NORTHRIM BANCORP INC
Form 10-K
March 13, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-K
(Mark One)
þ Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2014
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)
Securities registered pursuant to Section 12(b) of the Act: N/A
Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $1.00 par value	The NASDAQ Stock Market, LLC
(Title of Class)	(Name of Exchange on Which Listed)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ¨ Yes ý No
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ¨ Yes ý No
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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨ Yes ý 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 ¨ (Do not check if a smaller reporting company) Smaller Reporting Company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). ¨ Yes ý No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2014 (the last business day of the registrant's most recently completed second fiscal quarter) was $165,237,431.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date. 6,854,189 shares of Common Stock, $1.00 par value, as of March 12, 2015.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement on Schedule 14A, relating to the registrant's annual meeting of shareholders to be held on May 28, 2015, are incorporated by reference into Part III of this Form 10-K.

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PART I

Cautionary Note Regarding Forward Looking Statements

This Annual Report on Form 10-K includes “forward-looking statements”, within the meaning of the Private Securities Litigation Reform Act of 1995, as amended, which are not historical facts. These forward-looking statements describe management’s expectations about future events and developments such as future operating results, growth in loans and deposits, continued success of the Northrim BanCorp Inc.’s style of banking, and the strength of the local economy. All statements other than statements of historical fact, including statements regarding industry prospects and future results of operations or financial position, made in this report are forward-looking. We use words such as “anticipate,” “believe,” “expect,” “intend” and similar expressions in part to help identify forward-looking statements. Forward-looking statements reflect management’s current plans and expectations and are inherently uncertain. Our actual results may differ significantly from management’s expectations, and those variations may be both material and adverse. Forward-looking statements are subject to various risks and uncertainties that may cause our actual results to differ materially and adversely from our expectations as indicated in the forward-looking statements. These risks and uncertainties include: the general condition of, and changes in, the Alaska economy; factors that impact our net interest margin; and our ability to maintain asset quality our ability to implement our marketing and growth strategies; our expected cost savings, synergies, and other financial benefits from the merger of Northrim with Alaska Pacific might not be realized within the expected time frames and costs or difficulties relating to integration matters might be greater than expected; our expected cost savings, synergies and other financial benefits from the acquisition of Residential Mortgage Holding Company, LLC might not be realized within the expected time frames and costs or difficulties relating to integration matters might be greater than expected; and our ability to execute our business plan. Further, actual results may be affected by competition on price and other factors with other financial institutions; customer acceptance of new products and services; the regulatory environment in which we operate; and general trends in the local, regional and national banking industry and economy as those factors relate to our cost of funds and return on assets. In addition, there are risks inherent in the banking industry relating to collectability of loans and changes in interest rates. Many of these risks, as well as other risks that may have a material adverse impact on our operations and business, are identified Item 1A. Risk Factors, and in our filings with the Securities and Exchange Commission. However, you should be aware that these factors are not an exhaustive list, and you should not assume these are the only factors that may cause our actual results to differ from our expectations. In addition, you should note that we do not intend to update any of the forward-looking statements or the uncertainties that may adversely impact those statements, other than as required by law.

ITEM 1. BUSINESS

General

Northrim BanCorp, Inc. (the “Company”) is a publicly traded bank holding company headquartered in Anchorage, Alaska. The Company’s common stock trades on the Nasdaq Global Select Stock Market (“NASDAQ”) under the symbol, “NRIM.” The Company is regulated by the Board of Governors of the Federal Reserve System. We began banking operations in Anchorage in December 1990, and formed the Company as an Alaska corporation in connection with our reorganization into a holding company structure; that reorganization was completed effective December 31, 2001. The Company has grown to be the third largest commercial bank in Alaska and in Anchorage in terms of deposits, with $1.2 billion in total deposits and $1.4 billion in total assets at December 31, 2014. Through our fourteen branches, we are accessible to approximately 75% of the Alaska population.

The Company has four wholly-owned subsidiaries:

- Northrim Bank (the “Bank”), a state chartered, full-service commercial bank headquartered in Anchorage, Alaska. The Bank is regulated by the Federal Deposit Insurance Corporation and the State of Alaska Department of Commerce, Community and Economic Development, Division of Banking, Securities and Corporations. The Bank has fourteen branch locations in Alaska; seven in Anchorage, one in Wasilla, two in Juneau, one in Fairbanks, one in Ketchikan, one in Sitka, and one Eagle River. We also operate in Washington State through Northrim Funding Services (“NFS”), a factoring business that the Bank started in 2004. We offer a wide array of commercial and consumer loan and deposit products, investment products, and electronic banking services over the Internet;

- Northrim Investment Services Company ("NISC") was formed in November 2002 to hold the Company's equity interest in Elliott Cove Capital Management LLC, ("ECCM"), an investment advisory services company in which we hold a 43%. In the first quarter of 2006, through NISC, we purchased an interest in Pacific Wealth Advisors, LLC ("PWA"), an investment advisory, trust, and wealth management business located in Seattle, Washington, in which we hold a 23%;

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- Northrim Capital Trust I (“NCTI”), an entity that we formed in May of 2003 to facilitate a trust preferred securities offering by the Company;
- Northrim Statutory Trust 2 (“NST2”), an entity that we formed in December of 2005 to facilitate a trust preferred securities offering by the Company; and

The Bank has two wholly-owned subsidiaries:

- Northrim Capital Investments Co. (“NCIC”) is a wholly-owned subsidiary of the Bank, which holds a 100% interest in a residential mortgage holding company, Residential Mortgage Holding Company, LLC (“RML”). The predecessor of RML, Residential Mortgage, LLC, was formed in 1998 and has nine offices throughout Alaska. RML became a wholly-owned subsidiary of NCIC on December 1, 2014. Prior to that , the Company held a 23.5% interest in RML. RML also operates in real estate markets in the state of Washington through a joint venture. In March and December of 2005, NCIC purchased ownership interests totaling 50.1% in Northrim Benefits Group, LLC (“NBG”), an insurance brokerage company that focuses on the sale and servicing of employee benefit plans. In the fourth quarter of 2011, NCIC purchased an interest in Elliott Cove Insurance Agency LLC (“ECIA”); an insurance agency that offers annuity and other insurance products, which we now hold a 43% interest in; and
- Northrim Building, LLC (“NBL”) is a wholly-owned subsidiary of the Bank that owns and operates the Company’s main office facility at 3111 C Street in Anchorage.

Segments

The Company operates in two primary segments: Community Banking and Home Mortgage Lending. Prior to December 2014, the Company operated as a single segment. As of December 31, 2014, management determined, based on accounting principles generally accepted in the United States ("GAAP"), that the Company operates with two segments as a result of the acquisition of RML on December 1, 2014. Measures of the Company's revenues, profit or loss, and total assets are included in this report, Item 8. "Financial Statements and Supplementary Data", and incorporated herein by reference.

Business Strategy

The Company’s primary objective is to become Alaska's most trusted financial institution by adding value for our customers, communities, and shareholders. We aspire to be Alaska's premier bank and employer of choice as a leader in financial expertise, products, and services. We value our state, and we are proud to be Alaskan. We embody Alaska's frontier spirit and values, and we support our communities. We have a sincere appreciation for our customers, and we strive to deliver superior customer first service that is reliable, ethical, and secure. We look for growth opportunities for our customers, our institution and our employees.

Our strategy is one of value-added growth. Management believes that calculated, sustainable organic and inorganic market share growth coupled with good loan credit quality, an appropriate core deposit and capital base, operational efficiency, diversified sources of other operating income, and improved profitability is the most appropriate means of increasing shareholder value.

The Company executed on our strategy of inorganic growth in 2014 through our acquisition of Alaska Pacific Bancshares, Inc. ("Alaska Pacific Bank") on April 1, 2014 and our acquisition of the remaining 76.5% equity interest in RML on December 1, 2014. The acquisition of Alaska Pacific Bank benefits the Company's core business through increased loan and deposit balances, an increased customer base, and expansion into the Southeast region of Alaska. The acquisition of RML increases the Company's presence in the mortgage origination business in Alaska and Washington State and enhances our ability to provide financial services to our customers. Both of these transactions were accretive to the Company's earnings per share in 2014, and we expect that they will contribute to the Company's earnings in 2015 and into the future.

Our business strategy emphasizes commercial lending products and services through relationship banking with businesses and professional individuals. Additionally, we are a significant land development and residential construction lender and an active lender in the commercial real estate market in our Alaskan markets. Because of our relatively small size, our experienced senior management team can be more involved with serving customers and making credit decisions, allowing us to compete more favorably with larger competitors for lending relationships. We believe that there is opportunity to increase the Company’s loan portfolio, particularly in the commercial portion of the portfolio, in the Company’s current market areas through existing and new customers including in the Company's new market area in Southeast Alaska. Through our acquisition of Alaska Pacific Bank, the Company's market now includes Ketchikan, Sitka, and the state's capital city, Juneau. In addition to lending products, in many

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cases commercial customers also require multiple deposit and affiliate services that add franchise value to the Company. Additionally, management believes that our real estate construction and term real estate loan departments have developed a strong level of expertise and are well positioned to add quality loan volume in the current business environment. Lastly, we have dedicated additional resources to our small business lending operations and have targeted the acquisition of new customers in professional fields including physicians, dentists, accountants, and attorneys. While we expect that opportunities for growth will decrease should the recent decline in oil prices persist for an extended period of time, we believe that these strategies will continue to benefit the Company in the long term.

The Company benefits from solid capital and liquidity positions, and management believes that this provides a competitive advantage in the current business environment for growth opportunities. (See "Liquidity and Capital Resources" in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations".)

The Company's business strategy also stresses the importance of customer deposit relationships to support its lending activities. Our guiding principle is to serve our market areas by operating with a " Superior Customer First Service" philosophy, affording our customers the highest priority in all aspects of our operations. We believe that our successful execution of this philosophy has created a strong core deposit franchise that provides a stable, low cost funding source for expanded growth in all of our lending areas. We have devoted significant resources to future deposit product development, expansion of electronic services for both personal and business customers, and enhancement of information security related to these services.

In addition to market share growth, a significant aspect of the Company's business strategy is focused on managing the credit quality of our loan portfolio. Over the last several years, the Company has allocated substantial resources to the credit management function of the Bank to provide enhanced financial analysis of our largest, most complex loan relationships to further develop our processes for analyzing and managing various concentrations of credit within the overall loan portfolio and to develop strategies to improve or collect our existing loans. The acquisition of Alaska Pacific Bank increased our ratio of nonperforming assets to total assets, and the Company intends to improve our overall credit quality through integration of these acquired assets into our already established credit management and asset disposal processes. Continued success in maintaining or further improving the credit quality of our loan portfolio and decreasing our level of other real estate owned is a significant aspect of the Company's strategy for attaining sustainable, long-term market growth to affect increased shareholder value.

Employees

We believe that we provide a high level of customer service. To achieve our objective of providing "Superior Customer First Service", management emphasizes the hiring and retention of competent and highly motivated employees at all levels of the organization. Management believes that a well-trained and highly motivated core of employees allows maximum personal contact with customers in order to understand and fulfill customer needs and preferences. This "Superior Customer First Service" philosophy is combined with our emphasis on personalized, local decision making. In keeping with this philosophy and with our strategy to increase our market share, the Company hired three new loan officers in the last three years who have valuable expertise in our niche markets. Additionally, the Company plans to implement an enhanced company-wide employee training program in 2015.

We consider our relations with our employees to be satisfactory. We had 426 full-time equivalent employees at December 31, 2014. None of our employees are covered by a collective bargaining agreement. Of the 426 full-time equivalent employees, 309 were Community Banking employees and 117 were Home Mortgage Lending employees.

Products and Services

Community Banking

Lending Services: We have an emphasis on commercial and real estate lending. We also believe we have a significant niche in construction and land development lending in Anchorage, Fairbanks, the Matanuska-Susitna Valley, and Southeast Alaska. (See "Loans" in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations".)

Asset-based lending: We provide short-term working capital to customers primarily in our Alaska markets as well as Washington, Oregon and some other states by purchasing their accounts receivable through NFS. In 2015, we expect NFS to continue to penetrate these markets and to continue to contribute to the Company's net income.

Deposit Services: Our deposit services include noninterest-bearing checking accounts and interest-bearing time deposits, checking accounts, and savings accounts. Our interest-bearing accounts generally earn interest at rates established by management based on competitive market factors and management's desire to increase or decrease certain types or maturities of deposits. We have two deposit products that are indexed to specific U.S. Treasury rates. Several of our deposit services and products are:

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- An indexed money market deposit account;
- A “Jump-Up” certificate of deposit (“CD”) that allows additional deposits with the opportunity to increase the rate to the current market rate for a similar term CD;
- An indexed CD that allows additional deposits, quarterly withdrawals without penalty, and tailored maturity dates; and
- Arrangements to courier noncash deposits from our customers to their local Northrim Bank branch.

Other Services: In addition to our traditional deposit and lending services, we offer our customers several convenience services: Consumer Online Banking, Mobile App and Mobile Deposit, Mobile Web and Text Banking, Business Online Banking, FinanceWorks™ powered by Quicken®, Online Statements, Consumer Debit Cards, Business Debit Cards, Cash Back Rewards, personalized checks and instantly issued debit cards at account opening, telebanking, and automated teller services. Other special services include personalized checks at account opening, overdraft protection from a savings account, extended banking hours (Monday through Friday, 9 a.m. to 6 p.m. for the lobby, and 8 a.m. to 7 p.m. for the drive-up, and Saturday 10 a.m. to 3 p.m.), commercial drive-up banking with coin service, automatic transfers and payments, wire transfers, direct payroll deposit, electronic tax payments, Automated Clearing House origination and receipt, remote deposit capture, cash management programs to meet the specialized needs of business customers, and courier agents who pick up noncash deposits from business customers.

Other Services Provided through Affiliates: The Company sells and services employee benefit plans for small and medium sized businesses in Alaska through NBG, an insurance brokerage company. In the fourth quarter of 2013, we launched the Enroll Alaska initiative, a division of NBG, which is working to bring insurance coverage under the Affordable Health Care Act to uninsured Alaskans. The Company also offers annuity and other insurance products through ECIA, an insurance agency, and long term investment portfolios through ECCM, an investment advisory services company. As of March 11, 2015, there are six Northrim Bank employees who are licensed as Investment Advisor Representatives and are actively selling the Elliott Cove investment products. Finally, our affiliate PWA provides investment advisory, trust, and wealth management services for customers who are primarily located in the Pacific Northwest and Alaska. We plan to continue to leverage our affiliate relationships to strengthen our existing customer base and bring new customers into the Bank.

Significant Business Concentrations: No individual or single group of related accounts is considered material in relation to our total assets or total revenues, or to the total assets, deposits or revenues of the Bank, or in relation to our overall business. Based on classification by North American Industry Classification System, or "NAICS" codes, there are no segments that exceed 10% of portfolio loans, except for real estate (see Note 7, Loans, of the Notes to Consolidated Financial Statements included in Item 8 of this report for a breakout of real estate loans). In addition to its review of NAICS codes, the Company has also identified concentrations in two specialized industries. We estimate that approximately 8% of portfolio loans have direct exposure to the oil and gas industry in Alaska and approximately 8% of portfolio loans are attributable to a combination Alaska Native Regional and Village Corporations. Additionally, approximately 38% of our loan portfolio at December 31, 2014 is attributable to 25 large borrowing relationships. Moreover, our business activities are currently focused primarily in the state of Alaska. Consequently, our results of operations and financial condition are dependent upon the general trends in the Alaska economy and, in particular, the residential and commercial real estate markets in Anchorage, Juneau, Fairbanks, the Matanuska-Susitna Valley, Ketchikan, and Sitka.

Home Mortgage Lending

Lending Services: The Company originates 1-4 family residential mortgages throughout Alaska, and to a lesser extent in the state of Washington, which we sell to the secondary market. Residential mortgage choices include several products from the Alaska Housing Finance Corporation including first-time homebuyer, veteran's and rural community programs; Federal Housing Authority, or FHA loans; Veteran's Affairs, or VA loans; Jumbo loans; and various conventional mortgages.

Alaska Economy

Our growth and operations depend upon the economic conditions of Alaska and the specific markets we serve. Alaska is strategically located on the Pacific Rim, within nine hours by air from 95% of the industrialized world, and Anchorage has become a worldwide cargo and transportation link between the United States and international business in Asia and Europe. The economy of Alaska is dependent upon the natural resources industries. Key sectors of the Alaska economy are the oil industry, government and military spending, and the construction, fishing, forest products, tourism, mining, air cargo, and transportation industries, as well as medical services. The Company believes that the acquisition of Alaska Pacific Bank increases the Company's exposure in the tourism industry as Southeast Alaska is the primary destination for cruise ships that visit in Alaska. Based on information from Rain Coast Data, one million cruise ship tourists visited Southeast Alaska in 2013. We believe our increased exposure to this industry diversifies the Company's larger exposure to natural resource industries, specifically oil and gas, in Alaska.

The oil and gas industry plays a significant role in the economy of Alaska. According to the State of Alaska Department of Revenue, approximately 88% of the unrestricted revenues that fund the Alaska state government are generated through various taxes and royalties on the oil industry. Any significant changes in the Alaska economy and the markets we serve eventually could have a positive or negative impact on the Company. State revenues are sensitive to volatile oil prices and production levels have been in decline for over 20 years. If oil prices stabilize at their low levels, it will be a serious concern for both state revenues and for Alaska's long-term economic growth. However, Alaska's economy is less sensitive to price volatility in the short term than Alaska's state government budget. While state government revenue from oil royalties is immediately and directly impacted by a drop in oil prices, the large scale and nature of oil wells in Alaska are such that project commitments that currently exist will most likely not be disrupted by short term price volatility. Accordingly, subcontractors who provide oil field services and transportation for the large, multi-national companies that produce oil in Alaska will most likely not experience a significant slowdown in revenues in 2015 as a result of the decrease in prices. The State of Alaska is projecting a decrease in its operating and capital budgets due to declines in revenue caused by the dramatic decrease in oil prices in the last quarter of 2014 and in the first quarter of 2015. The State of Alaska has $66 billion in reserves, of which $14 billion can be used to finance short term funding gaps.

The long-run growth of the Alaska economy will most likely be determined by large scale natural resource development projects. Several multi-billion dollar projects are progressing or can potentially advance in the near term. Some of these projects include: a large diameter natural gas pipeline; related gas exploration at Point Thomson by ExxonMobil and partners that is currently underway; potential oil and gas activities in the Arctic National Wildlife Refuge; copper, gold and molybdenum production at the Donlin mine; and energy development in the National Petroleum Reserve Alaska and the Outer Continental Shelf in the Chukchi and Beaufort Seas. Because of their size, each of these projects faces tremendous challenges. Contentious political decisions need to be made by government regulators, issues need to be resolved in the court system, and multi-billion dollar financial commitments need to be made by the private sector if they are to advance. If none of these projects moves forward in the next ten years, then state revenues will probably continue to decline with falling oil production from older fields on the North Slope of Alaska. The decline in state revenues will likely have a negative effect on Alaska’s economy.

Tourism is another major employment sector of the Alaska economy. In the fall and winter period from October 1, 2013 to April 30, 2014, according to the State of Alaska’s Department of Commerce, revenue collected from bed taxes in Anchorage showed little change compared to the period from October 2013 through April 2013. Additionally, the Department of Commerce reported a 4% increase in people visiting the State of Alaska in the twelve month period ending April 30, 2014 as compared to the same period in 2013.

In the last several years, Alaska's economy has beenstronger relative to many other states in the nation, due largely to a natural resources based economy which has benefited from high commodity and energy prices. According to the Treasury Division of Alaska Department of Revenue, as of December 31, 2014, Alaska's Statutory Budget Reserve Fund and Constitutional Budget Reserve are $3.1 billion and $10.9 billion, respectively. As of December 31, 2014 the Alaska Permanent Fund had a balance of $52.3 billion. The fund pays an annual dividend to every Alaskan citizen. According to a January 23, 2015 press release from the Alaska Department of Labor and Workforce Development, the seasonally adjusted unemployment rates in the United States and Alaska were 5.6% and 6.3%, respectively, in December 2014. Prior to November 2014, the unemployment rate in Alaska had been lower than that of the United States as a whole since 2009. As general economic conditions in the United States have recovered over the past several years and oil prices have begun to decline, Alaska's unemployment rate now exceeds that of the United States as a whole. The Company does not anticipate that current, low oil prices will significantly impact employment in Alaska in 2015; however, if prices remain low for an extended period of time, we expect unemployment in Alaska to increase in 2016.

A material portion of our loans at December 31, 2014, were secured by real estate located in greater Anchorage, Matanuska-Susitna Valley, Fairbanks, and Southeast Alaska. 13% of our revenue was derived from the residential housing market in the form of loan fees and interest on residential construction and land development loans and income from RML. Real estate values generally

are affected by economic and other conditions in the area where the real estate is located, fluctuations in interest rates, changes in tax and other laws, and other matters outside of our control. A decline in real estate values in the greater Anchorage, Matanuska-Susitna Valley, Fairbanks, and Southeast Alaska areas could significantly reduce the value of the real estate collateral securing our real estate loans and could increase the likelihood of defaults under these loans.
At December 31, 2014, $306.5 million, or 33%, of our loan portfolio was represented by commercial loans in Alaska. Commercial loans generally have greater risk than real estate loans.
Alaska's residents are not subject to any state income or state sales taxes. For the past 30 years, Alaska residents have received annual distributions payable in October of each year from the Alaska Permanent Fund Corporation, which is supported by royalties from oil production. The distribution was $1,884 per eligible resident in 2014 for an aggregate distribution of approximately $1.2 billion. The Anchorage Economic Development Corporation estimates that, for most Anchorage households, distributions from the Alaska Permanent Fund exceed other Alaska taxes to which those households are subject (primarily real estate taxes).

Competition

We operate in a highly competitive and concentrated banking environment. We compete not only with other commercial banks, but also with many other financial competitors, including credit unions (including Alaska USA Federal Credit Union, one of the nation's largest credit unions), finance companies, mortgage banks and brokers, securities firms, insurance companies, private lenders, and other financial intermediaries, many of which have a state-wide or regional presence, and in some cases, a national presence. Many of our competitors have substantially greater resources and capital than we do and offer products and services that are not offered by us. Our non-bank competitors also generally operate under fewer regulatory constraints, and in the case of credit unions, are not subject to income taxes. We estimate that credit unions in Alaska have a 40% share of total deposits held in banks and credit unions in these markets as of June 30, 2014. Changes in credit union regulations have eliminated the "common bond" of membership requirement and liberalized their lending authority to include business and real estate loans on par with commercial banks. The differences in resources and regulation may make it harder for us to compete profitably, to reduce the rates that we can earn on loans and investments, to increase the rates we must offer on deposits and other funds, and adversely affect our financial condition and earnings.
As our industry becomes increasingly dependent on and oriented toward technology-driven delivery systems, permitting transactions to be conducted by telephone, computer and the Internet, non-bank institutions are able to attract funds and provide lending and other financial services even without offices located in our primary service area. Some insurance companies and brokerage firms compete for deposits by offering rates that are higher than may be appropriate for the Company in relation to its asset and liability management objectives. However, we offer a wide array of deposit products and services and believe we can compete effectively through relationship based pricing and effective delivery of "Superior Customer First Service". We also compete with full service investment firms for non-bank financial products and services offered by ECCM, ECIA and PWA.
In the late 1980s, eight of the thirteen commercial banks and savings and loan associations in Alaska failed, resulting in the largest commercial banks gaining significant market share. Currently, there are seven commercial banks operating in Alaska. At June 30, 2014, the date of the most recently available information, Northrim Bank had approximately a 11% share of the Alaska commercial bank deposits, 16% in the Anchorage area, 15% in Juneau, 15% in Sitka, 6% in Fairbanks, and 4% in Ketchikan.
The following table sets forth market share data for the commercial banks having a presence in the greater Anchorage area as of June 30, 2014, the most recent date for which comparative deposit information is available.

Financial institution	Number of branches	Total deposits (in thousands)	Market share of deposits	
Northrim Bank	8	$851,320	16	%
Wells Fargo Bank Alaska	13	2,723,234	51	%
First National Bank Alaska	10	1,152,129	21	%
Key Bank	4	669,410	12	%
Total	35	$5,396,093	100	%

Supervision and Regulation

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956 (the “BHC Act”) registered with and subject to examination by the Board of Governors of the Federal Reserve System (the “FRB”). The Company’s bank subsidiary is an Alaska-state chartered commercial bank and is subject to examination, supervision, and regulation by the Alaska Department of Commerce, Community and Economic Development, Division of Banking, Securities and Corporations (the “Division”). The FDIC insures Northrim Bank’s deposits and also examines, supervises, and regulates Northrim Bank. The Company’s affiliated investment companies, ECCM and ECIA, and its affiliated investment advisory and wealth management company, Pacific Portfolio Consulting LLC, are subject to and regulated under the Investment Advisors Act of 1940 and applicable state investment advisor rules and regulations. The Company’s affiliated trust company, Pacific Portfolio Trust Company, is regulated as a non-depository trust company under the trust company laws of the State of Washington.

The Company’s earnings and activities are affected, among other things, by legislation, by actions of the FRB, the Division, the FDIC and other regulators, by local legislative and administrative bodies, and decisions of courts. These include limitations on the ability of Northrim Bank to pay dividends to the Company, numerous federal and state consumer protection laws imposing requirements on the making, enforcement, and collection of consumer loans, and restrictions on and regulation of the sale of mutual funds and other uninsured investment products to customers.

As a result of the recent financial crisis, regulation of banks and the financial services industry has been undergoing major changes. Among these is the enactment in 2010 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). The Dodd-Frank Act significantly modifies and expands legal and regulatory requirements imposed on banks and other financial institutions. Some of these changes were effective immediately but others are being phased in over time. The Dodd-Frank Act requires various regulators, including the FRB and the FDIC, to adopt numerous regulations, not all of which have been finalized. Accordingly, not all of the requirements of the Dodd-Frank Act are yet known.

The Dodd-Frank Act significantly impacts Northrim Bank and its business and operations. The federal prohibition on paying interest on demand accounts (such as checking accounts) for businesses was eliminated, which could adversely impact Northrim Bank’s interest expense. The Dodd-Frank Act permanently increased the maximum amount of deposit insurance coverage to $250,000 per depositor and deposit insurance assessments paid by Northrim Bank are now based on Northrim Bank’s total assets. Other Dodd-Frank Act changes include: (i) tightened capital requirements for Northrim Bank and the Company; (ii) new requirements on parties engaged in residential mortgage origination, brokerage, lending and securitization; (iii) expanded restrictions on affiliate and insider transactions; (iv) enhanced restrictions on management compensation and related governance procedures; (v) creation of a federal Consumer Financial Protection Bureau with broad authority to regulate consumer financial products and services; and (vi) restrictions and prohibitions on the ability of banking entities to engage in proprietary trading and to invest in or have certain relationships with hedge funds and private equity funds.

It is difficult to predict at this time what specific impacts the Dodd-Frank Act and the implementing regulations will have on Northrim Bank and the Company. At a minimum, it is expected that they will increase our operating and compliance costs and could materially and negatively affect the profitability of our business.

The Gramm-Leach-Bliley Act (the “GLB Act”), which was enacted in 1999, allows bank holding companies to elect to become financial holding companies, subject to certain regulatory requirements. In addition to the activities previously permitted bank holding companies, financial holding companies may engage in non-banking activities that are financial in nature, such as securities, insurance, and merchant banking activities, subject to certain limitations. The Company could utilize this structure to accommodate an expansion of its products and services in the future.

Bank holding companies, such as the Company, are subject to a variety of restrictions on the activities in which they can engage and the acquisitions they can make. The activities or acquisitions of bank holding companies, such as the Company, that are not financial holding companies, are limited to those which constitute banking, managing or controlling banks or which are closely related activities. A bank holding company is required to obtain the prior approval of the FRB for the acquisition of more than 5% of the outstanding shares of any class of voting securities or substantially all of the assets of any bank or bank holding company. Nonbank acquisitions and activities of a bank holding company are also generally limited to the acquisition of up to 5% of the outstanding shares of any class of voting securities of a company and activities previously determined by the FRB by regulation or order to be closely related to banking, unless prior approval is obtained from the FRB.

The GLB Act also included extensive consumer privacy provisions. These provisions, among other things, require full disclosure of the Company's privacy policy to consumers and mandate offering the consumer the ability to "opt out" of having non-public personal information disclosed to third parties. Pursuant to these provisions, the federal banking regulators adopted privacy regulations. As a result of the Dodd-Frank Act, the rule-making authority for the privacy provisions of the GLB Act has been transferred to the CFPB. In addition, the states are permitted to adopt more extensive privacy protections through legislation or regulation.

There are various legal restrictions on the extent to which a bank holding company and certain of its nonbank subsidiaries can borrow or otherwise obtain credit from their banking subsidiaries or engage in certain other transactions with or involving those banking subsidiaries. With certain exceptions, federal law imposes limitations on, and requires collateral for, extensions of credit by insured depository institutions, such as Northrim Bank, to their non-bank affiliates, such as the Company. In addition, new capital rules may affect the Company's ability to pay dividends.

Subject to certain limitations and restrictions, a bank holding company, with prior approval of the FRB, may acquire an out-of-state bank. Banks in states that do not prohibit out-of-state mergers may merge with the approval of the appropriate federal banking agency. A state bank may establish a de novo branch out of state if such branching is permitted by the other state for state banks chartered by such other state.

Among other things, applicable federal and state statutes and regulations which govern a bank’s activities relate to minimum capital requirements, required reserves against deposits, investments, loans, legal lending limits, mergers and consolidations, borrowings, issuance of securities, payment of dividends, establishment of branches and other aspects of its operations. The Division and the FDIC also have authority to prohibit banks under their supervision from engaging in what they consider to be unsafe or unsound practices.

There also are certain limitations on the ability of the Company to pay dividends to its shareholders. It is the policy of the FRB that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization’s expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines a bank holding company’s ability to serve as a source of strength to its banking subsidiaries.

Various federal and state statutory provisions also limit the amount of dividends that subsidiary banks can pay to their holding companies without regulatory approval. The FDIC or the Division could take the position that paying a dividend would constitute an unsafe or unsound banking practice. In addition, new capital rules may affect the Bank's ability to pay dividends.

Under longstanding FRB policy and under the Dodd-Frank Act, a bank holding company is required to act as a source of financial strength for its subsidiary banks. The Company could be required to commit resources to its subsidiary banks in circumstances where it might not do so, absent such requirement.

Both the Company and the Bank are required to maintain minimum levels of regulatory capital. Federal banking regulations have generally recognized two types, or tiers, of capital: “core capital,” or Tier 1 capital, and “supplementary capital,” or Tier 2 capital. Tier 1 capital generally includes common shareholders' equity and noncumulative perpetual preferred stock, less most intangible assets. Tier 2 capital, which is recognized up to 100% of Tier 1 capital for risk-based capital purposes (after any deductions for disallowed intangibles and disallowed deferred tax assets), includes such items as qualifying general loan loss reserves (up to 1.25% of risk-weighted assets), cumulative perpetual preferred stock, long-term preferred stock (original maturity of at least 20 years), certain perpetual preferred stock, hybrid capital instruments including mandatory convertible debt, term subordinated debt, intermediate-term preferred stock (original average maturity of at least five years) and net unrealized holding gains on equity securities (subject to certain limitations); provided, however, the amount of term subordinated debt and intermediate term preferred stock that may be included in Tier 2 capital for risk-based capital purposes is limited to 50.0% of Tier 1 capital. “Total capital” generally means the sum of Tier 1 capital and Tier 2 capital.

Prior to 2015, the federal banking regulators have measured capital using the (1) total risk-based capital ratio, (2) Tier 1 risk-based capital ratio and (3) Tier 1 capital leverage ratio. The risk-based measures are based on ratios of qualifying capital to risk-weighted assets. To determine risk-weighted assets, assets are placed in one of five categories and given a percentage weight based on the relative risk of that category. In addition, certain off-balance-sheet items are converted to balance sheet credit equivalent amounts, and each amount is then assigned to one of the five categories. In evaluating the adequacy of a bank's capital, the regulators may also consider other factors that may affect an institution’s financial condition, such as interest rate risk exposure, liquidity, funding and market risks, the quality and level of earnings, concentration of credit risk, risks arising from nontraditional activities, loan and investment quality, the effectiveness of loan and investment policies, and management's ability to monitor and control financial operating risks. Under these capital rules, banks and their holding companies have been required to have a total risk-based capital ratio of at least 8.0%, a Tier 1 risk-based capital ratio of at least 4.0% and Tier 1 capital leverage ratio generally of at least 4.0%.

In July 2013, federal banking regulators (including the FDIC and the FRB) adopted new capital rules (the “Rules”). The Rules apply to both depository institutions (such as the Bank) and their holding companies (such as the Company). The Rules reflect, in part, certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as “Basel III”) as well as requirements contemplated by the Dodd-Frank Act.

Under the Rules, beginning in 2015, both the Company and the Bank will be required to meet more stringent minimum capital requirements. The Rules implement a new capital ratio of common equity Tier 1 capital to risk-based assets. Common equity Tier 1 capital generally consists of retained earnings and common stock instruments (subject to certain adjustments), as well as accumulated other comprehensive income (“AOCI”) except to the extent that the Company and the Bank exercise a one-time irrevocable option to exclude certain components of AOCI. The Company and the Bank are each required to have a common equity Tier 1 capital ratio of 4.5% as well as a Tier 1 leverage ratio of 4.0%, a Tier 1 risk-based ratio of 6.0% and a total risk-based ratio of 8.0%. In addition to the preceding requirements, both the Company and the Bank are required to establish a “conservation buffer,” consisting of common equity Tier 1 capital, which is at least 2.5% above each of the preceding common equity Tier 1 capital ratio, the Tier 1 risk-based ratio and the total risk-based ratio. An institution that does not meet the conservation buffer will be subject to restrictions on certain activities including payment of dividends, stock repurchases and discretionary bonuses to executive officers.

The Rules modify the manner in which certain capital elements are determined, including but not limited to, requiring certain deductions related to mortgage servicing rights and deferred tax assets. When the federal banking regulators initially proposed new capital rules in 2012, the rules would have phased out trust preferred securities as a component of Tier 1 capital. As finally adopted, however, the Rules permit holding companies with less than $15 billion in total assets as of December 31, 2009 (which includes the Company) to continue to include trust preferred securities issued prior to May 19, 2010 in Tier 1 capital, generally up to 25% of other Tier 1 capital.

The Rules make changes in the methods of calculating certain risk-based assets, which in turn affects the calculation of risk- based ratios. Higher or more sensitive risk weights are assigned to various categories of assets, among which are commercial real estate, credit facilities that finance the acquisition, development or construction of real property, certain exposures or credits that are 90 days past due or are nonaccrual, foreign exposures, certain corporate exposures, securitization exposures, equity exposures and in certain cases mortgage servicing rights and deferred tax assets.

Both the Company and the Bank are generally required to begin compliance with the Rules on January 1, 2015. The conservation buffer will be phased in beginning in 2016 and will take full effect on January 1, 2019. Certain calculations under the Rules will also have phase-in periods. We believe that the current capital levels of the Company and the Bank are in compliance with the standards under the Rules including the conservation buffer.

In addition to the minimum capital standards, the federal banking agencies have issued regulations to implement a system of "prompt corrective action." These regulations apply to the Bank but not the Company. The regulations establish five capital categories. Prior to 2015, a bank was:

“well capitalized” if it had a total risk-based capital ratio of 10.0% or more, a Tier 1 risk-based capital ratio of 6.0% or more, and a leverage capital ratio of 5.0% or more, and was not subject to any written agreement, order or capital directive to meet and maintain a specific capital level for any capital measure;

“adequately capitalized” if it had a total risk-based capital ratio of 8.0% or more, a Tier 1 risk-based capital ratio of 4.0% or more, and a leverage capital ratio of 4.0% or more;

“undercapitalized” if it had a total risk-based capital ratio less than 8.0%, a Tier 1 risk-based capital ratio less than 4.0%, or a leverage capital ratio less than 4.0%;

“significantly undercapitalized” if it had a total risk-based capital ratio less than 6.0%, a Tier 1 risk-based capital ratio less than 3.0%, or a leverage capital ratio less than 3.0%; and "critically undercapitalized" if it had a ratio of tangible equity to total assets equal to or less than 2.0%.

The Rules adopted by the banking regulators in July 2013 modified the prompt corrective action regulations by increasing some of the requirements for the capital categories and by adding a requirement for the common equity Tier 1 risk-based capital ratio. Accordingly, beginning in 2015, a bank is:

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“well capitalized” if it has a total risk-based capital ratio of 10.0% or more, a Tier 1 risk-based capital ratio of 8.0% or more, a common equity Tier 1 risk-based ratio of 6.5% or more, and a leverage capital ratio of 5.0% or more, and is not subject to any written agreement, order or capital directive to meet and maintain a specific capital level for any capital measure;

“adequately capitalized” if it has a total risk-based capital ratio of 8.0% or more, a Tier 1 risk-based capital ratio of 6.0% or more, a common equity Tier 1 risk-based ratio of 4.5% or more, and a leverage capital ratio of 4.0% or more;

“undercapitalized” if it has a total risk-based capital ratio less than 8.0%, a Tier 1 risk-based capital ratio less than 6.0%, a common equity risk-based ratio less than 4.5% or a leverage capital ratio less than 4.0%;

“significantly undercapitalized” if it has a total risk-based capital ratio less than 6.0%, a Tier 1 risk-based capital ratio less than 4.0%, a common equity risk-based ratio less than 3.0% or a leverage capital ratio less than 3.0%; and

“critically undercapitalized” if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%.

A bank that, based upon its capital levels, is classified as “well capitalized,” “adequately capitalized” or “undercapitalized” may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for a hearing, determines that an unsafe or unsound condition, or an unsafe or unsound practice, warrants such treatment.

Additionally, a bank that, based upon its capital levels, is classified as “well capitalized,” “adequately capitalized” or “undercapitalized” may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for a hearing, determines that an unsafe or unsound condition, or an unsafe or unsound practice, warrants such treatment.

At each successive lower capital category, a bank is subject to increasing supervisory restrictions. For example, being “adequately capitalized” rather than “well-capitalized” affects a bank’s ability to accept brokered deposits without the prior approval of the FDIC, and may cause greater difficulty obtaining retail deposits. Banks in the “adequately capitalized” classification may have to pay higher interest rates to continue to attract those deposits, and higher deposit insurance rates for those deposits. This status also affects a bank’s eligibility for a streamlined review process for acquisition proposals.

Management intends to maintain capital ratios for Northrim Bank in 2015 that exceed the FDIC’s new requirements for the “well-capitalized” capital requirement classification under the Basel Committee on Banking Supervision rules which take effect for the Company on January 1, 2015. The dividends that the Bank pays to the Company will be limited to the extent necessary for the Bank to meet the regulatory requirements of a “well-capitalized” bank.

The capital ratios for the Company exceed those for Northrim Bank primarily because the $18 million trust preferred securities offerings that the Company completed in the second quarter of 2003 and in the fourth quarter of 2005 are included in the Company’s capital for regulatory purposes, although they are accounted for as a liability in its consolidated financial statements. The trust preferred securities are not accounted for on Northrim Bank’s financial statements nor are they included in its capital (although the Company did contribute to Northrim Bank a portion of the cash proceeds from the sale of those securities). As a result, the Company has $18 million more in regulatory capital than Northrim Bank at December 31, 2014 and 2013, which explains most of the difference in the capital ratios for the two entities.

Northrim Bank is required to file periodic reports with the FDIC and the Division and is subject to periodic examinations and evaluations by those regulatory authorities. These examinations must be conducted every 12 months, except that certain “well-capitalized” banks may be examined every 18 months. The FDIC and the Division may each accept the results of an examination by the other in lieu of conducting an independent examination.

In the liquidation or other resolution of a failed insured depository institution, claims for administrative expenses (including certain employee compensation claims) and deposits are afforded a priority over other general unsecured claims, including non-deposit claims, and claims of a parent company such as the Company. Such priority creditors would include the FDIC, which succeeds to the position of insured depositors to the extent it has made payments to such depositors.

The Company is also subject to the information, proxy solicitation, insider trading restrictions and other requirements of the Securities Exchange Act of 1934, as amended (the “Securities Exchange Act of 1934”), including certain requirements under the Sarbanes-Oxley Act of 2002.

Northrim Bank is subject to the Community Reinvestment Act of 1977 (“CRA”). The CRA requires that Northrim Bank help meet the credit needs of the communities it serves, including low and moderate income neighborhoods, consistent with the safe and sound operation of the institution. The FDIC assigns one of four possible ratings to Northrim Bank’s CRA performance and makes the rating and the examination reports publicly available. The four possible ratings are outstanding, satisfactory, needs to improve and substantial noncompliance. A financial institution’s CRA rating can affect an institution’s future business. For example, a federal banking agency will take CRA performance into consideration when acting on an institution’s application to establish or move a branch, to merge or to acquire assets or assume liabilities of another institution. In its most recent CRA examination, Northrim Bank received a “Satisfactory” rating from the FDIC.

The Company is also subject to the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the “USA PATRIOT Act”). Among other things, the USA Patriot Act requires the Company and Northrim Bank to adopt and implement specific policies and procedures designed to prevent and defeat money laundering. Management believes the Company is in compliance with the USA Patriot Act as in effect on December 31, 2014.

Available Information

The Company’s annual report on Form 10-K and quarterly reports on Form 10-Q, as well as its Form 8-K filings (and all amendments thereto), which are filed with the Securities and Exchange Commission (“SEC”), are accessible free of charge at our website at http://www.northrim.com as soon as reasonably practicable after filing with the SEC. By making this reference to our website, the Company does not intend to incorporate into this report any information contained in the website. The website should not be considered part of this report.

The public may read and copy any materials we file with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may also obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains a website at http://www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers, including the Company, that file electronically with the SEC.

ITEM 1A. RISK FACTORS

An investment in the Company’s common stock is subject to risks inherent to the Company’s business. The material risks and uncertainties that management believes affect the Company are described below. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included or incorporated by reference in this report. The risks and uncertainties described below are not the only ones facing the Company. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair the Company’s business operations. This report is qualified in its entirety by these risk factors.

If any of the following risks actually occur, the Company’s financial condition and results of operations could be materially and adversely affected. If this were to happen, the value of the Company’s common stock could decline significantly, and you could lose all or part of your investment.

We operate in a highly regulated environment and changes of or increases in banking or other laws and regulations or governmental fiscal or monetary policies could adversely affect us.

We are subject to extensive regulation, supervision and examination by federal and state banking authorities. In addition, as a publicly-traded company, we are subject to regulation by the Securities and Exchange Commission. Any change in applicable regulations or federal or state legislation or in policies or interpretations or regulatory approaches to compliance and enforcement, income tax laws and accounting principles could have a substantial impact on us and our operations. Changes in laws and regulations may also increase our expenses by imposing additional fees or taxes or restrictions on our operations. Additional legislation and regulations that could significantly affect our authority and operations may be enacted or adopted in the future, which could have a material adverse effect on our financial condition and results of operations. Failure to appropriately comply with any such laws, regulations or principles could result in sanctions by regulatory agencies, or damage to our reputation, all of which could adversely affect our business, financial condition or results of operations.

In that regard, the Dodd-Frank Act was enacted in July 2010. Among other provisions, the new legislation created a new Consumer Financial Protection Bureau with broad powers to regulate consumer financial products such as credit cards and mortgages, creates a Financial Stability Oversight Council comprised of the heads of other regulatory agencies, will lead to new capital requirements from federal banking agencies, places new limits on electronic debt card interchange fees, and requires the SEC and national stock exchanges to adopt significant new corporate governance and executive compensation reforms. The new legislation and regulations are expected to increase the overall costs of regulatory compliance and limit certain sources of revenue.

Certain provisions of the new rules will have phase-in periods, including a 2.5% conservation buffer, which will be phased in beginning in 2016 and will take full effect on January 1, 2019. Further, regulators have significant discretion and authority to prevent or remedy practices that they deem to be unsafe or unsound, or violations of laws or regulations by financial institutions and holding companies in the performance of their supervisory and enforcement duties. These powers have been utilized more frequently in recent years due to the serious national economic conditions that faced the financial system in late 2008 and early 2009. The exercise of regulatory authority may have a negative impact on our financial condition and results of operations. Additionally, our business is affected significantly by the fiscal and monetary policies of the U.S. federal government and its agencies, including the FRB. We cannot accurately predict the full effects of recent legislation or the various other governmental, regulatory, monetary, and fiscal initiatives which have been and may be enacted on the financial markets and on the Company. The terms and costs of these activities could materially and adversely affect our business, financial condition, results of operations, and the trading price of our common stock.

We may be subject to more stringent capital and liquidity requirements which would adversely affect our net income and future growth.

In July 2013, the FRB and the FDIC announced the new capital rules, which would apply to both depository institutions and (subject to certain exceptions not applicable to the Company) their holding companies. As described in further detail above in “Item 1 Business - Supervision and Regulation” the new rules create new and increased capital requirements for United States depository institutions and their holding companies. The new rules include risk-based and leverage capital ratio requirements, which became effective on January 1, 2015. The new rules also revise the prompt corrective action framework, which is designed to place restrictions on insured depository institutions, including the Bank, if their capital levels do not meet certain thresholds. These revisions also became effective January 1, 2015.

Although we currently cannot predict the specific impact and long-term effects that the new rules will have on us and the banking industry more generally, higher regulatory capital levels could impact our operations, net income and ability to grow. Furthermore, our failure to comply with the minimum capital requirements could result in our regulators taking formal or informal actions against us which could restrict our future growth or operations.

Current economic conditions continue to pose significant challenges for us and could adversely affect our financial condition and results of operations.

We are operating in an uncertain economic environment, including sluggish national and global conditions, accompanied by very low interest rates. Financial institutions continue to be affected by changing conditions in the real estate and financial markets, along with an arduous regulatory climate. Dramatic declines in the housing market in recent years, with falling home prices and increasing foreclosures and unemployment, resulted in significant write-downs of asset values by financial institutions. While conditions have improved, a return to a recessionary economy could result in financial stress on our borrowers that would adversely affect our financial condition and results of operations. Deteriorating conditions in the regional economies of Anchorage, Matanuska-Susitna Valley, Fairbanks, and the Southeast areas of Alaska served by the Company could drive losses beyond that which is provided for in our allowance for loan losses. We may also face the following risks in connection with events:

- Ineffective monetary policy could cause rapid changes in interest rates and asset values that would have a materially adverse impact on our profitability and overall financial condition.
- Market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, resulting in increased delinquencies and default rates on loans and other credit facilities.
- Regulatory scrutiny of the industry could increase, leading to harsh regulation of our industry that could lead to a higher cost of compliance, limit our ability to pursue business opportunities and increase our exposure to the judicial system and the plaintiff’s bar.

Further erosion in the fiscal condition of the U.S. Treasury could lead to new taxes that would limit the ability of the Company to pursue growth and return profits to shareholders.

If these conditions or similar ones continue to exist or worsen, we could experience continuing or increased adverse effects on our financial condition.

The operations of our business, including our interaction with customers, are increasingly done via electronic means, and this has increased our risks related to cybersecurity.

The Company is exposed to cyber-attacks in the normal course of business. In general, cyber incidents can result from deliberate attacks or unintentional events. We have observed an increased level of attention focused on cyber-attacks that include, but are not limited to, gaining unauthorized access to digital systems for purposes of misappropriating assets or sensitive information, corrupting data, or causing operational disruption. Cyber-attacks may also be carried out in a manner that does not require gaining unauthorized access, such as by causing denial-of-service attacks on websites. Cyber-attacks may be carried out by third parties or insiders using techniques that range from highly sophisticated efforts to electronically circumvent network security or overwhelm websites to more traditional intelligence gathering and social engineering aimed at obtaining information necessary to gain access. The objectives of cyber-attacks vary widely and may include theft of financial assets, intellectual property, or other sensitive information belonging to the Company or our customers. Cyber-attacks may also be directed at disrupting the operations of the Company’s business.

While the Company has not incurred any material losses related to cyber-attacks, nor are we aware of any specific or threatened cyber-incidents as of the date of this report, we may incur substantial costs and suffer other negative consequences if we fall victim to successful cyber-attacks. Such negative consequences could include remediation costs that may include liability for stolen assets or information and repairing system damage that may have been caused; increased cybersecurity protection costs that may include organizational changes, deploying additional personnel and protection technologies, training employees, and engaging third party experts and consultants; lost revenues resulting from unauthorized use of proprietary information or the failure to retain or attract customers following an attack; litigation; and reputational damage adversely affecting customer or investor confidence.

Integrating Alaska Pacific’s and RML’s operations into the Company’s operations may be more difficult, costly, or time consuming than expected.

Until the completion of the merger with Alaska Pacific in April 2014 and Company’s acquisition of the remaining equity interests in RML in December 2014, each of the Company, Alaska Pacific and RML operated independently of each other. Although RML’s operations will be conducted under a separate wholly-owned subsidiary of the Company and the Company has taken steps to ensure that Alaska Pacific’s employees, operating systems and other assets have been integrated into the Company, the integration process in connection with both acquisitions is ongoing and it is possible that the integration process could result in the loss of key employees, the disruption of the Company’s ongoing business or inconsistencies in standards, controls, procedures and policies that adversely affect the Company’s ability to maintain relationships with clients, customers, depositors and employees. Further, successful integration of the two acquired entities' operations and personnel may place an additional burden on our management and internal resources. This additional burden could lead to a significant diversion of management attention and resources, which could lead to a decrease in our future operating results and thereby impact our share price.

Declines in the residential housing market would have a negative impact on our residential housing market income.

The Company earns revenue from the residential housing market in the form of interest income and fees on loans and earnings from RML. A slowdown in the residential sales cycle in our major markets and a constriction in the availability of mortgage financing negatively impacts real estate sales, which results in customers’ inability to repay loans. We expect earnings from RML to decrease if refinancing activity slows, and because of our acquisition of all of the remaining equity interest in RML in late 2014, our exposure to the slowdown in refinancing activity or the residential housing market in general is greater than it was before such acquisition. Further, declines in the residential housing market may have a material adverse effect on our financial condition through a decline in interest income and loan fees.

Our loan loss allowance may not be adequate to cover future loan losses, which may adversely affect our earnings.

We have established a reserve for probable losses we expect to incur in connection with loans in our credit portfolio. This allowance reflects our estimate of the collectability of certain identified loans, as well as an overall risk assessment of total loans outstanding. Our determination of the amount of loan loss allowance is highly subjective; although management personnel apply criteria such as risk ratings and historical loss rates, these factors may not be adequate predictors of future loan performance. Accordingly, we cannot offer assurances that these estimates ultimately will prove correct or that the loan loss allowance will be sufficient to protect against losses that ultimately may occur. If our loan loss allowance proves to be inadequate, we may suffer unexpected charges to income, which would adversely impact our results of operations and financial condition. Moreover, bank regulators frequently monitor banks' loan loss allowances, and if regulators were to determine that the allowance is inadequate, they may require us to increase the allowance, which also would adversely impact our net income and financial condition.

We have a significant concentration in real estate lending. A downturn in real estate within our markets has a negative impact on our results of operations.

Approximately 74% of the Bank’s loan portfolio at December 31, 2014 consisted of loans secured by commercial and residential real estate located in Alaska. In recent years, the slowdown in the residential sales cycle in our major markets and a constriction in the availability of mortgage financing have negatively impacted residential real estate sales, which has resulted in customers’ inability to repay loans. Although non-performing assets have decreased over the past several years following the financial crisis, we could see an increase in non-performing assets if more borrowers fail to perform according to loan terms and if we take possession of real estate properties. Additionally, if real estate values decline, the value of real estate collateral securing our loans could be significantly reduced. If any of these effects continue or become more pronounced, loan losses will increase more than we expect and our financial condition and results of operations would be adversely impacted.

Further, approximately 47% of the Bank’s loan portfolio at December 31, 2014 consisted of commercial real estate loans. Nationally, delinquencies in these types of portfolios have increased significantly in recent years. While our investments in these types of loans have not been as adversely impacted as residential construction and land development loans, there can be no assurance that the credit quality in these portfolios will remain stable. Commercial construction and commercial real estate loans typically involve larger loan balances to single borrowers or groups of related borrowers. Consequently, an adverse development with respect to one commercial loan or one credit relationship exposes us to significantly greater risk of loss compared to an adverse development with respect to a consumer loan. The credit quality of these loans may deteriorate more than expected which may result in losses that exceed the estimates that are currently included in our loan loss allowance, which could adversely affect our financial conditions and results of operations.

Real estate values may decrease leading to additional and greater than anticipated loan charge-offs and valuation write downs on our other real estate owned (“OREO”) properties.

Real estate owned by the Bank and not used in the ordinary course of its operations is referred to as “other real estate owned” or “OREO” property. We foreclose on and take title to the real estate serving as collateral for defaulted loans as part of our business. At December 31, 2014, the Bank held $4.6 million of OREO properties, many of which relate to residential construction and land development loans. Increased OREO balances lead to greater expenses as we incur costs to manage and dispose of the properties. Our ability to sell OREO properties is affected by public perception that banks are inclined to accept large discounts from market value in order to quickly liquidate properties. Any decrease in market prices may lead to OREO write downs, with a corresponding expense in our income statement. We evaluate OREO property values periodically and write down the carrying value of the properties if the results of our evaluations require it. Further write-downs on OREO or an inability to sell OREO properties could have a material adverse effect on our results of operations and financial condition.

Changes in the FRB’s monetary or fiscal policies could adversely affect our results of operations and financial condition.

Our earnings will be affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The FRB has, and is likely to continue to have, an important impact on the operating results of depository institutions through its power to implement national monetary policy, among other things, in order to curb inflation or combat a recession. The FRB affects the levels of bank loans, investments and deposits through its control over the issuance of United States government securities, its regulation of the discount rate applicable to member banks and its influence over reserve requirements to which member banks are subject. We cannot predict the nature or impact of future changes in monetary and fiscal policies.

Changes in market interest rates could adversely impact the Company.

Our earnings are impacted by changing interest rates. Changes in interest rates affect the demand for new loans, the credit profile of existing loans, the rates received on loans and securities, and rates paid on deposits and borrowings. The relationship between the rates received on loans and securities and the rates paid on deposits and borrowings is known as the net interest margin. Exposure to interest rate risk is managed by monitoring the repricing frequency of our rate-sensitive assets and rate-sensitive liabilities over any given period. Although we believe the current level of interest rate sensitivity is reasonable, significant fluctuations in interest rates could potentially have an adverse effect on our business, financial condition and results of operations.

Our concentration of operations in the Anchorage, Matanuska-Susitna Valley, Fairbanks,and Southeast areas of Alaska makes us more sensitive to downturns in those areas.

Substantially all of our business is derived from the Anchorage, Matanuska-Susitna Valley, Fairbanks, and Southeast areas of Alaska. The majority of our lending has been with Alaska businesses and individuals. At December 31, 2014, approximately 74% of the Bank’s loans are secured by real estate and 26% are for general commercial uses, including professional, retail, and small businesses, respectively. Substantially all of these loans are collateralized and repayment is expected from the borrowers’ cash flow or, secondarily, the collateral. Our exposure to credit loss, if any, is the outstanding amount of the loan if the collateral is proved to be of no value. These areas rely primarily upon the natural resources industries, particularly oil production, as well as tourism, government and U.S. military spending for their economic success. In particular, the oil and gas industry plays a significant role in the Alaskan economy, and if the global price of oil continues to decline or stabilizes at a relatively low level, the Alaskan economy would likely be adversely affected. Our business is and will remain sensitive to economic factors that relate to these industries and local and regional business conditions. As a result, local or regional economic downturns, or downturns that disproportionately affect one or more of the key industries in regions served by the Company, may have a more pronounced effect upon its business than they might on an institution that is less geographically concentrated. The extent of the future impact of these events on economic and business conditions cannot be predicted; however, prolonged or acute fluctuations could have a material and adverse impact upon our results of operation and financial condition.

We conduct substantially all of our operations through Northrim Bank, our banking subsidiary; our ability to pay dividends, repurchase our shares or to repay our indebtedness depends upon liquid assets held by the holding company and the results of operations of our subsidiaries.

The Company is a separate legal entity from our subsidiaries. It receives substantially all of its revenue from dividends paid from the Bank. There are legal limitations on the extent to which the Bank may extend credit, pay dividends or otherwise supply funds to, or engage in transactions with us. Our inability to receive dividends from the Bank could adversely affect our business, financial condition, results of operations and prospects.

Our net income depends primarily upon the Bank’s net interest income, which is the income that remains after deducting from total income generated by earning assets the expense attributable to the acquisition of the funds required to support earning assets (primarily interest paid on deposits and borrowings). The amount of interest income is dependent on many factors including the volume of earning assets, the general level of interest rates, the dynamics of changes in interest rates and the levels of nonperforming loans. All of those factors affect the Bank’s ability to pay dividends to the Company.

Various statutory provisions restrict the amount of dividends the Bank can pay to us without regulatory approval. The Bank may not pay cash dividends if that payment could reduce the amount of its capital below that necessary to meet the “adequately capitalized” level in accordance with regulatory capital requirements. It is also possible that, depending upon the financial condition of the Bank and other factors, regulatory authorities could conclude that payment of dividends or other payments, including payments to us, is an unsafe or unsound practice and impose restrictions or prohibit such payments. It is the policy of the FRB that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization’s expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines a bank holding company’s ability to serve as a source of strength to its banking subsidiaries.

The soundness of other financial institutions could adversely affect us.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. Many of these transactions expose us to credit risk in the event of default of our counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the financial instrument exposure. There can be no assurance that any such losses would not materially and adversely affect our results of operations.

The financial services business is intensely competitive and our success will depend on our ability to compete effectively.

The financial services business in our market areas is highly competitive. It is becoming increasingly competitive due to changes in regulation, technological advances, and the accelerating pace of consolidation among financial services providers. We face competition both in attracting deposits and in originating loans. We compete for loans principally through the pricing of interest rates and loan fees and the efficiency and quality of services. Increasing levels of competition in the banking and financial services industries may reduce our market share or cause the prices charged for our services to fall. Improvements in technology, communications, and the internet have intensified competition. As a result, our competitive position could be weakened, which could adversely affect our financial condition and results of operations.

We are a community bank and our ability to maintain our reputation is critical to the success of our business and the failure to do so could materially adversely affect our performance.

We are a community bank, and our reputation is one of the most valuable components of our business. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior service to our customers and caring about our customers and associates. If our reputation is negatively affected, by the actions of our employees or otherwise, our business and, therefore, our operating results could be materially adversely affected.

We may be unable to attract and retain key employees and personnel.

We will be dependent for the foreseeable future on the services of R. Marc Langland, our Chairman of the Board; Joseph M. Beedle, our President and Chief Executive Officer of the Company; Joseph M. Schierhorn, our Executive Vice President and Chief Operating Officer; Steven L. Hartung, our Executive Vice President and Chief Credit Officer; and Latosha M. Frye, our Senior Vice President and Chief Financial Officer. While we maintain keyman life insurance on the lives of Messrs. Beedle and Schierhorn in the amounts of $2 million each, we may not be able to timely replace Mr. Beedle or Mr. Schierhorn with a person of comparable ability and experience should the need to do so arise, causing losses in excess of the insurance proceeds. Currently, we do not maintain keyman life insurance on the life of Messrs. Langland, Hartung, and Ms. Frye. The unexpected loss of key employees could have a material adverse effect on our business and possibly result in reduced revenues and earnings.

Liquidity risk could impair our ability to fund operations and jeopardize our financial conditions.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings and other sources, could have a substantial negative effect on our liquidity and severely constrain our financial flexibility. Our primary source of funding is deposits gathered through our network of branch offices. Our access to funding sources in amounts adequate to finance our activities on terms that are acceptable to us could be impaired by factors that affect us specifically or the financial services industry or the economy in general. Factors that could negatively impact our access to liquidity sources include:

- a decrease in the level of our business activity as a result of an economic downturn in the markets in which our loans are concentrated;
- adverse regulatory actions against us; or
- our inability to attract and retain deposits.

Our ability to borrow could be impaired by factors that are not specific to us or our region, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry and unstable credit markets.

A failure of a significant number of our borrowers, guarantors and related parties to perform in accordance with the terms of their loans would have an adverse impact on our results of operations.

A source of risk arises from the possibility that losses will be sustained if a significant number of our borrowers, guarantors and related parties fail to perform in accordance with the terms of their loans. We have adopted underwriting and credit monitoring procedures and credit policies, including the establishment and review of our allowance for loan losses, which we believe are appropriate to minimize this risk by assessing the likelihood of nonperformance, tracking loan performance, and diversifying our credit portfolio. These policies and procedures, however, may not prevent unexpected losses that could materially affect our results of operations.

Non-compliance with the USA PATRIOT Act, Bank Secrecy Act, Real Estate Settlement Procedures Act, Truth-in-Lending Act or other laws and regulations could result in fines, sanctions or other adverse consequences.

Financial institutions are required under the USA PATRIOT Act and Bank Secrecy Act to develop programs to prevent financial institutions from being used for money-laundering and terrorist activities. Financial institutions are also obligated to file suspicious activity reports with the United States Treasury Department’s Office of Financial Crimes Enforcement Network if such activities are detected. These rules also require financial institutions to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts. Failure or the inability to comply with these regulations could result in fines or penalties, intervention or sanctions by regulators, and costly litigation or expensive additional controls and systems. In recent years, several banking institutions have received large fines for non-compliance with these laws and regulations. In addition, the federal government has imposed and is expected to expand laws and regulations relating to residential and consumer lending activities that create significant new compliance burdens and financial risks. We have developed policies and continue to augment procedures and systems designed to assist in compliance with these laws and regulations, however it is possible for such safeguards to fail or prove deficient during the implementation phase to avoid non-compliance with such laws.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The following sets forth information about our Community Banking branch locations:

Locations	Type	Leased/Owned
Midtown Financial Center: Northrim Headquarters 3111 C Street, Anchorage, AK	Traditional	Land partially leased, partially owned, building owned
SouthSide Financial Center 8730 Old Seward Highway, Anchorage, AK	Traditional	Land leased, building owned
36th Avenue Branch 811 East 36th Avenue, Anchorage, AK	Traditional	Leased
Huffman Branch 1501 East Huffman Road, Anchorage, AK	Supermarket	Leased
Jewel Lake Branch 9170 Jewel Lake Road, Anchorage, AK	Traditional	Leased
Seventh Avenue Branch 517 West Seventh Avenue, Suite 300, Anchorage, AK	Traditional	Leased
West Anchorage Branch/Small Business Center 2709 Spenard Road, Anchorage, AK	Traditional	Owned
Eagle River Branch 12812 Old Glenn Highway, Suite C03, Eagle River, AK	Traditional	Leased
Fairbanks Financial Center 360 Merhar Avenue, Fairbanks, AK	Traditional	Owned
Wasilla Financial Center 850 E. USA Circle, Suite A, Wasilla, AK	Traditional	Owned
Juneau Financial Center 2094 Jordan Avenue, Juneau, AK	Traditional	Leased
Juneau Downtown Branch 301 North Franklin Street, Juneau, AK	Traditional	Owned
Sitka Financial Center 315 Lincoln Street, Suite 206, Sitka, AK	Traditional	Leased
Tongass Branch 2442 Tongass Avenue, Ketchikan, AK	Traditional	Leased

The following sets forth information about our Home Mortgage Lending branch locations, operated by RML:

Locations	Leased/Owned
Main Office at Calais 100 Calais Drive, Anchorage, AK	Leased
ReMax/Dynamic Office 3350 Midtown Place, Suite 101, Anchorage, AK	Leased
Midtown Office 101 W. Benson Boulevard, #201, Anchorage, AK	Leased
Dwell Office 3230 C Street, Suite 100, Anchorage, AK	Leased
Real Estate Brokers of Alaska Office 1577 C Street, Suite 101A, Anchorage, AK	Leased
Eagle River Office 11901 Business Boulevard, #203, Eagle River, AK	Leased
Fairbanks Office 505 Old Steese Highway, Suite 117, Fairbanks, AK	Leased
Juneau Office 8800 Glacier Highway, #232, Juneau, AK	Leased
Kodiak Office 2011 Mill Bay Road, #101, Kodiak, AK	Leased
Sitka Office 315 Lincoln Street, Suite 206, Sitka, AK	Leased
Soldotna Office 44296 Sterling Highway, #1, Soldotna, AK	Leased

ITEM 3. LEGAL PROCEEDINGS

The Company from time to time may be involved with disputes, claims, and litigation related to the conduct of its banking business. Management does not expect that the resolution of these matters will have a material effect on the Company's business, financial position, results of operations, or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock trades on the NASDAQ under the symbol, "NRIM." We are aware that large blocks of our stock are held in street name by brokerage firms. At March 12, 2015, the number of shareholders of record of our common stock was 275.

The following are high and low closing prices as reported by NASDAQ. Prices do not include retail markups, markdowns or commissions.

		First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2014					
	High	$26.26	$25.74	$27.01	$29.03
	Low	$23.90	$23.64	$24.12	$25.73
2013					
	High	$23.01	$24.19	$27.49	$26.83
	Low	$21.44	$20.97	$22.58	$23.46

In 2014, we paid cash dividends of $0.17 per share in the first and second quarters and $0.18 per share in the third and fourth quarters. In 2013, we paid cash dividends of $0.15 per share in the first and second quarters and $0.17 per share in the third and fourth quarters. Cash dividends totaled $4.8 million, $4.2 million, and $3.7 million in 2014, 2013, and 2012, respectively. On February 26, 2015, the Board of Directors approved payment of a $0.18 per share dividend on March 20, 2015, to shareholders of record on March 12, 2015. The Company and the Bank are subject to restrictions on the payment of dividends pursuant to applicable federal and state banking regulations. The dividends that the Bank pays to the Company are limited to the extent necessary for the Bank to meet the regulatory requirements of a "well-capitalized" bank. Given the fact that the Bank remains "well-capitalized", the Company expects to receive dividends from the Bank in 2015. Beginning in 2016, a requirement to have a conservation buffer will start being phased in, and this requirement could adversely affect the Bank's ability to pay dividends. See Regulation and Supervision.

Repurchase of Securities

The Company did not repurchase any of its common stock during the fourth quarter of 2014.

Equity Compensation Plan Information

The following table sets forth information regarding securities authorized for issuance under the Company's equity plans as of December 31, 2014. Additional information regarding the Company's equity plans is presented in Note 21 of the Notes to Consolidated Financial Statements included in Item 8 of this report.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a) [2]	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)
Equity compensation plans approved by security holders[1]	239,476	$16.41	287,043
Total	239,476	$16.41	287,043

[1]Consists of the Company's 2014 Stock Incentive Plan, which replaced the 2010 Stock Incentive Plan (the "2010 Plan")

[2] Includes 199,037 options awarded under the 2010 Plan and other previous stock option plans.

We do not have any equity compensation plans that have not been approved by our shareholders.

Stock Performance Graph

The graph shown below depicts the total return to shareholders during the period beginning after December 31, 2009, and ending December 31, 2014. The definition of total return includes appreciation in market value of the stock, as well as the actual cash and stock dividends paid to shareholders. The comparable indices utilized are the Russell 3000 Index, representing approximately 98% of the U.S. equity market, and the SNL Financial Bank Stock Index, comprised of publicly traded banks with assets of $1 billion to $5 billion, which are located in the United States. The graph assumes that the value of the investment in the Company's common stock and each of the two indices was $100 on December 31, 2009, and that all dividends were reinvested.

	Period Ending					
Index	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13	12/31/14
Northrim BanCorp, Inc.	100.00	117.43	109.25	145.12	172.81	177.61
Russell 3000	100.00	116.93	118.13	137.52	183.66	206.72
SNL Bank $1B-$5B	100.00	113.35	103.38	127.47	185.36	193.81

ITEM 6. SELECTED FINANCIAL DATA [(1)]

	Years Ended December 31,				
(In Thousands, Except Share Data)	2014	2013	2012	2011	2010
	(Unaudited)				
Net interest income	$52,905	$44,034	$42,223	$42,364	$44,213
Provision (benefit) for loan losses	(636)	(635)	(1,559)	1,999	5,583
Other operating income	20,537	12,886	15,432	13,090	12,377
Other operating expense	49,375	39,866	39,600	36,755	37,624
Income before provision for income taxes	$24,703	$17,689	$19,614	$16,700	$13,383
Provision for income taxes	6,836	5,277	6,156	4,873	3,918
Net Income	17,867	12,412	13,458	11,827	9,465
Less: Net income attributable to noncontrolling interest	459	87	512	429	399
Net income attributable to Northrim Bancorp	$17,408	$12,325	$12,946	$11,398	$9,066
Earnings per share:					
Basic	$2.57	$1.89	$2.00	$1.77	$1.42
Diluted	2.54	1.87	1.97	1.74	1.40
Cash dividends per share	0.70	0.64	0.56	0.50	0.44
Assets	$1,449,349	$1,215,006	$1,160,107	$1,085,258	$1,054,529
Portfolio loans	924,504	770,016	704,213	645,562	671,812
Deposits	1,179,747	1,003,723	970,129	911,248	892,136
Borrowings	26,304	6,527	4,479	4,626	4,766
Junior subordinated debentures	18,558	18,558	18,558	18,558	18,558
Shareholders' equity	164,441	144,318	136,353	125,435	117,122
Book value per share	$23.99	$22.07	$20.94	$19.40	$18.22
Tangible book value per share[(2)]	$20.48	$20.86	$19.69	$18.09	$16.87
Net interest margin (tax equivalent)[(3)]	4.41%	4.29%	4.40%	4.59%	4.92%
Efficiency ratio[(4)]	66.84%	69.64%	68.25%	65.78%	65.96%
Return on assets	1.30%	1.07%	1.19%	1.09%	0.90%
Return on equity	11.19%	8.75%	9.85%	9.34%	7.87%
Equity/assets	11.35%	11.88%	11.75%	11.56%	11.11%
Dividend payout ratio	27.40%	34.18%	28.39%	28.67%	31.41%
Nonperforming loans/portfolio loans	0.51%	0.24%	0.64%	1.14%	1.70%
Net charge-offs (recoveries)/average loans	(0.12)%	(0.07)%	(0.21)%	(0.01)%	0.66%
Allowance for loan losses/portfolio loans	1.81%	2.11%	2.33%	2.56%	2.14%
Nonperforming assets/assets	0.64%	0.35%	0.78%	1.16%	2.07%
Effective tax rate	28%	30%	31%	29%	29%
Number of banking offices[(5)]	14	10	10	10	10
Number of employees (FTE)[(6)]	426	269	252	269	276

[1] These unaudited schedules provide selected financial information concerning the Company that should be read in conjunction with Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this report.

[2]Tangible book value per share is a non-GAAP ratio defined as shareholders' equity, less intangible assets, divided by common shares outstanding. Management believes that tangible book value is a useful measurement of the value of

the Company’s equity because if excludes the effect of tangible assets on the Company’s equity. See reconciliation to comparable GAAP measurement below.

[3]Tax-equivalent net interest margin is a non-GAAP performance measurement in which interest income on non-taxable investments and loans is presented on a tax-equivalent basis using a combined federal and state statutory rate of 41.11% in all years presented. Management believes that tax-equivalent net interest margin is a useful financial measure because it enables investors to evaluate net interest margin excluding tax expense in order to monitor our effectiveness in growing higher interest yielding assets and managing our costs of interest bearing liabilities over time on a fully tax equivalent basis. See reconciliation to comparable GAAP measurement below.

[4]In managing our business, we review the efficiency ratio exclusive of intangible asset amortization, which is a non-GAAP performance measurement. Management believes that this is a useful financial measurement because we believe this presentation provides investors with a more accurate picture of our operating efficiency. The efficiency ratio is calculated by dividing other operating expense, exclusive of intangible asset amortization, by the sum of net interest income and other operating income. Other companies may define or calculate this data differently. For additional information see the "Other Operating Expense" section in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operation" of this report. See reconciliation to comparable GAAP measurement below.
[5]Number of banking offices does not include RML locations
[6]FTE includes employees of the Bank, NBG, and in 2014 also includes RML.

Reconciliation of Selected Financial Data to GAAP Financial Measures

These unaudited schedules provide selected financial information concerning the Company that should be read in conjunction with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" of this report.

Reconciliation of tangible book value per share to book value per share

(In thousands, except per share data)	2014	2013	2012	2011	2010
Total shareholders' equity	$164,441	$144,318	$136,353	$125,435	$117,122
Divided by common shares outstanding	6,854,189	6,537,652	6,511,649	6,466,763	6,427,237
Book value per share	$23.99	$22.07	$20.94	$19.40	$18.22
(In thousands, except per share data)	2014	2013	2012	2011	2010
Total shareholders' equity	$164,441	$144,318	$136,353	$125,435	$117,122
Less: goodwill and intangible assets, net	24,035	7,942	8,170	8,421	8,697
	$140,406	$136,376	$128,183	$117,014	$108,425
Divided by common shares outstanding	6,854,189	6,537,652	6,511,649	6,466,763	6,427,237
Tangible book value per share	$20.48	$20.86	$19.69	$18.09	$16.87

Reconciliation of tax-equivalent net interest margin to net interest margin

(In Thousands)	2014	2013	2012	2011	2010
Net interest income[7]	$52,905	$44,034	$42,223	$42,364	$44,213
Divided by average interest-bearing assets	1,212,292	1,041,268	973,741	934,732	904,168
Net interest margin	4.36 %	4.23 %	4.34 %	4.53 %	4.89 %
(In Thousands)	2014	2013	2012	2011	2010
Net interest income[7]	$52,905	$44,034	$42,223	$42,364	$44,213
Plus: reduction in tax expense related to tax-exempt interest income	497	585	626	580	315
	$53,402	$44,619	$42,849	$42,944	$44,528
Divided by average interest-bearing assets	1,212,292	1,041,268	973,741	934,732	904,168
Tax-equivalent net interest margin	4.41 %	4.29 %	4.40 %	4.59 %	4.92 %

Calculation of efficiency ratio

(In Thousands)	2014	2013	2012	2011	2010
Net interest income[7]	$52,905	$44,034	$42,223	$42,364	$44,213
Other operating income	20,537	12,886	15,432	13,090	12,377
Total revenue	73,442	56,920	57,655	55,454	56,590
Other operating expense	49,375	39,866	39,600	36,755	37,624
Less intangible asset amortization	289	228	252	275	299
Adjusted other operating expense	$49,086	$39,638	$39,348	$36,480	$37,325
Efficiency ratio	66.84 %	69.64 %	68.25 %	65.78 %	65.96 %

[7] Amount represents net interest income before provision for loan losses.

Non-GAAP financial measures have inherent limitations, are not required to be uniformly applied, and are not audited. Although we believe these non-GAAP financial measures are frequently used by stakeholders in the evaluation of the Company, they have limitations as analytical tools and should not be considered in isolation or as a substitute for analysis of results as reported under GAAP.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion highlights key information as determined by management but may not contain all of the information that is important to you. For a more complete understanding, the following should be read in conjunction with the Company's audited consolidated financial statements and the notes thereto as of December 31, 2014, 2013, and 2012 included elsewhere in this report.

This annual report contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those indicated in forward-looking statements. See "Cautionary Note Regarding Forward-Looking Statements."

Executive Overview

The Company's net income increased 41% to $17.4 million or $2.54 per diluted share for the year ended December 31, 2014, from $12.3 million, or $1.87 per diluted share, for the year ended December 31, 2013, reflecting the impact of the two acquisitions completed during 2014 and growth in core earnings. Net income, excluding gains and expenses from the acquisitions of Alaska Pacific and RML, increased 23% for the full year in 2014. The acquisition of Alaska Pacific on April 1, 2014 added four new branch locations in southeastern Alaska and generated 10% earnings accretion, without transaction costs, and 3% accretion including transaction costs.

The following are significant items for the year ended December 31, 2014:

- Total revenues, which include net interest income plus other operating income, increased 29% to $73.4 million in 2014 from $56.9 million in 2013. Excluding the gains from the acquisition of RML in the fourth quarter of 2014 and the sale of a branch in the third quarter of 2014, total revenues increased 22% to $69.3 million as compared to 2013. This increase reflects increased net interest income resulting from higher average earnings assets due to both core loan growth and additional earnings from acquired assets and operations, as well as increased other operating income.
- Average portfolio loans increased 22% to $893.0 million in 2014 compared to $734.4 in 2013, reflecting the addition of the loans acquired from Alaska Pacific and organic growth in the portfolio that were offset by year-end payoffs of several large loans and the elimination of the RML warehouse line of credit following consolidation into the Company's balance sheet.
- Our benefit from a negative provision for loan losses in 2014 of $636,000 was essentially unchanged from a benefit of $635,000 in 2013. We experienced net recoveries of $1.1 million in 2014 as compared to net recoveries of $509,000 in 2013; however, our nonperforming loans at December 31, 2014 increased by $2.9 million, or 158%, from $1.8 million at December 31, 2013 to $4.7 million at December 31, 2014. Nonperforming loans acquired from Alaska Pacific accounted for $1.4 million of total nonperforming loans at December 31, 2014. The allowance for loan losses

(“Allowance”) totaled

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1.81% of total portfolio loans at December 31, 2014, compared to 2.11% at December 31, 2013. The Allowance compared to nonperforming loans decreased to 358% at December 31, 2014 from 897% at December 31, 2013.

- Other operating expenses increased in 2014 by 24% to $49.4 million from $39.9 million in 2013. Excluding merger and acquisition expenses, other operating expenses increased to $47.4 million, or 19%, in 2014 as compared to 2013. This increase reflects the Company's increased operating costs primarily due to the two acquisitions that occurred in 2014.
- Nonperforming assets increased by 121% year-over-year to $9.3 million at December 31, 2014 or 0.64% of total assets, compared to $4.2 million or 0.35% of total assets at December 31, 2013 in large part due to nonperforming assets acquired from Alaska Pacific which totaled $3.0 million at December 31, 2014.
- The Company continued to maintain strong capital ratios with Tier 1 Capital/risk adjusted assets of 13.06% at December 31, 2014 as compared to 15.35% a year ago. The decrease in Tier 1 Capital to Risk Adjusted Assets at December 31, 2014, compared to a year ago reflects the $47.6 million net increase in assets resulting from the acquisition of RML and the $167.2 million in assets acquired from Alaska Pacific. The Company paid $18.2 million in cash and assigned life insurance policies valued at $3.9 million for the acquisition of the remaining 76.5% equity interest in RML in December 2014. Additionally, the Company recorded a liability of $7.3 million which represents the net present value of earn-out payments that we expect to make in conjunction with the purchase of RML over the next five years. Accordingly, the total estimated purchase price of RML is $29.4 million. The Company paid $6.4 million in cash and issued 290,212 shares of common stock with a value of $7.4 million on April 1, 2014 for the acquisition of Alaska Pacific.
- Tangible book value was $20.48 per share at December 31, 2014, compared to $20.86 per share at December 31, 2013, reflecting an increase in intangible assets attributable to the two major acquisitions completed in the year. Tangible common equity to tangible assets at year end 2014 was 9.85%, down from 11.30% at year-end 2013. Tangible common equity to tangible assets is a non-GAAP ratio that represents total equity less goodwill and intangible assets divided by total assets less goodwill and intangible assets. The GAAP measure of equity to assets is total equity divided by total assets. Total equity to total assets was 11.35% at December 31, 2014 as compared to 11.88% at December 31, 2013.
- The cash dividend paid in the fourth quarter of 2014, rose 6% to $0.18 per diluted share from $0.17 per diluted share paid in the fourth quarter of 2013.

Reconciliation of total shareholders' equity to tangible common shareholders' equity (Non-GAAP) and total assets to tangible assets:

(In Thousands)	2014	2013	2012	2011	2010
Total shareholders' equity	$164,441	$144,318	$136,353	$125,435	$117,122
Less: goodwill and other intangible assets, net	24,035	7,942	8,170	8,421	8,697
Tangible common shareholders' equity	$140,406	$136,376	$128,183	$117,014	$108,425
Total assets	$1,449,349	$1,215,006	$1,160,107	$1,085,258	$1,054,529
Less: goodwill and other intangible assets, net	24,035	7,942	8,170	8,421	8,697
Tangible assets	$1,425,314	$1,207,064	$1,151,937	$1,076,837	$1,045,832
Tangible common equity ratio	9.85%	11.30%	11.12%	10.86%	10.37%

Critical Accounting Estimates

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

The accounting policies that involve significant estimates and assumptions by management, which have a material impact on the carrying value of certain assets and liabilities, are considered critical accounting policies. We believe that our most critical accounting policies upon which our financial condition depends, and which involve the most complex or subjective decisions or assessments are as follows:

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Allowance for loan losses: The Company maintains an Allowance to reflect inherent losses in its loan portfolio as of the balance sheet date. In determining its total Allowance, the Company first estimates a specific allocated allowance for impaired loans. This analysis is based upon a specific analysis for each impaired loan that is collateral dependent, including appraisals on loans secured by real property, management's assessment of the current market, recent payment history, and an evaluation of other sources of repayment. The Company obtains appraisals on real and personal property that secure its loans during the loan origination process in accordance with regulatory guidance and its loan policy. The Company obtains updated appraisals on loans secured by real or personal property based upon its assessment of changes in the current market or particular projects or properties, information from other current appraisals, and other sources of information. The Company uses the information provided in these updated appraisals along with its evaluation of all other information available on a particular property as it assesses the collateral coverage on its performing and nonperforming loans and the impact that may have on the adequacy of its Allowance. The Company then estimates a general allocated allowance for all other loans that were not impaired as of the balance sheet date using a formula-based approach that includes average historical loss factors that are adjusted for qualitative factors applied to segments and classes of loans not considered impaired for purposes of establishing the allocated portion of the general reserve of the Allowance. The Company first disaggregates the overall loan portfolio into the following segments: commercial, real estate construction one-to-four family, real estate construction other, real estate term owner occupied, real estate term non-owner occupied, real estate term other, consumer secured by 1st deeds of trust, and other consumer loans. Then the Company further disaggregates each segment into the following classes; pass, special mention, substandard, doubtful and loss. After the portfolio has been disaggregated into these segments and classes, the Company calculates a general reserve for each segment and class based on the average five year loss history for each segment and class. This general reserve is then adjusted for qualitative factors, by segment and class. Qualitative factors are based on management's assessment of current trends that may cause losses inherent in the current loan portfolio to differ significantly from historical losses. Some factors that management considers in determining the qualitative adjustment to the general reserve include loan quality trends in our own portfolio, the degree of concentrations of large borrowers in our loan portfolio, national and local economic trends, business conditions, underwriting policies and standards, trends in local real estate markets, effects of various political activities, peer group data, and internal factors such as underwriting policies and expertise of the Company's employees.

Finally, the Company assesses the overall adequacy of the Allowance based on several factors including the level of the Allowance as compared to total loans and nonperforming loans in light of current economic conditions. This portion of the Allowance is deemed "unallocated" because it is not allocated to any segment or class of the loan portfolio. This portion of the Allowance provides for coverage of credit losses inherent in the loan portfolio but not captured in the credit loss factors that are utilized in the risk rating-based component or in the specific impairment component of the Allowance and acknowledges the inherent imprecision of all loss prediction models.

The unallocated portion of the Allowance is based upon management's evaluation of various factors that are not directly measured in the determination of the allocated portions of the Allowance. Such factors include uncertainties in identifying triggering events that directly correlate to subsequent loss rates, uncertainties in economic conditions, risk factors that have not yet manifested themselves in loss allocation factors, and historical loss experience data that may not precisely correspond to the current portfolio. In addition, the unallocated reserve may fluctuate based upon the direction of various risk indicators. Examples of such factors include the risk as to current and prospective economic conditions, the level and trend of charge offs or recoveries, and the risk of heightened imprecision or inconsistency of appraisals used in estimating real estate values. Although this allocation process may not accurately predict credit losses by loan type or in aggregate, the total allowance for credit losses is available to absorb losses that may arise from any loan type or category. Due to the subjectivity involved in the determination of the unallocated portion of the Allowance, the relationship of the unallocated component to the total Allowance may fluctuate from period to period.

Based on our methodology and its components, management believes the resulting Allowance is adequate and appropriate for the risk identified in the Company's loan portfolio. Given current processes employed by the Company, management believes the segment, classes, and estimated loss rates currently assigned are appropriate. It is possible that others, given the same information, may at any point in time reach different reasonable conclusions that could be material to the Company's financial statements. In addition, current loan classes and fair value estimates of collateral are subject to change as we continue to review loans within our portfolio and as our borrowers are impacted by economic trends within their market areas. Although we have established an Allowance that we consider adequate, there can be no assurance that the established Allowance will be sufficient to offset losses on loans in the future.

Goodwill and other intangibles: Net assets of entities acquired in purchase transactions are recorded at fair value at the date of acquisition. Identified intangibles with estimated useful lives are amortized over the period benefited either on a straight-line basis or on an accelerated basis depending on the nature of the intangible. Goodwill and other intangibles with indefinite lives are not amortized but instead are reviewed for impairment on an annual basis or at an interim date if events or circumstances indicate a potential impairment. Goodwill impairment testing is performed at the segment level. We have determined that the Company has two segments: Community Banking and Home Mortgage Lending.

Under current guidance, the Company has the option to first assess qualitative factors to determine whether the existence of certain events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than the carrying amount. If, using the qualitative assessment described above, it is determined that it is more likely than not that the carrying value exceeds the fair value of the Company, then we must move on to a more comprehensive goodwill impairment analysis.

The first step of the comprehensive analysis, used to identify potential impairment, involves comparing the reporting unit's fair value to its carrying value including goodwill. If the fair value of a reporting unit exceeds its carrying value, applicable goodwill is considered not to be impaired. If the carrying value exceeds fair value, there is an indication of impairment and the second step is performed to measure the amount of impairment.

The second step involves calculating an implied fair value of goodwill for each reporting unit when the first step indicated impairment. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination, which is the excess of the fair value of the reporting unit, as determined in the first step, over the aggregate fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill in the "proforma" business combination accounting as described above exceeds the goodwill assigned to the reporting unit, there is no impairment. If the goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss recognized cannot exceed the amount of goodwill, and the loss establishes a new basis in the goodwill. Subsequent reversal of goodwill impairment losses is not permitted under applicable accounting standards.

The Company completed two acquisitions in 2014; there was no goodwill recorded in the acquisition of Alaska Pacific and $14.8 million in goodwill recorded in connection with the acquisition of RML. The Company performed its annual goodwill impairment testing at December 31, 2014 and 2013 in accordance with the policy described in Note 1 to the financial statements included with this report. At December 31, 2014, the Company performed its annual impairment test by applying the qualitative assessment described above. Significant positive inputs to the qualitative assessment included the Company's capital position; the Company's increasing net income as compared to historical trends, the Company's favorable budget-to-actual results of operations; the Company's current level of nonperforming assets to total assets; results of regulatory examinations; peer comparisons and the increasing trend of the Company's net interest margin; and trends in the Company's cash flows. Significant negative inputs to the qualitative assessment included the Company's general decline in stock prices for financial institutions as compared to pre-2008 stock prices and the recent decline in oil prices. We believe that the positive inputs to the qualitative assessment noted above outweigh the negative inputs, and we therefore concluded that it is more likely than not that the fair value of the Company exceeds its carrying value at December 31, 2014 and that no potential impairment existed at that time.

There have been no changes in RML's operations, earnings, or strategic plan that indicated that it is more likely than not that the fair value of RML had been impaired at December 31, 2014, and we therefore concluded that there was no potential impairment of goodwill at this segment.

The Company continues to monitor goodwill for potential impairment on an ongoing basis. No assurance can be given that we will not charge earnings in the future for goodwill impairment, if, for example, our stock price declines significantly, although there are many factors that we analyze in determining the impairment of goodwill.

Valuation of OREO: OREO represents properties acquired through foreclosure or its equivalent. Prior to foreclosure, the carrying value is adjusted to the fair value, less cost to sell, of the real estate to be acquired by an adjustment to the allowance for loan loss. The amount by which the fair value less cost to sell is greater than the carrying amount of the loan plus amounts previously charged off is recognized in earnings. Any subsequent reduction in the carrying value is charged against earnings.

RESULTS OF OPERATIONS

Income Statement

Net Income

Our results of operations are dependent to a large degree on our net interest income. We also generate other income primarily through purchased receivables products, mortgage banking income (earnings from our mortgage affiliate through November 2014), sales of employee benefit plans, service charges and fees, electronic banking income, and rental income. Our operating expenses consist in large part of salaries and other personnel costs, occupancy, marketing, professional and outside services, equipment expense, software expense, and expenses related to OREO. In 2014, merger and acquisition costs are also a significant portion of other operating expenses. Interest income and cost of funds are affected significantly by general economic conditions, particularly changes in market interest rates, by government policies and the actions of regulatory authorities, and by competition in our markets.

We earned net income of $17.4 million in 2014, compared to net income of $12.3 million in 2013, and $12.9 million in 2012. During these periods, net income per diluted share was $2.54, $1.87, and $1.97, respectively. The increase in net income in 2014 was primarily due to increases of $8.9 million and $7.7 million in net interest income and other operating income, respectively, which were partially offset by increases of $9.5 million and $1.6 million in other operating expense and in income taxes, respectively, in 2014 as compared to 2013. The acquisition of Alaska Pacific and the purchase of the remaining 76.5% equity interest in RML during 2014 both had significant impacts on all of these items in 2014. The decrease in net income in 2013 was primarily due to a decrease in other operating income of $2.5 million and an increase in the provision for loan losses of $924,000 which was partially offset by an increase of $1.8 million in net interest income and a decrease of $879,000 in income taxes in 2013 as compared to 2012.

Net Interest Income / Net Interest Margin

Net interest income is the difference between interest income from loan and investment securities portfolios and interest expense on customer deposits and borrowings. Net interest income in 2014 was $52.9 million, compared to $44.0 million in 2013 and $42.2 million in 2012. The increase in 2014 as compared to 2013 was primarily due to increased interest income earned on loans and long-term investments due to higher averages balances, largely due to assets acquired from Alaska Pacific and, to a lesser extent, assets acquired from RML, which was only partially offset by decreased average yields on loans and long-term investments. The increase in 2013 as compared to 2012 was primarily due to increased interest income earned on loans and long-term investments due to higher averages balances, which was only partially offset by decreased average yields on loans and long-term investments.

Changes in net interest income result from changes in volume and spread, which in turn affect our margin. For this purpose, volume refers to the average dollar level of interest-earning assets and interest-bearing liabilities, spread refers to the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, and margin refers to net interest income divided by average interest-earning assets. Changes in net interest income are influenced by yields and the level and relative mix of interest-earning assets and interest-bearing liabilities.

During the fiscal years ended December 31, 2014, 2013, and 2012, net interest margins were 4.36%, 4.23%, and 4.34%, respectively. The increase in the net interest margin in 2014 as compared to 2013 is primarily the result of increased average interest-earnings assets, particularly loans, again largely due to the two acquisitions that occurred in 2014. The Company acquired $138.4 million in portfolio loans from Alaska Pacific on April 1, 2014 and $41.3 million in loans held for sale from RML on December 1, 2014. Additionally, since loans held for sale are short term in nature, the yield on these loans is significantly higher than the yield on portfolio loans because the origination fees on loans held for sale are recognized when the loans are sold. Origination fees on portfolio loans are amortized over the life of the loans. The Company estimates that the acquisitions of Alaska Pacific and RML increased the net interest margin by 7 and 6 basis points, respectively, for a total of 13 basis points in 2014. Accordingly, we estimate that the net interest margin would have been consistent with 2013 at 4.23% if the acquisitions had not occurred. Average portfolio loans grew in 2014 without the addition of loans acquired from Alaska Pacific, but the increase in net interest income from this growth was mostly offset by a decrease in the yield. The decrease in the net interest margin in 2013 as compared to 2012 reflects margin compression arising from pressure on loan yields as customers refinanced their loans at historically low interest rates in 2013, and continued decreases in yields on long-term investments. The average cost of interest-bearing liabilities also decreased in all periods, but only enough to partially offset the decrease in the average yield on interest-earning assets in 2013 as compared to 2012. While the overall net interest margin decreased in 2013 compared to 2012, the increase in the average outstanding balance of interest-earning loans offset the effect of decreased yields in this asset class for the first time since 2008 when the average yield on loans first started to decline. The Company intends to continue to implement strategies designed to grow our loan portfolio, while actively managing non-performing assets, to offset the negative effect that today's relatively low interest rates have on our net interest margin.

The following table sets forth for the periods indicated information with regard to average balances of assets and liabilities, as well as the total dollar amounts of interest income from interest-earning assets and interest expense on interest-bearing liabilities. Resultant yields or costs, net interest income, and net interest margin are also presented:

Years ended December 31,	2014			2013			2012		
(In Thousands)	Average outstanding balance	Interest income / expense	Average Yield / Cost	Average outstanding balance	Interest income / expense	Average Yield / Cost	Average outstanding balance	Interest income / expense	Average Yield / Cost
Loans [(1),(2)]	$904,263	$51,627	5.71 %	$745,828	$43,137	5.78 %	$687,853	$41,515	6.04 %
Long-term Investments	243,634	3,133	1.29 %	229,807	2,714	1.18 %	200,600	2,935	1.46 %
Short-term investments	64,394	198	0.31 %	65,633	223	0.34 %	85,288	278	0.33 %
Total interest-earning assets	$1,212,291	$54,958	4.53 %	$1,041,268	$46,074	4.42 %	$973,741	$44,728	4.59 %
Noninterest-earning assets	123,638			115,232			114,678		
Total	$1,335,929			$1,156,500			$1,088,419		
Interest-bearing deposits	$727,078	$1,419	0.20 %	$613,745	$1,241	0.20 %	$597,445	$1,682	0.28 %
Borrowings	44,164	634	1.44 %	44,142	799	1.81 %	39,596	823	2.08 %
Total interest-bearing liabilities	$771,242	$2,053	0.27 %	$657,887	$2,040	0.31 %	$637,041	$2,505	0.39 %
Demand deposits and other non-interest bearing liabilities	409,096			357,689			320,010		
Equity	155,591			140,924			131,368		
Total	$1,335,929			$1,156,500			$1,088,419		
Net interest income		$52,905			$44,034			$42,223	
Net interest margin [(3)]			4.36 %			4.23 %			4.34 %

[1]Interest income includes loan fees. Loan fees recognized during the period and included in the yield calculation totaled $3.2 million, $3.0 million and $2.7 million for 2014, 2013 and 2012, respectively. Loan fees increased by $612,000 in 2014 as a result of the acquisition of RML in December, 2014.

[2]Nonaccrual loans are included with a zero effective yield. Average nonaccrual loans included in the computation of the average loans were $3.0 million,$3.5 million, and $5.8 million in 2014, 2013 and 2012, respectively.

[3]The net interest margin on a tax equivalent basis was 4.41%, 4.29%, and 4.40%, respectively, for 2014, 2013, and 2012.

The following table sets forth the changes in consolidated net interest income attributable to changes in volume and to changes in interest rates. Changes attributable to the combined effect of volume and interest rate have been allocated proportionately to the changes due to volume and the changes due to interest rate:

	2014 compared to 2013			2013 compared to 2012		
	Increase (decrease) due to			Increase (decrease) due to		
(In Thousands)	Volume	Rate	Total	Volume	Rate	Total
Interest Income:						
Loans	$9,038	($548)	$8,490	$3,210	($1,588)	$1,622
Long-term investments	169	250	419	679	(900)	(221)
Short term investments	(4)	(21)	(25)	(68)	13	(55)
Total interest income	$9,203	($319)	$8,884	$3,821	($2,475)	$1,346
Interest Expense:						
Interest-bearing deposits	$219	($41)	$178	$47	($488)	($441)
Borrowings	—	(165)	(165)	188	(212)	(24)

Total interest expense	$219	($206)	$13	$235	($700)	($465)

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The following table sets forth information with regard to average balances of assets and liabilities, as well as the total dollar amounts of interest income from interest-earning assets and interest expense on interest-bearing liabilities, for the Home Mortgage Lending segment on a stand-alone basis. This data represents activity from December 1, 2014 through December 31, 2014. Resultant yields or costs, net interest income, and net interest margin are also presented:

Years ended December 31,	2014			
(In Thousands)	Average outstanding balance	Interest income / expense	Average Yield / Cost (annualized)	
Loans held for sale[(1)(2)]	$34,344	$753	26.31	%
Total interest-earning assets	$34,344	$753	26.31	%
Borrowings	$30,159	$110	4.38	%
Total interest-bearing liabilities	$30,159	$110	4.38	%
Net interest income		$643		
Net interest margin			22.47	%

[1]Interest income includes loan fees. Loan fees recognized during the period and included in the yield calculation totaled $612,000 for 2014.

[2]There were no nonaccrual loans included in 2014.

The primary reason for the higher yield on loan held for sale as compared to portfolio loans in the Community Banking segment is the recognition of loan origination fees. Loan origination fees are recognized over the life of a loan for both portfolio loans and loans held for sale, and since loans held for sale are sold immediately following origination, fees are recognized sooner than they are for portfolio loans.

Provision for Loan Losses

We recorded a benefit for the provision for loan losses in 2014 of $636,000, compared to a benefit of $635,000 and $1.6 million in 2013 and 2012 respectively. We recorded a benefit under our loan loss provision in 2014, 2013, and 2012 primarily due to the fact that we had net recoveries of previously charged off loans of $1.1 million, $509,000, and $1.5 million in 2014, 2013, and 2012, respectively. In 2014, credit quality worsened slightly as the ratio of nonperforming loans to portfolio loans increased to 0.51% at December 31, 2014 as compared to 0.24% at December 31, 2013. In 2013 and 2012, credit quality improved in both periods. The ratio of nonperforming loans to portfolio loans was 0.64% at December 31, 2012. See the “Allowance for Loan Loss” section under “Financial Condition” and Note 8 of the Notes to Consolidated Financial Statements included in Item 8 of this report for further discussion of these decreases and changes in the Company’s Allowance.

Other Operating Income

Total other operating income increased $7.7 million, or 59%, in 2014 as compared to 2013, and decreased $2.5 million, or 16%, in 2013 as compared to 2012. The following table details the major components of other operating income for the years ended December 31:

(In Thousands)	2014	$ Change	% Change	2013	$ Change	% Change	2012
Other Operating Income							
Employee benefit plan income	$3,497	$1,156	49%	$2,341	($28)	(1)%	$2,369
Gain on purchase of mortgage affiliate	3,001	3,001	NM	—	—	NM	—
Electronic banking fees	2,356	205	10%	2,151	93	5%	2,058
Service charges on deposit accounts	2,155	39	2%	2,116	(85)	(4)%	2,201
Purchased receivable income	2,074	(723)	(26)%	2,797	(229)	(8)%	3,026
Mortgage banking income	1,620	1,620	NM	—	—	NM	—
Gain on sale of premise and equipment	1,115	1,115	NM	—	—	NM	—
Equity in earnings from RML	894	(333)	(27)%	1,227	(1,408)	(53)%	2,635
Merchant credit card transaction fees	583	74	15%	509	(69)	(12)%	578
Gain on sale of securities	461	128	38%	333	(3)	(1)%	336
Loan service fees	412	146	55%	266	(164)	(38)%	430
Rental income	260	152	141%	108	(665)	(86)%	773
Other income	2,109	1,071	103%	1,038	12	1%	1,026
Total other operating income	$20,537	$7,651	59%	$12,886	($2,546)	(16)%	$15,432

2014 Compared to 2013

Other operating income was impacted by several one-time items in 2014. The Company recognized a one-time $3 million gain in 2014 due to a fair value adjustment in connection with our purchase of the the remaining 76.5% equity interest of RML in December of 2014. The Company also recognized a one-time gain of $1.1 million on the sale of a branch location to the Sate of Alaska in connection with a major road project in the third quarter of 2014. The Company currently intends to open a new branch in the University Medical District in Anchorage in the second quarter of 2015, and intends to keep its existing branch open until the new branch is open. Additionally, in connection with the acquisition of Alaska Pacific, the Company recognized a $695,000 gain on the disposition of loans acquired in such transaction at a discount and a $170,000 bargain purchase gain on the transaction as a whole in 2014. Both of these items are included in other income in the preceding table. Excluding these one-time items, other operating income increased $2.7 million, or 21% in 2014 compared to 2013. This increase was the result of increases in employee benefit plan income and mortgage banking income. Employee benefit plan income increased in 2014 reflecting revenues generated through Enroll Alaska which provides health insurance plans to individuals under the Affordable Care Act. Mortgage banking income represents one month of gross income from RML since it became a 100% wholly-owned subsidiary in December 2014. These increases were partially offset by purchased receivable income which decreased $723,000 or 26% in 2014 compared to 2013 due to decreased purchased receivable balances outstanding during the year.

2013 Compared to 2012

Other operating income decreased in 2013 as compared to the prior year primarily due to decreases in earnings from RML, rental income, and purchased receivable income. Earnings from RML have fluctuated with activity in the housing market, which has been affected by local economic conditions and changes in mortgage interest rates. Earnings from RML decreased in 2013 as refinance activity decreased due to an increase in mortgage interest rates in the second half of 2013. Rental income decreased in 2013 as a result of vacancies in leased space in the Company’s corporate office building as areas recently vacated by previous tenants underwent capital improvements. Finally, income from the Company’s purchased receivable products decreased in 2013 due to decreased average purchased receivable balances outstanding during the year. Outstanding purchased receivable balances vary from year to year depending upon the financing needs of the Company's customers.

Other Operating Expense

Total other operating expense increased $9.5 million, or 24%, in 2014 as compared to 2013 and increased $266,000, or 1%, in 2013 as compared to 2012. The following table details the major components of other operating expense for the years ended December 31:

(In Thousands)	2014	$ Change	% Change	2013	$ Change	% Change	2012
Other Operating Expense							
Salaries and other personnel expense	$27,758	$3,962	17 %	$23,796	$1,764	8 %	$22,032
Occupancy expense	4,360	896	26 %	3,464	(151)	(4)%	3,615
Marketing expense	2,059	206	11 %	1,853	(122)	(6)%	1,975
Merger and acquisition expense	1,962	1,426	266 %	536	536	NM	—
Equipment expense	1,465	226	18 %	1,239	34	3 %	1,205
Professional and outside services	1,437	169	13 %	1,268	(211)	(14)%	1,479
Amortization of low income housing tax investments	1,337	368	38 %	969	48	5 %	921
Software expense	1,275	209	20 %	1,066	(45)	(4)%	1,111
Insurance expense	1,031	210	26 %	821	(92)	(10)%	913
Internet banking expense	900	122	16 %	778	77	11 %	701
Reserve for purchased receivables	704	604	604 %	100	(257)	(72)%	357
Intangible asset amortization	289	61	27 %	228	(24)	(10)%	252
OREO (income) expense, net rental income and gains on sale:							
OREO operating expense	174	32	23 %	142	(559)	(80)%	701
Impairment on OREO	56	(56)	(50)%	112	(357)	(76)%	469
Rental income on OREO	(3)	23	(88)%	(26)	9	(26)%	(35)
Gains on sale of OREO	(643)	(355)	123 %	(288)	(242)	526 %	(46)
Subtotal	(416)	(356)	593 %	(60)	(1,149)	(106)%	1,089
Other expenses	5,214	1,406	37 %	3,808	(142)	(4)%	3,950
Total other operating expense	$49,375	$9,509	24 %	$39,866	$266	1 %	$39,600

2014 Compared to 2013

Other operating expense increased in 2014 as compared to the prior year primarily due to increased costs related to the two acquisitions that were completed in 2014, particularly in salaries and other personnel expense, merger and acquisition expense and occupancy expense. In addition to merger and acquisition expenses, the Company incurred operating costs related to the additional branch locations acquired from Alaska Pacific in Southeast Alaska during the last three quarters of 2014, and the consolidation of 100% of the operating expenses of RML in December 2014. In total, the Company estimates that other operating expenses increased $4.3 million in 2014 as compared to 2013 for direct operating costs related to the addition of employees, branch locations, and customers in Southeast Alaska related to the acquisition of Alaska Pacific. This includes $2.4 million in salaries and other personnel expense, $685,000 in occupancy expense, and $231,000 in marketing costs. Operating expenses related to the operation of RML in December 2014 were $1.9 million. This includes salaries and other personnel expenses of $790,000, occupancy expenses of $215,000, and commissions paid to loan originators of $509,000, which is included in other expenses. Additionally, salaries and other personnel expenses related to the operations of Northrim Bank and NBG increased due to normal cost of living and performance based annual salary increases. Lastly, the reserve of purchased receivable losses increased in 2014 due to increases in the allowance for the balance of two nonperforming purchased receivable accounts.

2013 Compared to 2012

Other operating expense increased in 2013 as compared to the prior year primarily due to increased costs related to salaries and other personnel expenses and professional and outside services. These increases were partially offset by a decrease in net costs related to OREO properties. Salaries and other personnel expense increased in 2013 primarily due to increased salary costs, partially due to normal cost of living and performance based annual salary increases. On an average basis, full time equivalent employees were flat at 252 in 2013 and 2012. However, the mix of our employee base changed in 2013 as we hired more highly compensated employees, such as experienced loan officers to facilitate loan growth, agents and supervisors at NBG to launch the Enroll Alaska initiative, and information technology professionals to manage our systems. These positions replaced lower cost full time equivalent jobs in several departments of the Company including back office and branch transaction processing positions as those areas become more dependent on technology and less dependent on people. Additionally, other personnel expense increased due to increased medical claims costs and a change in the Company's vacation policy. Professional and outside services increased primarily as a result of legal, accounting, and other consulting services related to the acquisition of Alaska Pacific which was completed in 2014. These costs were partially offset by a decrease in consulting fees related to the Company’s salaries and other personnel benefits programs.

The increases in salaries and other personnel expenses and professional and outside services in 2013 as compared to 2012 were partially offset by a decrease in net costs related to OREO properties due to decreases in OREO operating expenses and impairment on OREO as the Company's carrying balance of OREO properties decreased. Additionally, gains on the sale of OREO properties increased in 2013 due to increased sales activity with respect to the Company's OREO properties, which effectively decreases net OREO expense in 2013.

Results of Segment Operations

The Company's operations are managed along two operating segments: Community Banking and Home Mortgage Lending. The Community Banking segment's principal business focus is the offering of loan and deposit products to business and consumer customers in its primary market areas. As of December 31, 2014, the Community Banking segment operated 14 branches throughout Alaska. The Home Mortgage Lending segment's principal business focus is the origination and sale of mortgage loans for 1-4 family residential properties. Prior to December 1, 2014, Home Mortgage Lending income was limited to equity in earnings from RML.

Net income by operating segment is presented in the tables below. Activity reported in the Home Mortgage Lending segment in 2014 represents eleven months of net income for RML accounted for using the equity method of accounting and one month accounted for on a consolidated basis following the Company's acquisition of the remaining 76.5% equity interest in RML on December 1, 2014, making RML a wholly-owned, consolidated subsidiary of the Company. Activity reported in the Home Mortgage Lending segment in 2013 represents one year of net income for RML accounted for using the equity method of accounting. The Company reported only one segment in 2013, but information in the table for 2013 below has been reclassified for comparative purposes in accordance with GAAP.

The following tables present each segment's financial information:

December 31, 2014

(In Thousands)	Community Banking	Home Mortgage Lending	Consolidated
Interest income	$54,205	$753	$54,958
Interest expense	1,943	110	2,053
Net interest income	52,262	643	52,905
Provision (benefit) for loan losses	(636)	—	(636)
Other operating income	17,929	2,608	20,537
Other operating expense	47,502	1,873	49,375
Income before provision for income taxes	23,325	1,378	24,703
Provision for income taxes	6,224	612	6,836
Net income	17,101	766	17,867
Less: net income attributable to the noncontrolling interest	459	—	459
Net income attributable to Northrim BanCorp	$16,642	$766	$17,408
Total assets	$1,391,862	$57,487	$1,449,349
Loans held for resale	$—	$43,866	$43,866
Borrowings	$2,164	$24,140	$26,304

December 31, 2013

(In Thousands)	Community Banking	Home Mortgage Lending	Consolidated
Interest income	$46,074	$—	$46,074
Interest expense	2,040	—	2,040
Net interest income	44,034	—	44,034
Provision (benefit) for loan losses	(635)	—	(635)
Other operating income	11,659	1,227	12,886
Other operating expense	39,866	—	39,866
Income before provision for income taxes	16,462	1,227	17,689
Provision for income taxes	4,773	504	5,277
Net income	11,689	723	12,412
Less: net income attributable to the noncontrolling interest	87	—	87
Net income attributable to Northrim BanCorp	$11,602	$723	$12,325
Total assets	$1,215,006	$—	$1,215,006
Loans held for resale	$11,301	$—	$11,301
Borrowings	$6,527	$—	$6,527

Income Taxes

The provision for income taxes increased $1.6 million, or 30%, to $6.8 million in 2014 as compared to 2013 and decreased $879,000, or 14%, to $5.3 million in 2013 as compared to 2012. These changes are due primarily to the 40% increase and 10% decrease in income before income taxes in 2014 and 2013, respectively. Additionally, the Company's effective tax rates were 28%, 30%, and 31% in 2014, 2013, and 2012, respectively. The decrease in the effective tax rate in 2014 compared to 2013 is primarily the result of the $3.0 million, tax exempt fair value adjustment in connection with our purchase of the remaining 76.5% equity interest in RML in December of 2014, and an increase in tax exempt income on investments and tax credits relative to the level of taxable income in 2014. The decrease in in the effective tax rate in 2013 is the result of an increase in tax exempt income on investments and tax credits relative to the level of taxable income in 2012.

Financial Condition

Investment Securities

Our investment portfolio consists primarily of government sponsored entity securities, corporate securities, and municipal securities. Investment securities at December 31, 2014 increased $33.0 million, or 13%, to $283.9 million from $250.9 million at December 31, 2013. The increase at December 31, 2014 as compared to December 31, 2013 is primarily due to investment of funds previously held in interest bearing deposits in other banks as these longer term investment securities have a higher yield. The average maturity of the investment portfolio was approximately two years at December 31, 2014.

The composition of our investment securities portfolio reflects management’s investment strategy of maintaining an appropriate level of liquidity while providing a relatively stable source of interest income. The investment securities portfolio also mitigates interest rate and credit risk inherent in the loan portfolio, while providing a vehicle for the investment of available funds, a source of liquidity (by pledging as collateral or through repurchase agreements), and collateral for certain public funds deposits.

Our investment portfolio is divided into two classes: securities available for sale and securities held to maturity. Available for sale securities are carried at fair value with any unrealized gains or losses reflected as an adjustment to other comprehensive income included in shareholders’ equity. Securities held to maturity are carried at amortized cost. Investment securities designated as available for sale comprised 99% of the portfolio and are available to meet liquidity requirements.

Both available for sale and held to maturity securities may be pledged as collateral to secure public deposits. At December 31, 2014 and 2013, $54.1 million and $46.8 million in securities were pledged for deposits and borrowings, respectively. Pledged securities increased at December 31, 2014 as compared to December 31, 2013 because the Company had new public deposit balances acquired from Alaska Pacific, which are secured by pledged securities at December 31, 2014.

The following tables set forth the composition of our investment portfolio at December 31 for the years indicated:

(In Thousands)	Amortized Cost	Fair Value
Securities Available for Sale:		
2014:		
U.S. Treasury and government sponsored entities	$226,624	$226,190
Municipal Securities	11,843	12,124
U.S. Agency Mortgage-backed Securities	1,024	1,029
Corporate Bonds	38,820	39,235
Preferred Stock	2,999	3,152
Total	$281,310	$281,730
2013:		
U.S. Treasury and government sponsored entities	$168,922	$168,702
Municipal Securities	19,825	20,149
U.S. Agency Mortgage-backed Securities	25	25
Corporate Bonds	55,798	56,778
Preferred Stock	2,999	3,034
Total	$247,569	$248,688
2012:		
U.S. Treasury and government sponsored entities	$123,959	$124,414
Municipal Securities	21,124	21,728
U.S. Agency Mortgage-backed Securities	35	36
Corporate Bonds	52,951	53,982
Preferred Stock	3,524	3,758
Total	$201,593	$203,918
Securities Held to Maturity:		
2014:		
Municipal Securities	$2,201	$2,308
Total	$2,201	$2,308
2013:		
Municipal Securities	$2,208	$2,361
Total	$2,208	$2,361
2012:		
Municipal Securities	$2,749	$2,978
Total	$2,749	$2,978

The following table sets forth the market value, maturities and weighted average pretax yields of our investment portfolio for the periods indicated as of December 31, 2014:

(In Thousands)	Maturity Within 1 Year	1-5 Years	5-10 Years	Over 10 Years	Total
Securities Available for Sale:					
U.S. Treasury and government sponsored entities					
Balance	$—	$225,706	$484.00	$—	$226,190
Weighted average yield	—	1.18 %	2.27 %	—	1.18 %
Municipal securities					
Balance	$3,559	$3,412	$5,153	$—	$12,124
Weighted average yield	0.82 %	2.64 %	4.54 %	—	2.89 %
U.S. Agency Mortgage-backed					
Balance	$—	$54	$309	$666	$1,029
Weighted average yield	—	2.39 %	3.27 %	2.94 %	3.01 %
Corporate bonds					
Balance	$738	$36,490	$2,007	$—	$39,235
Weighted average yield	0.89 %	1.35 %	1.02 %	—	1.33 %
Preferred Stock					
Balance	$—	$—	$—	$3,152	$3,152
Weighted average yield	—	—	—	5.42 %	5.42 %
Total					
Balance	$4,297	$265,662	$7,953	$3,818	$281,730
Weighted average yield	0.83 %	1.22 %	3.44 %	4.97 %	1.33 %
Securities Held to Maturity					
Municipal securities					
Balance	$—	$2,201	$—	$—	$2,201
Weighted average yield	—	4.15 %	—	—	4.15 %

The Company's investment in preferred stock does not have a maturity date but it has been included in the over 10 years column above. At December 31, 2014, we held no securities of any single issuer (other than government sponsored entities) that exceeded 10% of our shareholders' equity.

Loans

Our loan products include short and medium-term commercial loans, commercial credit lines, construction and real estate loans, and consumer loans. To a lesser extent, through our now wholly-owned subsidiary RML, we also originate mortgage loans which we sell to the secondary market. We emphasize providing financial services to small and medium-sized businesses and to individuals. From our inception, we have emphasized commercial, land development and home construction, and commercial real estate lending. These types of lending have provided us with needed market opportunities and generally provide higher net interest margins compared to other types of lending such as consumer lending. However, they also involve greater risks, including greater exposure to changes in local economic conditions.

All of our loans and credit lines are subject to approval procedures and amount limitations. These limitations apply to the borrower's total outstanding indebtedness and commitments to us, including the indebtedness of any guarantor. Generally, we are permitted to make loans to one borrower of up to 15% of the unimpaired capital and surplus of the Bank. The loan-to-one-borrower limitation for the Bank was $24.6 million at December 31, 2014. At December 31, 2014, the Company had two relationships whose total direct and indirect commitments exceeded $24.6 million; however, no individual direct relationship exceeded the loans-to-one borrower limitation. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Provision for Loan Losses."

Our lending operations are guided by loan policies, which outline the basic policies and procedures by which lending operations are conducted. Generally, the policies address our desired loan types, target markets, underwriting and collateral requirements, terms, interest rate and yield considerations, and compliance with laws and regulations. The policies are reviewed and approved annually by the board of directors of the Bank. Our Quality Assurance department provides a detailed financial analysis of our largest, most complex loans. In addition, the Quality Assurance department, along with the Chief Credit Officer of the Bank and others in the Loan Administration department, has developed processes to analyze and manage various concentrations of credit within the overall loan portfolio. The Loan Administration department has also enhanced the procedures and processes for the analysis and reporting of problem loans along with the development of strategies to resolve them. Finally, our Internal Audit Department also performs an independent review of each loan portfolio for compliance with loan policy as well as a review of credit quality. The Internal Audit review follows the FDIC sampling guidelines, and a review of each portfolio is performed on an annual basis.

The Company acquired $138.4 million in loans in connection with the acquisition of Alaska Pacific on April 1, 2014. The following table sets forth the composition of our loan portfolio by loan segment:

(In Thousands)	December 31, 2014 Dollar Amount	December 31, 2014 Percent of Total	December 31, 2013 Dollar Amount	December 31, 2013 Percent of Total	December 31, 2012 Dollar Amount	December 31, 2012 Percent of Total	December 31, 2011 Dollar Amount	December 31, 2011 Percent of Total	December 31, 2010 Dollar Amount	December 31, 2010 Percent of Total
Commercial	$306,543	33.2 %	$300,338	39.0 %	$273,432	38.8 %	$252,689	39.1 %	$256,971	38.3 %
Real estate construction one-to-four family	34,842	3.8 %	30,161	3.9 %	32,573	4.6 %	21,859	3.4 %	27,794	4.1 %
Real estate construction other	91,195	9.9 %	32,599	4.2 %	21,061	3.0 %	18,323	2.8 %	34,826	5.2 %
Real estate term owner occupied	109,472	11.8 %	91,098	11.8 %	78,107	11.1 %	81,481	12.6 %	75,234	11.2 %
Real estate term non-owner occupied	286,616	31.0 %	255,324	33.2 %	234,643	33.3 %	195,454	30.3 %	211,251	31.4 %
Real estate term other	36,894	4.0 %	29,976	3.9 %	31,809	4.5 %	38,925	6.0 %	25,643	3.8 %
Consumer secured by 1st deeds of trust	32,000	3.5 %	16,483	2.1 %	17,714	2.5 %	20,212	3.1 %	19,648	2.9 %
Consumer other	31,493	3.4 %	18,058	2.3 %	18,305	2.6 %	19,622	3.0 %	23,616	3.5 %
Subtotal	$929,055		$774,037		$707,644		$648,565		$674,983	
Less: Unearned origination fee, net of origination costs	(4,551)	(0.5)%	(4,021)	(0.5)%	(3,431)	(0.5)%	(3,003)	(0.5)%	(3,171)	(0.5)%
Total portfolio loans	$924,504		$770,016		$704,213		$645,562		$671,812	

Commercial Loans: Our commercial loan portfolio includes both secured and unsecured loans for working capital and expansion. Short-term working capital loans generally are secured by accounts receivable, inventory, or equipment. We also make longer-term commercial loans secured by equipment and real estate. We also make commercial loans that are guaranteed in large part by the Small Business Administration or the Bureau of Indian Affairs and commercial real estate loans that are purchased by the Alaska Industrial Development and Export Authority (“AIDEA”). Commercial loans increased to $306.5 million at December 31, 2014 from $300.3 million at December 31, 2013 and represented approximately 33% and 39% of our total loans outstanding as of December 31, 2014 and December 31, 2013, respectively. Commercial loans reprice more frequently than other types of loans, such as real estate loans. More frequent repricing means that interest cash flows from commercial loans are more sensitive to changes in interest rates. In a rising interest rate environment, our philosophy is to emphasize the pricing of loans on a floating rate basis, which allows these loans to reprice more frequently and to contribute positively to our net interest margin. As of December 31, 2014, approximately 72% of commercial loans are variable rate loans, of which

72% reprice within one year. The majority of these loans reprice to an index based upon the prime rate of interest or the respective FHLB of Seattle rate. The Company also uses floors in its commercial loan pricing as loans are originated or renewed during the year.

Commercial Real Estate: We are an active lender in the commercial real estate market. At December 31, 2014, commercial real estate loans increased to $433 million from $376.4 million at December 31, 2013, and represented approximately 47% and 48% of our loan portfolio as of December 31, 2014 and December 31, 2013, respectively. These loans are typically secured by office buildings, apartment complexes or warehouses. Loan amortization periods range from 10 to 25 years and generally have a maximum maturity of 10 years. At December 31, 2014, the interest rates for approximately 87% of commercial real estate loans are variable, of which 48% reset within one year. Approximately 40% of commercial real estate variable rate loans reprice in greater than one year but within three years. The indices for these loans include the prime rate of interest or the respective Treasury or FHLB of Seattle rate. The Company also uses floors in its commercial real estate loan pricing as loans are originated or renewed during the year.

We may sell all or a portion of our commercial real estate loans to two State of Alaska entities, the AIDEA and the Alaska Housing Finance Corporation (“AHFC”), which were both established to provide long-term financing in the State of Alaska. The loans that AIDEA purchases typically feature a maturity twice that of the loans retained by us and bear a lower interest rate. The blend of our and AIDEA's loan terms allows us to provide competitive long-term financing to our customers, while reducing the risk inherent in this type of lending. We also originate and sell to AHFC loans secured by multifamily residential units. Typically, 100% of these loans are sold to AHFC and we provide ongoing servicing of the loans for a fee. AIDEA and AHFC make it possible for us to originate these commercial real estate loans and enhance fee income while reducing our exposure to interest rate risk. The Company acquired $1.2 million in mortgage servicing rights in connection with our acquisition of Alaska Pacific on April 1, 2014. The servicing portfolio acquired in connection with our acquisition of Alaska Pacific is comprised of 1-4 family loans serviced for FHLMC and AHFC.

Construction Loans: We provide construction lending for commercial real estate projects. Such loans generally are made only when the Company has also committed to finance the completed project with a commercial real estate loan, or if there is a firm take-out commitment upon completion of the project by a third party lender. Additionally, we provide land development and residential subdivision construction loans. We also originate one-to-four-family residential and condominium construction loans to builders for construction of homes. The Company's construction loans increased in 2014 to $126.0 million, up from $62.8 million in 2013, and represented approximately 14% and 8% of our loan portfolio in December 31, 2014 and December 31, 2013, respectively . The Company saw an increase in construction loans due to an increase in commercial real estate construction and low income housing tax credit projects. The Company currently expects activity in the residential construction market to remain stable in 2015.

Consumer Loans: We provide personal loans for automobiles, recreational vehicles, boats, and other larger consumer purchases. We provide both secured and unsecured consumer credit lines to accommodate the needs of our individual customers, with home equity lines of credit serving as the major product in this area.

Maturities and Sensitivities of Loans to Change in Interest Rates: At December 31, 2014, 60% of the portfolio was scheduled to mature or reprice in 2015 with 36% scheduled to mature or reprice between 2016 and 2019. The following table presents the aggregate maturity data of our loan portfolio, excluding loans held for sale, at December 31, 2014:

	Maturity			
(In Thousands)	Within 1 Year	1-5 Years	Over 5 Years	Total
Commercial	$106,391	$84,596	$115,556	$306,543
Real estate construction one-to-four family	33,167	1,675	—	34,842
Real estate construction other	62,128	25,600	3,467	91,195
Real estate term owner occupied	2,475	21,082	85,915	109,472
Real estate term non-owner occupied	7,270	77,348	201,998	286,616
Real estate term other	2,055	7,961	26,878	36,894
Consumer secured by 1st deeds of trust	143	2,015	29,842	32,000
Consumer other	1,200	6,549	23,744	31,493
Total	$214,829	$226,826	$487,400	$929,055
Fixed interest rate	$141,622	$60,413	$96,032	$298,067
Floating interest rate	73,207	166,413	391,368	630,988
Total	$214,829	$226,826	$487,400	$929,055

Loans Held for Sale: Prior to December 1, 2014, the Company had an agreement to purchase residential loans from our mortgage affiliate, RML, which the Company then sold in the secondary market. All loans purchased and sold in 2014 and 2013 were newly originated loans that did not affect nonperforming loans. The Company purchased $132.0 million and sold $203.4 million in residential loans related to these transactions in 2014, and the Company purchased $156.5 million and sold $156.9 million in residential loans during 2013 related to these transactions. When RML became a wholly-owned subsidiary of the Company on December 1, 2014, we stopped purchasing loans from RML. As a now 100% owned subsidiary, all loans held for sale by RML are included on the Company's balance sheet as of December 31, 2014. As in prior periods, these loans are all sold to the secondary market. On a consolidated basis, there were $43.9 million and $11.3 million in loans held for sale, carried at lower of cost or market, as of December 31, 2014 and 2013, respectively. At December 31, 2014, the increase in the balance of loans held for sale at the end of

2014 as compared to 2013 is the result of the consolidation of RML's balance sheet with the Company's.

Credit Quality and Nonperforming Assets

Nonperforming assets consist of nonaccrual loans, accruing loans that are 90 days or more past due, repossessed assets and OREO. The following table sets forth information regarding our nonperforming loans and total nonperforming assets:

(In Thousands)	2014	2013	2012	2011	2010
Nonperforming loans					
Nonaccrual loans	$4,674	$1,815	$4,531	$7,361	$11,414
Accruing loans past due 90 days or more	—	—	—	—	—
Total nonperforming loans	$4,674	$1,815	$4,531	$7,361	$11,414
Real estate owned & repossessed assets	4,626	2,402	4,543	5,183	10,403
Total nonperforming assets	$9,300	$4,217	$9,074	$12,544	$21,817
Performing restructured loans	$5,353	$6,635	$8,627	$2,305	$—
Allowance for loan losses to portfolio loans	1.81%	2.11%	2.33%	2.56%	2.14%
Allowance for loan losses to nonperforming loans	358%	897%	362%	224%	126%
Nonperforming loans to portfolio loans	0.51%	0.24%	0.64%	1.14%	1.70%
Nonperforming assets to total assets	0.64%	0.35%	0.78%	1.16%	2.07%

Nonaccrual, Accruing Loans 90 Days or More Past Due, and Troubled Debt Restructuring ("TDR"): The Company's financial statements are prepared on the accrual basis of accounting, including recognition of interest income on its loan portfolio, unless a loan is placed on a nonaccrual basis. Loans are placed on a nonaccrual basis when management believes serious doubt exists about the collectability of principal or interest. Our policy generally is to discontinue the accrual of interest on all loans 90 days or more past due unless they are well secured and in the process of collection. Cash payments on nonaccrual loans are directly applied to the principal balance. The amount of unrecognized interest on nonaccrual loans was $218,000, $453,000 and $734,000, in 2014, 2013, and 2012, respectively. There was interest income of $350,000, $344,000, and $270,000 recognized in net income for 2014, 2013, and 2012 respectively, related to interest collected on nonaccrual loans whose principal has been paid down to zero. The increase in the Company's nonaccrual loans is due in part to the acquisition of the Alaska Pacific loan portfolio which included $1.2 million nonaccrual loans as of December 31, 2014. The Company had three relationships each that represented more than 10% of nonaccrual loans as of December 31, 2014.

TDRs are those loans for which concessions, including the reduction of interest rates below a rate otherwise available to that borrower, have been granted due to the borrower's weakened financial condition. Interest on TDRs will be accrued at the restructured rates when it is anticipated that no loss of original principal will occur, and the interest can be collected, which is generally after a period of six months. The Company had $5.4 million and $8.6 million in loans classified as TDRs that were performing as of December 31, 2014 and 2013, respectively. Additionally, there were $2.3 million and $3.5 million in TDRs included in nonaccrual loans at December 31, 2014 and 2013 for total TDRs of $7.7 million and $12.1 million at December 31, 2014 and 2013, respectively. The decrease in TDRs at December 31, 2014 as compared to 2013 is due to several payoffs and regular principal paydowns on loans classified as TDRs that were not offset by new TDRs in 2014. See Note 7 of the Notes to Consolidated Financial Statements included in Item 8 of this report for further discussion of TDRs.

Loans Measured for Impairment, OREO, and Potential Problem Loans: At December 31, 2014, the Company had $11.3 million in loans measured for impairment and $4.6 million in OREO, as compared to $8.8 million in loans measured for impairment and $2.4 million in OREO at December 31, 2013.

At December 31, 2014, management had identified potential problem loans of $18.0 million as compared to potential problem loans of $8.2 million at December 31, 2013. Potential problem loans are loans which are currently performing that have developed negative indications that the borrower may not be able to comply with present payment terms and which may later be included in nonaccrual, past due, or impaired loans. The $9.8 million increase in potential problem loans at December 31, 2014 from December 31, 2013 is primarily due to one relationship that includes three loans secured by equipment.

At December 31, 2014 and 2013 the Company held $4.6 million and $2.4 million, respectively, of OREO assets. At December 31, 2014, OREO consists of $1.3 million in residential lots in various stages of development, a $1 million commercial lot, and a $152,000 duplex. All OREO property is located in Alaska. The Bank initiates foreclosure proceedings to recover and sell collateral pledged by a debtor to secure a loan based on various events of default and circumstances related to loans that are secured by either commercial or residential real property. These events and circumstances include delinquencies, the Company's relationship with the borrower, and the borrower's ability to repay the loan via a source other than the collateral. If the loan has not yet matured, the debtors may cure the events of default up to the time of sale to retain their interest in the collateral. Failure to cure the defaults will result in the debtor losing ownership interest in the property, which is taken by the creditor, or high bidder at a foreclosure sale.

During 2014, additions to OREO totaled $4.0 million which included $904,000 transferred from the Company's premises and equipment, $1.7 million in OREO acquired in connection with our acquisition of Alaska Pacific, and $270,000 acquired with our purchase of the remaining equity interest in RML. Additionally, there were two $145,000 three bedroom townhomes and five $169,000 four bedroom townhomes added in 2014. The $904,000 transferred from premises and equipment is land that the Company has listed for sale that was originally purchased for a new branch. The Company acquired six OREO properties valued at $1.7 million in connection with the acquisition of Alaska Pacific which consisted of two commercial properties valued at $1.5 million, one piece of developed land valued at $130,000, and 3 lots valued at $112,000. The $270,000 acquired as a result of our purchase of the remaining equity interest in RML is a single family residence. During 2014, the Company received approximately $2.4 million in proceeds from the sale of OREO which included $1.9 million from the sale of residential lots and land, $409,000 from the sale of two townhomes, $41,000 from the sale of two commercial properties and $10,000 from the sale of personal property. The Company recognized $607,000, $231,000, and $109,000 in gains and $2,300, $2,000, and $63,000 in losses on the sale of OREO properties in 2014, 2013, and 2012, respectively.

The Company also recognized $38,000, $59,000, and zero in gains on sales previously deferred for net gains of $631,000, $288,000, and $46,000 in 2014, 2013, and 2012, respectively. The Company had remaining accumulated deferred gains on the sale of OREO properties of $296,000 and $335,000 at December 31, 2014 and 2013, respectively.

The Company did not make any loans to facilitate the sale of OREO in 2014 or 2013. The Company made loans to facilitate the sale of OREO of $300,000 in 2012. Our underwriting policies and procedures for loans to facilitate the sale of other real estate owned are no different than our standard loan policies and procedures.

The Company recognized impairments of $56,000, $112,000 and $469,000 in 2014, 2013, and 2012, respectively, due to adjustments to the Company's estimate of the fair value of certain properties based on changes in estimated costs to complete the projects and changes in the Anchorage and Fairbanks real estate markets.

The following summarizes OREO activity for the periods indicated:

(In Thousands)	2014	2013	2012
Balance, beginning of the year	$2,402	$4,543	$5,183
Transfers from loans	1,137	365	1,684
Transfers from premises and equipment	904	—	—
Acquired from Alaska Pacific	1,709	—	—
Acquired from mortgage affiliate	270	—	—
Investment in other real estate owned	—	—	98
Proceeds from the sale of other real estate owned	(2,352)	(2,623)	(1,994)
Gain on sale of other real estate owned, net	631	288	46
Deferred gain on sale of other real estate owned	(38)	(59)	(5)
Impairment on other real estate owned	(56)	(112)	(469)
Balance, end of year	$4,607	$2,402	$4,543

Allowance for Loan Losses

The Company maintains an Allowance to reflect management's assessment of probable, estimable losses inherent in the loan portfolio. The Allowance is increased by provisions for loan losses and loan recoveries and decreased by loan charge-offs. The size of the Allowance is determined through quarterly assessments of probable estimated losses in the loan portfolio. Our methodology for making such assessments and determining the adequacy of the Allowance includes the following key elements:

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A specific allocation for impaired loans. Management determines the fair value of the majority of these loans based on the underlying collateral values. This analysis is based upon a specific analysis for each impaired loan, including

external appraisals on loans secured by real property, management's assessment of the current market, recent payment history, and an evaluation of other sources of repayment. In-house evaluations of fair value are used in the impairment analysis in some situations. Inputs to the in-house evaluation process include information about sales of comparable properties in the appropriate markets and changes in tax assessed values. The Company obtains appraisals on real and personal property that secure its loans during the loan origination process in accordance with regulatory guidance and its loan policy. The Company obtains updated appraisals on loans secured by real or personal property based upon its assessment of changes in the current market or particular projects or properties, information from other current appraisals, and other sources of information. Appraisals may be adjusted downward by the Company based on its evaluation of the facts and circumstances on a case by case basis. External appraisals may be discounted when management believes that the absorption period used in the appraisal is unrealistic, when expected liquidation costs exceed those included in the appraisal, or when management's evaluation of deteriorating market conditions warrants an adjustment. Additionally, the Company may also adjust appraisals in the above circumstances between appraisal dates. The Company uses the information provided in these updated appraisals along with its evaluation of all other information available on a particular property as it assesses the collateral coverage on its performing and nonperforming loans and the impact that may have on the adequacy of its Allowance. The specific allowance for impaired loans, as well as the overall Allowance, may increase based on the Company's assessment of updated appraisals. See Note 24 of the Notes to Consolidated Financial Statements included in Item 8 of this report for further discussion of the Company's estimation of the fair value of impaired loans.
When the Company determines that a loss has occurred on an impaired loan, a charge-off equal to the difference between carrying value and fair value is recorded. If a specific allowance is deemed necessary for a loan, and then that loan is partially charged off, the loan remains classified as a nonperforming loan after the charge-off is recognized. Loans measured for impairment based on collateral value and all other loans measured for impairment are accounted for in the same way.

- A general allocation. The Company has identified segments and classes of loans not considered impaired for purposes of establishing the general allocation allowance. These segments and classes were revised in 2012. The Company disaggregates of the loan portfolio into segments and classes based on its assessment of how different pools of loans with like characteristics in the portfolio behave over time. This determination is based on historical experience and management's assessment of how current facts and circumstances are expected to affect the loan portfolio.

Prior to 2012, the Company first disaggregated the loan portfolio into the following segments: commercial, real estate construction, real estate term, and home equity lines and other consumer loans. As of December 31, 2012, the Company increased the number of segments from four to eight: commercial, real estate construction one-to-four family, real estate construction other, real estate term owner occupied, real estate term non-owner occupied, real estate term other, consumer secured by 1st deeds of trust, and other consumer loans. The Company determined that further disaggregation of the loan segments is appropriate based on its assessment of risk pockets within the loan portfolio and to better align the loan segments with regulatory reporting requirements. There have been no changes to these loan segments in 2014.

After division of the loan portfolio into segments, the Company then further disaggregates each of the segments into classes. Prior to 2012, the Company had a total of eight classes, which were made up of its risk rating categories of excellent, good, satisfactory, watch, special mention, substandard, doubtful, and loss. As of December 31, 2012, the Company adjusted its loan classes. This change integrates a new loan risk grading system known as the Asset Quality Rating ("AQR") system that the Company began utilizing in the first quarter of 2011. The new risk ratings, which have been increased from eight risk ratings to ten AQR ratings, are discussed in Note 7 to the Consolidated Financial Statements included in Item 8 of this report. Additionally, the pass AQR grades, which are grades 1 – 6, have been combined into one loan class so there are now a total of five loan classes: pass, special mention, substandard, doubtful, and loss. There have been no changes to these loan classes in 2014.

After the portfolio has been disaggregated into segments and classes, the Company calculates a general reserve for each segment and class based on the average loss history for each segment and class. In 2012, the Company increased the look-back period used in the calculation of average historical loss rates from four years to five years. Management made this change because we believe that continuing to include the elevated loss experience from earlier year that occurred as a result of the economic downturn from that time is appropriate in light of continuing economic uncertainty. There have been no changes to the look-back period in 2014.

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

An unallocated reserve. The unallocated portion of the Allowance provides for other credit losses inherent in our loan portfolio that may not have been contemplated in the specific and general components of the Allowance, and it acknowledges the inherent imprecision of all loss prediction models. The unallocated component is reviewed periodically based on trends in credit losses and overall economic conditions. At December 31, 2014 and 2013, the unallocated allowance as a percentage of the total Allowance was 7% and 14%, respectively.

The following table shows the allocation of the Allowance for the years indicated: The Company refined its method of estimating the Allowance in the third quarter of 2010. The Company elected this enhanced method of estimating the Allowance because we believe that it more accurately allocates expected losses by loan segment and class. The Company performed a retrospective review of the Allowance as of December 31, 2009, March 31, 2010 and June 30, 2010 and determined that this refinement does not have an effect on the Company's financial position, results of operations, or earnings per share for any period; rather, the refined method of estimating the Allowance changes how the total Allowance is allocated among the Company's loan types and the unallocated portion of the Allowance. Allocations are calculated under the enhanced methodology for 2014, 2013, 2012, and 2011:

	2014		2013		2012		2011		2010	
(In Thousands)	Amount	% of Loans(1)	Amount	% of Loans(1)	Amount	% of Loans(1)	Amount	% of Loans(1)	Amount	% of Loans(1)
Commercial	$5,643	33 %	$5,779	39 %	$6,308	39 %	$6,783	39 %	$6,374	38 %
Real estate construction one-to-four family	644	4 %	557	4 %	1,029	5 %	468	3 %	459	4 %
Real estate construction other	1,653	10 %	539	4 %	326	3 %	1,169	3 %	576	5 %
Real estate term owner occupied	1,580	12 %	1,583	12 %	1,441	11 %	1,272	13 %	1,029	11 %
Real estate term non-owner occupied	4,704	31 %	4,297	33 %	4,065	33 %	2,975	30 %	2,890	31 %
Real estate term other	656	4 %	537	4 %	539	5 %	788	6 %	351	4 %
Consumer secured by 1st deeds of trust	285	3 %	322	2 %	344	2 %	374	3 %	337	3 %
Consumer other	410	3 %	390	2 %	388	2 %	418	3 %	404	4 %
Unallocated	1,148	— %	2,278	— %	1,968	— %	2,256	— %	1,986	— %
Total	$16,723	100 %	$16,282	100 %	$16,408	100 %	$16,503	100 %	$14,406	100 %

[1] Represents percentage of this category of loans to total portfolio loans.

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

(In Thousands)	2014	2013	2012	2011	2010
Balance at beginning of year	$16,282	$16,408	$16,503	$14,406	$13,108
Charge-offs:					
Commercial	(319)	(1,018)	(496)	(1,225)	(3,919)
Real estate construction one-to-four family	—	—	—	—	(79)
Real estate construction other	—	—	—	(133)	(1,440)
Real estate term owner occupied	—	—	(274)	—	(222)
Real estate term non-owner occupied	(160)	—	—	—	—
Real estate term other	—	—	(280)	(90)	(120)
Consumer secured by 1st deeds of trust	(59)	(14)	—	—	—
Consumer other	(87)	(164)	(122)	(71)	(322)
Total charge-offs	(625)	(1,196)	(1,172)	(1,519)	(6,102)
Recoveries:					
Commercial	1,041	1,049	2,518	1,426	1,490
Real estate construction one-to-four family	625	77	48	1	4
Real estate construction other	—	79	—	90	—
Real estate term owner occupied	—	—	—	—	232
Real estate term non-owner occupied	—	488	—	—	—
Real estate term other	—	—	50	54	—
Consumer secured by 1st deeds of trust	4	—	—	—	15
Consumer other	32	12	20	46	76
Total recoveries	1,702	1,705	2,636	1,617	1,817
Net, recoveries (charge-offs)	1,077	509	1,464	98	(4,285)
Provision (benefit) for loan losses	(636)	(635)	(1,559)	1,999	5,583
Balance at end of year	$16,723	$16,282	$16,408	$16,503	$14,406
Ratio of net charge-offs to average loans outstanding during the period	(0.12)%	(0.07)%	(0.21)%	(0.01)%	0.66%

In accordance with GAAP, loans acquired in connection with our acquisition of Alaska Pacific on April 1, 2014 were recorded at their fair value at the acquisition date. Credit discounts were included in the determination of fair value; therefore, an allowance for loan losses was not recorded at the acquisition date. Purchased credit impaired loans were evaluated on a loan by loan basis and the valuation allowance for these loans was netted against the carrying value. The provision for loan losses in 2014 as compared to 2013 was relatively flat despite an increase in net recoveries in 2014. The Company determined that an Allowance of $16.7 million, or 1.81% of portfolio loans, is appropriate as of December 31, 2014 based on our analysis of the current credit quality of the portfolio and current economic conditions, including the significant decrease in the price of oil in the fourth quarter of 2014. The increase in the provision for loan losses in 2013 as compared to 2012 is due to the decrease in net recoveries. The decreases in the provision for loan losses in 2012 as compared to 2011 and in 2011 as compared to 2010 is due primarily to the decreases in net charge offs during each year.

While management believes that it uses the best information available to determine the Allowance, unforeseen market conditions and other events could result in an adjustment to the Allowance, and net income could be significantly affected if circumstances differed substantially from the assumptions used in making the final determination of the Allowance.

Purchased Receivables

We purchase accounts receivable from our business customers and provide them with short-term working capital. We provide this service to our customers in Alaska, Washington, Oregon and some other states through NFS.

Our purchased receivable activity is guided by policies that outline risk management, documentation, and approval limits. The policies are reviewed and approved annually by the Company's Board of Directors. In 2012, the

Company established a reserve for purchased receivable losses. Purchased receivables are recorded on the balance sheet net of this reserve.

Purchased receivable balances decreased at December 31, 2014 to $15.3 million from $16.0 million at December 31, 2013, and year-to-date average purchased receivable balances were $12.6 million, $18.7 million, and $20.9 million in 2014, 2013, and 2012, respectively. Yields on purchased receivables did not fluctuate significantly in 2014, 2013 and 2012, and accordingly, purchased receivable income fluctuated in these years with the changes in average balances. Purchased receivable income was $2.1 million, $2.8 million, and $3.0 million in 2014, 2013, and 2012, respectively. The Company currently expects that purchased receivable balances will increase in the future as NFS continues to expand its customer base.

The following table sets forth information regarding changes in the purchased receivable reserve for the years indicated:

(In Thousands)	2014	2013	2012
Balance at beginning of year	$273	$323	$—
Charge-offs	(793)	(150)	(34)
Recoveries	105	—	—
Charge-offs net of recoveries	(688)	(150)	(34)
Reserve of purchased receivables	704	100	357
Balance at end of year	$289	$273	$323
Ratio of net charge-offs to average purchased receivables during the period[1]	5.47%	0.80%	0.16%

[1]Net charge-offs to average purchased receivables during 2011 and 2010 were 0.32% and 4.62%, respectively. Totals for these periods are not presented in the table above because the purchase receivable reserve was not established until 2012. Prior to 2012, losses on purchased receivables were charge directly to other operating expense, and totaled $57,000 and $402,000 in 2011 and 2010, respectively.

Deposits

Deposits are our primary source of funds. Total deposits increased 18% to $1.2 billion at December 31, 2014 from $1.0 billion at December 31, 2013. On April 1, 2014, the Company acquired $151.4 million in deposits in connection with our acquisition of Alaska Pacific. Our deposits generally are expected to fluctuate according to the level of our market share, economic conditions, and normal seasonal trends.

The following table sets forth the average balances outstanding and average interest rates for each major category of our deposits, for the periods indicated:

	2014		2013		2012	
(In Thousands)	Average balance	Average rate paid	Average balance	Average rate paid	Average balance	Average rate paid
Interest-bearing demand accounts	$169,467	0.04%	$139,963	0.04%	$137,772	0.05%
Money market accounts	221,508	0.17%	183,620	0.18%	170,014	0.25%
Savings accounts	226,743	0.23%	199,655	0.24%	185,518	0.27%
Certificates of deposit	109,360	0.42%	90,507	0.40%	104,141	0.65%
Total interest-bearing accounts	727,078	0.20%	613,745	0.20%	597,445	0.28%
demand accounts	384,516		340,180		311,684	
Total average deposits	$1,111,594		$953,925		$909,129	

Certificates of Deposit: The only deposit category with stated maturity dates is certificates of deposit. At December 31, 2014, we had $142.2 million in certificates of deposit, of which $81.9 million, or 58%, are scheduled to mature in 2015. The Company's certificates of deposit increased to $142.2 million during 2014 as compared to $86.2 million at December 31, 2013 as customers responded to a certificates of deposit promotion. The aggregate amount of certificates of deposit in amounts of $100,000 or more at December 31, 2014, and 2013, was $84.0 million and $50.8 million, respectively. The following table sets forth the amount outstanding of certificates of deposits in amounts of $100,000 or more by time remaining until maturity and percentage of total deposits as of December 31, 2014:

	Time Certificates of Deposits of $100,000 or More		
(In Thousands)	Amount	Percent of Total Deposits	
Amounts maturing in:			
Three months or less	$12,590	15	%
Over 3 through 6 months	6,603	8	%
Over 6 through 12 months	26,861	32	%
Over 12 months	37,909	45	%
Total	$83,963	100	%

The Company is also a member of the Certificate of Deposit Account Registry System ("CDARS") which is a network of over 3,000 banks throughout the United States. The CDARS system was founded in 2003 and allows participating banks to exchange FDIC insurance coverage so that 100% of the balance of their customers' certificates of deposit is fully subject to FDIC insurance. At December 31, 2014 and 2013, the Company had $1.0 million and zero, respectively, in CDARS certificates of deposit.

Alaska Certificates of Deposit: The Alaska Certificate of Deposit ("Alaska CD") is a savings deposit product with an open-ended maturity, interest rate that adjusts to an index that is tied to the two-year United States Treasury Note, and limited withdrawals. The total balance in the Alaska CD at December 31, 2014, was $99.7 million, an decrease of $13.0 million as compared to the balance of $112.7 million at December 31, 2013.

Borrowings

Long-term Borrowings: The Company purchased its main office facility for $12.9 million on July 1, 2008. In this transaction, the Company, through NBL, assumed an existing loan secured by the building in an amount of approximately $5.1 million. This loan was paid off in its entirety in January, 2014.

FHLB: FHLB advances are dependent on the availability of acceptable collateral such as marketable securities or real estate loans, although all FHLB advances are secured by a blanket pledge of the Company's assets. At December 31, 2014, our maximum borrowing line from the FHLB was $351.2 million, approximately 25% of the Company's assets, subject to the FHLB's collateral requirements. The Company has an outstanding FHLB Community Investment Program advance of $2.2 million as of December 31, 2014 that was originated in 2013 and is included in borrowings. This advance was originated to match fund a $2.2 million loan to one borrower for the construction of a low income housing project that qualifies for a long term fixed interest rate. It has an eighteen year term with a 30 year amortization period, which mirrors the term of the term real estate loan made to the borrower.

Federal Reserve Bank: The Federal Reserve Bank is holding $86.2 million of loans as collateral to secure advances made through the discount window on December 31, 2014. There were no discount window advances outstanding at December 31, 2014 or 2013.

Other Short-term Borrowings: Securities sold under agreements to repurchase were $19.8 million and $21.1 million, for December 31, 2014 and 2013, respectively. The average balance outstanding of securities sold under agreements to repurchase during 2014 and 2013 was $20.1 million and $19.4 million, respectively, and the maximum outstanding at any month-end was $22.4 million and $24.0 million, respectively, during the same time periods. The securities sold under agreements to repurchase are held by the Federal Home Loan Bank under the Company's control.

The Company, through RML, had borrowings of $24.1 million at December 31, 2014 and did not have any other short-term borrowings at December 31, 2013. The $24.1 million is a line of credit used by RML to fund mortgage originations that matures in August 12, 2015. There were no short-term (original maturity of one year or less) borrowings for which the average balance outstanding during 2014, 2013 and 2012 exceeded 30% of shareholders' equity at December 31, 2014, December 31, 2013, and December 31, 2012.

Contractual Obligations

The following table references contractual obligations of the Company for the periods indicated:

	Payments Due by Period				
(In Thousands)	Within 1 Year	1-3 Years	3-5 Years	Over 5 Years	Total
December 31, 2014:					
Certificates of deposit	$81,924	$58,658	$1,278	$352	$142,212
Short-term borrowings	43,983	—	—	—	43,983
Long-term borrowings	45	94	102	1,923	2,164
Junior subordinated debentures	—	—	—	18,558	18,558
Operating lease obligations	2,616	4,530	3,605	10,192	20,943
Other long-term liabilities	8,657	7,695	575	344	17,271
Capital commitments	2,894	—	—	—	2,894
Total	$140,119	$70,977	$5,560	$31,369	$248,025
December 31, 2013:					
Certificates of deposit	$55,355	$30,042	$828	$—	$86,225
Short-term borrowings	21,143	—	—	—	21,143
Long-term borrowings	4,364	91	98	1,974	6,527
Junior subordinated debentures	—	—	—	18,558	18,558
Operating lease obligations	635	1,068	735	6,332	8,770
Other long-term liabilities	9,202	1,122	523	138	10,985
Capital commitments	$2,211	$—	$—	$—	$2,211
Total	$92,910	$32,323	$2,184	$27,002	$154,419

Short and long-term borrowings included in the table above are described in the "Borrowings" section above. Junior subordinated debentures include $8.2 million that was originated on May 8, 2003, matures on May 15, 2033, and bears interest at a rate of 90-day LIBOR plus 3.15%, adjusted quarterly, and $10.3 million that was originated on December 16, 2005, matures on March 15, 2036, and bears interest at a rate of 90-day LIBOR plus 1.37%, adjusted quarterly. Operating lease obligations are more fully described in Note 18 of the Company's Consolidated Financial Statements attached to this report. Other long-term liabilities consist of amounts that the Company owes for its investments in Delaware limited partnerships that develop low-income housing projects throughout the United States. The Company purchased a $2.5 million interest in WNC Institutional Tax Credit Fund 37 L.P. ("WNC") in December 2012. The investment in WNC is expected to be fully funded in 2017. The Company purchased a $10.7 million interest in R4 Frontier Housing Partners L.P., Coronado Park Senior Village L.P. ("R4-Coronado") in March 2013. The investment in R4-Coronado is expected to be 94% funded by the end of 2015 and fully funded in 2029. The Company also purchased an $8.5 million interest in R4 Frontier Housing Partners L.P., Mountain View Village V L.P. ("R4-MVV") in May 2014. The investment in R4-MVV is expected to be 97% funded by the end of 2016 and fully funded in 2030.

Off-Balance Sheet Arrangements

The Company is a party to financial instruments with off-balance sheet risk. Among the off-balance sheet items entered into in the ordinary course of business are commitments to extend credit and the issuance of letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized on the balance sheet. Certain commitments are collateralized. We apply the same credit standards to these commitments as in all of our lending activities and include these commitments in our lending risk evaluations.

As of December 31, 2014 we had commitments to extend credit of $219.3 million which were not reflected on our balance sheet. Commitments to extend credit are agreements to lend to customers. These commitments have specified interest rates and generally have fixed expiration dates but may be terminated by the Company if certain conditions of the contract are violated. Collateral held relating to these commitments varies, but generally includes real estate, inventory, accounts receivable, and equipment. Our exposure to credit loss under commitments to extend credit is represented by the amount of these commitments. Since many of the commitments are expected to expire without being drawn upon, these total commitment amounts do not necessarily represent future cash requirements.

As of December 31, 2014 we had standby letters of credit of $6.0 million which were not reflected on our balance sheet. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Credit risk arises in these transactions from the possibility that a customer may not be able to repay the Company upon default of performance. Collateral held for standby letters of credit is based on an individual evaluation of each customer’s creditworthiness.

Our total unfunded lending commitments at December 31, 2014, which includes commitments to extend credit and standby letters of credit, were $225.4 million. We do not expect that all of these commitments are likely to be fully drawn upon at any one time. The Company has established reserves of $112,000 and $97,000 at December 31, 2014 and 2013, respectively, for losses related to these commitments that are recorded in other liabilities on the consolidated balance sheet.

Additional information regarding Off-Balance Sheet Arrangements is included in Note 18 of the Notes to Consolidated Financial Statements in Item 8 below.

Liquidity and Capital Resources

The Company is a single bank holding company and its primary ongoing source of liquidity is from dividends received from the Bank. Such dividends arise from the cash flow and earnings of the Bank. Banking regulations and regulatory authorities may limit the amount of, or require the Bank to obtain certain approvals before paying, dividends to the Company. Given that the Bank currently meets all applicable capital adequacy requirement for a “well-capitalized” institution by regulatory standards, the Company expects to continue to receive dividends from the Bank during 2015. Beginning in 2016, a requirement to have a conservation buffer will start being phased in and this requirement could adversely affect the Bank's ability to pay dividends.

The Bank manages its liquidity through its Asset and Liability Committee. Our primary sources of funds are customer deposits and advances from the Federal Home Loan Bank of Seattle. These funds, together with loan repayments, loan sales, other borrowed funds, retained earnings, and equity are used to make loans, to acquire securities and other assets, and to fund deposit flows and continuing operations. The primary sources of demands on our liquidity are customer demands for withdrawal of deposits and borrowers’ demands that we advance funds against unfunded lending commitments. Our total unfunded commitments to fund loans and letters of credit at December 31, 2014, were $225.4 million. We do not expect that all of these loans are likely to be fully drawn upon at any one time. Additionally, as noted above, our total deposits at December 31, 2014, were $1.2 billion.

As shown in the Consolidated Statements of Cash Flows, net cash provided by operating activities was $20.5 million, $18.6 million, and $32.5 million in 2014, 2013, and 2012 respectively. The primary reason that net cash provided by operating activities increased in 2014 as compared to 2013 was that the Company had net proceeds from sales of loans held for sale of $71.4 million in 2014, while in 2013 the Company had net proceeds from sales of loans held for sale of $404,000. The primary source of cash provided by operating activities for all periods presented was positive net income in each of these periods. Net cash of $48.7 million, $108.0 million, and $28.3 million was used in investing activities in 2014, 2013, and 2012 as the Company invested available cash primarily in available for sale securities and portfolio loans. Financing activities provided cash of $11.1 million, $33.6 million, and $57.5 million in 2014, 2013, and 2012, respectively. The decrease in net cash provided by financing activities in 2014 as compared to 2013 was the primarily the result of reduced deposit growth in 2014 compared to 2013.

The sources by which we meet the liquidity needs of our customers are current assets and borrowings available through our correspondent banking relationships and our credit lines with the Federal Reserve Bank and the FHLB. At December 31, 2014, our current assets were $309.8 million and our funds available for borrowing under our existing lines of credit were $242.5 million. Given these sources of liquidity and our expectations for customer demands for cash and for our operating cash needs, we believe our sources of liquidity to be sufficient in the foreseeable future.

During 2014, the Company's Board of Directors approved a quarterly cash dividend of $0.17 per common share for the first and second quarters and $0.18 per common share for the third and fourth quarters. These dividends were made pursuant to our existing dividend policy and in consideration of, among other things, earnings, regulatory capital levels, liquidity, asset quality, and the overall payout ratio. We expect that the dividend rate will be reassessed on a quarterly basis by the Board of Directors in accordance with the dividend policy. The payment of cash dividends is subject to regulatory limitations as described under the

Supervision and Regulation section of Part I of this report. There is no assurance that future cash dividends on common shares will be declared or increased.

On February 26, 2015, the Board of Directors approved payment of a $0.18 per share dividend on March 20, 2015, to shareholders of record on March 12, 2015 . This dividend is consistent with the Company's dividends that were declared and paid in 2014.

In September 2002, our Board of Directors approved a plan whereby we would periodically repurchase for cash up to approximately 5% of our shares of common stock in the open market. We purchased an aggregate of 688,442 shares of our stock under this program through December 31, 2009 at a total cost of $14.2 million at an average price of $20.65, which left a balance of 227,242 shares available under the stock repurchase program. We intend to continue to repurchase our stock from time to time depending upon market conditions, but we can make no assurances that we will continue this program or that we will repurchase all of the authorized shares. The Company did not repurchase any of its shares in 2010 through 2014. The table below shows this effect on diluted earnings per share.

Years Ending:	Diluted EPS as Reported	Diluted EPS without Stock Repurchase
2014	$2.54	$2.29
2013	$1.87	$1.67
2012	$1.97	$1.77
2011	$1.74	$1.56
2010	$1.40	$1.25

On May 8, 2003, the Company's newly formed subsidiary, NCT1, issued trust preferred securities in the principal amount of $8 million. These securities carry an interest rate of 90-day LIBOR plus 3.15% per annum that was initially set at 4.45% adjusted quarterly. The securities have a maturity date of May 15, 2033, and are callable by the Company on or after May 15, 2008. These securities are treated as Tier 1 capital by the Company's regulators for capital adequacy calculations. The interest cost to the Company of the trust preferred securities was $274,000 in 2014. At December 31, 2014, the securities had an interest rate of 3.38%.

On December 16, 2005, the Company's newly formed subsidiary, NST2, issued trust preferred securities in the principal amount of $10 million. These securities carry an interest rate of 90-day LIBOR plus 1.37% per annum that was initially set at 5.86% adjusted quarterly. The securities have a maturity date of March 15, 2036, and are callable by the Company on or after March 15, 2011. These securities are treated as Tier 1 capital by the Company's regulators for capital adequacy calculations. The interest cost to the Company of these securities was $163,000 in 2014. At December 31, 2014, the securities had an interest rate of 1.61%.

Our shareholders' equity at December 31, 2014, was $164.4 million, as compared to $144.3 million at December 31, 2013. The Company earned net income of $17.4 million during 2014 and issued 26,325 shares through the exercise of stock options. The Company issued 290,212 shares of the Company's common stock in connection with the acquisition of Alaska Pacific on April 1, 2014. At December 31, 2014, the Company had approximately 6.9 million shares of its common stock outstanding.

We are subject to minimum capital requirements. Federal banking agencies have adopted regulations establishing minimum requirements for the capital adequacy of banks and bank holding companies. The requirements address both risk-based capital and leverage capital. We believe as of December 31, 2014, that the Company and the Bank met all applicable capital adequacy requirements for a "well-capitalized" institution by regulatory standards.

The table below illustrates the capital requirements in effect prior to 2015 for the Company and the Bank and the actual capital ratios for each entity that exceed these requirements. Management intends to maintain a capital ratios for the Bank in 2015, exceeding the FDIC's new requirements for the "well-capitalized" classification. The capital ratios for the Company exceed those for the Bank primarily because the $8 million trust preferred securities offering that the Company completed in the second quarter of 2003 and another offering of $10 million completed in the fourth quarter of 2005 are included in the Company's capital for regulatory purposes although they are accounted for as a long-term debt in our financial statements. The trust preferred securities are not accounted for on the Bank's financial statements nor are they included in its capital. As a result, the Company has $18 million more in regulatory capital than the Bank, which explains most of the difference in the capital ratios for the two entities.

December 31, 2014	Adequately-Capitalized	Well-Capitalized	Actual Ratio Company	Actual Ratio Bank
Tier 1 risk-based capital	4.00%	6.00%	13.06%	12.05%
Total risk-based capital	8.00%	10.00%	14.31%	13.30%
Leverage ratio	4.00%	5.00%	11.21%	10.35%

See Note 22 of the Consolidated Financial Statements for a detailed discussion of the capital ratios.

Effects of Inflation and Changing Prices: The primary impact of inflation on our operations is increased operating costs. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Although interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services, increases in inflation generally have resulted in increased interest rates, which could affect the degree and timing of the repricing of our assets and liabilities. In addition, inflation has an impact on our customers' ability to repay their loans.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The disclosures in this item are qualified by the Risk Factors set forth in Item 1A and the Section entitled "Note Regarding Forward-Looking Statements" included in Part I in this report and any other cautionary statements contained herein.

The Company's results of operations depend substantially on our net interest income and are largely dependent upon our ability to manage market risks. Market risk such as foreign currency exchange rate risk and commodity price risk do not arise in the normal course of the Company's business. Like most financial institutions, our interest income and cost of funds are affected by general economic conditions, by competition, by changes in interest rates, and in addition, our community banking focus makes our results of operations particularly dependent on the Alaska economy.

Interest Rate Risk: The Company is exposed to interest rate risk. Interest rate risk is the risk that financial performance will decline over time due to changes in prevailing interest rates and resulting yields on interest-earning assets and costs of interest-bearing liabilities. Generally, there are four sources of interest rate risk as described below:

- Re-pricing Risk: Generally, re-pricing risk is the risk of adverse consequences from a change in interest rates that arises because of differences in the timing of when those interest rate changes affect an institution's assets and liabilities.
- Basis Risk: Basis risk is the risk of adverse consequences resulting from unequal changes in the spread between two or more rates for different instruments with the same maturity.
- Yield Curve Risk: Also called yield curve twist risk, yield curve risk is the risk of adverse consequences resulting from unequal changes in the spread between two or more rates for different maturities for the same instrument.
- Option Risk: In banking, option risks are known as borrower options to prepay loans and depositor options to make deposits, withdrawals, and early redemptions. Option risk arises whenever bank products give customers the right,

but not the obligation, to alter the quantity of the timing of cash flows.

Asset/Liability and Interest Rate Risk Management: The purpose of asset/liability management is to provide stable net interest income growth by protecting our earnings from undue interest rate risk, which arises from changes in interest rates and changes in the balance sheet mix, and by managing the risk/return relationships between liquidity, interest rate risk, market risk, and capital adequacy. We maintain an asset/liability management policy that provides guidelines for controlling exposure to interest rate risk by setting a target range and minimum for the net interest margin and running simulation models under different interest rate scenarios to measure the risk to earnings over the next 24-month period.

A number of measures are used to monitor and manage interest rate risk, including interest sensitivity (gap) analysis and income simulations. An income simulation model is the primary tool used to assess the direction and magnitude of changes in net interest income resulting from changes in interest rates. Key assumptions in the model include loan and deposit volumes and pricing, prepayment speeds on fixed rate assets, and cash flows and maturities of investment securities. These assumptions are inherently uncertain and, as a result, the model cannot precisely estimate net interest income or precisely predict the impact of higher or lower interest rates on net interest income. Actual results will differ from simulated results due to timing, magnitude and frequency of interest rate changes, changes in market conditions and management strategies, among other factors.

Although analysis of interest rate gap (the difference between the repricing of interest-earning assets and interest-bearing liabilities during a given period of time) is one standard tool for the measurement of exposure to interest rate risk, we believe that because interest rate gap analysis does not address all factors that can affect earnings performance it should not be used as the primary indicator of exposure to interest rate risk and the related volatility of net interest income in a changing interest rate environment. Interest rate gap analysis is primarily a measure of liquidity based upon the amount of change in principal amounts of assets and liabilities outstanding, as opposed to a measure of changes in the overall net interest margin.

The Company uses derivatives in the Home Mortgage Lending segment, including commitments to originate residential mortgage loans at fixed prices, and it enters into forward delivery contracts to sell mortgage-backed securities to broker/dealers at specific prices and dates in order to hedge the interest rate risk in its residential mortgage loan commitments. The Company does not use derivatives outside of these activities in the Home Mortgage Lending segment to manage our interest rate risk exposures. However, the Company does enter into commercial loan interest rate swap agreements in its Community Banking segment in order to provide commercial loan customers the ability to convert from variable to fixed interest rates. Commercial loan interest rate swap agreements are offset with corresponding swap agreements with a third party swap dealer in order to offset the Company's exposure on the fixed component of the customer’s interest rate swap. Additional information regarding the Company’s customer interest rate swap program is presented in Note 19 of the Notes to Consolidated Financial Statements included in Item 8 of this report.

The following table sets forth the estimated maturity or repricing, and the resulting interest rate gap, of our interest-earning assets and interest-bearing liabilities at December 31, 2014. The amounts in the table are derived from internal data based upon regulatory reporting formats and, therefore, may not be wholly consistent with financial information appearing elsewhere in the audited financial statements that have been prepared in accordance with generally accepted accounting principles. The amounts shown below could also be significantly affected by external factors such as changes in prepayment assumptions, early withdrawals of deposits, and competition.

	Estimated maturity or repricing at December 31, 2014			
(In Thousands)	Within 1 year	1-5 years	>5 years	Total
Interest -Earning Assets:				
Interest bearing deposits in other banks	$36,020	$—	$—	$36,020
Portfolio investments and FHLB Stock	127,591	158,062	1,682	287,335
Portfolio loans	534,616	352,049	37,824	924,489
Loans held for sale	43,866	—	—	43,866
Total interest-earning assets	$742,093	$510,111	$39,506	$1,291,710
Percent of total interest-earning assets	57.4 %	39.5 %	3.1 %	100.0 %
Interest-Bearing Liabilities:				
Interest-bearing demand accounts	$185,114	$—	$—	$185,114
Money market accounts	226,574	—	—	226,574
Savings accounts	222,324	—	—	222,324
Certificates of deposit	81,466	60,395	351	142,212
Short-term borrowings	43,982	—	—	43,982
Long-term borrowings	103	447	1,615	2,165
Junior subordinated debentures	18,558	—	—	18,558
Total interest-bearing liabilities	$778,121	$60,842	$1,966	$840,929
Percent of total interest-bearing liabilities	92.6 %	7.2 %	0.2 %	100.0 %
Interest sensitivity gap	($36,028)	$449,269	$37,540	$450,781
Cumulative interest sensitivity gap	($36,028)	$413,241	$450,781	
Cumulative interest sensitivity gap as a percentage of total interest-earning assets	(3.0)%	32.0 %	35.0 %	

As stated previously, certain shortcomings, including those described below, are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or periods of repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market interest rates. Additionally, certain assets have features that restrict changes in their interest rates, both on a short-term basis and over the lives of the assets. Further, in the event of a change in market interest rates, prepayment and early withdrawal levels could deviate significantly from those assumed in calculating the tables as can the relationship of rates between different loan and deposit categories. Moreover, the ability of many borrowers to service their adjustable-rate debt may decrease in the event of an increase in market interest rates.

As indicated in the table above, at December 31, 2014, the Company’s interest-earning assets reprice or mature slower than the Company’s interest-bearing liabilities by a margin of $36.0 million over the next 12 months. As of December 31, 2013, the Company’s interest-earning assets reprice or mature faster than the Company’s interest-bearing liabilities by a margin of $3.9 million over the next 12 months. These interest rate sensitivity gaps represent a cumulative gap as a percentage of interest-earning assets of negative 3.0% and positive 0.4%, at December 31, 2014 and 2013, respectively.

While the analysis above sets forth the estimated maturity or repricing and the resulting interest rate gap of our interest-earning assets and interest-bearing liabilities, the Company analyzes the estimated impact on our net interest income over a time horizon of one year based on the results of our interest rate simulation model as of December 31, 2014 and 2013. For the scenarios shown in the table below, the interest rate simulation assumes an immediate parallel shift in market interest rates at the beginning of a twelve-month period and no changes in the composition or size of the balance sheet.

(In Thousands)	2014 Change in net interest income from base scenario	Percentage change	2013 Change in net interest income from base scenario	Percentage change
Scenario:				
Up 100 basis points	$113	0.19 %	($295)	(0.66)%
Up 200 basis points	490	0.82 %	(6)	(0.01)%
Down 100 basis points	NM	NM	NM	NM

The change in net interest income from the base scenario in the up 100 and up 200 basis point scenarios increased $408,000 and $496,000, respectively, in 2014 as compared to 2013. The increase in both of these scenarios is primarily due to a change in the mix of the Company's interest-earning assets. As of December 31, 2014, 78% of the interest-earning assets that reprice within the first year are loans, as compared to 62% at December 31, 2013. Portfolio loans and loans held for sale are the highest yielding assets, and the increase in interest income due to this change in mix between the two periods more than offsets the increase in interest expense on interest-bearing liabilities that reprice within one year due at December 31, 2014 as compared to December 31, 2013. In both the up 100 and up 200 basis point scenarios, the change in net interest income as compared to the base scenario is less than 1%, which indicates that the Company's sensitivity to increases in interest rates in the next 12 months is low. The results of the down 100 basis point scenario at December 31, 2014 and 2013 are not measurable since interest rates were already at a low point and a further decrease resulted in some indexes being nonexistent.

Impact of Inflation and Changing Prices: The primary impact of inflation on the Company’s operations is increased operating costs. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature and as a result, interest rates generally have a more significant impact on a financial institution’s performance than the effects of general levels of inflation. Although interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services, increases in inflation generally have resulted in increased interest rates.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following report, audited consolidated financial statements and the notes thereto are set forth in this Annual Report on Form 10-K on the pages indicated:

Report of Independent Registered Public Accounting Firm

The Board of Directors of
Northrim BanCorp, Inc.

We have audited the accompanying consolidated balance sheets of Northrim BanCorp, Inc. and Subsidiaries (the "Company") as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2014. We also have audited the Company's internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risks. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Northrim BanCorp, Inc. and Subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2014, in conformity with generally accepted accounting principles in the United States of America. Also in our opinion, Northrim BanCorp, Inc. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control - Integrated Framework (2013) issued by COSO.

/s/ Moss Adams LLP

Bellingham, Washington
March 12, 2015

CONSOLIDATED FINANCIAL STATEMENTS

NORTHRIM BANCORP, INC.
Consolidated Balance Sheets
December 31, 2014 and 2013

(In Thousands, Except Share Data)	December 31, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$36,036	$33,112
Interest bearing deposits in other banks	36,020	65,979
Investment securities available for sale	281,730	248,688
Investment securities held to maturity	2,201	2,208
Total portfolio investments	283,931	250,896
Investment in Federal Home Loan Bank stock	3,404	1,896
Loans held for sale	43,866	11,301
Loans	924,504	770,016
Allowance for loan losses	(16,723)	(16,282)
Net loans	951,647	765,035
Purchased receivables, net	15,254	16,025
Accrued interest receivable	3,373	2,729
Other real estate owned, net	4,607	2,402
Premises and equipment, net	35,643	28,324
Goodwill and intangible assets, net	24,035	7,942
Other assets	55,399	40,666
Total assets	$1,449,349	$1,215,006
LIABILITIES		
Deposits:		
Demand	$403,523	$363,969
Interest-bearing demand	185,114	143,703
Savings	122,588	94,518
Alaska CDs	99,736	112,702
Money market	226,574	202,606
Certificates of deposit less than $100,000	58,249	35,432
Certificates of deposit greater than $100,000	83,963	50,793
Total deposits	1,179,747	1,003,723
Securities sold under repurchase agreements	19,843	21,143
Borrowings	26,304	6,527
Junior subordinated debentures	18,558	18,558
Other liabilities	40,456	20,737
Total liabilities	1,284,908	1,070,688
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, 6,854,189 and 6,537,652 shares issued and outstanding at December 31, 2014 and December 31, 2013, respectively	6,854	6,538
Additional paid-in capital	61,729	54,089

Retained earnings	95,493	82,855
Accumulated other comprehensive income	247	669
Total Northrim BanCorp shareholders' equity	164,323	144,151
Noncontrolling interest	118	167
Total shareholders' equity	164,441	144,318
Total liabilities and shareholders' equity	$1,449,349	$1,215,006

See notes to consolidated financial statements

NORTHRIM BANCORP, INC.
Consolidated Statements of Income
Years Ended December 31, 2014, 2013, and 2012

(In Thousands, Except Per Share Data)	2014	2013	2012
Interest Income			
Interest and fees on loans	$51,627	$43,137	$41,515
Interest on investment securities available for sale	3,042	2,603	2,796
Interest on investment securities held to maturity	91	111	139
Interest on deposits in other banks	198	223	278
Total Interest Income	54,958	46,074	44,728
Interest Expense			
Interest expense on deposits, borrowings and junior subordinated debentures	2,053	2,040	2,505
Net Interest Income	52,905	44,034	42,223
Provision (benefit) for loan losses	(636)	(635)	(1,559)
Net Interest Income After Provision (Benefit) for Loan Losses	53,541	44,669	43,782
Other Operating Income			
Employee benefit plan income	3,497	2,341	2,369
Gain on purchase of mortgage affiliate	3,001	—	—
Electronic banking income	2,356	2,151	2,058
Service charges on deposit accounts	2,155	2,116	2,201
Purchased receivable income	2,074	2,797	3,026
Mortgage banking income	1,620	—	—
Gain on sale of premises and equipment	1,115	—	—
Equity in earnings from RML	894	1,227	2,635
Gain on sale of securities	461	333	336
Rental income	260	108	773
Other income	3,104	1,813	2,034
Total Other Operating Income	20,537	12,886	15,432
Other Operating Expense			
Salaries and other personnel expense	27,758	23,796	22,032
Occupancy expense	4,360	3,464	3,615
Marketing expense	2,059	1,853	1,975
Merger and acquisition expense	1,962	536	—
Equipment expense	1,465	1,239	1,205
Professional and outside services	1,437	1,268	1,479
Amortization of low income housing tax investments	1,337	969	921
Software expense	1,275	1,066	1,111
Insurance expense	1,031	821	913
Internet banking expense	900	778	701
Reserve for purchased receivables	704	100	357
Intangible asset amortization expense	289	228	252
OREO (income) expense, net rental income and gains on sale	(416)	(60)	1,089
Other operating expense	5,214	3,808	3,950
Total Other Operating Expense	49,375	39,866	39,600
Income Before Provision for Income Taxes	24,703	17,689	19,614
Provision for income taxes	6,836	5,277	6,156
Net Income	17,867	12,412	13,458
Less: Net income attributable to the noncontrolling interest	459	87	512
Net Income Attributable to Northrim BanCorp	$17,408	$12,325	$12,946

Earnings Per Share, Basic	$2.57	$1.89	$2.00
Earnings Per Share, Diluted	$2.54	$1.87	$1.97
Weighted Average Shares Outstanding, Basic	6,761,328	6,518,772	6,477,266
Weighted Average Shares Outstanding, Diluted	6,852,267	6,609,950	6,574,993

See notes to consolidated financial statements

NORTHRIM BANCORP, INC.
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2014, 2013, and 2012
2010

(In Thousands)	2014	2013	2012
Net income	$17,867	$12,412	$13,458
Other comprehensive income, net of tax:			
Securities available for sale:			
Unrealized gains (losses) arising during the period	($237)	($1,204)	$1,843
Reclassification of net gains included in net income (net of tax expense $190, $137, and $138 in 2014, 2013, and 2012, respectively)	(271)	(196)	(198)
Income tax benefit (expense) related to unrealized (losses) gains	86	701	(560)
Other comprehensive income (loss), net of tax	(422)	(699)	1,085
Comprehensive income	17,445	11,713	14,543
Less: comprehensive income attributable to the noncontrolling interest	459	87	512
Comprehensive income attributable to Northrim BanCorp	$16,986	$11,626	$14,031

See notes to consolidated financial statements

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NORTHRIM BANCORP, INC.
Consolidated Statements of Changes in Shareholders' Equity
Years Ended December 31, 2014, 2013, and 2012

(In Thousands)	Common Stock Number of Shares	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Non-controlling Interest	Total
Balance at January 1, 2012	6,467	$6,467	$53,164	$65,469	$283	$52	$125,435
Cash dividend declared	—	—	—	(3,673)	—	—	(3,673)
Stock based compensation expense	—	—	454	—	—	—	454
Exercise of stock options	45	45	(213)	—	—	—	(168)
Excess tax benefits from share-based payment arrangements	—	—	233	—	—	—	233
Distributions to noncontrolling interest	—	—	—	—	—	(471)	(471)
Change in unrealized holding (loss) on available for sale securities, net of tax	—	—	—	—	1,085	—	1,085
Net income attributable to the noncontrolling interest	—	—	—	—	—	512	512
Net income attributable to Northrim BanCorp	—	—	—	12,946	—	—	12,946
Balance at December 31, 2012	6,512	$6,512	$53,638	$74,742	$1,368	$93	$136,353
Cash dividend declared	—	—	—	(4,212)	—	—	(4,212)
Stock based compensation expense	—	—	506	—	—	—	506
Exercise of stock options	26	26	(155)	—	—	—	(129)
Excess tax benefits from share-based payment arrangements	—	—	100	—	—	—	100
Distributions to noncontrolling interest	—	—	—	—	—	(13)	(13)
Change in unrealized holding (loss) on available for sale securities, net of tax	—	—	—	—	(699)	—	(699)
Net income attributable to the noncontrolling interest	—	—	—	—	—	87	87
Net income attributable to Northrim BanCorp	—	—	—	12,325	—	—	12,325
Balance at December 31, 2013	6,538	$6,538	$54,089	$82,855	$669	$167	$144,318
Purchase of Alaska Pacific	290	290	7,156				7,446
Cash dividend declared	—	—	—	(4,770)	—	—	(4,770)
Stock based compensation expense	—	—	360	—	—	—	360
Exercise of stock options	26	26	28	—	—	—	54
Excess tax benefits from share-based payment	—	—	96	—	—	—	96

arrangements							
Distributions to noncontrolling interest	—	—	—	—	—	(508)	(508)
Change in unrealized holding (loss) on available for sale securities, net of tax	—	—	—	—	(422)	—	(422)
Net income attributable to the noncontrolling interest	—	—	—	—	—	459	459
Net income attributable to Northrim BanCorp	—	—	—	17,408	—	—	17,408
Balance at December 31, 2014	6,854	$6,854	$61,729	$95,493	$247	$118	$164,441

See notes to consolidated financial statements

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NORTHRIM BANCORP, INC.
Consolidated Statements of Cash Flows
Years Ended December 31, 2014, 2013, and 2012

(In Thousands)	2014	2013	2012
Operating Activities:			
Net income	$17,867	$12,412	$13,458
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Gain on sale of securities, net	(461)	(333)	(336)
Gain on sale of premises and equipment	(1,115)	—	—
Gain on purchase of mortgage affiliate	(3,001)	—	—
Depreciation and amortization of premises and equipment	1,865	1,793	1,674
Amortization of software	180	180	181
Intangible asset amortization	289	228	252
Amortization of investment security premium, net of discount accretion	(187)	22	170
Deferred tax (benefit) liability	(1,311)	1,215	881
Stock-based compensation	360	506	454
Excess tax benefits from share-based payment arrangements	(96)	(100)	(233)
Deferral of loan fees and costs, net	530	590	428
Provision (benefit) for loan losses	(636)	(635)	(1,559)
Reserve for purchased receivables	704	100	357
Purchases of loans held for sale	(132,013)	(156,521)	(242,535)
Proceeds from the sale of loans held for sale	203,404	156,925	258,652
Origination of loans held for sale	(62,652)	—	—
Gain on sale of other real estate owned	(643)	(288)	(46)
Impairment on other real estate owned	56	112	469
Equity in undistributed earnings from mortgage affiliate	(172)	200	(816)
Net changes in assets and liabilities:			
(Increase) decrease in accrued interest receivable	(644)	(111)	280
Proceeds from refund of prepaid FDIC premiums	—	3,405	—
(Increase) decrease in other assets	6,412	403	(1,762)
(Decrease) increase in other liabilities	(8,258)	(1,455)	2,580
Net Cash Provided (Used) by Operating Activities	20,478	18,648	32,549
Investing Activities:			
Investment in securities:			
Purchases of investment securities available for sale	(264,943)	(140,856)	(111,431)
Proceeds from sales/maturities of securities available for sale	237,425	95,199	131,610
Proceeds from calls/maturities of securities held to maturity	—	535	1,065
Purchases of domestic certificates of deposit	(3,500)	(13,500)	(11,500)
Proceeds from maturities of domestic certificates of deposit	13,500	13,500	10,000
Proceeds from redemption of FHLB stock	165	71	36
(Increase) decrease in purchased receivables, net	67	2,897	10,830
(Increase) decrease in loans, net	(27,686)	(66,249)	(59,299)
Proceeds from sale of other real estate owned	2,402	2,623	1,994
Alaska Pacific acquisition, net of cash received	6,367	—	—
Residential Mortgage acquisition, net of cash received	(7,412)	—	—
Investment in other real estate owned	—	—	(98)
Decrease in loan to Elliott Cove, net	239	—	106
Purchases of premises and equipment	(5,282)	(2,209)	(1,589)

Net Cash (Used) Provided by Investing Activities	(48,658)	(107,989)	(28,276)
Financing Activities:			
Increase in deposits	24,585	33,594	58,881
Increase (decrease) in securities sold under repurchase agreements	(1,300)	2,105	2,690
Increase (decrease) in borrowings	(7,032)	2,048	(147)
Distributions to noncontrolling interest	(508)	(13)	(471)
Proceeds from the issuance of common stock	54	—	—
Excess tax benefits from share-based payment arrangements	96	100	233
Cash dividends paid	(4,750)	(4,215)	(3,676)
Net Cash Provided by Financing Activities	11,145	33,619	57,510
Net (Decrease) Increase in Cash and Cash Equivalents	(17,035)	(55,722)	61,783
Cash and Cash Equivalents at Beginning of Year	85,591	141,313	79,530
Cash and Cash Equivalents at End of Year	$68,556	$85,591	$141,313

Supplemental Information:			
Income taxes paid	$5,927	$3,552	$6,632
Interest paid	$2,087	$2,035	$2,510
Transfer of loans to other real estate owned	$1,175	$365	$1,684
Loans made to facilitate sales of other real estate owned	$—	$—	$300
Cash dividends declared but not paid	$49	$42	$39

See notes to consolidated financial statements

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - Summary of Significant Accounting Policies

Northrim BanCorp, Inc. (the "Company"), is a publicly traded bank holding company headquartered in Anchorage, Alaska and is the parent company of Northrim Bank (the "Bank"), a commercial bank that provides personal and business banking services through locations in Anchorage, Eagle River, Wasilla, Juneau, Sitka, Ketchikan and Fairbanks, Alaska, and a factoring division in Bellevue, Washington. Affiliated companies include Northrim Benefits Group, LLC ("NBG"), Residential Mortgage Holding Company, LLC ("RML"), Elliott Cove Capital Management, LLC ("ECCM"), Elliott Cove Insurance Agency, LLC ("ECIA"), and Pacific Wealth Advisors, LLC ("PWA").

Method of Accounting: The Company prepares its consolidated financial statements in conformity with accounting principles generally accepted in the United States and prevailing practices within the banking industry. The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of income, gains, expenses, and losses during the reporting periods. Actual results could differ from those estimates. Significant estimates include the allowance for loan losses ("Allowance"), valuation of goodwill and other intangibles, valuation of mortgage servicing rights, valuation of other real estate owned ("OREO"), and fair value disclosures.

Consolidation: The accompanying consolidated financial statements include the accounts of the Company, the Bank, and Northrim Investment Services Company ("NISC"). All significant intercompany balances have been eliminated in consolidation. As of December 31, 2014, the Company had two wholly-owned trusts ("Trusts") that were formed to issue trust preferred securities and related common securities of the Trusts. The Company has not consolidated the accounts of the Trusts in its consolidated financial statements in accordance with Financial Accounting Standards Board Accounting Standards Codification ("FASB") ASC 810, Consolidation ("ASC 810"). As a result, the junior subordinated debentures issued by the Company to the Trusts are reflected on the Company's consolidated balance sheet as junior subordinated debentures.

Variable interest entities ("VIEs"): The Company consolidates affiliates in which we have a controlling interest. To determine if we have a controlling financial interest in an entity we first evaluate if we are required to apply the variable interest entity model, otherwise the entity is evaluated under the voting interest model. The Company continuously evaluates its non-majority owned investments in affiliates to determine if they are VIEs. Where we hold current or potential rights that give us the power to direct the activities of a VIE that most significantly impact the VIE's economic performance combined with a variable interest that gives us the right to receive potentially significant benefits or the obligation to absorb potentially significant losses, we have a controlling financial interest in that VIE. Rights held by others to remove the party with power over the VIE are not considered unless one party can exercise those rights unilaterally. When changes occur to the design of an entity we reconsider whether it is subject to the VIE model. We continuously evaluate whether we have a controlling financial interest in a VIE. We hold a controlling financial interest in other entities where we currently hold, directly or indirectly, more than 50% of the voting rights or where we exercise control through substantive participating rights or as a general partner. Where we are a general partner we consider substantive removal rights held by other partners in determining if we hold a controlling financial interest. We reevaluate whether we have a controlling financial interest in these entities when our voting or substantive participating rights change.

Affiliates are unconsolidated VIEs and other entities in which we do not have a controlling financial interest, but over which we have significant influence, most often because we hold a voting interest of 20% to 50%. Affiliates are accounted for as equity method investments.

As of December 31, 2014, the Company owns a 100% interest in RML and 50.1% interest in NBG and consolidates their balance sheets and income statements into its financial statements.

The Company does not consolidate the balance sheets and income statements of ECCM, ECIA, or PWA into its financial statements. The Company has determined that ECIA and PWA are not VIEs. The Company has determined that ECCM is a VIE. However, the Company does not have a controlling interest in ECCM and therefore does not consolidate ECCM's balance sheet and income statement into its financial statements. Results of affiliated companies that are not consolidated are presented on a one-line basis. Results of ECCM, ECIA, and PWA are included in "Other income" in our Consolidated Statements of Income. Investments in, and advances to, associated companies are presented on a one-line basis in the caption “Other assets” in our "Consolidated Balance Sheets".

Operating Segments: Public enterprises are required to report certain information about their operating segments in a complete set of financial statements to shareholders. The basis for determining the Company's operating segments is the manner in which management operates the business. Management has identified two primary business segments, Community Banking and Home Mortgage Lending.

Reclassifications: Certain 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.

Subsequent Events: The Company has evaluated events and transactions subsequent to December 31, 2014 for potential recognition or disclosure.

Cash and Cash Equivalents: For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits with other banks, banker's acceptances, commercial paper, securities purchased under agreement to resell, federal funds sold, and securities with maturities of less than 90 days at acquisition.

Investment Securities: Securities available for sale are stated at fair value with unrealized holding gains and losses, net of tax, excluded from earnings and reported as a separate component of other comprehensive income, unless an unrealized loss is deemed other than temporary. Gains and losses on available for sale securities sold are determined on a specific identification basis.

Held to maturity securities are stated at cost, adjusted for amortization of premium and accretion of discount on a level-yield basis. The Company has the ability and intent to hold these securities to maturity.

A decline in the market value of any available for sale or held to maturity security below cost that is deemed other than temporary results in a charge to earnings and the establishment of a new cost basis for the security. Unrealized investment securities losses are evaluated at least quarterly on a specific identification basis to determine whether such declines in value should be considered "other than temporary" and therefore be subject to immediate loss recognition in income. Although these evaluations involve significant judgment, an unrealized loss in the fair value of a debt security is generally deemed to be temporary when the fair value of the security is below the carrying value primarily due to changes in interest rates and there has not been significant deterioration in the financial condition of the issuer. The Company does not intend to sell, nor is it more likely than not that it will be required to sell, securities whose market value is less than carrying value. 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. Other factors that may be considered in determining whether a decline in the value is "other than temporary" include the financial condition, capital strength, and near-term prospects of the issuer; actions of commercial banks or other lenders relative to the continued extension of credit facilities to the issuer of the security; recommendations of investment advisors or market analysts; and ratings by recognized rating agencies.

Federal Home Loan Bank Stock: The Company's investment in Federal Home Loan Bank ("FHLB") stock is carried at par value because the shares can only be redeemed with the FHLB at par. The Company is required to maintain a minimum level of investment in FHLB stock based on the Company's capital stock and lending activity. Stock redemptions are at the discretion of the FHLB or of the Company, upon five years prior notice for FHLB Class B stock. FHLB stock is carried at cost and is subject to recoverability testing at least annually.

Loans held for sale: Loans held for sale are recorded at cost, which approximates fair value, determined on an aggregate basis. Loans held for sale include residential mortgage loans that have been sold without recourse at a committed fixed price and are in the process of being delivered to secondary markets at that committee price. Gains or losses on the sale of loans that are held for sale and servicing rights on those loans are recognized at the time of sale and determined by the difference between net sale proceeds and the net book value of the loans.

Loans: Loans are carried at their principal amount outstanding, net of unamortized fees and direct loan origination costs. 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 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 and certain ongoing performance criteria have been met.

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, unless the loan is collateral dependent, in which case the impairment is measured by using the fair value of the loan’s collateral. Nonperforming loans greater than $50,000 are individually evaluated for impairment based upon the borrower's overall financial condition, resources, and payment record, and the prospects for support from any financially responsible guarantors.

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

The Company uses external appraisals to estimate fair value for projects that are not fully constructed as of the date of valuation. These projects are generally valued as if complete, with an appropriate allowance for cost of completion, including contingencies developed from external sources such as vendors, engineers, and contractors.

The Company classifies fair value measurements using observable inputs, such as external appraisals, as level 2 valuations in the fair value hierarchy, and fair value measurements with unobservable inputs, such as in-house evaluations, as level 3 valuations in the fair value hierarchy.

When the fair value measurement of the impaired loan is less than the recorded amount of the loan, an impairment is recognized by recording a charge-off to the Allowance or by designating a specific reserve in accordance with GAAP. The Company's policy is to record cash payments received on impaired loans that are not also nonaccrual loans in the same manner that cash payments are applied to performing loans.

A loan is classified as a troubled debt restructuring ("TDR") when a borrower is experiencing financial difficulties that lead to a restructuring of the loan, and the Company grants concessions to the borrower in the restructuring that it would not otherwise consider. These concessions may include interest rate reductions, principal forgiveness, extension of maturity date and other actions intended to minimize potential losses. Generally, a nonaccrual loan that is restructured remains on nonaccrual status for a period of at least six months to demonstrate that the borrower can meet the restructured terms. If the borrower's performance under the new terms is not reasonably assured, the loan remains classified as a nonaccrual loan.

Loan origination fees received in excess of direct origination costs are deferred and accreted to interest income using a method approximating the level-yield method over the life of the loan.

Acquired Loans: Loans are recorded at their fair value at the acquisition date. Credit discounts are included in the determination of fair value; therefore, an allowance for loan losses is not recorded at the acquisition date. Purchased loans are evaluated upon acquisition and classified as either purchased impaired or purchased non-impaired.

Purchased impaired loans reflect credit deterioration since origination such that it is probable at acquisition that the Company will be unable to collect all contractually required payments.

Purchased impaired loans were individually evaluated for credit impairment at acquisition using expected future cash flows or the estimated value of underlying collateral. A purchased impaired loan will be removed from impaired loans only if the loan is sold, foreclosed, or assets are received in full satisfaction of the loan, and it will be removed from impaired loans at its carrying value. If an individual loan is removed, the difference between its relative carrying amount and its cash, fair value of the collateral, or other assets received will be recognized in other income immediately as a gain and would not affect the effective yield used to recognize the accretable yield on purchased impaired loans.

The excess of the undiscounted contractual balances due over the cash flows expected to be collected is considered to be the nonaccretable difference. The nonaccretable difference represents our estimate of the credit losses expected to occur and was considered in determining the fair value of the purchased impaired loans as of the acquisition date. Subsequent to the acquisition date, any increases in expected cash flows over those expected at purchase date in excess of fair value are adjusted through an increase to the accretable yield on a prospective basis. The purchased impaired loans are and will continue to be subject to the Company's internal and external credit review and monitoring. If credit deterioration is experienced subsequent to the initial acquisition fair value amount, such deterioration will be measured, and a charge off will be recorded.

For purchased non-impaired loans, the difference between the fair value and unpaid principal balance of the loan at the acquisition date is amortized or accreted to interest income over the estimated life of the loans.

Mortgage Servicing Rights: Mortgage servicing rights ("MSRs") are the rights to service mortgage loans for others. The Company measures MSRs at fair value and reports changes in fair value through earnings. Changes in the fair value of MSRs occur primarily due to the collection/realization of expected cash flows, as well as changes in valuation inputs and assumptions. Under the fair value method, MSRs are carried in the balance sheet at fair value and the changes in fair value are reported in earnings in other operating income in the period in which the change occurs. Fair value measurements are determined using a discounted cash flow model. In order to determine the fair value of MSRs, the present value of net expected future cash flows is estimated. Assumptions used include market discount rates, anticipated prepayment speeds, escrow calculations, delinquency rates, and ancillary fee income net of servicing costs. The model assumptions are also compared to publicly filed information from several large MSR holders, as available.

Allowance for Loan Losses: The Company maintains an Allowance to reflect inherent losses from its loan portfolio. The Allowance is decreased by loan charge-offs and increased by loan recoveries and provisions for loan losses. The Company has identified the following segments: commercial, real estate construction one-to-four family, real estate construction other, real estate term owner occupied, real estate term non-owner occupied, real estate term other, consumer loans secured by 1st deeds of trust, and other consumer loans. Then the Company further disaggregates each segment into the following classes, which are also known as asset quality ratings: pass (grades 1-6), special mention (grade 7), substandard (grade 8), doubtful (grade 9), and loss (grade 10).

In determining its total Allowance, the Company first estimates a specific allocated allowance for impaired loans. This analysis is based upon a specific analysis for each impaired loan, including appraisals and in-house evaluations on loans secured by real property, management’s assessment of the current market, recent payment history, and an evaluation of other sources of repayment.

The Company then estimates a general allocated allowance for all other loans that were not impaired as of the balance sheet date using a formula-based approach that includes average historical loss factors that are adjusted for quantitative and qualitative factors. Qualitative factors are based on management’s assessment of current trends that may cause losses inherent in the current loan portfolio to differ significantly from historical losses.

Finally, the Company assesses the overall adequacy of the Allowance based on several factors including the level of the Allowance as compared to total loans and nonperforming loans in light of current economic conditions. This portion of the Allowance is deemed “unallocated” because it is not allocated to any segment or class of the loan portfolio. This portion of the Allowance provides for coverage of credit losses inherent in the loan portfolio but not captured in the credit loss factors that are utilized in the risk rating-based component, or in the specific impairment component of the Allowance, and it acknowledges the inherent imprecision of all loss prediction models. Due to the subjectivity involved in the determination of the unallocated portion of the Allowance, the relationship of the unallocated component to the total Allowance may fluctuate from period to period.

Based on our methodology and its components, management believes the resulting Allowance is adequate and appropriate for the risk identified in the Company's loan portfolio. While management believes that it uses the best information available to determine the Allowance, unforeseen market conditions and other events could result in adjustment to the Allowance, and net income could be significantly affected if circumstances differed substantially from the assumptions used in making the final determination. Our banking regulators, as an integral part of their examination process, periodically review the Company's Allowance. Our regulators may require the Company to recognize additions to the Allowance based on their judgments related to information available to them at the time of their examinations.

Reserve for Unfunded Loan Commitments and Letters of Credit: The Company maintains a separate reserve for losses related to unfunded loan commitments and letters of credit. The determination of the adequacy of the reserve is based on periodic evaluations of the unfunded credit facilities including assessment of historical losses and current economic conditions. The allowance for unfunded loan commitments and letters of credit is included in other liabilities on the consolidated balance sheets, with changes to the balance charged against noninterest expense.

Purchased Receivables: The Bank purchases accounts receivable at a discount from its customers. The purchased receivables are carried at cost. The discount and fees charged to the customer are earned while the balances of the purchases are outstanding, which is typically less than one year. The Company maintains a separate reserve for losses related to purchased receivable assets. The determination of the adequacy of the reserve is based on periodic evaluations of purchased receivable assets including an assessment of historical losses and current economic conditions. The reserve for purchased receivable assets is included in the balance of these accounts on a net basis on the consolidated balance sheets, with changes to the balance charged against noninterest expense.

Premises and Equipment: Premises and equipment, including leasehold improvements, are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization expense for financial reporting purposes is computed using the straight-line method based upon the shorter of the lease term or the estimated useful lives of the assets that vary according to the asset type and include; furniture and equipment ranging between 3 and 7 years, leasehold improvements ranging between 2 and

15 years, and buildings over 39 years. Maintenance and repairs are charged to current operations, while renewals and betterments are capitalized. Long-lived assets such as premises and equipment are reviewed for impairment at least annually or whenever events or changes in business circumstances indicate that the remaining useful life may warrant revision, or that the carrying amount of the long-lived asset may not be fully recoverable. If impairment is determined to exist, any related impairment loss is calculated based on fair value. Impairment losses on assets to be disposed of, if any, are based on the estimated proceeds to be received, less costs of disposal.
Goodwill and Other Intangible Assets: Intangible assets are comprised of goodwill and other intangibles acquired in business combinations. Goodwill and intangible assets with indefinite useful lives are not amortized. Intangible assets with definite useful lives are amortized to their estimated residual values over their respective useful lives, and are also reviewed for impairment. Amortization of intangible assets is included in other operating expense in the Consolidated Statements of Income. The Company performs a goodwill impairment analysis on an annual basis. Additionally, the Company performs a goodwill impairment evaluation on an interim basis when events or circumstances indicate impairment potentially exists.
Other Real Estate Owned: Other real estate owned represents properties acquired through foreclosure or its equivalent. Prior to foreclosure, the carrying value is adjusted to the fair value, less cost to sell, of the real estate to be acquired by an adjustment to the Allowance. Management's evaluation of fair value is based on appraisals or discounted cash flows of anticipated sales. The amount by which the fair value less cost to sell is greater than the carrying amount of the loan plus amounts previously charged off is recognized in earnings. Any subsequent reduction in the carrying value is charged against earnings. Operating expenses associated with other real estate owned are charged to earnings in the period they are incurred.
Low Income Housing Tax Credit Partnerships: The Company earns a return on its investments in the form of tax credits and deductions that flow through to it as a limited partner in these partnerships. The Company amortizes these investments in other operating expense over the period during which tax credits are used.
Other Assets: Other assets include purchased software and prepaid expenses. Purchased software is carried at amortized cost and is amortized using the straight-line method over its estimated useful life or the term of the agreement. Also included in other assets is the net deferred tax asset and the Company's investments in NBG, ECCM, ECIA, and PWA. All of these entities are affiliates of the Company.
Derivatives: The Bank enters into interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps are simultaneously hedged by offsetting the interest rate swaps that the Bank executes with a third party, such that the Bank minimizes its net risk exposure. Additionally, RML enters into commitments to originate residential mortgage loans, and it enters into forward delivery contracts to sell mortgage-backed securities to broker/dealers at specific prices and dates in order to hedge the interest rate risk in its residential mortgage loan commitments. The commitments to originate mortgage loans held for sale and the related forward delivery contracts are considered derivatives. The Company recognizes all derivatives as either assets or liabilities in the balance sheet and requires measurement of those instruments at fair value through adjustments to current earnings. None of the Company's derivatives are designated as hedging instruments. Rather, they are accounted for as free-standing derivatives, or economic hedges, and the Company reports changes in fair values of its derivatives in current period net income.
Transfers or sales of financial assets: For transfers of financial assets recorded as sales, we recognize and initially measure at fair value all assets obtained and liabilities incurred. We record a gain or loss in noninterest income for the difference between the carrying amount and the fair value of the assets sold. Fair values are based on quoted market prices, quoted market prices for similar assets, or if market prices are not available, then the fair value is estimated using discounted cash flow analysis with assumptions for credit losses, prepayments and discount rates that are corroborated by and verified against market observable data, where possible.
Advertising: Advertising, promotion and marketing costs are expensed as incurred. The Company reported total expenses in these areas of $2.1 million, $1.9 million, and $2.0 million for each of the periods ending December 31, 2014, 2013, and 2012.
Income Taxes: The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred income taxes are recognized for the future consequences attributable to differences between

the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date.

Earnings Per Share: Earnings per share is calculated using the weighted average number of shares and dilutive common stock equivalents outstanding during the period. Stock options and restricted stock units, as described in Note 21, are considered to be common stock equivalents. Potentially dilutive shares are excluded from the computation of earnings per share if their effect is anti-dilutive. There were no anti-dilutive shares outstanding related to options to acquire common stock in 2014, 2013, or 2012.

Information used to calculate earnings per share was as follows:

(In Thousands)	2014	2013	2012
Net income	$17,408	$12,325	$12,946
Basic weighted average common shares outstanding	6,761	6,519	6,477
Dilutive effect of potential common shares from awards granted under equity incentive program	91	91	98
Total	6,852	6,610	6,575
Earnings per common share			
Basic	$2.57	$1.89	$2.00
Dilutive	$2.54	$1.87	$1.97

Stock Incentive Plans: The Company accounts for its stock incentive plans using a fair-value-based method of accounting for stock-based employee compensation plans. The Company has elected the modified prospective method for recognition of compensation cost associated with stock-based employee compensation awards. The Company amortizes stock-based compensation expense over the vesting period of each award.

Comprehensive Income: Comprehensive income consists of net income and net unrealized gains (losses) on securities available for sale after tax effect and is presented in the consolidated statements of shareholders' equity and comprehensive income.

Concentrations: Substantially all of the Company's business is derived from the Anchorage, Matanuska-Susitna Valley, Fairbanks, and Southeast areas of Alaska. As such, the Company's growth and operations depend upon the economic conditions of Alaska and these specific markets. These areas rely primarily upon the natural resources industries, particularly oil production, as well as tourism, government and U.S. military spending for their economic success. A significant majority of the unrestricted revenues of the Alaska state government are currently funded through various taxes and royalties on the oil industry. The Company's business is and will remain sensitive to economic factors that relate to these industries and local and regional business conditions. As a result, local or regional economic downturns, or downturns that disproportionately affect one or more of the key industries in regions served by the Company, may have a more pronounced effect upon its business than they might on an institution that is less geographically concentrated. The extent of the future impact of these events on economic and business conditions cannot be predicted; however, prolonged or acute fluctuations could have a material and adverse impact upon the Company's results of operation and financial condition.

At December 31, 2014 and 2013, the Company had $432.6 million and $363.1 million, respectively, in commercial and construction loans in Alaska. Additionally, the Company continues to have a concentration in large borrowing relationships. At December 31, 2014, 38% of the Company's loan portfolio is attributable to 25 large borrowing relationships. The Company has additional unfunded commitments to these borrowers of $128.9 million at December 31, 2014.

Recent Accounting Pronouncements

In January 2014, the FASB issued ASU No. 2014-01, Accounting for Investments in Qualified Affordable Housing Projects. ASU 2014-01 permit an entity to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2014 and should be applied prospectively. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In January 2014, the FASB issued ASU No. 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon foreclosure. ASU 2014-04 clarifies that if an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2014 and can be applied with a modified retrospective transition method or prospectively. The adoption of this ASU did not have a material impact on the Company’s consolidated financial statements.

In March 2014, the Financial Accounting Standards Board (“FASB”) issued ASU 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity (“ASU 2014-08”). The amendments to the Codification in ASU 2014-08 change the requirements for reporting discontinued operations. A discontinued operation may include a component of an entity or a group of components of an entity, or a business or nonprofit activity. A disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results when any of the following occurs: 1) the component of an entity or group of components of an entity meets the criteria to be classified as held for sale, 2) the component of an entity or group of components of an entity is disposed of by sale, or 3) the component of an entity or group of components of an entity is disposed of other than by sale (for example, by abandonment or in a distribution to owners in a spinoff). A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. A component of an entity may be a reportable segment or an operating segment, a reporting unit, a subsidiary, or an asset group. This ASU is effective for the Company’s financial statements for annual and interim periods beginning on or after December 15, 2014, and must be applied prospectively. The adoption of this ASU did not have a material impact on the Company’s consolidated financial statements.

In June 2014, the Financial Accounting Standards Board (“FASB”) issued ASU 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures (“ASU 2014-11”). The amendments to the Codification in ASU 2014-11 require two accounting changes. First, the amendments change the accounting for repurchase-to maturity transactions to secured borrowing accounting. Second, for repurchase financing agreements, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement. This ASU is effective for the Company’s financial statements for annual and interim periods beginning on or after December 15, 2014, and must be applied prospectively. The adoption of this ASU did not have a material impact on the Company’s consolidated financial statements.

In August 2014, the Financial Accounting Standards Board (“FASB”) issued ASU 2014-14, Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure (“ASU 2014-14”). The amendments to the Codification in ASU 2014-14 require that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: 1) the loan has a government guarantee that is not separable from the loan before foreclosure, 2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim, and 3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. This ASU is effective for the Company’s financial statements for annual and interim periods beginning on or after December 15, 2014, and must be applied prospectively. The Company does not believe that the adoption of this standard will have a material impact on the Company’s consolidated financial position or results of operations. The adoption of ASU No. 2014-14 did not have a material impact on the Company's consolidated financial statements.

NOTE 2 - Business Combinations

Alaska Pacific

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

The application of the acquisition method of accounting resulted in the recognition of a bargain purchase gain of $170,000 and a core deposit intangible of $623,000, or 0.5% of core deposits. The bargain purchase gain represents the excess of the estimated fair value of the net assets acquired in excess of the purchase price and is included in Other Income in the Consolidated Statements of Net Income in this Form 10-Q. This acquisition resulted in a bargain purchase gain primarily due to the inclusion of certain adjustments to the purchase price for potential risks identified by the Company during the due diligence and price negotiation stages of the acquisition that were concluded in October of 2013. The Company has concluded that the potential risks identified at that time do not represent a liability to the Company and, accordingly, they have not been allocated any value in the application of the acquisition method of accounting. The bargain purchase gain increased from April 1, 2014 to December 31, 2014, due to an adjustment to the fair value of accrued liabilities acquired.

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

(In Thousands)	Alaska Pacific April 1, 2014	
Cost basis net assets	$14,733	
Cash payment made	(6,423	)
Common stock issued	(7,446	)
Fair value adjustments:		
Net loans	(1,137	)
Premises and equipment	547	
Other intangible assets	623	
Mortgage servicing rights	(119	)
Deposits	(844	)
Other	236	
Bargain purchase gain	$170	

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

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

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

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

Alaska Pacific purchased loans subject to the requirements of FASB ASC 310-30 Loans and Debt Securities Acquired with Deteriorated Credit Quality. The Company identified eighteen purchased credit impaired loans as of April 1, 2014. This group of loans consists primarily of commercial and commercial real estate loans, and unlike a pool of consumer mortgages, it is not practicable for the Company to analyze the accretable yield of these loans. As such, the Company has elected the cost recovery method of income recognition for these loans, and thus no accretable difference has been identified for these loans.

Purchased credit impaired loans at acquisition are presented below:

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

The acquisition of Alaska Pacific is not considered significant to the Company’s financial statements. The operations of Alaska Pacific are included in our operating results from April 1, 2014, and added revenue of $7.5 million, non-interest expense of $4.3 million, and net income of $2.9 million, before taxes, for the year ended December 31, 2014. Alaska Pacific’s results of operations prior to the acquisition are not included in our operating results. Additionally, merger-related costs of $1.5 million for the year ended December 31, 2014 have been incurred and expensed in connection with the acquisition of Alaska Pacific and recognized within the merger and acquisition expense on the Consolidated Statements of Income.

The following table presents unaudited pro forma results of operations for the years ended December 31, 2014 and 2013 as if the acquisition of Alaska Pacific had occurred on January 1, 2013. The proforma results have been prepared for comparative purposes only and are not necessarily indicative of the results that would have been obtained had the acquisition actually occurred on January 1, 2013.

(In Thousands, except earnings per share data)	December 31, 2014			
	Company	Alaska Pacific[1]	Pro Forma Adjustments	Pro Forma Combined
Net interest and other income	$73,442	$2,095	$— [2]	$75,537
Net income attributable to Northrim BanCorp, Inc.	17,408	(1,282)	(180) [3]	15,946
Earnings Per Share, Basic	$2.57			$2.36
Earnings Per Share, Diluted	$2.54			$2.33
Weighted Average Shares Outstanding, Basic	6,761,328			6,761,328
Weighted Average Shares Outstanding, Diluted	6,852,267			6,852,267

(In Thousands, except earnings per share data)	December 31, 2013			
	Company	Alaska Pacific[1]	Pro Forma Adjustments	Pro Forma Combined
Net interest and other income	$56,920	$9,872	($38) [2]	$66,754
Net income attributable to Northrim BanCorp, Inc.	12,325	329	82 [3]	12,736
Earnings Per Share, Basic	$1.89			$1.95
Earnings Per Share, Diluted	$1.87			$1.93
Weighted Average Shares Outstanding, Basic	6,518,772			6,518,772
Weighted Average Shares Outstanding, Diluted	6,609,950			6,609,950

[1] Alaska Pacific represents results from January 1 to March 31 for 2014 and represents results from January 1 to December 31 for 2013.

[2] Amount of amortization/ accretion of the fair value adjustments on loans and certificates of deposit.

[3] Amount of amortization/accretion of the fair value adjustments on loans and certificates of deposit, bargain purchase gain, amortization of cored deposit intangible, and the change in the provision for income taxes.

Residential Mortgage

On December 1, 2014, the Company completed the acquisition of 76.5% of the equity interest in Residential Mortgage Holding Company, LLC ("RML"), the parent company of Residential Mortgage, LLC ("Residential Mortgage"), in a cash transaction valued at $29.5 million. The primary reason for the acquisition was to expand the Company's presence in the mortgage lending business in Alaska. The fair value of the Company's equity interest in RML immediately prior to the acquisition was $9.0 million. The Company recorded a $3.0 million gain in the fourth quarter of 2014 as a result of remeasuring the Company's equity interest in RML immediately prior to the acquisition, which is included in the Company's Consolidated Statement of Income in the line item entitled "Gain on purchase of mortgage affiliate" . The Company utilized a market value approach to value its equity interest in RML which included analysis of current trading values and historical acquisition multiples of comparable mortgage companies.

The consideration transferred or transferable to the former owners of RML and the assets acquired and liabilities assumed have been accounted for under the acquisition method of accounting and were recorded at their estimated fair values as of the December 1, 2014 acquisition date. Estimated fair values recorded in the transaction are subject to change for up to one year after the closing date of the acquisition. The application of the acquisition method of accounting resulted in the recognition of goodwill in the amount of $14.8 million and a trade name intangible of $950,000.

The former owners of RML (the "sellers") will receive additional cash proceeds (the “earn-out payments”) based on the adjusted earnings of RML in all or a portion of the calendar years 2014, 2015, 2016, 2017, 2018 and 2019 . Under the purchase agreement, the sellers will receive earn-out payments equal to: 40% of adjusted earnings of RML between $1.0 million and $2.0 million (“Tier One Earn-Out Amount”); 50% of adjusted earnings of RML between $2.0 million and $3.0 million plus the Tier One Earn-Out Amount (“Tier Two Earn-Out Amount”); 70% of adjusted earnings of

RML between $3.0 million and $4.0 million

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plus the Tier Two Earn-Out Amount (“Tier Three Earn-Out Amount”); 85% of adjusted earnings of RML between $4.0 million and $6.0 million plus the Tier Three Earn-Out Amount (“Tier Four Earn-Out Amount”); and 55% of adjusted earnings of RML over $6.0 million plus the Tier Four Earn-Out Amount. The Company recorded a $7.3 million liability as part of its purchase accounting for future earn-out payments.

The purchase agreement provides for these earn-out payments as a portion of the purchase price to be paid to the sellers in future periods, contingent on future events. Therefore we included an estimate of the acquisition-date fair value of the contingent consideration of $7.3 million as part of the cost of the combination. The accounting treatment of the contingent consideration to be paid to those of the sellers who continue employment with the Company was evaluated to determine whether the amounts represent purchase consideration or a separate transaction, such as post-transaction employee compensation. Factors evaluated require significant judgment and include, among other factors; consideration of the terms of continuing employment, levels of post-transaction compensation, ownership interest of the sellers/employees, linkage of the contingent consideration to the transaction date combination valuation, and any other agreements or matters related to the transaction.

Based on an evaluation of the factors surrounding the transaction and the terms of the purchase agreement, the amount due under the earn-out provision was accounted for as acquisition consideration. We concluded that the contingent consideration to be paid to the sellers/employees was a significant component of the transaction date valuation of the acquired business. The calculation of the contingent payment was based upon factors established at the date of the transaction to be paid upon meeting the established earnings criteria of RML. The post transaction employment arrangements of the continuing employees are at market rates, and the formula for determining the contingent consideration is consistent with the business valuation methodologies, based upon a multiplier of earnings recognized from RML for five twelve month periods following the acquisition.

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

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

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

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

The acquisition of RML is not considered significant to the Company’s financial statements and results in a new reporting segment, Home Mortgage Lending.

The operations of RML are included in our operating results from December 1, 2014, and added revenue of $2.4 million, non-interest expense of $1.9 million, and net income of $484,000, before taxes, for the year ended December 31, 2014. RML’s results of operations prior to the December 1, 2014 acquisition are included in our operating results under the equity method. Additionally, merger-related costs of $507,000 for the year ended December 31, 2014 have been incurred and expensed in connection with the acquisition of RML and recognized within the merger and acquisition expense on the Consolidated Statements of Income.

The following table presents unaudited pro forma results of operations for the years ended December 31, 2014 and 2013 as if the acquisition of RML had occurred on January 1, 2013. The proforma results have been prepared for comparative purposes only and are not necessarily indicative of the results that would have been obtained had the acquisition actually occurred on January 1, 2013.

(In Thousands, except earnings per share data)	December 31, 2014			
	Company	RML[1]	Pro Forma Adjustments	Pro Forma Combined
Net interest and other income	$73,442	$22,227 [2]	($847) [3]	$94,822
Net income attributable to Northrim BanCorp, Inc.	17,408	4,000	(3,545) [4]	17,863
Earnings Per Share, Basic	$2.57			$2.64
Earnings Per Share, Diluted	$2.54			$2.61
Weighted Average Shares Outstanding, Basic	6,761,328			6,761,328
Weighted Average Shares Outstanding, Diluted	6,852,267			6,852,267

(In Thousands, except earnings per share data)	December 31, 2013			
	Company	RML[1]	Pro Forma Adjustments	Pro Forma Combined
Net interest and other income	$56,920	$28,507 [2]	($1,176) [3]	$84,251
Net income attributable to Northrim BanCorp, Inc.	12,325	4,466	2,250 [4]	19,041
Earnings Per Share, Basic	$1.89			$2.92
Earnings Per Share, Diluted	$1.87			$2.88
Weighted Average Shares Outstanding, Basic	6,518,772			6,518,772
Weighted Average Shares Outstanding, Diluted	6,609,950			6,609,950

[1] RML represents results from January 1 to November 30 for 2014 and represents results from January 1 to December 31 for 2013.

[2] 2014 amount is comprised of net interest income and loan origination fees of $6.0 million and $16.2 million of other income. The 2013 amount is comprised of net interest income and loan origination fees of $7.8 million and $20.7 million of other income.

[3] Amount of accretion of the fair value adjustments on loans and income recognized under the equity method prior to the December 2014 acquisition.

[4] Amount of accretion of the fair value adjustments on loans, income recognized under the equity method, gain on acquisition, earn out accretion, and the change in the provision for income taxes.

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

NOTE 3 – Cash and Due from Banks

The Company is required to maintain a $500,000 minimum average daily balance with the 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 average reserve requirement for the maintenance period, which included December 31, 2014, was $0.

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

As discussed in Note 1 of the Notes to Consolidated Financial Statements, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits with other banks, banker's acceptances, commercial paper, securities purchased under agreement to resell, federal funds sold, and securities with maturities of less than 90 days at acquisition. Accordingly, domestic certificates of deposit with maturities of greater than 90 days totaling $3.5 million and $13.5 million at December 31, 2014 and 2013, respectively, have been excluded from cash and cash equivalents in the Statement of Cash Flows.

NOTE 4 - Interest Bearing Deposits in Other Banks

All interest bearing deposits in other banks have a maturity of one year or less. Balances at December 31 for the respective years are as follows:

(In Thousands)	2014	2013
Interest bearing deposits at Federal Reserve Bank (FRB)	$31,806	$51,923
Interest bearing deposits at Federal Home Loan Bank (FHLB)	420	329
Domestic certificates of deposit at other institutions	3,500	13,500
Other interest bearing deposits at other institutions	294	227
Total	$36,020	$65,979

NOTE 5 - Investment Securities

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

(In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2014				
Securities available for sale				
U.S. Treasury and government sponsored entities	$226,624	$105	$539	$226,190
Municipal securities	11,843	285	4	12,124
U.S. Agency mortgage-backed securities	1,024	6	1	1,029
Corporate bonds	38,820	415	—	39,235
Preferred stock	2,999	153	—	3,152
Total securities available for sale	$281,310	$964	$544	$281,730
Securities held to maturity				
Municipal securities	$2,201	$107	$—	$2,308
Total securities held to maturity	$2,201	$107	$—	$2,308
December 31, 2013				
Securities available for sale				
U.S. Treasury and government sponsored entities	$168,922	$103	$323	$168,702
Municipal securities	19,825	378	54	20,149
U.S. Agency mortgage-backed securities	25	—	—	25
Corporate bonds	55,798	1,000	20	56,778
Preferred stock	2,999	35	—	3,034
Total securities available for sale	$247,569	$1,516	$397	$248,688
Securities held to maturity				
Municipal securities	$2,208	$153	$—	$2,361
Total securities held to maturity	$2,208	$153	$—	$2,361

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 December 31, 2014 and 2013 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
2014:						
Securities Available for Sale						
U.S. Treasury and government sponsored entities	$165,004	$539	$—	$—	$165,004	$539
Municipal Securities	567	4	—	—	567	4
Mortgage-backed Securities	117	1	—	—	117	1
Total	$165,688	$544	$—	$—	$165,688	$544
2013:						
Securities Available for Sale						
U.S. Treasury and government sponsored entities	$122,560	$323	$—	$—	$122,560	$323
Municipal Securities	5,613	54	—	—	5,613	54
Corporate Bonds	6,051	20	—	—	6,051	20
Total	$134,224	$397	$—	$—	$134,224	$397

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The unrealized losses on investments in government sponsored entities, corporate bonds and municipal securities in both periods were caused by changes in interest rates. At December 31, 2014 and 2013, there were twenty-nine and twenty-six available-for-sale securities in an unrealized loss position, respectively, that have been in a loss position for less than twelve months. There were no securities with unrealized losses at December 31, 2014 and 2013 that have been at a loss position for more than twelve months. The contractual terms of these investments 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 December 31, 2014 and 2013, $54.1 million and $46.8 million in securities were pledged for deposits and borrowings, respectively.

The amortized cost and fair values of debt securities at December 31, 2014, are distributed by contractual maturity as shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Although preferred stock has no stated maturity, it is aggregated in the calculation of weighted average yields presented below in the category of investments that mature in ten years or more.

(In Thousands)	Amortized Cost	Fair Value	Weighted Average Yield	
U.S. Treasury and government sponsored entities				
1-5 years	$226,144	$225,706	1.18	%
5-10 years	480	484	2.27	%
Total	$226,624	$226,190	1.18	%
U.S. Agency mortgage-backed securities				
1-5 years	$54	$54	2.39	%
5-10 years	309	309	3.27	%
Over 10 years	661	666	2.94	%
Total	$1,024	$1,029	3.01	%
Corporate bonds				
Within 1 year	$736	$738	0.89	%
1-5 years	36,084	36,490	1.35	%
5-10 years	2,000	2,007	1.02	%
Total	$38,820	$39,235	1.33	%
Preferred stock				
Over 10 years	$2,999	$3,152	5.42	%
Total	$2,999	$3,152	5.42	%
Municipal securities				
Within 1 year	$3,556	$3,559	0.82	%
1-5 years	5,533	5,720	3.24	%
5-10 years	4,955	5,153	4.54	%
Total	$14,044	$14,432	3.08	%

The proceeds and resulting gains and losses, computed using specific identification, from sales of investment securities for the years ending December 31, 2014, 2013, and 2012, respectively, are as follows:

(In Thousands)	Proceeds	Gross Gains	Gross Losses
2014			
Available for sale securities	$24,102	$465	$4
2013			

Available for sale securities	$23,514	$333	$—
2012			
Available for sale securities	$21,382	$419	$—

A summary of interest income for the years ending December 31, 2014, 2013, and 2012 on available for sale investment securities is as follows:

(In Thousands)	2014	2013	2012
U.S. Treasury and government sponsored entities	$1,769	$898	$941
U.S. Agency mortgage-backed securities	25	1	2
Other	857	1,136	1,280
Total taxable interest income	$2,651	$2,035	$2,223
Municipal securities	$391	$568	$573
Total tax-exempt interest income	$391	$568	$573
Total	$3,042	$2,603	$2,796

NOTE 6 - Loans Held for Sale

The Company acquired the remaining 76.5% of RML on December 1, 2014. RML originates 1-4 family residential mortgages and sells them to the secondary market. These loans are shown as loans held for sale on the Company's Consolidated Balance Sheet. RML originated $62.7 million in loans in December 2014. Prior to December 1, 2014, the Company had a 23.5% ownership interest in RML and purchased residential loans from them. The Company then sold these loans in the secondary market. The Company purchased $132.0 million in loans from RML in 2014. In 2014, the Company sold $203.4 million in loans, including loans purchased from RML prior to December 1, 2014 and loans originated by RML in December 2014. The Company purchased $156.5 million and sold $156.9 million in loans in 2013.

NOTE 7 - Loans

The composition of the loan portfolio as of the periods indicated is as follows:

	December 31, 2014		December 31, 2013	
(In Thousands)	Dollar Amount	Percent of Total	Dollar Amount	Percent of Total
Commercial	$306,543	33.2 %	$300,338	39.0 %
Real estate construction one-to-four family	34,842	3.8 %	30,161	3.9 %
Real estate construction other	91,195	9.9 %	32,599	4.2 %
Real estate term owner occupied	109,472	11.8 %	91,098	11.8 %
Real estate term non-owner occupied	286,616	31.0 %	255,324	33.2 %
Real estate term other	36,894	4.0 %	29,976	3.9 %
Consumer secured by 1st deeds of trust	32,000	3.5 %	16,483	2.1 %
Consumer other	31,493	3.4 %	18,058	2.3 %
Subtotal	$929,055		$774,037	
Less: Unearned origination fee,				
net of origination costs	(4,551)	(0.5)%	(4,021)	(0.5)%
Total loans	$924,504		$770,016	

The Company’s primary market areas are Anchorage, the Matanuska-Susitna Valley, Southeast Alaska, and Fairbanks, Alaska, where the majority of its lending has been with Alaska businesses and individuals. At December 31, 2014, approximately 74% of the Company’s loans are secured by real estate, and approximately 26% are for general commercial uses, including professional, retail, and small businesses. Substantially all of these loans are collateralized and repayment is expected from the borrowers’ cash flow or, secondarily, the collateral. The Company’s exposure to credit loss, if any, is the outstanding amount of the loan if the collateral is proved to be of no value.

As part of the on-going monitoring of the credit quality of the Company’s loan portfolio, management tracks certain credit quality indicators including trends in past due and nonaccrual loans, gross and net charge offs, and movement in loan balances within the risk classifications. The Company utilizes a loan risk grading system called the Asset Quality

Rating (“AQR”) system to assign a risk classification to each of its loans. Loans are graded on a scale of 1 to 10 and, loans graded 1 – 6 are considered “pass” grade loans. A description of the general characteristics of the AQR risk classifications are as follows:

Pass grade loans – 1 through 6: The borrower demonstrates sufficient cash flow to fund debt service, including acceptable profit margins, cash flows, liquidity and other balance sheet ratios. Historic and projected performance indicates that the borrower is able to meet obligations under most economic circumstances. The company has competent management with an acceptable track record. The category does not include loans with undue or unwarranted credit risks that constitute identifiable weaknesses.

Special Mention – 7: A "special mention" credit has weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of either the repayment prospects for the asset or the Bank's credit position at some future date. Special mention assets are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification. Loans are currently protected, but are weak due to negative trends in the balance sheet and income statement. Current cash flow may be insufficient to meet debt service, with prospects that the condition may not be temporary. Profitability and key balance sheet ratios are below peers. There is a lack of effective control over collateral or there are documentation deficiencies as well as a potential risk of payment default. Collateral coverage is minimal in gross dollars or due to quality issues. Financial information may be inadequate to show the recent condition of borrower. The loan would not be approved as a new credit, and new loans would not be granted. Management may not be adequately qualified or may have very limited prior experience with similar activities or markets. The ability of management to cope with current conditions is questionable. Internal conflict and turnover in key positions may be present. Succession is unclear. The borrower's asset quality is below average. The capital base may be insufficient to cover capital losses. Leverage is above average or increasing. The industry outlook is generally negative but there are reasonable expectations of a turnaround within 12-18 months. The firm may be new, resulting in competitive deficiencies in comparison to the older, more established firms in the industry. Over-capacity may be evident in the industry. Collateral and guarantor strength are comparable to Management Attention-6, but agings and certifications of accounts receivable and inventory are required and are not being provided on a regular basis.

Substandard – 8: A "substandard" credit is inadequately protected by the current sound worth and paying capacity of the obligor or by the collateral pledged, if any. Assets so classified must have a well-defined weakness, or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loans have well-defined weaknesses where a payment default and/or a loss are possible, but not yet probable. Cash flow is insufficient to service debt, with prospects that the condition is permanent. Assets classified as substandard are inadequately protected by the current net worth and paying capacity of the borrower, and there is a likelihood that collateral will have to be liquidated and/or the guarantor called upon to repay the debt. Generally, the loan is considered collectible as to both principal and interest, primarily because of collateral coverage. Loan(s) may have been restructured at less than market terms or have been partially charged off. If deficiencies are not corrected quickly, there is a probability of loss and the borrower’s ability to operate as a going concern may be deemed questionable/is questionable. Management has no prior experience with similar activities, demonstrating inability to realistically address problems and meet commitments. The borrower’s asset quality is poor. The capital base is weak and insufficient to absorb continuing losses, and leverage is significantly above peers. Liquidity is poor with significant reliance on short-term borrowing to support trade debt. Key balance sheet ratios are substantially inferior to industry norms. The industry is currently trending downward or demonstrating recovery from an adverse cycle. The outlook is generally negative at this time. Timing of recovery is unclear, but expectations are that market conditions will improve within 18-24 months. The borrower has substantial competitive deficiencies when compared to other firms, such as excess capacity and over-supply, resulting in frequent and significant concessions and discounting. Business failures are prevalent. Collateral coverage is marginal or non-existent. Collateral may be located outside the borrower’s market area. There are no agings or certifications of accounts receivable and inventory being received from the borrower, and collateral has doubtful marketability/convertibility. If guaranteed, the guarantor has limited outside worth and is highly leveraged with a poor credit report, which may reflect liens, collection problems, or lawsuits.

Doubtful – 9: An asset classified "doubtful" has all the weaknesses inherent in one that is classified "substandard-8" with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions, and values, highly questionable and improbable. The loan has substandard characteristics, and available information suggests that it is unlikely that the loan will be repaid in its entirety. Cash flow is insufficient to service debt. The company has had a series of substantial losses. If the current material adverse trends continue, it is unlikely the borrower will have the ability to meet the terms of the loan agreement. It may be difficult to predict the exact amount of loss, but the probability of some loss is greater than 50%. Loans are to be placed on non-accrual status when any portion is classified as doubtful. Non-accrual loans would not be classified "doubtful" as long as the collateral appears adequate to retire the outstanding balance. Management is clearly unable to address problems and meet commitments, and there is little expectation either of improvement or for sustaining the relationship with current management. The company is highly illiquid with excessive leverage. Key balance sheet ratios are at unacceptable levels, and downturn is severe. Timing of recovery is undeterminable. The company is unable to compete; collateral and guarantees provide limited support.

Loss – 10: An asset classified "loss" is considered uncollectible and of such little value that its continuance on the books is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this basically worthless asset, even though partial recovery may be affected in the future. The loan has doubtful characteristics, but the loan will definitely not be repaid in full. Debt service coverage clearly reflects the company's inability to service debt. The borrower cannot generate sufficient cash flow to cover fixed charges. All near-term and long-term trends concerning cash flow and earnings are negative. The damage to the financial condition of the company cannot be reversed at this point in time. Collateral and guarantees provide no support.

The loan portfolio segmented by risk class at December 31, 2014 and 2013, respectively, is shown below:

(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
December 31, 2014									
AQR Pass	$291,020	$34,651	$91,195	$103,049	$282,774	$36,705	$31,118	$31,399	$901,911
AQR Special Mention	11,618	—	—	5,817	2,095	39	396	47	20,012
AQR Substandard	3,905	191	—	606	1,747	150	486	47	7,132
AQR Doubtful	—	—	—	—	—	—	—	—	—
AQR Loss	—	—	—	—	—	—	—	—	—
Subtotal	$306,543	$34,842	$91,195	$109,472	$286,616	$36,894	$32,000	$31,493	$929,055
Less: Unearned origination fees, net of origination costs									(4,551)
Total loans									$924,504
December 31, 2013									
AQR Pass	$293,803	$28,227	$31,633	$84,191	$251,384	$28,684	$15,877	$17,694	$751,493
AQR Special Mention	6,022	1,934	966	6,235	2,620	—	397	196	18,370
AQR Substandard	513	—	—	672	1,320	1,292	209	168	4,174
AQR Doubtful	—	—	—	—	—	—	—	—	—
AQR Loss	—	—	—	—	—	—	—	—	—
Subtotal	$300,338	$30,161	$32,599	$91,098	$255,324	$29,976	$16,483	$18,058	$774,037
Less: Unearned origination fees, net of origination costs									(4,021)
Total loans									$770,016

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 totaled $4.7 million and $1.8 million December 31, 2014 and December 31, 2013, respectively. Interest income which would have been earned on nonaccrual loans for 2014, 2013, and 2012 amounted to $218,000, $188,000, and $453,000, respectively. Additionally, the Company recognized interest income of $350,000, $250,000, and $344,000 in 2014, 2013, and 2012, respectively, related to interest collected on nonaccrual loans whose principal has been paid down to zero. Nonaccrual loans at the periods indicated, by segment are presented below:

(In Thousands)	December 31, 2014	December 31, 2013
Commercial	$2,031	$222
Real estate construction one-to-four family	191	—
Real estate construction other	—	—
Real estate term owner occupied	135	—
Real estate term non-owner occupied	1,746	151
Real estate term other	39	1,136
Consumer secured by 1st deeds of trust	485	187
Consumer other	47	119
Total	$4,674	$1,815

There were no past due loans greater than 90 days and still accruing interest at December 31, 2014 and 2013, respectively. Past due loans and nonaccrual loans at the periods indicated are presented below by loan class:

(In Thousands)	30-59 Days Past Due Still Accruing	60-89 Days Past Due Still Accruing	Greater Than 90 Days Still Accruing	Nonaccrual	Total Past Due	Current	Total
December 31, 2014							
AQR Pass	$696	$545	$—	$—	$1,241	$900,670	$901,911
AQR Special Mention	—	—	—	—	—	20,012	20,012
AQR Substandard	40	—	—	4,674	4,714	2,418	7,132
AQR Doubtful	—	—	—	—	—	—	—
AQR Loss	—	—	—	—	—	—	—
Subtotal	$736	$545	$—	$4,674	$5,955	$923,100	$929,055
Less: Unearned origination fees, net of origination costs							(4,551)
Total							$924,504
December 31, 2013							
AQR Pass	$672	$—	$—	$127	$799	$750,694	$751,493
AQR Special Mention	385	—	—	—	385	17,985	18,370
AQR Substandard	—	—	—	1,688	1,688	2,486	4,174
AQR Doubtful	—	—	—	—	—	—	—
AQR Loss	—	—	—	—	—		