Cash dividend declared	—	—	—	(5,126 )	—	—	(5,126 )
Stock-based compensation expense	—	—	608	—	—	—	608
Exercise of stock options	23	23	27	—	—	—	50
Excess tax benefits from stock based payment arrangements	—	—	56	—	—	—	56
Distributions to noncontrolling interest	—	—	—	—	—	(490 )	(490 )
Other comprehensive loss, net of tax	—	—	—	—	(659 )	—	(659 )
Net income attributable to the noncontrolling interest	—	—	—	—	—	551	551
Net income attributable to Northrim BanCorp, Inc.	—	—	—	17,783	—	—	17,783
Twelve Months Ended December 31, 2015	6,877	\$6,877	\$62,420	\$108,150	(\$412 )	\$179	\$177,214
Cash dividend declared	—	—	—	(2,638 )	—	—	(2,638 )
Stock-based compensation expense	—	—	377	—	—	—	377
Distributions to noncontrolling interest	—	—	—	—	—	(154 )	(154 )
Other comprehensive income, net of tax	—	—	—	—	1,154	—	1,154
Net income attributable to the noncontrolling interest	—	—	—	—	—	286	286
Net income attributable to Northrim BanCorp, Inc.	—	—	—	7,726	—	—	7,726
Six Months Ended June 30, 2016	6,877	\$6,877	\$62,797	\$113,238	\$742	\$311	\$183,965

See notes to consolidated financial statements

NORTHRIM BANCORP, INC.  
Consolidated Statements of Cash Flows  
(Unaudited)

(In Thousands)	Six Months Ended June 30,	
	2016	2015
<b>Operating Activities:</b>		
Net income	\$8,012	\$8,576
<b>Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:</b>		
Loss (gain) on sale of securities, net	11	(130 )
Loss on sale of premises and equipment	358	7
Depreciation and amortization of premises and equipment	1,178	1,122
Amortization of software	84	90
Intangible asset amortization	70	145
Amortization of investment security premium, net of discount accretion	8	(119 )
Deferred tax liability	448	(685 )
Stock-based compensation	377	237
Excess tax benefits from share-based payment arrangements	—	1
Deferral of loan fees and costs, net	(292 )	(92 )
Provision for loan losses	903	702
Recovery from purchased receivables	(18 )	(72 )
Gain on sale of loans	(11,924 )	(13,686 )
Proceeds from the sale of loans held for sale	344,087	376,782
Origination of loans held for sale	(341,970 )	(392,823 )
Gain on sale of other real estate owned	(112 )	(136 )
Impairment on other real estate owned	130	268
<b>Net changes in assets and liabilities:</b>		
Decrease (increase) in accrued interest receivable	62	(26 )
(Increase) decrease in other assets	(3,302 )	2,352
Decrease in other liabilities	(6,472 )	(8,731 )
<b>Net Cash Provided by (Used in) Operating Activities</b>	<b>(8,362 )</b>	<b>(26,218 )</b>
<b>Investing Activities:</b>		
<b>Investment in securities:</b>		
Purchases of investment securities available for sale	(31,985 )	(59,196 )
Purchases of FHLB stock	(151 )	—
Proceeds from sales/calls/maturities of securities available for sale	34,283	115,917
Proceeds from maturities of domestic certificates of deposit	—	3,500
Proceeds from redemption of FHLB stock	1	1,587
(Increase) decrease in purchased receivables, net	(252 )	1,278
Decrease (increase) in loans, net	13,063	(50,597 )
Proceeds from sale of other real estate owned	477	1,971
Elliott Cove divestiture, net of cash received	—	219
Sales of premises and equipment	1,379	—
Purchases of premises and equipment	(1,369 )	(3,428 )
<b>Net Cash Provided by Investing Activities</b>	<b>15,446</b>	<b>11,251</b>
<b>Financing Activities:</b>		
Increase in deposits	14,896	58,970
Decrease in securities sold under repurchase agreements	(5,371 )	(1,948 )
Increase (decrease) in borrowings	2,242	(3,995 )

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Distributions to noncontrolling interest	(154 )	(75 )
Cash dividends paid	(2,614 )	(2,470 )
Net Cash Provided by Financing Activities	8,999	50,482
Net Change in Cash and Cash Equivalents	16,083	35,515
Cash and Cash Equivalents at Beginning of Period	58,673	68,556
Cash and Cash Equivalents at End of Period	\$74,756	\$104,071

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Supplemental Information:

Income taxes paid	\$2,162	\$4,011
Interest paid	\$1,213	\$1,556
Noncash commitments to invest in Low Income Housing Tax Credit Partnerships	\$6,809	\$55
Transfer of loans to other real estate owned	\$—	\$337
Cash dividends declared but not paid	\$24	\$22

See notes to consolidated financial statements

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

### 1. Basis of Presentation

The accompanying unaudited consolidated financial statements and corresponding footnotes have been prepared by Northrim BanCorp, Inc. (the "Company") in accordance with accounting principles generally accepted in the United States of America ("GAAP") and with instructions to Form 10-Q under the Securities Exchange Act of 1934, as amended. The year-end Consolidated Balance Sheet data was derived from the Company's audited financial statements. Accordingly, they do not include all of the information and footnotes required by Generally Accepted Accounting Principles ("GAAP") for complete financial statements. The Company owns a 100% interest in Residential Mortgage Holding Company, LLC ("RML"), the parent company of Residential Mortgage, LLC ("Residential Mortgage") and a 50.1% interest in Northrim Benefits Group, LLC ("NBG") and consolidates their balance sheets and income statements into its financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Certain immaterial reclassifications have been made to prior year amounts to maintain consistency with the current year with no impact on net income or total shareholders' equity. The Company determined that it operates in two primary operating segments: Community Banking and Home Mortgage Lending. The Company has evaluated events and transactions through August 8, 2016 for potential recognition or disclosure. Operating results for the interim period ended June 30, 2016, are not necessarily indicative of the results anticipated for the year ending December 31, 2016. These consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

### 2. Significant Accounting Policies and Recent Accounting Pronouncements

The Company's significant accounting policies are discussed in Note 1 to the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"). ASU 2016-01 requires that equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. ASU 2016-01 is effective for the Company's financial statements for annual and interim periods beginning on or after December 15, 2017, and the Company will apply the amendments by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption and the amendments related to equity securities without readily determinable

fair values (including disclosure requirements) will be applied prospectively to equity investments that exist as of the date of adoption of ASU 2016-01. The Company does not believe that the adoption of this standard will have a material impact on the Company's consolidated financial position or results of operations.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) ("ASU 2016-02"). ASU 2016-02 increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about lease arrangements. ASU 2016-02 is effective for the Company's financial statements for annual and interim periods beginning on or after December 15, 2018, and must be applied prospectively. The Company is currently evaluating how the adoption of this standard will impact the Company's consolidated financial position and results of operations.

In March 2016, the FASB issued ASU 2016-06, Derivatives and Hedging (Topic 815): Contingent Put and Call Option in Debt Instruments ("ASU 2016-06"). ASU 2016-06 simplifies the embedded derivative analysis for debt instruments containing contingent call or put options by removing the requirement to assess whether a contingent event is related to interest rates or credit risks. ASU 2016-06 is effective for the Company's financial statements for annual and interim periods beginning on or after December 15, 2016, and interim periods within those fiscal years. The Company does not believe that the adoption of this standard will have a material impact on the Company's consolidated financial position or results of operations.

In March 2016, the FASB issued ASU 2016-07, Simplifying the Transition to the Equity Method of Accounting ("ASU 2016-07"). ASU 2016-07 eliminates the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods that the investment had been held. ASU 2016-07 requires that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. Therefore, upon qualifying for the equity method of accounting, no retroactive adjustment of the investment is required. ASU 2016-17 requires that an entity that has an available-for-sale equity security that becomes qualified for the equity method of accounting recognize through earnings the unrealized holding gain or loss in accumulated other comprehensive income at the date the investment becomes qualified for use of the equity method. ASU 2016-07 is effective for the Company's financial statements for annual and interim periods beginning on or after December 15, 2016, and must be applied prospectively. The Company does not believe that the adoption of this standard will have a material impact on the Company's consolidated financial position or results of operations.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for the Company's financial statements for annual and interim periods beginning on or after December 15, 2016, and must be applied prospectively. The Company does not believe that the adoption of this standard will have a material impact on the Company's consolidated financial position or results of operations.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses ("ASU 2016-13"). ASU 2016-13 requires a financial asset (or a group of financial assets) that is measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset or assets to present the net carrying value at the amount expected to be collected on the financial asset. The income statement reflects the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. An entity must use judgment in determining the relevant information and estimation methods that are appropriate in its circumstances. The allowance for credit losses for purchased financial assets with a more-than insignificant amount of credit deterioration since origination ("PCD assets") that are measured at amortized cost basis is determined in a similar manner to other financial assets measured at amortized cost basis; however, the initial allowance for credit losses is added to the purchase price rather than being reported as a credit loss expense. Only subsequent changes in the allowance for credit losses are recorded as a credit loss expense for these assets. Interest income for PCD assets should be recognized based on the effective interest rate, excluding the discount embedded in the purchase price that is attributable to the acquirer's assessment of credit losses at acquisition. ASU 2016-13 requires credit losses relating to available-for-sale debt securities to be recorded through an allowance for credit losses. Available-for-sale accounting recognizes that value may be realized either through collection of contractual cash flows or through sale of the security. Therefore, the amendments limit the amount of the allowance for credit losses to the amount by which fair value is below amortized cost because the classification as available for sale is premised on an investment strategy that recognizes that the investment could be sold at fair value, if cash collection would result in

the realization of an amount less than fair value. The allowance for credit losses for purchased available-for-sale securities with a more-than-insignificant amount of credit deterioration since origination is determined in a similar manner to other available-for-sale debt securities; however, the initial allowance for credit losses is added to the purchase price rather than reported as a credit loss expense. Only subsequent changes in the allowance for credit losses are recorded in credit loss expense. Interest income should be recognized based on the effective interest rate, excluding the discount embedded in the purchase price. ASU 2016-13 is effective for the Company's financial statements for annual and interim periods beginning on or after December 15, 2019, and must be applied prospectively. The Company is currently evaluating the impact that the adoption of this standard will have on the Company's consolidated financial position and results of operations.



### 3. Cash and Cash Equivalents

The Company is required to maintain a \$500,000 minimum average daily balance with the Federal Reserve Bank of San Francisco ("Federal Reserve Bank") for purposes of settling financial transactions and charges for Federal Reserve Bank services. The Company is also required to maintain cash balances or deposits with the Federal Reserve Bank sufficient to meet its statutory reserve requirements.

The Company is required to maintain a \$500,000 balance with a correspondent bank for outsourced servicing of ATMs.

### 4. Investment Securities

The carrying values and estimated fair values of investment securities at the periods indicated are presented below:

(In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2016				
Securities available for sale				
U.S. Treasury and government sponsored entities	\$234,388	\$1,055	\$7	\$235,436
Municipal securities	9,290	68	17	9,341
U.S. Agency mortgage-backed securities	6	—	—	6
Corporate bonds	40,838	83	36	40,885
Preferred stock	4,922	55	44	4,933
Total securities available for sale	\$289,444	\$1,261	\$104	\$290,601
Securities held to maturity				
Municipal securities	\$901	\$44	\$—	\$945
Total securities held to maturity	\$901	\$44	\$—	\$945
December 31, 2015				
Securities available for sale				
U.S. Treasury and government sponsored entities	\$238,116	\$150	\$830	\$237,436
Municipal securities	10,227	117	18	10,326
U.S. Agency mortgage-backed securities	818	1	10	809
Corporate bonds	39,049	57	88	39,018
Preferred stock	3,549	8	33	3,524
Total securities available for sale	\$291,759	\$333	\$979	\$291,113
Securities held to maturity				
Municipal securities	\$903	\$56	\$—	\$959
Total securities held to maturity	\$903	\$56	\$—	\$959

Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2016 and December 31, 2015 were as follows:

(In Thousands)	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2016:						
Securities Available for Sale						
U.S. Treasury and government sponsored entities	\$12,422	\$3	\$489	\$4	\$12,911	\$7
Corporate Bonds	17,421	36	—	—	17,421	36
Municipal Securities	1,209	4	1,480	13	2,689	17
Preferred Stock	1,506	44	—	—	1,506	44
Total	\$32,558	\$87	\$1,969	\$17	\$34,527	\$104
December 31, 2015:						
Securities Available for Sale						
U.S. Treasury and government sponsored entities	\$146,433	\$829	\$36	\$1	\$146,469	\$830
Corporate Bonds	19,874	88	—	—	19,874	88
Municipal Securities	4,454	18	—	—	4,454	18
Mortgage-backed Securities	637	9	100	1	737	10
Preferred Stock	2,514	33	—	—	2,514	33
Total	\$173,912	\$977	\$136	\$2	\$174,048	\$979

The unrealized losses on investments in government sponsored entities, corporate bonds, preferred stock, and municipal securities in both periods were caused by changes in interest rates. At June 30, 2016 and December 31, 2015, respectively, there were eight and thirty-nine available-for-sale securities with unrealized losses that have been in a loss position for less than twelve months. There were two and six securities as of June 30, 2016 and December 31, 2015 that have been in an unrealized loss position for more than twelve months. The contractual terms of the investments in a loss position do not permit the issuer to settle the securities at a price less than the amortized cost of the investment. Because it is more likely than not that the Company will hold these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

At June 30, 2016 and December 31, 2015, \$55.5 million and \$59.7 million in securities were pledged for deposits and borrowings.

The amortized cost and estimated fair values of debt securities at June 30, 2016, are distributed by contractual maturity as shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Although preferred stock has no stated maturity, it is aggregated in the calculation of weighted average yields presented below in the category of investments that mature in ten years or more.

(In Thousands)	Amortized Cost	Fair Value	Weighted Average Yield
US Treasury and government sponsored entities			
Within 1 year	\$9,996	\$10,015	0.84 %
1-5 years	224,392	225,421	1.14 %
Total	\$234,388	\$235,436	1.12 %
U.S. Agency mortgage-backed securities			
1-5 years	\$6	\$6	1.47 %
Total	\$6	\$6	1.47 %
Corporate bonds			
Within 1 year	\$7,106	\$7,117	1.44 %
1-5 years	33,732	33,768	1.39 %
Total	\$40,838	\$40,885	1.40 %
Preferred stock			
Over 10 years	\$4,922	\$4,933	7.16 %
Total	\$4,922	\$4,933	7.16 %
Municipal securities			
Within 1 year	\$478	\$479	0.93 %
1-5 years	7,679	7,780	2.91 %
5-10 years	2,034	2,027	4.12 %
Total	\$10,191	\$10,286	3.06 %

The proceeds and resulting gains and losses, computed using specific identification, from sales of investment securities for the six months ending June 30, 2016 and 2015, respectively, are as follows:

(In Thousands)	Proceeds	Gross Gains	Gross Losses
2016			
Available for sale securities	\$5,785	\$12	\$23
2015			
Available for sale securities	\$2,621	\$130	\$—

A summary of interest income for the six months ending June 30, 2016 and 2015 on available for sale investment securities is as follows:

(In Thousands)	2016	2015
US Treasury and government sponsored entities	\$1,336	\$1,120
U.S. Agency mortgage-backed securities	4	13
Other	447	344
Total taxable interest income	\$1,787	\$1,477
Municipal securities	\$146	\$167
Total tax-exempt interest income	\$146	\$167
Total	\$1,933	\$1,644



## 5. Loans and Credit Quality

The following table presents total portfolio loans by portfolio segment and class of financing receivable, based on our asset quality rating ("AQR") criteria:

(In Thousands)	Commercial	Real estate construction one-to-four family	Real estate construction other	Real estate term owner occupied	Real estate term non-owner occupied	Real estate term other	Consumer secured by 1st deeds of trust	Consumer other	Total
June 30, 2016									
AQR Pass	\$314,597	\$34,811	\$55,541	\$135,670	\$291,379	\$38,793	\$25,970	\$27,036	\$923,797
AQR Special Mention	3,109	—	—	1,256	—	285	152	6	4,808
AQR Substandard	19,648	3,972	1,912	16,338	221	—	909	61	43,061
Subtotal	\$337,354	\$38,783	\$57,453	\$153,264	\$291,600	\$39,078	\$27,031	\$27,103	\$971,666
Less: Unearned origination fees, net of origination costs									(4,320 )
Total loans									\$967,346
December 31, 2015									
AQR Pass	\$313,689	\$44,488	\$74,931	\$112,248	\$313,710	\$37,938	\$26,015	\$28,882	\$951,901
AQR Special Mention	536	—	—	—	—	91	171	10	808
AQR Substandard	15,309	—	—	16,515	359	—	487	20	32,690
Subtotal	\$329,534	\$44,488	\$74,931	\$128,763	\$314,069	\$38,029	\$26,673	\$28,912	\$985,399
Less: Unearned origination fees, net of origination costs									(4,612 )
Total loans									\$980,787

Loans are carried at their principal amount outstanding, net of charge-offs, unamortized fees and direct loan origination costs. Loan balances are charged-off to the allowance for loan losses ("Allowance") when management believes that collection of principal is unlikely. Interest income on loans is accrued and recognized on the principal amount outstanding except for loans in a nonaccrual status. All classes of loans are placed on nonaccrual and considered impaired when management believes doubt exists as to the collectability of the interest or principal. Cash payments received on nonaccrual loans are directly applied to the principal balance. Generally, a loan may be returned to accrual status when the delinquent principal and interest is brought current in accordance with the terms of the loan agreement. Additionally, certain ongoing performance criteria, which generally includes a performance period of six months, must be met in order for a loan to be returned to accrual status. Loans are reported as past due when installment payments, interest payments, or maturity payments are past due based on contractual terms. Nonaccrual loans: Nonaccrual loans net of government guarantees totaled \$9.6 million and \$2.1 million at June 30, 2016 and December 31, 2015, respectively. Nonaccrual loans at the periods indicated, by segment, are presented below:

(In Thousands)	June 30, 2016	December 31, 2015
Commercial	\$4,479	\$3,013
Real estate construction one-to-four family	3,972	—
Real estate construction other	1,912	—
Real estate term owner occupied	34	38
Real estate term non-owner occupied	221	359
Consumer secured by 1st deeds of trust	552	256
Consumer other	14	20
Total nonaccrual loans	\$11,184	\$3,686
Government guarantees on nonaccrual loans	(1,600 )	(1,561 )
Net nonaccrual loans	\$9,584	\$2,125



Past Due Loans: Past due loans and nonaccrual loans at the periods indicated are presented below by segment:

(In Thousands)	30-59	60-89	Greater	Total	Nonaccrual	Current	Total
	Days	Days	Than				
	Past Due	Past Due	90 Days	Past			
	Still	Still	Still	Due			
	Accruing	Accruing	Accruing				
June 30, 2016							
Commercial	\$334	\$137	\$—	\$471	\$4,479	\$332,404	\$337,354
Real estate construction one-to-four family	—	—	—	—	3,972	34,811	38,783
Real estate construction other	—	—	—	—	1,912	55,541	57,453
Real estate term owner occupied	550	—	—	550	34	152,680	153,264
Real estate term non-owner occupied	—	—	—	—	221	291,379	291,600
Real estate term other	—	—	—	—	—	39,078	39,078
Consumer secured by 1st deed of trust	143	—	—	143	552	26,336	27,031
Consumer other	—	—	47	47	14	27,042	27,103
Subtotal	\$1,027	\$137	\$47	\$1,211	\$11,184	\$959,271	\$971,666
							(4,320 )
Total							\$967,346
December 31, 2015							
Commercial	\$242	\$21	\$—	\$263	\$3,013	\$326,258	\$329,534
Real estate construction one-to-four family	—	—	—	—	—	44,488	44,488
Real estate construction other	—	—	—	—	—	74,931	74,931
Real estate term owner occupied	—	—	—	—	38	128,725	128,763
Real estate term non-owner occupied	—	—	—	—	359	313,710	314,069
Real estate term other	289	—	—	289	—	37,740	38,029
Consumer secured by 1st deed of trust	568	—	—	568	256	25,849	26,673
Consumer other	30	—	—	30	20	28,862	28,912
Subtotal	\$1,129	\$21	\$—	\$1,150	\$3,686	\$980,563	\$985,399
							(4,612 )
Total							\$980,787

Impaired Loans: The Company considers a loan to be impaired when it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan agreement. Once a loan is determined to be impaired, the impairment is measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate, except that if the loan is collateral dependent, the impairment is measured by using the fair value of the loan's collateral. Nonperforming loans greater than \$50,000 are individually evaluated for impairment based upon the borrower's overall financial condition, resources, and payment record, and the prospects for support from any financially responsible guarantors.

At June 30, 2016 and December 31, 2015, the recorded investment in loans that are considered to be impaired was \$44.4 million and \$34.6 million, respectively. The following table presents information about impaired loans by class as of the periods indicated:

(In Thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
June 30, 2016			
With no related allowance recorded			
Commercial - AQR special mention	\$151	\$151	\$—
Commercial - AQR substandard	19,427	20,107	—
Real estate construction other - AQR substandard	1,912	1,912	—
Real estate term owner occupied- AQR pass	257	257	—
Real estate term owner occupied- AQR substandard	16,259	16,259	—
Real estate term non-owner occupied- AQR pass	457	457	—
Real estate term non-owner occupied- AQR substandard	216	216	—
Real estate term other - AQR pass	662	662	—
Real estate term other - AQR special mention	77	77	—
Consumer secured by 1st deeds of trust - AQR pass	74	74	—
Consumer secured by 1st deeds of trust - AQR substandard	509	509	—
Subtotal	\$40,001	\$40,681	\$—
With an allowance recorded			
Real estate construction one-to-four family - AQR substandard	\$3,972	\$3,972	\$204
Consumer secured by 1st deeds of trust - AQR substandard	400	400	23
Subtotal	\$4,372	\$4,372	\$227
Total			
Commercial - AQR special mention	\$151	\$151	\$—
Commercial - AQR substandard	19,427	20,107	—
Real estate construction one-to-four family - AQR substandard	3,972	3,972	204
Real estate construction other - AQR substandard	1,912	1,912	—
Real estate term owner-occupied - AQR pass	257	257	—
Real estate term owner-occupied - AQR substandard	16,259	16,259	—
Real estate term non-owner occupied - AQR pass	457	457	—
Real estate term non-owner occupied - AQR substandard	216	216	—
Real estate term other - AQR pass	662	662	—
Real estate term other - AQR special mention	77	77	—
Consumer secured by 1st deeds of trust - AQR pass	74	74	—
Consumer secured by 1st deeds of trust - AQR substandard	909	909	23
Total	\$44,373	\$45,053	\$227



(In Thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
December 31, 2015			
With no related allowance recorded			
Commercial - AQR special mention	\$157	\$157	\$—
Commercial - AQR substandard	14,030	14,443	—
Real estate term owner occupied - AQR pass	753	753	—
Real estate term owner occupied - AQR substandard	16,476	16,476	—
Real estate term non-owner occupied - AQR pass	473	473	—
Real estate term non-owner occupied - AQR substandard	352	352	—
Real estate term other - AQR pass	699	699	—
Real estate term other - AQR special mention	91	91	—
Consumer secured by 1st deeds of trust - AQR pass	76	76	—
Consumer secured by 1st deeds of trust - AQR substandard	472	472	—
Subtotal	\$33,579	\$33,992	\$—
With an allowance recorded			
Commercial - AQR substandard	\$1,061	\$1,061	\$344
Subtotal	\$1,061	\$1,061	\$344
Total			
Commercial - AQR special mention	\$157	\$157	\$—
Commercial - AQR substandard	15,091	15,504	344
Real estate term owner occupied - AQR pass	753	753	—
Real estate term owner occupied - AQR substandard	16,476	16,476	—
Real estate term non-owner occupied - AQR pass	473	473	—
Real estate term non-owner occupied - AQR substandard	352	352	—
Real estate term other - AQR pass	699	699	—
Real estate term other - AQR special mention	91	91	—
Consumer secured by 1st deeds of trust - AQR pass	76	76	—
Consumer secured by 1st deeds of trust - AQR substandard	472	472	—
Total	\$34,640	\$35,053	\$344

The unpaid principal balance included in the tables above represents the recorded investment at the dates indicated, plus amounts charged off for book purposes.

The following tables summarize our average recorded investment and interest income recognized on impaired loans for the three and six month periods ended June 30, 2016 and 2015, respectively:

Three Months Ended June 30,	2016		2015	
(In Thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
<b>With no related allowance recorded</b>				
Commercial - AQR special mention	\$152	\$3	\$164	\$3
Commercial - AQR substandard	19,699	176	12,315	41
Real estate construction other - AQR pass	—	—	743	30
Real estate construction other - AQR substandard	1,912	—	—	—
Real estate term owner occupied- AQR pass	258	5	766	17
Real estate term owner occupied- AQR substandard	16,283	232	5,269	19
Real estate term non-owner occupied- AQR pass	462	18	541	19
Real estate term non-owner occupied- AQR special mention	—	—	2,079	44
Real estate term non-owner occupied- AQR substandard	222	—	1,652	—
Real estate term other - AQR pass	674	12	—	—
Real estate term other - AQR special mention	83	2	—	—
Real estate term other - AQR substandard	—	—	149	3
Consumer secured by 1st deeds of trust - AQR pass	75	1	80	1
Consumer secured by 1st deeds of trust - AQR substandard	486	5	444	4
Subtotal	\$40,306	\$454	\$24,202	\$181
<b>With an allowance recorded</b>				
Commercial - AQR substandard	\$—	\$2,414	\$—	\$—
Real estate construction one-to-four family - AQR substandard	3,972	—	—	—
Consumer secured by 1st deeds of trust - AQR substandard	292	—	—	—
Subtotal	\$4,264	\$2,414	\$—	\$—
<b>Total</b>				
Commercial - AQR special mention	\$152	\$3	\$164	\$3
Commercial - AQR substandard	19,699	176	14,729	41
Real estate construction one-to-four family - AQR substandard	3,972	—	—	—
Real estate construction other - AQR pass	—	—	743	30
Real estate construction other - AQR substandard	1,912	—	—	—
Real estate term owner-occupied - AQR pass	258	5	766	17
Real estate term owner-occupied - AQR substandard	16,283	232	5,269	19
Real estate term non-owner occupied - AQR pass	462	18	541	19
Real estate term non-owner occupied - AQR special mention	—	—	2,079	44
Real estate term non-owner occupied - AQR substandard	222	—	1,652	—
Real estate term other - AQR pass	674	12	—	—
Real estate term other - AQR special mention	83	2	—	—
Real estate term other - AQR substandard	—	—	149	3
Consumer secured by 1st deeds of trust - AQR pass	75	1	80	1
Consumer secured by 1st deeds of trust - AQR substandard	778	5	444	4
Total Impaired Loans	\$44,570	\$454	\$26,616	\$181

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Six Months Ended June 30,	2016		2015	
(In Thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded				
Commercial - AQR special mention	\$154	\$6	\$166	\$7
Commercial - AQR substandard	18,143	374	7,703	70
Real estate construction one-to-four family - AQR substandard	1,986	—	—	—
Real estate construction other - AQR pass	—	—	753	59
Real estate construction other - AQR substandard	1,912	—	—	—
Real estate term owner occupied- AQR pass	504	19	634	28
Real estate term owner occupied- AQR special mention	—	—	135	5
Real estate term owner occupied- AQR substandard	16,342	467	2,967	28
Real estate term non-owner occupied- AQR pass	466	37	544	38
Real estate term non-owner occupied- AQR special mention	—	—	2,127	88
Real estate term non-owner occupied- AQR substandard	230	—	2,009	—
Real estate term other - AQR pass	608	24	—	—
Real estate term other - AQR special mention	87	4	—	—
Real estate term other - AQR substandard	—	—	149	7
Consumer secured by 1st deeds of trust - AQR pass	75	2	81	2
Consumer secured by 1st deeds of trust - AQR substandard	476	8	560	4
Subtotal	\$40,983	\$941	\$17,828	\$336
With an allowance recorded				
Commercial - AQR substandard	\$297	<del>\$2,330</del>	\$—	\$—
Real estate construction one-to-four family - AQR substandard	1,986	—	—	—
Real estate term other - AQR substandard	—	<del>141</del>	—	—
Consumer secured by 1st deeds of trust - AQR substandard	146	—	—	—
Subtotal	\$2,429	<del>\$2,471</del>	\$—	\$—
Total				
Commercial - AQR special mention	\$154	\$6	\$166	\$7
Commercial - AQR substandard	18,440	374	10,033	70
Real estate construction one-to-four family - AQR substandard	3,972	—	—	—
Real estate construction other - AQR pass	—	—	753	59
Real estate construction other - AQR substandard	1,912	—	—	—
Real estate term owner-occupied - AQR pass	504	19	634	28
Real estate term owner-occupied - AQR special mention	—	—	135	5
Real estate term owner-occupied - AQR substandard	16,342	467	2,967	28
Real estate term non-owner occupied - AQR pass	466	37	544	38
Real estate term non-owner occupied - AQR special mention	—	—	2,127	88
Real estate term non-owner occupied - AQR substandard	230	—	2,009	—
Real estate term other - AQR pass	608	24	—	—
Real estate term other - AQR special mention	87	4	—	—
Real estate term other - AQR substandard	—	—	290	7
Consumer secured by 1st deeds of trust - AQR pass	75	2	81	2
Consumer secured by 1st deeds of trust - AQR substandard	622	8	560	4
Total Impaired Loans	\$43,412	\$941	\$20,299	\$336



**Purchased Credit Impaired Loans:** The Company acquired 18 purchased credit impaired loans in connection with its acquisition of Alaska Pacific Bancshares, Inc. on April 1, 2014 subject to the requirements of FASB ASC 310-30 Loans and Debt Securities Acquired with Deteriorated Credit Quality. This group of loans consists primarily of commercial and commercial real estate loans, and unlike a pool of consumer mortgages, it is not practicable for the Company to analyze the accretable yield of these loans. As such, the Company has elected the cost recovery method of income recognition for these loans, and thus no accretable difference has been identified for these loans. At the acquisition date, April 1, 2014, the fair value of this group of loans was \$3.9 million. The carrying value of these loans as of June 30, 2016 is \$1.4 million.

**Troubled Debt Restructurings:** Loans classified as troubled debt restructurings (“TDR”) totaled \$12.5 million and \$13.7 million at June 30, 2016 and December 31, 2015, respectively. A TDR is a loan to a borrower that is experiencing financial difficulty that has been modified from its original terms and conditions in such a way that the Company is granting the borrower a concession that it would not grant otherwise. The Company has granted a variety of concessions to borrowers in the form of loan modifications. The modifications granted can generally be described in the following categories:

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

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

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

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

AQR pass graded loans included above in the impaired loan data are loans classified as TDRs. By definition, TDRs are considered impaired loans. All of the Company's TDRs are included in impaired loans.

The Company had no newly restructured loans during the three and six month periods ended June 30, 2016.

The Company had no commitments to extend additional credit to borrowers whose terms have been modified in TDRs. There were no charge offs in the six months ended June 30, 2016 on loans that were later classified as TDRs. All TDRs are also classified as impaired loans and are included in the loans individually evaluated for impairment in the calculation of the Allowance. There were no TDRs with specific impairment at June 30, 2016 and December 31, 2015, respectively.

The Company had no TDRs that subsequently defaulted within the first twelve months of restructure, during the periods ending June 30, 2016 and December 31, 2015, respectively.

## 6. Allowance for Loan Losses

The following tables detail activity in the Allowance for the periods indicated:

Three Months Ended June 30,	Commercial	Real estate one-to-four family	Real estate construction other	Real estate term owner occupied	Real estate term non-owner occupied	Real estate term other	Consumer secured by 1st deed of trust	Consumer other	Unallocated	Total
2016										
Balance, beginning of period	\$5,749	\$760	\$1,621	\$1,739	\$5,498	\$638	\$264	\$396	\$1,518	\$18,183
Charge-Offs	(135)	—	—	—	—	—	—	—	—	(135)
Recoveries	135	—	—	—	—	—	—	2	—	137
Provision (benefit)	118	132	(524)	546	(200)	32	82	22	(8)	200
Balance, end of period	\$5,867	\$892	\$1,097	\$2,285	\$5,298	\$670	\$346	\$420	\$1,510	\$18,385
Balance, end of period: Individually evaluated for impairment	\$—	\$204	\$—	\$—	\$—	\$—	\$23	\$—	\$—	\$227
Balance, end of period: Collectively evaluated for impairment	\$5,867	\$688	\$1,097	\$2,285	\$5,298	\$670	\$323	\$420	\$1,510	\$18,158
2015										
Balance, beginning of period	\$6,091	\$757	\$1,663	\$1,570	\$4,794	\$756	\$274	\$402	\$640	\$16,947
Charge-Offs	—	—	—	—	—	—	—	—	—	—
Recoveries	91	—	—	—	—	—	—	4	—	95
Provis										