NORTHRIM BANCORP INC
Form 10-Q
November 06, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q
(Mark One)
þ Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2015
o 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.
ý 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).
ý 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 ý 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 ý No
The number of shares of the issuer's Common Stock, par value $1 per share, outstanding at November 6, 2015 was 6,862,916.

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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, 2014.

ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED FINANCIAL STATEMENTS
NORTHRIM BANCORP, INC.
Consolidated Balance Sheets
(Unaudited)

| (In Thousands, Except Share Data) | September 30, 2015 | December 31, 2014 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $42,257 | $36,036 |
| Interest bearing deposits in other banks | 102,309 | 36,020 |
| Investment securities available for sale | 234,273 | 281,730 |
| Investment securities held to maturity | 904 | 2,201 |
| Total portfolio investments | 235,177 | 283,931 |
| Investment in Federal Home Loan Bank stock | 1,816 | 3,404 |
| Loans held for sale | 66,597 | 43,866 |
| Loans | 973,680 | 924,504 |
| Allowance for loan losses | (17,848) | (16,723) |
| Net loans | 955,832 | 907,781 |
| Purchased receivables, net | 13,732 | 15,254 |
| Accrued interest receivable | 3,476 | 3,373 |
| Other real estate owned, net | 3,511 | 4,607 |
| Premises and equipment, net | 39,434 | 35,643 |
| Goodwill | 22,334 | 22,334 |
| Other intangible assets, net | 1,483 | 1,701 |
| Other assets | 51,295 | 55,399 |
| Total assets | $1,539,253 | $1,449,349 |
| LIABILITIES | | |
| Deposits: | | |
| Demand | $485,304 | $403,523 |
| Interest-bearing demand | 179,080 | 185,114 |
| Savings | 221,205 | 222,324 |
| Money market | 236,488 | 226,574 |
| Certificates of deposit less than $100,000 | 53,386 | 58,249 |
| Certificates of deposit greater than $100,000 | 89,456 | 83,963 |
| Total deposits | 1,264,919 | 1,179,747 |
| Securities sold under repurchase agreements | 33,413 | 19,843 |
| Borrowings | 12,458 | 26,304 |
| Junior subordinated debentures | 18,558 | 18,558 |
| Other liabilities | 34,569 | 40,456 |
| Total liabilities | 1,363,917 | 1,284,908 |
| SHAREHOLDERS' EQUITY | | |
| Preferred stock, $1 par value, 2,500,000 shares authorized, none issued or outstanding | — | — |
| Common stock, $1 par value, 10,000,000 shares authorized, 6,859,351 and 6,854,189 shares issued and outstanding at September 30, 2015 and December 31, 2014, respectively | 6,859 | 6,854 |
| Additional paid-in capital | 62,183 | 61,729 |
| Retained earnings | 105,363 | 95,493 |

| | | |
|---|---|---|
| Accumulated other comprehensive income | 784 | 247 |
| Total Northrim BanCorp shareholders' equity | 175,189 | 164,323 |
| Noncontrolling interest | 147 | 118 |
| Total shareholders' equity | 175,336 | 164,441 |
| Total liabilities and shareholders' equity | $1,539,253 | $1,449,349 |

See notes to consolidated financial statements

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In Thousands, Except Per Share Data) | 2015 | 2014 | 2015 | 2014 |
| Interest Income | | | | |
| Interest and fees on loans | $14,484 | $13,437 | $42,086 | $37,390 |
| Interest on investment securities available for sale | 844 | 696 | 2,488 | 2,176 |
| Interest on investment securities held to maturity | 13 | 24 | 61 | 69 |
| Interest on deposits in other banks | 47 | 55 | 82 | 145 |
| Total Interest Income | 15,388 | 14,212 | 44,717 | 39,780 |
| Interest Expense | | | | |
| Interest expense on deposits, borrowings and junior subordinated debentures | 706 | 487 | 2,208 | 1,411 |
| Net Interest Income | 14,682 | 13,725 | 42,509 | 38,369 |
| Provision for loan losses | 676 | — | 1,378 | (1,136) |
| Net Interest Income After Provision for Loan Losses | 14,006 | 13,725 | 41,131 | 39,505 |
| Other Operating Income | | | | |
| Mortgage banking income | 8,113 | — | 23,235 | — |
| Employee benefit plan income | 1,004 | 899 | 2,712 | 2,653 |
| Electronic banking income | 721 | 590 | 2,043 | 1,694 |
| Purchased receivable income | 587 | 582 | 1,738 | 1,547 |
| Service charges on deposit accounts | 559 | 599 | 1,617 | 1,682 |
| Gain on sale of securities, net | 4 | 15 | 134 | 461 |
| Gain on sale of premises and equipment | — | 1,115 | — | 1,115 |
| Equity in earnings from RML | — | 384 | — | 608 |
| Other income | 1,419 | 750 | 3,026 | 2,014 |
| Total Other Operating Income | 12,407 | 4,934 | 34,505 | 11,774 |
| Other Operating Expense | | | | |
| Salaries and other personnel expense | 11,440 | 7,107 | 33,115 | 19,866 |
| Occupancy expense | 1,522 | 1,041 | 4,720 | 3,030 |
| Change in fair value, RML earn-out liability | 780 | — | 2,869 | — |
| Professional and outside services | 642 | 323 | 2,184 | 947 |
| Marketing expense | 565 | 417 | 1,824 | 1,425 |
| Insurance expense | 406 | 319 | 1,075 | 788 |
| Equipment expense | 387 | 405 | 1,249 | 1,062 |
| Software expense | 298 | 383 | 947 | 997 |
| Internet banking expense | 229 | 264 | 676 | 677 |
| Intangible asset amortization expense | 73 | 81 | 218 | 214 |
| Merger and acquisition expense | — | 1,031 | — | 1,736 |
| Reserve for (recovery from) purchased receivables | (23) | 241 | (95) | 447 |
| OREO (income) expense, net rental income and gains on sale | 152 | (68) | 328 | (315) |
| Other operating expense | 1,732 | 1,235 | 5,308 | 3,494 |
| Total Other Operating Expense | 18,203 | 12,779 | 54,418 | 34,368 |
| Income Before Provision for Income Taxes | 8,210 | 5,880 | 21,218 | 16,911 |
| Provision for income taxes | 2,678 | 1,982 | 7,111 | 5,848 |
| Net Income | 5,532 | 3,898 | 14,107 | 11,063 |
| Less: Net income attributable to the noncontrolling interest | 197 | 191 | 431 | 329 |

| | | | | |
|---|---|---|---|---|
| Net Income Attributable to Northrim BanCorp, Inc. | $5,335 | $3,707 | $13,676 | $10,734 |
| Earnings Per Share, Basic | $0.78 | $0.54 | $2.00 | $1.59 |
| Earnings Per Share, Diluted | $0.77 | $0.53 | $1.97 | $1.57 |
| Weighted Average Shares Outstanding, Basic | 6,856,059 | 6,831,976 | 6,854,862 | 6,733,175 |
| Weighted Average Shares Outstanding, Diluted | 6,952,209 | 6,919,993 | 6,941,861 | 6,822,288 |

See notes to consolidated financial statements

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

| (In Thousands) | Three Months Ended September 30, 2015 | Three Months Ended September 30, 2014 | Nine Months Ended September 30, 2015 | Nine Months Ended September 30, 2014 |
|---|---|---|---|---|
| Net income | $5,532 | $3,898 | $14,107 | $11,063 |
| Other comprehensive income (loss), net of tax: | | | | |
| Securities available for sale: | | | | |
| Unrealized gains (losses) arising during the period | $217 | ($307) | $953 | $400 |
| Reclassification of net gains included in net income (net tax expense of $2 and $6 for the third quarter of 2015 and 2014, respectively and $55 and $190 for the first nine months of 2015 and 2014, respectively) | (2) | (9) | (79) | (271) |
| Income tax (benefit) expense related to unrealized gains and losses | (74) | 108 | (337) | (152) |
| Other comprehensive income (loss) | 141 | (208) | 537 | (23) |
| Comprehensive income | 5,673 | 3,690 | 14,644 | 11,040 |
| Less: comprehensive income attributable to the noncontrolling interest | 197 | 191 | 431 | 329 |
| Comprehensive income attributable to Northrim BanCorp, Inc. | $5,476 | $3,499 | $14,213 | $10,711 |

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 | Non-controlling Interest | Total |
|---|---|---|---|---|---|---|---|
| Balance as of January 1, 2014 | 6,538 | $6,538 | $54,089 | $82,855 | $669 | $167 | $144,318 |
| Purchase of Alaska Pacific | 290 | 290 | 7,156 | — | — | — | 7,446 |
| Cash dividend declared | — | — | — | (4,770) | — | — | (4,770) |
| Stock-based compensation expense | — | — | 360 | — | — | — | 360 |
| Exercise of stock options | 26 | 26 | 28 | — | — | — | 54 |
| Excess tax benefits from stock based payment arrangements | — | — | 96 | — | — | — | 96 |
| Distributions to noncontrolling interest | — | — | — | — | — | (508) | (508) |
| Other comprehensive loss, net of tax | — | — | — | — | (422) | — | (422) |
| Net income attributable to the noncontrolling interest | — | — | — | — | — | 459 | 459 |
| Net income attributable to Northrim BanCorp, Inc. | — | — | — | 17,408 | — | — | 17,408 |
| Twelve Months Ended December 31, 2014 | 6,854 | $6,854 | $61,729 | $95,493 | $247 | $118 | $164,441 |
| Cash dividend declared | — | — | — | (3,806) | — | — | (3,806) |
| Stock-based compensation expense | — | — | 357 | — | — | — | 357 |
| Exercise of stock options | 5 | 5 | 92 | — | — | — | 97 |
| Excess tax benefits from share-based payment arrangements | — | — | 5 | — | — | — | 5 |
| Distributions to noncontrolling interest | — | — | — | — | — | (402) | (402) |
| Other comprehensive income, net of tax | — | — | — | — | 537 | — | 537 |
| Net income attributable to the noncontrolling interest | — | — | — | — | — | 431 | 431 |
| Net income attributable to Northrim BanCorp, Inc. | — | — | — | 13,676 | — | — | 13,676 |
| Nine Months Ended September 30, 2015 | 6,859 | $6,859 | $62,183 | $105,363 | $784 | $147 | $175,336 |

See notes to consolidated financial statements

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

| | Nine Months Ended September 30, | |
|---|---|---|
| (In Thousands) | 2015 | 2014 |
| Operating Activities: | | |
| Net income | $14,107 | $11,063 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | |
| Gain on sale of securities, net | (134) | (461) |
| Gain on sale of premises and equipment | — | (1,115) |
| Depreciation and amortization of premises and equipment | 1,670 | 1,355 |
| Amortization of software | 136 | 136 |
| Intangible asset amortization | 218 | 214 |
| Amortization of investment security premium, net of discount accretion | (196) | (126) |
| Deferred tax liability | (314) | (1,503) |
| Stock-based compensation | 357 | 254 |
| Excess tax benefits from share-based payment arrangements | (5) | (5) |
| Deferral of loan fees and costs, net | (203) | 627 |
| Provision (benefit) for loan losses | 1,378 | (1,136) |
| Reserve for (recovery from) purchased receivables | (95) | 447 |
| Purchases of loans held for sale | — | (117,225) |
| Proceeds from the sale of loans held for sale | 571,494 | 118,201 |
| Origination of loans held for sale | (594,225) | — |
| Gain on sale of other real estate owned | (136) | (470) |
| Impairment on other real estate owned | 360 | 45 |
| Equity in undistributed earnings from mortgage affiliate | — | (239) |
| Net changes in assets and liabilities: | | |
| (Increase) in accrued interest receivable | (103) | (754) |
| Decrease in other assets | 3,836 | 1,685 |
| Decrease in other liabilities | (5,937) | (2,606) |
| Net Cash (Used) Provided by Operating Activities | (7,792) | 8,387 |
| Investing Activities: | | |
| Investment in securities: | | |
| Purchases of investment securities available for sale | (107,873) | (156,014) |
| Proceeds from sales/maturities of securities available for sale | 156,491 | 173,239 |
| Proceeds from calls/maturities of securities held to maturity | 1,285 | — |
| Purchases of domestic certificates of deposit | — | (3,500) |
| Proceeds from maturities of domestic certificates of deposit | 3,500 | 13,500 |
| Proceeds from redemption of FHLB stock | 1,588 | 129 |
| Alaska Pacific acquisition, net of cash received | — | 6,367 |
| Decrease in purchased receivables, net | 1,617 | 1,250 |
| Increase in loans, net | (50,359) | (28,899) |
| Proceeds from sale of other real estate owned | 1,971 | 1,828 |
| Elliott Cove divestiture, net of cash received | 219 | — |
| Decrease in loan to Elliott Cove, net | — | 189 |
| Purchases of premises and equipment | (5,461) | (4,104) |
| Net Cash (Used) Provided by Investing Activities | 2,978 | 3,985 |
| Financing Activities: | | |

| | | |
|---|---|---|
| Increase in deposits | 85,172 | 37,206 |
| Increases (decrease) in securities sold under repurchase agreements | 13,570 | (1,212) |
| Decrease in borrowings | (13,846) | (4,352) |
| Distributions to noncontrolling interest | (402) | (341) |
| Proceeds from the issuance of common stock | 97 | 75 |
| Excess tax benefits from share-based payment arrangements | 5 | 5 |

| | | |
|---|---|---|
| Cash dividends paid | (3,772 ) | (3,503 ) |
| Net Cash Provided (Used) by Financing Activities | 80,824 | 27,878 |
| | | |
| Net Change in Cash and Cash Equivalents | 76,010 | 40,250 |
| Cash and Cash Equivalents at Beginning of Period | 68,556 | 85,591 |
| Cash and Cash Equivalents at End of Period | $144,566 | $125,841 |
| Supplemental Information: | | |
| Income taxes paid | $4,136 | $3,627 |
| Interest paid | $2,174 | $1,408 |
| Noncash commitments to invest in Low Income Housing Tax Credit Partnerships | $55 | $8,518 |
| Transfer of loans to other real estate owned | $1,133 | $1,158 |
| Transfer of premises to other real estate owned | $— | $904 |
| Cash dividends declared but not paid | $34 | $23 |
| Acquisitions: | | |
| Assets acquired | $— | $167,199 |
| Liabilities assumed | $— | $153,172 |

See notes to consolidated financial statements

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. Prior to December 2014, the Company operated in a single segment: Community Banking. The Company has evaluated events and transactions through November 6, 2015 for potential recognition or disclosure. Operating results for the interim period ended September 30, 2015, are not necessarily indicative of the results anticipated for the year ending December 31, 2015. 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, 2014.

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, 2014.
In January 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-01, Accounting for Investments in Qualified Affordable Housing Projects. ASU 2014-01 permits an entity to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2014 and should be applied prospectively. The Company adopted ASU 2014-01 in its consolidated financial statements as of January 1, 2015. As a result, amortization expense related to the Company's investments in low income housing tax credit partnerships has been included in the line item entitled "Provision for income taxes" in the Consolidated Statements of Income for all periods presented.
In February 2015, the Financial Accounting Standards Board (“FASB”) issued ASU 2015-02, Amendments to the Consolidation Analysis (“ASU 2015-02”). The amendments to the Codification in ASU 2015-02 affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. The amendments in this update affect the following areas: 1) the effect of related parties on the primary beneficiary determination, 2) evaluating fees paid to a decision maker or a service provider as a variable interest, 3) the effect of fee arrangements on the primary beneficiary determination, and 4) certain investment funds. This ASU is effective for the Company’s financial statements for annual and interim periods beginning on or after December 15, 2015, 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 April 2015, the Financial Accounting Standards Board (“FASB”) issued ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs (“ASU 2015-03”). The amendments to the Codification in ASU 2015-03 identify, evaluate, and

improve areas of generally accepted accounting principles (GAAP) for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements. To simplify presentation of debt issuance costs, the amendments in this Update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this Update. This ASU is effective for the Company's financial statements for annual and interim periods beginning on or after December 15, 2015, 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 August 2015, the Financial Accounting Standards Board ("FASB") issued ASU 2015-14, Revenue from Contracts with Customers ("ASU 2015-14"). The amendments to the Codification in ASU 2015-14 defer the effective date of Update 2014-09

for all entities by one year. This ASU is effective for the Company’s financial statements for annual and interim periods beginning on or after December 15, 2017, 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 September 2015, the Financial Accounting Standards Board (“FASB”) issued ASU 2015-16, Business Combinations (“ASU 2015-16”). The amendments to the Codification in ASU 2015-16 require that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The amendments in this update require that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. The amendments in this update require an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. This ASU is effective for fiscal years beginning on or after December 15, 2015, 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.

3. Business Combinations
Alaska Pacific Bancshares, Inc.
On April 1, 2014, the Company completed the acquisition of 100% of the outstanding shares of Alaska Pacific Bancshares, Inc. ("Alaska Pacific") for a total purchase price of $13.9 million, which was comprised of the issuance of 290,212 shares of the Company’s common stock (at a volume weighted average closing price of $25.66 per share) and $6.4 million in cash. The assets acquired and liabilities assumed have been accounted for under the acquisition method of accounting and were recorded at their estimated fair values as of the April 1, 2014 acquisition date. Estimated fair values recorded in the transaction were subject to change for up to one year after the closing date of the acquisition. The primary reason for the acquisition was to expand the Company's geographic footprint in Alaska.

The application of the acquisition method of accounting resulted in the recognition of a bargain purchase gain of $170,000 and a core deposit intangible of $623,000, or 0.5% of core deposits. The bargain purchase gain represents the excess of the estimated fair value of the net assets acquired in excess of the purchase price and is included in Other Income in the Consolidated Statements of Income in this Form 10-Q. This acquisition resulted in a bargain purchase gain primarily due to the inclusion of certain adjustments to the purchase price for potential risks identified by the Company during the due diligence and price negotiation stages of the acquisition that were concluded in October of 2013. The Company has concluded that the potential risks identified at that time do not represent a liability to the Company and, accordingly, they have not been allocated any value in the application of the acquisition method of accounting.

A summary of the net assets acquired and the estimated fair value adjustments of Alaska Pacific are presented below:

| (In Thousands) | Alaska Pacific April 1, 2014 | |
|---|---|---|
| Cost basis net assets | $14,733 | |
| Cash payment made | (6,423 | ) |
| Common stock issued | (7,446 | ) |
| Fair value adjustments: | | |
| Net loans | (1,137 | ) |
| Premises and equipment | 547 | |
| Other intangible assets | 623 | |
| Mortgage servicing rights | (119 | ) |

| | |
|---|---|
| Deposits | (844 ) |
| Other | 236 |
| Bargain purchase gain | $170 |

A summary of assets acquired and liabilities assumed at their estimated fair values are presented below:

| (In Thousands) | Alaska Pacific April 1, 2014 |
|---|---|
| Assets Acquired: | |
| Cash and equivalents | $12,956 |
| Investment securities | 7,240 |
| Loans | 138,432 |
| Premises and equipment | 3,436 |
| Other intangibles | 623 |
| Mortgage servicing rights | 1,170 |
| Other real estate owned | 1,709 |
| Other assets | 1,645 |
| Total assets acquired | $167,211 |
| Liabilities Assumed: | |
| Deposits | $151,438 |
| Other liabilities | 1,734 |
| Total liabilities assumed | $153,172 |

Alaska Pacific purchased loans not subject to the requirements of FASB ASC 310-30 Loans and Debt Securities Acquired with Deteriorated Credit Quality ("ASC 310-30") are presented below at acquisition:

| (In Thousands) | April 1, 2014 |
|---|---|
| Contractually required principal payments | $133,921 |
| Purchase adjustment for credit, interest rate, and liquidity | 612 |
| Fair value of purchased non-credit impaired loans | $134,533 |

Alaska Pacific purchased loans subject to the requirements of FASB ASC 310-30 Loans and Debt Securities Acquired with Deteriorated Credit Quality. The Company identified eighteen purchased credit impaired loans as of April 1, 2014. 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.

Purchased credit impaired loans at acquisition are presented below:

| (In Thousands) | April 1, 2014 |
|---|---|
| Contractually required principal payments | $7,553 |
| Nonaccretable difference | (3,654) |
| Fair value of purchased credit impaired loans | $3,899 |

The acquisition of Alaska Pacific is not considered significant to the Company’s financial statements. The operations of Alaska Pacific are included in our operating results from April 1, 2014, and the Company estimates that these operations added revenue of $6.7 million, non-interest expense of $3.9 million, and net income of $2.8 million, before taxes, for the nine months ended September 30, 2015. Alaska Pacific’s results of operations prior to the acquisition are not included in our operating results. Additionally, merger-related costs of $1.3 million for the nine months ended September 30, 2014 were incurred and expensed in connection with the acquisition of Alaska Pacific and recognized within the merger and acquisition expense on the Consolidated Statements of Income.

The following table presents unaudited pro forma results of operations for the nine month period ended September 30, 2014 as if the acquisition of Alaska Pacific had occurred on January 1, 2014. The proforma results have been prepared for comparative purposes only and are not necessarily indicative of the results that would have been obtained had the acquisition actually occurred on January 1, 2014.

| (In Thousands, except earnings per share data) | Nine Months Ended September 30, 2014 | | | |
|---|---|---|---|---|
| | Company | Alaska Pacific[1] | Pro Forma Adjustments | Pro Forma Combined |
| Net interest and other income | $50,143 | $2,095 | ($10 )[2] | $52,228 |
| Net income attributable to Northrim BanCorp, Inc. | 10,734 | (1,282 ) | 101[3] | 9,553 |
| Earnings Per Share, Basic | $1.59 | | | $1.36 |
| Earnings Per Share, Diluted | $1.57 | | | $1.34 |
| Weighted Average Shares Outstanding, Basic | 6,733,175 | | | 7,023,387 |
| Weighted Average Shares Outstanding, Diluted | 6,822,288 | | | 7,112,500 |

1 Alaska Pacific represents results from January 1 to March 31 for 2014.
2 Amount of amortization/ accretion of the fair value adjustments on loans and certificates of deposit.
3 Amount of amortization/accretion of the fair value adjustments on loans and certificates of deposit, bargain purchase gain, amortization of core deposit intangible, and the change in the provision for income taxes.

Residential Mortgage Holding Company, LLC

On December 1, 2014, the Company completed the acquisition of 76.5% of the equity interest in RML, the parent company of Residential Mortgage, in a cash transaction valued at $29.5 million, resulting in RML becoming an indirect wholly-owned subsidiary of the Company. The primary reason for the acquisition was to expand the Company's presence in the mortgage lending business in Alaska. The fair value of the Company's 23.5% equity interest in RML immediately prior to the acquisition was $9.0 million. The Company recorded a $3.0 million gain in the fourth quarter of 2014 as a result of remeasuring the Company's equity interest in RML immediately prior to the acquisition, which was included in the Company's Consolidated Statements of Income in the line item entitled "Gain on purchase of mortgage affiliate". The Company utilized a market value approach to value its equity interest in RML which included analysis of current trading values and historical acquisition multiples of comparable mortgage companies. The consideration transferred or transferable to the former owners of RML and the assets acquired and liabilities assumed have been accounted for under the acquisition method of accounting and were recorded at their estimated fair values as of the December 1, 2014 acquisition date. Estimated fair values recorded in the transaction are subject to change for up to one year after the closing date of the acquisition. The application of the acquisition method of accounting resulted in the recognition of goodwill in the amount of $14.8 million and a trade name intangible of $950,000. RML holds a 30% equity interest in Homestate Mortgage LLC.

The former owners of RML (the "sellers") will receive additional cash proceeds (the "earn-out" payments) based on the adjusted pretax earnings of RML for each of the twelve months periods ending November 30, 2015, 2016, 2017, 2018 and 2019. The Company recorded a $7.3 million liability as of December 1, 2014 as part of its purchase accounting for future earn-out payments. Per the purchase agreement, the earn-out payments are calculated as follows:

| | | |
|---|---|---|
| First tier earn-out payment | Adjusted pretax earnings greater than $1,000,000 and less than or equal to $2,000,000 | Payment will be calculated as product of amount of adjusted pretax earnings times 40% |
| Second tier earn-out payment | Adjusted pretax earnings greater than $2,000,000 and less than or equal to $3,000,000 | The first tier earn-out payment, plus the product of amount of adjusted pretax earnings greater than $2,000,000 and less than $3,000,000 times 50% |
| Third tier earn-out payment | Adjusted pretax earnings greater than $3,000,000 and less than or equal to $4,000,000 | The first tier plus the second tier earn-out payment, plus the product of amount of adjusted pretax earnings greater than $3,000,000 and less than $4,000,000 times 70% |
| Fourth tier earn- out payment | Adjusted pretax earnings greater than $4,000,000 and less than or equal to $6,000,000 | The first, second and third tier earn-out payment, plus the product of amount of adjusted pretax earnings greater than $4,000,000 and less than $6,000,000 times 85% |
| Fifth tier earn-out payment | Adjusted pretax earnings greater than $6,000,000 | The first, second, third and fourth tier earn-out payment, plus the product of amount of adjusted pretax earnings greater than $6,000,000 times 55% |

The purchase agreement provides for these earn-out payments as a portion of the purchase price to be paid to the sellers in future periods, contingent on future events. Therefore the Company included an estimate of the acquisition-date fair value of the contingent consideration of $7.3 million as part of the cost of the combination. The accounting treatment of the contingent consideration to be paid to those of the sellers who continue employment with the Company was evaluated to determine whether the amounts represent purchase consideration or a separate transaction, such as post-transaction employee compensation. Factors evaluated require significant judgment and include, among other factors; consideration of the terms of continuing employment, levels of post-transaction compensation, ownership interest of the sellers/employees, linkage of the contingent consideration to the transaction date combination valuation, and any other agreements or matters related to the transaction.
Based on an evaluation of the factors surrounding the transaction and the terms of the purchase agreement, the amount due under the earn-out provision was accounted for as acquisition consideration. The Company concluded that the contingent consideration to be paid to the sellers/employees was a significant component of the transaction date valuation of the acquired business. The calculation of the contingent payment was based upon factors established at the date of the transaction to be paid upon meeting the established earnings criteria of RML. The post transaction employment arrangements of the continuing employees are at market rates, and the formula for determining the contingent consideration is consistent with the business valuation methodologies, based upon a multiplier of earnings recognized from RML for five twelve month periods following the acquisition.

For the nine month period ended September 30, 2015, the Company recorded an adjustment to increase the contingent liability by $2.9 million. The increase in the contingent liability resulted from the excess of RML's pretax income from December 1, 2014 through the end of the third quarter of 2015 over and above estimates made at the close of the purchase of RML. The adjustment to the contingent liability for estimated future earn-out payments is recorded in the line item titled "Change in fair value, RML earn-out liability" in other operating expense on the Consolidated

Statements of Income. The total contingent liability as of September 30, 2015 is $10.3 million.

A summary of the net assets acquired and the estimated fair value adjustments of RML are presented below:

| (In Thousands) | RML December 1, 2014 |
|---|---|
| Cost basis net assets | $11,915 |
| Cash payment made | (18,240) |
| Cash surrender value of life insurance paid | (3,896) |
| Liability for future earn out payments | (7,318) |
| Fair value adjustments: | |
| Loans | (360) |
| Trade name intangible | 950 |
| Rate lock derivative asset | 960 |
| Investment in Homestate Mortgage, LLC | 1,490 |
| Other | (311) |
| Goodwill | ($14,810) |

A summary of assets acquired and liabilities assumed at their estimated fair values are presented below:

| (In Thousands) | RML December 1, 2014 |
|---|---|
| Assets Acquired: | |
| Cash and equivalents | $10,828 |
| Net loans | 41,304 |
| Premises and equipment | 255 |
| Trade name intangible | 950 |
| Rate lock derivative asset | 960 |
| Investment in Homestate Mortgage LLC | 3,000 |
| Other real estate owned | 270 |
| Other assets | 10,291 |
| Total assets acquired | $67,858 |
| Liabilities Assumed: | |
| Borrowings | $37,541 |
| Other liabilities | 6,625 |
| Total liabilities assumed | $44,166 |

The acquisition of RML is not considered significant to the Company’s financial statements under Regulation S-X; however, the Company has determined that the acquisition results in a new reporting segment, Home Mortgage Lending.

The operations of RML are included in our operating results from December 1, 2014, and added revenue of $23.8 million, non-interest expense of $16.4 million, and net income of $7.4 million, before taxes, for the nine month period ended September 30, 2015. RML’s results of operations prior to the December 1, 2014 acquisition are included in our operating results under the equity method. Additionally, merger-related costs of $430,000 for the nine-month period ended September 30, 2014 were incurred and expensed in connection with the acquisition of RML and recognized within the merger and acquisition expense on the Consolidated Statements of Income.

The following table presents unaudited pro forma results of operations for the nine month period ended September 30, 2014 as if the acquisition of RML had occurred on January 1, 2014. The proforma results have been prepared for comparative purposes only and are not necessarily indicative of the results that would have been obtained had the acquisition actually occurred on January 1, 2014.

| (In Thousands, except earnings per share data) | Nine Months Ended September 30, 2014 | | | |
|---|---|---|---|---|
| | Company | RML[1] | Pro Forma Adjustments | Pro Forma Combined |
| Net interest and other income | $50,143 | $17,978 [2] | ($569) [3] | $67,552 |
| Net income attributable to Northrim BanCorp, Inc. | 10,734 | 3,172 | 2,625 [4] | 16,531 |
| Earnings Per Share, Basic | $1.59 | | | $2.46 |
| Earnings Per Share, Diluted | $1.57 | | | $2.42 |
| Weighted Average Shares Outstanding, Basic | 6,733,175 | | | 6,733,175 |
| Weighted Average Shares Outstanding, Diluted | 6,822,288 | | | 6,822,288 |

[1] RML represents results from January 1 to September 30.
[2] 2014 amount is comprised of net interest income of $244,000 and $17.7 million of other income.
[3] Amount of accretion of the fair value adjustments on loans and income recognized under the equity method prior to the December 2014 acquisition.
[4] Amount of accretion of the fair value adjustments on loans, income recognized under the equity method, gain on acquisition, earn out accretion, and the change in the provision for income taxes.

Prior to December 1, 2014, the Company accounted for RML under the equity method of accounting. As of December 1, 2014, the Company owns 100% interest in RML and consolidates RML's activity into the Company's Consolidated Financial Statements.

The following table presents unaudited combined pro forma results of operations for the nine month period ended September 30, 2014 as if the acquisition of Alaska Pacific and RML had occurred on January 1, 2014. The proforma results have been prepared for comparative purposes only and are not necessarily indicative of the results that would have been obtained had the acquisitions actually occurred on January 1, 2014.

| (In Thousands, except earnings per share data) | Nine Months Ended September 30, 2014 | | | | |
|---|---|---|---|---|---|
| | Company | Alaska Pacific[1] | RML[2] | Pro Forma Adjustments | Pro Forma Combined |
| Net interest and other income | $50,143 | $2,095 | $17,978 [3] | ($597) [4] | $69,619 |
| Net income attributable to Northrim BanCorp, Inc. | 10,734 | (1,282) | 3,172 | 2,726 [5] | 15,350 |
| Earnings Per Share, Basic | $1.59 | | | | $2.19 |
| Earnings Per Share, Diluted | $1.57 | | | | $2.16 |
| Weighted Average Shares Outstanding, Basic | 6,733,175 | | | | 7,023,387 |
| Weighted Average Shares Outstanding, Diluted | 6,822,288 | | | | 7,112,500 |

[1] Alaska Pacific represents results from January 1 to March 31 for 2014.
[2] RML represents results from January 1 to September 30.
[3] 2014 amount is comprised of net interest income of $244,000 and $17.7 million of other income.
[4] Amount of amortization/ accretion of the fair value adjustments on loans and certificates of deposit for Alaska Pacific and amount of accretion of the fair value adjustments on loans and income recognized under the equity method prior to the December 2014 acquisition for RML.

[5] Amount of amortization/accretion of the fair value adjustments on loans and certificates of deposit, bargain purchase gain, amortization of core deposit intangible, and the change in the provision for income taxes for Alaska Pacific and amount of accretion of the fair value adjustments on loans, income recognized under the equity method, gain on acquisition, earn out accretion, and the change in the provision for income taxes for RML.

4. Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits with other banks, banker's acceptances, commercial paper, securities purchased under agreement to resell, federal funds sold, and securities with maturities of less than 90 days at acquisition. As of September 30, 2015, the Company had no certificate of deposit in another bank with original maturity greater than 90 days. Cash and cash equivalent balances placed with the Federal Reserve of San Francisco is the only concentration representing more than 10% of the Company's equity.

5. Investment Securities

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

| (In Thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| September 30, 2015 | | | | |
| Securities available for sale | | | | |
| U.S. Treasury and government sponsored entities | $181,920 | $859 | $5 | $182,774 |
| Municipal securities | 10,932 | 172 | 13 | 11,091 |
| U.S. Agency mortgage-backed securities | 875 | 3 | 4 | 874 |
| Corporate bonds | 38,309 | 228 | — | 38,537 |
| Preferred stock | 998 | — | 1 | 997 |
| Total securities available for sale | $233,034 | $1,262 | $23 | $234,273 |
| Securities held to maturity | | | | |
| Municipal securities | $904 | $68 | $— | $972 |
| Total securities held to maturity | $904 | $68 | $— | $972 |
| December 31, 2014 | | | | |
| Securities available for sale | | | | |
| U.S. Treasury and government sponsored entities | $226,624 | $105 | $539 | $226,190 |
| Municipal securities | 11,843 | 285 | 4 | 12,124 |
| U.S. Agency mortgage-backed securities | 1,024 | 6 | 1 | 1,029 |
| Corporate bonds | 38,820 | 415 | — | 39,235 |
| Preferred stock | 2,999 | 153 | — | 3,152 |
| Total securities available for sale | $281,310 | $964 | $544 | $281,730 |
| Securities held to maturity | | | | |
| Municipal securities | $2,201 | $107 | $— | $2,308 |
| Total securities held to maturity | $2,201 | $107 | $— | $2,308 |

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 September 30, 2015 and December 31, 2014 were as follows:

| | Less Than 12 Months | | More Than 12 Months | | Total | |
|---|---|---|---|---|---|---|
| (In Thousands) | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| September 30, 2015: | | | | | | |
| Securities Available for Sale | | | | | | |
| U.S. Treasury and government sponsored entities | $3,621 | $5 | $39 | $— | $3,660 | $5 |
| Municipal Securities | 2,145 | 13 | — | — | 2,145 | 13 |
| Mortgage-backed Securities | 508 | 3 | 80 | 1 | 588 | 4 |
| Preferred Stock | 996 | 1 | — | — | 996 | 1 |
| Total | $7,270 | $22 | $119 | $1 | $7,389 | $23 |
| December 31, 2014: | | | | | | |
| Securities Available for Sale | | | | | | |
| U.S. Treasury and government sponsored entities | $165,004 | $539 | $— | $— | $165,004 | $539 |
| Municipal Securities | 567 | 4 | — | — | 567 | 4 |
| Mortgage-backed Securities | 117 | 1 | — | — | 117 | 1 |
| Total | $165,688 | $544 | $— | $— | $165,688 | $544 |

There were twelve and twenty-nine available-for-sale securities with unrealized losses as of September 30, 2015 and December 31, 2014, respectively, that have been in a loss position for less than twelve months. There were three and no securities as of September 30, 2015 and December 31, 2014 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 the Company does not intend to sell, nor is it required to sell these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

At September 30, 2015, $64.0 million in securities, or 27%, of the investment portfolio was pledged for deposits and borrowings, as compared to $54.1 million, or 19%, at December 31, 2014. We held no securities of any single issuer (other than government sponsored entities) that exceeded 10% of our shareholders' equity at September 30, 2015 and December 31, 2014.

The amortized cost and fair values of debt securities at September 30, 2015, 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 | | | | |
| 1-5 years | $181,920 | $182,774 | 1.26 | % |
| Total | $181,920 | $182,774 | 1.26 | % |
| U.S. Agency mortgage-backed securities | | | | |
| 1-5 years | $37 | $36 | 1.99 | % |
| 5-10 years | 250 | 248 | 3.04 | % |
| Over 10 years | 588 | 590 | 2.82 | % |
| Total | $875 | $874 | 2.85 | % |
| Corporate bonds | | | | |
| Within 1 year | $17,233 | $17,388 | 1.99 | % |
| 1-5 years | 21,076 | 21,149 | 1.07 | % |
| Total | $38,309 | $38,537 | 1.48 | % |
| Preferred stock | | | | |
| Over 10 years | $998 | $997 | 6.02 | % |
| Total | $998 | $997 | 6.02 | % |
| Municipal securities | | | | |
| Within 1 year | $658 | $666 | 2.64 | % |
| 1-5 years | 6,289 | 6,434 | 2.11 | % |
| 5-10 years | 4,889 | 4,963 | 4.54 | % |
| Total | $11,836 | $12,063 | 3.14 | % |

The proceeds and resulting gains and losses, computed using specific identification, from sales of investment securities for the nine months ending September 30, 2015 and 2014, respectively, are as follows:

| (In Thousands) | Proceeds | Gross Gains | Gross Losses |
|---|---|---|---|
| 2015 | | | |
| Available for sale securities | $3,633 | $134 | $— |
| 2014 | | | |
| Available for sale securities | $24,102 | $465 | $4 |

A summary of interest income for the nine months ending September 30, 2015 and 2014 on available for sale investment securities is as follows:

| (In Thousands) | 2015 | 2014 |
|---|---|---|
| US Treasury and government sponsored entities | $1,713 | $1,186 |
| U.S. Agency mortgage-backed securities | 20 | 17 |
| Other | 507 | 671 |
| Total taxable interest income | $2,240 | $1,874 |
| Municipal securities | $248 | $302 |
| Total tax-exempt interest income | $248 | $302 |
| Total | $2,488 | $2,176 |

6. Loans Held for Sale

The Company acquired the remaining 76.5% of RML on December 1, 2014. The Company originates 1-4 family residential mortgages through RML and sells them to the secondary market. These loans are shown as loans held for sale on the Company's Consolidated Balance Sheet. The Company originated $594.2 million and sold $571.5 million in loans during the nine-month period ending September 30, 2015. Prior to December 1, 2014, the Company had a 23.5% ownership interest in RML and purchased residential loans from them. The Company then sold these loans in the secondary market. The Company purchased $117.2 million and sold $118.2 million in loans from RML during the nine-month period ending September 30, 2014.

7. Loans

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 |
|---|---|---|---|---|---|---|---|---|---|
| September 30, 2015 | | | | | | | | | |
| AQR Pass | $309,102 | $48,527 | $96,037 | $106,573 | $290,743 | $36,076 | $26,964 | $29,159 | $943,181 |
| AQR Special Mention | 573 | — | — | 746 | 108 | 367 | 164 | 21 | 1,979 |
| AQR Substandard | 15,417 | — | 11,356 | 5,208 | 262 | — | 536 | 89 | 32,868 |
| AQR Doubtful | — | — | — | — | — | — | — | — | — |
| AQR Loss | — | — | — | — | — | — | — | — | — |
| Subtotal | $325,092 | $48,527 | $107,393 | $112,527 | $291,113 | $36,443 | $27,664 | $29,269 | $978,028 |
| Less: Unearned origination fees, net of origination costs | | | | | | | | | (4,348) |
| Total loans | | | | | | | | | $973,680 |
| December 31, 2014 | | | | | | | | | |
| AQR Pass | $291,020 | $34,651 | $91,195 | $103,049 | $282,774 | $36,705 | $31,118 | $31,399 | $901,911 |
| AQR Special Mention | 11,618 | — | — | 5,817 | 2,095 | 39 | 396 | 47 | 20,012 |
| AQR Substandard | 3,905 | 191 | — | 606 | 1,747 | 150 | 486 | 47 | 7,132 |
| AQR Doubtful | — | — | — | — | — | — | — | — | — |
| AQR Loss | — | — | — | — | — | — | — | — | — |
| Subtotal | $306,543 | $34,842 | $91,195 | $109,472 | $286,616 | $36,894 | $32,000 | $31,493 | $929,055 |
| Less: Unearned origination fees, net of origination costs | | | | | | | | | (4,551) |
| Total loans | | | | | | | | | $924,504 |

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 totaled $3.7 million and $4.7 million at September 30, 2015 and December 31, 2014, respectively. Nonaccrual loans at the periods indicated, by segment, are presented below:

| (In Thousands) | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Commercial | $3,041 | $2,031 |
| Real estate construction one-to-four family | — | 191 |
| Real estate term owner occupied | 41 | 135 |
| Real estate term non-owner occupied | 262 | 1,746 |
| Real estate term other | — | 39 |
| Consumer secured by 1st deeds of trust | 302 | 485 |
| Consumer other | 89 | 47 |
| Total | $3,735 | $4,674 |

Past due loans and nonaccrual loans at the periods indicated are presented below by AQR:

| (In Thousands) | 30-59 Days Past Due Still Accruing | 60-89 Days Past Due Still Accruing | Greater Than 90 Days Still Accruing | Nonaccrual | Total Past Due | Current | Total |
|---|---|---|---|---|---|---|---|
| September 30, 2015 | | | | | | | |
| AQR Pass | $80 | $— | $— | $— | $80 | $943,101 | $943,181 |
| AQR Special Mention | 15 | — | — | — | 15 | 1,964 | 1,979 |
| AQR Substandard | — | — | — | 3,735 | 3,735 | 29,133 | 32,868 |
| AQR Doubtful | — | — | — | — | — | — | — |
| AQR Loss | — | — | — | — | — | — | — |
| Subtotal | $95 | $— | $— | $3,735 | $3,830 | $974,198 | $978,028 |
| Less: Unearned origination fees, net of origination costs | | | | | | | (4,348) |
| Total | | | | | | | $973,680 |
| December 31, 2014 | | | | | | | |
| AQR Pass | $696 | $545 | $— | $— | $1,241 | $900,670 | $901,911 |
| AQR Special Mention | — | — | — | — | — | 20,012 | 20,012 |
| AQR Substandard | 40 | — | — | 4,674 | 4,714 | 2,418 | 7,132 |
| AQR Doubtful | — | — | — | — | — | — | — |
| AQR Loss | — | — | — | — | — | — | — |
| Subtotal | $736 | $545 | $— | $4,674 | $5,955 | $923,100 | $929,055 |
| Less: Unearned origination fees, net of origination costs | | | | | | | (4,551) |
| Total | | | | | | | $924,504 |

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 September 30, 2015 and December 31, 2014, the recorded investment in loans that are considered to be impaired was $35.0 million and $11.3 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 |
|---|---|---|---|
| September 30, 2015 | | | |
| With no related allowance recorded | | | |
| Commercial - AQR special mention | $160 | $160 | $— |
| Commercial - AQR substandard | 14,011 | 14,460 | — |
| Real estate construction other - AQR pass | 721 | 721 | — |
| Real estate construction other - AQR substandard | 11,356 | 11,356 | |
| Real estate term owner occupied- AQR pass | 758 | 758 | — |
| Real estate term owner occupied- AQR substandard | 5,167 | 5,167 | — |
| Real estate term non-owner occupied- AQR pass | 493 | 493 | — |
| Real estate term non-owner occupied- AQR special mention | 101 | 101 | — |
| Real estate term non-owner occupied- AQR substandard | 262 | 262 | — |
| Real estate term other - AQR special mention | 148 | 148 | — |
| Consumer secured by 1st deeds of trust - AQR pass | 78 | 78 | — |
| Consumer secured by 1st deeds of trust - AQR substandard | 482 | 482 | — |
| Subtotal | $33,737 | $34,186 | $— |
| With an allowance recorded | | | |
| Commercial - AQR substandard | $1,169 | $1,169 | $433 |
| Consumer other - AQR substandard | 80 | 80 | 80 |
| Subtotal | $1,249 | $1,249 | $513 |
| Total | | | |
| Commercial - AQR special mention | $160 | $160 | $— |
| Commercial - AQR substandard | 15,180 | 15,629 | 433 |
| Real estate construction other - AQR pass | 721 | 721 | — |
| Real estate construction other - AQR substandard | 11,356 | 11,356 | — |
| Real estate term owner-occupied - AQR pass | 758 | 758 | — |
| Real estate term owner-occupied - AQR substandard | 5,167 | 5,167 | — |
| Real estate term non-owner occupied - AQR pass | 493 | 493 | — |
| Real estate term non-owner occupied - AQR special mention | 101 | 101 | — |
| Real estate term non-owner occupied - AQR substandard | 262 | 262 | — |
| Real estate term other - AQR special mention | 148 | 148 | — |
| Consumer secured by 1st deeds of trust - AQR pass | 78 | 78 | — |
| Consumer secured by 1st deeds of trust - AQR substandard | 482 | 482 | — |
| Consumer other - AQR substandard | 80 | 80 | 80 |
| Total | $34,986 | $35,435 | $513 |

| (In Thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance |
|---|---|---|---|
| December 31, 2014 | | | |
| With no related allowance recorded | | | |
| Commercial - AQR special mention | $170 | $170 | $— |
| Commercial - AQR substandard | 3,000 | 3,045 | — |
| Real estate construction one-to-four family - AQR special mention | 191 | 191 | — |
| Real estate construction other - AQR pass | 772 | 772 | — |
| Real estate term owner occupied - AQR pass | 501 | 501 | — |
| Real estate term owner occupied - AQR special mention | 273 | 273 | — |
| Real estate term owner occupied - AQR substandard | 558 | 558 | — |
| Real estate term non-owner occupied - AQR pass | 549 | 549 | — |
| Real estate term non-owner occupied - AQR special mention | 2,088 | 2,088 | — |
| Real estate term non-owner occupied - AQR substandard | 1,709 | 1,709 | — |
| Real estate term other - AQR substandard | 150 | 150 | — |
| Consumer secured by 1st deeds of trust - AQR pass | 82 | 82 | — |
| Consumer secured by 1st deeds of trust - AQR special mention | 448 | 461 | — |
| Subtotal | $10,491 | $10,549 | $— |
| With an allowance recorded | | | |
| Commercial - AQR substandard | $806 | $806 | $75 |
| Subtotal | $806 | $806 | $75 |
| Total | | | |
| Commercial - AQR special mention | $170 | $170 | $— |
| Commercial - AQR substandard | 3,806 | 3,851 | 75 |
| Real estate construction one-to-four family - AQR special mention | 191 | 191 | — |
| Real estate construction other - AQR pass | 772 | 772 | — |
| Real estate term owner occupied - AQR pass | 501 | 501 | — |
| Real estate term owner occupied - AQR special mention | 273 | 273 | — |
| Real estate term owner occupied - AQR substandard | 558 | 558 | — |
| Real estate term non-owner occupied - AQR pass | 549 | 549 | — |
| Real estate term non-owner occupied - AQR special mention | 2,088 | 2,088 | — |
| Real estate term non-owner occupied - AQR substandard | 1,709 | 1,709 | — |
| Real estate term other - AQR substandard | 150 | 150 | — |
| Consumer secured by 1st deeds of trust - AQR pass | 82 | 82 | — |
| Consumer secured by 1st deeds of trust - AQR special mention | 448 | 461 | — |
| Total | $11,297 | $11,355 | $75 |

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 nine month periods ended September 30, 2015 and 2014, respectively:

| Three Months Ended September 30, | 2015 | | 2014 | |
|---|---|---|---|---|
| (In Thousands) | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| With no related allowance recorded | | | | |
| Commercial - AQR pass | $— | $— | $323 | $1 |
| Commercial - AQR special mention | 161 | 3 | 358 | 10 |
| Commercial - AQR substandard | 13,661 | 155 | 1,661 | 65 |
| Real estate construction other - AQR pass | 726 | 13 | — | — |
| Real estate construction other - AQR substandard | 5,678 | — | — | — |
| Real estate term owner occupied- AQR pass | 761 | 17 | 505 | 12 |
| Real estate term owner occupied- AQR special mention | — | — | 276 | 6 |
| Real estate term owner occupied- AQR substandard | 5,203 | 85 | 1,218 | 24 |
| Real estate term non-owner occupied- AQR pass | 516 | 19 | 591 | 19 |
| Real estate term non-owner occupied- AQR special mention | 101 | 10 | 3,103 | 168 |
| Real estate term non-owner occupied- AQR substandard | 269 | — | 1,118 | — |
| Real estate term other - AQR special mention | 148 | 3 | 795 | 30 |
| Real estate term other - AQR substandard | — | — | 424 | 3 |
| Consumer secured by 1st deeds of trust - AQR pass | — | — | 84 | 1 |
| Consumer secured by 1st deeds of trust - AQR special mention | 78 | 1 | — | — |
| Consumer secured by 1st deeds of trust - AQR substandard | 461 | 2 | 467 | — |
| Subtotal | $27,763 | $308 | $10,923 | $339 |
| With an allowance recorded | | | | |
| Commercial - AQR substandard | $944 | $— | $— | $— |
| Consumer secured by 1st deeds of trust - AQR substandard | — | — | 165 | — |
| Consumer other - AQR substandard | 40 | — | — | — |
| Subtotal | $984 | $— | $165 | $— |

| | | | | |
|---|---|---|---|---|
| Total | | | | |
| Commercial - AQR pass | $— | $— | $323 | $1 |
| Commercial - AQR special mention | 161 | 3 | 358 | 10 |
| Commercial - AQR substandard | 14,605 | 155 | 1,661 | 65 |
| Real estate construction other - AQR pass | 726 | 13 | — | — |
| Real estate construction other - AQR substandard | 5,678 | — | — | — |
| Real estate term owner-occupied - AQR pass | 761 | 17 | 505 | 12 |
| Real estate term owner-occupied - AQR special mention | — | — | 276 | 6 |
| Real estate term owner-occupied - AQR substandard | 5,203 | 85 | 1,218 | 24 |
| Real estate term non-owner occupied - AQR pass | 516 | 19 | 591 | 19 |
| Real estate term non-owner occupied - AQR special mention | 101 | 10 | 3,103 | 168 |
| Real estate term non-owner occupied - AQR substandard | 269 | — | 1,118 | — |
| Real estate term other - AQR special mention | 148 | 3 | 795 | 30 |
| Real estate term other - AQR substandard | — | — | 424 | 3 |
| Consumer secured by 1st deeds of trust - AQR pass | — | — | 84 | 1 |
| Consumer secured by 1st deeds of trust - AQR special mention | 78 | 1 | — | — |
| Consumer secured by 1st deeds of trust - AQR substandard | 461 | 2 | 632 | — |
| Consumer other - AQR substandard | 40 | — | — | — |
| Total Impaired Loans | $28,747 | $308 | $11,088 | $339 |

| Nine Months Ended September 30, | 2015 | | 2014 | |
|---|---|---|---|---|
| (In Thousands) | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| With no related allowance recorded | | | | |
| Commercial - AQR pass | $— | $— | $130 | $2 |
| Commercial - AQR special mention | 165 | 10 | 281 | 20 |
| Commercial - AQR substandard | 9,711 | 225 | 1,538 | 72 |
| Real estate construction one-to-four family - AQR special mention | — | — | 116 | 6 |
| Real estate construction other - AQR pass | 744 | 72 | — | — |
| Real estate construction other - AQR special mention | — | — | 271 | 29 |
| Real estate construction other - AQR substandard | 1,913 | — | — | — |
| Real estate term owner occupied- AQR pass | 677 | 46 | 508 | 39 |
| Real estate term owner occupied- AQR special mention | 90 | 5 | 307 | 15 |
| Real estate term owner occupied- AQR substandard | 3,720 | 113 | 1,168 | 51 |
| Real estate term non-owner occupied- AQR pass | 534 | 57 | 607 | 74 |
| Real estate term non-owner occupied- AQR special mention | 1,444 | 97 | 2,447 | 209 |
| Real estate term non-owner occupied- AQR substandard | 1,423 | — | 1,062 | — |
| Real estate term other - AQR special mention | 50 | 3 | 655 | 77 |
| Real estate term other - AQR substandard | 99 | 7 | 245 | 10 |
| Consumer secured by 1st deeds of trust - AQR pass | 80 | 3 | 85 | 3 |
| Consumer secured by 1st deeds of trust - AQR substandard | 526 | 6 | 284 | — |
| Consumer other - AQR substandard | — | — | 38 | — |
| Subtotal | $21,176 | $644 | $9,742 | $607 |

| | | | | |
|---|---|---|---|---|
| With an allowance recorded | | | | |
| Commercial - AQR special mention | $— | $— | $61 | $6 |
| Commercial - AQR substandard | 1,863 | — | 198 | — |
| Real estate term other - AQR substandard | 93 | — | — | — |
| Consumer secured by 1st deeds of trust - AQR substandard | — | — | 234 | — |
| Consumer other - AQR substandard | 14 | — | — | — |
| Subtotal | $1,970 | $— | $493 | $6 |
| Total | | | | |
| Commercial - AQR pass | $— | $— | $130 | $2 |
| Commercial - AQR special mention | 165 | 10 | 342 | 26 |
| Commercial - AQR substandard | 11,574 | 225 | 1,736 | 72 |
| Real estate construction one-to-four family - AQR special mention | — | — | 116 | 6 |
| Real estate construction other - AQR pass | 744 | 72 | — | — |
| Real estate construction other - AQR special mention | — | — | 271 | 29 |
| Real estate construction other - AQR substandard | 1,913 | — | — | — |
| Real estate term owner-occupied - AQR pass | 677 | 46 | 508 | 39 |
| Real estate term owner-occupied - AQR special mention | 90 | 5 | 307 | 15 |
| Real estate term owner-occupied - AQR substandard | 3,720 | 113 | 1,168 | 51 |
| Real estate term non-owner occupied - AQR pass | 534 | 57 | 607 | 74 |
| Real estate term non-owner occupied - AQR special mention | 1,444 | 97 | 2,447 | 209 |
| Real estate term non-owner occupied - AQR substandard | 1,423 | — | 1,062 | — |
| Real estate term other - AQR special mention | 50 | 3 | 655 | 77 |
| Real estate term other - AQR substandard | 192 | 7 | 245 | 10 |
| Consumer secured by 1st deeds of trust - AQR pass | 80 | 3 | 85 | 3 |
| Consumer secured by 1st deeds of trust - AQR substandard | 526 | 6 | 518 | — |
| Consumer other - AQR substandard | 14 | — | 38 | — |
| Total Impaired Loans | $23,146 | $644 | $10,235 | $613 |

As described in Note 3 above, the Company acquired 18 purchased credit impaired loans from Alaska Pacific 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 September 30, 2015 is $1.7 million.

Loans classified as troubled debt restructurings ("TDR") totaled $5.1 million and $7.7 million at September 30, 2015 and December 31, 2014, 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 following table presents the breakout between newly restructured loans that occurred during the nine months ended September 30, 2015 and restructured loans that occurred prior to 2015 that are still included in portfolio loans:

| (In Thousands) | Accrual Status | Nonaccrual Status | Total Modifications |
|---|---|---|---|
| New Troubled Debt Restructurings | | | |
| Commercial - AQR substandard | $66 | $1,317 | $1,383 |
| Subtotal | $66 | $1,317 | $1,383 |
| Existing Troubled Debt Restructurings | $3,138 | $583 | $3,721 |
| Total | $3,204 | $1,900 | $5,104 |

The following table presents newly restructured loans that occurred during the nine months ended September 30, 2015, by concession (terms modified):

| | | September 30, 2015 | | | | |
|---|---|---|---|---|---|---|
| (In Thousands) | Number of Contracts | Rate Modification | Term Modification | Payment Modification | Combination Modification | Total Modifications |
| Pre-Modification Outstanding Recorded Investment: | | | | | | |
| Commercial - AQR substandard | 4 | $— | $— | $423 | $900 | $1,323 |
| Total | 4 | $— | $— | $423 | $900 | $1,323 |
| Post-Modification Outstanding Recorded Investment: | | | | | | |
| Commercial - AQR substandard | 4 | $— | $— | $406 | $977 | $1,383 |
| Total | 4 | $— | $— | $406 | $977 | $1,383 |

The Company had no commitments to extend additional credit to borrowers whose terms have been modified in TDRs. There was a $304,000 charge off in the nine months ended September 30, 2015 on a loan that was later classified as a TDR.

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 September 30, 2015 and December 31, 2014, respectively.

The Company had no TDRs that subsequently defaulted within the first twelve months of restructure, during the periods ending September 30, 2015 and December 31, 2014.

8. Allowance for Loan Losses

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

| Three Months Ended September 30, | 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 deed of trust | Consumer other | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| 2015 | | | | | | | | | | |
| Balance, beginning of period | $5,687 | $689 | $1,863 | $1,470 | $4,888 | $671 | $265 | $415 | $1,470 | $17,418 |
| Charge-Offs | (367) | — | — | — | — | — | (28) | (5) | — | (400) |
| Recoveries | 152 | — | — | — | — | — | — | 2 | — | 154 |
| Provision (benefit) | 308 | 202 | (81) | 54 | 54 | (69) | 31 | 64 | 113 | 676 |
| Balance, end of period | $5,780 | $891 | $1,782 | $1,524 | $4,942 | $602 | $268 | $476 | $1,583 | $17,848 |
| Balance, end of period: Individually evaluated for impairment | $433 | $— | $— | $— | $— | $— | $— | $80 | $— | $513 |
| Balance, end of period: Collectively evaluated for impairment | $5,347 | $891 | $1,782 | $1,524 | $4,942 | $602 | $268 | $396 | $1,583 | $17,335 |
| 2014 | | | | | | | | | | |
| Balance, beginning of period | $5,134 | $570 | $830 | $1,384 | $4,124 | $642 | $272 | $370 | $2,706 | $16,032 |
| Charge-Offs | — | — | — | — | — | — | (13) | (41) | — | (54) |
| Recoveries | 259 | — | — | — | — | — | — | 6 | — | 265 |
| Provision (benefit) | 22 | 64 | 285 | 177 | 87 | 254 | 7 | 53 | (949) | — |
| Balance, end of period | $5,415 | $634 | $1,115 | $1,561 | $4,211 | $896 | $266 | $388 | $1,757 | $16,243 |
| Balance, end of period: Individually evaluated for impairment | $— | $— | $— | $— | $— | $— | $8 | $— | $— | $8 |
| Balance, end of period: Collectively evaluated for impairment | $5,415 | $634 | $1,115 | $1,561 | $4,211 | $896 | $258 | $388 | $1,757 | $16,235 |

| Nine Months Ended September 30, | 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 deed of trust | Consumer other | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| 2015 | | | | | | | | | | |
| Balance, beginning of period | $5,643 | $644 | $1,653 | $1,580 | $4,704 | $656 | $285 | $410 | $1,148 | $16,723 |
| Charge-Offs | (474) | — | — | — | — | (81) | (28) | (5) | — | (588) |
| Recoveries | 310 | — | — | — | — | 17 | — | 8 | — | 335 |
| Provision (benefit) | 301 | 247 | 129 | (56) | 238 | 10 | 11 | 63 | 435 | 1,378 |
| Balance, end of period | $5,780 | $891 | $1,782 | $1,524 | $4,942 | $602 | $268 | $476 | $1,583 | $17,848 |
| Balance, end of period: Individually evaluated for impairment | $433 | $— | $— | $— | $— | $— | $— | $80 | $— | $513 |
| Balance, end of period: Collectively evaluated for impairment | $5,347 | $891 | $1,782 | $1,524 | $4,942 | $602 | $268 | $396 | $1,583 | $17,335 |
| 2014 | | | | | | | | | | |
| Balance, beginning of period | $5,779 | $557 | $539 | $1,583 | $4,297 | $537 | $322 | $390 | $2,278 | $16,282 |
| Charge-Offs | (320) | — | — | — | — | — | (52) | (74) | — | (446) |
| Recoveries | 889 | 625 | — | — | — | — | — | 29 | — | 1,543 |
| Provision (benefit) | (933) | (548) | 576 | (22) | (86) | 359 | (4) | 43 | (521) | (1,136) |
| Balance, end of period | $5,415 | $634 | $1,115 | $1,561 | $4,211 | $896 | $266 | $388 | $1,757 | $16,243 |
| Balance, end of period: Individually evaluated for impairment | $— | $— | $— | $— | $— | $— | $8 | $— | $— | $8 |
| Balance, end of period: Collectively evaluated for impairment | $5,415 | $634 | $1,115 | $1,561 | $4,211 | $896 | $258 | $388 | $1,757 | $16,235 |

The following is a detail of the recorded investment in the loan portfolio, segregated by amounts evaluated individually or collectively in the Allowance at the periods indicated:

| (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 deed of trust | Consumer other | Total |
|---|---|---|---|---|---|---|---|---|---|
| September 30, 2015 | | | | | | | | | |
| Balance, end of period | $325,092 | $48,527 | $107,393 | $112,527 | $291,113 | $36,443 | $27,664 | $29,269 | $978,028 |
| Balance, end of period: Individually evaluated for impairment | $15,340 | $— | $12,077 | $5,925 | $856 | $148 | $560 | $80 | $34,986 |
| Balance, end of period: Collectively evaluated for impairment | $309,752 | $48,527 | $95,316 | $106,602 | $290,257 | $36,295 | $27,104 | $29,189 | $943,042 |
| December 31, 2014 | | | | | | | | | |
| Balance, end of period | $306,543 | $34,842 | $91,195 | $109,472 | $286,616 | $36,894 | $32,000 | $31,493 | $929,055 |
| Balance, end of period: Individually evaluated for impairment | $3,976 | $191 | $772 | $1,332 | $4,346 | $150 | $530 | $— | $11,297 |
| Balance, end of period: Collectively evaluated for impairment | $302,567 | $34,651 | $90,423 | $108,140 | $282,270 | $36,744 | $31,470 | $31,493 | $917,758 |

The following represents the balance of the Allowance for the periods indicated segregated by segment and class:

| (In Thousands) | Commercial | Real estate construction 1-4 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 | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| September 30, 2015 | | | | | | | | | | |
| Individually evaluated for impairment: | | | | | | | | | | |
| AQR Substandard | $432 | $— | $— | $— | $— | $— | $— | $80 | $— | $512 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Collectively: evaluated for impairment: | | | | | | | | | | |
| AQR Pass | 5,320 | 891 | 1,782 | 1,498 | 4,942 | 598 | 264 | 395 | — | 15,690 |
| AQR Special Mention | 15 | — | — | 26 | — | 4 | 3 | — | — | 48 |
| AQR Substandard | 13 | — | — | — | — | — | 1 | 1 | — | 15 |
| Unallocated | — | — | — | — | — | — | — | — | 1,583 | 1,583 |
| | $5,780 | $891 | $1,782 | $1,524 | $4,942 | $602 | $268 | $476 | $1,583 | $17,848 |
| December 31, 2014 | | | | | | | | | | |
| Individually evaluated for impairment: | | | | | | | | | | |
| AQR Substandard | $75 | $— | $— | $— | $— | $— | $— | $— | $— | $75 |
| Collectively: evaluated for impairment: | | | | | | | | | | |
| AQR Pass | 4,938 | 644 | 1,653 | 1,382 | 4,703 | 651 | 278 | 394 | — | 14,643 |
| AQR Special Mention | 621 | — | — | 198 | — | 5 | 7 | 1 | — | 832 |
| AQR Substandard | 9 | — | — | — | 1 | — | — | 15 | — | 25 |
| Unallocated | — | — | — | — | — | — | — | — | 1,148 | 1,148 |
| | $5,643 | $644 | $1,653 | $1,580 | $4,704 | $656 | $285 | $410 | $1,148 | $16,723 |

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9. Purchased Receivables

Purchased receivables are carried at their principal amount outstanding, net of a reserve for anticipated losses that have not yet been identified, and have a maturity of less than one year. Purchased receivable balances are charged against this reserve when management believes that collection of principal is unlikely. Management evaluates the adequacy of the reserve for purchased receivable losses based on historical loss experience by class of receivable and its assessment of current economic conditions. As of September 30, 2015, the Company has one class of purchased receivables. There were no purchased receivables past due at September 30, 2015 or December 31, 2014, respectively, and there were no restructured purchased receivables at September 30, 2015 or December 31, 2014.

Income on purchased receivables is accrued and recognized on the principal amount outstanding using an effective interest method except when management believes doubt exists as to the collectability of the income or principal. As of September 30, 2015, the Company is accruing income on all purchased receivable balances outstanding.

The following table summarizes the components of net purchased receivables for the periods indicated:

| (In Thousands) | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Purchased receivables | $13,956 | $15,543 |
| Reserve for purchased receivable losses | (224) | (289) |
| Total | $13,732 | $15,254 |

The following table sets forth information regarding changes in the purchased receivable reserve for the three and nine month periods ending September 30, 2015 and 2014, respectively:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In Thousands) | 2015 | 2014 | 2015 | 2014 |
| Balance at beginning of period | $247 | $242 | $289 | $273 |
| Charge-offs | — | — | — | (240) |
| Recoveries | — | — | 30 | 3 |
| Charge-offs net of recoveries | — | — | 30 | (237) |
| Reserve for (recovery from) purchased receivables | (23) | 241 | (95) | 447 |
| Balance at end of period | $224 | $483 | $224 | $483 |

The Company did not record any charge-offs in the first nine months of 2015. The Company recorded one partial charge-off for $215,000 and one full charge-off for $25,000 in the first nine months of 2014.

10. Goodwill and Intangible Assets

The Company acquired Alaska Pacific on April 1, 2014. The Company did not record goodwill related to the acquisition of Alaska Pacific. The Company recorded a core deposit intangible of $623,000 related to deposits acquired from Alaska Pacific that will be amortized over its estimated useful life of ten years using an accelerated method. See Note 3 above for further discussion of this transaction.

The Company acquired the remaining 76.5% of RML on December 1, 2014. The Company recorded $14.8 million of goodwill and $950,000 of trade name intangible as part of the acquisition of RML. These assets have indefinite useful lives and are not amortized. See Note 3 above for further discussion of this transaction.

The Company performs goodwill impairment testing annually in accordance with the policy described in Note 1 of the Company's Annual Report on Form 10-K for the year ended December 31, 2014. There was no indication of impairment as of September 30, 2015. The Company continues to monitor the Company's goodwill for potential impairment on an ongoing basis. No assurance can be given that there will not be an impairment charge to earnings during 2015 for goodwill impairment, if, for example, our stock price declines and trades at a significant discount to its book value, although there are many qualitative and quantitative factors that we analyze in determining the impairment of goodwill.

11. Deposit Activities

Total deposits at September 30, 2015 and December 31, 2014 were $1.3 billion and $1.2 billion, respectively. The only deposit category with stated maturity dates is certificates of deposit. At September 30, 2015, the Company had $142.8 million in certificates of deposit as compared to certificates of deposit of $142.2 million at December 31, 2014. At September 30, 2015, $91.6 million, or 64%, of the Company's certificates of deposits are scheduled to mature over the next 12 months as compared to $81.9 million, or 58%, of total certificates of deposit at December 31, 2014.

12. Derivatives

The Company enters into commercial loan interest rate swap agreements in order to provide commercial loan customers the ability to convert from variable to fixed interest rates. Under these agreements, the Company enters into a variable-rate loan agreement with a customer in addition to a swap agreement that effectively converts the customer's variable rate loan into a fixed rate. The Company then simultaneously enters into a corresponding swap agreement with a third party financial institution ("counterparty") in order to offset its exposure on the fixed component of the customer's interest rate swap. The Company has an agreement with its counterparty that contains a provision that provides that if the Company fails to maintain its status as a well-capitalized institution, then the counterparty could terminate the derivative positions and the Company would be required to settle its obligations under the agreement. This agreement also requires that the Company and the counterparty collateralize any fair value shortfalls that exceed $250,000 with eligible collateral, which includes cash and securities backed with the full faith and credit of the federal government. Similarly, the Company could be required to settle its obligations under the agreement if specific regulatory events occur, such as if the Company were issued a prompt corrective action directive or a cease and desist order, or if certain regulatory ratios fall below specified levels. The Company pledged $262,000 and zero in available for sale securities to collateralize fair value shortfalls on interest rate swap agreements as of September 30, 2015 and December 31, 2014, respectively.

The interest rate swap agreements with our customers and the counterparty are not designated as hedging instruments under the Derivatives and Hedging topic of the FASB ASC 815, rather they are accounted for as free standing derivatives with changes in fair value reported in income. The Company had interest rate swaps with an aggregate notional amount of $21.9 million and $23.6 million at September 30, 2015 and December 31, 2014, respectively. At September 30, 2015, the notional amount of interest rate swaps is made up of two swaps totaling $11.0 million, a variable to fixed rate swap to a commercial loan customer and two swaps totaling $11.0 million fixed to variable rate swap with a counterparty. Changes in fair value from these four interest rate swaps offset each other in the third quarter of 2015. The Company did not recognize any fee income related to interest rate swaps in the three month and nine month periods ending September 30, 2015 or 2014, respectively. Interest rate swap income is recorded in other income on the Consolidated Statements of Income.

The Company also uses derivatives to hedge the risk of changes in the fair values of interest rate lock commitments. None of the Company's derivatives are designated as hedging instruments. Rather, they are accounted for as free-standing derivatives, or economic hedges, with changes in the fair value of the derivatives reported in income. The Company primarily utilizes forward interest rate contracts in its derivative risk management strategy.

RML enters into commitments to originate residential mortgage loans, and it enters into forward delivery contracts to sell mortgage-backed securities to broker/dealers at specific prices and dates in order to hedge the interest rate risk in its residential mortgage loan commitments. Market risk with respect to commitments to originate loans arises from changes in the value of contractual positions due to changes in interest rates. RML had commitments to originate mortgage loans held for sale totaling $74.6 million and $39.6 million at September 30, 2015 and December 31, 2014, respectively. Changes in the value of RML's interest rate derivatives are recorded in the mortgage banking income on the Consolidated Statements of Income.

The following table presents the fair value of derivatives not designated as hedging instruments at September 30, 2015 and December 31, 2014:

| (In Thousands) | Asset Derivatives | | |
|---|---|---|---|
| | | September 30, 2015 | December 31, 2014 |
| | Balance Sheet Location | Fair Value | Fair Value |
| Interest rate contracts | Other assets | $240 | $78 |
| Interest rate lock commitments | Other assets | 1,787 | 841 |
| Total | | $2,027 | $919 |

| (In Thousands) | Liability Derivatives | | |
|---|---|---|---|
| | | September 30, 2015 | December 31, 2014 |
| | Balance Sheet Location | Fair Value | Fair Value |
| Interest rate contracts | Other liabilities | $535 | $158 |

The following table presents the net gains of derivatives not designated as hedging instruments for the nine month period ending September 30, 2015:

| (In Thousands) | Income Statement Location | September 30, 2015 |
|---|---|---|
| Interest rate contracts | Mortgage banking income | ($569) |
| Interest rate lock commitments | Mortgage banking income | 887 |
| Total | | $318 |

13. Stock Incentive Plan

The Company adopted the 2014 Stock Option Plan ("2014 Plan") following shareholder approval of the 2014 Plan at the 2014 Annual Meeting. Subsequent to the adoption of the 2014 Plan, no additional grants may be issued under the prior plans. The 2014 Plan provides for grants of up to 350,000 shares of common stock.

Stock Options: Under the 2014 Plan and previous plans, certain key employees have been granted the option to purchase set amounts of common stock at the market price on the day the option was granted. Optionees, at their own discretion, may cover the cost of exercise through the exchange at the then fair value of already owned shares of the Company's stock. Options are granted for a 10-year period and vest on a pro-rata basis over the initial three years from grant.

The Company measures the fair value of each stock option at the date of grant using the Black-Scholes option pricing model. For the quarters ended September 30, 2015 and 2014, the Company recognized $22,000 and $16,000, respectively, in stock option compensation expense as a component of salaries and other personnel expense. For the nine months ended September 30, 2015 and 2014, the Company recognized $66,000 and $49,000, respectively, in stock option compensation expense as a component of salaries and other personnel expense.

The Company issued 4,938 and 5,162 shares from the exercise of stock options in the three and nine months ended September 30, 2015, respectively. Proceeds from the exercise of stock options in the three and nine months ended September 30, 2015 were $160,000 and $209,000, respectively. The Company withheld $63,000 and $112,000 to pay for stock option exercises or income taxes that resulted from the exercise of stock options in the three and nine months ended September 30, 2015, respectively.

Proceeds from the exercise of stock options in the three and nine months ended September 30, 2014 were $331,000 and $395,000, respectively. The Company withheld $320,000 to pay for stock option exercises or income taxes that resulted from the exercise of stock options in the three and nine months ended September 30, 2014, respectively.

There were no stock options granted in the third quarter of 2015.

Restricted Stock Units: The Company grants restricted stock units to certain key employees periodically. Recipients of restricted stock units do not pay any cash consideration to the Company for the shares and receive all dividends with respect to such shares when the shares vest. Restricted stock units cliff vest at the end of a three-year time period. For the three months ended September 30, 2015 and 2014, the Company recognized $98,000 and $48,000, respectively, in restricted stock unit compensation expense as a component of salaries and other personnel expense. For the nine months ended September 30, 2015 and 2014, the Company recognized $291,000 and $205,000, respectively, in restricted stock unit compensation expense as a component of salaries and other personnel expense. There were no restricted stock units granted in the third quarter of 2015.

14. Fair Value of Assets and Liabilities

The Company groups its assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1: Valuation is based upon quoted prices for identical instruments traded in active exchange markets, such as the New York Stock Exchange. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
- Level 2: Valuation is based upon quoted market prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3: Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company's estimation of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

The following methods and assumptions were used to estimate fair value disclosures. All financial instruments are held for other than trading purposes.

Cash and cash equivalents: Due to the short term nature of these instruments, the carrying amounts reported in the balance sheet represent their fair values.

Investment securities: Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. Investments in Federal Home Loan Bank stock are recorded at cost, which also represents fair value.

Loans held for sale: Due to the short term nature of these instruments, the carrying amounts reported in the balance sheet approximate their fair values.

Loans: Fair values were generally determined by discounting both principal and interest cash flows on pools of loans expected to be collected using a discount rate for similar instruments with adjustments that the Company believes a market participant would consider in determining fair value. The Company estimates the cash flows expected to be collected using internal credit risk, interest rate and prepayment risk models that incorporate the Corporation's best estimate of current key assumptions, such as default rates, loss severity and prepayment speeds for the life of the loan.

Purchased receivables: Fair values for purchased receivables are based on their carrying amounts due to their short duration and repricing frequency. Generally, purchased receivables have a duration of less than one year.

Mortgage servicing rights: MSR are measured at fair value on a recurring basis. These assets are classified as Level 3. In order to determine the fair value of MSRs, the present value of net expected future cash flows is estimated. Assumptions used include market discount rates, anticipated prepayment speeds, escrow calculations, delinquency rates, and ancillary fee income net of servicing costs. The model assumptions are also compared to publicly filed information from several large MSR holders, as available.

Accrued interest receivable: Due to the short term nature of these instruments, the carrying amounts reported in the balance sheet represent their fair values.

Deposits: The fair value for deposits with stated maturities was determined by discounting contractual cash flows using current market rates for instruments with similar maturities. For deposits with no stated maturities, the carrying value was considered to approximate fair value and does not take into account the significant value of the cost advantage and stability of the Company's long-term relationships with depositors.

Accrued interest payable: Due to the short term nature of these instruments, the carrying amounts reported in the balance sheet represent their fair values.

Securities sold under repurchase agreements: Fair values for securities sold under repurchase agreements are based on their carrying amounts due to their short duration and repricing frequency.

Borrowings: Due to the short term nature of these instruments, the carrying amount of short-term borrowings reported in the balance sheet approximate the fair value. Fair values for long-term borrowings are estimated using a discounted cash flow calculation that applies currently offered interest rates to a schedule of aggregate expected monthly payments.

Contingent liability, earn-out payments related to acquisition of RML: The contingent liability for estimated earn-out payments included as a portion of the purchase price for RML is recorded in the balance sheet at it estimated fair value, and fair value adjustments to the liability are reported in other operating expense. The fair value for this contingent liability is estimated based on management's assessment of expected pre-tax income at RML over the remaining earn out period. These cash flows are discounted to present value using the appropriate FHLB borrowing rate, Inputs to this assessment include the general economic conditions in our markets that impact mortgage loan originations, current and anticipated trends in local market demand for mortgage, including interest rates, and RML's estimated market share.

Junior subordinated debentures: Fair value adjustments for junior subordinated debentures are based on discounted cash flows to maturity using current interest rates for similar financial instruments. Management utilized a market approach to determine the appropriate discount rate for junior subordinated debentures.

Derivative instruments: The fair value of the interest rate lock commitments are estimated using quoted or published market prices for similar instruments, adjusted for factors such as pull-through rate assumptions based on historical information, where appropriate. The pull-through rate assumptions are considered Level 3 valuation inputs and are significant to the interest rate lock commitment valuation; as such, the interest rate lock commitment derivatives are classified as Level 3. Interest rate contracts are valued in a model, which uses as its basis a discounted cash flow technique incorporating credit valuation adjustments to reflect nonperformance risk in the measurement of fair value. Although the Bank has determined that the majority of inputs used to value its interest rate derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of September 30, 2015, the Bank has assessed the significance of the impact of these adjustments on the overall valuation of its interest rate positions and has determined that the they are not significant to the overall valuation of its interest rate derivatives. As a result, the Bank has classified its interest rate derivative valuations in Level 2 of the fair value hierarchy.

Assets subject to nonrecurring adjustment to fair value: The Company is also required to measure certain assets such as equity method investments, goodwill, intangible assets, impaired loans, and other real estate owned ("OREO") at fair value on a nonrecurring basis in accordance with GAAP. Any nonrecurring adjustments to fair value usually result from the write down of individual assets.

The Company uses either in-house evaluations or external appraisals to estimate the fair value of OREO and impaired loans as of each reporting date. In-house appraisals are considered Level 3 inputs and external appraisals are considered Level 2 inputs. The Company's determination of which method to use is based upon several factors. The Company takes into account compliance with legal and regulatory guidelines, the amount of the loan, the size of the assets, the location and type of property to be valued and how critical the timing of completion of the analysis is to the assessment of value. Those factors are balanced with the level of internal expertise, internal experience and market information available, versus external expertise available such as qualified appraisers, brokers, auctioneers and equipment specialists.

The Company uses external sources to estimate fair value for projects that are not fully constructed as of the date of valuation. These projects are generally valued as if complete, with an appropriate allowance for cost of completion, including contingencies developed from external sources such as vendors, engineers and contractors. The Company believes that recording other real estate owned that is not fully constructed based on as if complete values is more appropriate than recording other real estate owned that is not fully constructed using as is values. We concluded that as-is-complete values are appropriate for these types of projects based on the accounting guidance for capitalization of project costs and subsequent measurement of the value

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of real estate. GAAP specifically states that estimates and cost allocations must be reviewed at the end of each reporting period and reallocated based on revised estimates. The Company adjusts the carrying value of other real estate owned in accordance with this guidance for increases in estimated cost to complete that exceed the fair value of the real estate at the end of each reporting period.

Commitments to extend credit and standby letters of credit: The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligation with the counterparties at the reporting date.

Limitations: Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company’s entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company’s financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Estimated fair values as of the periods indicated are as follows:

| (In Thousands) | September 30, 2015 Carrying Amount | September 30, 2015 Fair Value | December 31, 2014 Carrying Amount | December 31, 2014 Fair Value |
|---|---|---|---|---|
| Financial assets: | | | | |
| Level 1 inputs: | | | | |
| Cash, due from banks and deposits in other banks | $144,566 | $144,566 | $72,056 | $72,056 |
| Investment securities | 36,958 | 36,958 | 45,570 | 45,570 |
| Level 2 inputs: | | | | |
| Investment securities | 198,219 | 198,287 | 238,361 | 238,468 |
| Investment in Federal Home Loan Bank stock | 1,816 | 1,816 | 3,404 | 3,404 |
| Accrued interest receivable | 3,476 | 3,476 | 3,373 | 3,373 |
| Interest rate contracts | 240 | 240 | 78 | 78 |
| Level 3 inputs: | | | | |
| Loans and loans held for sale | 1,040,277 | 1,038,911 | 968,370 | 974,366 |
| Purchased receivables, net | 13,732 | 13,732 | 15,254 | 15,254 |
| Interest rate lock commitments | 1,787 | 1,787 | 841 | 841 |
| Mortgage servicing rights | 1,199 | 1,199 | 1,010 | 1,010 |
| Financial liabilities: | | | | |
| Level 2 inputs: | | | | |
| Deposits | $1,264,919 | $1,264,995 | $1,179,747 | $1,180,136 |
| Securities sold under repurchase agreements | 33,413 | 33,413 | 19,843 | 19,843 |
| Borrowings | 12,458 | 12,491 | 26,304 | 26,485 |
| Accrued interest payable | 52 | 52 | 18 | 18 |
| Interest rate contracts | 535 | 535 | 158 | 158 |
| Level 3 inputs: | | | | |
| RML earn-out liability | 10,262 | 10,262 | 7,324 | 7,324 |
| Junior subordinated debentures | 18,558 | 17,254 | 18,558 | 17,239 |
| Unrecognized financial instruments: | | | | |
| Commitments to extend credit[1] | $242,506 | $2,425 | $219,349 | $2,193 |
| Standby letters of credit[1] | 8,122 | 81 | 6,004 | 60 |

[1] Carrying amounts reflect the notional amount of credit exposure under these financial instruments.

The following table sets forth the balances as of the periods indicated of assets measured at fair value on a recurring basis:

| (In Thousands) | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| September 30, 2015 | | | | |
| Assets: | | | | |
| Available for sale securities | | | | |
| U.S. Treasury and government sponsored entities | $182,774 | $15,166 | $167,608 | $— |
| Municipal securities | 11,091 | — | 11,091 | — |
| U.S. Agency mortgage-backed securities | 874 | — | 874 | — |
| Corporate bonds | 38,537 | 21,792 | 16,745 | — |
| Preferred stock | 997 | — | 997 | — |
| Total available for sale securities | $234,273 | $36,958 | $197,315 | $— |
| Interest rate contracts | $240 | $— | $240 | $— |
| Interest rate lock commitments | 1,787 | — | — | 1,787 |
| Mortgage servicing rights | 1,199 | — | — | 1,199 |
| Total other assets | $3,226 | $— | $240 | $2,986 |
| Liabilities: | | | | |
| Interest rate contracts | $535 | $— | $535 | $— |
| December 31, 2014 | | | | |
| Assets: | | | | |
| Available for sale securities | | | | |
| U.S. Treasury and government sponsored entities | $226,190 | $15,545 | $210,645 | $— |
| Municipal securities | 12,124 | — | 12,124 | — |
| U.S. Agency mortgage-backed securities | 1,029 | — | 1,029 | — |
| Corporate bonds | 39,235 | 26,873 | 12,362 | — |
| Preferred stock | 3,152 | 3,152 | — | — |
| Total available for sale securities | $281,730 | $45,570 | $236,160 | $— |
| Interest rate contracts | $78 | $— | $78 | $— |
| Interest rate lock commitments | 841 | — | — | 841 |
| Mortgage servicing rights | 1,010 | — | — | 1,010 |
| Total other assets | $1,929 | $— | $78 | $1,851 |
| Liabilities: | | | | |
| Interest rate contracts | $158 | $— | $158 | $— |

As of and for the nine months ending September 30, 2015 and 2014, no impairment or valuation adjustment was recognized for assets recognized at fair value on a nonrecurring basis, except for certain assets as shown in the following table. For loans measured for impairment, the Company classifies fair value measurements using observable inputs, such as external appraisals, as Level 2 valuations in the fair value hierarchy, and unobservable inputs, such as in-house evaluations, as Level 3 valuations in the fair value hierarchy.

| (In Thousands) | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total (gains) losses |
|---|---|---|---|---|---|
| September 30, 2015 | | | | | |
| Loans measured for impairment | $1,249 | $— | $— | $1,249 | $437 |
| Other real estate owned | 830 | — | — | 830 | 360 |
| Total | $2,079 | $— | $— | $2,079 | $797 |
| September 30, 2014 | | | | | |
| Loans measured for impairment | $165 | $— | $— | $165 | ($3 ) |
| Other real estate owned | 227 | — | — | 227 | 45 |
| Total | $392 | $— | $— | $392 | $42 |

Assets and Liabilities Measured at Fair Value Using Significant Unobservable Inputs (Level 3)

The following table provides a description of the valuation technique, unobservable input, and qualitative information about the unobservable inputs for the Company's assets and liabilities classified as Level 3 and measured at fair value on a nonrecurring basis at September 30, 2015:

| Financial Instrument | Valuation Technique | Unobservable Input | Weighted Average Rate Range |
|---|---|---|---|
| Loans measured for impairment | In-house valuation of real estate; discounted cash flow | Discount rate | 25% - 100% |
| | | Cash flows | NA[1] |
| Other real estate owned | Fair value of collateral | Estimated selling and holding costs | 7% - 25% |
| Interest rate lock commitment | External pricing model | Pull through rate | 91.95 % |
| Mortgage servicing rights | Discounted cash flow | Constant prepayment rate | 9.92% - 27.59% |
| | | Discount rate | 9.20% - 9.69% |
| RML earn-out liability | Discounted cash flow | Financial projections of mortgage operations | 0.47% - 1.99% |

[1] Fair value of impaired collateral dependent loans was calculated using contractual cash flows for specific impaired loan.

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15. Segment Information

The Company operates two primary segments: Community Banking and Home Mortgage Lending. The Community Banking segment's principal business focus is the offering of loan and deposit products to business and consumer customers in its primary market areas. As of September 30, 2015, the Community Banking segment operated 14 branches throughout Alaska. The Home Mortgage Lending segment's principal business focus is the origination and sale of mortgage loans for 1-4 family residential properties.

Prior to December 1, 2014, Home Mortgage Lending income was limited to equity in earnings from RML.

Summarized financial information for the Company's reportable segments and the reconciliation to the consolidated financial results is shown in the following tables:

| | Three Months Ended September 30, 2015 | | |
|---|---|---|---|
| (In Thousands) | Community Banking | Home Mortgage Lending | Consolidated |
| Interest income | $14,883 | $505 | $15,388 |
| Interest expense | 458 | 248 | 706 |
| Net interest income | 14,425 | 257 | 14,682 |
| Provision (benefit) for loan losses | 676 | — | 676 |
| Other operating income | 4,294 | 8,113 | 12,407 |
| Other operating expense | 12,633 | 5,570 | 18,203 |
| Income before provision for income taxes | 5,410 | 2,800 | 8,210 |
| Provision for income taxes | 1,523 | 1,155 | 2,678 |
| Net income | 3,887 | 1,645 | 5,532 |
| Less: net income attributable to the noncontrolling interest | 197 | — | 197 |
| Net income attributable to Northrim BanCorp, Inc. | $3,690 | $1,645 | $5,335 |

| | Nine Months Ended September 30, 2015 | | |
|---|---|---|---|
| (In Thousands) | Community Banking | Home Mortgage Lending | Consolidated |
| Interest income | $43,227 | $1,490 | $44,717 |
| Interest expense | 1,302 | 906 | 2,208 |
| Net interest income | 41,925 | 584 | 42,509 |
| Provision (benefit) for loan losses | 1,378 | — | 1,378 |
| Other operating income | 11,270 | 23,235 | 34,505 |
| Other operating expense | 37,975 | 16,443 | 54,418 |
| Income before provision for income taxes | 13,842 | 7,376 | 21,218 |
| Provision for income taxes | 4,066 | 3,045 | 7,111 |
| Net income | 9,776 | 4,331 | 14,107 |
| Less: net income attributable to the noncontrolling interest | 431 | — | 431 |
| Net income attributable to Northrim BanCorp, Inc. | $9,345 | $4,331 | $13,676 |

| (In Thousands) | Three Months Ended September 30, 2014<br>Community Banking | Home Mortgage Lending | Consolidated |
|---|---|---|---|
| Interest income | $14,212 | $— | $14,212 |
| Interest expense | 487 | — | 487 |
| Net interest income | 13,725 | — | 13,725 |
| Provision (benefit) for loan losses | — | — | — |
| Other operating income (loss) | 4,550 | 384 | 4,934 |
| Other operating expense | 12,779 | — | 12,779 |
| Income before provision for income taxes | 5,496 | 384 | 5,880 |
| Provision for income taxes | 1,824 | 158 | 1,982 |
| Net income (loss) | 3,672 | 226 | 3,898 |
| Less: net income attributable to the noncontrolling interest | 191 | — | 191 |
| Net income (loss) attributable to Northrim BanCorp, Inc. | $3,481 | $226 | $3,707 |

| (In Thousands) | Nine Months Ended September 30, 2014<br>Community Banking | Home Mortgage Lending | Consolidated |
|---|---|---|---|
| Interest income | $39,780 | $— | $39,780 |
| Interest expense | 1,411 | — | 1,411 |
| Net interest income | 38,369 | — | 38,369 |
| Provision (benefit) for loan losses | (1,136) | — | (1,136) |
| Other operating income (loss) | 11,166 | 608 | 11,774 |
| Other operating expense | 34,368 | — | 34,368 |
| Income before provision for income taxes | 16,303 | 608 | 16,911 |
| Provision for income taxes | 5,598 | 250 | 5,848 |
| Net income (loss) | 10,705 | 358 | 11,063 |
| Less: net income attributable to the noncontrolling interest | 329 | — | 329 |
| Net income (loss) attributable to Northrim BanCorp, Inc. | $10,376 | $358 | $10,734 |

| September 30, 2015<br>(In Thousands) | Community Banking | Home Mortgage Lending | Consolidated |
|---|---|---|---|
| Total assets | $1,456,032 | $83,221 | $1,539,253 |
| Loans held for sale | $— | $66,597 | $66,597 |
| Borrowings | $2,131 | $10,327 | $12,458 |

| December 31, 2014<br>(In Thousands) | Community Banking | Home Mortgage Lending | Consolidated |
|---|---|---|---|
| Total assets | $1,391,862 | $57,487 | $1,449,349 |
| Loans held for sale | $— | $43,866 | $43,866 |
| Borrowings | $2,164 | $24,140 | $26,304 |

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion should be read in conjunction with the unaudited consolidated financial statements of Northrim BanCorp, Inc. (the “Company”) and the notes thereto presented elsewhere in this report and with the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

Except as otherwise noted, references to "we", "our", "us" or "the Company" refer to Northrim BanCorp, Inc. and its subsidiaries that are consolidated for financial reporting purposes.

Note Regarding Forward Looking-Statements

This quarterly report on Form 10-Q includes “forward-looking statements,” as that term is defined for purposes of Section 21D of the Securities Exchange Act of 1934, as amended, which are not historical facts. These forward-looking statements describe management’s expectations about future events and developments such as future operating results, growth in loans and deposits, continued success of the Company’s style of banking, and the strength of the local economy. All statements other than statements of historical fact, including statements regarding industry prospects and future results of operations or financial position, made in this report are forward-looking. We use words such as “anticipate,” “believe,” “expect,” “intend” and similar expressions in part to help identify forward-looking statements. Forward-looking statements reflect management’s current plans and expectations and are inherently uncertain. Our actual results may differ significantly from management’s expectations, and those variations may be both material and adverse. Forward-looking statements are subject to various risks and uncertainties that may cause our actual results to differ materially and adversely from our expectations as indicated in the forward-looking statements. These risks and uncertainties include: the general condition of, and changes in, the Alaska economy; factors that impact our net interest margin; our ability to maintain asset quality and expand our market share or net interest margin; the acquisition of Residential Mortgage Holding Company, LLC might result in costs or difficulties relating to integration matters that might be greater than expected; and our ability to execute our business plan. Further, actual results may be affected by competition on price and other factors with other financial institutions; customer acceptance of new products and services; the regulatory environment in which we operate; and general trends in the local, regional and national banking industry and economy. Many of these risks, as well as other risks that may have a material adverse impact on our operations and business, are identified in Part II. Item 1A Risk Factors of this report and Item 1A in the Company's Annual Report on form 10-K for the year ended December 31, 2014, as well as in our other filings with the Securities and Exchange Commission. However, you should be aware that these factors are not an exhaustive list, and you should not assume these are the only factors that may cause our actual results to differ from our expectations. In addition, you should note that we do not intend to update any of the forward-looking statements or the uncertainties that may adversely impact those statements, other than as required by law.

Critical Accounting Policies

The preparation of the consolidated financial statements requires us to make a number of estimates and assumptions that affect the reported amounts and disclosures in the consolidated financial statements. On an ongoing basis, we evaluate our estimates and assumptions based upon historical experience and various other factors and circumstances. We believe that our estimates and assumptions are reasonable; however, actual results may differ significantly from these estimates and assumptions which could have a material impact on the carrying value of assets and liabilities at the balance sheet dates and on our results of operations for the reporting periods.

The accounting policies that involve significant estimates and assumptions by management, which have a material impact on the carrying value of certain assets and liabilities, are considered critical accounting policies. The Company's critical accounting policies include those that address the accounting for the allowance for loan losses ("Allowance"), valuation of goodwill and other intangible assets, and the valuation of other real estate owned.  These critical accounting policies are further described in Item 7, Management's Discussion and Analysis, and in Note 1, Summary of Significant Accounting Policies, of the Notes to Consolidated Financial Statements in the Company's Form 10-K for the year ended December 31, 2014. Management has applied its critical accounting policies and estimation methods consistently in all periods presented in these consolidated financial statements.

Update on Economic Conditions

Although the Company believes that there is uncertainty about the future of Alaska's economy, we also believe that the economy is currently stable and showing resilience in the face of the on-going low-price energy marketplace. While Shell Oil's decision to cease exploratory drilling operations in the Chuckchi Sea was a disappointment to many Alaskans, the Company believes that activity on the North Slope continues to reflect the long-term commitments of the oil industry to the region.

Highlights and Summary of Performance - Third Quarter of 2015

Year over year loan growth of 4% and deposit growth of 6%, increased net interest income in the three and nine month periods ending September 30, 2015 as compared to the same periods in 2014. The integration of the assets and operations acquired by the Company in connection with the acquisitions of Alaska Pacific Bancshares, Inc. ("Alaska Pacific") and Residential Mortgage Holding Company, LLC ("RML"), that were completed in 2014 also contributed to increases of 44% and 27%, respectively, in net income attributable to Northrim BanCorp, Inc. for the three and nine month periods ended September 30, 2015 as compared to the same periods in 2014. Additionally, management determined that as a result of the acquisition of RML, the Company now operates two business segments: Community Banking and Home Mortgage Lending, with RML's operations falling under the Home Mortgage Lending segment. See Note 15 of the Notes to Consolidated Financial Statements included in Item 1 of this report for further discussion on our business segments and results of operations for each such business segment.

- Year-to-date profits increased 27% to $13.7 million, or $1.97 per diluted share at September 30, 2015, from $10.7 million, or $1.57 per diluted share at September 30, 2014.
- Total revenues, which include net interest income plus other operating income, were $27.1 million in the third quarter of 2015, a 45% increase from total revenues of $18.7 million in the third quarter a year ago.
- Net interest income increased 7% to $14.7 million in the third quarter of 2015, compared to $13.7 million in the quarter ended September 30, 2014.
- Return on average assets was 1.42% and return on average equity was 12.37% at September 30, 2015, as compared to 1.07% and 9.29% at September 30, 2014, respectively.
- Average portfolio loans increased 5% to $982.3 million for the third quarter of 2015 as compared to $936.4 million for the third quarter of 2014, reflecting organic loan growth.
- Net interest margin was 4.32% in the third quarter of 2015 and 4.35% in the first nine months of 2015 as compared to 4.38% and 4.33% in the same periods of 2014. The decrease in the third quarter of 2015 compared to the third quarter of 2014 was primarily the result of decreased balances of higher yielding portfolio loans as a percentage of total interest earning assets during the current quarter, while the increase in net interest margin year to date compared to the same period last year was mainly the result of increased average loan balances, partially offset by a decrease in yield on loans and increases in both volume and cost for interest-bearing liabilities.
- Northrim paid a quarterly cash dividend of $0.19 per share in September of 2015, compared to the $0.18 per share dividend paid in September 2014. The dividend provides a yield of approximately 2.6% at current market share prices.
- Tangible book value[1] was $22.09 per share at September 30, 2015 as compared to $20.48 per share at December 31, 2014. Tangible book value is a non-GAAP ratio that represents total shareholders' equity less goodwill and intangible assets divided by the number of shares outstanding. Although we believe this non-GAAP financial measure is frequently used by stakeholders in the evaluation of companies in the banking industry, there are limitations, it is not required to be uniformly applied, and it is not audited. The most comparable GAAP measure of book value per share consists of total shareholders' equity divided by the number of shares outstanding, which was $25.56 at September 30, 2015, compared to $23.99 at December 31, 2014.
- The Company remains well-capitalized with Tier 1 Capital to Risk Adjusted Assets at September 30, 2015, of 13.00%, compared to 13.06% at December 31, 2014. The decrease in Tier 1 Capital to Risk Adjusted Assets at

September 30, 2015 was primarily the result of the new BASEL III requirements.

- Tangible common equity to tangible assets[2] was 10.00% at September 30, 2015, compared to 9.85% December 31, 2014. Tangible common equity to tangible assets is a non-GAAP ratio that represents total equity less goodwill and intangible assets divided by total assets less goodwill and intangible assets. Although we believe this non-GAAP financial measure is frequently used by stakeholders in the evaluation of companies in the banking industry, there are limitations, it is not required to be uniformly applied, and it is not audited. The most comparable GAAP measure of equity to assets consists of total equity divided by total assets. Total equity to total assets was 11.39% at September 30, 2015 as compared to 11.35% at December 31, 2014.

[1] Tangible book value is a non-GAAP measure defined as shareholders' equity, less intangible assets, divided by shares outstanding. The reconciliation of tangible book value per share to book value per share is shown in the table below:

| (In thousands, except per share data) | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Total shareholders' equity | $175,336 | $164,441 |
| Divided by common shares outstanding | 6,859,351 | 6,854,189 |
| Book value per share | $25.56 | $23.99 |

| (In thousands, except per share data) | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Total shareholders' equity | $175,336 | $164,441 |
| Less: goodwill and intangible assets, net | 23,817 | 24,035 |
| | $151,519 | $140,406 |
| Divided by common shares outstanding | 6,859,351 | 6,854,189 |
| Tangible book value per share | $22.09 | $20.48 |

[2] Tangible common equity to tangible assets is a non-GAAP ratio that represents total equity less goodwill and intangible assets divided by total assets less goodwill and intangible assets. This ratio has received more attention over the past several years from stock analysts and regulators. The most comparable GAAP measure of common equity to assets is calculated by dividing total equity by total assets. The reconciliation of total shareholders' equity to tangible common shareholders' equity (non-GAAP) and total assets to tangible assets is shown in the table below:

| (In Thousands) | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Total shareholders' equity | $175,336 | $164,441 |
| Less: goodwill and other intangible assets, net | 23,817 | 24,035 |
| Tangible common shareholders' equity | $151,519 | $140,406 |
| Total assets | $1,539,253 | $1,449,349 |
| Less: goodwill and other intangible assets, net | 23,817 | 24,035 |
| Tangible assets | $1,515,436 | $1,425,314 |
| Tangible common equity ratio | 10.00 % | 9.85 % |

The Company reported net income and diluted earnings per share of $5.3 million and $0.77, respectively, for the third quarter of 2015 compared to net income and diluted earnings per share of $3.7 million and $0.53, respectively, for the third quarter of 2014. The Company reported net income and diluted earnings per share of $13.7 million and $1.97, respectively, year to date as of September 30, 2015 compared to net income and diluted earnings per share of $10.7 million and $1.57, respectively, for the same period in 2014. The increase in net income for both of these periods in 2015 as compared to the same periods of 2014 was primarily the result of mortgage banking income recognized from RML's home mortgage lending operations combined with increased interest and fees on loans. The increase in interest and fees on loans in the three month period ending September 30, 2015 compared to the same period in 2014 was primarily the result of organic loan growth. Interest and fees on loans increased in the nine month period ending September 30, 2015 compared to the same period of 2014 primarily due to organic loan growth combined with the acquisition of Alaska Pacific on April 1, 2014. These increases were partially offset by increased operating expenses primarily resulting from the acquisitions of RML and Alaska Pacific as well as expense recorded in connection with the change in fair value of our earn-out liability associated with the acquisition of RML. Additionally, the increases in other operating income and net interest income for these periods in 2015 as compared to the same periods in 2014 were partially offset by a loan loss provision of $1.4 million recorded for the first nine months of 2015 compared to a $1.1 million benefit for loan losses recorded in the same period of 2014 due to net recoveries in 2014 that led to a negative loan loss provision.

The Company’s total assets were $1.5 billion and $1.4 billion at September 30, 2015 and December 31, 2014, respectively. Increases in loans and loans held for sale were partially offset by decreases in investment securities available for sale. Net loans increased to $955.8 million at September 30, 2015 as compared to $907.8 million at December 31, 2014, mainly due to increases in commercial, commercial real estate, and construction loans in the first nine months of 2015.

Credit Quality

Nonperforming assets: Nonperforming assets at September 30, 2015 decreased $2.0 million, or 22% to $7.2 million as compared to $9.3 million at December 31, 2014. Nonaccrual loans decreased $939,000 to $3.7 million and total other real estate owned ("OREO") decreased $1.1 million to $3.5 million at September 30, 2015 as compared to $4.7 million and $4.6 million at December 31, 2014, respectively. Nonperforming purchased receivables were zero at September 30, 2015 and December 31, 2014, respectively. Government guarantees included in nonperforming assets totaled $1.6 million at September 30, 2015 as compared to $2.1 million at December 31, 2014. These represent the portion of nonperforming assets that are guaranteed by governmental agencies including the Small Business Administration, the United States Department of Agriculture, the Bureau of Indian Affairs, and the Alaska Industrial Development and Export Authority.

The following table summarizes OREO activity for the three and nine month periods ending September 30, 2015 and 2014:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| | (In Thousands) | | | |
| Balance, beginning of the period | $2,807 | $4,897 | $4,607 | $2,402 |
| Transfers from loans | 796 | — | 1,133 | 1,158 |
| Transfers from premises and equipment | — | — | — | 904 |
| Acquired from Alaska Pacific | — | — | — | 1,709 |
| Proceeds from the sale of other real estate owned | — | (229) | (1,971) | (1,828) |
| Gain on sale of other real estate owned, net | — | 102 | 136 | 470 |
| Deferred gain on sale of other real estate owned | — | (38) | (34) | (38) |
| Impairment on other real estate owned | (92) | — | (360) | (45) |
| Balance at end of period | $3,511 | $4,732 | $3,511 | $4,732 |

Potential problem loans: Potential problem loans are loans which are currently performing that have developed negative indications that the borrower may not be able to comply with present payment terms and which may later be included in nonaccrual, past due, or impaired loans. At September 30, 2015, management had identified potential problem loans of $29.0 million as compared to potential problem loans of $18.0 million at December 31, 2014. The increase in potential problem loans from December 31, 2014 to September 30, 2015 is primarily the result of one commercial real estate construction project.

Troubled debt restructurings (“TDRs”): TDRs are those loans for which concessions, including the reduction of interest rates below a rate otherwise available to that borrower, have been granted due to the borrower’s weakened financial condition. Interest on TDRs will be accrued at the restructured rates when it is anticipated that no loss of original principal will occur, and the interest can be collected, which is generally after a period of six months. The Company had $3.2 million in loans classified as TDRs that were performing and $1.9 million in TDRs included in nonaccrual loans at September 30, 2015 for a total of approximately $5.1 million. At December 31, 2014 there were $5.4 million in loans classified as TDRs that were performing and $2.3 million in TDRs included in nonaccrual loans for a total of $7.7 million. See Note 6 of the Notes to Consolidated Financial Statements included in Item 1 of this report for further discussion of TDRs.

RESULTS OF OPERATIONS

Income Statement

Net Income

Net income attributable to the Company for the third quarter of 2015 increased $1.6 million, or 43%, to $5.3 million as compared to $3.7 million for the same period in 2014. Net income attributable to the Company for the nine months ended September 30, 2015 increased $2.9 million, or 27%, to $13.7 million as compared to the same period in 2014.

The increases in net income

for the three and nine month periods ending September 30, 2015 as compared to the same periods in 2014 was primarily due to the acquisition of the remaining 76.5% of RML in the fourth quarter of 2014, the acquisition of Alaska Pacific in the second quarter of 2014, as well as organic loan growth.

Net Interest Income / Net Interest Margin

Net interest income for the third quarter of 2015 increased $957,000, or 7%, to $14.7 million as compared to $13.7 million for the third quarter in 2014. Net interest income increased $4.1 million, or 11%, to $42.5 million in the first nine months of 2015 as compared to $38.4 million for the same period in 2014. Net interest margin decreased 6 basis points to 4.32% in the third quarter and increased 2 basis points 4.35% in the first nine months of 2015 as compared to 4.38% and 4.33% in the same periods of 2014. The increases in net interest income in the three and nine month periods ending September 30, 2015 as compared to the same periods in 2014 were primarily the result of increased average loan balances, partially offset by increases in both volume and cost for interest-bearing liabilities. The decrease in net interest margin in the third quarter of 2015 as compared to the third quarter of 2014 is primarily the result of decreased balances of higher yielding portfolio loans as a percentage of total interest-earning assets.

Average loans, the largest category of interest-earning assets, increased by $45.9 million, or 5% to $982.3 million in the three-month period ending September 30, 2015, and increased $87.4 million, or 10% to $965.2 million in the nine-month period ending September 30, 2015, as compared to the same periods in 2014, respectively. Total interest income from loans increased $578,000 for the third quarter of 2015 and increased $3.4 million in the nine-month period ending September 30, 2015 as compared to the same period in 2014, respectively, mainly due to increased average balances. Average loan balances increased in the three month period ended September 30, 2015 compared to the same period in 2014 as a result of loan growth from the Company's legacy operations (excluding the impact of loans acquired in connection with the transaction with Alaska Pacific). In addition to growth from legacy operations, the acquisition of Alaska Pacific contributed to the increase in average loan balances in the nine month period ending September 30, 2015 as compared to 2014.

Average loans held for sale increased by $47.6 million, or 542% to $56.4 million in the three-month period ending September 30, 2015, and increased $46.6 million, or 532% to $55.3 million in the nine-month period ending September 30, 2015, as compared to the same periods in 2014, respectively. Total interest income from loans held for sale increased $469,000 for the third quarter of 2015 and increased $1.3 million in the nine-month period ending September 30, 2015 as compared to the same period in 2014, respectively, as a result of the increase in average balances. Average balances and net interest income for loans held for sale increased in both the third quarter and first nine months of 2015 primarily as a result of loans acquired by the Company in connection with the Company's acquisition of the remaining 76.5% of RML on December 1, 2014 and loans generated by RML subsequent to the acquisition.

Average investments increased by $10.4 million, or 3% to $308.2 million in the three-month period ending September 30, 2015, and decreased $9.4 million, or 3% to $287.5 million in the nine-month period ending September 30, 2015, as compared to the same periods in 2014. The increase in average investments for the three-month period ending September 30, 2015 as compared to the same period in 2014 is mainly the result of purchases of long-term investments funded by increased deposit balances. The decrease in average investments for the nine-month period ending September 30, 2015 as compared to the same period in 2014 is mainly a result of decreased short-term investment balances.

Average interest-bearing liabilities increased $55.4 million, or 7%, to $841.6 million during the third quarter of 2015 and increased $86.3 million, or 11%, to $838.5 million in the nine-month period ending September 30, 2015, as compared to $786.2 million and $752.2 million, for the same periods in 2014, respectively. These increases were primarily the result of increased borrowings resulting from a warehouse line of credit acquired as a result of our acquisition of RML. Additionally, certificates of deposits increased in both periods compared to 2014 mainly as a result of a campaign the Company ran in the fourth quarter of 2014. Average interest-bearing liabilities increased in the nine months ended September 30, 2015 as compared to 2014 mostly due to the deposit balances acquired in connection with the acquisition of Alaska Pacific. The average cost of interest-bearing liabilities increased $219,000 and $797,000, or 45% and 56%, for the three and nine-month periods ending September 30, 2015, respectively, as compared to the same periods in 2014, primarily due to increases in both average balances and interest rates for both deposits and borrowings. Interest rates on deposits increased due to a change in the mix of the Company's deposits. Average certificates of deposits accounted for 12% and 10% of total average deposits for the third quarters of 2015 and 2014, respectively, and 12% and 9% of total average deposits year-to-date at September 30, 2015 and 2014, respectively. Additionally, interest rates on short term borrowings increased mainly due to the Company's use of some higher cost short term funding lines used to fund mortgage originations.

Components of Net Interest Margin

The following table compares average balances and rates as well as net tax equivalent margins on earning assets for the three-month periods ended September 30, 2015 and 2014:

| (Dollars in Thousands) | Three Months Ended September 30, | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Average Balances | | Change | | Interest income/ expense | | Change | | Average Yields/Costs Tax Equivalent[3] | | |
| | 2015 | 2014 | $ | % | 2015 | 2014 | $ | % | 2015 | 2014 | Change |
| Loans[1,2] | $982,301 | $936,415 | $45,886 | 5 % | $13,929 | $13,351 | $578 | 4 % | 5.67 % | 5.68 % | (0.01 )% |
| Loans held for sale | 56,379 | 8,787 | 47,592 | 542 % | 555 | 86 | 469 | 545 % | 3.90 % | 3.90 % | — % |
| Short-term investments | 74,895 | 72,844 | 2,051 | 3 % | 47 | 55 | (8 ) | (15 )% | 0.25 % | 0.29 % | (0.04 )% |
| Long-term investments | 233,255 | 224,898 | 8,357 | 4 % | 857 | 720 | 137 | 19 % | 1.58 % | 1.43 % | 0.15 % |
| Total investments | 308,150 | 297,742 | 10,408 | 3 % | 904 | 775 | 129 | 17 % | 1.25 % | 1.14 % | 0.11 % |
| Interest-earning assets | 1,346,830 | 1,242,944 | 103,886 | 8 % | 15,388 | 14,212 | 1,176 | 8 % | 4.58 % | 4.58 % | — % |
| Nonearning assets | 145,747 | 133,829 | 11,918 | 9 % | | | | | | | |
| Total | $1,492,577 | $1,376,773 | $115,804 | 8 % | | | | | | | |
| Interest-bearing deposits | $783,721 | $744,631 | $39,090 | 5 % | $490 | $352 | $138 | 39 % | 0.25 % | 0.19 % | 0.06 % |
| Borrowings | 57,916 | 41,594 | 16,322 | 39 % | 216 | 135 | 81 | 60 % | 1.45 % | 1.25 % | 0.20 % |
| Total interest-bearing liabilities | 841,637 | 786,225 | 55,412 | 7 % | 706 | 487 | 219 | 45 % | 0.33 % | 0.24 % | 0.09 % |
| Demand deposits and other noninterest -bearing liabilities | 479,843 | 432,226 | 47,617 | 11 % | | | | | | | |
| Equity | 171,097 | 158,322 | 12,775 | 8 % | | | | | | | |
| Total | $1,492,577 | $1,376,773 | $115,804 | 8 % | | | | | | | |
| Net interest income | | | | | $14,682 | $13,725 | $957 | 7 % | | | |
| Tax equivalent net interest margin on interest earning assets[3] | | | | | | | | | 4.38 % | 4.43 % | (0.05 )% |

[1]Interest income includes loan fees. Loan fees recognized during the period and included in the yield calculation totaled $923,000 and $799,000 in the third quarter of 2015 and 2014, respectively.

[2]Nonaccrual loans are included with a zero effective yield. Average nonaccrual loans included in the computation of the average loans were $4.1 million and $2.9 million in the third quarter of 2015 and 2014 respectively.

[3]Tax-equivalent net interest margin is a non-GAAP performance measurement in which interest income on non-taxable investments and loans is presented on a tax-equivalent basis using a combined federal and state statutory rate of 41.11% in both 2015 and 2014. Although we believe this non-GAAP financial measure is frequently used by stakeholders in the evaluation of companies in the banking industry, there are limitations, it is not required to be uniformly applied, and it is not audited. The most comparable GAAP measure, net interest margin, was 4.32% and 4.38%, respectively, for the third quarter of 2015 and 2014.

The following table is a reconciliation of tax-equivalent net interest margin to net interest margin for the periods indicated:

| (In Thousands) | Three Months Ended September 30, 2015 | 2014 |
|---|---|---|
| Net interest income | $14,682 | $13,725 |
| Divided by average interest-bearing assets | 1,346,830 | 1,242,944 |
| Net interest margin | 4.32% | 4.38% |

| (In Thousands) | 2015 | 2014 |
|---|---|---|
| Net interest income | $14,682 | $13,725 |
| Plus: reduction in tax expense related to tax-exempt interest income | 185 | 148 |
| | $14,867 | $13,873 |
| Divided by average interest-bearing assets | 1,346,830 | 1,242,944 |
| Tax-equivalent net interest margin | 4.38% | 4.43% |

The following table compares average balances and rates as well as net tax equivalent margins on earning assets for the nine-month periods ended September 30, 2015 and 2014:

| (Dollars in Thousands) | Nine Months Ended September 30, | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Average Balances | | Change | | Interest income/ expense | | Change | | Average Yields/Costs Tax Equivalent[3] | | |
| | 2015 | 2014 | $ | % | 2015 | 2014 | $ | % | 2015 | 2014 | Change |
| Loans[1,2] | $965,241 | $877,800 | $87,441 | 10% | $40,549 | $37,127 | $3,422 | 9% | 5.66% | 5.68% | (0.02)% |
| Loans held for sale | 55,319 | 8,747 | 46,572 | 532% | 1,537 | 263 | 1,274 | 484% | 3.72% | 4.01% | (0.29)% |
| Short-term investments | 43,122 | 59,870 | (16,748) | (28)% | 82 | 145 | (63) | (43)% | 0.25% | 0.32% | (0.07)% |
| Long-term investments | 244,357 | 237,033 | 7,324 | 3% | 2,549 | 2,245 | 304 | 14% | 1.52% | 1.40% | 0.12% |
| Total investments | 287,479 | 296,903 | (9,424) | (3)% | 2,631 | 2,390 | 241 | 10% | 1.34% | 1.19% | 0.15% |
| Interest-earning assets | 1,308,039 | 1,183,450 | 124,589 | 11% | 44,717 | 39,780 | 4,937 | 12% | 4.62% | 4.54% | 0.08% |
| Nonearning assets | 147,830 | 117,397 | 30,433 | 26% | | | | | | | |
| Total | $1,455,869 | $1,300,847 | $155,022 | 12% | | | | | | | |
| Interest-bearing deposits | $781,320 | $709,877 | $71,443 | 10% | $1,460 | $986 | $474 | 48% | 0.25% | 0.19% | 0.06% |
| Borrowings | 57,177 | 42,362 | 14,815 | 35% | 748 | 425 | 323 | 76% | 1.71% | 1.31% | 0.40% |
| Total interest-bearing liabilities | 838,497 | 752,239 | 86,258 | 11% | 2,208 | 1,411 | 797 | 56% | 0.35% | 0.25% | 0.10% |
| Demand deposits and other noninterest -bearing liabilities | 448,917 | 394,981 | 53,936 | 14% | | | | | | | |
| Equity | 168,455 | 153,627 | 14,828 | 10% | | | | | | | |
| Total | $1,455,869 | $1,300,847 | $155,022 | 12% | | | | | | | |
| Net interest income | | | | | $42,509 | $38,369 | $4,140 | 11% | | | |

| | | | |
|---|---|---|---|
| Tax equivalent net interest margin on interest earning assets[3] | 4.40 % | 4.38 % | 0.02 % |

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[1]Interest income includes loan fees.  Loan fees recognized during the period and included in the yield calculation totaled $2.7 million and $2.2 million in the first nine months of 2015 and 2014, respectively.
[2]Nonaccrual loans are included with a zero effective yield.  Average nonaccrual loans included in the computation of the average loans were $4.5 million and $2.9 million in the first nine months of 2015 and 2014 respectively.
[3]Tax-equivalent net interest margin is a non-GAAP performance measurement in which interest income on non-taxable investments and loans is presented on a tax-equivalent basis using a combined federal and state statutory rate of 41.11% in both 2015 and 2014. Although we believe this non-GAAP financial measure is frequently used by stakeholders in the evaluation of companies in the banking industry, there are limitations, it is not required to be uniformly applied, and it is not audited. The most comparable GAAP measure, net interest margin, was 4.35% and 4.33%, respectively, for the first nine months of 2015 and 2014.

The following table is a reconciliation of tax-equivalent net interest margin to net interest margin for the periods indicated:

| | Nine Months Ended September 30, | |
|---|---|---|
| (In Thousands) | 2015 | 2014 |
| Net interest income | $42,509 | $38,369 |
| Divided by average interest-bearing assets | 1,308,039 | 1,183,450 |
| Net interest margin | 4.35% | 4.33% |

| (In Thousands) | 2015 | 2014 |
|---|---|---|
| Net interest income | $42,509 | $38,369 |
| Plus: reduction in tax expense related to tax-exempt interest income | 535 | 428 |
| | $43,044 | $38,797 |
| Divided by average interest-bearing assets | 1,308,039 | 1,183,450 |
| Tax-equivalent net interest margin | 4.40% | 4.38% |

The following tables set forth the changes in consolidated net interest income attributable to changes in volume and to changes in interest rates for the three and nine-month periods ending September 30, 2015 and 2014.  Changes attributable to the combined effect of volume and interest rate have been allocated proportionately to the changes due to volume and the changes due to interest rates:

| (In Thousands) | Three Months Ended September 30, 2015 vs. 2014 | | |
|---|---|---|---|
| | Increase (decrease) due to | | |
| | Volume | Rate | Total |
| Interest Income: | | | |
| Loans | $693 | ($115) | $578 |
| Loans held for sale | 469 | — | 469 |
| Short-term investments | 1 | (9) | (8) |
| Long-term investments | 36 | 101 | 137 |
| Total interest income | $1,199 | ($23) | $1,176 |
| Interest Expense: | | | |
| Interest-bearing deposits | $20 | $118 | $138 |
| Borrowings | 57 | 24 | 81 |
| Total interest expense | $77 | $142 | $219 |

| (In Thousands) | Nine Months Ended September 30, 2015 vs. 2014 | | |
|---|---|---|---|
| | Increase (decrease) due to | | |
| | Volume | Rate | Total |
| Interest Income: | | | |
| Loans | $3,738 | ($316) | $3,422 |
| Loans held for sale | 1,290 | (16) | 1,274 |
| Short-term investments | (38) | (25) | (63) |
| Long-term investments | 78 | 226 | 304 |
| Total interest income | $5,068 | ($131) | $4,937 |
| Interest Expense: | | | |
| Interest-bearing deposits | $106 | $368 | $474 |
| Borrowings | 162 | 161 | 323 |
| Total interest expense | $268 | $529 | $797 |

Provision for Loan Losses

We recorded a provision for loan losses of $676,000 for the third quarter of 2015 compared to no provision for loan losses in the same period of 2014. We recorded a provision for loan losses of $1.4 million and a benefit for the provision of loan losses of $1.1 million for the nine month periods ending September 30, 2015 and 2014, respectively. The increase in the provision for loan losses in both periods of 2015 as compared to 2014 is primarily the result of an increase in portfolio loans. Net recoveries in 2014 led to the loan loss benefit. See "Analysis of the Allowance for Loan Losses" under the "Financial Condition-Balance Sheet Overview" and Note 8 of the Notes to Consolidated Financial Statements included in Part I of this report for more information on changes in the Company's Allowance.

Other Operating Income

Other operating income for the three-month period ending September 30, 2015, increased $7.5 million, or 151%, to $12.4 million as compared to the same period in 2014. This increase is primarily the result of $8.1 million in mortgage banking income earned in the third quarter of 2015. The Company acquired the remaining 76.5% of RML on December 1, 2014 making RML a wholly-owned, consolidated subsidiary of the Company. RML's results of operations prior to the December 1, 2014 acquisition were included in our operating results under the equity method. Additionally, other income increased $669,000 in the third quarter of 2015 compared to the same period in 2014 primarily due to $683,000 in gains on loans acquired at a discount in connection with the acquisition of Alaska Pacific in 2014 that were paid off in the second quarter of 2015. These increases were partially offset by a decrease of $1.1 million in gains on the sale of premises and equipment, which was the result of the Company selling a branch location in 2014 to the State of Alaska in order to accommodate a major road project in Anchorage.

Other operating income for the nine-month period ending September 30, 2015, increased $22.7 million, or 193%, to $34.5 million as compared to the same period in 2014. This increase is primarily the result of $23.2 million in mortgage banking income earned in the first nine months of 2015 as a result of the acquisition of RML noted above. Additionally, other income increased $1.0 million the first nine months of 2015 compared to the same period of 2014 primarily due to $910,000 in gains recognized on the disposition of loans acquired in connection with the acquisition of Alaska Pacific in 2014 at a discount, as well as an increase in rental income of $200,000 due to new tenants occupying space in the Company's main office building beginning August 1, 2014. These increases were partially offset by a decrease of $1.1 million in gains on the sale of premises and equipment as a result of the branch sale noted above.

Other Operating Expense

Other operating expense for the third quarter of 2015 increased $5.4 million, or 42%, to $18.2 million as compared to the same period in 2014, mainly as a result of a $4.3 million increase in salaries and other personnel expense and an expense of $780,000 incurred in the third quarter of 2015 related to the earn out liability attributable to the RML acquisition. The increase in salaries and other personnel expense was primarily due to an increase in average full time equivalent employees from 314 at September 30, 2014 to 434 at September 30, 2015, primarily due to the acquisition of RML. Additionally, occupancy expense, professional and outside services expense, other loan expense, and OREO expense net of rental income and gains on sale increased $481,000, $319,000, $258,000 and $220,000, respectively, in the third quarter of 2015 as compared to the third quarter of 2014. Occupancy and professional and outside services expenses increased primarily due to the acquisition of RML. Other loan expense increased in the third quarter of 2015 compared to the same period of 2014 primarily due to an increase in portfolio loans, while OREO expense net of rental income and gains on sale also increased due to increased impairment on OREO properties and a decrease in gains on sale. These increases were partially offset by a decrease of $1.0 million in merger and acquisition expense, which mostly resulted from costs incurred in connection with the acquisitions of Alaska Pacific and RML in 2014 and a $264,000 decrease in the reserve for purchased receivables.

Other operating expense for the nine-month period ending September 30, 2015 increased $20.0 million, or 58%, to $54.4 million as compared to the same period in 2014, primarily due to an $13.2 million increase in salaries and other personnel expense primarily due to the acquisitions of RML and Alaska Pacific, and an expense of $2.9 million related to the earn out liability attributable to the RML acquisition. The following are other changes in other operating expense: an increase of $1.7 million in occupancy expense, an increase of $1.2 million in professional and other outside services, an increase of $804,000 in other loan expense, and an increase of $643,000 in OREO expense net of rental income and gains on sale. These expenses increased in the nine month period ending September 30, 2015 compared to the same period of 2014 primarily due to the same factors discussed above for the third quarter. Additionally, marketing expense, equipment expense, and insurance expense also increased by $399,000, $187,000, and $287,000, respectively, primarily due to the acquisitions of Alaska Pacific and RML. These increases were partially offset by decreases of $1.7 million and $542,000, in merger and acquisition expense and the reserve for purchased receivables, respectively.

Income Taxes

The provision for income taxes for the three and nine-month periods ending September 30, 2015 increased $696,000 and $1.3 million, or 35% and 22%, respectively, as compared to the same periods in 2014 primarily due to increases in pre-tax net income. The effective tax rate for the nine-month periods ending September 30, 2015 and 2014 was 34% and 35%, respectively.

## FINANCIAL CONDITION

### Balance Sheet Overview

#### Investment Securities

Investment securities at September 30, 2015 decreased $48.7 million, or 17%, to $235.2 million from $283.9 million at December 31, 2014. This decrease was primarily due to sales, maturities, and security calls of available for sale securities, which were only partially offset by purchases. The Company used proceeds from the net decrease in investment securities to fund loan growth in the first nine months of 2015.

#### Loans and Lending Activities

Our loan products include short and medium-term commercial loans, commercial credit lines, construction and real estate loans, and consumer loans. From our inception, we have emphasized commercial, land development and home construction, and commercial real estate lending. This type of lending has provided us with market opportunities and higher net interest margins than other types of lending. However, it also involves greater risks, including greater exposure to changes in local economic conditions, than certain other types of lending.

Portfolio loans increased by $49.2 million, or 5%, to $973.7 million at September 30, 2015 from $924.5 million at December 31, 2014, primarily the result of organic growth in commercial, commercial real estate and real estate construction loans. The growth in real estate construction loans in 2015 was from commercial real estate projects and tax-advantaged low-income housing projections. Residential housing construction loans remain consistent at approximately 5% of portfolio loans at September 30, 2015.

The following table details loan balances by loan type as of the dates indicated:

| (In Thousands) | September 30, 2015 Dollar Amount | Percent of Total | December 31, 2014 Dollar Amount | Percent of Total |
|---|---|---|---|---|
| Commercial | $325,092 | 33.4% | $306,543 | 33.2% |
| Real estate construction one-to-four family | 48,527 | 5.0% | 34,842 | 3.8% |
| Real estate construction other | 107,393 | 11.0% | 91,195 | 9.9% |
| Real estate term owner occupied | 112,527 | 11.6% | 109,472 | 11.8% |
| Real estate term non-owner occupied | 291,113 | 29.9% | 286,616 | 31.0% |
| Real estate term other | 36,443 | 3.7% | 36,894 | 4.0% |
| Consumer secured by 1st deeds of trust | 27,664 | 2.8% | 32,000 | 3.5% |
| Consumer other | 29,269 | 3.0% | 31,493 | 3.4% |
| Subtotal | $978,028 | | $929,055 | |
| Less: Unearned origination fee, net of origination costs | (4,348) | (0.3)% | (4,551) | (0.6)% |
| Total loans | $973,680 | | $924,504 | |

Analysis of Allowance for Loan Losses

The Company maintains an Allowance to reflect losses inherent in the loan portfolio. The Allowance is increased by provisions for loan losses and loan recoveries and decreased by loan charge-offs. The size of the Allowance is determined through quarterly assessments of probable estimated losses in the loan portfolio.

Our methodology for making such assessments and determining the adequacy of the Allowance includes the following key elements:

A specific allocation for impaired loans. Management determines the fair value of the majority of these loans based on the underlying collateral values. This analysis is based upon a specific analysis for each impaired loan, including external appraisals on loans secured by real property, management’s assessment of the current market, recent payment history, and an evaluation of other sources of repayment. In-house evaluations of fair value are used in the impairment analysis in some situations. Inputs to the in-house evaluation process include information about sales of comparable properties in the appropriate markets and changes in tax assessed values. The Company obtains appraisals on real and personal property that secure its loans during the loan origination process in accordance with regulatory guidance and its loan policy. The Company obtains updated appraisals on loans secured by real or personal property based upon its assessment of changes in the current market or particular projects or properties, information from other current appraisals, and other sources of information. Appraisals may be adjusted downward by the Company based on its evaluation of the facts and circumstances on a case by case basis. External appraisals may be discounted when management believes that the absorption period used in the appraisal is unrealistic, when expected liquidation costs exceed those included in the appraisal, or when management’s evaluation of deteriorating market conditions warrants an adjustment. Additionally, the Company may also adjust appraisals in the above circumstances between appraisal dates. The Company uses the information provided in these updated appraisals along with its evaluation of all other information available on a particular property as it assesses the collateral coverage on its performing and nonperforming loans and the impact that may have on the adequacy of its Allowance. The specific allowance for impaired loans, as well as the overall Allowance, may increase based on the Company’s assessment of updated appraisals. When the Company determines that a loss has occurred on an impaired loan, a charge-off equal to the difference between carrying value and fair value is recorded. If a specific allowance is deemed necessary for a loan, and then that loan is partially charged off, the loan remains classified as a nonperforming loan after the charge-off is recognized. Loans measured for impairment based on collateral value and all other loans measured for impairment are accounted for in the same way. As of September 30, 2015 and December 31, 2014, 30% and 6% of nonperforming loans, which totaled $3.7 million and $4.7 million, respectively, had partially charged-off balances.

A general allocation. The Company has identified segments and classes of loans not considered impaired for purposes of establishing the general allocation allowance. The Company determined the disaggregation of the loan portfolio into segments and classes based on its assessment of how different pools of loans with like characteristics in the portfolio behave over time. This determination is based on historical experience and management's assessment of how current facts and circumstances are expected to affect the loan portfolio.

The Company has the following loan segments: 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, and other consumer loans. The Company has five loan classes: pass, special mention, substandard, doubtful, and loss.

After the portfolio has been disaggregated into segments and classes, the Company calculates a general reserve for each segment and class based on the average year loss history for each segment and class using a five year look-back period.

After the Company calculates a general allocation using its loss history, the general reserve is then adjusted for qualitative factors by segment and class. Qualitative factors are based on management's assessment of current trends that may cause losses inherent in the current loan portfolio to differ significantly from historical losses. Some factors that management considers in determining the qualitative adjustment to the general reserve include loan quality trends in our own portfolio, national and local economic trends, business conditions, underwriting policies and standards, trends in local real estate markets, effects of various political activities, peer group data, and internal factors such as underwriting policies and expertise of the Company's employees.

An unallocated reserve. The unallocated portion of the Allowance provides for other credit losses inherent in the Company's loan portfolio that may not have been contemplated in the specific and general components of the Allowance, and it acknowledges the inherent imprecision of all loss prediction models. The unallocated component is reviewed periodically based on trends in credit losses and overall economic conditions.

At September 30, 2015, the unallocated portion of the Allowance as a percentage of the total Allowance was 9%. The unallocated portion of the Allowance as a percentage of the total Allowance was 7% at December 31, 2014.

Further discussion of the enhancement to the Company's Allowance methodology can be found in Item 7 in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

Allowance related to acquired loans: In accordance with generally accepted accounting principles, loans acquired in connection with the acquisition of Alaska Pacific on April 1, 2014 were recorded at their fair value at the acquisition date. Credit discounts were included in the determination of fair value; therefore, an allowance for loan losses was not recorded at the acquisition date. Purchased credit impaired loans were evaluated on a loan by loan basis and the valuation allowance for these loans was netted against the carrying value. Deterioration in credit quality of the acquired loans subsequent to acquisition date results in the establishments of an allowance. There was no allowance related to acquired loans at September 30, 2015.

The following table sets forth information regarding changes in the Allowance for the periods indicated:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In Thousands) | 2015 | 2014 | 2015 | 2014 |
| Balance at beginning of period | $17,418 | $16,032 | $16,723 | $16,282 |
| Charge-offs: | | | | |
| Commercial | 367 | — | 474 | 320 |
| Real estate term other | — | — | 81 | — |
| Consumer secured by 1st deeds of trust | 28 | 13 | 28 | 52 |
| Consumer other | 5 | 41 | 5 | 74 |
| Total charge-offs | 400 | 54 | 588 | 446 |
| Recoveries: | | | | |
| Commercial | 152 | 259 | 310 | 889 |
| Real estate construction one-to-four family | — | — | — | 625 |
| Real estate term other | — | — | 17 | — |
| Consumer other | 2 | 6 | 8 | 29 |
| Total recoveries | 154 | 265 | 335 | 1,543 |
| Net, charge-offs (recoveries) | 246 | (211) | 253 | (1,097) |
| Provision for loan losses | 676 | — | 1,378 | (1,136) |
| Balance at end of period | $17,848 | $16,243 | $17,848 | $16,243 |

While management believes that it uses the best information available to determine the Allowance, unforeseen market conditions and other events could result in adjustment to the Allowance, and net income could be significantly affected if circumstances differed substantially from the assumptions used in making the final determination of the Allowance. Moreover, bank regulators frequently monitor banks' loan loss allowances, and if regulators were to determine that the Company's Allowance is inadequate, they may require the Company to increase the Allowance, which may adversely impact the Company's net income and financial condition.

Deposits

Deposits are the Company's primary source of funds. Total deposits increased $85.2 million or 7% with a balance of $1.3 billion at September 30, 2015 and December 31, 2014, respectively. The following table summarizes the Company's composition of deposits as of the periods indicated:

| | September 30, 2015 | | | December 31, 2014 | | |
|---|---|---|---|---|---|---|
| (In thousands) | Balance | % of total | | Balance | % of total | |
| Demand deposits | $485,304 | 39 | % | $403,523 | 35 | % |
| Interest-bearing demand | 179,080 | 14 | % | 185,114 | 15 | % |
| Savings deposits | 221,205 | 17 | % | 222,324 | 18 | % |
| Money market deposits | 236,488 | 19 | % | 226,574 | 20 | % |
| Time deposits | 142,842 | 11 | % | 142,212 | 12 | % |
| Total deposits | $1,264,919 | | | $1,179,747 | | |

The Company's mix of deposits continues to contribute to a low cost of funds with balances in transaction accounts representing 89% and 88% of total deposits September 30, 2015 and December 31, 2014, respectively. There were no depositors with deposits representing 10% or more of total deposits at September 30, 2015 or December 31, 2014.

Borrowings

The Company has a maximum line of credit with the Federal Home Loan Bank of Des Moines, or "FHLB" approximating 35% of eligible assets. FHLB advances are subject to collateral criteria that require the Company to pledge assets under a blanket pledge arrangement as collateral for its borrowings from the FHLB. Based on assets currently pledged and advances currently outstanding at September 30, 2015, the Company's available borrowing line from the FHLB, was $180.0 million, representing approximately 12% of the Company's assets. The Company has an outstanding FHLB advance of $2.1 million and $2.2 million as of September 30, 2015 and December 31, 2014, respectively, that was originated in the first quarter of 2013. FHLB advances are dependent on the availability of acceptable collateral such as marketable securities or real estate loans, although all FHLB advances are secured by a blanket pledge of the Company's assets. The $2.2 million FHLB advance that the Company drew in the first quarter of 2013 was to match fund a $2.2 million loan to one borrower for the construction of a low income housing project that qualified for a long term fixed interest rate of 3.12%. This FHLB borrowing originally had an eighteen year term with a 30 year amortization period, which mirrors the term of the construction loan made to the borrower. The maturity date of this borrowing is March 21, 2031.

The Company, through RML, had borrowings of $10.3 million and $24.1 million at September 30, 2015 and December 31, 2014, respectively. This borrowing is a line of credit used by RML to fund mortgage originations that matures on August 10, 2016.

At September 30, 2015 and December 31, 2014, the Company had no short-term (original maturity of one year or less) borrowings that exceeded 30% of shareholders' equity.

Liquidity and Capital Resources

The Company manages its liquidity through its Asset and Liability Committee. In addition to the $144.6 million of cash and due from banks and interest bearing deposits in other banks and $170.3 million in unpledged available for sale securities held at September 30, 2015, the Company had additional funding sources which include fed fund borrowing lines and advances available at the FHLB of Des Moines and the Federal Reserve Bank of approximately $222.2 million as of September 30, 2015.

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At September 30, 2015, $64.0 million in securities, or 27%, of the investment portfolio was pledged, as compared to $54.1 million, or 19%, at December 31, 2014. As shown in the Consolidated Statements of Cash Flows included in Part I - Item 1 "Financial Statements" of this report, net cash used by operating activities was $7.8 million for the first nine months of 2015 primarily due to cash used in connection with net originations of loans held for sale and a decrease in other liabilities being partially offset by cash received from proceeds from the sale of loans held for sale. Net cash provided by investing activities was $3.0 million for the same period, primarily due to cash received from proceeds from sales and maturities of securities available for sale. These proceeds were partially offset by loan fundings and purchases of investment securities available for sale. Net cash provided by financing activities was $80.8 million, primarily due to an increase in deposits.

The Company issued 4,938 shares of its common stock in the third quarter of 2015 and did not repurchase any shares of its common stock under the Company's publicly announced repurchase program. At September 30, 2015, the Company had 6,859,351 shares of its common stock outstanding.

Capital Requirements and Ratios

The Company and its wholly-owned subsidiary, Northrim Bank (the "Bank"), are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum regulatory capital requirements can result in certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material adverse effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by regulators about the components of regulatory capital, risk weightings, and other factors. The regulatory agencies may establish higher minimum requirements if, for example, a bank or bank holding company has previously received special attention or has a high susceptibility to interest rate risk.

Effective January 1, 2015, both the Company and the Bank were required to meet more stringent minimum capital requirements standards, commonly referred to as "Basel III". As such, the ratios presented as of June 30, 2015 are calculated under the new regulations of Basel III. The ratios presented as of December 31, 2014 are calculated under the prior regulations of Basel II.

The requirements address both risk-based capital and leverage capital. At September 30, 2015, all capital ratios of the Company and the Bank exceeded the ratios required for a "well-capitalized" institution under regulatory guidelines. The following table sets forth the actual capital ratios for the Company and the Bank as calculated under regulatory guidelines, compared to the regulatory minimum capital ratios and the regulatory minimum capital ratios needed to be eligible to qualify as a "well-capitalized" institution as of September 30, 2015.

| | Adequately-Capitalized | Well-Capitalized | Northrim BanCorp, Inc. | Northrim Bank |
|---|---|---|---|---|
| September 30, 2015 | | | | |
| Common equity tier 1 capital | 4.50% | 6.50% | 11.60% | 11.86% |
| Tier 1 risk-based capital | 6.00% | 8.00% | 13.00% | 11.88% |
| Total risk-based capital | 8.00% | 10.00% | 14.25% | 13.13% |
| Leverage ratio | 4.00% | 5.00% | 10.21% | 10.00% |
| December 31, 2014 | | | | |
| Tier 1 risk-based capital | 4.00% | 6.00% | 13.06% | 12.05% |
| Total risk-based capital | 8.00% | 10.00% | 14.31% | 13.30% |
| Leverage ratio | 4.00% | 5.00% | 11.21% | 10.35% |

The regulatory capital ratios for the Company exceed those for the Bank in certain categories primarily because the $18.6 million junior subordinated debenture offerings that the Company completed in the third quarter of 2003 and the fourth quarter of 2005 are included in the Company's capital for regulatory purposes although such securities are accounted for as a long-term debt in its financial statements. The junior subordinated debentures are not accounted for on the Bank’s financial statements nor are they included in its capital. As a result, the Company has $18.6 million more in regulatory capital than the Bank.

Off-Balance Sheet Items

The Company is a party to financial instruments with off-balance sheet risk. Among the off-balance sheet items entered into in the ordinary course of business are commitments to extend credit and the issuance of letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized on the balance sheet. Certain commitments are collateralized. As of September 30, 2015 and December 31, 2014, the Company's commitments to extend credit and to provide letters of credit which are not reflected on its balance sheet amounted to $250.6 million and $225.4 million, respectively. Since many of the commitments are expected to expire without being drawn upon, these total commitment amounts do not necessarily represent future cash requirements. The Company has established reserves of $137,000 and $112,000 at September 30, 2015 and December 31, 2014, respectively, for losses related to these commitments that are recorded in other liabilities on the consolidated balance sheet.

Capital Expenditures and Commitments

At September 30, 2015 the Company has capital commitments of $508,000 related to the construction of new branch locations and $996,000 related to planned improvements to the Company's corporate office building. The Company expects these capital expenditures to be incurred in the fourth quarter of 2015 and first quarter of 2016.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our assessment of market risk as of September 30, 2015 indicates that there are no material changes in the quantitative and qualitative disclosures from those in our Annual Report on Form 10-K for the year ended December 31, 2014.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, we evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934). Our principal executive and financial officers supervised and participated in this evaluation. Based on this evaluation, our principal executive and financial officers each concluded that as of September 30, 2015, the disclosure controls and procedures are effective in timely alerting them to material information required to be included in the periodic reports to the Securities and Exchange Commission. The design of any system of controls is based in part upon various assumptions about the likelihood of future events, and there can be no assurance that any of our plans, products, services or procedures will succeed in achieving their intended goals under future conditions.

Changes in Internal Control over Disclosure and Reporting

There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) and 15-d-15(f) of the Securities Exchange Act of 1934) that occurred during the quarterly period ended September 30, 2015 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

During the normal course of its business, the Company is a party to various debtor-creditor legal actions, disputes, claims, and litigation related to the conduct of its banking business. These include cases filed as a plaintiff in collection and foreclosure cases, and the enforcement of creditors' rights in bankruptcy proceedings. Management does not expect that the resolution of these matters will have a material effect on the Company's business, financial position, results of operations, or cash flows.

ITEM 1A. RISK FACTORS

For information regarding risk factors, please refer to Item 1A in the Company's Annual Report on Form 10-K for the year ended December 31, 2014. These risk factors have not materially changed as of September 30, 2015.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a)-(b) Not applicable

(c) There were no stock repurchases by the Company during the nine months ending September 30, 2015.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION
(a) Not applicable
(b) There have been no material changes to the procedures by which shareholders may nominate directors to the Company's board of directors.

ITEM 6. EXHIBITS

| | |
|---|---|
| 31.1 | Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) |
| 31.2 | Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) |
| 32.1 | Certification of Chief Executive Officer required by Rule 13a-14(b) or Rule 15d-14(b) and Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350 |
| 32.2 | Certification of Chief Financial Officer required by Rule 13a-14(b) or Rule 15d-14(b) and Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350 |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Schema Document |
| 101.CAL | XBRL Calculation Linkbase Document |
| 101.LAB | XBRL Labels Linkbase Document |
| 101.PRE | XBRL Presentation Linkbase Document |
| 101.DEF | XBRL Definition Linkbase Document |

Notes to Exhibits List:

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheet, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income and Changes in Shareholders' Equity, (iv) Consolidated Statements of Cash Flows, and (v) Notes to the Consolidated Financial Statements. In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NORTHRIM BANCORP, INC.

| | | |
|---|---|---|
| November 6, 2015 | By | /s/ Joseph M. Beedle<br>Joseph M. Beedle<br>President and Chief Executive Officer<br>(Principal Executive Officer) |
| November 6, 2015 | By | /s/ Latosha M. Frye<br>Latosha M. Frye<br>Executive Vice President, Chief Financial Officer<br>(Principal Financial and Accounting Officer) |

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