Bank of Marin Bancorp
Form 10-Q
August 07, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015

OR

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 001-33572

Bank of Marin Bancorp
(Exact name of Registrant as specified in its charter)

California	20-8859754
(State or other jurisdiction of incorporation)	(IRS Employer Identification No.)
504 Redwood Blvd., Suite 100, Novato, CA	94947
(Address of principal executive office)	(Zip Code)

Registrant’s telephone number, including area code: (415) 763-4520

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No o

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 o Accelerated filer x Non-accelerated filer o Smaller reporting company o

Indicate by check mark if the registrant is a shell company, as defined in Rule 12b-2 of the Exchange Act.
Yes o No x

As of July 31, 2015, there were 5,988,926 shares of common stock outstanding.

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PART I FINANCIAL INFORMATION

ITEM 1. Financial Statements

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CONDITION
at June 30, 2015 and December 31, 2014

(in thousands, except share data; 2015 unaudited)	June 30, 2015	December 31, 2014
Assets		
Cash and due from banks	$117,533	$41,367
Investment securities		
Held-to-maturity, at amortized cost	94,475	116,437
Available-for-sale, at fair value (amortized cost $252,709 and $199,045 at June 30, 2015 and December 31, 2014, respectively)	254,018	200,848
Total investment securities	348,493	317,285
Loans, net of allowance for loan losses of $14,354 and $15,099 at June 30, 2015 and December 31, 2014, respectively	1,324,851	1,348,252
Bank premises and equipment, net	9,673	9,859
Goodwill	6,436	6,436
Core deposit intangible	3,423	3,732
Interest receivable and other assets	60,353	60,199
Total assets	$1,870,762	$1,787,130
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Non-interest-bearing	$741,107	$670,890
Interest-bearing		
Transaction accounts	95,622	93,758
Savings accounts	132,377	133,714
Money market accounts	502,263	503,543
Time accounts	159,114	149,714
Total deposits	1,630,483	1,551,619
Federal Home Loan Bank ("FHLB") borrowings	15,000	15,000
Subordinated debentures	5,291	5,185
Interest payable and other liabilities	12,806	15,300
Total liabilities	1,663,580	1,587,104
Stockholders' Equity		
Preferred stock, no par value Authorized - 5,000,000 shares, none issued	—	—
Common stock, no par value Authorized - 15,000,000 shares; Issued and outstanding - 5,983,551 and 5,939,482 at June 30, 2015 and December 31, 2014, respectively	83,826	82,436
Retained earnings	122,625	116,502
Accumulated other comprehensive income, net	731	1,088
Total stockholders' equity	207,182	200,026
Total liabilities and stockholders' equity	$1,870,762	$1,787,130

The accompanying notes are an integral part of these consolidated financial statements.

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands, except per share amounts; unaudited)	Three months ended June 30, 2015	Three months ended June 30, 2014	Six months ended June 30, 2015	Six months ended June 30, 2014
Interest income				
Interest and fees on loans	$15,287	$16,363	$30,666	$32,682
Interest on investment securities				
Securities of U.S. government agencies	990	1,193	2,025	2,425
Obligations of state and political subdivisions	511	607	1,051	1,241
Corporate debt securities and other	179	256	384	524
Interest on Federal funds sold and due from banks	51	37	72	88
Total interest income	17,018	18,456	34,198	36,960
Interest expense				
Interest on interest-bearing transaction accounts	30	26	60	49
Interest on savings accounts	13	11	25	22
Interest on money market accounts	123	131	250	289
Interest on time accounts	215	231	437	466
Interest on FHLB and overnight borrowings	78	78	156	156
Interest on subordinated debentures	105	105	209	210
Total interest expense	564	582	1,137	1,192
Net interest income	16,454	17,874	33,061	35,768
Provision for loan losses	—	600	—	750
Net interest income after provision for loan losses	16,454	17,274	33,061	35,018
Non-interest income				
Service charges on deposit accounts	504	528	1,029	1,084
Wealth Management and Trust Services	603	613	1,241	1,177
Debit card interchange fees	368	360	715	660
Merchant interchange fees	129	207	259	405
Earnings on bank-owned life insurance	203	211	406	424
Dividends on FHLB stock	461	130	608	260
Gain on sale of securities	—	97	8	89
Other income	340	222	531	485
Total non-interest income	2,608	2,368	4,797	4,584
Non-interest expense				
Salaries and related benefits	6,672	6,232	13,462	13,162
Occupancy and equipment	1,493	1,329	2,835	2,663
Depreciation and amortization	650	403	1,071	819
Federal Deposit Insurance Corporation insurance	253	269	489	519
Data processing	792	748	1,578	2,108
Professional services	515	412	1,079	1,040
Directors' expense	247	157	438	312
Information technology	216	173	368	338
Reversal of losses on off-balance sheet commitments	(109)	(15)	(310)	(15)
Other expense	1,590	1,749	3,166	3,354
Total non-interest expense	12,319	11,457	24,176	24,300
Income before provision for income taxes	6,743	8,185	13,682	15,302
Provision for income taxes	2,457	3,017	4,939	5,601
Net income	$4,286	$5,168	$8,743	$9,701

Net income per common share:				
Basic	$0.72	$0.88	$1.47	$1.65
Diluted	$0.71	$0.86	$1.44	$1.62
Weighted average shares used to compute net income per common share:				
Basic	5,945	5,888	5,933	5,879
Diluted	6,062	5,993	6,055	5,987
Dividends declared per common share	$0.22	$0.19	$0.44	$0.38
Comprehensive income:				
Net income	$4,286	$5,168	$8,743	$9,701
Other comprehensive income				
Change in net unrealized (loss) gain on available-for-sale securities	(1,803)	976	(486)	2,391
Reclassification adjustment for (gain) loss on available-for-sale securities included in net income	—	—	(8)	15
Net change in unrealized (loss) gain on available-for-sale securities, before tax	(1,803)	976	(494)	2,406
Deferred tax (benefit) expense	(691)	450	(137)	969
Other comprehensive (loss) income, net of tax	(1,112)	526	(357)	1,437
Comprehensive income	$3,174	$5,694	$8,386	$11,138

The accompanying notes are an integral part of these consolidated financial statements.

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
for the year ended December 31, 2014 and the six months ended June 30, 2015

(in thousands, except share data; 2015 unaudited)	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income, Net of Taxes	Total
Balance at December 31, 2013	5,877,524	$80,095	$101,464	$(672)	$180,887
Net income	—	—	19,771	—	19,771
Other comprehensive income	—	—	—	1,760	1,760
Stock options exercised	49,415	1,452	—	—	1,452
Excess tax benefit - stock-based compensation	—	172	—	—	172
Stock issued under employee stock purchase plan	521	23	—	—	23
Restricted stock granted	8,523	—	—	—	—
Restricted stock forfeited / cancelled	(2,067)	—	—	—	—
Stock-based compensation - stock options	—	200	—	—	200
Stock-based compensation - restricted stock	—	246	—	—	246
Cash dividends paid on common stock	—	—	(4,733)	—	(4,733)
Stock purchased by directors under director stock plan	260	12	—	—	12
Stock issued in payment of director fees	5,306	236	—	—	236
Balance at December 31, 2014	5,939,482	$82,436	$116,502	$1,088	$200,026
Net income	—	—	8,743	—	8,743
Other comprehensive loss	—	—	—	(357)	(357)
Stock options exercised	25,233	774	—	—	774
Excess tax benefit - stock-based compensation	—	162	—	—	162
Stock issued under employee stock purchase plan	171	8	—	—	8
Restricted stock granted	15,970	—	—	—	—
Stock-based compensation - stock options	—	127	—	—	127
Stock-based compensation - restricted stock	—	181	—	—	181
Cash dividends paid on common stock	—	—	(2,620)	—	(2,620)
Stock issued in payment of director fees	2,695	138	—	—	138
Balance at June 30, 2015	5,983,551	$83,826	$122,625	$731	$207,182

The accompanying notes are an integral part of these consolidated financial statements.

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
for the six months ended June 30, 2015 and 2014

(in thousands; unaudited)	June 30, 2015	June 30, 2014
Cash Flows from Operating Activities:		
Net income	$8,743	$9,701
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	—	750
Reversal of losses on off-balance sheet commitments	(310)	(15)
Compensation expense-common stock for director fees	138	133
Stock-based compensation expense	308	229
Excess tax benefits from exercised stock options	(141)	(67)
Amortization of core deposit intangible	309	386
Amortization of investment security premiums, net of accretion of discounts	1,217	1,300
Accretion of discount on acquired loans	(1,076)	(2,410)
Accretion of discount on subordinated debentures	106	108
Net amortization of deferred loan origination costs/fees	(294)	(265)
Write-down of other real estate owned	40	—
Gain on sale of investment securities	(8)	(89)
Depreciation and amortization	1,071	819
Loss on disposal of premises and equipment	4	—
Earnings on bank-owned life insurance policies	(406)	(424)
Net change in operating assets and liabilities:		
Interest receivable	109	139
Interest payable	(4)	(35)
Deferred rent and other rent-related expenses	86	69
Other assets	1,504	(670)
Other liabilities	(2,271)	(3,176)
Total adjustments	382	(3,218)
Net cash provided by operating activities	9,125	6,483
Cash Flows from Investing Activities:		
Purchase of held-to-maturity securities	(2,375)	—
Purchase of available-for-sale securities	(76,708)	(9,872)
Proceeds from sale of available-for-sale securities	1,559	2,023
Proceeds from sale of held-to-maturity securities	—	2,146
Proceeds from paydowns/maturity of held-to-maturity securities	23,723	10,891
Proceeds from paydowns/maturity of available-for-sale securities	20,814	23,584
Proceeds from the sale of loan	1,502	—
Loans originated and principal collected, net	22,818	(66,666)
Purchase of FHLB stock	(136)	—
Purchase of premises and equipment	(889)	(1,005)
Cash paid for low income housing tax credit investment	(434)	(208)
Net cash provided by investing activities	(10,126)	(39,107)
Cash Flows from Financing Activities:		
Net increase in deposits	78,864	11,721
Proceeds from stock options exercised	774	672
Proceeds from stock issued under employee and director stock purchase plans	8	14
Cash dividends paid on common stock	(2,620)	(2,243)

Excess tax benefits from exercised stock options	141	67
Net cash provided by financing activities	77,167	10,231
Net increase (decrease) in cash and cash equivalents	76,166	(22,393)
Cash and cash equivalents at beginning of period	41,367	103,773
Cash and cash equivalents at end of period	$117,533	$81,380
Supplemental disclosure of cash flow information:		
Cash paid for interest	$1,035	$1,126
Cash paid for income taxes	$5,270	$4,680
Supplemental disclosure of non-cash investing and financing activities:		
Change in unrealized (loss) gain on available-for-sale securities	$(494)	$2,406
Securities transferred from available-for-sale to held-to-maturity	$—	$14,297
Transfer of loan to loans held-for-sale at fair value	$1,502	$—
Subscription in low income housing tax credit investment	$1,023	$1,000
Stock issued in payment of director fees	$138	$103

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Basis of Presentation

The consolidated financial statements include the accounts of Bank of Marin Bancorp (“Bancorp”), a bank holding company, and its wholly-owned bank subsidiary, Bank of Marin (the “Bank”), a California state-chartered commercial bank. References to “we,” “our,” “us” mean the holding company and the Bank that are consolidated for financial reporting purposes. The accompanying unaudited consolidated interim financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles ("GAAP") have been condensed or omitted pursuant to those rules and regulations. Although we believe that the disclosures are adequate and the information presented is not misleading, we suggest that these interim financial statements be read in conjunction with the financial statements and the notes thereto included in our 2014 Annual Report on Form 10-K. In the opinion of Management, the unaudited consolidated financial statements reflect all adjustments which are necessary for a fair presentation of the consolidated financial position, the results of operations, changes in comprehensive income, changes in stockholders’ equity, and cash flows for the periods presented. All material intercompany transactions have been eliminated. The results of these interim periods may not be indicative of the results for the full year or for any other period. We have evaluated subsequent events through the date of filing with the SEC and have determined that there are no subsequent events that require additional recognition or disclosure.

In connection with the acquisition of NorCal Community Bancorp ("NorCal") (the "Acquisition"), Bancorp assumed ownership of Norcal Community Bancorp Trusts I and II (the "Trusts"). Bancorp is not considered the primary beneficiary of the Trusts (variable interest entities), therefore the Trusts are not consolidated in our consolidated financial statements, but rather the subordinated debentures due to the Trusts are shown as a liability on our consolidated statements of condition (see Note 6). Bancorp's investment in the common stock of the Trusts is accounted for under the equity method and is included in interest receivable and other assets on the consolidated statements of condition.

The following table shows: 1) weighted average basic shares, 2) potentially dilutive common shares related to stock options, unvested restricted stock awards and stock warrant, and 3) weighted average diluted shares. Basic earnings per share (“EPS”) are calculated by dividing net income by the weighted average number of common shares outstanding during each period, excluding unvested restricted stock awards. Diluted EPS are calculated using the weighted average number of potentially dilutive common shares, which is based on the average market prices during the three months of the reporting period, under the treasury stock method. The number of potentially dilutive common shares included in year-to-date diluted EPS is a year-to-date weighted average of potentially dilutive common shares included in each quarterly diluted EPS computation. We have two forms of outstanding stock: common stock and unvested restricted stock awards. Holders of unvested restricted stock awards receive non-forfeitable dividends at the same rate as common shareholders and they both share equally in undistributed earnings. Therefore, under the two-class method, the difference in EPS is not significant for these participating securities.

(in thousands, except per share data; unaudited)	Three months ended June 30, 2015	June 30, 2014	Six months ended June 30, 2015	June 30, 2014
Weighted average basic shares outstanding	5,945	5,888	5,933	5,879
Add: Potentially dilutive common shares related to stock options	41	40	44	42
Potentially dilutive common shares related to unvested restricted stock	3	2	4	4
Potentially dilutive common shares related to the warrant	73	63	74	62
Weighted average diluted shares outstanding	6,062	5,993	6,055	5,987
Net income	$4,286	$5,168	$8,743	$9,701
Basic EPS	$0.72	$0.88	$1.47	$1.65
Diluted EPS	$0.71	$0.86	$1.44	$1.62
Weighted average anti-dilutive shares not included in the calculation of diluted EPS	41	54	34	44

Note 2: Recently Issued Accounting Standards

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). The ASU is a converged standard involving FASB and International Financial Reporting Standards that provides a single comprehensive revenue recognition model for all contracts with customers across transactions and industries. The core principal of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount and at a time that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In July 2015, the FASB adopted a one-year deferral of the effective date of this amendment to January 1, 2018. Because this ASU does not apply to financial instruments and we do not have a significant source of non-interest income subject to this ASU, we do not expect it to have a material impact on our financial condition or results of operations.

In June 2014, the FASB issued ASU No. 2014-12, Compensation - Stock Compensation (Topic 718) Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. This ASU provides guidance for entities that grant their employees share-based payment awards where a performance target that affects vesting could be achieved after the requisite service period. That is the case when an employee is eligible to retire or otherwise terminate employment before the end of the period in which a performance target could be achieved and still be eligible to vest in the award if and when the performance target is achieved. This ASU stipulates that compensation expense should be recognized in the period where the performance target becomes probable of being achieved as opposed to the date that the award was granted. ASU 2014-12 is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. We do not expect this ASU to have a material impact on our financial condition or results of operations.

In April 2015, the FASB issued ASU No. 2015-05, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40) Customer's Accounting for Fees Paid in a Cloud Computing Arrangement. The amendments in this ASU provide guidance about a customer's accounting for fees paid in a cloud computing arrangement. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, then the customer should account for the arrangement as a service contract. The two criteria that must be met to be considered a software license are: 1) the customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty; and 2) it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software. ASU 2015-05 is effective for annual periods, including interim periods within those annual periods beginning after December 15, 2015. We do not expect this ASU to have a material impact on our financial condition or results of operations.

Note 3: Fair Value of Assets and Liabilities

Fair Value Hierarchy and Fair Value Measurement

We group our assets and liabilities that are measured at fair value into three levels within the fair value hierarchy, 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: Valuations are based on quoted prices in active markets for identical assets or liabilities. Since valuations are based on quoted prices that are readily and regularly available, valuation of these products does not involve a significant degree of judgment.

Level 2: Valuations are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuations for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3: Valuations are based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Values are determined using pricing models and discounted cash flow models and include Management judgment and estimation which may be significant.

Transfers between levels of the fair value hierarchy are recognized through our monthly and/or quarterly valuation process in the reporting period during which the event or circumstances that caused the transfer occurred.

The following table summarizes our assets and liabilities that were required to be recorded at fair value on a recurring basis.

(in thousands) Description of Financial Instruments	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
At June 30, 2015 (unaudited):				
Securities available-for-sale:				
Mortgage-backed securities and collateralized mortgage obligations issued by U.S. government-sponsored agencies	$175,786	$—	$173,149	$2,637
Debentures of government-sponsored agencies	$31,072	$—	$31,072	$—
Privately-issued collateralized mortgage obligations	$5,209	$—	$5,209	$—
Obligations of state and political subdivisions	$36,937	$—	$36,937	$—
Corporate bonds	$5,014	$—	5,014	$—
Derivative financial assets (interest rate contracts)	$116	$—	$116	$—
Derivative financial liabilities (interest rate contracts)	$1,631	$—	$1,631	$—
At December 31, 2014:				
Securities available-for-sale:				
Mortgage-backed securities and collateralized mortgage obligations issued by U.S. government-sponsored agencies	$158,119	$—	$155,421	$2,698
Debentures of government-sponsored agencies	$14,557	$—	$14,557	$—
Privately-issued collateralized mortgage obligations	$7,294	$—	$7,294	$—
Obligations of state and political subdivisions	$15,880	$—	$15,771	$—
Corporate bonds	$4,998	$—	$5,437	$—
Derivative financial assets (interest rate contracts)	$61	$—	$61	$—
Derivative financial liabilities (interest rate contracts)	$1,996	$—	$1,996	$—

Securities available-for-sale are recorded at fair value on a recurring basis. When available, quoted market prices (Level 1) are used to determine the fair value of securities available-for-sale. If quoted market prices are not available, we obtain pricing information from a reputable third-party service provider, who may utilize valuation techniques that use current market-based or independently sourced parameters, such as bid/ask prices, dealer-quoted prices, interest rates, benchmark yield curves, prepayment speeds, probability of default, loss severity and credit spreads (Level 2). Level 2 securities include obligations of state and political subdivisions, U.S. agencies or government sponsored agencies' debt securities, mortgage-backed securities, government agency-issued and privately-issued collateralized mortgage obligations. As of June 30, 2015 and December 31, 2014, there were no securities that were considered Level 1 securities. As of June 30, 2015, we had one available-for-sale security that was considered a Level 3 security. The security is a U.S. government agency obligation collateralized by a small pool of business equipment loans guaranteed by the Small Business Administration program. This security is not actively traded and is owned only by a few investors. The significant unobservable data that is reflected in the fair value measurement include dealer quotes, projected prepayment speeds/average life and credit information, among other things. It was transferred to a Level 3 security during the second quarter of 2014. The increase in unrealized gain during the first six months of 2015 was

$13 thousand.

Securities held-to-maturity may be written down to fair value (determined using the same techniques discussed above for securities available-for-sale) as a result of an other-than-temporary impairment, if any.

On a recurring basis, derivative financial instruments are recorded at fair value, which is based on the income approach using observable Level 2 market inputs, reflecting market expectations of future interest rates as of the measurement date. Standard valuation techniques are used to calculate the present value of the future expected cash flows assuming an orderly transaction. Valuation adjustments may be made to reflect both our own credit risk and the counterparties' credit risk in determining the fair value of the derivatives. Level 2 inputs for the valuations are limited to observable market prices for London Interbank Offered Rate ("LIBOR") and Overnight Index Swap ("OIS") rates (for the very short term), quoted prices for LIBOR futures contracts, observable market prices for LIBOR and OIS swap rates, and one-month and three-month LIBOR basis spreads at commonly quoted intervals. Mid-market pricing of the inputs is used as a practical expedient in the fair value measurements. We project spot rates at reset days specified by each swap to determine future cash flows, then discount to present value using either LIBOR or OIS curves depending on the collateral posted as of the measurement date. When the value of any collateral placed with counterparties is less than the interest rate derivative liability, a credit valuation adjustment ("CVA") is applied to reflect the credit risk we pose to counterparties. We have used the spread between the Standard & Poor's BBB rated U.S. Bank Composite rate and LIBOR for the closest maturity term corresponding to the duration of the swaps to derive the CVA. A similar credit risk adjustment, correlated to the credit standing of the counterparty, is made when collateral posted by the counterparty does not fully cover their liability to Bank of Marin.

Certain financial assets may be measured at fair value on a non-recurring basis. These assets are subject to fair value adjustments that result from the application of the lower of cost or fair value accounting or write-downs of individual assets, such as impaired loans and other real estate owned ("OREO").

The following table presents the carrying value of financial instruments that were measured at fair value on a non-recurring basis and that were held in the consolidated statements of condition at each respective period end, by level within the fair value hierarchy as of June 30, 2015 and December 31, 2014.

(in thousands) Description of Financial Instruments	Carrying Value[1]	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3) [1]
At June 30, 2015 (unaudited):				
Impaired loans carried at fair value:				
None				
At December 31, 2014:				
Impaired loans carried at fair value:				
Installment and other consumer	$77	$—	$—	$77

[1] Represents collateral-dependent loan principal balances that had been generally written down to the values of the underlying collateral, net of specific valuation allowances. At December 31, 2014, the $77 thousand carrying value of a consumer loan was net of a $26 thousand specific valuation allowance. The carrying value of loans fully charged-off, which includes unsecured lines of credit, overdrafts and all other loans, is zero.

When a loan is identified as impaired, it is reported at the lower of cost or fair value, measured based on the loan's observable market price (Level 1) or the current net realizable value of the underlying collateral securing the loan, if the loan is collateral dependent (Level 3). Net realizable value of the underlying collateral is the fair value of the collateral less estimated selling costs and any prior liens. Appraisals, recent comparable sales, offers and listing prices are factored in when valuing the collateral. We review and verify the qualifications and licenses of the certified general appraisers used for appraising commercial properties or certified residential appraisers for residential properties. Real estate appraisals may utilize a combination of approaches including replacement cost, sales comparison and the income approach. Comparable sales and income data are analyzed by the appraisers and adjusted to reflect differences between them and the subject property such as property type, leasing status and physical condition. When appraisals are received, Management reviews the assumptions and methodology utilized in the appraisal, as well as the overall resulting value in conjunction with independent data sources such as recent market data and industry-wide statistics. We generally use a 6% discount for selling costs which is applied to all properties, regardless of size. Appraised values may be adjusted to reflect changes in market conditions that have occurred subsequent to the appraisal date, or for revised estimates regarding the timing or cost of the property sale. These adjustments are based on qualitative judgments made by Management on a case-by-case basis and are generally unobservable valuation inputs as they are specific to the underlying collateral. There have been no significant changes in the valuation techniques during the six months ended June 30, 2015.

OREO represents collateral acquired through foreclosure and is initially recorded at fair value as established by a current appraisal, adjusted for disposition costs. Subsequently, OREO is measured at lower of cost or fair value. OREO values are reviewed on an ongoing basis and any subsequent decline in fair value is recorded as a foreclosed asset expense in the current period. The value of OREO is determined based on independent appraisals, similar to the process used for impaired loans, discussed above, and is generally classified as Level 3. We had $421 thousand and $461 thousand of OREO as of June 30, 2015 and December 31, 2014, respectively, all of which was acquired from Bank of Alameda as part of the Acquisition. There was a $40 thousand decline in the estimated fair value of the OREO during the first six months ended June 30, 2015.

Disclosures about Fair Value of Financial Instruments

The table below is a summary of fair value estimates for financial instruments as of June 30, 2015 and December 31, 2014, excluding financial instruments recorded at fair value on a recurring basis (summarized in the first table in this note). The carrying amounts in the following table are recorded in the consolidated statements of condition under the indicated captions. We have excluded non-financial assets and non-financial liabilities defined by the Codification (ASC 820-10-15-1A), such as Bank premises and equipment, deferred taxes and other liabilities. In addition, we have not disclosed the fair value of financial instruments specifically excluded from disclosure requirements of the Financial Instruments Topic of the Codification (ASC 825-10-50-8), such as Bank-owned life insurance policies.

	June 30, 2015			December 31, 2014		
(in thousands; 2015 unaudited)	Carrying Amounts	Fair Value	Fair Value Hierarchy	Carrying Amounts	Fair Value	Fair Value Hierarchy
Financial assets						
Cash and cash equivalents	$117,533	$117,533	Level 1	$41,367	$41,367	Level 1
Investment securities held-to-maturity	94,475	96,017	Level 2	116,437	118,643	Level 2
Loans, net	1,324,851	1,332,708	Level 3	1,348,252	1,361,244	Level 3
Interest receivable	5,800	5,800	Level 2	5,909	5,909	Level 2
Financial liabilities						
Deposits	1,630,483	1,631,106	Level 2	1,551,619	1,552,446	Level 2
Federal Home Loan Bank borrowings	15,000	15,445	Level 2	15,000	15,484	Level 2
Subordinated debentures	5,291	5,192	Level 3	5,185	5,290	Level 3
Interest payable	209	209	Level 2	213	213	Level 2

Following is a description of methods and assumptions used to estimate the fair value of each class of financial instrument not recorded at fair value but required for disclosure purposes:

Cash and Cash Equivalents - The carrying amounts of cash and cash equivalents approximate their fair value because of the short-term nature of these instruments.

Held-to-maturity Securities - Held-to-maturity securities, which generally consist of mortgage-backed securities, obligations of state and political subdivisions and corporate bonds, are recorded at their amortized cost. The fair value for disclosure purposes is determined using methodologies similar to those described above for available-for-sale securities using Level 2 inputs. If Level 2 inputs are not available, we may utilize pricing models that incorporate unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities (Level 3). As of June 30, 2015 and December 31, 2014, we did not hold any held-to-maturity securities whose fair value was measured using significant unobservable inputs.

Loans - The fair value of loans with variable interest rates approximates current carrying value, because their rates are regularly adjusted to current market rates. The fair value of fixed rate loans or variable loans at negotiated interest rate floors or ceilings with remaining maturities in excess of one year is estimated by discounting the future cash flows using current market rates at which similar loans would be made to borrowers with similar creditworthiness and similar remaining maturities. The allowance for loan losses (“ALLL”) is considered to be a reasonable estimate of the portion of loan discount attributable to credit risks.

Interest Receivable and Payable - The interest receivable and payable balances approximate their fair value due to the short-term nature of their settlement dates.

Deposits - The fair value of deposits without stated maturity, such as transaction accounts, savings accounts and money market accounts, is the amount payable on demand at the reporting date. The fair value of time deposits is estimated by discounting the future cash flows using current rates offered for deposits of similar remaining maturities.

Federal Home Loan Bank Borrowings - The fair value is estimated by discounting the future cash flows using current rates offered by the Federal Home Loan Bank of San Francisco ("FHLB") for similar credit advances corresponding to the remaining duration of our fixed-rate credit advances.

Subordinated Debentures - As part of the Acquisition, we assumed two subordinated debentures from NorCal. See Note 6 for further information. The fair values of the subordinated debentures were estimated by discounting the future cash flows (interest payment at a rate of three-month LIBOR plus 3.05% and 1.40%, respectively) to their present values using current market rates at which similar debt securities would be issued with similar credit ratings as ours and similar remaining maturities. Each interest payment was discounted at the spot rate for the corresponding term, determined based on the yields and terms of comparable trust preferred securities, plus a liquidity premium. In July 2010, the Dodd-Frank Act was signed into law and limits the ability of certain bank holding companies to treat trust preferred security debt issuances as Tier 1 capital. This law effectively closed the trust-preferred securities markets for new issuance and led to the absence of observable or comparable transactions in the market place. Due to the use of unobservable inputs of trust preferred securities, we consider the fair value to be a Level 3 measurement.

Commitments - The value of unrecognized financial instruments is estimated based on the fee income associated with the commitments which, in the absence of credit exposure, is considered to approximate their settlement value.

Note 4: Investment Securities

Our investment securities portfolio consists of obligations of state and political subdivisions, corporate bonds, U.S. government agency securities, including mortgage-backed securities (“MBS”) and collateralized mortgage obligations (“CMOs”) issued or guaranteed by Federal National Mortgage Association ("FNMA"), Federal Home Loan Mortgage Corporation ("FHLMC"), or Government National Mortgage Association ("GNMA"), debentures issued by government-sponsored agencies such as FNMA, FHLB and FHLMC, as well as privately issued CMOs, as reflected in the table below:

	June 30, 2015				December 31, 2014			
	Amortized	Fair	Gross Unrealized		Amortized	Fair	Gross Unrealized	
(in thousands; 2015 unaudited)	Cost	Value	Gains	(Losses)	Cost	Value	Gains	(Losses)
Held-to-maturity								
Obligations of state and political subdivisions	$54,183	$55,455	$1,332	$(60)	$63,425	$65,121	$1,736	$(40)
Corporate bonds	27,615	27,732	122	(5)	40,257	40,448	216	(25)
MBS pass-through securities issued by FHLMC and FNMA	12,677	12,830	160	(7)	12,755	13,074	319	—
Total held-to-maturity	94,475	96,017	1,614	(72)	116,437	118,643	2,271	(65)
Available-for-sale								
Securities of U.S. government agencies:								
MBS pass-through securities issued by FHLMC and FNMA	120,719	121,273	748	(194)	92,963	94,214	1,262	(11)
CMOs issued by FNMA	12,993	13,106	150	(37)	14,771	14,790	77	(58)
CMOs issued by FHLMC	27,065	27,191	164	(38)	31,238	31,260	109	(87)
CMOs issued by GNMA	13,950	14,216	274	(8)	17,573	17,855	298	(16)
Debentures of government-sponsored agencies	31,121	31,072	98	(147)	14,694	14,557	95	(232)
Privately issued CMOs	5,011	5,209	200	(2)	7,137	7,294	172	(15)
Obligations of state and political subdivisions	36,909	36,937	123	(95)	15,733	15,880	155	(8)
Corporate bonds	4,941	5,014	73	—	4,936	4,998	66	(4)
Total available-for-sale	252,709	254,018	1,830	(521)	199,045	200,848	2,234	(431)
Total investment securities	$347,184	$350,035	$3,444	$(593)	$315,482	$319,491	$4,505	$(496)

The amortized cost and fair value of investment debt securities by contractual maturity at June 30, 2015 are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	June 30, 2015				December 31, 2014			
	Held-to-Maturity		Available-for-Sale		Held-to-Maturity		Available-for-Sale	
(in thousands; 2015 unaudited)	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	$30,306	$30,400	$11,426	$11,508	$39,778	$39,913	$2,378	$2,388

After one year but within five years	41,659	42,429	56,275	56,324	50,983	51,953	43,866	43,919
After five years through ten years	10,965	11,477	45,935	45,885	11,679	12,426	9,644	9,749
After ten years	11,545	11,711	139,073	140,301	13,997	14,351	143,157	144,792
Total	$94,475	$96,017	$252,709	$254,018	$116,437	$118,643	$199,045	$200,848

We sold two available-for-sale securities in 2015 with total proceeds of $1.6 million and realized a gross gain of $8 thousand.

We sold one available-for-sale and six held-to-maturity securities in the first six months of 2014 with total proceeds of $2.0 million and $2.1 million, respectively, and incurred a gross loss of $15 thousand and gross gains of $104 thousand, respectively. The sales of the held-to-maturity securities were due to evidence of significant deterioration of creditworthiness of the issuers since purchase.

Investment securities carried at $70.1 million and $74.7 million at June 30, 2015 and December 31, 2014, respectively, were pledged to the State of California: $69.3 million and $73.8 million to secure public deposits in compliance with the Local Agency Security Program at June 30, 2015 and December 31, 2014, respectively, and $848 thousand and $856 thousand to provide collateral for trust deposits at June 30, 2015 and December 31, 2014, respectively. In addition, investment securities carried at $1.1 million were pledged to collateralize a Wealth Management and Trust Services ("WMTS") checking account at both June 30, 2015 and December 31, 2014.

Other-Than-Temporarily Impaired Debt Securities

We have evaluated the credit of our investment securities and their issuer and/or insurers. Based on our evaluation, Management has determined that no investment security in our investment portfolio is other-than-temporarily impaired as of June 30, 2015. We do not have the intent, and it is more likely than not that we will not have to sell securities temporarily impaired at June 30, 2015 before recovery of the cost basis.

Thirty-five and twenty-eight investment securities were in unrealized loss positions at June 30, 2015 and December 31, 2014, respectively. Those securities are summarized and classified according to the duration of the loss period in the table below:

June 30, 2015	< 12 continuous months		> 12 continuous months		Total securities in a loss position	
(in thousands; unaudited)	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
Held-to-maturity						
Obligations of state & political subdivisions	$12,348	$(47)	$357	$(13)	$12,705	$(60)
Corporate bonds	5,543	(5)	—	—	5,543	(5)
MBS pass-through securities issued by FHLMC and FNMA	2,356	(7)	—	—	2,356	(7)
Total held-to-maturity	20,247	(59)	357	(13)	20,604	(72)
Available-for-sale						
MBS pass-through securities issued by FHLMC and FNMA	30,577	(194)	—	—	30,577	(194)
CMOs issued by FNMA	—	—	3,698	(37)	3,698	(37)
CMOs issued by FHLMC	—	—	2,140	(38)	2,140	(38)
CMOs issued by GNMA	2,810	(8)	—	—	2,810	(8)
Debentures of government-sponsored agencies	—	—	9,853	(147)	9,853	(147)
Privately issued CMOs	414	(2)	—	—	414	(2)
Obligations of state & political subdivisions	15,390	(93)	585	(2)	15,975	(95)

Total available-for-sale	49,191	(297)	16,276	(224)	65,467	(521)
Total temporarily impaired securities	$69,438	$(356)	$16,633	$(237)	$86,071	$(593)

December 31, 2014	< 12 continuous months		> 12 continuous months		Total securities in a loss position	
(dollars in thousands)	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
Held-to-maturity						
Obligations of state & political subdivisions	$5,830	$(27)	$359	$(13)	$6,189	$(40)
Corporate bonds	3,009	(1)	3,533	(24)	6,542	(25)
Total held-to-maturity	8,839	(28)	3,892	(37)	12,731	(65)
Available-for-sale						
MBS pass-through securities issued by FHLMC and FNMA	1,960	(11)	—	—	1,960	(11)
CMOs issued by FNMA	—	—	4,115	(58)	4,115	(58)
CMOs issued by FHLMC	17,157	(44)	2,291	(43)	19,448	(87)
CMOs issued by GNMA	3,262	(16)	—	—	3,262	(16)
Debentures of government-sponsored agencies	494	(1)	9,769	(231)	10,263	(232)
Privately issued CMOs	817	(15)	—	—	817	(15)
Obligations of state & political subdivisions	2,695	(3)	1,112	(5)	3,807	(8)
Corporate bonds	1,002	(1)	990	(3)	1,992	(4)
Total available-for-sale	27,387	(91)	18,277	(340)	45,664	(431)
Total temporarily impaired securities	$36,226	$(119)	$22,169	$(377)	$58,395	$(496)

As of June 30, 2015, there were six investment positions that had been in a continuous loss position for more than twelve months. These securities consisted of a government-sponsored agency debenture, obligations of U.S. state and political subdivisions, and CMOs. We have evaluated each of the bonds and believe that the decline in fair value is primarily driven by factors other than credit. It is probable that we will be able to collect all amounts due according to the contractual terms and no other-than-temporary impairment exists on these securities. The CMOs issued by FNMA and FHLMC are supported by the U.S. Federal Government to protect us from credit losses. Additionally, the obligations of state and political subdivisions were deemed creditworthy based on our review of the issuers' recent financial information and their insurers, if any. Based upon our assessment of the credit fundamentals and the credit enhancements, we concluded that these securities were not other-than-temporarily impaired at June 30, 2015.

Twenty-nine investment securities in our portfolio were in a temporary loss position for less than twelve months as of June 30, 2015. They consisted of a U.S. Agency CMO, MBS pass-through securities, obligations of U.S. state and political subdivisions, corporate bonds and privately issued CMOs. We determine that the strengths of GNMA through the U.S. Federal Government guarantee is sufficient to protect us from credit losses. Other temporarily impaired securities are deemed creditworthy after internal analysis. Additionally, all are rated as investment grade by at least one major rating agency. As a result of this impairment analysis, we concluded that these securities were not other-than-temporarily impaired at June 30, 2015.

Non-Marketable Securities

As a member of the FHLB, we are required to maintain a minimum investment in the FHLB capital stock determined by the Board of Directors of the FHLB. The minimum investment requirements can increase in the event we increase our total asset size or borrowings with the FHLB. Shares cannot be purchased or sold except between the FHLB and its members at the $100 per share par value. We held $8.4 million and $8.2 million of FHLB stock recorded at cost in other assets on the consolidated statements of condition at June 30, 2015 and December 31, 2014, respectively. The carrying amounts of these investments are reasonable estimates of fair value because the securities are restricted to member banks and they do not have a readily determinable market value. Management does not believe that the FHLB stock is other-than-temporarily-impaired, as we expect to be able to redeem this stock at cost. FHLB distributed on May 14, 2015 a cash dividend at an annualized dividend rate of 7.67% in addition to a special dividend distributed on June 23, 2015 at an annualized dividend rate of 14.98% for shares outstanding during the first quarter of 2015. On July 28, 2015, FHLB announced a cash dividend for the second quarter of 2015 at an annualized dividend rate of 10.01% to be distributed in mid August. Cash dividends paid on FHLB capital stock are recorded as non-interest income.

As a member bank of Visa U.S.A., we hold 16,939 shares of Visa Inc. Class B common stock with a carrying value of zero, which is equal to our cost basis. These shares are restricted from resale until their conversion into Class A (voting) shares upon the termination of Visa Inc.'s covered litigation escrow account. As a result of the restriction, these shares are not considered available-for-sale and are not carried at fair value. When converting this Class B common stock to Class A common stock under the current conversion rate of 1.6483 and the closing stock price of Class A shares, the value of our shares of Class B common stock would have been $1.9 million at June 30, 2015 and $1.8 million at December 31, 2014. The conversion rate is subject to further reduction upon the final settlement of the covered litigation against Visa Inc. and its member banks. See Note 8 herein.

We invest in low income housing tax credit funds as a limited partner, which totaled $2.8 million and $1.8 million recorded in other assets as of June 30, 2015 and December 31, 2014, respectively. In the first six months of 2015, we recognized $132 thousand of low income housing tax credits and other tax benefits, net of $102 thousand of amortization expense of low income housing tax credit investment, as a component of income tax benefit. As of June 30, 2015, our unfunded commitments for these low income housing tax credit funds totaled $2.0 million. We did not recognize any impairment losses on these low income housing tax credit investments during the first six months of 2015, or the year ended December 31, 2014.

Note 5: Loans and Allowance for Loan Losses

Credit Quality of Loans

Outstanding loans by class and payment aging as of June 30, 2015 and December 31, 2014 are as follows:

Loan Aging Analysis by Class as of June 30, 2015 and December 31, 2014

(dollars in thousands; 2015 unaudited)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential [1]	Installment and other consumer	Total
June 30, 2015								
30-59 days past due	$—	$—	$—	$—	$999	$—	$148	$1,147
60-89 days past due	—	—	—	—	—	—	4	4
Greater than 90 days past due (non-accrual) [2]	347	1,403	2,278	2,733	265	—	42	7,068
Total past due	347	1,403	2,278	2,733	1,264	—	194	8,219
Current	184,673	233,718	661,079	46,021	114,229	73,721	17,545	1,330,986
Total loans [3]	$185,020	$235,121	$663,357	$48,754	$115,493	$73,721	$17,739	$1,339,205
Non-accrual loans to total loans	0.2 %	0.6 %	0.3 %	5.6 %	0.2 %	— %	0.2 %	0.5 %
December 31, 2014								

30-59 days past due	$183	$—	$—	$—	$646	$—	$180	$1,009
60-89 days past due	—	—	—	—	—	—	—	—
Greater than 90 days past due (non-accrual) [2]	—	1,403	2,429	5,134	280	—	104	9,350
Total past due	183	1,403	2,429	5,134	926	—	284	10,359
Current	210,040	229,202	671,070	43,279	109,862	73,035	16,504	1,352,992
Total loans [3]	$210,223	$230,605	$673,499	$48,413	$110,788	$73,035	$16,788	$1,363,351
Non-accrual loans to total loans	— %	0.6 %	0.4 %	10.6 %	0.3 %	— %	0.6 %	0.7 %

[1] Our residential loan portfolio does not include sub-prime loans, nor is it our practice to underwrite loans commonly referred to as "Alt-A mortgages", the characteristics of which are loans lacking full documentation, borrowers having low FICO scores or higher loan-to-value ratios.

[2] Amounts include $1.4 million of Purchased Credit Impaired ("PCI") loans that had stopped accreting interest at both June 30, 2015 and December 31, 2014. Amounts exclude accreting PCI loans of $3.7 million and $3.8 million at June 30, 2015 and December 31, 2014, respectively, as we have a reasonable expectation about future cash flows to be collected and we continue to recognize accretable yield on these loans in interest income. There were no accruing loans past due more than ninety days at June 30, 2015 or December 31, 2014.

[3] Amounts include net deferred loan costs of $781 thousand and $487 thousand at June 30, 2015 and December 31, 2014, respectively. Amounts are also net of unaccreted purchase discounts on non-PCI loans of $3.7 million and $4.4 million at June 30, 2015 and December 31, 2014, respectively.

Our commercial loans are generally made to established small and mid-sized businesses to provide financing for their working capital needs, equipment purchases and/or acquisitions. Management examines historical, current, and projected cash flows to determine the ability of the borrower to repay obligations as agreed. Commercial loans are made based primarily on the identified cash flows of the borrower and secondarily on the underlying collateral and/or guarantor support. The cash flows of borrowers, however, may not occur as expected, and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed, such as accounts receivable and/or inventory, and typically include a personal guarantee. We target stable businesses with guarantors that have proven to be resilient in periods of economic stress. Typically, the guarantors provide an additional source of repayment for most of our credit extensions.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans discussed above. We underwrite these loans to be repaid from cash flow and to be supported by real property collateral. Underwriting standards for commercial real estate loans include, but are not limited to, debt coverage and loan-to-value ratios. Furthermore, substantially all of our loans are guaranteed by the owners of the properties. Commercial real estate loans may be adversely affected by conditions in the real estate markets or in the general economy. In the event of a vacancy, guarantors are expected to carry the loans until a replacement tenant can be found. The owner's substantial equity investment provides a strong economic incentive to continue to support the commercial real estate projects. As such, we have generally experienced a relatively low level of loss and delinquencies in this portfolio.

Construction loans are generally made to developers and builders to finance construction, renovation and occasionally land acquisitions. These loans are underwritten after evaluation of the borrower's financial strength, reputation, prior track record, and independent appraisals. The construction industry can be impacted by significant events, including: the inherent volatility of real estate markets and vulnerability to delays due to weather, change orders, inability to obtain construction permits, labor or material shortages, and price changes. Estimates of construction costs and value associated with the complete project may be inaccurate. Repayment of construction loans is largely dependent on the ultimate success of the project.

Consumer loans primarily consist of home equity lines of credit, other residential (tenancy-in-common, or “TIC”) loans, and installment and other consumer loans. We originate consumer loans utilizing credit score information, debt-to-income ratio and loan-to-value ratio analysis. Diversification, coupled with relatively small loan amounts that are spread across many individual borrowers, mitigates risk. Additionally, trend reports are reviewed by Management on a regular basis. Underwriting standards for home equity lines of credit include, but are not limited to, a conservative loan-to-value ratio, the number of such loans a borrower can have at one time, and documentation requirements. Our residential loan portfolio includes TIC units in San Francisco. These loans tend to have more equity in their properties than conventional residential mortgages, which mitigates risk. Installment and other consumer loans include mostly loans for floating homes and mobile homes along with a small number of installment loans.

We use a risk rating system to evaluate asset quality, and to identify and monitor credit risk in individual loans, and ultimately in the portfolio. Definitions of loans that are risk graded “Special Mention” or worse are consistent with those used by the Federal Deposit Insurance Corporation ("FDIC"). Our internally assigned grades are as follows:

Pass – Loans to borrowers of acceptable or better credit quality. Borrowers in this category demonstrate fundamentally sound financial positions, repayment capacity, credit history and management expertise. Loans in this category must have an identifiable and stable source of repayment and meet the Bank’s policy regarding debt service coverage ratios. These borrowers are capable of sustaining normal economic, market or operational setbacks without significant financial impacts. Negative external industry factors are generally not present. The loan may be secured, unsecured or supported by non-real estate collateral for which the value is more difficult to determine and/or marketability is more uncertain. This category also includes “Watch” loans, where the primary source of repayment has been delayed. “Watch” is intended to be a transitional grade, with either an upgrade or downgrade within a reasonable period.

Special Mention - Potential weaknesses that deserve close attention. If left uncorrected, those potential weaknesses may result in deterioration of the payment prospects for the asset. Special Mention assets do not present sufficient risk to warrant adverse classification.

Substandard - Inadequately protected by either the current sound worth and paying capacity of the obligor or the collateral pledged, if any. A Substandard asset has a well-defined weakness or weaknesses that jeopardize(s) the liquidation of the debt. Substandard assets are characterized by the distinct possibility that we will sustain some loss if such weaknesses or deficiencies are not corrected. Well-defined weaknesses include adverse trends or developments of the borrower's financial condition, managerial weaknesses and/or significant collateral deficiencies.

Doubtful - Critical weaknesses that make collection or liquidation in full improbable. There may be specific pending events that work to strengthen the asset; however, the amount or timing of the loss may not be determinable. Pending events generally occur within one year of the asset being classified as Doubtful. Examples include: merger, acquisition, or liquidation; capital injection; guarantee; perfecting liens on additional collateral; and refinancing. Such loans are placed on nonaccrual status and usually are collateral-dependent.

We regularly review our credits for accuracy of risk grades whenever new information is received. Borrowers are required to submit financial information at regular intervals:

- Generally, commercial borrowers with lines of credit are required to submit financial information with reporting intervals ranging from monthly to annually depending on credit size, risk and complexity.
- Investor commercial real estate borrowers are generally required to submit rent rolls or property income statements at least annually.
- Construction loans are monitored monthly, and reviewed on an ongoing basis.
- Home equity and other consumer loans are reviewed based on delinquency.
- Loans graded "Watch" or more severe, regardless of loan type, are reviewed no less than quarterly.

The following table represents an analysis of loans by internally assigned grades, including the PCI loans, at June 30, 2015 and December 31, 2014:

(in thousands; 2015 unaudited)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Purchased credit-impaired	Total
Credit Risk Profile by Internally Assigned Grade:									
June 30, 2015									
Pass	$ 171,350	$ 210,225	$ 654,056	$ 45,471	$ 113,616	$ 72,123	$ 17,439	$ 2,211	$ 1,286,491
Special Mention	10,334	11,004	2,116	—	428	—	—	1,027	24,909
Substandard	3,145	10,820	5,450	3,277	1,382	1,598	300	1,833	27,805
Total loans	$ 184,829	$ 232,049	$ 661,622	$ 48,748	$ 115,426	$ 73,721	$ 17,739	$ 5,071	$ 1,339,205
December 31, 2014									
Pass	$ 197,659	$ 205,820	$ 651,548	$ 41,710	$ 107,933	$ 70,987	$ 16,101	$ 2,210	$ 1,293,968
Special Mention	6,776	10,406	13,304	1,008	322	—	190	1,140	33,146
Substandard	5,464	11,763	6,473	5,684	2,466	2,048	497	1,842	36,237
Total loans	$ 209,899	$ 227,989	$ 671,325	$ 48,402	$ 110,721	$ 73,035	$ 16,788	$ 5,192	$ 1,363,351

Troubled Debt Restructuring

Our loan portfolio includes certain loans that have been modified in a Troubled Debt Restructuring ("TDR"), where economic concessions have been granted to borrowers experiencing financial difficulties. These concessions typically result from our loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. TDRs on nonaccrual status at the time of restructure may be returned to accruing status after Management considers the borrower's sustained repayment performance for a reasonable period, generally six months, and obtains reasonable assurance of repayment and performance.

A loan may no longer be reported as a TDR if all of the following conditions are met:

- The loan is subsequently refinanced or restructured at current market interest rates and the new terms are consistent with the treatment of creditworthy borrowers under regular underwriting standards;
- The borrower is no longer considered to be in financial difficulty;
- Performance on the loan is reasonably assured; and;
- Existing loan did not have any forgiveness of principal or interest.

The removal of TDR status must be approved by the same management level that approved the upgrading of the loan classification.

During the first half of 2015, three loans with a recorded investment totaling $396 thousand were removed from TDR designation. There were no loans removed from TDR designation during 2014.

The table below summarizes outstanding TDR loans by loan class as of June 30, 2015 and December 31, 2014. The summary includes both TDRs that are on non-accrual status and those that continue to accrue interest.

(in thousands; 2015 unaudited)	As of	
Recorded investment in Troubled Debt Restructurings [1]	June 30, 2015	December 31, 2014
Commercial and industrial	$4,149	$3,584
Commercial real estate, owner-occupied	8,396	8,459
Commercial real estate, investor	740	524
Construction [2]	3,277	5,684
Home equity	558	694
Other residential	2,029	2,045
Installment and other consumer	1,400	1,713
Total	$20,549	$22,703

[1] Includes $16.1 million and $15.9 million of TDR loans that were accruing interest as of June 30, 2015 and December 31, 2014, respectively. Includes $1.6 million and $1.8 million of acquired loans at June 30, 2015 and December 31, 2014, respectively.
[2] In June 2015, one TDR loan was transferred to loans held-for-sale at fair value totaling $1.5 million, net of an $839 thousand charge-off to the allowance for loan losses. The loan was subsequently sold in June 2015 for no gain or loss.

The table below presents the following information for loans modified in a TDR during the presented periods: number of contracts modified, the recorded investment in the loans prior to modification, and the recorded investment in the loans after the loans were restructured. The table below excludes fully paid-off and fully charged-off TDR loans.

(dollars in thousands; unaudited)	Number of Contracts Modified	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment at period end
Troubled Debt Restructurings during the three months ended June 30, 2015:				
Commercial and industrial	4	$ 782	$ 882	$882
Commercial real estate, investor	1	222	221	221
Total	5	$ 1,004	$ 1,103	$1,103
Troubled Debt Restructurings during the three months ended June 30, 2014:				
Commercial and industrial	3	$ 308	$ 354	$354
Installment and other consumer	3	111	110	109
Total	6	$ 419	$ 464	$463
Troubled Debt Restructurings during the six months ended June 30, 2015:				
Commercial and industrial	4	$782	$882	$882
Commercial real estate, investor	1	222	221	221
Total	5	$1,004	$1,103	$1,103

Troubled Debt Restructurings during the six months ended June 30, 2014:				
Commercial and industrial	6	$1,728	$1,759	$1,471
Home equity	1	150	150	149
Installment and other consumer	6	281	278	276
Total	13	$2,159	$2,187	$1,896

Modifications during the six months ended June 30, 2015 primarily involved maturity extensions and renewals, while modifications during the six months ended June 30, 2014 primarily involved maturity extensions. During the first six months of 2015 and 2014, there were no defaults on loans that had been modified in a TDR within the prior twelve-month period. We report defaulted TDRs based on a payment default definition of more than ninety days past due.

Impaired Loan Balances and Their Related Allowance by Major Classes of Loans

The tables below summarize information on impaired loans and their related allowance. Total impaired loans include non-accrual loans, accruing TDR loans and accreting PCI loans that have experienced post-acquisition declines in cash flows expected to be collected.

(in thousands; unaudited)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Total
June 30, 2015								
Recorded investment in impaired loans:								
With no specific allowance recorded	$ 1,903	$ 5,514	$ 3,018	$ 2,727	$265	$1,022	$281	$14,730
With a specific allowance recorded	2,592	2,882	—	556	393	1,007	1,139	8,569
Total recorded investment in impaired loans	$ 4,495	$ 8,396	$ 3,018	$ 3,283	$658	$2,029	$1,420	$23,299
Unpaid principal balance of impaired loans:								
With no specific allowance recorded	$ 1,899	$ 6,514	$ 5,010	$ 2,727	$265	$1,022	$281	$17,718
With a specific allowance recorded	2,656	2,882	—	741	393	1,007	1,139	8,818
Total unpaid principal balance of impaired loans	$ 4,555	$ 9,396	$ 5,010	$ 3,468	$658	$2,029	$1,420	$26,536
Specific allowance	$ 772	$ 70	$ —	$ 6	$3	$79	$149	$1,079
Average recorded investment in impaired loans during the quarter ended June 30, 2015	$ 4,173	$ 8,412	$ 2,947	$ 4,475	$610	$2,033	$1,557	$24,207
Interest income recognized on impaired loans during the quarter ended June 30, 2015	$ 56	$ 78	$ 8	$ 9	$4	$23	$17	$195
Average recorded investment in impaired loans during the six months ended June 30, 2015	$ 3,946	$ 8,427	$ 2,931	$ 5,078	$618	$2,037	$1,650	$24,687
Interest income recognized on	$ 118	$ 144	$ 14	$ 18	$9	$46	$36	$385

impaired loans during the six months ended June 30, 2015								
Average recorded investment in impaired loans during the quarter ended June 30, 2014	$ 6,217	$ 5,476	$ 3,186	$ 6,503	$755	$1,686	$1,898	$25,721
Interest income recognized on impaired loans during the quarter ended June 30, 2014	$ 103	$ 83	$ 7	$ 23	$5	$19	$19	$259
Average recorded investment in impaired loans during the six months ended June 30, 2014	$ 6,081	$ 5,480	$ 3,235	$ 6,513	$666	$1,870	$1,891	$25,736
Interest income recognized on impaired loans during the six months ended June 30, 2014	$ 221	$ 166	$ 14	$ 44	$9	$42	$37	$533

(in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Total
December 31, 2014								
Recorded investment in impaired loans:								
With no specific allowance recorded	$ 1,141	$ 5,577	$ 2,954	$ 5,134	$393	$1,026	$239	$16,464
With a specific allowance recorded	2,443	2,882	—	561	300	1,019	1,554	$8,759
Total recorded investment in impaired loans	$ 3,584	$ 8,459	$ 2,954	$ 5,695	$693	$2,045	$1,793	$25,223
Unpaid principal balance of impaired loans:								
With no specific allowance recorded	$ 1,186	$ 6,577	$ 4,945	$ 7,824	$880	$1,026	$239	$22,677
With a specific allowance recorded	2,524	2,882	—	749	300	1,019	1,554	9,028
Total unpaid principal balance of impaired loans	$ 3,710	$ 9,459	$ 4,945	$ 8,573	$1,180	$2,045	$1,793	$31,705
Specific allowance	$ 694	$ 65	$—	$ 3	$—	$92	$284	$1,138
Average recorded investment in impaired loans during 2014	5,354	6,604	3,138	6,471	741	1,744	1,857	25,909
Interest income recognized on impaired loans during 2014	378	288	28	85	19	74	76	948

Management monitors delinquent loans continuously and identifies problem loans, generally loans graded substandard or worse, to be evaluated individually for impairment testing. Generally, the recorded investment in impaired loans is net of any charge-offs from estimated losses related to specifically-identified impaired loans when they are deemed uncollectible. The charged-off portion of impaired loans outstanding at June 30, 2015 totaled approximately $2.7 million. In addition, the recorded investment in impaired loans is net of purchase discounts or premiums on acquired loans. At June 30, 2015, there were $767 thousand outstanding commitments to extend credit on impaired loans, including loans to borrowers whose terms have been modified in TDRs.

The following tables disclose loans by major portfolio category and activity in the ALLL, as well as the related ALLL disaggregated by impairment evaluation method.

Allowance for Loan Losses Rollforward for the Period

(in thousands; unaudited)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Unallocated	Total
For the three months ended June 30, 2015									

Allowance for loan losses:									
Beginning balance	$ 2,620	$ 2,094	$ 6,292	$ 778	$ 923	$ 430	$ 462	$ 1,557	$ 15,156
Provision (reversal)	(117)	(42)	(351)	596	(81)	5	(14)	4	—
Charge-offs	(1)	—	—	(839)	—	—	(5)	—	(845)
Recoveries	38	—	3	—	1	—	1	—	43
Ending balance	$ 2,540	$ 2,052	$ 5,944	$ 535	$ 843	$ 435	$ 444	$ 1,561	$ 14,354

For the six months ended June 30, 2015									
Allowance for loan losses:									
Beginning balance	$ 2,837	$ 1,924	$ 6,672	$ 839	$ 859	$ 433	$ 566	$ 969	$ 15,099
Provision (reversal)	(392)	128	(734)	535	(18)	2	(113)	592	—
Charge-offs	(3)	—	—	(839)	—	—	(11)	—	(853)
Recoveries	98	—	6	—	2	—	2	—	108
Ending balance	$ 2,540	$ 2,052	$ 5,944	$ 535	$ 843	$ 435	$ 444	$ 1,561	$ 14,354

Allowance for Loan Losses Rollforward for the Period

(in thousands; unaudited)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Unallocated	Total
For the three months ended June 30, 2014									
Allowance for loan losses:									
Beginning balance	$ 2,772	$ 1,985	$ 6,469	$ 536	$ 887	$ 409	$ 565	$ 609	$ 14,232
Provision (reversal)	310	(6)	213	42	56	45	(84)	24	600
Charge-offs	(5)	—	—	(7)	—	—	(1)	—	(13)
Recoveries	48	—	31	—	1	—	1	—	81
Ending balance	$ 3,125	$ 1,979	$ 6,713	$ 571	$ 944	$ 454	$ 481	$ 633	$ 14,900
For the six months ended June 30, 2014									
Allowance for loan losses:									
Beginning balance	$ 3,056	$ 2,012	$ 6,196	$ 633	$ 875	$ 317	$ 629	$ 506	$ 14,224
Provision (reversal)	55	(33)	481	142	67	137	(226)	127	750
Charge-offs	(66)	—	—	(204)	—	—	(4)	—	(274)
Recoveries	80	—	36	—	2	—	82	—	200
Ending balance	$ 3,125	$ 1,979	$ 6,713	$ 571	$ 944	$ 454	$ 481	$ 633	$ 14,900

Allowance for Loan Losses and Recorded Investment in Loans

(dollars in thousands; unaudited)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Unalloca	To
As of June 30, 2015:									
Ending ALLL related to loans collectively evaluated for impairment	$1,768	$1,982	$5,944	$529	$840	$356	$295	$1,561	$13
Ending ALLL related to loans individually evaluated for impairment	$771	$70	$—	$—	$3	$79	$149	$—	$1,
Ending ALLL related to purchased credit-impaired loans	$1	$—	$—	$6	$—	$—	$—	$—	$7
Total	$2,540	$2,052	$5,944	$535	$843	$435	$444	$1,561	$14
Loans outstanding:									
Collectively evaluated for impairment	$180,489	$225,057	$658,604	$45,471	$114,768	$71,692	$16,319	$—	$1,
	4,340	6,993	3,018	3,277	657	2,029	1,420	—	21,

Individually evaluated for impairment[1]															
Purchased credit-impaired	191		3,071		1,735		6		68		—		—		—	5,0
Total	$185,020		$235,121		$663,357		$48,754		$115,493		$73,721		$17,739		$—	$1,
Ratio of allowance for loan losses to total loans	1.37	%	0.87	%	0.90	%	1.10	%	0.73	%	0.59	%	2.50	%	NM	1.0
Allowance for loan losses to non-accrual loans	732	%	146	%	261	%	20	%	318	%	—	%	1,057	%	NM	203

[1] Total excludes $1.6 million of PCI loans that have experienced post-acquisition declines in cash flows expected to be collected. These loans are included in the "purchased credit-impaired" amount in the next line below.

NM - Not Meaningful

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Allowance for Loan Losses and Recorded Investment in Loans

(dollars in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Unallocated	Total
As of December 31, 2014:									
Ending ALLL related to loans collectively evaluated for impairment	$2,143	$1,859	$6,672	$836	$859	$341	$282	$969	$13,9
Ending ALLL related to loans individually evaluated for impairment	$690	$65	$—	$—	$—	$92	$284	$—	$1,13
Ending ALLL related to purchased credit-impaired loans	$4	$—	$—	$3	$—	$—	$—	$—	$7
Total	$2,837	$1,924	$6,672	$839	$859	$433	$566	$969	$15,0
Loans outstanding:									
Collectively evaluated for impairment	$206,603	$220,933	$668,371	$42,718	$110,028	$70,990	$14,995	$—	$1,33
Individually evaluated for impairment[1]	3,296	7,056	2,954	5,684	693	2,045	1,793	—	23,52
Purchased credit-impaired	324	2,616	2,174	11	67	—	—	—	5,192
Total	$210,223	$230,605	$673,499	$48,413	$110,788	$73,035	$16,788	$—	$1,36
Ratio of allowance for loan losses to total loans	1.35 %	0.83 %	0.99 %	1.73 %	0.78 %	0.59 %	3.37 %	NM	1.11
Allowance for loan losses to non-accrual loans	NM	137 %	275 %	16 %	307 %	NM	544 %	NM	161

[1] Total excludes $1.7 million PCI loans that have experienced credit deterioration post-acquisition, which are included in the "purchased credit-impaired" amount in the next line below.

NM - Not Meaningful

Purchased Credit-Impaired Loans

We evaluated loans purchased in acquisitions in accordance with accounting guidance in ASC 310-30 related to loans acquired with deteriorated credit quality. Acquired loans are considered credit-impaired if there is evidence of deterioration of credit quality since origination and it is probable, at the acquisition date, that we will be unable to collect all contractually required payments receivable. Management has determined certain loans purchased in our two acquisitions to be PCI loans based on credit indicators such as nonaccrual status, past due status, loan risk grade, loan-to-value ratio, etc. Revolving credit agreements (e.g., home equity lines of credit and revolving commercial loans) are not considered PCI loans as cash flows cannot be reasonably estimated.

The following table reflects the outstanding balance and related carrying value of PCI loans as of June 30, 2015 and December 31, 2014.

	June 30, 2015	December 31, 2014

PCI Loans (in thousands; 2015 unaudited)	Unpaid principal balance	Carrying value	Unpaid principal balance	Carrying value
Commercial and industrial	$280			