NORTHRIM BANCORP INC
Form 10-Q
November 07, 2018

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, 2018
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 ¨ Emerging Growth Company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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 7, 2018 was 6,884,386.

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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, 2017.

ITEM 1. FINANCIAL STATEMENTS

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

(In Thousands, Except Share Data)	September 30, 2018	December 31, 2017
ASSETS		
Cash and due from banks	$37,651	$25,016
Interest bearing deposits in other banks	32,528	52,825
Investment securities available for sale, at fair value	264,193	307,019
Marketable equity securities	6,035	5,731
Investment in Federal Home Loan Bank stock	2,103	2,115
Loans held for sale	56,636	43,979
Loans	982,007	954,953
Allowance for loan losses	(20,160)	(21,461)
Net loans	961,847	933,492
Purchased receivables, net	12,706	22,231
Mortgage servicing rights, at fair value	9,695	7,305
Other real estate owned, net	8,707	8,651
Premises and equipment, net	38,637	37,867
Goodwill	15,017	15,017
Other intangible assets, net	1,154	1,207
Other assets	55,764	56,141
Total assets	$1,502,673	$1,518,596
LIABILITIES		
Deposits:		
Demand	$450,409	$414,686
Interest-bearing demand	240,974	252,009
Savings	233,611	247,458
Money market	208,614	243,603
Certificates of deposit less than $250,000	66,831	69,283
Certificates of deposit $250,000 and greater	32,829	31,244
Total deposits	1,233,268	1,258,283
Securities sold under repurchase agreements	32,429	27,746
Borrowings	7,282	7,362
Junior subordinated debentures	10,310	10,310
Other liabilities	16,142	22,093
Total liabilities	1,299,431	1,325,794
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, 6,884,386 and 6,871,963 issued and outstanding at September 30, 2018 and December 31, 2017, respectively	6,884	6,872
Additional paid-in capital	62,512	61,793
Retained earnings	134,487	124,407
Accumulated other comprehensive loss, net of tax	(641)	(270)
Total shareholders' equity	203,242	192,802
Total liabilities and shareholders' equity	$1,502,673	$1,518,596

See notes to consolidated financial statements

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
(In Thousands, Except Per Share Data)	2018	2017	2018	2017
Interest Income				
Interest and fees on loans and loans held for sale	$14,992	$14,341	$42,291	$41,180
Interest on investment securities available for sale	1,314	956	3,870	3,158
Dividends on marketable equity securities	86	87	252	259
Interest on investment securities held to maturity	—	11	—	31
Dividends on Federal Home Loan Bank stock	19	6	45	18
Interest on deposits in other banks	169	118	512	230
Total Interest Income	16,580	15,519	46,970	44,876
Interest Expense				
Interest expense on deposits	595	429	1,413	1,325
Interest expense on securities sold under agreements to repurchase	9	9	26	25
Interest expense on borrowings	59	54	174	130
Interest expense on junior subordinated debentures	98	110	286	402
Total Interest Expense	761	602	1,899	1,882
Net Interest Income	15,819	14,917	45,071	42,994
(Benefit) provision for loan losses	—	2,500	(300)	3,200
Net Interest Income After Provision for Loan Losses	15,819	12,417	45,371	39,794
Other Operating Income				
Mortgage banking income	5,903	6,219	16,325	18,020
Purchased receivable income	767	752	2,474	2,217
Bankcard fees	724	664	2,056	1,903
Service charges on deposit accounts	407	406	1,137	1,254
Gain on sale of Northrim Benefits Group	—	4,443	—	4,443
Employee benefit plan income	—	609	—	2,506
Gain (loss) on sale of securities, net	—	(3)	—	11
Other income	872	765	2,457	2,168
Total Other Operating Income	8,673	13,855	24,449	32,522
Other Operating Expense				
Salaries and other personnel expense	11,261	11,115	33,208	33,750
Occupancy expense	1,687	1,706	4,407	4,991
Data processing expense	1,503	1,509	4,374	4,209
Impairment of equity method investment	804	—	804	—
Professional and outside services	727	674	1,780	1,908
Marketing expense	367	332	1,461	1,733
Insurance expense	171	475	645	922
OREO expense, net rental income and gains on sale	43	(44)	157	216
Intangible asset amortization expense	18	26	53	79
Compensation expense - RML acquisition payments	—	149	—	323
Other operating expense	1,518	1,749	4,611	4,685
Total Other Operating Expense	18,099	17,691	51,500	52,816
Income Before Provision for Income Taxes	6,393	8,581	18,320	19,500
Provision for income taxes	1,129	2,980	3,164	6,236

Net Income	5,264	5,601	15,156	13,264
Less: Net income attributable to the noncontrolling interest	—	78	—	327
Net Income Attributable to Northrim BanCorp, Inc.	$5,264	$5,523	$15,156	$12,937
Earnings Per Share, Basic	$0.77	$0.80	$2.21	$1.88
Earnings Per Share, Diluted	$0.75	$0.79	$2.17	$1.85
Weighted Average Shares Outstanding, Basic	6,877,194	6,872,273	6,873,843	6,897,577
Weighted Average Shares Outstanding, Diluted	6,990,633	6,959,035	6,978,679	6,983,778

See notes to consolidated financial statements

NORTHRIM BANCORP, INC.
Consolidated Statements of Comprehensive Income
(Unaudited)
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	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2018	2017	2018	2017
Net income	$5,264	$5,601	$15,156	$13,264
Other comprehensive income (loss), net of tax:				
Securities available for sale:				
Unrealized (losses) gains arising during the period	($218)	$197	($1,325)	$884
Reclassification of net (gains) losses included in net income (net of tax (benefit) expense) of $0 and ($1) for the third quarter of 2018 and 2017, respectively, and $0 and $5 for the nine months ended September 30, 2018 and 2017, respectively)	—	2	—	(6)
Derivatives and hedging activities:				
Unrealized gains arising during the period	234	127	855	127
Income tax benefit (expense) related to unrealized gains and losses	44	(80)	290	(334)
Other comprehensive income (loss), net of tax	60	246	(180)	671
Comprehensive income	5,324	5,847	14,976	13,935
Less: comprehensive income attributable to the noncontrolling interest	—	78	—	327
Comprehensive income attributable to Northrim BanCorp, Inc.	$5,324	$5,769	$14,976	$13,608

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 Loss	Non-controlling Interest	Total
Balance as of January 1, 2017	6,898	$6,898	$62,952	$117,141	($397)	$118	$186,712
Cash dividend declared	—	—	—	(5,970)	—	—	(5,970)
Stock-based compensation expense	—	—	665	—	—	—	665
Exercise of stock options and vesting of restricted stock units, net	32	32	(275)	—	—	—	(243)
Treasury stock buy-back	(58)	(58)	(1,549)	—	—	—	(1,607)
Distributions to noncontrolling interest	—	—	—	—	—	(445)	(445)
Other comprehensive income, net of tax	—	—	—	—	212	—	212
Reclassification for remeasuring of deferred tax assets related to investment securities	—	—	—	85	(85)	—	—
Net income attributable to the noncontrolling interest	—	—	—	—	—	327	327
Net income attributable to Northrim BanCorp, Inc.	—	—	—	13,151	—	—	13,151
Balance as of December 31, 2017	6,872	$6,872	$61,793	$124,407	($270)	$—	$192,802
Cash dividend declared	—	—	—	(5,205)	—	—	(5,205)
Stock-based compensation expense	—	—	571	—	—	—	571
Exercise of stock options and vesting of restricted stock units, net	12	12	148	—	—	—	160
Other comprehensive loss, net of tax	—	—	—	—	(180)	—	(180)
Cumulative effect of adoption of accounting principles related to premium amortization of investment securities	—	—	—	(62)	—	—	(62)
Reclassification for cumulative effect of adoption of accounting principles related to fair value measurement of equity securities	—	—	—	191	(191)	—	—
Net income attributable to Northrim BanCorp, Inc.	—	—	—	15,156	—	—	15,156
Balance as of September 30, 2018	6,884	$6,884	$62,512	$134,487	($641)	$—	$203,242

See notes to consolidated financial statements

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

(In Thousands)	Nine Months Ended September 30, 2018	2017
Operating Activities:		
Net income	$15,156	$13,264
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Gain on sale of securities, net	—	(11)
Gain on sale of Northrim Benefits Group	—	(4,443)
Loss on disposal of premises and equipment	3	3
Depreciation and amortization of premises and equipment	1,504	2,042
Amortization of software	670	184
Intangible asset amortization	53	79
Amortization of investment security premium, net of discount accretion	156	172
Change in fair value of marketable equity securities	143	—
(Increase) decrease deferred tax asset, net	(207)	617
Stock-based compensation	571	435
Deferral of loan fees and (costs), net	199	(459)
(Benefit) provision for loan losses	(300)	3,200
(Benefit) reserve for purchased receivables	(4)	29
Additions to mortgage servicing rights carried at fair value	(2,662)	(2,086)
Change in fair value of mortgage servicing rights carried at fair value	272	62
Gain on sale of loans	(11,666)	(13,929)
Proceeds from the sale of loans held for sale	412,562	419,783
Origination of loans held for sale	(413,553)	(421,472)
Gain on sale of other real estate owned	(133)	(369)
Impairment on other real estate owned	—	340
Impairment on equity method investment	804	—
Net changes in assets and liabilities:		
Increase in accrued interest receivable	(402)	(396)
Decrease (increase) in other assets	683	(1,459)
Decrease in other liabilities	(6,061)	(40)
Net Cash Used by Operating Activities	(2,212)	(4,454)
Investing Activities:		
Investment in securities:		
Purchases of investment securities available for sale	(48,570)	(16,283)
Purchases of marketable equity securities	(998)	—
Purchases of FHLB stock	—	(3,665)
Proceeds from sales/calls/maturities of securities available for sale	89,903	77,865
Proceeds from calls/sales of marketable equity securities	500	—
Proceeds from redemption of FHLB stock	12	3,514
Decrease in purchased receivables, net	9,529	7,532
Increase in loans, net	(28,789)	(15,379)
Proceeds from sale of other real estate owned	612	3,265
Proceeds from the sale of Northrim Benefits Group	—	4,625
Proceeds from sale of premises and equipment	3	116

Purchases of premises and equipment	(2,280)	(2,889)
Net Cash Provided by Investing Activities	19,922	58,701
Financing Activities:		
Decrease in deposits	(25,015)	(9,337)
Increase in securities sold under repurchase agreements	4,683	3,477
(Decrease) increase in borrowings	(80)	3,049
Distributions to noncontrolling interest	—	(445)

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Repayment of junior subordinated debentures	—	(8,248)
Repurchase of common stock	—	(1,608)
Proceeds from the issuance of common stock	194	—
Cash dividends paid	(5,154)	(4,417)
Net Cash Used by Financing Activities	(25,372)	(17,529)
Net Change in Cash and Cash Equivalents	(7,662)	36,718
Cash and Cash Equivalents at Beginning of Period	77,841	50,551
Cash and Cash Equivalents at End of Period	$70,179	$87,269
Supplemental Information:		
Income taxes paid	$324	$7,764
Interest paid	$1,798	$1,821
Transfer of loans to other real estate owned	$535	$167
Cash dividends declared but not paid	$51	$41

See notes to consolidated financial statements

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

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 GAAP for complete financial statements. The Company owns a 100% interest in Residential Mortgage Holding Company, LLC, the parent company of Residential Mortgage, LLC (collectively "RML") and consolidates their balance sheets and income statement into its financial statements. The Company owned a 50.1% interest in Northrim Benefits Group, LLC ("NBG") through August 14, 2017, and consolidated NBG's balance sheets and income statements into its financial statements through the date of the sale on August 14, 2017. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Certain immaterial reclassifications have been made to prior year amounts to maintain consistency with the current year with no impact on net income or total shareholders’ equity. The Company determined that it operates in two primary operating segments: Community Banking and Home Mortgage Lending. The Company has evaluated subsequent events and transactions for potential recognition or disclosure. Operating results for the interim period ended September 30, 2018, are not necessarily indicative of the results anticipated for the year ending December 31, 2018. 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, 2017. 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, 2017.

Reclassification of Prior Year Presentation

Certain prior year amounts have been reclassified for consistency with the current period presentation. These reclassifications had no effect on the reported results of operations.

Recent Accounting Pronouncements

Accounting pronouncements implemented in 2018

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In general, this new guidance requires companies to use more judgment and make more estimates than under current guidance, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. For financial reporting purposes, the standard allows for either full retrospective adoption, meaning the standard is applied to all of the periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements with the cumulative effect of initially applying the standard recognized at the date of initial application. The Company has reviewed all revenue sources to determine the sources that are in scope for this guidance. As a bank, key revenue sources, including interest income and mortgage banking income have been identified as out of scope of this new guidance. The Company's overall assessment of material in-scope revenue sources include service charges on deposits, bankcard fees, and other miscellaneous revenue sources. The Company adopted the guidance on January 1, 2018, utilizing the modified retrospective approach, which did not have a material impact on how the Company recognizes revenue or on our consolidated financial statements and disclosures. See Note 2 of the Notes to Consolidated Financial Statements included in Item 1 of this report for disclosures related to revenue generated from contracts with customers.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities (“ASU 2016-01”). The new guidance is intended to improve the recognition and measurement of financial instruments. ASU 2016-01 requires that equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) be measured at fair value with changes in fair value recognized in net income. In addition, the amendment requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes and requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements. ASU 2016-01 also eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet. The amendment also requires a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument specific credit risk (also referred to as "own credit") when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. The Company adopted the guidance on January 1, 2018 and reclassified $191,000 in unrealized gains on its investments in preferred stock from other comprehensive income to retained earnings. Adoption of the guidance does not have a material or significant impact on the Company's consolidated financial statements. As of January 1, 2018, unrealized gains and losses on marketable equity securities are included in other operating income in the Consolidated Statement of Income.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”). ASU 2016-15 provides guidance on eight specific cash flow issues: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The Company adopted the guidance on January 1, 2018 and made an accounting policy election to classify distributions from equity method investees using the cumulative earnings approach. Accordingly, these distributions are recorded as cash inflows in the operating activity section of the Statement of Cash Flows. Adoption of the guidance does not have a material or significant impact on the Company's consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation-Stock Compensation (“ASU 2017-09”). ASU 2017-09 provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. The Company adopted the guidance on January 1, 2018 and it did not have a material impact on the Company’s consolidated financial position or results of operations.

In March 2017, the FASB issued ASU 2017-08, Receivables-Nonrefundable Fees and Other Costs (“ASU 2017-08”). ASU 2017-08 amends the amortization period for certain purchased callable debt securities held at a premium by shortening the amortization period for the premium to the earliest call date. Under the current guidance, entities generally amortize the premium as an adjustment of yield over the contractual life of the instrument. ASU 2017-08 is effective for the Company’s financial statements for annual and interim periods beginning on or after December 15, 2018, and should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings. The Company early adopted this standard in the first quarter of 2018, which resulted in a $62,000 decrease in beginning retained earnings through a cumulative-effect adjustment.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (“ASU 2017-12”). ASU 2017-12 improves the financial reporting of hedging relationships to better portray the economic results of an entity’s risk management activities in its financial statements. In addition to that main objective, the amendments in this ASU make certain targeted improvements to simplify the application of the hedge accounting guidance in current GAAP based on the feedback received from preparers, auditors, users, and other stakeholders. ASU 2017-12 is effective for the Company’s financial statements for annual and interim periods beginning on or after December 15, 2018, and all transition requirements and elections must be applied to hedging relationships existing (that is, hedging relationships in which the hedging instrument has not expired, been sold, terminated, or exercised or the entity has not removed the designation of the hedging relationship) on the date of adoption. The Company early adopted this standard in the first quarter of 2018, and it did not have a significant impact on the Company’s consolidated financial position or results of operations.

Accounting pronouncements to be implemented in future periods

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) (“ASU 2016-02”). ASU 2016-02 requires lessees, among other things, to recognize lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous authoritative guidance. This update also introduces new disclosure requirements for leasing arrangements. ASU 2016-02 is effective for the Company's financial statements for annual and interim periods beginning on or after December 15, 2018. All entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. As the Company expects to elect the transition option provided in ASU No. 2018-11 (see below), the modified retrospective approach will be applied on January 1, 2019 (as opposed to January 1, 2017). The Company also expects to elect certain relief options offered in ASU 2016-02 including the package of practical expedients, the option not to separate lease and non-lease components and instead to account for them as a single lease component, and the option not to recognize right-of-use assets and lease liabilities that arise from short-term leases (i.e., leases with terms of twelve months or less). The Company will likely not elect the hindsight practical expedient, which allows entities to use hindsight when determining lease term and impairment of right-of-use assets. The Company has several lease agreements, such as branch locations, which are currently considered operating leases, and therefore, not recognized on the Company’s consolidated statements of condition. The Company expects the new accounting standard will require these lease agreements to be recognized on the consolidated statements of condition as a right-of-use asset and a corresponding lease liability. Therefore, the Company’s preliminary evaluation indicates the provisions of ASU 2016-02 are expected to impact the Company’s consolidated statements of condition, along with the Company’s regulatory capital ratios. However, the Company does not expect the new guidance to have a material impact on the Company’s consolidated statements of income. The Company has an implementation team working through the provisions of ASU 2016-02 and ASU 2018-11 to assess the impact on its accounting, disclosures, processes, internal control over financial reporting, regulatory capital, and risk-weighted assets. The Company is substantially complete with the evaluation of its lease population. It is expected that the Company will recognize right-of-use assets and lease liabilities (estimated between $15 and $25 million) upon adoption on January 1, 2019. The estimates will change due to changes in the lease portfolio prior to the adoption date.

In July 2018, the FASB issued ASU 2018-11, Leases - Targeted Improvements ("ASU 2018-11") to provide entities with relief from the costs of implementing certain aspects of the new leasing standard, ASU 2016-02. Specifically, under the amendments in ASU 2018-11: (1) entities may elect not to recast the comparative periods presented when transitioning to the new leasing standard, and (2) lessors may elect not to separate lease and non-lease components when certain conditions are met. The amendments have the same effective date as ASU 2016-02 (January 1, 2019 for the Company). The Company expects to elect both transition options. ASU 2018-11 is not expected to have a material impact on the Company’s Consolidated Financial Statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (“ASU 2016-13”). ASU 2016-13 is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The standard requires the measurement of all expected credit losses for certain financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates, but will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. ASU 2016-13 requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The ASU is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2019. Early application will be permitted for specified periods. ASU 2016-13 is effective for the Company’s financial statements for annual and interim periods beginning on or after December 15, 2019, and must be applied prospectively. The Company has formed a cross-functional team to begin implementation efforts of this new guidance. The team is evaluating the data elements and modeling options that are expected to be critical to the new process and has engaged external consulting services related to this effort. An estimate of the impact of this standard on the Company's consolidated financial position and results of operations has not yet been determined; however, the impact on the Company's process for calculating the allowance for loan losses ("Allowance") is expected to be significant.

In January 2017, the FASB issued ASU 2017-04, Intangibles-Goodwill and Other (“ASU 2017-04”). ASU 2017-04 simplifies how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. ASU 2017-04 is effective for the Company’s financial statements for annual and interim periods beginning on or after December 15, 2019, and must be applied on a prospective basis. 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 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820) (“ASU 2018-13”). ASU 2018-13 modifies the disclosure requirements on fair value measurements in Topic 820, Fair Value Measurement, based on the concepts in the Concepts Statement, including the consideration of costs and benefits. ASU 2018-13 is effective for the Company’s financial statements for annual and interim periods beginning on or after December 15, 2019. 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.

2. Revenue

The Company's revenue is included in net interest income and other operating income on its Consolidated Statements of Income. ASU 2014-09, which amends Topic 606 in the Accounting Standards Codification ("ASC"), establishes principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts to provide goods or services to customers. The core principle requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it expects to be entitled to receive in exchange for those goods or services recognized as performance obligations are satisfied.

The majority of our ongoing revenue-generating transactions are not subject to ASC 606, including revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, purchased receivable income, financial guarantees, and derivatives are also not in scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as deposit related fees, interchange fees, merchant services income, and commissions from the sales of mutual funds and other investments. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Company’s non-interest revenue is generated from contracts with customers. Noninterest revenue streams in-scope of Topic 606 are discussed below.

Bankcard fees

Bankcard fees are primarily comprised of debit card income and ATM fees. Debit card income is primarily comprised of interchange fees earned whenever the Company’s debit cards are processed through card payment networks such as Visa or MasterCard. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. The Company’s performance obligation for bankcard fees are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payments are typically received immediately or in the following month.

Service charges on deposit accounts

Service charges on deposit accounts consist of general service fees for monthly account maintenance, activity- or transaction-based fees, and account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), and other deposit account related fees and consist of transaction-based revenue, time-based revenue (service period), item-based revenue or some other individual attribute-based revenue. Revenue is recognized when our performance obligation is completed which is generally monthly for account maintenance services or when a transaction has been completed. Payments for service charges on deposit accounts are primarily received immediately or in the following month through a direct charge to customers’ accounts.

Other

Other operating income consists of other recurring revenue streams such as merchant services income, commissions from sales of mutual funds and other investments, safety deposit box rental fees, bank check and other check fees, unrealized gains and losses on marketable securities, and other miscellaneous revenue streams. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. The Company’s performance obligation for merchant services income is largely satisfied, and related revenue recognized, when the transactions have been completed. Payment is typically received immediately or in the following month. The Company earns commissions from the sale of mutual funds as periodic service fees (i.e., trailers) from Elliott Cove Capital Management typically based on a percentage of net asset value. Trailer revenue is recorded over time, quarterly, as net asset value is determined. The Company also earns commission income from the sale of annuity products. The Company acts as an intermediary between the Company's customer and Elliott Cove Investment Advisors for these transactions, and Commissions from annuity product sales are recorded when the Company’s performance obligation is satisfied, which is generally upon the issuance of the annuity policy. The Company does not earn trailer fees on annuity sales. Payment for commissions from sales of mutual funds and other investments and annuity sales is typically received in the following quarter. Other service charges include revenue from safety deposit box rental fees, processing wire transfers, bank check and other check fees, and other services. The Company’s performance obligations for these other revenue streams are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payments are typically received immediately or in the following month.

The following presents other operating income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the three and nine-month periods ended September 30, 2018 and 2017:

(In Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
Other operating income	2018	2017	2018	2017
In-scope of Topic 606:				
Bankcard fees	$724	$664	$2,056	$1,903
Service charges on deposit accounts	407	406	1,137	1,254
Other	405	371	1,204	1,094
Other operating income (in-scope of Topic 606)	$1,536	$1,441	$4,397	$4,251
Other operating income (out-of-scope of Topic 606)	7,137	12,414	20,052	28,271
Total other operating income	$8,673	$13,855	$24,449	$32,522

Contract Balances

A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Company's other operating revenue streams are largely based on transactional activity, or standard month-end revenue accruals. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of September 30, 2018 and December 31, 2017, the Company did not have any significant contract balances.

Contract Acquisition Costs

In connection with the adoption of Topic 606, an entity is required to capitalize, and subsequently amortize into expense, certain incremental costs of obtaining a contract with a customer if these costs are expected to be recovered. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, sales commission). The Company utilizes the practical expedient which allows entities to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less. Upon adoption of Topic 606, the Company did not capitalize any contract acquisition costs.

3. Cash and Cash Equivalents

The Company is required to maintain a $557,000 minimum average daily balance with the Federal Reserve Bank of San Francisco ("Federal Reserve Bank") for purposes of settling financial transactions and charges for Federal Reserve Bank services. The Company is also required to maintain cash balances or deposits with the Federal Reserve Bank sufficient to meet its statutory reserve requirements.

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

The Company is required to maintain a $100,000 and $300,000 balance with a correspondent bank to collateralize the initial margin and the fair value exposure of its interest rate swap, respectively.

4. Investment Securities

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

(In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2018				
Securities available for sale				
U.S. Treasury and government sponsored entities	$208,321	$—	$2,489	$205,832
Municipal securities	11,879	8	44	11,843
Corporate bonds	40,142	374	—	40,516
Collateralized loan obligations	6,000	5	3	6,002
Total securities available for sale	$266,342	$387	$2,536	$264,193
December 31, 2017				
Securities available for sale				
U.S. Treasury and government sponsored entities	$250,794	$3	$1,336	$249,461
Municipal securities	14,395	72	46	14,421
Corporate bonds	36,654	478	—	37,132
Collateralized loan obligations	6,000	5	—	6,005
Total securities available for sale	$307,843	$558	$1,382	$307,019

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, 2018 and December 31, 2017 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, 2018:						
Securities Available for Sale						
U.S. Treasury and government sponsored entities	$111,942	$1,645	$93,890	$844	$205,832	$2,489
Collateralized loan obligations	2,997	3	—	—	2,997	3
Municipal securities	6,365	18	1,566	26	7,931	44
Total	$121,304	$1,666	$95,456	$870	$216,760	$2,536
December 31, 2017:						
Securities Available for Sale						
U.S. Treasury and government sponsored entities	$116,331	$496	$122,605	$840	$238,936	$1,336
Municipal securities	3,994	17	2,298	29	6,292	46
Total	$120,325	$513	$124,903	$869	$245,228	$1,382

The unrealized losses on investments in U.S. treasury and government sponsored entities, collateralized loan obligations, and municipal securities in both periods were caused by changes in interest rates. At September 30, 2018 and December 31, 2017, there were 24 available-for-sale securities with unrealized losses that have been in a loss position for less than twelve months. There were 16 and 17 securities as of September 30, 2018 and December 31, 2017 that have been in an unrealized loss position for more than twelve months, respectively. The contractual terms of the investments in a loss position do not permit the issuer to settle the securities at a price less than the amortized cost of the investment. Because it is more likely than not that the Company will hold these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

At September 30, 2018 and December 31, 2017, $53.5 million and $51.6 million in securities were pledged for deposits and borrowings, respectively.

The amortized cost and estimated fair values of debt securities at September 30, 2018, 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.

(In Thousands)	Amortized Cost	Fair Value	Weighted Average Yield
US Treasury and government sponsored entities			
Within 1 year	$30,005	$29,969	1.15 %
1-5 years	174,986	172,576	1.87 %
5-10 years	3,330	3,287	3.00 %
Total	$208,321	$205,832	1.79 %
Corporate bonds			
1-5 years	$21,702	$21,897	3.17 %
5-10 years	18,440	18,619	3.37 %
Total	$40,142	$40,516	3.26 %
Collateralized loan obligations			
5-10 years	$3,000	$2,997	3.77 %
Over 10 years	3,000	3,005	4.07 %
Total	$6,000	$6,002	3.92 %
Municipal securities			
Within 1 year	$2,592	$2,591	2.05 %
1-5 years	9,287	9,252	2.41 %
Total	$11,879	$11,843	2.34 %

The proceeds and resulting gains and losses, computed using specific identification, from sales of investment securities for the three and nine-month periods ending September 30, 2018 and 2017, are as follows:

(In Thousands)	Proceeds	Gross Gains	Gross Losses
Three Months Ended September 30, 2018			
Available for sale securities	$—	$—	$—
Three Months Ended September 30, 2017			
Available for sale securities	$14,996	$—	$3
Nine Months Ended September 30, 2018			
Available for sale securities	$—	$—	$—
Nine Months Ended September 30, 2017			
Available for sale securities	$25,006	$14	$3

A summary of interest and dividend income for the three and nine-month periods ending September 30, 2018 and 2017, on available for sale investment securities and marketable equity securities are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2018	2017	2018	2017
US Treasury and government sponsored entities	$868	$653	$2,653	$2,255
Other	468	298	1,255	881
Total taxable interest income	$1,336	$951	$3,908	$3,136
Municipal securities	$64	$92	$214	$281
Total tax-exempt interest income	$64	$92	$214	$281
Total	$1,400	$1,043	$4,122	$3,417

5. Loans and Credit Quality

The following table presents total portfolio loans by portfolio segment and class of financing receivable, based on the Company's 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, 2018									
AQR Pass	$301,757	$36,119	$61,857	$120,902	$322,051	$40,889	$19,525	$22,495	$925,595
AQR Special Mention	6,279	—	—	4,484	18,300	—	199	16	29,278
AQR Substandard	25,096	—	—	4,780	469	577	478	62	31,462
AQR Doubtful	—	—	—	—	—	27	—	—	27
Subtotal	$333,132	$36,119	$61,857	$130,166	$340,820	$41,493	$20,202	$22,573	$986,362
Less: Unearned origination fees, net of origination costs									(4,355)
Total loans									$982,007
December 31, 2017									
AQR Pass	$277,371	$31,201	$80,093	$127,059	$307,780	$39,777	$21,846	$19,895	$905,022
AQR Special Mention	4,921	—	—	2,095	11,051	634	3	22	18,726
AQR Substandard	31,222	—	—	2,888	482	—	767	2	35,361
Subtotal	$313,514	$31,201	$80,093	$132,042	$319,313	$40,411	$22,616	$19,919	$959,109
Less: Unearned origination fees, net of origination costs									(4,156)
Total loans									$954,953

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 when management believes that collection of principal is unlikely. Interest income on loans is accrued and recognized on the principal amount outstanding except for loans in a nonaccrual status. All classes of loans are placed on nonaccrual and considered impaired when management believes doubt exists as to the collectability of the interest or principal. Cash payments received on nonaccrual loans are directly applied to the principal balance. Generally, a loan may be returned to accrual status when the delinquent principal and interest is brought current in accordance with the terms of the loan agreement. Additionally, certain ongoing performance criteria, which generally includes a performance period of six months, must be met in order for a loan to be returned to accrual status. Loans are reported as past due when installment payments, interest payments, or maturity payments are past due based on contractual terms.

Nonaccrual loans: Nonaccrual loans net of government guarantees totaled $16.4 million and $21.2 million at September 30, 2018 and December 31, 2017, respectively. Nonaccrual loans at the periods indicated are presented below by segment:

(In Thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Current	Total
September 30, 2018					
Commercial	$121	$600	$2,742	$11,271	$14,734
Real estate term owner occupied	—	—	1,694	—	1,694
Real estate term other	—	—	26	—	26
Consumer secured by 1st deeds of trust	—	—	226	—	226
Consumer other	—	—	40	8	48
Total nonperforming loans	121	600	4,728	11,279	16,728
Government guarantees on nonaccrual loans	—	—	(62)	(217)	(279)
Net nonaccrual loans	$121	$600	$4,666	$11,062	$16,449
December 31, 2017					
Commercial	$810	$—	$2,652	$16,455	$19,917
Real estate term owner occupied	—	—	—	1,331	1,331
Consumer secured by 1st deeds of trust	—	—	378	—	378
Total nonperforming loans	810	—	3,030	17,786	21,626
Government guarantees on nonaccrual loans	—	—	(94)	(373)	(467)
Net nonaccrual loans	$810	$—	$2,936	$17,413	$21,159

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

(In Thousands)	30-59 Days Past Due Still Accruing	60-89 Days Past Due Still Accruing	Greater Than 90 Days Still Accruing	Total Past Due	Nonaccrual	Current	Total
September 30, 2018							
Commercial	$1,098	$—	$—	$1,098	$14,734	$317,300	$333,132
Real estate construction one-to-four family	—	—	—	—	—	36,119	36,119
Real estate construction other	—	—	—	—	—	61,857	61,857
Real estate term owner occupied	211	738	—	949	1,694	127,523	130,166
Real estate term non-owner occupied	—	—	—	—	—	340,820	340,820
Real estate term other	—	577	—	577	26	40,890	41,493
Consumer secured by 1st deed of trust	—	—	152	152	226	19,824	20,202
Consumer other	22	10	—	32	48	22,493	22,573
Subtotal	$1,331	$1,325	$152	$2,808	$16,728	$966,826	$986,362
Less: Unearned origination fees, net of origination costs							(4,355)
Total							$982,007
December 31, 2017							
Commercial	$503	$—	$240	$743	$19,917	$292,854	$313,514
Real estate construction one-to-four family	—	—	—	—	—	31,201	31,201
Real estate construction other	90	—	—	90	—	80,003	80,093
Real estate term owner occupied	966	—	—	966	1,331	129,745	132,042
Real estate term non-owner occupied	—	—	—	—	—	319,313	319,313
Real estate term other	—	—	—	—	—	40,411	40,411
Consumer secured by 1st deed of trust	363	—	—	363	378	21,875	22,616
Consumer other	161	53	12	226	—	19,693	19,919
Subtotal	$2,083	$53	$252	$2,388	$21,626	$935,095	$959,109
Less: Unearned origination fees, net of origination costs							(4,156)
Total							$954,953

Impaired Loans: The Company considers a loan to be impaired when it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan agreement. Once a loan is determined to be impaired, the impairment is measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate, except that if the loan is collateral dependent, the impairment is measured by using the fair value of the loan's collateral. Nonperforming loans with an outstanding balance of $50,000 or greater 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, 2018 and December 31, 2017, the recorded investment in loans that are considered to be impaired was $35.4 million and $32.0 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, 2018			
With no related allowance recorded			
Commercial - AQR special mention	$2,105	$2,105	$—
Commercial - AQR substandard	23,608	25,148	—
Real estate term owner occupied- AQR special mention	1,008	1,008	—
Real estate term owner occupied- AQR substandard	4,781	4,781	—
Real estate term non-owner occupied- AQR pass	319	319	—
Real estate term non-owner occupied- AQR substandard	469	469	—
Real estate term other - AQR pass	504	504	—
Real estate term other - AQR substandard	577	577	—
Consumer secured by 1st deeds of trust - AQR pass	131	131	—
Consumer secured by 1st deeds of trust - AQR substandard	252	252	—
Subtotal	$33,754	$35,294	$—
With an allowance recorded			
Commercial - AQR substandard	$1,454	$1,958	$323
Consumer secured by 1st deeds of trust - AQR substandard	226	226	49
Subtotal	$1,680	$2,184	$372
Total			
Commercial - AQR special mention	$2,105	$2,105	$—
Commercial - AQR substandard	25,062	27,106	323
Real estate term owner-occupied - AQR special mention	1,008	1,008	—
Real estate term owner-occupied - AQR substandard	4,781	4,781	—
Real estate term non-owner occupied - AQR pass	319	319	—
Real estate term non-owner occupied - AQR substandard	469	469	—
Real estate term other - AQR pass	504	504	—
Real estate term other - AQR substandard	577	577	—
Consumer secured by 1st deeds of trust - AQR pass	131	131	—
Consumer secured by 1st deeds of trust - AQR substandard	478	478	49
Total	$35,434	$37,478	$372

(In Thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
December 31, 2017			
With no related allowance recorded			
Commercial - AQR special mention	$2,153	$2,153	$—
Commercial - AQR substandard	16,671	17,742	—
Real estate term owner occupied - AQR substandard	2,862	2,862	—
Real estate term non-owner occupied - AQR pass	303	303	—
Real estate term non-owner occupied - AQR special mention	89	89	—
Real estate term non-owner occupied - AQR substandard	482	482	—
Real estate term other - AQR pass	559	559	—
Consumer secured by 1st deeds of trust - AQR pass	136	136	—
Consumer secured by 1st deeds of trust - AQR substandard	724	809	—
Subtotal	$23,979	$25,135	$—
With an allowance recorded			
Commercial - AQR substandard	$7,988	$7,988	$966
Subtotal	$7,988	$7,988	$966
Total			
Commercial - AQR special mention	$2,153	$2,153	$—
Commercial - AQR substandard	24,659	25,730	966
Real estate term owner occupied - AQR substandard	2,862	2,862	—
Real estate term non-owner occupied - AQR pass	303	303	—
Real estate term non-owner occupied - AQR special mention	89	89	—
Real estate term non-owner occupied - AQR substandard	482	482	—
Real estate term other - AQR pass	559	559	—
Consumer secured by 1st deeds of trust - AQR pass	136	136	—
Consumer secured by 1st deeds of trust - AQR substandard	724	809	—
Total	$31,967	$33,123	$966

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, 2018 and 2017:

Three Months Ended September 30,	2018		2017	
(In Thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded				
Commercial - AQR special mention	$2,113	$31	$97	$—
Commercial - AQR substandard	26,518	43	18,125	72
Real estate term owner occupied- AQR special mention	617	—	—	—
Real estate term owner occupied- AQR substandard	2,908	52	7,345	114
Real estate term non-owner occupied- AQR pass	206	7	346	6
Real estate term non-owner occupied- AQR substandard	287	8	580	9
Real estate term other - AQR pass	310	11	585	10
Real estate term other - AQR substandard	353	—	641	11
Consumer secured by 1st deeds of trust - AQR pass	132	2	—	—
Consumer secured by 1st deeds of trust - AQR special mention	—	—	139	3
Consumer secured by 1st deeds of trust - AQR substandard	154	2	771	5
Subtotal	$33,598	$156	$28,629	$230
With an allowance recorded				
Commercial - AQR special mention	$—	$—	$2,083	$3
Commercial - AQR substandard	1,081	10	10,056	4
Consumer secured by 1st deeds of trust - AQR substandard	136	—	—	—
Subtotal	$1,217	$10	$12,139	$7
Total				
Commercial - AQR special mention	$2,113	$31	$2,180	$3
Commercial - AQR substandard	27,599	53	28,181	76
Real estate term owner-occupied - AQR special mention	617	—	—	—
Real estate term owner-occupied - AQR substandard	2,908	52	7,345	114
Real estate term non-owner occupied - AQR pass	206	7	346	6
Real estate term non-owner occupied - AQR substandard	287	8	580	9
Real estate term other - AQR pass	310	11	585	10
Real estate term other - AQR substandard	353	—	641	11
Consumer secured by 1st deeds of trust - AQR pass	132	2	—	—
Consumer secured by 1st deeds of trust - AQR special mention	—	—	139	3
Consumer secured by 1st deeds of trust - AQR substandard	290	2	771	5
Total Impaired Loans	$34,815	$166	$40,768	$237

Nine Months Ended September 30,	2018		2017	
(In Thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded				
Commercial - AQR special mention	$2,192	$96	$49	$1
Commercial - AQR substandard	25,271	300	20,363	405
Real estate term owner occupied- AQR pass	—	—	82	5
Real estate term owner occupied- AQR special mention	208	—	—	—
Real estate term owner occupied- AQR substandard	4,019	129	6,257	260
Real estate term non-owner occupied- AQR pass	294	18	367	38
Real estate term non-owner occupied- AQR special mention	29	2	—	—
Real estate term non-owner occupied- AQR substandard	413	22	654	38
Real estate term other - AQR pass	462	28	604	32
Real estate term other - AQR substandard	119	—	652	34
Consumer secured by 1st deeds of trust - AQR pass	136	10	—	—
Consumer secured by 1st deeds of trust - AQR special mention	—	—	141	10
Consumer secured by 1st deeds of trust - AQR substandard	168	8	506	13
Consumer other - AQR substandard	—	—	17	1
Subtotal	$33,311	$613	$29,692	$837
With an allowance recorded				
Commercial - AQR special mention	$—	$—	$702	$3
Commercial - AQR substandard	2,866	17	7,979	4
Commercial - AQR doubtful	18	—	—	—
Consumer secured by 1st deeds of trust - AQR substandard	126	—	—	—
Subtotal	$3,010	$17	$8,681	$7
Total				
Commercial - AQR special mention	$2,192	$96	$751	$4
Commercial - AQR substandard	28,137	317	28,342	409
Commercial - AQR doubtful	18	—	—	—
Real estate term owner-occupied - AQR pass	—	—	82	5
Real estate term owner-occupied - AQR special mention	208	—	—	—
Real estate term owner-occupied - AQR substandard	4,019	129	6,257	260
Real estate term non-owner occupied - AQR pass	294	18	367	38
Real estate term non-owner occupied - AQR special mention	29	2	—	—
Real estate term non-owner occupied - AQR substandard	413	22	654	38
Real estate term other - AQR pass	462	28	604	32
Real estate term other - AQR substandard	119	—	652	34
Consumer secured by 1st deeds of trust - AQR pass	136	10	—	—
Consumer secured by 1st deeds of trust - AQR special mention	—	—	141	10
Consumer secured by 1st deeds of trust - AQR substandard	294	8	506	13
Consumer other - AQR substandard	—	—	17	1
Total Impaired Loans	$36,321	$630	$38,373	$844

Purchased Credit Impaired Loans: The Company acquired 18 purchased credit impaired loans in connection with its acquisition of Alaska Pacific Bancshares, Inc. on April 1, 2014 subject to the requirements of FASB ASC 310-30 Loans and Debt Securities

Acquired with Deteriorated Credit Quality. This group of loans consists primarily of commercial and commercial real estate loans, and unlike a pool of consumer mortgages, it is not practicable for the Company to analyze the accretable yield of these loans. As such, the Company has elected the cost recovery method of income recognition for these loans, and thus no accretable yield 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, 2018 was $792,000.

Troubled Debt Restructurings: Loans classified as troubled debt restructurings (“TDR”) totaled $17.9 million and $23.8 million at September 30, 2018 and December 31, 2017, 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, 2018 and restructured loans that occurred prior to 2018 that are still included in portfolio loans:

(In Thousands)	Accrual Status	Nonaccrual Status	Total Modifications
New Troubled Debt Restructurings			
Commercial - AQR substandard	$—	$1,738	$1,738
Real estate term owner occupied- AQR substandard	—	1,694	1,694
Subtotal	$—	$3,432	$3,432
Existing Troubled Debt Restructurings	$3,252	$11,178	$14,430
Total	$3,252	$14,610	$17,862

The following tables present newly restructured loans that occurred during the nine months ended September 30, 2018 and 2017, by concession (terms modified):

		September 30, 2018				
(In Thousands)	Number of Contracts	Rate Modification	Term Modification	Payment Modification	Combination Modification	Total Modifications
Pre-Modification Outstanding Recorded Investment:						
Commercial - AQR substandard	4	$—	$—	$2,704	$—	$2,704
Real estate term owner occupied- AQR substandard	2	—	—	1,694	—	1,694
Total	6	$—	$—	$4,398	$—	$4,398
Post-Modification Outstanding Recorded Investment:						
Commercial - AQR substandard	4	$—	$—	$1,738	$—	$1,738
Real estate term owner occupied- AQR substandard	2	—	—	1,694	—	1,694
Total	6	$—	$—	$3,432	$—	$3,432

		September 30, 2017				
(In Thousands)	Number of Contracts	Rate Modification	Term Modification	Payment Modification	Combination Modification	Total Modifications
Pre-Modification Outstanding Recorded Investment:						
Commercial - AQR special mention	1	$—	$2,078	$—	$—	$2,078
Commercial - AQR substandard	2	—	10,665	210	—	10,875
Total	3	$—	$12,743	$210	$—	$12,953
Post-Modification Outstanding Recorded Investment:						
Commercial - AQR special mention	1	$—	$2,078	$—	$—	$2,078
Commercial - AQR substandard	2	—	9,099	205	—	9,304
Total	3	$—	$11,177	$205	$—	$11,382

The Company had no commitments to extend additional credit to borrowers whose terms have been modified in TDRs. There were $965,000 of charge-offs in the nine months ended September 30, 2018 on loans that were newly classified as TDRs during the same period.

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 two TDRs with specific impairment at September 30, 2018 and December 31, 2017.

The Company had no TDRs that subsequently defaulted within the first twelve months of restructure, during the year ending December 31, 2017. The following table presents TDRs that occurred during the twelve-month period ending September 30, 2018 that subsequently defaulted during the nine months ended September 30, 2018:

(In Thousands)	Number of Contracts	September 30, 2018 Recorded Investment
Troubled Debt Restructurings that Subsequently Defaulted:		
Commercial - AQR substandard	2	$559
Real estate term owner occupied - AQR substandard	1	1,331
Total	3	$1,890

6. 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
2018										
Balance, beginning of period	$5,626	$596	$1,086	$2,170	$6,219	$1,001	$352	$396	$2,662	$20,108
Charge-Offs	—	—	—	—	—	—	—	(9)	—	(9)
Recoveries	57	—	—	—	—	1	1	2	—	61
Provision (benefit)	254	79	34	(43)	(11)	(291)	21	27	(70)	—
Balance, end of period	$5,937	$675	$1,120	$2,127	$6,208	$711	$374	$416	$2,592	$20,160
Balance, end of period: Individually evaluated for impairment	$323	$—	$—	$—	$—	$—	$49	$—	$—	$372
Balance, end of period: Collectively evaluated for impairment	$5,614	$675	$1,120	$2,127	$6,208	$711	$325	$416	$2,592	$19,788
2017										
Balance, beginning of period	$5,822	$521	$1,517	$2,354	$7,075	$774	$327	$362	$1,309	$20,061
Charge-Offs	(1,118)	—	—	—	—	—	(85)	—	—	(1,203)
Recoveries	102	—	—	—	—	—	—	4	—	106
Provision (benefit)	2,210	79	261	(10)	(60)	10	93	(2)	(81)	2,500
Balance, end of period	$7,016	$600	$1,778	$2,344	$7,015	$784	$335	$364	$1,228	$21,464
Balance, end of period: Individually evaluated for impairment	$1,514	$—	$—	$—	$—	$—	$—	$—	$—	$1,514
Balance, end of period: Collectively evaluated for impairment	$5,502	$600	$1,778	$2,344	$7,015	$784	$335	$364	$1,228	$19,950

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
2018										
Balance, beginning of period	$6,172	$629	$1,566	$2,194	$6,043	$725	$315	$307	$3,510	$21,461
Charge-Offs	(1,042)	—	—	—	—	—	(91)	(80)	—	(1,213)
Recoveries	200	—	—	—	—	3	2	7	—	212
Provision (benefit)	607	46	(446)	(67)	165	(17)	148	182	(918)	(300)
Balance, end of period	$5,937	$675	$1,120	$2,127	$6,208	$711	$374	$416	$2,592	$20,160
Balance, end of period: Individually evaluated for impairment	$323	$—	$—	$—	$—	$—	$49	$—	$—	$372
Balance, end of period: Collectively evaluated for impairment	$5,614	$675	$1,120	$2,127	$6,208	$711	$325	$416	$2,592	$19,788
2017										
Balance, beginning of period	$5,535	$550	$1,465	$2,358	$6,853	$819	$313	$408	$1,396	$19,697
Charge-Offs	(1,582)	—	—	—	—	(5)	(85)	(17)	—	(1,689)
Recoveries	246	—	—	—	—	—	2	8	—	256
Provision (benefit)	2,817	50	313	(14)	162	(30)	105	(35)	(168)	3,200
Balance, end of period	$7,016	$600	$1,778	$2,344	$7,015	$784	$335	$364	$1,228	$21,464
Balance, end of period: Individually evaluated for impairment	$1,514	$—	$—	$—	$—	$—	$—	$—	$—	$1,514
Balance, end of period: Collectively evaluated for impairment	$5,502	$600	$1,778	$2,344	$7,015	$784	$335	$364	$1,228	$19,950

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, 2018									
Balance, end of period	$333,132	$36,119	$61,857	$130,166	$340,820	$41,493	$20,202	$22,573	$986,362
Balance, end of period: Individually evaluated for impairment	$27,167	$—	$—	$5,789	$788	$1,081	$609	$—	$35,434
Balance, end of period: Collectively evaluated for impairment	$305,965	$36,119	$61,857	$124,377	$340,032	$40,412	$19,593	$22,573	$950,928
December 31, 2017									
Balance, end of period	$313,514	$31,201	$80,093	$132,042	$319,313	$40,411	$22,616	$19,919	$959,109
Balance, end of period: Individually evaluated for impairment	$26,812	$—	$—	$2,862	$874	$559	$860	$—	$31,967
Balance, end of period: Collectively evaluated for impairment	$286,702	$31,201	$80,093	$129,180	$318,439	$39,852	$21,756	$19,919	$927,142

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

(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	Unallocated	Total
September 30, 2018										
Individually evaluated for impairment:										
AQR Substandard	$323	$—	$—	$—	$—	$—	$49	$—	$—	$372
Collectively evaluated for impairment:										
AQR Pass	5,435	675	1,120	2,065	5,631	711	320	397	—	16,354
AQR Special Mention	179	—	—	62	577	—	5	—	—	823
AQR Substandard	—	—	—	—	—	—	—	19	—	19
Unallocated	—	—	—	—	—	—	—	—	2,592	2,592
	$5,937	$675	$1,120	$2,127	$6,208	$711	$374	$416	$2,592	$20,160
December 31, 2017										
Individually evaluated for impairment:										

AQR Substandard	$966	$—	$—	$—	$—	$—	$—	$—	$—	$966
Collectively evaluated for impairment:										
AQR Pass	5,079	629	1,566	2,154	5,680	725	315	305	—	16,453
AQR Special Mention	120	—	—	40	363	—	—	1	—	524
AQR Substandard	7	—	—	—	—	—	—	1	—	8
Unallocated	—	—	—	—	—	—	—	—	3,510	3,510
	$6,172	$629	$1,566	$2,194	$6,043	$725	$315	$307	$3,510	$21,461

7. 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, 2018, the Company has one class of purchased receivables. There were no purchased receivables past due at September 30, 2018 or December 31, 2017, and there were no restructured purchased receivables at September 30, 2018 or December 31, 2017.

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, 2018, 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, 2018	December 31, 2017
Purchased receivables	$12,902	$22,431
Reserve for purchased receivable losses	(196)	(200)
Total	$12,706	$22,231

The following table sets forth information regarding changes in the purchased receivable reserve for the three and nine-month periods ending September 30, 2018 and 2017, respectively:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2018	2017	2018	2017
Balance, beginning of period	$201	$194	$200	$171
Charge-offs	—	—	—	—
Recoveries	—	—	—	—
Charge-offs net of recoveries	—	—	—	—
(Benefit) reserve for purchased receivables	(5)	6	(4)	29
Balance, end of period	$196	$200	$196	$200

8. Mortgage Servicing Rights

The following table details the activity in the Company's mortgage servicing rights ("MSR") for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	2018	2017	2018	2017
Balance, beginning of period	$8,733	$5,828	$7,305	$4,157
Additions for new MSR capitalized	1,090	649	2,662	2,086
Changes in fair value:				
Due to changes in model inputs of assumptions (1)	125	(188)	490	332
Other (2)	(253)	(108)	(762)	(394)
Balance, end of period	$9,695	$6,181	$9,695	$6,181

(1) Principally reflects changes in discount rates and prepayment speed assumptions, which are primarily affected by changes in interest rates.
(2) Represents changes due to collection/realization of expected cash flows over time.

The following table details information related to our serviced mortgage loan portfolio as of September 30, 2018 and December 31, 2017:

(In Thousands)	September 30, 2018		December 31, 2017	
Balance of mortgage loans serviced for others	$516,008		$406,291	
MSR as a percentage of serviced loans	1.88	%	1.80	%

The Company recognized servicing fees of $1.6 million and $997,000 during the three-month periods ending September 30, 2018 and 2017, respectively, and $4.0 million and $3.0 million during the nine-month periods ending September 30, 2018 and 2017, respectively, which includes revenues recognized at origination of new MSR, late fees, and ancillary fees as a component of other noninterest income in the Company's Consolidated Statements of Income.

The following table outlines the key assumptions used in measuring the fair value of MSR as of September 30, 2018 and December 31, 2017:

	2018		2017	
Constant prepayment rate	8.28	%	9.00	%
Discount rate	9.89	%	9.45	%

Key economic assumptions and the sensitivity of the current fair value for MSR to immediate adverse changes in those assumptions at September 30, 2018 and December 31, 2017 were as follows:

(In Thousands)	September 30, 2018		December 31, 2017	
Aggregate portfolio principal balance	$516,008		$406,291	
Weighted average rate of note	3.86	%	3.77	%

September 30, 2018	Base		1.0% Adverse Rate Change		2.0% Adverse Rate Change	
Conditional prepayment rate	8.28	%	21.26	%	23.04	%
Discount rate	9.89	%	8.89	%	7.89	%
Fair value MSR	$9,695		$6,163		$5,896	
Percentage of MSR	1.88	%	1.19	%	1.14	%
December 31, 2017						
Conditional prepayment rate	9.00	%	23.33	%	25.25	%
Discount rate	9.45	%	8.45	%	7.45	%
Fair value MSR	$7,305		$4,343		$4,109	
Percentage of MSR	1.80	%	1.07	%	1.01	%

The above tables show the sensitivity to market rate changes for the par rate coupon for a conventional one-to-four family Alaska Housing Finance Corporation/FNMA/FHLMC serviced home loan. The above tables reference a 100 basis point and 200 basis point decrease in note rates.

These sensitivities are hypothetical and should be used with caution as the tables above demonstrate the Company's methodology for estimating the fair value of MSR is highly sensitive to changes in key assumptions. For example, actual prepayment experience may differ and any difference may have a material effect on MSR fair value. Changes in fair value resulting from changes in assumptions generally cannot be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear. Also, in these tables, the effects of a variation in a particular assumption on the fair value of the MSR is calculated without changing any other assumption; in reality, changes in one factor may be associated with changes in another (for example, decreases in market interest rates may provide an incentive to refinance; however, this may also indicate a slowing economy and an increase in the unemployment rate, which reduces the number of borrowers who qualify for refinancing), which may magnify or counteract the sensitivities. Thus, any measurement of MSR fair value is limited by the conditions existing and assumptions made at a particular point in time. Those assumptions may not be appropriate if they are applied to a different point in time.

9. Derivatives

Interest rates swaps related to community banking activities

The Company enters into commercial loan interest rate swap agreements with commercial banking customers which are offset with a corresponding swap agreement with a third party financial institution ("counterparty"). The Company has agreements with its counterparties that contain provisions that provide 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 agreements. These agreements also require 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 $300,000 in available for sale securities to collateralize fair value shortfalls on interest rate swap agreements as of both September 30, 2018 and December 31, 2017.

The Company had interest rate swaps related to commercial loans with an aggregate notional amount of $15.2 million and $12.5 million at September 30, 2018 and December 31, 2017, respectively. At September 30, 2018, the notional amount of interest rate swaps is made up of two variable to fixed rate swaps to a commercial loan customer totaling $7.6 million, and two fixed to variable rate swaps with a counterparty totaling $7.6 million. Changes in fair value from these four interest rate swaps offset each other in the first nine months of 2018. The Company recognized $70,000 in fee income related to interest rate swaps in the three and nine-month periods ending September 30, 2018 and recognized $10,000 and $26,000 in fee income in the three and nine-month periods ending September 30, 2017, respectively. Interest rate swap income is recorded in other income on the Consolidated Statements of Income. None of these interest rate swaps are designated as hedging instruments.

The Company entered into an interest rate swap in the third quarter of 2017 to hedge the variability in cash flows arising out of its junior subordinated debentures, which is floating rate debt, by swapping the cash flows with an interest rate swap which receives floating and pays fixed. The Company has designated this interest rate swap as a hedging instrument. The interest rate swap effectively fixes the Company's interest payments on the $10.0 million of junior subordinated debentures held under Northrim Statutory Trust 2 at 3.72% through its maturity date. The floating rate that the dealer pays is equal to the three month LIBOR plus 1.37% which reprices quarterly on the payment date. This rate was 3.70% as of September 30, 2018. The Company pledged $400,000 in cash to collateralize initial margin and fair value exposure of our counterparty on this interest rate swap as of September 30, 2018. Changes in the fair value of this interest rate swap are reported in other comprehensive income. The unrealized gain on this interest rate swap was $1.0 million as of September 30, 2018.

Interest rates swaps related to home mortgage banking activities

The Company also uses derivatives to hedge the risk of changes in the fair values of interest rate lock commitments. The Company enters into commitments to originate residential mortgage loans at specific rates; the value of these commitments are detailed in the table below as "interest rate lock commitments". The Company also hedges the interest rate risk associated with its residential mortgage loan commitments, which are referred to as "retail interest rate contracts" in the table below. 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 $69.0 million and $43.6 million at September 30, 2018 and December 31, 2017, respectively. Changes in the value of RML's interest rate derivatives are recorded in mortgage banking income on the Consolidated Statements of Income. None of these derivatives are designated as hedging instruments.

The following table presents the fair value of derivatives not designated as hedging instruments at September 30, 2018 and December 31, 2017:

(In Thousands)	Asset Derivatives		
		September 30, 2018	December 31, 2017
	Balance Sheet Location	Fair Value	Fair Value
Interest rate swaps	Other assets	$122	$77
Interest rate lock commitments	Other assets	1,117	873
Total		$1,239	$950

(In Thousands)	Liability Derivatives		
		September 30, 2018	December 31, 2017
	Balance Sheet Location	Fair Value	Fair Value
Interest rate swaps	Other liabilities	$122	$77
Total		$122	$77

The following table presents the net gains (losses) of derivatives not designated as hedging instruments for the three and nine-month periods ending September 30, 2018 and 2017:

		Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands)	Income Statement Location	2018	2017	2018	2017
Interest rate contracts	Mortgage banking income	$138	($370)	$511	($482)
Interest rate lock commitments	Mortgage banking income	(281)	193	203	364
Total					