

NORTHRIM BANCORP INC

Form 10-K

March 16, 2007

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**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-K**

**ANNUAL REPORT UNDER SECTION 13 OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2006**

**Commission File Number 0-33501**

**Northrim BanCorp, Inc.**  
*(Exact name of registrant as specified in its charter)*

**Alaska**  
*(State or other jurisdiction of  
incorporation or organization)*

**92-0175752**  
*(I.R.S. Employer  
Identification Number)*

**3111 C Street  
Anchorage, Alaska 99503**  
*(Address of principal executive offices) (Zip Code)*

**Registrant's Telephone Number, Including Area Code:  
(907) 562-0062**

**Securities Registered Pursuant to Section 12(b) of the Act:  
None**

**Securities Registered Pursuant to Section 12(g) of the Act:  
Common Stock, \$1.00 Par Value  
(Title of Class)**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ 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 ☐ 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. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (17 C.F.R. 229.405) 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 amendments to this Form 10-K. Yes ☐ No ☒

Indicate by check mark if the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated filer ☐

Accelerated filer ☐

Non-Accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

The aggregate market value of common stock held by non-affiliates of registrant at June 30, 2006, was \$133,680,506.

The number of shares of registrant's common stock outstanding at March 1, 2007, was 6,115,822.

Documents incorporated by reference and parts of Form 10-K into which incorporated: The portions of the Proxy Statement for Northrim BanCorp's Annual Shareholders' Meeting to be held on May 3, 2007, referenced in Part III of this Form 10-K are incorporated by reference therein.

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**Note Regarding Forward-Looking Statements**

This report includes forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements describe Northrim's management's expectations about future events and developments such as future operating results, growth in loans and deposits, continued success of Northrim'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 "anticipates," "believes," "expects," "intends" and similar expressions in part to help identify forward-looking statements. Forward-looking statements reflect management's current 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 margins; and our ability to maintain asset quality. Further, actual results may be affected by our ability to compete on price and other factors with other financial institutions; customer acceptance of new products and services; the regulatory environment in which we operate; and general trends in the local, regional and national banking industry and economy. Many of these risks, as well as other risks that may have a material adverse impact on our operations and business, are identified in our filings with the SEC. 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.**

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**Northrim BanCorp, Inc.  
About the Company**

**Overview**

Northrim BanCorp, Inc. (the Company) is a publicly traded bank holding company with four wholly-owned subsidiaries, Northrim Bank (the Bank), a state chartered, full-service commercial bank; Northrim Investment Services Company (NISC), which we formed in November 2002 to hold the Company's equity interest in Elliott Cove Capital Management LLC, (Elliott Cove), an investment advisory services company; Northrim Capital Trust 1 (NCT1), an entity that we formed in May of 2003 to facilitate a trust preferred security offering by the Company; and Northrim Statutory Trust 2 (NST2), an entity that we formed in December of 2005 to facilitate a trust preferred security offering by the Company. We also hold a 24% interest in the profits and losses of a residential mortgage holding company, Residential Mortgage Holding Company LLC (RML Holding Company) through Northrim Bank's wholly-owned subsidiary, Northrim Capital Investments Co. (NCIC). The predecessor of RML Holding Company, Residential Mortgage LLC (RML), was formed in 1998 and has offices throughout Alaska. We also operate in the Washington and Oregon market areas through Northrim Funding Services, a division of the Bank that was formed in 2004. 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. Finally, in the first quarter of 2006, through NISC, we purchased a 24% interest in Pacific Wealth Advisors, LLC (PWA), an investment advisory and wealth management business located in Seattle, Washington.

The Company is regulated by the Board of Governors of the Federal Reserve System, and the Bank is regulated by the Federal Deposit Insurance Corporation (FDIC), and the State of Alaska Department of Community and Economic Development, Division of Banking, Securities and Corporations. We began banking operations in Anchorage in December 1990, and formed the Company in connection with our reorganization into a holding company structure; that reorganization was completed effective December 31, 2001. We make our Securities Exchange Act reports available free of charge on our Internet web site, [www.northrim.com](http://www.northrim.com). Our reports can also be obtained through the Securities and Exchange Commission's EDGAR database at [www.sec.gov](http://www.sec.gov).

We opened for business in 1990 shortly after the dramatic consolidation of the Alaska banking industry in the late 1980s that left three large commercial banks with over 93% of commercial bank deposits in greater Anchorage. Through the successful implementation of our Customer First Service philosophy of providing our customers with the highest level of service, we capitalized on the opportunity presented by this consolidation and carved out a market niche among small business and professional customers seeking more responsive and personalized service.

We grew substantially in 1999 when we completed a public stock offering in which we raised \$18.5 million and acquired eight branches from Bank of America. The Bank of America branch acquisition was completed in June 1999 and increased our outstanding loans by \$114 million, our deposits by \$124 million, and provided us fixed assets valued at \$2 million, for a purchase price of \$5.9 million, in addition to the net book value of the loans and fixed assets. The stock offering allowed us to achieve the Bank of America acquisition while remaining well-capitalized under bank regulatory guidelines.

We have grown to be the third largest commercial bank in Anchorage and Alaska in terms of deposits, with \$794.9 million in total deposits and \$925.6 million in total assets at December 31, 2006. Through our 10 branches, we are accessible by approximately 65% of the Alaska population.

***Anchorage:*** We have two major financial centers in Anchorage, four smaller branches, and one supermarket branch. We are also exploring future branching opportunities in this market.

***Fairbanks:*** We opened our financial center in Fairbanks, Alaska's second largest city, in mid-1996. This branch has given us a strong foothold in Interior Alaska, and management believes that there is significant potential to increase our share of that market. We plan to begin construction of a second branch in the Fairbanks market in the second quarter of 2007.

***Eagle River:*** We also serve Eagle River, a community outside of Anchorage. In January of 2002, we moved from a supermarket branch into a full-service branch to provide a higher level of service to this growing market.

***Wasilla:*** Wasilla is a rapidly growing market in the Matanuska Valley outside of Anchorage where we completed construction of a new financial center in December of 2002 and moved from our supermarket branch and loan production office into this new facility.

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**Elliott Cove Capital Management LLC**

As of December 31, 2006, the Company owned a 47% equity interest in Elliott Cove, an investment advisory services company, through its wholly owned subsidiary, NISC. Elliott Cove began active operations in the fourth quarter of 2002 and has had start-up losses since that time as it continues to build its assets under management. In addition to its ownership interest, the Company provides Elliott Cove with a line of credit that has a committed amount of \$750,000 and an outstanding balance of \$617,000 as of December 31, 2006.

As of December 31, 2006, there are 11 Northrim Bank employees who are licensed as IARs and actively selling the Elliott Cove product. We plan to continue to use the Elliott Cove products to strengthen our existing customer relationships and bring new customers into the Bank. In addition, as Elliott Cove builds its assets under management, we expect that it will reach a break-even point on a monthly basis on its operations in 2008.

**Northrim Funding Services**

In the third quarter of 2004, we formed Northrim Funding Services ( NFS ) as a division of the Bank. NFS is based in Bellevue, Washington and provides short-term working capital to customers in the states of Washington and Oregon by purchasing their accounts receivable. During its second full year of operations in 2006, the employees of NFS expanded the base of their operations. In 2007, we expect NFS to continue to penetrate its market and increase its market share in the purchased receivables business.

**High Performance Checking**

In the first part of 2005, we launched our High Performance Checking ( HPC ) product consisting of several consumer checking accounts tailored to the needs of specific segments of our market, including a totally free checking product. We supported the new products with a targeted marketing program and extensive branch sales promotions. Through the concentrated efforts of our branch employees, we increased the number of our deposit accounts and the balances in them.

In the fourth quarter of 2006, we introduced HPC for our business checking accounts. In 2007, we plan to continue to support the HPC consumer and business checking products with the same program of targeted marketing and branch promotions in an effort to continue to expand our core deposits.

**Business Strategies**

In addition to our acquisition strategy, we are pursuing a strategy of aggressive internal growth. Our success will depend on our ability to manage our credit risks and control our costs while providing competitive products and services. To achieve our objectives, we are pursuing the following business strategies:

***Providing Customer First Service:*** We believe that we provide a high level of customer service. Our guiding principle is to serve our market areas by operating with a Customer First Service philosophy, affording our customers the highest priority in all aspects of our operations. To achieve this objective, our 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 Customer First Service philosophy is combined with our emphasis on personalized, local decision making.



***Emphasizing Business and Professional Lending:*** We endeavor to provide commercial lending products and services, and to emphasize relationship banking with businesses and professional individuals. Management believes that our focus on providing financial services to businesses and professional individuals has and may continue to increase lending and core deposit volumes.

***Providing Competitive and Responsive Real Estate Lending:*** We estimate that we are a major land development and residential construction lender and an active lender in the commercial real estate market. Management believes that our willingness to provide these services in a professional and responsive manner has contributed significantly to our growth. Because of our relatively small size, our experienced senior management can be more involved with serving customers and making credit decisions, allowing us to compete more favorably for lending relationships.

***Pursuing Strategic Opportunities for Additional Growth:*** Management believes that the Bank of America branch acquisition in 1999 significantly strengthened our local market position and enabled us to further capitalize on expansion opportunities resulting from the demand for a locally based banking institution providing a high level of service. Not only did the acquisition increase our size, number of branch offices and lending capacity, but it also expanded our consumer

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lending, further diversifying our loan portfolio. We expect to continue seeking similar opportunities to further our growth while maintaining a high level of credit quality. We plan to affect our growth strategy through a combination of growth at existing branch locations, new branch openings, primarily in Anchorage, Wasilla and Fairbanks, and strategic banking and non-banking acquisitions.

***Developing a Sales Culture:*** In 2003, we conducted extensive sales training throughout the Company and developed a comprehensive approach to sales. Since then, we have continued with this sales training in all of our major customer contact areas. Our goal throughout this process is to increase and broaden the relationships that we have with new and existing customers and to continue to increase our market share within our existing markets.

## **Services**

We provide a wide range of banking services in South Central and Interior Alaska to businesses, professionals, and individuals with high service expectations.

***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 innovative deposit services and products are:

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 branch.

***Lending Services:*** We are an active lender with 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, and the Matanuska Valley (near Anchorage). To a lesser extent, we provide consumer loans. See Lending Activities.

***Other Customer Services:*** In addition to our deposit and lending services, we offer our customers several 24-hour services: Telebanking, faxed account statements, Internet banking for individuals and businesses, 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, cash management programs to meet the specialized needs of business customers, and courier agents who pick up noncash deposits from business customers.

***Directors and Executive Officers:*** The following table presents the names and occupations of our directors and executive officers.

| <b>Executive Officers/Age</b> | <b>Occupation</b>                                                                                     |
|-------------------------------|-------------------------------------------------------------------------------------------------------|
| *R. Marc Langland, 65         | Chairman, President, & CEO of the Company and the Bank, and Director, Alaska Air Group                |
| *Christopher N. Knudson, 53   | Executive Vice President and Chief Operating Officer of the Company and the Bank                      |
| Joseph M. Schierhorn, 49      | Executive Vice President, Chief Financial Officer, and Compliance Manager of the Company and the Bank |
| Joseph M. Beedle, 55          | Executive Vice President of the Company and Chief Lending Officer of the Bank                         |
| Victor P. Mollozzi, 57        | Senior Vice President, Senior Credit Officer of the Bank                                              |

\*Indicates individual serving as both director and executive officer.

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| <b>Directors/Age</b>   | <b>Occupation</b>                                                                                                                                                          |
|------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Larry S. Cash, 55      | President and CEO, RIM Architects (Alaska), Inc.; CEO, RIM Architects (Guam), LLC.                                                                                         |
| Mark G. Copeland, 64   | Owner and sole member of Strategic Analysis, LLC, a management consulting firm                                                                                             |
| Frank A. Danner, 73    | Secretary/Treasurer, IMEX, Ltd. dba Dynamic Properties (real estate firm)                                                                                                  |
| Ronald A. Davis, 74    | Former Vice President, Acordia of Alaska Insurance (full service insurance agency)                                                                                         |
| Anthony Drabek, 59     | President and CEO, Natives of Kodiak, Inc. (Alaska Native Corporation), Chairman and President, Koncor Forest Products Co.; Secretary/Director, Atikon Forest Products Co. |
| Richard L. Lowell, 66  | Former Chairman, Ribelin Lowell Alaska USA Insurance Brokers, Inc. (insurance brokerage firm)                                                                              |
| Irene Sparks Rowan, 65 | Former Chairman and Director, Klukwan, Inc. (Alaska Native Corporation) and its subsidiaries                                                                               |
| John C. Swalling, 57   | President, Swalling & Associates, P.C. (accounting firm)                                                                                                                   |
| David G. Wight, 66     | Former President and CEO, Alyeska Pipeline Service Company, and Director, Storm Cat Energy Corporation                                                                     |

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|                                                  | 2006                                                            | 2005      | 2004      | 2003      | 2002      |
|--------------------------------------------------|-----------------------------------------------------------------|-----------|-----------|-----------|-----------|
|                                                  | <i>Unaudited</i><br><i>(In Thousands Except Per Share Data)</i> |           |           |           |           |
| Net interest income                              | \$47,522                                                        | \$43,908  | \$41,271  | \$39,267  | \$34,670  |
| Provision for loan losses                        | 2,564                                                           | 1,170     | 1,601     | 3,567     | 3,095     |
| Other operating income                           | 7,658                                                           | 4,833     | 3,792     | 6,089     | 5,199     |
| Other operating expense                          | 31,368                                                          | 29,477    | 26,535    | 24,728    | 23,061    |
| Income before income taxes and minority interest | 21,248                                                          | 18,094    | 16,927    | 17,061    | 13,713    |
| Minority interest in subsidiaries                | 296                                                             |           |           |           |           |
| Pre tax income                                   | 20,952                                                          | 18,094    | 16,927    | 17,061    | 13,713    |
| Income taxes                                     | 7,978                                                           | 6,924     | 6,227     | 6,516     | 5,171     |
| Net income                                       | \$12,974                                                        | \$11,170  | \$10,700  | \$10,545  | \$8,542   |
| Earnings per share:                              |                                                                 |           |           |           |           |
| Basic                                            | \$2.12                                                          | \$1.78    | \$1.68    | \$1.68    | \$1.33    |
| Diluted                                          | 2.09                                                            | 1.72      | 1.63      | 1.61      | 1.29      |
| Cash dividends per share                         | 0.47                                                            | 0.43      | 0.38      | 0.33      | 0.20      |
| Assets                                           | \$925,620                                                       | \$895,580 | \$800,726 | \$738,569 | \$704,249 |
| Loans                                            | 717,056                                                         | 705,059   | 678,269   | 601,119   | 534,990   |
| Deposits                                         | 794,904                                                         | 779,866   | 699,061   | 646,197   | 626,415   |
| Long-term debt                                   | 2,174                                                           | 2,574     | 2,974     | 3,374     | 3,774     |
| Junior subordinated debentures                   | 18,558                                                          | 18,558    | 8,000     | 8,000     |           |
| Shareholders' equity                             | 95,418                                                          | 84,474    | 83,358    | 75,285    | 68,373    |
| Book value                                       | \$15.61                                                         | \$13.86   | \$13.01   | \$11.82   | \$10.66   |
| Tangible book value                              | \$14.48                                                         | \$12.65   | \$11.97   | \$10.73   | \$9.51    |
| Net interest margin (tax equivalent)             | 5.89%                                                           | 5.66%     | 5.88%     | 6.04%     | 5.82%     |
| Efficiency ratio (cash) <sup>(1)</sup>           | 55.97%                                                          | 59.72%    | 58.07%    | 53.71%    | 56.92%    |
| Return on assets                                 | 1.46%                                                           | 1.33%     | 1.44%     | 1.50%     | 1.33%     |
| Return on equity                                 | 14.45%                                                          | 13.17%    | 13.50%    | 14.89%    | 13.32%    |
| Equity/assets                                    | 10.31%                                                          | 9.44%     | 10.41%    | 10.19%    | 9.71%     |
| Dividend payout ratio                            | 21.43%                                                          | 22.92%    | 21.57%    | 19.04%    | 14.29%    |
| Nonperforming loans/portfolio loans              | 0.92%                                                           | 0.86%     | 0.97%     | 1.72%     | 1.09%     |
| Net charge-offs/average loans                    | 0.16%                                                           | 0.18%     | 0.16%     | 0.33%     | 0.36%     |

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|                                           |       |       |       |       |       |
|-------------------------------------------|-------|-------|-------|-------|-------|
| Allowance for loan losses/portfolio loans | 1.69% | 1.52% | 1.59% | 1.70% | 1.61% |
| Nonperforming assets/assets               | 0.79% | 0.69% | 0.82% | 1.40% | 0.81% |
| Number of banking offices                 | 10    | 10    | 10    | 10    | 10    |
| Number of employees (FTE)                 | 277   | 272   | 272   | 268   | 246   |

- (1) In managing our business, we review the efficiency ratio exclusive of intangible asset amortization (see definition in table below), which is not defined in accounting principles generally accepted in the United States ( GAAP ). The efficiency ratio is calculated by dividing noninterest expense, exclusive of intangible asset amortization, by the sum of net interest income and noninterest income. Other companies may define or calculate this data differently. We believe this presentation provides investors with a more accurate picture of our operating efficiency. In this presentation, noninterest expense is adjusted for intangible asset amortization. For additional information see the Noninterest Expense section in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operation of this report.

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| Years ended December 31,                              | 2006     | 2005     | 2004     | 2003     | 2002     |
|-------------------------------------------------------|----------|----------|----------|----------|----------|
| Net interest income <sup>(1)</sup>                    | \$47,522 | \$43,908 | \$41,271 | \$39,267 | \$34,670 |
| Noninterest income                                    | 7,658    | 4,833    | 3,792    | 6,089    | 5,199    |
| Noninterest expense                                   | 31,368   | 29,477   | 26,535   | 24,728   | 23,061   |
| Intangible asset amortization                         | 482      | 368      | 368      | 368      | 368      |
| Adjusted noninterest expense                          | \$30,886 | \$29,109 | \$26,167 | \$24,360 | \$22,693 |
| Efficiency ratio                                      | 56.85%   | 60.48%   | 58.88%   | 54.52%   | 57.84%   |
| Efficiency ratio (less intangible asset amortization) | 55.97%   | 59.72%   | 58.07%   | 53.71%   | 56.92%   |
| Tax rate                                              | 38%      | 38%      | 37%      | 38%      | 38%      |

(1) Amount represents net interest income before provision for loan losses.

(2) 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.

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**Management's Discussion and Analysis of Financial Condition and  
Results of Operation**

**Overview**

We are a publicly traded bank holding company with four wholly-owned subsidiaries: the Bank, a state chartered, full-service commercial bank; NISC, a company formed to invest in both Elliott Cove, an investment advisory services company, and PWA, an investment advisory and wealth management business located in Seattle, Washington; and NCT1 and NST2, entities formed to facilitate two trust preferred securities offerings. The Bank in turn has a wholly-owned subsidiary, NCIC, which has an interest in RML Holding Company, a residential mortgage holding company and NBG, an insurance brokerage company that provides employee benefits plans to businesses throughout Alaska. We are headquartered in Anchorage and have 10 branch locations, seven in Anchorage, and one each in Fairbanks, Eagle River, and Wasilla. The Bank also operates Northrim Funding Services, a division headquartered in Bellevue, Washington with operations in the Washington and Oregon markets. We offer a wide array of commercial and consumer loan and deposit products, investment products, and electronic banking services over the Internet.

We opened the Bank for business in Anchorage in 1990. The Bank became the wholly-owned subsidiary of the Company effective December 31, 2001, when we completed our bank holding company reorganization. We opened our first branch in Fairbanks in 1996, and our second location in Anchorage in 1997. During the second quarter of 1999, we purchased eight branches located in Anchorage, Eagle River and Wasilla from Bank of America. This acquisition resulted in us acquiring \$114 million in loans, \$124 million in deposits and \$2 million in fixed assets for a purchase price of \$5.9 million.

One of our major objectives is to increase our market share in Anchorage, Fairbanks, and the Matanuska Valley, Alaska's three largest urban areas. We estimate that we hold a 21% share of the commercial bank deposit market in Anchorage, a 9% share of the Fairbanks market, and a 10% share of the Matanuska Valley market as of June 30, 2006.

Our growth and operations depend upon the economic conditions of Alaska and the specific markets we serve. The economy of Alaska is dependent upon the natural resources industries, in particular oil production, as well as tourism, government, and U.S. military spending. According to the State of Alaska Department of Revenue, approximately 86% of the Alaska state government is funded 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.

During the second quarter of 1999, we sold 1,842,900 shares of our common stock in an underwritten common stock offering that generated \$18.5 million in net proceeds. We used the proceeds to purchase the Bank of America branches and to provide capital for additional growth.

At December 31, 2006, we had assets of \$925.6 million and gross loans of \$717.1 million, an increase of 3% and 2%, respectively, over assets of \$895.6 million and gross loans of \$705.1 million at December 31, 2005. Our net income and diluted earnings per share for 2006 were \$13 million and \$2.09, respectively, an increase of 16% and 22%, respectively, from \$11.2 million and \$1.72 at year end 2005. During the same time period, our net interest income increased by \$3.6 million, or 8%, to \$47.5 million, from \$43.9 million for the year ended 2005. Our provision for loan losses in 2006 increased by \$1.4 million, or 119% to \$2.6 million, from \$1.2 million in 2005, as our nonperforming loans increased by \$561,000, or 9% for 2006, from \$6.1 million in 2005 to \$6.6 million for 2006. In contrast, for 2006 our other operating income increased by \$2.8 million, or 58%, to \$7.7 million from \$4.8 million in 2005. The growth



in our net interest income combined with the positive effects of the increases in our other operating income was offset in part by an increase in other operating expenses of \$1.9 million, or 6%, to \$31.4 million in 2006 from \$29.5 million for 2005, which resulted in an increase in our net income and earnings per share.

## **Results of Operations**

### **Net Income**

We earned net income of \$13 million in 2006, compared to net income of \$11.2 million in 2005, and \$10.7 million in 2004. During these periods, net income per diluted share was \$2.09, \$1.72, and \$1.63, respectively.

### **Net Interest Income**

Our results of operations are dependent to a large degree on our net interest income. We also generate other income, primarily through service charges and fees, earnings from our mortgage affiliate and purchased receivables products, and other sources. Our operating expenses consist in large part of compensation, employee benefits expense, occupancy, and marketing expense. Interest income and cost of funds are affected significantly by general economic conditions, particularly changes in market interest rates, and by government policies and the actions of regulatory authorities.

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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 2006 was \$47.5 million compared to \$43.9 million in 2005, and \$41.3 million in 2004, reflecting an increase in our interest-earning assets and the general level of interest rates. Average interest-earning assets increased \$32.3 million, or 4%, in 2006 compared to an increase in average interest-bearing liabilities in 2006 of \$36 million, or 6%. Average interest-earning assets increased \$74.1 million, or 11%, in 2005 compared to an increase in average interest-bearing liabilities in 2005 of \$76.1 million, or 15%.

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 the level and relative mix of interest-earning assets and interest-bearing liabilities. During the fiscal years ended December 31, 2006, 2005, and 2004, average interest-earning assets were \$810.9 million, \$778.6 million, and \$704.5 million, respectively. During these same periods, net interest margins were 5.86%, 5.64%, and 5.86%, respectively, which reflect our balance sheet mix and premium pricing on loans compared to other community banks and an emphasis on construction lending, which has a higher fee base. Our average yield on earning-assets was 8.57% in 2006, 7.55% in 2005, and 6.89% in 2004, while the average cost of interest-bearing liabilities was 3.63% in 2006, 2.61% in 2005, and 1.48% in 2004.

Our net interest margin increased in 2006 from 2005 due to the interaction of several factors. First, in 2006, the cost of interest-bearing liabilities increased by 102 basis points while the yield on interest-earning assets also increased by 102 basis points. During this time, the average balance of our interest-bearing demand deposits increased by \$13 million to \$78.9 million at December 31, 2006 from \$65.9 million at December 31, 2005. The average balance of our demand deposits and other noninterest-bearing liabilities also increased by \$5.5 million to \$193.5 million at December 31, 2006 from \$188 million at December 31, 2005. The increase in these lower cost deposits in 2006 helped to contain the rate of growth in the cost of interest-bearing liabilities. Second, the 102 basis point increase in the yield on earning assets in 2006 had a larger effect on net interest income because it was applied to earning assets with an average balance of \$810.9 million versus the 102 basis point increase in the cost of interest-bearing liabilities that was applied to an average balance of \$605.6 million. Finally, in 2006, earning assets increased by \$32.3 million, or 4% compared to growth of \$74.1 million, or 11% in 2005. However, during these same time periods, net interest income increased by \$3.6 million, or 8% and \$2.6 million, or 6%, respectively in 2006 and 2005. The growth rate of net interest income increased in 2006 while the rate of growth in earning assets decreased, which contributed to the increase in the net interest margin.

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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,                                  | 2006                              |                                            |                | 2005                              |                                            |                | 2004                              |                                            |                |
|-----------------------------------------------------------|-----------------------------------|--------------------------------------------|----------------|-----------------------------------|--------------------------------------------|----------------|-----------------------------------|--------------------------------------------|----------------|
|                                                           | Average<br>outstanding<br>balance | Interest<br>earned/<br>paid <sup>(1)</sup> | Yield/<br>rate | Average<br>outstanding<br>balance | Interest<br>earned/<br>paid <sup>(1)</sup> | Yield/<br>rate | Average<br>outstanding<br>balance | Interest<br>earned/<br>paid <sup>(1)</sup> | Yield/<br>rate |
| <i>(In Thousands)</i>                                     |                                   |                                            |                |                                   |                                            |                |                                   |                                            |                |
| Assets:                                                   |                                   |                                            |                |                                   |                                            |                |                                   |                                            |                |
| Loans <sup>(2)</sup>                                      | \$712,116                         | \$65,347                                   | 9.18%          | \$698,240                         | \$55,870                                   | 8.00%          | \$628,830                         | \$45,898                                   | 7.30%          |
| Securities                                                | 71,164                            | 2,757                                      | 3.87%          | 61,125                            | 2,202                                      | 3.60%          | 64,008                            | 2,492                                      | 3.89%          |
| Overnight investments                                     | 27,665                            | 1,374                                      | 4.97%          | 19,232                            | 709                                        | 3.69%          | 11,633                            | 164                                        | 1.41%          |
| Total interest-earning assets                             | 810,945                           | 69,478                                     | 8.57%          | 778,597                           | 58,781                                     | 7.55%          | 704,471                           | 48,554                                     | 6.89%          |
| Noninterest-earning assets                                | 77,920                            |                                            |                | 63,810                            |                                            |                | 54,788                            |                                            |                |
| Total assets                                              | \$888,865                         |                                            |                | \$842,407                         |                                            |                | \$759,259                         |                                            |                |
| Liabilities and Shareholders' Equity                      |                                   |                                            |                |                                   |                                            |                |                                   |                                            |                |
| Deposits:                                                 |                                   |                                            |                |                                   |                                            |                |                                   |                                            |                |
| Interest-bearing demand accounts                          | \$78,872                          | \$830                                      | 1.05%          | \$65,890                          | \$369                                      | 0.56%          | \$57,373                          | \$221                                      | 0.39%          |
| Money market accounts                                     | 151,871                           | 6,053                                      | 3.99%          | 139,331                           | 3,876                                      | 2.78%          | 126,567                           | 1,527                                      | 1.21%          |
| Savings accounts                                          | 254,209                           | 10,113                                     | 3.98%          | 207,277                           | 6,263                                      | 3.02%          | 139,876                           | 2,290                                      | 1.64%          |
| Certificates of deposit                                   | 94,595                            | 3,320                                      | 3.51%          | 138,284                           | 3,482                                      | 2.52%          | 155,134                           | 2,671                                      | 1.72%          |
| Total interest-bearing deposits                           | 579,547                           | 20,316                                     | 3.51%          | 550,782                           | 13,990                                     | 2.54%          | 478,950                           | 6,709                                      | 1.40%          |
| Borrowings                                                | 26,052                            | 1,640                                      | 6.30%          | 18,792                            | 883                                        | 4.70%          | 14,525                            | 574                                        | 3.95%          |
| Total interest-bearing liabilities                        | 605,599                           | 21,956                                     | 3.63%          | 569,574                           | 14,873                                     | 2.61%          | 493,475                           | 7,283                                      | 1.48%          |
| Demand deposits and other noninterest-bearing liabilities | 193,461                           |                                            |                | 188,000                           |                                            |                | 186,506                           |                                            |                |

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|                                            |           |           |           |
|--------------------------------------------|-----------|-----------|-----------|
| Total liabilities                          | 799,060   | 757,574   | 679,981   |
| Shareholders' equity                       | 89,805    | 84,833    | 79,278    |
|                                            |           |           |           |
| Total liabilities and shareholders' equity | \$888,865 | \$842,407 | \$759,259 |
|                                            |           |           |           |
| Net interest income                        | \$47,522  | \$43,908  | \$41,271  |
|                                            |           |           |           |
| Net interest margin <sup>(3)</sup>         | 5.86%     | 5.64%     | 5.86%     |

(1) Interest income included loan fees.

(2) Nonaccrual loans are included with a zero effective yield.

(3) The net interest margin on a tax equivalent basis was 5.89%, 5.66%, 5.88%, 6.04%, and 5.82%, respectively, for 2006, 2005, 2004, 2003, and 2002.

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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.

|                                  | 2006 compared to 2005                |             |              | 2005 compared to 2004                |             |              |
|----------------------------------|--------------------------------------|-------------|--------------|--------------------------------------|-------------|--------------|
|                                  | Increase (decrease) due to<br>Volume | Rate        | Total        | Increase (decrease) due to<br>Volume | Rate        | Total        |
| <b>Interest Income:</b>          |                                      |             |              |                                      |             |              |
| Loans                            | \$1,129                              | \$8,348     | \$9,477      | \$5,327                              | \$4,645     | \$9,972      |
| Securities                       | 381                                  | 174         | 555          | (109)                                | (181)       | (290)        |
| Overnight investments            | 371                                  | 294         | 665          | 157                                  | 388         | 545          |
| <br>Total interest income        | <br>\$1,881                          | <br>\$8,816 | <br>\$10,697 | <br>\$5,375                          | <br>\$4,852 | <br>\$10,227 |
| <br><b>Interest Expense:</b>     |                                      |             |              |                                      |             |              |
| Deposits:                        |                                      |             |              |                                      |             |              |
| Interest-bearing demand accounts | \$85                                 | \$376       | \$461        | \$37                                 | \$112       | \$148        |
| Money market accounts            | 375                                  | 1,802       | 2,177        | 168                                  | 2,181       | 2,349        |
| Savings accounts                 | 1,605                                | 2,245       | 3,850        | 1,441                                | 2,532       | 3,973        |
| Certificates of deposit          | (1,292)                              | 1,130       | (162)        | (250)                                | 1,061       | 811          |
| <br>Total interest on deposits   | <br>773                              | <br>5,554   | <br>6,326    | <br>1,396                            | <br>5,885   | <br>7,281    |
| Borrowings                       | 403                                  | 354         | 757          | 188                                  | 121         | 309          |
| <br>Total interest expense       | <br>\$1,176                          | <br>\$5,908 | <br>\$7,083  | <br>\$1,584                          | <br>\$6,006 | <br>\$7,590  |

**Other Operating Income**

Total other operating income increased \$2.8 million, or 59%, in 2006, after increasing \$1 million, or 27%, in 2005, and decreasing \$2.3 million, or 38%, in 2004. The following table separates the more routine (operating) sources of other income from those that can fluctuate significantly from period to period:

| Years Ended December 31, | 2006                  | 2005 | 2004 | 2003 | 2002 |
|--------------------------|-----------------------|------|------|------|------|
|                          | <i>(In Thousands)</i> |      |      |      |      |

|                                                    |         |         |         |         |         |
|----------------------------------------------------|---------|---------|---------|---------|---------|
| Other Operating Income                             |         |         |         |         |         |
| Deposit service charges                            | \$1,975 | \$1,800 | \$1,718 | \$1,805 | \$1,687 |
| Purchased receivable income                        | 1,855   | 993     | 201     | 35      |         |
| Employee benefit plan income                       | 1,113   |         |         |         |         |
| Electronic banking fees                            | 790     | 632     | 608     | 563     | 654     |
| Equity in earnings from RML                        | 649     | 493     | 438     | 2,785   | 1,917   |
| Merchant credit card transaction fees              | 531     | 444     | 414     | 363     | 423     |
| Other transaction fees                             | 227     | 214     | 204     | 247     | 283     |
| Loan service fees                                  | 531     | 374     | 379     | 416     | 350     |
| Equity in loss from Elliott Cove                   | (230)   | (424)   | (457)   | (554)   | (239)   |
| Other income                                       | 217     | 298     | 136     | 74      | 11      |
| Operating sources                                  | 7,658   | 4,824   | 3,641   | 5,734   | 5,086   |
| Gain on sale of securities available for sale, net |         | 9       | 151     | 310     | 113     |
| Gain on sale of other real estate owned            |         |         |         | 45      |         |
| Other sources                                      |         | 9       | 151     | 355     | 113     |
| Total other operating income                       | \$7,658 | \$4,833 | \$3,792 | \$6,089 | \$5,199 |

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Total operating sources of other operating income in 2006 increased \$2.8 million, or 59% over 2005 levels. In 2005, this income increased \$1.2 million, or 32%, and in 2004, it decreased \$2.1 million, or 37% as compared to 2003 levels. The main reason for the increase in other operating income in 2006 was the increase in income from purchased receivables and the consolidation of NBG into the Company's financial statements.

Deposit service charges increased \$175,000, or 10%, in 2006 as compared to 2005, and they increased \$118,000, or 5%, in 2005 as compared to 2004 due to the increased personal account base that resulted from the marketing of the HPC deposit product. The Company began to market this product in the second quarter of 2005. As a result, the increase in deposit service charges was larger in 2006 than it was in 2005 since 2006 reflected a full year of activity with the HPC product.

Income from the Company's purchased receivable products increased by \$862,000, or 87%, in 2006 as compared to 2005, and this income increased \$792,000, or 394%, in 2005 as compared to 2004. The Company uses these products to purchase accounts receivable from its customers and provide them with working capital for their businesses. While the customers are responsible for collecting these receivables, the Company mitigates this risk with extensive monitoring of the customers' transactions and control of the proceeds from the collection process. The Company earns income from the purchased receivable product by charging finance charges to its customers for the purchase of their accounts receivable. The income from this product has grown as the Company has used it to purchase more receivables from its customers. The Company expects the income level from this product to show growth on a year-over-year comparative basis as the Company increases this line of business at NFS as it continues to increase its market share.

In December of 2005, the Company, through its wholly-owned subsidiary NCIC, purchased an additional 40.1% interest in NBG, which brought its ownership interest in this company to 50.1%. As a result of this increase in ownership, the Company now consolidates the balance sheet and income statement of NBG into its financial statements. In 2006, the Company included employee benefit plan income from NBG of \$1.1 million in its other operating income. In contrast, the Company did not record any income for this item in its other operating income in 2005 as it purchased a 10% interest in NBG in March of 2005 and accounted for this interest according to the equity method in 2005.

The Company's electronic banking fees increased by \$158,000, or 25%, in 2006 as compared to 2005, and these fees increased by \$24,000, or 4%, in 2005 as compared to 2004. As the Company increased the number of its deposit accounts through the marketing of the HPC product, it also sold additional services to these new accounts, which helped it to increase its electronic banking fees.

Included in operating sources of other operating income in 2006, 2005, and 2004 were \$649,000, \$493,000, and \$438,000, respectively, of income from our share of the earnings from RML. RML was formed in 1998 and has offices throughout Alaska. During the third quarter of 2004, RML reorganized and became a wholly-owned subsidiary of a newly formed holding company, RML Holding Company. In this process, RML Holding Company acquired another mortgage company, Pacific Alaska Mortgage Company (PAM). In the first quarter of 2005, PAM was merged into RML. Prior to the reorganization, the Company, through Northrim Bank's wholly-owned subsidiary, NCIC, owned a 30% interest in the profits and losses of RML. Following the reorganization, the Company's interest in RML Holding Company decreased to 24%.

Earnings from RML and RML Holding Company have fluctuated with activity in the housing market, which has been affected by local economic conditions and changes in mortgage interest rates. In 2003, and 2002, declining mortgage interest rates generated a significant increase in the demand for mortgage loans by consumers both for the refinance of existing loans and the purchase of new homes. Mortgage rates began to increase in the third quarter of 2003 from the historic lows reached in the second quarter. As a result, the refinance activity in the mortgage industry began to

decrease in the latter part of 2003. Due to this trend of increasing long-term mortgage interest rates and the costs associated with the merger of RML and PAM, our share of the earnings from RML declined in 2004. In 2005 and 2006, RML Holding Company began to realize some efficiencies from its merger and increased its income from its combined operations.

Merchant credit card transaction fees increased by \$87,000, or 20% in 2006 as compared to 2005, and these fees increased by \$30,000, or 7%, in 2005 as compared to 2004 as the Company increased the sales volume of this product to its larger account base.

Loan service fees increased by \$157,000, or 42% in 2006 as compared to 2005 as the Company increased the collection of late fees on its loan portfolio. In contrast, loan service fees decreased by \$5,000, or 1%, in 2005 as compared to 2004.

Our share of the loss from Elliott Cove decreased to \$230,000 in 2006, as compared to losses of \$424,000 and \$457,000, respectively, in 2005 and 2004 as Elliott Cove increased its assets under management, which provided it with increased revenues.

Other income decreased by \$81,000, or 27%, to \$217,000 at December 31, 2006 from \$298,000 at December 31, 2005. In the first quarter of 2006, through our subsidiary, NISC, the Company purchased a 24% interest in PWA. PWA is a holding company that owns Pacific Portfolio Consulting, LLC ( PPC ) and Pacific Portfolio Trust Company ( PPTC ). PPC is an investment advisory company with an existing client base while PPTC is a start-up operation. In 2006, the Company incurred a loss of \$126,000 on its investment in PWA. The losses from PWA were partially offset by increases in commissions that the Company receives for its sales of



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the Elliott Cove investment products, which were accounted for as other operating income. Finally, the Company expects to incur losses over the next several years as PWA builds the customer base of its combined operations.

Included in other sources of income is gain on sale of other real estate owned and gain on available for sale securities. No net security gains were recorded in 2006, whereas \$9,000 of net gains was recorded in 2005, and \$151,000 was recorded in 2004. In 2005, this income decreased \$142,000, or 94%; and in 2004, it decreased \$204,000, or 57%.

**Expenses**

**Provision for Loan Losses:** The provision for loan losses in 2006 was \$2.6 million, compared to \$1.2 million in 2005 and \$1.6 million in 2004. We increased the provision for loan losses in 2006 due to overall loan growth and an increase in our nonperforming loans. In 2006, nonperforming loans increased to \$6.6 million from a balance of \$6.1 million at December 31, 2005. In addition, net loan charge-offs were \$1.1 million, or 0.16% of average loans, in 2006 as compared to \$1.2 million, or 0.18% of average loans, in 2005 and \$1 million, or 0.16% of average loans, in 2004. The allowance for loan losses also increased in 2006 as a result of the increases in nonperforming loans and was \$12.1 million, or 1.69% of portfolio loans as compared to \$10.7 million, or 1.52% of portfolio loans at December 31, 2005 and \$10.8 million, or 1.59% of portfolio loans, at December 31, 2004. Likewise, the coverage ratio of the allowance for loan losses versus nonperforming loans increased to 183% in 2006 as compared to a coverage ratio of 176% in 2005 and 163% in 2004.

**Other Operating Expense:** Other operating expense increased \$1.9 million, or 6%, in 2006, \$2.9 million, or 11%, in 2005, and \$1.8 million, or 7%, in 2004. The following table breaks out the other operating expense categories:

| Years ended December 31,             | 2006     | 2005     | 2004     | 2003     | 2002     |
|--------------------------------------|----------|----------|----------|----------|----------|
| <i>(In Thousands)</i>                |          |          |          |          |          |
| Other Operating Expense              |          |          |          |          |          |
| Salaries and other personnel expense | \$19,277 | \$17,656 | \$15,708 | \$14,180 | \$13,023 |
| Occupancy, net                       | 2,503    | 2,417    | 2,130    | 2,000    | 2,040    |
| Equipment, net                       | 1,350    | 1,371    | 1,372    | 1,504    | 1,405    |
| Marketing                            | 1,641    | 1,657    | 1,201    | 1,205    | 1,136    |
| Intangible asset amortization        | 482      | 368      | 368      | 368      | 368      |
| Other expenses                       | 6,115    | 6,008    | 5,756    | 5,471    | 5,089    |
| Total other operating expense        | \$31,368 | \$29,477 | \$26,535 | \$24,728 | \$23,061 |

Salaries and other personnel expense increased \$1.6 million, or 9%, in 2006, \$1.9 million, or 12%, in 2005, and \$1.5 million, or 11%, in 2004, reflecting increases in salary and benefit costs throughout this time due in part to ongoing competition for our employees, which placed upward pressure on our salary structure. In 2006, the increase in the Company's salary costs was partially offset by a \$357,000 decrease in its health care costs. The Company does not expect continuing declines in its health care costs. Moreover, due to the tight labor market in the Company's major markets and ongoing competition for its employees, the Company expects further increases in salaries and benefits. In addition, as noted above, the Company now accounts for NBG on a consolidated basis. In 2006, the Company

included \$446,000 of NBG's salary and benefit costs in its own salary and benefit costs. Also, in the first quarter of 2006, the Company adopted FASB Statement 123R, *Share-Based Payment*. As a result, in 2006 the Company recorded \$256,000 in additional expense associated with its stock options.

Between 2006 and 2004, our occupancy expenses increased by \$373,000, or 18%, to \$2.5 million from \$2.1 million, as we incurred higher costs in our new branch locations and occupied additional space at our main Financial Center.

Marketing costs decreased by \$16,000, or 1%, in 2006, increased by \$456,000, or 38%, in 2005, and decreased \$4,000, or less than 1%, in 2004. The main reason for the increase in marketing expenses in 2005 was the costs associated with marketing our HPC product. Although the Company has incurred additional marketing expenses due to promoting its HPC Program in 2006, those costs have been offset by a decrease in other marketing expenses such as advertising for some of the Company's other products. The Company plans to continue to market its HPC Program as it has since the second quarter of 2005. Moreover, the company expects to incur increased marketing costs for the HPC for business product that it will begin marketing in 2007. The Company expects that the Bank will increase its deposit accounts and balances as it continues to implement the HPC Program over the next year. Furthermore, the Company expects that the additional deposit accounts will continue to generate increased fee income that will offset a majority of the increased marketing costs associated with the HPC Program.

Intangible asset amortization increased by \$114,000 or 31% to \$482,000 at December 31, 2006 from \$368,000 at December 31, 2005, as the Company began to amortize the customer relationship intangible asset associated with NBG. As noted

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above, the Company purchased an additional 40.1% interest in NBG in December of 2005, which increased its ownership interest in this company to 50.1%. The Company has invested \$1.1 million in NBG since its initial investment in the first quarter of 2005 and has attributed all of this investment to an intangible asset represented by the value of the customer relationships of NBG. The Company is amortizing the NBG intangible asset over a ten-year period on a straight-line basis. In 2006, the amortization expense on the NBG intangible asset was \$115,000, which accounts for the increase in amortization expense in that year. Prior to the Company's additional investment in NBG in December of 2005, the Company accounted for its investment in NBG according to the equity method and did not record its amortization expense on the NBG investment on a separate basis. The other portion of intangible asset amortization at December 31, 2006 pertains to the core deposit intangible that was created when the Bank purchased branches from Bank of America in 1999. The amortization on the core deposit intangible will end in June 2007.

Other expenses, which includes professional fees, software expenses, ATM and Visa processing fees and other operational expenses, increased \$107,000, or 2%, in 2006 as compared to 2005 and increased \$252,000, or 4%, in 2005 as compared to 2004 due to changes in a variety of expense accounts.

**Income Taxes:** The provision for income taxes increased \$1.1 million, or 15%, to \$8 million in 2006, increased \$697,000, or 11%, to \$6.9 million in 2005, and decreased \$289,000, or 4%, to \$6.2 million in 2004. The effective tax rate for 2006 and 2005 was 38%, compared to 37% in 2004. The effective tax rate in 2004 was lower than that for 2005 due in part to the favorable resolution of a dispute on a prior year's tax return recorded in 2004.

## **Financial Condition**

### **Assets**

### **Loans and Lending Activities**

**General:** Our loan products include short and medium-term commercial loans, commercial credit lines, construction and real estate loans and consumer loans. 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 higher net interest margins than other types of lending. However, they also involve greater risks, including greater exposure to changes in local economic conditions, than certain other types of lending.

Loans are the highest yielding component of earning assets. Average loans were \$13.9 million, or 2% greater in 2006 than in 2005. Average loans were \$69.4 million, or 11% greater in 2005 than in 2004. Loans comprised 88% of total earning assets on average in 2006, 90% in 2005 and 89% in 2004. The yield on loans averaged 9.18% in 2006, 8.00% in 2005, and 7.30% in 2004.

Growth in the loan portfolio during 2006 was \$12 million, or 2%. Commercial loans decreased \$336,000, or less than 1%, commercial real estate loans decreased \$14.8 million, or 6%, and construction loans increased \$21.5 million, or 16%, in 2006. Installment and consumer loans increased \$5.6 million, or 15%. Funding for the growth in loans in 2006 came from an increase in interest-bearing liabilities and from noninterest-bearing sources of funds and capital.

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***Nonperforming Loans; Real Estate Owned:*** Nonperforming assets consist of nonaccrual loans, accruing loans that are 90 days or more past due, restructured loans, and real estate owned. We had real estate owned property of \$717,000 at December 31, 2006. The following table sets forth information regarding our nonperforming loans and total nonperforming assets:

| December 31,                                     | 2006                  | 2005    | 2004    | 2003     | 2002    |
|--------------------------------------------------|-----------------------|---------|---------|----------|---------|
|                                                  | <i>(In Thousands)</i> |         |         |          |         |
| Nonperforming loans                              |                       |         |         |          |         |
| Nonaccrual loans                                 | \$5,176               | \$5,090 | \$5,876 | \$7,426  | \$4,717 |
| Accruing loans past due 90 days or more          | 708                   | 981     | 290     | 2,283    | 1,019   |
| Restructured loans                               | 748                   |         | 424     | 597      |         |
| Total nonperforming loans                        | 6,632                 | 6,071   | 6,590   | 10,306   | 5,736   |
| Real estate owned                                | 717                   | 105     |         |          |         |
| Total nonperforming assets                       | \$7,349               | \$6,176 | \$6,590 | \$10,306 | \$5,736 |
| Allowance for loan losses to portfolio loans     | 1.69%                 | 1.52%   | 1.59%   | 1.70%    | 1.61%   |
| Allowance for loan losses to nonperforming loans | 183%                  | 176%    | 163%    | 99%      | 148%    |
| Nonperforming loans to portfolio loans           | 0.92%                 | 0.86%   | 0.97%   | 1.72%    | 1.09%   |
| Nonperforming assets to total assets             | 0.79%                 | 0.69%   | 0.82%   | 1.40%    | 0.81%   |

***Nonaccrual, Accruing Loans 90 Days or More Past Due, and Restructured Loans:*** 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 \$437,000, \$353,000, and \$658,000, in 2006, 2005, and 2004, respectively.

Restructured loans are those 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 restructured loans 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.

Total nonperforming loans at December 31, 2006, were \$6.6 million, or 0.92% of portfolio loans, an increase of \$561,000 from \$6.1 million at December 31, 2005, and an increase of \$42,000 from \$6.6 million at December 31, 2004.

**Potential Problem Loans:** At December 31, 2006, management had identified potential problem loans of \$6.4 million as compared to potential problem loans of \$9.1 million at December 31, 2005. Loans in the amount of \$4.1 million were reported as potential problem loans at December 31, 2005 and December 31, 2006. Potential problem loans are loans which are currently performing and are not included in nonaccrual, accruing loans 90 days or more past due, or restructured loans 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 restructured loans.

**Analysis of Allowance for Loan Losses:** The allowance for loan losses is maintained at a level considered adequate by management to provide for inherent loan losses based on management's assessment of various factors affecting the loan portfolio, including a review of problem loans, business conditions, estimated collateral values, loss experience, credit concentrations, and an overall evaluation of the quality of the underlying collateral, and holding and disposal costs. The allowance is increased by provisions charged to operations and reduced by loans charged off, net of recoveries. Management believes that at December 31, 2006, the allowance is adequate to cover losses that are probable in light of our current loan portfolio and existing economic conditions.

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

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The following table shows the allocation of the allowance for loan losses for the periods indicated:

| December 31,                  | 2006     |                                 | 2005     |                                 | 2004     |                                 | 2003     |                                 | 2002    |                                 |
|-------------------------------|----------|---------------------------------|----------|---------------------------------|----------|---------------------------------|----------|---------------------------------|---------|---------------------------------|
| Amount applicable to:         | Amount   | % of Total Loans <sup>(1)</sup> | Amount   | % of Total Loans <sup>(1)</sup> | Amount   | % of Total Loans <sup>(1)</sup> | Amount   | % of Total Loans <sup>(1)</sup> | Amount  | % of Total Loans <sup>(1)</sup> |
| <i>(Dollars in Thousands)</i> |          |                                 |          |                                 |          |                                 |          |                                 |         |                                 |
| Commercial                    | \$8,208  | 40%                             | \$6,913  | 41%                             | \$5,130  | 39%                             | \$5,610  | 37%                             | \$4,285 | 100%                            |
| Construction                  | 330      | 21%                             | 246      | 19%                             | 276      | 18%                             | 282      | 17%                             | 1,327   | 100%                            |
| Real estate term              | 964      | 33%                             | 1,214    | 35%                             | 1,634    | 37%                             | 413      | 40%                             | 275     | 100%                            |
| Loans for sale                |          | 0%                              |          | 0%                              |          | 0%                              |          | 0%                              |         | 100%                            |
| Installment and other         |          |                                 |          |                                 |          |                                 |          |                                 |         |                                 |
| Consumer                      | 6        | 6%                              | 37       | 5%                              |          | 6%                              | 3        | 6%                              | 22      | 100%                            |
| Unallocated                   | 2,617    | 0%                              | 2,296    | 0%                              | 3,724    |                                 | 3,878    |                                 | 2,567   | 100%                            |
| Total                         | \$12,125 | 100%                            | \$10,706 | 100%                            | \$10,764 | 100%                            | \$10,186 | 100%                            | \$8,476 | 100%                            |

(1) Represents percentage of this category of loans to total loans.

The following table sets forth for the periods indicated information regarding changes in our allowance for loan losses:

| December 31,                         | 2006     | 2005     | 2004     | 2003    | 2002    |
|--------------------------------------|----------|----------|----------|---------|---------|
| <i>(In Thousands)</i>                |          |          |          |         |         |
| Balance at beginning of period       | \$10,706 | \$10,764 | \$10,186 | \$8,476 | \$7,200 |
| Charge-offs:                         |          |          |          |         |         |
| Commercial loans                     | (2,545)  | (1,552)  | (2,067)  | (2,067) | (1,791) |
| Construction loans                   |          | (100)    |          |         |         |
| Real estate loans                    |          |          |          | (127)   | (67)    |
| Installment and other consumer loans | (72)     | (63)     | (84)     | (91)    | (257)   |
| Total charge-offs                    | (2,617)  | (1,715)  | (1,471)  | (2,285) | (2,115) |
| Recoveries:                          |          |          |          |         |         |
| Commercial loans                     | 1,086    | 418      | 200      | 279     | 168     |
| Construction loans                   |          | 15       | 185      |         |         |
| Real estate loans                    | 355      | 15       |          | 111     | 48      |

|                                                                         |          |          |          |          |         |
|-------------------------------------------------------------------------|----------|----------|----------|----------|---------|
| Installment and other consumer loans                                    | 31       | 39       | 63       | 38       | 80      |
| Total recoveries                                                        | 1,472    | 487      | 448      | 428      | 296     |
| Charge-offs net of recoveries                                           | (1,145)  | (1,228)  | (1,023)  | (1,857)  | (1,819) |
| Provision for loan losses                                               | 2,564    | 1,170    | 1,601    | 3,567    | 3,095   |
| Balance at end of period                                                | \$12,125 | \$10,706 | \$10,764 | \$10,186 | \$8,476 |
| Ratio of net charge-offs to average loans outstanding during the period | 0.16%    | 0.18%    | 0.16%    | 0.33%    | 0.36%   |

***Credit Authority and Loan Limits:*** 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 \$16.5 million at December 31, 2006. See Management's Discussion and Analysis of Financial Condition and Results of Operations - Provision for Loan Losses.

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**Loan Policy:** 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. We supplement our own supervision of the loan underwriting and approval process with periodic loan reviews by experienced officers who examine quality, loan documentation, and compliance with laws and regulations.

**Loans Receivable:** Loans receivable increased to \$717.1 million at December 31, 2006, compared to \$705.1 million and \$678.3 million at December 31, 2005 and 2004, respectively. At December 31, 2006, 78% of the portfolio was scheduled to mature or reprice in 2007 with 19% scheduled to mature or reprice between 2008 and 2011. Future growth in loans is generally dependent on new loan demand and deposit growth, constrained by our policy of being well-capitalized as determined by the FDIC.

**Loan Portfolio Composition:** The following table sets forth at the dates indicated our loan portfolio composition by type of loan:

| As of December 31,        | 2006                          |                  | 2005             |                  | 2004             |                  | 2003             |                  | 2002             |
|---------------------------|-------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
|                           | Amount                        | Percent of total | Amount           | Percent of total | Amount           | Percent of total | Amount           | Percent of total | Amount           |
|                           | <i>(Dollars in Thousands)</i> |                  |                  |                  |                  |                  |                  |                  |                  |
| Commercial loans          | \$287,281                     | 40.06%           | \$287,617        | 40.79%           | \$267,737        | 39.47%           | \$220,774        | 36.73%           | \$187,312        |
| Real estate loans:        |                               |                  |                  |                  |                  |                  |                  |                  |                  |
| Mortgage                  | 153,059                       | 21.35%           | 131,532          | 18.66%           | 122,873          | 18.12%           | 102,311          | 17.02%           | 82,739           |
| Commercial term           | 237,599                       | 33.14%           | 252,395          | 35.80%           | 252,358          | 37.21%           | 239,545          | 39.85%           | 212,740          |
| Commercial loans          |                               | 0.00%            |                  | 0.00%            |                  | 0.00%            | 1,395            | 0.23%            | 7,437            |
| Consumer and              |                               |                  |                  |                  |                  |                  |                  |                  |                  |
| Automotive                | 42,140                        | 5.88%            | 36,519           | 5.18%            | 38,166           | 5.63%            | 39,796           | 6.62%            | 47,415           |
| Other                     | 720,079                       | 100.42%          | 708,063          | 100.43%          | 681,134          | 100.42%          | 603,821          | 100.45%          | 537,643          |
| Securities purchased      |                               | 0.00%            |                  | 0.00%            | (44)             | -0.01%           | (44)             | -0.01%           | (44)             |
| Loan fees and origination | (3,023)                       | -0.42%           | (3,004)          | -0.43%           | (2,821)          | -0.42%           | (2,658)          | -0.44%           | (2,609)          |
| <b>Total</b>              | <b>\$717,056</b>              | <b>100.00%</b>   | <b>\$705,059</b> | <b>100.00%</b>   | <b>\$678,269</b> | <b>100.00%</b>   | <b>\$601,119</b> | <b>100.00%</b>   | <b>\$534,990</b> |

The following table presents at December 31, 2006, the aggregate maturity and repricing data of our loan portfolio:



|                                | Within<br>1 Year | Maturity<br>1-5<br>Years<br><i>(In Thousands)</i> | Over 5<br>Years | Total         |
|--------------------------------|------------------|---------------------------------------------------|-----------------|---------------|
| Commercial                     | \$151,755        | \$87,093                                          | \$48,433        | \$287,281     |
| Construction                   | 140,775          | 10,656                                            | 1,628           | 153,059       |
| Real estate term               | 59,140           | 70,870                                            | 107,589         | 237,599       |
| Installment and other consumer | 1,032            | 8,032                                             | 33,076          | 42,140        |
| <br>Total                      | <br>\$352,702    | <br>\$176,651                                     | <br>\$190,726   | <br>\$720,079 |
| <br>Fixed interest rate        | <br>\$130,689    | <br>\$56,828                                      | <br>\$55,869    | <br>\$243,386 |
| Floating interest rate         | 222,013          | 119,823                                           | 134,857         | 476,693       |
| <br>Total                      | <br>\$352,702    | <br>\$176,651                                     | <br>\$190,726   | <br>\$720,079 |

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**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 participated with the Alaska Industrial Development and Export Authority ( AIDEA ). Commercial loans represented 40% of our total loans outstanding as of December 31, 2006 and reprice more frequently than other types of loans, such as real estate loans. More frequent repricing means that 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.

### ***Construction Loans:***

**Land Development:** We believe we are a major land development and residential construction lender. At December 31, 2006, we had \$46.8 million of residential subdivision land development loans outstanding, or 7% of total loans.

**One-to-Four-Family Residences:** We financed approximately one-third of the single-family houses constructed in Anchorage in 2006. We originated one-to-four-family residential construction loans to builders for construction of homes. At December 31, 2006, we had \$86.2 million of one-to-four-family residential and condominium construction loans, or 12% of total loans. Of the homes under construction at December 31, 2006, for which these loans had been made, 36% were subject to sale contracts between the builder and homebuyers who were pre-qualified for loans, usually with other financial institutions.

**Commercial Construction:** We also provide construction lending for commercial real estate projects. Such loans generally are made only when there is a firm take-out commitment upon completion of the project by a third party lender.

**Real Estate Loans for Sale:** In 1998, our wholly-owned subsidiary, NCIC, purchased a 30% profits and losses interest of RML, a mortgage company with offices throughout Alaska, in order for us to obtain a presence in the residential mortgage market. As noted above, in the third quarter of 2004, RML merged with PAM, another mortgage company. As a result, we now own 24% of RML Holding Company, the holding company for RML and PAM.

**Commercial Real Estate:** We believe we are an active lender in the commercial real estate market. At December 31, 2006, our commercial real estate loans were \$237.6 million, or 33% of our loan portfolio. These loans are typically secured by office buildings, apartment complexes or warehouses. Loan maturities range from 10 to 25 years, ordinarily subject to our right to call the loan within 10 to 15 years of its origination. The interest rate for approximately 49% of these loans originated by Northrim resets every one to five years based on the spread over an index rate, normally prime or the respective Treasury rate.

We often sell all or a portion of our commercial real estate loans to two State of Alaska entities that were established to provide long-term financing in the State, AIDEA, and the Alaska Housing Finance Corporation ( AHFC ). We often sell up to a 90% loan participation to AIDEA. AIDEA's portion of the participated loan typically features a maturity twice that of the portion retained by us and bears 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 risk.

**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.

**Off-Balance Sheet Arrangements    Commitments and Contingent Liabilities:** In the ordinary course of business, we enter into various types of transactions that include commitments to extend credit that are not reflected on our balance sheet. 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. Our exposure to credit loss under commitments to extend credit is represented by the amount of these commitments. See Note 18 to Notes to Consolidated Financial Statements in our Annual Report for the year ended December 31, 2006. See also Liquidity and Capital Resources.

### **Investments and Investment Activities**

**General:** Our investment portfolio consists primarily of U.S. Treasury and government sponsored entity securities, and municipal securities. Investment securities totaled \$100.3 million at December 31, 2006, an increase of \$45.4 million, or 83%, from year-end 2005. The average maturity of the investment portfolio was approximately two years at December 31, 2006.

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Investment securities designated as available for sale comprised 87% 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, 2006, \$15.7 million in securities were pledged for deposits and borrowings.

***Investment Portfolio Composition:*** Our investment portfolio is divided into two classes:

***Securities Available For Sale:*** These are securities we may hold for indefinite periods of time. These securities include those that management intends to use as part of our asset/liability management strategy and that may be sold in response to changes in interest rates and/or significant prepayment risks. We carry these securities at market value with any unrealized gains or losses reflected as an adjustment to shareholders' equity.

***Securities Held To Maturity:*** These are securities that we have the ability and the intent to hold to maturity. Events that may be reasonably anticipated are considered when determining our intent to hold investment securities to maturity. These securities are carried at amortized cost.

The following tables set forth the composition of our investment portfolio at the dates indicated:

| December 31,                          | Amortized<br>Cost | Market<br>Value |
|---------------------------------------|-------------------|-----------------|
| <i>(In Thousands)</i>                 |                   |                 |
| <b>Securities Available for Sale:</b> |                   |                 |
| 2006:                                 |                   |                 |
| U.S. Treasury                         | \$16,860          | \$16,840        |
| Government Sponsored Entities         | 70,438            | 69,971          |
| Mortgage-backed Securities            | 183               | 182             |
| Total                                 | \$87,481          | \$86,993        |
| 2005:                                 |                   |                 |
| U.S. Treasury                         | \$15,930          | \$15,761        |
| Government Sponsored Entities         | 37,140            | 36,482          |
| Mortgage-backed Securities            | 242               | 240             |
| Total                                 | \$53,312          | \$52,483        |
| 2004:                                 |                   |                 |
| U.S. Treasury                         | \$5,503           | \$5,481         |
| Government Sponsored Entities         | 53,628            | 53,656          |
| Mortgage-backed Securities            | 311               | 312             |

|       |          |          |
|-------|----------|----------|
| Total | \$59,442 | \$59,449 |
|-------|----------|----------|

**Securities Held to Maturity:**

2006:

|                      |          |          |
|----------------------|----------|----------|
| Municipal securities | \$11,776 | \$11,775 |
|----------------------|----------|----------|

|       |          |          |
|-------|----------|----------|
| Total | \$11,776 | \$11,775 |
|-------|----------|----------|

2005:

|                      |       |       |
|----------------------|-------|-------|
| Municipal securities | \$936 | \$957 |
|----------------------|-------|-------|

|       |       |       |
|-------|-------|-------|
| Total | \$936 | \$957 |
|-------|-------|-------|

2004:

|                      |       |       |
|----------------------|-------|-------|
| Municipal securities | \$724 | \$771 |
|----------------------|-------|-------|

|       |       |       |
|-------|-------|-------|
| Total | \$724 | \$771 |
|-------|-------|-------|

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For the periods ending December 31, 2006, 2005, and 2004, we held Federal Home Loan Bank ( FHLB ) stock with a book value approximately equal to its market value in the amounts of \$1.6 million, \$1.6 million, and \$1.3 million, respectively.

**Market Value, Maturities and Weighted Average Yields:** The following table sets forth the market value, maturities and weighted average yields of our investment portfolio for the periods indicated as of December 31, 2006:

|                                       | Maturity         |              |               |                  |          |
|---------------------------------------|------------------|--------------|---------------|------------------|----------|
|                                       | Within<br>1 Year | 1-5<br>Years | 5-10<br>Years | Over 10<br>Years | Total    |
| <i>(Dollars In Thousands)</i>         |                  |              |               |                  |          |
| <b>Securities Available for Sale:</b> |                  |              |               |                  |          |
| U.S. Treasury                         |                  |              |               |                  |          |
| Balance                               | \$16,840         | \$           | \$            | \$               | \$16,840 |
| Weighted Average Yield                | 3.78%            | 0.00%        | 0.00%         | 0.00%            | 3.78%    |
| Government Sponsored Entities         |                  |              |               |                  |          |
| Balance                               | 16,779           | 53,192       |               |                  | 69,971   |
| Weighted Average Yield                | 3.65%            | 4.96%        | 0.00%         | 0.00%            | 4.65%    |
| Mortgage-Backed Securities            |                  |              |               |                  |          |
| Balance                               |                  |              |               | 182              | 182      |
| Weighted Average Yield                | 0.00%            | 0.00%        | 0.00%         | 5.35%            | 5.35%    |
| Total                                 |                  |              |               |                  |          |
| Balance                               | \$33,619         | \$53,192     | \$            | \$182            | \$86,993 |
| Weighted Average Yield                | 3.71%            | 4.96%        | 0.00%         | 5.35%            | 4.48%    |
| <b>Securities Held to Maturity:</b>   |                  |              |               |                  |          |
| Municipal Securities                  |                  |              |               |                  |          |
| Balance                               | \$70             | \$10,351     | \$1,354       | \$               | \$11,775 |
| Weighted Average Yield                | 4.12%            | 3.80%        | 3.76%         | 0.00%            | 3.80%    |

At December 31, 2006, we held no securities of any single issuer (other than government sponsored entities) that exceeded 10% of our shareholders' equity.

**Purchased Receivables**

**General:** 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 with our Business Manager® and MedCash Manager® products and in Washington and Oregon through NFS.

Our purchased receivable balances increased in 2006 to \$21.2 million, as compared to \$12.2 million in 2005. The funding for this growth in purchased receivables came from an increase in interest-bearing liabilities and from noninterest-bearing sources of funds and capital.

***Policy and Authority Limits:*** 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 Board of Directors.

## **Liabilities**

### **Deposits**

***General:*** Deposits are our primary source of funds. Total deposits increased 2% to \$794.9 million at December 31, 2006, compared with \$779.9 million at December 31, 2005, and \$699.1 million at December 31, 2004. Our deposits generally are expected to fluctuate according to the level of our market share, economic conditions, and normal seasonal trends.

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

| December 31,                            | 2006               |                      | 2005               |                      | 2004               |                      | 2003               |                      | 2002               |                      |
|-----------------------------------------|--------------------|----------------------|--------------------|----------------------|--------------------|----------------------|--------------------|----------------------|--------------------|----------------------|
|                                         | Average<br>balance | Average<br>rate paid | Average<br>balance | Average<br>rate paid | Average<br>balance | Average<br>rate paid | Average<br>balance | Average<br>rate paid | Average<br>balance | Average<br>rate paid |
| <i>(Dollars in Thousands)</i>           |                    |                      |                    |                      |                    |                      |                    |                      |                    |                      |
| Interest-bearing<br>demand accounts     | \$78,872           | 1.05%                | \$65,890           | 0.56%                | \$57,373           | 0.39%                | \$52,955           | 0.39%                | \$49,198           | 0.72%                |
| Money market<br>accounts                | 151,871            | 3.99%                | 139,331            | 2.78%                | 126,567            | 1.21%                | 134,582            | 0.96%                | 131,227            | 1.57%                |
| Savings accounts                        | 254,209            | 3.98%                | 207,277            | 3.02%                | 139,876            | 1.64%                | 104,158            | 1.13%                | 82,061             | 1.84%                |
| Certificates of<br>deposit              | 94,595             | 3.51%                | 138,284            | 2.52%                | 155,134            | 1.72%                | 164,847            | 2.14%                | 172,531            | 3.50%                |
| Non-interest-bearing<br>demand accounts | 579,547            | 3.51%                | 550,782            | 2.54%                | 478,950            | 1.40%                | 456,542            | 1.36%                | 435,017            | 2.29%                |
| Non-interest-bearing<br>demand accounts | 185,958            |                      | 182,535            |                      | 181,731            |                      | 159,858            |                      | 135,181            |                      |
| Total average<br>deposits               | \$765,505          |                      | \$733,317          |                      | \$660,681          |                      | \$616,400          |                      | \$570,198          |                      |

**Certificates of Deposit:** The only deposit category with stated maturity dates is certificates of deposit. At December 31, 2006, we had \$85.9 million in certificates of deposit, of which \$59.4 million, or 69%, are scheduled to mature in 2007.

**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, 2006, was \$207.5 million, an increase of \$9.5 million as compared to the balance of \$198 million at December 31, 2005.

**Alaska Permanent Fund:** The Alaska Permanent Fund may invest in certificates of deposit at Alaska banks in an aggregate amount with respect to each bank, not to exceed its capital and at specified rates and terms. The depository bank must collateralize the deposit. At December 31, 2006, we did not hold any certificates of deposit for the Alaska Permanent Fund.

**Borrowings**



**FHLB:** At December 31, 2006, our maximum borrowing line from the FHLB was equal to \$107 million, approximately 12% of the Company's assets. At December 31, 2006, there was \$2.2 million outstanding on the line. At December 31, 2005, there was \$2.6 million outstanding on the line and an additional \$15.5 million of the borrowing line was committed to secure public deposits. FHLB advances are secured by a blanket pledge of the Company's assets.

**Other Short-term Borrowing:** At December 31, 2006, there were no short-term (original maturity of one year or less) borrowings that exceeded 30% of shareholders' equity.

### **Contractual Obligations**

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

|                             | Payments Due by Period |              |              |                 | Total    |
|-----------------------------|------------------------|--------------|--------------|-----------------|----------|
|                             | Within<br>1 Year       | 1-3<br>Years | 3-5<br>Years | Over<br>5 Years |          |
| December 31, 2006           |                        |              |              |                 |          |
| <i>(In Thousands)</i>       |                        |              |              |                 |          |
| Long-term debt obligations  | \$400                  | \$800        | \$800        | \$18,732        | \$20,732 |
| Operating lease obligations | 1,434                  | 2,928        | 2,867        | 3,711           | 10,940   |
| Other long-term liabilities | 1,217                  | 3,277        |              |                 | 4,494    |
| Total                       | \$3,051                | \$7,005      | \$3,667      | \$22,443        | \$36,166 |

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|                             | Payments Due by Period |              |              |                 |          |
|-----------------------------|------------------------|--------------|--------------|-----------------|----------|
|                             | Within<br>1 Year       | 1-3<br>Years | 3-5<br>Years | Over<br>5 Years | Total    |
| December 31, 2005           |                        |              |              |                 |          |
| <i>(In Thousands)</i>       |                        |              |              |                 |          |
| Long-term debt obligations  | \$400                  | \$800        | \$800        | \$18,574        | \$20,574 |
| Operating lease obligations | 1,338                  | 2,420        | 225          | 1,544           | 5,527    |
| Other long-term liabilities |                        |              |              |                 |          |
| Total                       | \$1,738                | \$3,220      | \$1,025      | \$20,118        | \$26,101 |

Long-term debt obligations consist of (a) \$2.2 million advance from the FHLB that was originated on May 7, 2002, matures on May 7, 2012, and bears interest at 5.46%, (b) \$8.2 million junior subordinated debentures that were originated on May 8, 2003, mature on May 15, 2033, and bear interest at a rate of LIBOR plus 3.15%, adjusted quarterly, and (c) \$10.3 million junior subordinated debentures that were originated on December 16, 2005, mature on December 15, 2035, and bear interest at a rate of LIBOR plus 1.37%, adjusted quarterly. The operating lease obligations are more fully described at Note 18 of the Company's annual 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 \$3 million interest in CharterMac Corporate Partners XXXIII, L.P., ( CharterMac ), in September 2006 and a \$3 million interest in U.S.A. Institutional Tax Credit Fund LVII L.P. ( USA 57 ) in December 2006. The investments in CharterMac and USA 57 will be funded in 2009 and 2010, respectively.

**Liquidity and Capital Resources**

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 lending commitments at December 31, 2006, were \$172 million, and 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, 2006, were \$794.9 million.

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, 2006, our current assets were \$459 million and our funds available for borrowing under our existing lines of credit were \$166.4 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.

In September 2002, our Board of Directors approved a plan whereby we would periodically repurchase for cash up to approximately 5%, or 306,372, of our shares of common stock in the open market. In August of 2004, the Board of Directors amended the stock repurchase plan and increased the number of shares available under the program by 5%

of total shares outstanding, or 304,283 shares. We purchased 550,942 shares of our stock under this program through December 31, 2006 at a total cost of \$10.8 million at an average price of \$19.64, which left a balance of 59,713 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.

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The stock repurchase program had an effect on earnings per share because it decreased the total number of shares outstanding in 2006, 2005, 2003, and 2002, by 17,500, 308,642, 155,800, and 69,000 shares respectively. The Company did not repurchase any of its shares in 2004. The table below shows this effect on diluted earnings per share as adjusted for the 5% stock dividend in 2006.

| Years Ending: | Diluted EPS<br>as Reported | Diluted<br>EPS without<br>Stock Repurchase |
|---------------|----------------------------|--------------------------------------------|
| 2006          | \$2.09                     | \$1.92                                     |
| 2005          | \$1.72                     | \$1.64                                     |
| 2004          | \$1.63                     | \$1.57                                     |
| 2003          | \$1.61                     | \$1.57                                     |
| 2002          | \$1.29                     | \$1.28                                     |

On May 8, 2003, the Company's newly formed subsidiary, Northrim Capital Trust 1, issued trust preferred securities in the principal amount of \$8 million. These securities carry an interest rate of 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 \$665,000 in 2006. At December 31, 2006, the securities had an interest rate of 8.52%.

On December 16, 2005, the Company's newly formed subsidiary, Northrim Statutory Trust 2, issued trust preferred securities in the principal amount of \$10 million. These securities carry an interest rate of 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 \$654,000 in 2006. At December 31, 2006, the securities had an interest rate of 6.73%.

Our shareholders' equity at December 31, 2006, was \$95.4 million, as compared to \$84.5 million at December 31, 2005. The Company earned net income of \$13 million during 2006, issued 38,000 shares through the exercise of stock options, and repurchased 17,500 shares of its common stock under the Company's publicly announced repurchase program. In addition, on September 1, 2006, the Company paid a 5% stock dividend to shareholders of record as of August 18, 2006. As a result, the Company issued 290,727 of its shares along with a cash dividend of \$2,000 to pay for fractional shares. At December 31, 2006, the Company had 6.1 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, 2006, that the Company and Northrim Bank met all applicable capital adequacy requirements.

The FDIC has in place qualifications for banks to be classified as well-capitalized. As of June 15, 2006, the most recent notification from the FDIC categorized Northrim Bank as well-capitalized. There were no conditions or events since the FDIC notification that we believe have changed Northrim Bank's classification.

The table below illustrates the capital requirements for the Company and the Bank and the actual capital ratios for each entity that exceed these requirements. 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

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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, 2006         | Adequately<br>-<br>Capitalized | Well -<br>Capitalized | Actual<br>Ratio BHC | Actual<br>Ratio Bank |
|---------------------------|--------------------------------|-----------------------|---------------------|----------------------|
| Tier 1 risk-based capital | 4.00%                          | 6.00%                 | 12.95%              | 11.09%               |
| Total risk-based capital  | 8.00%                          | 10.00%                | 14.21%              | 12.35%               |
| Leverage ratio            | 4.00%                          | 5.00%                 | 11.71%              | 10.06%               |

(See Note 19 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 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.

**Market for Common Stock**

Our common stock trades on the Nasdaq Stock Market under the symbol, NRIM. We are aware that large blocks of our stock are held in street name by brokerage firms. At December 31, 2006, the number of shareholders of record of our common stock was 187.

We began paying regular cash dividends of \$0.05 per share in the second quarter of 1996. In the second quarters of 2006, 2005, and 2004, we paid cash dividends of \$0.125, \$0.11, and \$0.095 per share, respectively. Cash dividends totaled \$2.8 million, \$2.6 million, and \$2.3 million in 2006, 2005, and 2004, respectively. On January 11, 2007, the Board of Directors approved payment of a \$0.125 per share dividend on February 9, 2007, to shareholders of record on January 29, 2007. On August 3, 2006, the Board of Directors approved payment of a 5% stock dividend on September 1, 2006, of the Company's common stock as of the close of business August 18, 2006. The Company and the Bank are subject to restrictions on the payment of dividends pursuant to applicable federal and state banking regulations.

The following are high and low sales prices as reported by Nasdaq. Prices do not include retail markups, markdowns or commissions. Prices have been adjusted for applicable stock dividends.

| First<br>Quarter | Second<br>Quarter | Third<br>Quarter | Fourth<br>Quarter |
|------------------|-------------------|------------------|-------------------|
|------------------|-------------------|------------------|-------------------|

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|      |          |          |          |          |
|------|----------|----------|----------|----------|
| 2006 |          |          |          |          |
| High | \$ 21.77 | \$ 23.90 | \$ 27.33 | \$ 27.68 |
| Low  | \$ 20.70 | \$ 21.37 | \$ 22.04 | \$ 25.89 |
| 2005 |          |          |          |          |
| High | \$ 23.98 | \$ 23.81 | \$ 23.90 | \$ 24.29 |
| Low  | \$ 22.10 | \$ 21.02 | \$ 22.27 | \$ 22.14 |

**Table of Contents****Market Price of and Dividends on the Registrant's Common Equity and Related Stockholder Matters****Stock Performance Graph**

The graph shown below depicts the total return to shareholders during the period beginning after December 31, 2001, and ending December 31, 2006. 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 \$500 million to \$1 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 three indices was \$100 on December 31, 2001, and that all dividends were reinvested.

**Total Return Performance**

| December 31,               | 2001   | 2002   | 2003   | 2004   | 2005   | 2006   |
|----------------------------|--------|--------|--------|--------|--------|--------|
| Northrim BanCorp, Inc.     | 100.00 | 95.91  | 166.68 | 173.87 | 175.88 | 213.55 |
| Russell 3000               | 100.00 | 78.46  | 102.83 | 115.11 | 122.16 | 141.35 |
| SNL \$500M-\$1B Bank Index | 100.00 | 127.67 | 184.09 | 208.62 | 217.57 | 247.44 |



**Table of Contents****Repurchase of Securities**

The Company did not repurchase any of its common stock in the fourth quarter of 2006.

**Equity Compensation Plan Information**

| Plan Category                                             | Number of securities<br>to be issued<br><br>upon exercise of<br>outstanding options,<br>warrants and rights<br>(a) | Weighted-average<br><br>exercise price of<br>outstanding options,<br>warrants and rights<br>(b) | Number of securities<br>remaining available for<br>future issuance under<br>equity compensation<br>plans<br>(Excluding Securities<br>Reflected in Column<br>(a)) |
|-----------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Equity compensation plans approved by<br>security holders | 439,027                                                                                                            | \$13.37                                                                                         | 173,734                                                                                                                                                          |
| Total                                                     | 439,027                                                                                                            | \$13.37                                                                                         | 173,734                                                                                                                                                          |

**Recent Accounting Pronouncements**

Between February of 2006 and December of 2006, the Financial Accounting Standards Board ( FASB ) issued Statement No. 155, *Accounting for Certain Hybrid Financial Instruments*, Statement No. 156, *Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140*, Statement No. 157, *Fair Value Measurements*, Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132R*, and FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*. The Company believes the adoption of these Statements will have no impact on its financial statements.

In December 2004, the FASB issued Statement No. 123R, *Share-Based Payment*, which is a revision of FASB Statement No. 123, *Accounting for Stock-Based Compensation*. This Statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services primarily in share-based payment transactions with its employees. This Statement supersedes the provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related implementation guidance.

As of January 1, 2006, the Company adopted FASB No. 123R according to the modified prospective method, which requires measurement of compensation cost from January 1, 2006 for all unvested stock-based awards at fair value on the date of grant and recognition of the compensation associated with these stock-based awards over the service period for the awards that are expected to vest. In accordance with the modified prospective transition method, results for prior periods have not been restated.

The adoption of FASB No. 123R resulted in additional stock compensation expense of \$256,000 for the year ending December 31, 2006. The Company recognized a tax benefit of \$74,000 related to stock compensation expense on

non-qualified stock options.

The fair value of restricted stock units is determined based on the number of shares granted and the quoted price of the Company's stock on the date of grant, and the fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with the Company's valuation techniques previously utilized for options in footnote disclosures required under FASB 123R. The Company recognizes the fair value of the restricted stock units and stock options as expense over the required service period, net of estimated forfeitures, using the straight line attribution method for stock-based payment grants previously granted but not fully vested at January 1, 2006 as well as grants made after January 1, 2006 as prescribed in FASB 123R. As a result, the Company recognized expense of \$134,000 on the fair value of restricted stock units and \$256,000 on the fair value of stock options for a total of \$390,000 in stock-based compensation expense for the year ending December 31, 2006.

Prior to January 1, 2006, the Company accounted for stock-based awards using the intrinsic value method, which followed the recognition and measurement principles of APB Opinion No. 25.

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Outlined below are valuation assumptions used in the Black-Scholes valuation model for stock options that were used in estimating the fair value for each stock option granted in November of 2006 and 2005 and in December of 2004.

| Options:                     | Granted   |           |           |
|------------------------------|-----------|-----------|-----------|
|                              | Nov. 2006 | Nov. 2005 | Dec. 2004 |
| Expected option life (years) | 7.4       | 7.5       | 7.7       |
| Risk free rate               | 4.57%     | 4.45%     | 4.09%     |
| Dividends per share          | \$0.56    | \$0.50    | \$0.44    |
| Expected volatility factor   | 37.44%    | 37.06%    | 39.28%    |

The expected life represents the weighted average period of time that options granted are expected to be outstanding when considering vesting periods and the exercise history of the Company. The risk free rate is based upon the equivalent yield of a United States Treasury zero-coupon issue with a term equivalent to the expected life of the option. The expected dividends are based on projected dividends for the Company at the date of the option grant taking into account projected net income growth, dividend pay-out ratios, and other factors. The expected volatility is based upon the historical price volatility of the Company's stock. See Note 17 Options for additional information.

*Fair Value Disclosures Prior to FASB 123R Adoption*

Stock-based compensation for the period prior to January 1, 2006 was determined using the intrinsic value method. The following table illustrates the effect on net income and earnings per share as if the fair value based method under FASB 123R had been applied to all outstanding and unvested awards in periods prior to January 1, 2006:

|                                        |             | 2005     | 2004     |
|----------------------------------------|-------------|----------|----------|
| Net income (in thousands)              | As reported | \$11,170 | \$10,700 |
| Less stock-based employee compensation |             | (173)    | (163)    |
| Net income                             | Pro forma   | \$10,997 | \$10,537 |
| Earnings per share, basic              | As reported | \$1.78   | \$1.68   |
|                                        | Pro forma   | \$1.75   | \$1.65   |
| Earnings per share, diluted            | As reported | \$1.72   | \$1.63   |
|                                        | Pro forma   | \$1.70   | \$1.60   |

Prior to the adoption of FASB 123R, the Company presented any tax benefits of deductions resulting from the exercise of stock options within operating cash flows in the condensed consolidated statements of cash flow. FASB 123R requires tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options ( excess tax benefits ) to be classified and reported as both an operating cash outflow and a financing cash inflow upon adoption of FASB 123R. Accordingly, the Company has recognized these excess tax benefits in the condensed statement of cash flow for the year ended December 31, 2006.

FASB Staff Position No. FAS No. 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards* ( *FSP 123R-3* ), effective November 10, 2005, provides for a practical transition method that may be elected to calculate the pool of excess tax benefits available to absorb tax deficiencies upon the adoption of FASB 123R. The method comprises a computational component that establishes the beginning balance of the additional paid in capital ( APIC ) pool related to employee compensation and a simplified method to determine the subsequent impact on the APIC pool of awards that are fully vested and outstanding upon the adoption of FASB 123R. The Company has elected to use the long haul method to calculate the beginning balance of the APIC pool as opposed to electing this simplified method.

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**Quantitative and Qualitative Disclosure About Market Risk**

Our results of operations depend substantially on our net interest income. Like most financial institutions, our interest income and cost of funds are affected by general economic conditions, levels of market interest rates, and by competition, and in addition, our community banking focus makes our results of operations particularly dependent on the Alaska economy.

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 12-month period.

In order to control interest rate risk in a rising interest rate environment, our philosophy is to shorten the average maturity of the investment portfolio and emphasize the pricing of new loans on a floating rate basis in order to achieve a more asset sensitive position, therefore, allowing quicker repricings and maximizing net interest margin. Conversely, in a declining interest rate environment, our philosophy is to lengthen the average maturity of the investment portfolio and emphasize fixed rate loans, thereby becoming more liability sensitive. In each case, the goal is to exceed our targeted net interest margin range without exceeding earnings risk parameters.

Our excess liquidity not needed for current operations has generally been invested in short-term assets or securities, primarily securities issued by government sponsored entities. The securities portfolio contributes to our profits and plays an important part in the overall interest rate management. The primary tool used to manage interest rate risk is determination of mix, maturity, and repricing characteristics of the loan portfolios. The loan and securities portfolios must be used in combination with management of deposits and borrowing liabilities and other asset/liability techniques to actively manage the applicable components of the balance sheet. In doing so, we estimate our future needs, taking into consideration historical periods of high loan demand and low deposit balances, estimated loan and deposit increases, and estimated interest rate changes.

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, such as early withdrawal of time deposits and prepayment of loans, 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.

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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, 2006. 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, 2006 |               |              |               |
|---------------------------------------------------------------------|------------------------------------------------------|---------------|--------------|---------------|
|                                                                     | Within 1 year                                        | 1-5 years     | ≥5 years     | Total         |
|                                                                     | <i>(In Thousands)</i>                                |               |              |               |
| Interest-Earning Assets:                                            |                                                      |               |              |               |
| Money market investments                                            | \$18,717                                             | \$            | \$           | \$18,717      |
| Investment securities                                               | 33,690                                               | 63,543        | 3,092        | 100,325       |
| Loans:                                                              |                                                      |               |              |               |
| Commercial                                                          | 239,215                                              | 43,966        | 1,429        | 284,610       |
| Real estate construction                                            | 150,808                                              | 506           | 1,628        | 152,942       |
| Real estate term                                                    | 153,748                                              | 75,337        | 6,238        | 235,323       |
| Installment and other consumer                                      | 15,549                                               | 14,829        | 11,650       | 42,028        |
| <br>Total interest-earning assets                                   | <br>\$611,727                                        | <br>\$198,181 | <br>\$24,037 | <br>\$833,945 |
| Percent of total interest-earning assets                            | 73%                                                  | 24%           | 3%           | 100%          |
| <br>Interest-Bearing Liabilities:                                   |                                                      |               |              |               |
| Interest-bearing demand accounts                                    | \$89,476                                             | \$            | \$           | \$89,476      |
| Money market accounts                                               | 157,345                                              |               |              | 157,345       |
| Savings accounts                                                    | 255,822                                              |               |              | 255,822       |
| Certificates of deposit                                             | 59,357                                               | 26,537        | 24           | 85,918        |
| FHLB advances                                                       |                                                      |               | 2,174        | 2,174         |
| Other borrowings                                                    | 4,328                                                |               |              | 4,328         |
| Junior subordinated debentures                                      | 18,558                                               |               |              | 18,558        |
| <br>Total interest-bearing liabilities                              | <br>\$584,886                                        | <br>\$26,537  | <br>\$2,198  | <br>\$613,621 |
| Percent of total interest-bearing liabilities                       | 95%                                                  | 4%            | 0%           | 100%          |
| <br>Interest sensitivity gap                                        | <br>\$26,841                                         | <br>\$171,644 | <br>\$21,839 | <br>\$220,324 |
| Cumulative interest sensitivity gap                                 | \$26,841                                             | \$198,485     | \$220,324    |               |
| Cumulative interest sensitivity gap as a percentage of total assets | 3%                                                   | 21%           | 24%          |               |

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 to 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.

We utilize a simulation model to monitor and manage interest rate risk within parameters established by our internal policy. The model projects the impact of a 100 basis point increase and a 100 basis point decrease, from prevailing interest rates, on the

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balance sheet over a period of 12 months. Generalized assumptions are made on how investment securities, classes of loans and various deposit products might respond to the interest rate changes. These assumptions are inherently uncertain, and as a result, the model cannot precisely estimate net interest income nor precisely predict the impact of higher or lower interest rates on net interest income. Actual results would differ from simulated results due to factors such as timing, magnitude and frequency of rate changes, customer reaction to rate changes, changes in market conditions and management strategies, among other factors.

Based on the results of the simulation models at December 31, 2006, we expect an increase in net interest income of \$250,000 million and a decrease of \$292,000 million in net interest income over a 12-month period, if interest rates decreased or increased an immediate 100 basis points, respectively.

## **Critical Accounting Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles involves the use of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses during the reporting period. Actual results could differ from those estimates.

Our estimate for the loan loss reserve is based on our assessment of various factors affecting the loan portfolio, including a review of problem loans, business conditions, estimated collateral values, loss experience, credit concentrations, and an overall evaluation of the quality of the underlying collateral, and holding and disposal costs. While we believe that we have used the best information available to determine the allowance for loan losses, unforeseen market conditions and other events could result in adjustment to the allowance for loan losses, and net income could be significantly affected, if circumstances differed substantially from the assumptions used in making the final determination.

## **Controls and Procedures**

### **Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

As of the end of the period covered by this report, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Our principal executive and financial officers supervised and participated in this evaluation. Based on this evaluation, our principal executive and financial officers each concluded that our disclosure controls and procedures were effective in timely alerting them to material information required to be included in our periodic reports to the Securities and Exchange Commission. The design of any system of controls is based in part upon various assumptions about the likelihood of future events, and there can be no assurance that any of our plans, products, services or procedures will succeed in achieving their intended goals under future conditions. There were no changes in the Company's internal controls over financial reporting that occurred during the period covered by this report that have materially affected, or are likely to materially affect, the Company's internal control over financial reporting.

### **Management's Report on Internal Control Over Financial Reporting**

Management of the Company is responsible for establishing and maintaining internal control over financial reporting as defined in Rules 13a-15(f) and 15(d)-15(f) of the Securities Exchange Act of 1934. The Company's internal control over financial reporting is 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.



Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements and can provide only reasonable assurance with respect to financial statement preparation and presentation. 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 policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2006. In making this assessment management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control - Integrated Framework*.

Based on our assessment and the criteria discussed above, management believes that, as of December 31, 2006, the Company maintained effective internal control over financial reporting.

The Company's registered public accounting firm has issued an attestation report on management's assessment of the Company's internal control over financial reporting. This report follows below.

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors of  
Northrim BanCorp, Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Effectiveness of Internal Control Over Financial Reporting, that Northrim BanCorp, Inc. and subsidiaries (the Company) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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, management's assessment that Northrim BanCorp, Inc. and subsidiaries maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Northrim BanCorp, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Northrim BanCorp, Inc. and subsidiaries as of December 31, 2006 and

2005, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2006, and our report dated February 16, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP  
Anchorage, Alaska  
February 16, 2007

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**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, 2006 and 2005, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Northrim BanCorp, Inc.'s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 16, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP  
Anchorage, Alaska  
February 16, 2007

**Table of Contents****Consolidated Financial Statements**

NORTHRIM BANCORP, INC.  
Consolidated Balance Sheets  
December 31, 2006 and 2005

|                                                         | 2006                                       | 2005          |
|---------------------------------------------------------|--------------------------------------------|---------------|
|                                                         | <i>(In Thousands Except Share Amounts)</i> |               |
| Assets                                                  |                                            |               |
| Cash and due from banks (Note 2)                        | \$25,565                                   | \$28,854      |
| Money market investments (Note 3)                       | 18,717                                     | 60,836        |
| Investment securities held to maturity (Note 4)         | 11,776                                     | 936           |
| Investment securities available for sale (Note 4)       | 86,993                                     | 52,483        |
| Investment in Federal Home Loan Bank stock (Note 4)     | 1,556                                      | 1,556         |
| <br>Total Portfolio Investments                         | <br>100,325                                | <br>54,975    |
| Loans (Note 5)                                          | 717,056                                    | 705,059       |
| Allowance for loan losses (Note 6)                      | (12,125)                                   | (10,706)      |
| <br>Net Loans                                           | <br>704,931                                | <br>694,353   |
| Purchased receivables                                   | 21,183                                     | 12,198        |
| Accrued interest receivable                             | 4,916                                      | 4,397         |
| Premises and equipment, net (Note 7)                    | 12,874                                     | 10,603        |
| Intangible assets (Notes 1 and 8)                       | 6,903                                      | 7,385         |
| Other assets (Notes 1 and 8)                            | 30,206                                     | 21,979        |
| <br>Total Assets                                        | <br>\$925,620                              | <br>\$895,580 |
| <br>Liabilities                                         |                                            |               |
| Deposits:                                               |                                            |               |
| Demand                                                  | \$206,343                                  | \$196,616     |
| Interest-bearing demand                                 | 89,476                                     | 75,988        |
| Savings                                                 | 48,330                                     | 46,790        |
| Alaska CDs                                              | 207,492                                    | 197,989       |
| Money market                                            | 157,345                                    | 151,903       |
| Certificates of deposit less than \$100,000 (Note 9)    | 57,601                                     | 59,331        |
| Certificates of deposit greater than \$100,000 (Note 9) | 28,317                                     | 51,249        |
| <br>Total Deposits                                      | <br>794,904                                | <br>779,866   |

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|                                                                                                                                                                    |               |               |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|---------------|
| Borrowings (Note 10)                                                                                                                                               | 6,502         | 8,415         |
| Junior subordinated debentures (Note 11)                                                                                                                           | 18,558        | 18,558        |
| Other liabilities                                                                                                                                                  | 10,209        | 4,267         |
| <br>Total Liabilities                                                                                                                                              | <br>830,173   | <br>811,106   |
| <br>Minority interest in subsidiaries                                                                                                                              | <br>29        |               |
| Shareholders' Equity (Note 16 and 17)                                                                                                                              |               |               |
| Common stock, \$1 par value, 10,000,000 shares authorized,<br>6,114,247 and 5,803,487 shares issued and outstanding<br>at December 31, 2006 and 2005, respectively | 6,114         | 5,803         |
| Additional paid-in capital                                                                                                                                         | 46,379        | 39,161        |
| Retained earnings                                                                                                                                                  | 43,212        | 39,999        |
| Accumulated other comprehensive income-<br>net unrealized gains/losses on available for sale on investment securities                                              | (287)         | (489)         |
| <br>Total Shareholders' Equity                                                                                                                                     | <br>95,418    | <br>84,474    |
| <br>Commitments and contingencies (Notes 2, 4, 10, 15, 18, 19, and 22)                                                                                             |               |               |
| <br>Total Liabilities and Shareholders' Equity                                                                                                                     | <br>\$925,620 | <br>\$895,580 |

See accompanying notes to the consolidated financial statements.

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NORTHRIM BANCORP, INC.  
Consolidated Statements of Income  
Years Ended December 31, 2006, 2005 and 2004

|                                                               | 2006                                           | 2005       | 2004       |
|---------------------------------------------------------------|------------------------------------------------|------------|------------|
|                                                               | <i>(In Thousands Except Per Share Amounts)</i> |            |            |
| Interest Income                                               |                                                |            |            |
| Interest and fees on loans                                    | \$65,347                                       | \$55,870   | \$45,898   |
| Interest on investment securities-available for sale (Note 4) | 2,396                                          | 2,171      | 2,400      |
| Interest on investment securities-held to maturity (Note 4)   | 403                                            | 31         | 92         |
| Interest on money market investments                          | 1,375                                          | 709        | 164        |
| <br>Total Interest Income                                     | <br>69,521                                     | <br>58,781 | <br>48,554 |
| Interest Expense                                              |                                                |            |            |
| Interest expense on deposits and borrowings (Note 12)         | 21,999                                         | 14,873     | 7,283      |
| <br>Net Interest Income                                       | <br>47,522                                     | <br>43,908 | <br>41,271 |
| Provision for loan losses (Note 6)                            | 2,564                                          | 1,170      | 1,601      |
| <br>Net Interest Income After Provision for Loan Losses       | <br>44,958                                     | <br>42,738 | <br>39,670 |
| Other Operating Income                                        |                                                |            |            |
| Service charges on deposit accounts                           | 1,975                                          | 1,800      | 1,718      |
| Purchased receivable income                                   | 1,855                                          | 993        | 201        |
| Employee benefit plan income                                  | 1,113                                          |            |            |
| Equity in earnings from mortgage affiliate                    | 649                                            | 493        | 438        |
| Equity in loss from Elliott Cove                              | (230)                                          | (424)      | (457)      |
| Other income                                                  | 2,296                                          | 1,971      | 1,892      |
| <br>Total Other Operating Income                              | <br>7,658                                      | <br>4,833  | <br>3,792  |
| <br>Other Operating Expense                                   |                                                |            |            |
| Salaries and other personnel expense                          | 19,277                                         | 17,656     | 15,708     |
| Occupancy, net                                                | 2,503                                          | 2,417      | 2,130      |
| Equipment expense                                             | 1,350                                          | 1,371      | 1,372      |
| Marketing expense                                             | 1,641                                          | 1,657      | 1,201      |
| Intangible asset amortization expense                         | 482                                            | 368        | 368        |
| Other expense                                                 | 6,115                                          | 6,008      | 5,756      |
| <br>Total Other Operating Expense                             | <br>31,368                                     | <br>29,477 | <br>26,535 |

|                                                  |           |           |           |
|--------------------------------------------------|-----------|-----------|-----------|
| Income Before Income Taxes and Minority Interest | 21,248    | 18,094    | 16,927    |
| Minority interest in subsidiaries                | 296       |           |           |
| Income Before Income Taxes                       | 20,952    | 18,094    | 16,927    |
| Provision for income taxes (Note 13)             | 7,978     | 6,924     | 6,227     |
| Net Income                                       | \$12,974  | \$11,170  | \$10,700  |
| Earnings Per Share, Basic                        | \$2.12    | \$1.78    | \$1.68    |
| Earnings Per Share, Diluted                      | \$2.09    | \$1.72    | \$1.63    |
| Weighted Average Shares Outstanding, Basic       | 6,120,002 | 6,286,774 | 6,383,281 |
| Weighted Average Shares Outstanding, Diluted     | 6,205,826 | 6,481,794 | 6,584,146 |

See accompanying notes to the consolidated financial statements.



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NORTHRIM BANCORP, INC.  
Consolidated Statements of Changes in  
Shareholders' Equity and Comprehensive Income  
Years Ended December 31, 2006, 2005 and 2004

| Common Stock                                                                                                                              |                     |              |                                  |                      |                                                 |          |
|-------------------------------------------------------------------------------------------------------------------------------------------|---------------------|--------------|----------------------------------|----------------------|-------------------------------------------------|----------|
|                                                                                                                                           | Number<br>of shares | Par<br>value | Additional<br>paid-in<br>capital | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>income | Total    |
| <i>(In Thousands)</i>                                                                                                                     |                     |              |                                  |                      |                                                 |          |
| Balance as of January 1, 2004                                                                                                             | 6,050               | \$6,050      | \$45,615                         | \$22,997             | \$623                                           | \$75,285 |
| Cash dividend declared                                                                                                                    |                     |              |                                  | (2,308)              |                                                 | (2,308)  |
| Exercise of Stock Options                                                                                                                 | 39                  | 39           | (150)                            |                      |                                                 | (111)    |
| Excess tax benefits from share-based<br>payment arrangements                                                                              |                     |              | 411                              |                      |                                                 | 411      |
| Comprehensive income:                                                                                                                     |                     |              |                                  |                      |                                                 |          |
| Change in unrealized holding<br>(gain/loss) on available for sale<br>investment securities, net of related<br>income tax effect (Note 14) |                     |              |                                  |                      | (619)                                           | (619)    |
| Net Income                                                                                                                                |                     |              |                                  | 10,700               |                                                 | 10,700   |
| Total Comprehensive Income                                                                                                                |                     |              |                                  |                      |                                                 | 10,081   |
| Balance as of December 31, 2004                                                                                                           | 6,089               | \$6,089      | \$45,876                         | \$31,389             | \$4                                             | \$83,358 |
| Cash dividend declared                                                                                                                    |                     |              |                                  | (2,560)              |                                                 | (2,560)  |
| Stock option expense                                                                                                                      |                     |              | 68                               |                      |                                                 | 68       |
| Exercise of stock options                                                                                                                 | 23                  | 23           | 106                              |                      |                                                 | 129      |
| Excess tax benefits from share-based<br>payment arrangements                                                                              |                     |              | 140                              |                      |                                                 | 140      |
| Treasury stock buy-back                                                                                                                   | (309)               | (309)        | (7,029)                          |                      |                                                 | (7,338)  |
| Comprehensive income:                                                                                                                     |                     |              |                                  |                      |                                                 |          |
| Change in unrealized holding<br>(gain/loss) on available for sale<br>investment securities, net of related<br>income tax effect (Note 14) |                     |              |                                  |                      | (493)                                           | (493)    |
| Net Income                                                                                                                                |                     |              |                                  | 11,170               |                                                 | 11,170   |

|                                                                                                                                  |       |         |          |          |         |          |
|----------------------------------------------------------------------------------------------------------------------------------|-------|---------|----------|----------|---------|----------|
| Total Comprehensive Income                                                                                                       |       |         |          |          |         | 10,677   |
| Balance as of December 31, 2005                                                                                                  | 5,803 | \$5,803 | \$39,161 | \$39,999 | (\$489) | \$84,474 |
| Cash dividend declared                                                                                                           |       |         |          | (2,780)  |         | (2,780)  |
| Stock dividend                                                                                                                   | 291   | 291     | 6,690    | (6,981)  |         |          |
| Stock option expense                                                                                                             |       |         | 390      |          |         | 390      |
| Exercise of stock options                                                                                                        | 38    | 38      | 300      |          |         | 338      |
| Excess tax benefits from share-based payment arrangements                                                                        |       |         | 230      |          |         | 230      |
| Treasury stock buy-back                                                                                                          | (18)  | (18)    | (392)    |          |         | (410)    |
| Comprehensive income:                                                                                                            |       |         |          |          |         |          |
| Change in unrealized holding (gain/loss) on available for sale investment securities, net of related income tax effect (Note 14) |       |         |          |          | 202     | 202      |
| Net Income                                                                                                                       |       |         |          | 12,974   |         | 12,974   |
| Total Comprehensive Income                                                                                                       |       |         |          |          |         | 13,176   |
| Balance as of December 31, 2006                                                                                                  | 6,114 | \$6,114 | \$46,379 | \$43,212 | (\$287) | \$95,418 |

See accompanying notes to the consolidated financial statements.

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NORTHRIM BANCORP, INC.  
Consolidated Statements of Cash Flows  
Years Ended December 31, 2006, 2005 and 2004

|                                                                                   | 2006                  | 2005       | 2004       |
|-----------------------------------------------------------------------------------|-----------------------|------------|------------|
|                                                                                   | <i>(In Thousands)</i> |            |            |
| Operating Activities:                                                             |                       |            |            |
| Net income                                                                        | \$12,974              | \$11,170   | \$10,700   |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: |                       |            |            |
| Security (gains), net                                                             |                       | (9)        | (151)      |
| Depreciation and amortization of premises and equipment                           | 1,116                 | 1,244      | 1,142      |
| Amortization of software                                                          | 354                   | 544        | 558        |
| Intangible asset amortization                                                     | 482                   | 368        | 368        |
| Amortization of investment security premium, net of discount accretion            | (133)                 |            | 151        |
| Deferred tax (benefit)                                                            | (1,826)               | (821)      | (1,260)    |
| Stock-based compensation                                                          | 390                   | 68         |            |
| Excess tax benefits from share-based payment arrangements                         | (230)                 | (140)      | (411)      |
| Deferral of loan fees and costs, net                                              | 19                    | 183        | 163        |
| Provision for loan losses                                                         | 2,564                 | 1,170      | 1,601      |
| Earnings in excess of distributions from RML                                      | (124)                 | (11)       | (71)       |
| Equity in loss from Elliott Cove                                                  | 230                   | 424        | 457        |
| Minority interest in subsidiaries                                                 | 296                   |            |            |
| (Increase) in accrued interest receivable                                         | (519)                 | (719)      | (378)      |
| (Increase) in other assets                                                        | (7,234)               | (494)      | (656)      |
| Increase (decrease) of other liabilities                                          | 6,160                 | 578        | 296        |
| <br>Net Cash Provided by Operating Activities                                     | <br>14,519            | <br>13,555 | <br>12,509 |
| <br>Investing Activities:                                                         |                       |            |            |
| Investment in securities:                                                         |                       |            |            |
| Purchases of investment securities available-for-sale                             | (40,643)              | (10,874)   | (28,341)   |
| Purchases of investment securities held-to-maturity                               | (10,905)              | (277)      |            |
| Proceeds from sales/maturities of securities available-for-sale                   | 6,608                 | 17,012     | 38,559     |
| Proceeds from calls/maturities of securities held-to-maturity                     | 65                    | 65         | 220        |
| Investment in Federal Home Loan Bank stock, net                                   |                       | (254)      | 244        |
| Investment in purchased receivables, net                                          | (8,985)               | (10,007)   | (1,729)    |
| Investments in loans:                                                             |                       |            |            |
| Sales of loans and loan participations                                            | 22,601                | 25,116     | 20,036     |
| Loans made, net of repayments                                                     | (35,762)              | (53,317)   | (98,373)   |
| Investment in Elliott Cove                                                        | (210)                 | (150)      | (250)      |
| Investment in NBG                                                                 |                       | (1,146)    |            |
| Subscription in PWA                                                               |                       | (2,015)    |            |
| Loan to Elliott Cove, net of repayments                                           | 58                    | (575)      | (250)      |

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|                                                           |          |          |          |
|-----------------------------------------------------------|----------|----------|----------|
| Loan to PWA, net of repayments                            | 385      | (385)    |          |
| Purchases of premises and equipment                       | (3,387)  | (1,264)  | (618)    |
| Net Cash Used by Investing Activities                     | (70,175) | (38,071) | (70,502) |
| Financing Activities:                                     |          |          |          |
| Increase in deposits                                      | 15,038   | 80,805   | 52,864   |
| Increase (decrease) in borrowings                         | (1,913)  | 1,937    | 1,335    |
| Distributions to minority interests                       | (267)    |          |          |
| Proceeds from issuance of common stock                    | 338      | 129      | (111)    |
| Excess tax benefits from share-based payment arrangements | 230      | 140      | 411      |
| Proceeds from issuance of junior subordinated debentures  |          | 10,000   |          |
| Repurchase of common stock                                | (410)    | (7,338)  |          |
| Cash dividends paid                                       | (2,768)  | (2,560)  | (2,308)  |
| Net Cash Provided by Financing Activities                 | 10,248   | 83,113   | 52,191   |
| Net Increase (Decrease) by Cash and Cash Equivalents      | (45,408) | 58,597   | (5,802)  |
| Cash and cash equivalents at beginning of period          | 89,690   | 31,093   | 36,895   |
| Cash and Cash Equivalents at End of Year                  | \$44,282 | \$89,690 | \$31,093 |
| Supplemental Information:                                 |          |          |          |
| Income taxes paid                                         | \$9,296  | \$7,550  | \$6,825  |
| Interest paid                                             | \$21,891 | \$14,741 | \$7,766  |
| Conversion of Elliott Cove loan to equity                 | \$       | \$       | \$625    |

See accompanying notes to the consolidated financial statements.

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**Notes to Consolidated Financial Statements**

**NOTE 1 Organization and Summary of Significant Accounting Policies**

Northrim BanCorp, Inc. (the Company) is a bank holding company whose subsidiaries are Northrim Bank (the Bank), which serves Anchorage, Eagle River, the Matanuska Valley, Fairbanks, Alaska, and the Pacific Northwest through its Northrim Funding Services division (NFS); Northrim Investment Services Company (NISC) which holds the Company's interest in both Elliott Cove Capital Management LLC (Elliott Cove), an investment advisory services company, and Pacific Wealth Advisors (PWA), an investment advisory and wealth management business located in Seattle, Washington; and Northrim Capital Trust 1 (NCT1) and Northrim Statutory Trust 2 (NST2), entities that were formed to facilitate trust preferred securities offerings by the Company. The Company is regulated by the State of Alaska and the Federal Reserve Board. The Company was incorporated in Alaska, and its primary market areas include Anchorage, the Matanuska Valley, and Fairbanks, Alaska, where the majority of its lending and deposit activities have been with Alaska businesses and individuals.

Effective December 31, 2001, Northrim Bank became a wholly-owned subsidiary of a new bank holding company, Northrim BanCorp, Inc. The Bank's shareholders agreed to exchange their ownership in the Bank for ownership in the Company. The ownership interests in the Company are the same as the ownership interests in the Bank prior to the exchange. The exchange has been accounted for similarly to a pooling of interests.

The Bank formed a wholly-owned subsidiary, Northrim Capital Investments Co. (NCIC), in 1998. This subsidiary owns a 24% profit interest in Residential Mortgage Holding Company LLC (RML Holding Company), a residential mortgage holding company that owns one mortgage company, Residential Mortgage LLC (RML). RML has branches throughout Alaska. The Company accounts for RML Holding Company using the equity method. In addition, NCIC owns a 50.1% interest in Northrim Benefits Group, LLC (NBG), an insurance brokerage company that provides employee benefit plans to businesses throughout Alaska.

**Estimates and Assumptions:** In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenue and expenses for the period and the disclosure of contingent assets and liabilities in accordance with generally accepted accounting principles. Actual results could differ from those estimates.

**Cash and Cash Equivalents:** For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing balances with other banks, money market investments including interest-bearing balances with the FHLB, banker's acceptances, commercial paper, securities purchased under agreement to resell, and federal funds sold.

**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 net amount in a separate component of other comprehensive income, unless an unrealized loss is deemed other than temporary. The gain or loss on available-for-sale securities sold is 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 for securities with similar attributes 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, there has not been significant deterioration in the financial condition of the issuer, and the Company has the intent and ability to hold the security for a sufficient time to recover the carrying value. Other factors that may be considered in determining whether a decline in the value is other than temporary include ratings by recognized rating agencies; actions of commercial banks or other lenders relative to the continued extension of credit facilities to the issuer of the security; the financial condition, capital strength and near-term prospects of the issuer, and recommendations of investment advisors or market analysts.

***Loans and Loan Fees:*** Loans are carried at their principal amount outstanding, adjusted for the net of unamortized fees and related direct loan origination costs. Interest income on loans is accrued and recognized on the principal amount outstanding except for loans in a non-accrual status. Loans are placed on non-accrual when management believes doubt exists as to the collectibility of the interest or principal. Cash payments received on non-accrual loans are directly applied to the principal balance. 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.

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**Allowance for Loan Losses:** The allowance for loan losses is a management estimate of the reserve necessary to absorb probable losses in the Company's loan portfolio. The Company charges off the balance of a loan or writes down a portion of a loan when it identifies a loss in the respective loan. In determining the adequacy of the allowance, management evaluates prevailing economic conditions, results of regular examinations and evaluations of the quality of the loan portfolio by external parties, actual loan loss experience, the extent of existing risks in the loan portfolio, commitments to lend other funds, and other pertinent factors. Future additions to the allowance may be necessary based on changes in economic conditions and other factors used in evaluating the loan portfolio. Additionally, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses. Such agencies may require additions to the allowance based on their judgments of information available to them at the time of their examination.

The allowance for impaired loans is based on discounted cash flows using the loan's initial effective interest rate or the fair value of the collateral for certain collateral dependent loans.

**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.

**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; vehicles at 3 years, furniture and equipment ranging between 3 and 7 years, leasehold improvements ranging between 2 and 11 years, and buildings over 39 years. Maintenance and repairs are charged to current operations, while renewals and betterments are capitalized.

**Intangible Assets:** As part of an acquisition of branches from Bank of America in 1999, the Company recorded \$6.9 million of goodwill and \$2.9 million of core deposit intangible. In accordance with Statements of Financial Accounting Standards (SFAS) No. 142 Goodwill and Other Intangible Assets, management reviews goodwill annually for impairment by reviewing a number of key market indicators. In addition, the Company amortizes its core deposit intangible over 8 years using a straight-line method. Finally, the Company recorded \$1.1 million in intangible assets related to customer relationships purchased in the acquisition of an additional 40.1% of NBG in December 2005. The Company amortizes this intangible over its estimated life of ten years.

**Other Assets:** Other assets include purchased software and prepaid expenses. These assets are carried at amortized cost and are amortized using the straight-line method over their estimated useful life or the term of the agreement. Also included in other assets is the deferred tax asset and the Company's investments in RML Holding Company, Elliott Cove, NBG, and three low income housing partnerships. These partnerships include Related Corporate Partners XXII, L.P., ( RCP ), CharterMac Corporate Partners XXXIII, L.P., ( CharterMac ) and U.S.A. Institutional Tax Credit Fund LVII L.P. ( USA 57 ). These entities are all Delaware limited partnerships. The Company purchased a \$3 million interest in each of these partnerships in January 2003, September 2006 and December 2006, respectively.

**Other Real Estate:** Other real estate represents properties acquired through foreclosure or its equivalent. Prior to foreclosure, the carrying value is adjusted to the lower of cost or fair market value of the real estate to be acquired by a charge to the allowance for loan loss. Any subsequent reduction in the carrying value is charged against earnings.

**Advertising:** Advertising, promotion and marketing costs are expensed as incurred. For the periods ending December 31, 2006, 2005, and 2004, the Company reported total expenses of \$1.6 million, \$1.7 million, and \$1.2 million, respectively.

**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, as described in Note 17, are considered to be common stock equivalents. Incremental shares were 92,782, 178,681, and 191,300 for 2006, 2005, and 2004, respectively. On September 1, 2006, the Company paid a 5% stock dividend to shareholders of record as of August 18, 2006. As a result, the Company issued 290,727 of its shares along with a cash dividend of \$2,000 to pay for fractional shares.

**Stock Option Plans:** The Company accounts for its stock option plans in accordance with the provisions of FASB Statement No. 123R, *Share Based-Payment*, a revision of FASB 123 *Accounting for Stock Based Compensation*. FASB Statement No. 123R establishes accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. In accordance with FASB Statement No. 148, *Accounting for Stock-Based Compensation*



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Transition and Disclosure, the Company has elected the modified prospective method for recognition of compensation cost associated with stock options and has elected to recognize compensation expense for options with pro-rata vesting using the straight-line method. Accordingly, results for prior periods have not been restated. Prior to January 1, 2006 the Company accounted for its stock options in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, for the years ending December 31, 2005 and 2004, compensation expense is calculated using the intrinsic-value-based method of accounting. Under this method, expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price.

The following table illustrates the effect on net income if the fair-value-based method had been applied to all outstanding and unvested awards in each period in which the intrinsic-value-based method of accounting was applied:

|                                        |             | 2005     | 2004     |
|----------------------------------------|-------------|----------|----------|
| Net income (in thousands)              | As reported | \$11,170 | \$10,700 |
| Less stock-based employee compensation |             | (173)    | (163)    |
| Net income                             | Pro forma   | \$10,997 | \$10,537 |
| Earnings per share, basic              | As reported | \$1.78   | \$1.68   |
|                                        | Pro forma   | \$1.75   | \$1.65   |
| Earnings per share, diluted            | As reported | \$1.72   | \$1.63   |
|                                        | Pro forma   | \$1.70   | \$1.60   |

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

**Reclassifications:** Certain reclassifications have been made to prior year amounts, due primarily to aggregation, to maintain consistency with the current year with no impact on net income or total shareholders' equity.

**Segments:** The Company has identified only one reportable segment.

**Geographic Concentration and Alaska Economy:** The Company's growth and operations depend upon the economic conditions of Alaska and the specific markets it serves. The economy in Alaska is dependent upon the natural resources industries, in particular oil production, as well as tourism, government, and U.S. military spending. Approximately 86% of the Alaska state government is funded through various taxes and royalties on the oil industry. Any significant changes in the Alaska economy and the markets the Company serves eventually could have a positive or negative impact on the Company.

**Consolidation Policy:** The consolidated financial statements include the financial information for Northrim BanCorp, Inc. and its wholly-owned subsidiaries that include Northrim Bank, and NISC. All intercompany balances have been eliminated in consolidation. The Company accounts for its investments in RML Holding Company, Elliott Cove, and Pacific Wealth Advisors, LLC using the equity method.

**NOTE 2 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, 2006, was \$0.

**NOTE 3 Money Market Investments**

Money market investment balances are as follows:

| December 31,                                               | 2006                  | 2005     |
|------------------------------------------------------------|-----------------------|----------|
|                                                            | <i>(In Thousands)</i> |          |
| Interest bearing deposits at Federal Home Loan Bank (FHLB) | \$18,717              | \$54,036 |
| Fed funds sold                                             |                       | 6,800    |
| Total                                                      | \$18,717              | \$60,836 |

All money market investments had a one-day maturity.

**Table of Contents****NOTE 4 Investment Securities**

The carrying values and approximate market values of investment securities are presented below:

|                               | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Market<br>Value |
|-------------------------------|-------------------|------------------------------|-------------------------------|-----------------|
| <i>(In Thousands)</i>         |                   |                              |                               |                 |
| 2006:                         |                   |                              |                               |                 |
| Securities Available for Sale |                   |                              |                               |                 |
| U.S. Treasury                 | \$16,860          | \$                           | \$20                          | \$16,840        |
| Government Sponsored Entities | 70,438            | 16                           | 483                           | 69,971          |
| Mortgage-backed Securities    | 183               |                              | 1                             | 182             |
| Total                         | \$87,481          | \$16                         | \$504                         | \$86,993        |
| Securities Held to Maturity   |                   |                              |                               |                 |
| Municipal Securities          | \$11,776          | \$32                         | \$33                          | \$11,775        |
| Federal Home Loan Bank Stock  | \$1,556           | \$                           | \$                            | \$1,556         |
| 2005:                         |                   |                              |                               |                 |
| Securities Available for Sale |                   |                              |                               |                 |
| U.S. Treasury                 | \$15,930          | \$                           | \$169                         | \$15,761        |
| Government Sponsored Entities | 37,140            |                              | 659                           | 36,482          |
| Mortgage-backed Securities    | 242               |                              | 2                             | 240             |
| Total                         | \$53,312          | \$                           | \$830                         | \$52,483        |
| Securities Held to Maturity   |                   |                              |                               |                 |
| Municipal Securities          | \$936             | \$28                         | \$7                           | \$957           |
| Federal Home Loan Bank Stock  | \$1,556           | \$                           | \$                            | \$1,556         |

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

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December 31, 2006 and 2005 were as follows:

| December 31,                  | Less Than 12 Months |                   | More Than 12 Months |                   | Total      |                   |
|-------------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|                               | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| <i>(In Thousands)</i>         |                     |                   |                     |                   |            |                   |
| 2006:                         |                     |                   |                     |                   |            |                   |
| Securities Available for Sale |                     |                   |                     |                   |            |                   |
| U.S. Treasury                 | \$5,862             | \$5               | \$10,978            | \$15              | \$16,840   | \$20              |
| Government Sponsored Entities |                     |                   | 39,966              | 483               | 39,966     | 483               |
| Mortgage-backed Securities    |                     |                   | 182                 | 1                 | 182        | 1                 |
| Total                         | \$5,862             | \$5               | \$51,126            | \$499             | \$56,988   | \$504             |
| Securities Held to Maturity   |                     |                   |                     |                   |            |                   |
| Municipal Securities          | \$8,105             | \$30              | \$274               | \$3               | \$8,379    | \$33              |

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| December 31,                  | Less Than 12 Months |                   | More Than 12 Months |                   | Total      |                   |
|-------------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|                               | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| <i>(In Thousands)</i>         |                     |                   |                     |                   |            |                   |
| 2005:                         |                     |                   |                     |                   |            |                   |
| Securities Available for Sale |                     |                   |                     |                   |            |                   |
| U.S. Treasury                 | \$4,883             | \$53              | \$10,878            | \$116             | \$15,761   | \$169             |
| Government Sponsored Entities | 10,519              | 176               | 25,963              | 483               | 36,482     | 659               |
| Mortgage-backed Securities    | 240                 | 2                 |                     |                   | 240        | 2                 |
| Total                         | \$15,642            | \$231             | \$36,841            | \$599             | \$52,483   | \$830             |
| Securities Held to Maturity   |                     |                   |                     |                   |            |                   |
| Municipal Securities          | \$270               | \$7               |                     |                   | \$270      | \$7               |

The unrealized losses on investments in U.S. Treasury and government sponsored entities were caused by interest rate increases. At December 31, 2006, there were fifteen of these securities in an unrealized loss position of \$504,000. 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 the Company has the ability and intent to hold these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

The amortized cost and market values of debt securities at December 31, 2006, are distributed by contractual maturity as shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|                               | Within<br>1 Year | 1-5 Years | 5-10 Years | Over<br>10 Years | Amortized<br>Cost | Market<br>Value |
|-------------------------------|------------------|-----------|------------|------------------|-------------------|-----------------|
| <i>(In Thousands)</i>         |                  |           |            |                  |                   |                 |
| Securities Available for Sale |                  |           |            |                  |                   |                 |
| U.S. Treasury                 | \$16,860         | \$        | \$         | \$               | \$16,860          | \$16,840        |
| Government Sponsored Entities | 16,902           | 53,536    |            |                  | 70,438            | 69,971          |
| Mortgage-backed Securities    |                  |           |            | 183              | 183               | 182             |
| Total                         | \$33,762         | \$53,536  | \$         | \$183            | \$87,481          | \$86,993        |

|                             |       |          |         |       |          |          |
|-----------------------------|-------|----------|---------|-------|----------|----------|
| Weighted Average Yield      | 3.71% | 4.96%    | 0.00%   | 5.35% | 4.48%    |          |
| Securities Held to Maturity |       |          |         |       |          |          |
| Municipal Securities        | \$70  | \$10,357 | \$1,349 | \$    | \$11,776 | \$11,775 |
| Weighted Average Yield      | 4.12% | 3.80%    | 3.76%   | 0.00% | 3.80%    |          |

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The proceeds and resulting gains and losses, computed using specific identification, from sales of investment securities are as follows:

| December 31,                  | Proceeds | Gross<br>Gains | Gross<br>Losses |
|-------------------------------|----------|----------------|-----------------|
| <i>(In Thousands)</i>         |          |                |                 |
| 2006:                         |          |                |                 |
| Available-for-Sale Securities | \$       | \$             | \$              |
| Held-to-Maturity Securities   | \$       | \$             | \$              |
| 2005:                         |          |                |                 |
| Available-for-Sale Securities | \$6,148  | \$44           | \$35            |
| Held-to-Maturity Securities   | \$       | \$             | \$              |
| 2004:                         |          |                |                 |
| Available-for-Sale Securities | \$3,789  | \$151          | \$              |
| Held-to-Maturity Securities   | \$       | \$             | \$              |

The Company pledged \$15.7 million and \$20.9 million of investment securities at December 31, 2006, and 2005, respectively, as collateral for public deposits and borrowings.

A summary of taxable interest income on available for sale investment securities is as follows:

| December 31,                  | 2006    | 2005    | 2004    |
|-------------------------------|---------|---------|---------|
| <i>(In Thousands)</i>         |         |         |         |
| U.S. Treasury                 | \$438   | \$472   | \$67    |
| Government Sponsored Entities | 1,948   | 1,688   | 2,319   |
| Other                         | 10      | 11      | 14      |
| Total                         | \$2,396 | \$2,171 | \$2,400 |

Included in investment securities is a required investment in stock of the FHLB. The amount of the required investment is based on the Company's capital stock and lending activity, and amounted to \$1.6 million for both 2006 and 2005.





**Table of Contents****NOTE 5   Loans**

The composition of the loan portfolio is presented below:

| December 31,                                              | 2006                  | 2005      |
|-----------------------------------------------------------|-----------------------|-----------|
|                                                           | <i>(In Thousands)</i> |           |
| Commercial                                                | \$287,281             | \$287,617 |
| Real estate construction                                  | 153,059               | 131,532   |
| Real estate term                                          | 237,599               | 252,395   |
| Installment and other consumer                            | 42,140                | 36,519    |
| Sub-total                                                 | 720,079               | 708,063   |
| Less: Unearned origination fees, net of origination costs | (3,023)               | (3,004)   |
| Total loans                                               | 717,056               | 705,059   |
| Allowance for loan losses                                 | (12,125)              | (10,706)  |
| Net Loans                                                 | \$704,931             | \$694,353 |

The Company's primary market areas are Anchorage, the Matanuska Valley, and Fairbanks, Alaska, where the majority of its lending has been with Alaska businesses and individuals. At December 31, 2006, approximately 71% and 27% of the Company's loans are secured by real estate, or 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. 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.

Non-accrual loans totaled \$5.2 million and \$5.1 million at December 31, 2006, and 2005, respectively. Interest income which would have been earned on non-accrual loans for 2006, 2005, and 2004 amounted to \$437,000, \$353,000, and \$658,000, respectively. There are no commitments to lend additional funds to borrowers whose loans are in a non-accrual status or are troubled debt restructurings.

At December 31, 2006, and 2005, the recorded investment in loans that are considered to be impaired was \$32 million and \$18.3 million, respectively, (of which \$5.2 million and \$5 million, respectively, were on a non-accrual basis). A specific allowance of \$4.3 million was established for the \$32 million of impaired loans. The average recorded investment in impaired loans during the years ended December 31, 2006, and 2005, was approximately \$32.2 million and \$18.1 million, respectively. For the years ended December 31, 2006, 2005, and 2004, the Company recognized interest income on these impaired loans of \$2.5 million, \$945,000, and \$117,000, respectively.

At December 31, 2006, and 2005, there were no loans pledged as collateral to secure public deposits.

At December 31, 2006, and 2005, the Company serviced \$97 million and \$90 million of loans, respectively, which had been sold to various investors without recourse. At December 31, 2006, and 2005, the Company held \$1.1 million and \$734,000, respectively, in trust for these loans for the payment of such items as taxes, insurance, and maintenance costs.

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Maturities and sensitivity of accrual loans to changes in interest rates as of December 31, 2006 are as follows:

|                                | Maturity              |               |                 |               |
|--------------------------------|-----------------------|---------------|-----------------|---------------|
|                                | Within<br>1 Year      | 1-5 Years     | Over<br>5 Years | Total         |
|                                | <i>(In Thousands)</i> |               |                 |               |
| Commercial                     | \$149,325             | \$86,951      | \$48,334        | \$284,610     |
| Construction                   | 140,658               | 10,656        | 1,628           | 152,942       |
| Real estate term               | 58,131                | 70,772        | 106,420         | 235,323       |
| Installment and other consumer | 1,032                 | 8,032         | 32,964          | 42,028        |
| <br>Total                      | <br>\$349,146         | <br>\$176,411 | <br>\$189,346   | <br>\$714,903 |
| <br>Fixed interest rate        | <br>\$130,312         | <br>\$56,601  | <br>\$54,489    | <br>\$241,402 |
| Floating interest rate         | 218,834               | 119,810       | 134,857         | 473,501       |
| <br>Total                      | <br>\$349,146         | <br>\$176,411 | <br>\$189,346   | <br>\$714,903 |

Certain directors, and companies of which directors are principal owners, have loans and other transactions such as insurance placement and architectural fees with the Company. Such transactions are made on substantially the same terms, including interest rates and collateral required, as those prevailing for similar transactions of unrelated parties. An analysis of the loan transactions follows:

| December 31,                               | 2006                  | 2005        |
|--------------------------------------------|-----------------------|-------------|
|                                            | <i>(In Thousands)</i> |             |
| Balance, beginning of the year             | \$2,995               | \$3,132     |
| Loans made                                 | 11,520                | 16,848      |
| Repayments or change to nondirector status | 13,392                | 16,985      |
| <br>Balance, end of year                   | <br>\$1,123           | <br>\$2,995 |

The Company's unfunded loan commitments to these directors or their related interests on December 31, 2006, and 2005, were \$3.4 million and \$1.5 million, respectively.

**Table of Contents****NOTE 6 Allowance for Loan Losses**

The following is a detail of the allowance for loan losses:

| December 31,                    | 2006                  | 2005     | 2004     |
|---------------------------------|-----------------------|----------|----------|
|                                 | <i>(In Thousands)</i> |          |          |
| Balance, beginning of the year  | \$10,706              | \$10,764 | \$10,186 |
| Provision charged to operations | 2,564                 | 1,170    | 1,601    |
| Charge-offs:                    |                       |          |          |
| Commercial                      | (2,544)               | (1,552)  | (1,387)  |
| Construction                    |                       | (100)    |          |
| Real estate                     |                       |          |          |
| Installment and other consumer  | (72)                  | (63)     | (84)     |
| Total Charge-offs               | (2,616)               | (1,715)  | (1,471)  |
| Recoveries:                     |                       |          |          |
| Commercial                      | 1,086                 | 418      | 200      |
| Construction                    |                       | 15       | 185      |
| Real estate                     | 354                   | 15       |          |
| Installment and other consumer  | 31                    | 39       | 63       |
| Total Recoveries                | 1,471                 | 487      | 448      |
| Charge-offs net of recoveries   | (1,145)               | (1,228)  | (1,023)  |
| Balance, End of Year            | \$12,125              | \$10,706 | \$10,764 |

At December 31, 2006, the allowance for loan losses was \$12.1 million as compared to balances of \$10.7 million and \$10.8 million, respectively, at December 31, 2005 and 2004. The increase in the allowance for the loan losses between December 31, 2006 and December 31, 2005 was caused in part by an increase in loans measured for impairment that increased to \$32 million at December 31, 2006 from \$18.3 million at December 31, 2005, as well as growth in the loan portfolio.

**NOTE 7 Premises and Equipment**

The following summarizes the components of premises and equipment:

| December 31,                              | Useful Life | 2006     | 2005     |
|-------------------------------------------|-------------|----------|----------|
| <i>(In Thousands)</i>                     |             |          |          |
| Land                                      |             | \$1,443  | \$1,443  |
| Vehicle                                   | 3 years     | 61       | 61       |
| Furniture and equipment                   | 3-7 years   | 9,608    | 8,915    |
| Tenant improvements                       | 2-11 years  | 7,307    | 4,839    |
| Buildings                                 | 39 years    | 6,865    | 6,848    |
| Total Premises and Equipment              |             | 25,284   | 22,106   |
| Accumulated depreciation and amortization |             | (12,410) | (11,503) |
| Total Premises and Equipment, Net         |             | \$12,874 | \$10,603 |

During 1991, the Company purchased the building in which it operates and simultaneously sold the building to a partnership, in which three of the Company's directors had an approximate 54% ownership interest. The net gain on the sale of the building, \$176,000, was being amortized over the lease term; approximately \$12,000 was recognized in 2004, at which time the gain was fully amortized.

**Table of Contents****NOTE 8 Other Assets**

A summary of intangible assets and other assets is as follows:

| December 31,                                  | 2006                  | 2005         |
|-----------------------------------------------|-----------------------|--------------|
|                                               | <i>(In Thousands)</i> |              |
| Intangible assets:                            |                       |              |
| Goodwill                                      | \$5,735               | \$5,735      |
| Core deposits intangible                      | 163                   | 531          |
| NBG customer relationships                    | 1,005                 | 1,119        |
| <br>Total                                     | <br>\$6,903           | <br>\$7,385  |
| <br>Prepaid expenses                          | <br>\$719             | <br>\$572    |
| Software                                      | 553                   | 466          |
| Deferred taxes, net                           | 10,560                | 8,838        |
| Note receivable from Elliott Cove             | 617                   | 1,060        |
| Investment in Elliott Cove                    | 80                    | 101          |
| Investment in PWA                             | 1,894                 | 2,015        |
| Investment in RML Holding Company             | 4,327                 | 4,203        |
| Investment in Low Income Housing Partnerships | 8,220                 | 2,440        |
| Other assets                                  | 3,236                 | 2,284        |
| <br>Total                                     | <br>\$30,206          | <br>\$21,979 |

As part of the acquisition of branches from Bank of America in 1999, the Company recorded goodwill and a core deposit intangible ( CDI ). The CDI is net of accumulated amortization of \$2.8 million and \$2.4 million for the periods ending December 31, 2006, and 2005, respectively. The Company intends to continue amortizing the CDI through June of 2007, which will be the remainder of its useful life.

In the first quarter of 2005, NCIC purchased a 10% interest in NBG, an insurance brokerage company that provides employee benefit plans to businesses throughout Alaska. In the fourth quarter of 2005, NCIC purchased an additional 40.1% interest in NBG, bringing its ownership interest to 50.1%. The Company has invested \$1.1 million in NBG and has attributed all of this investment to an intangible asset represented by the value of the customer relationships of NBG. The Company is amortizing the NBG intangible asset over a ten-year period on a straight-line basis. In 2006, the amortization expense on the NBG intangible asset was \$115,000.

The Company recorded amortization expense of its intangible assets of \$482,000, \$368,000, and \$368,000 in 2006, 2005, and 2004, respectively. The increase in the amortization expense in 2006 resulted from the additional

amortization expense on the NBG intangible asset. The amortization expense that is required on these assets as of December 31, 2006, is as follows:

Year Ending December 31:

*(In Thousands)*

|            |         |
|------------|---------|
| 2007       | \$278   |
| 2008       | 115     |
| 2009       | 115     |
| 2010       | 115     |
| 2011       | 115     |
| Thereafter | 430     |
| Total      | \$1,168 |



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As of December 31, 2006, the Company owns a 47% equity interest in Elliott Cove, an investment advisory services company, through its wholly owned subsidiary, NISC. Elliott Cove began active operations in the fourth quarter of 2002 and has had start-up losses since that time as it continues to build its assets under management. In addition to its ownership interest, the Company provides Elliott Cove with a line of credit that has a committed amount of \$750,000 and an outstanding balance of \$617,000 as of December 31, 2006.

In the fourth quarter of 2005, the Company, through NISC, purchased subscription rights to an ownership interest in Pacific Wealth Advisors, LLC ( PWA ), an investment advisory and wealth management business located in Seattle, Washington. The Company also made commitments to make two loans to PWA of \$225,000 and \$175,000, respectively. There were no outstanding balances on these two commitments as of December 31, 2006. Subsequent to the investment in these subscription rights, PWA purchased Pacific Portfolio Consulting L.P., an investment advisory business, and formed Pacific Portfolio Trust Company. After the completion of these transactions, NISC owned a 24% interest in PWA and applies the equity method of accounting for its ownership interest in PWA.

RML was formed in 1998 and has offices throughout Alaska. During the third quarter of 2004, RML reorganized and became a wholly-owned subsidiary of a newly formed holding company, RML Holding Company. In this process, RML Holding Company acquired another mortgage company, PAM, which was merged into RML in the first quarter of 2005. Prior to the reorganization, the Company, through Northrim Bank's wholly-owned subsidiary, NCIC, owned a 30% interest in the profits of RML. As a result of the reorganization, the Company now owns a 24% interest in the profits of RML Holding Company and applies the equity method of accounting for its ownership interest in RML.

Below is summary balance sheet and income statement information for RML Holding Company.

| December 31,          | 2006                  | 2005     |
|-----------------------|-----------------------|----------|
|                       | <i>(In Thousands)</i> |          |
| Assets                |                       |          |
| Current assets        | \$53,072              | \$70,315 |
| Long-term assets      | 6,455                 | 5,958    |
| Total Assets          | \$59,527              | \$76,273 |
| Liabilities           |                       |          |
| Current liabilities   | \$41,980              | \$58,285 |
| Long-term liabilities | 964                   | 1,906    |
| Total Liabilities     | 42,944                | 60,191   |
| Shareholders' Equity  | 16,583                | 16,082   |

|                                            |          |          |
|--------------------------------------------|----------|----------|
| Total Liabilities and Shareholders' Equity | \$59,527 | \$76,273 |
| Income/expense                             |          |          |
| Gross income                               | \$17,036 | \$15,819 |
| Total expense                              | 14,403   | 13,107   |
| Joint venture allocations                  | 102      | (522)    |
| Net Income                                 | \$2,735  | \$2,190  |

In December of 2006, September of 2006 and January of 2003 the Company made investments of \$3 million each in USA 57, CharterMac and RCP, respectively. 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 over a fifteen, eighteen and eighteen-year period, respectively.

#### **NOTE 9 Deposits**

The aggregate amount of certificates of deposit in amounts of \$100,000 or more at December 31, 2006, and 2005, was \$28.3 million and \$51.2 million, respectively.

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At December 31, 2006, the scheduled maturities of certificates of deposit (excluding Alaska CD s, which do not have scheduled maturities) are as follows:

Year Ending December 31:

*(In Thousands)*

|            |          |
|------------|----------|
| 2007       | \$59,357 |
| 2008       | 16,852   |
| 2009       | 9,425    |
| 2010       | 146      |
| 2011       | 114      |
| Thereafter | 24       |
| Total      | \$85,918 |

At December 31, 2006, the Company did not hold any certificates of deposit from a public entity collateralized by letters of credit issued by the Federal Home Loan Bank compared to 2005 where the Company held \$15 million of these types of deposits.

**NOTE 10 Borrowings**

The Company has a line of credit with the FHLB of Seattle approximating 12% of assets, or \$107 million at December 31, 2006. The line is secured by a blanket pledge of the Company s assets. At December 31, 2006, and 2005, there was \$2.2 million and \$18.1 million committed on the line, respectively. At December 31, 2005, there was \$2.6 million outstanding on the line and an additional \$15.5 million of the borrowing line was committed to secure public deposits. The outstanding balances on the FHLB line of credit at December 31, 2006, and 2005, of \$2.2 million and \$2.6 million, respectively, have a maturity date of May 7, 2012.

The Company entered into a note agreement with the Federal Reserve Bank on the payment of tax deposits. The Federal Reserve has the option to call the note at any time. The balance at December 31, 2006, and 2005, was \$1 million.

The Federal Reserve Bank is holding \$55.5 million of loans as collateral to secure advances made through the discount window on December 31, 2006. There were no discount window advances outstanding at December 31, 2006.

Securities sold under agreements to repurchase were \$3.3 million with an interest rate of 3.69%, and \$4.9 million with an interest rate of 2.28%, at December 31, 2006, and 2005, respectively. The average balance outstanding of securities sold under agreement to repurchase during 2006 and 2005 was \$3.3 million and \$2.8 million, respectively, and the maximum outstanding at any month-end was \$6.7 million and \$5.4 million, respectively. The securities sold under agreement to repurchase are held by the Federal Home Loan Bank under the Company s control.

## NOTE 11 Junior Subordinated Debentures

In May of 2003, the Company formed a wholly-owned Delaware statutory business trust subsidiary, Northrim Capital Trust 1 (the Trust), which issued \$8 million of guaranteed undivided beneficial interests in the Company's Junior Subordinated Deferrable Interest Debentures (Trust Preferred Securities). These debentures qualify as Tier 1 capital under Federal Reserve Board guidelines. All of the common securities of the Trust are owned by the Company. The proceeds from the issuance of the common securities and the Trust Preferred Securities were used by the Trust to purchase \$8.2 million of junior subordinated debentures of the Company. The Trust Preferred Securities of the Trust are not consolidated in the Company's financial statements in accordance with FASB Interpretation No. 46R (FIN 46); therefore, the Company has recorded its investment in the Trust as an other asset and the subordinated debentures as a liability. The debentures which represent the sole asset of the Trust, accrue and pay distributions quarterly at a variable rate of 90-day LIBOR plus 3.15% per annum, adjusted quarterly, of the stated liquidation value of \$1,000 per capital security. The interest rate on these debentures was 8.52% at December 31, 2006. The interest cost to the Company on these debentures was \$665,000 in 2006 and \$523,000 in 2005. The Company has entered into contractual arrangements which, taken collectively, fully and unconditionally guarantee payment of: (i) accrued and unpaid distributions required to be paid on the Trust Preferred Securities; (ii) the redemption price with respect to any Trust Preferred Securities called for redemption by the Trust and (iii) payments due upon a voluntary or involuntary dissolution, winding up or liquidation of the Trust. The Trust Preferred Securities are mandatorily redeemable upon maturity of the debentures on May 15, 2033, or upon earlier redemption as provided in the indenture. The Company has the right to redeem the debentures purchased by the Trust in whole or in part, on or after May 15, 2008. As specified in the indenture, if the debentures are redeemed prior to maturity, the redemption price will be the principal amount and any accrued but unpaid interest.

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In December of 2005, the Company formed a wholly-owned Connecticut statutory business trust subsidiary, Northrim Statutory Trust 2 (the Trust 2), which issued \$10 million of guaranteed undivided beneficial interests in the Company's Junior Subordinated Deferrable Interest Debentures (Trust Preferred Securities 2). These debentures qualify as Tier 1 capital under Federal Reserve Board guidelines. All of the common securities of Trust 2 are owned by the Company. The proceeds from the issuance of the common securities and the Trust Preferred Securities 2 were used by Trust 2 to purchase \$10.3 million of junior subordinated debentures of the Company. The Trust Preferred Securities of the Trust 2 are not consolidated in the Company's financial statements in accordance with FIN 46; therefore, the Company has recorded its investment in the Trust 2 as an other asset and the subordinated debentures as a liability. The debentures which represent the sole asset of Trust 2, accrue and pay distributions quarterly at a variable rate of 90-day LIBOR plus 1.37% per annum, adjusted quarterly, of the stated liquidation value of \$1,000 per capital security. The interest rate on these debentures was 6.73% at December 31, 2006. The interest cost to the Company on these debentures was \$654,000 in 2006 and \$26,000 in 2005. The Company has entered into contractual arrangements which, taken collectively, fully and unconditionally guarantee payment of: (i) accrued and unpaid distributions required to be paid on the Trust Preferred Securities 2; (ii) the redemption price with respect to any Trust Preferred Securities 2 called for redemption by Trust 2 and (iii) payments due upon a voluntary or involuntary dissolution, winding up or liquidation of Trust 2. The Trust Preferred Securities 2 are mandatorily redeemable upon maturity of the debentures on March 15, 2036, or upon earlier redemption as provided in the indenture. The Company has the right to redeem the debentures purchased by Trust 2 in whole or in part, on or after March 15, 2011. As specified in the indenture, if the debentures are redeemed prior to maturity, the redemption price will be the principal amount and any accrued but unpaid interest.

**NOTE 12 Interest Expense**

Interest expense on deposits and borrowings is presented below:

| December 31,                                   | 2006                  | 2005     | 2004    |
|------------------------------------------------|-----------------------|----------|---------|
|                                                | <i>(In Thousands)</i> |          |         |
| Interest-bearing demand accounts               | \$830                 | \$369    | \$221   |
| Money market accounts                          | 6,053                 | 3,876    | 1,527   |
| Savings accounts                               | 10,113                | 6,263    | 2,290   |
| Certificates of deposit greater than \$100,000 | 1,425                 | 2,170    | 1,620   |
| Certificates of deposit less than \$100,000    | 1,897                 | 1,312    | 1,051   |
| Borrowings                                     | 1,681                 | 883      | 574     |
| Total                                          | \$21,999              | \$14,873 | \$7,283 |

**Table of Contents****NOTE 13 Income Taxes**

Components of the provision for income taxes are as follows:

| December 31,          |         | Current Tax<br>Expense | Deferred<br>(Benefit) | Total<br>Expense |
|-----------------------|---------|------------------------|-----------------------|------------------|
| <i>(In Thousands)</i> |         |                        |                       |                  |
| 2006:                 | Federal | \$7,828                | (\$1,436)             | \$6,392          |
|                       | State   | 2,012                  | (426)                 | 1,586            |
| Total                 |         | \$9,840                | (\$1,862)             | \$7,978          |
| 2005:                 | Federal | \$6,148                | (\$639)               | \$5,509          |
|                       | State   | 1,597                  | (182)                 | 1,415            |
| Total                 |         | \$7,745                | (\$821)               | \$6,924          |
| 2004:                 | Federal | \$6,139                | (\$998)               | \$5,141          |
|                       | State   | 1,348                  | (262)                 | 1,086            |
| Total                 |         | \$7,487                | (\$1,260)             | \$6,227          |

The actual expense for 2006, 2005, and 2004, differs from the expected tax expense (computed by applying the U.S. Federal Statutory Tax Rate of 35% for the year ended December 31, 2006, 2005, and 2004) as follows:

| December 31,                         | 2006    | 2005    | 2004    |
|--------------------------------------|---------|---------|---------|
| <i>(In Thousands)</i>                |         |         |         |
| Computed expected income tax expense | \$7,333 | \$6,333 | \$5,924 |
| State income taxes, net              | 1,031   | 920     | 706     |
| Other                                | (386)   | (329)   | (403)   |
| Total                                | \$7,978 | \$6,924 | \$6,227 |

The components of the deferred tax asset are as follows:

| December 31,                                                | 2006         | 2005<br><i>(In Thousands)</i> | 2004        |
|-------------------------------------------------------------|--------------|-------------------------------|-------------|
| Provision for loan losses                                   | \$7,113      | \$5,796                       | \$5,612     |
| Loan fees, net of costs                                     | 1,240        | 1,227                         | 1,150       |
| Unrealized gain on available-for-sale investment securities | 201          | 341                           | (3)         |
| Depreciation                                                | 826          | 678                           | 386         |
| Other, net                                                  | 1,180        | 796                           | 528         |
| <br>Net Deferred Tax Asset                                  | <br>\$10,560 | <br>\$8,838                   | <br>\$7,673 |

A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. The primary source of recovery of the deferred tax assets will be future taxable income. Management believes it is more likely than not that the results of future operations will generate sufficient taxable income to realize the deferred tax assets. The deferred tax asset is included in other assets.

**Table of Contents****NOTE 14 Comprehensive Income**

At December 31, 2006, 2005, and 2004, the related tax effects allocated to each component of other comprehensive income are as follows:

| December 31,                                                                    | Before Tax<br>Amount | Tax<br>(Expense)<br>Benefit<br><i>(In Thousands)</i> | Net Amount |
|---------------------------------------------------------------------------------|----------------------|------------------------------------------------------|------------|
| <b>2006:</b>                                                                    |                      |                                                      |            |
| Unrealized net holding losses on investment securities arising during 2006      | \$342                | (\$140)                                              | \$202      |
| Plus: Reclassification adjustment for net realized gains included in net income |                      |                                                      |            |
| Net unrealized losses                                                           | \$342                | (\$140)                                              | \$202      |
| <b>2005:</b>                                                                    |                      |                                                      |            |
| Unrealized net holding losses on investment securities arising during 2005      | (\$828)              | \$340                                                | (\$488)    |
| Plus: Reclassification adjustment for net realized gains included in net income | (9)                  | 4                                                    | (5)        |
| Net unrealized losses                                                           | (\$837)              | \$344                                                | (\$493)    |
| <b>2004:</b>                                                                    |                      |                                                      |            |
| Unrealized net holding losses on investment securities arising during 2004      | (\$900)              | \$370                                                | (\$530)    |
| Plus: Reclassification adjustment for net realized gains included in net income | (151)                | 62                                                   | (89)       |
| Net unrealized losses                                                           | (\$1,051)            | \$432                                                | (\$619)    |

**NOTE 15 Employee Benefit Plans**

On July 1, 1992, the Company implemented a profit sharing plan, including a provision designed to qualify the plan under Section 401(k) of the Internal Revenue Code of 1986, as amended. Employees may participate in the plan if they work more than 1,000 hours per year. Under the plan, each eligible participant may contribute a percentage of



their eligible salary to a maximum established by the IRS, and the Company matches 25% up to 6% of the employee contribution. The Company may increase the matching contribution at the discretion of the Board of Directors. The plan also allows the Company to make a discretionary contribution on behalf of eligible employees based on their length of service to the Company.

To be eligible for 401(k) contributions, participants must be employed at the end of the plan year, except in the case of death, disability or retirement. The Company expensed \$727,000, \$773,000, and \$619,000, in 2006, 2005, and 2004, respectively for 401(k) contributions and included these expenses in salaries and other personal expense in the Consolidated Statements of Income.

On July 1, 1994, the Company implemented a Supplemental Executive Retirement Plan to executive officers of the Company whose retirement benefits under the 401(k) plan have been limited under provisions of the Internal Revenue Code. Contributions to this plan totaled \$255,000, \$165,000, and \$161,000, in 2006, 2005, and 2004, respectively and included these expenses in salaries and other personal expense in the Consolidated Statements of Income. At December 31, 2006 and 2005, the balance of the accrued liability for this plan was included in other liabilities and totaled \$1.4 million and \$1.1 million, respectively.

In February of 2002, the Company implemented a non-qualified deferred compensation plan in which certain of the executive officers participate. Contributions to this plan totaled \$381,000, \$268,000, and \$119,000 in 2006, 2005, and 2004 respectively and included these expenses in salaries and other personal expense in the Consolidated Statements of Income. At December 31, 2006 and 2005, the balance of the accrued liability for this plan was included in other liabilities and totaled \$1.1 million and \$702,000, respectively.

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**NOTE 16 Common Stock**

Quarterly cash dividends were paid aggregating to \$2.8 million, \$2.6 million, and \$2.3 million, or \$0.47 per share, \$0.43 per share, and \$0.38 per share, in 2006, 2005, and 2004, respectively. On January 11, 2007, the Board of Directors declared a \$0.125 per share cash dividend payable on February 9, 2007, to shareholders of record on January 29, 2007. Federal and State regulations place certain limitations on the payment of dividends by the Company.

In September 2002, our Board of Directors approved a plan whereby we would periodically repurchase for cash up to approximately 5%, or 306,372, of our shares of common stock in the open market. In August of 2004, the Board of Directors amended the stock repurchase plan and increased the number of shares available under the program by 5% of total shares outstanding, or 304,283 shares. We purchased 550,942 shares of our stock under this program through December 31, 2006 at a total cost of \$10.8 million at an average price of \$19.64, which left a balance of 59,713 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.

On September 1, 2006, the Company paid a 5% stock dividend to shareholders of record as of August 18, 2006. As a result, the Company issued 290,727 of its shares along with a cash dividend of \$2,000 to pay for fractional shares.

**NOTE 17 Options**

The Company has set aside 315,000 shares of authorized stock for the 2004 Stock Incentive Plan ( 2004 Plan ) under which it may grant stock options and restricted stock units. The Company's policy is to issue new shares to cover awards. The total number of shares under the 2004 Plan and previous stock incentive plans at December 31, 2006 was 439,027, which includes 141,266 shares granted under the 2004 Plan leaving 173,734 shares available for future awards. This information has been adjusted for the 5% stock dividend paid on September 1, 2006. Under the 2004 Plan, certain key employees have been granted the option to purchase set amounts of common stock at the market price on the day the option was granted. Optionees, at their own discretion, may cover the cost of exercise through the exchange, at then fair market value, of already owned shares of the Company's stock. Options are granted for a 10-year period and vest on a pro rata basis over the initial three years from grant. In addition to stock options, the Company has granted restricted stock units to certain key employees under the 2004 Plan. These restricted stock grants cliff vest at the end of a three-year time period.

**Table of Contents***Options and Restricted Stock Outstanding*

Activity on options and restricted stock units granted under the 2004 Plan and prior plans is as follows. This information has been adjusted for the 5% stock dividend paid on September 1, 2006:

|                               | Shares<br>Under<br>Option | Weighted<br>Average<br>Exercise<br>Price | Range of<br>Exercise<br>Price |
|-------------------------------|---------------------------|------------------------------------------|-------------------------------|
| December 31, 2003 outstanding | 443,058                   | \$9.90                                   | \$6.32-\$22.01                |
| Granted 2004                  | 52,295                    | 18.87                                    |                               |
| Forfeited                     | (7,085)                   | 12.74                                    |                               |
| Exercised                     | (62,950)                  | 6.41                                     |                               |
| December 31, 2004 outstanding | 425,319                   | \$11.48                                  | \$6.32-\$22.01                |
| Granted 2005                  | 48,709                    | 19.43                                    |                               |
| Forfeited                     | (3,004)                   | 16.93                                    |                               |
| Exercised                     | (25,873)                  | 9.15                                     |                               |
| December 31, 2005 outstanding | 445,150                   | \$12.45                                  | \$6.32-\$22.01                |
| Granted 2006                  | 47,363                    | 19.30                                    |                               |
| Forfeited                     | (6,217)                   | 16.15                                    |                               |
| Exercised                     | (47,269)                  | 10.25                                    |                               |
| December 31, 2006 outstanding | 439,027                   | \$13.37                                  | \$7.52-\$27.24                |

Stock options outstanding and exercisable at December 31, 2006 are as follows:

|                                | Number of<br>Shares | Weighted<br>Average<br>Exercise<br>Price |
|--------------------------------|---------------------|------------------------------------------|
| Outstanding at January 1, 2006 | 429,662             | \$12.90                                  |
| Changes during the period:     |                     |                                          |

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|                                            |          |         |
|--------------------------------------------|----------|---------|
| Granted                                    | 33,554   | 27.24   |
| Exercised                                  | (47,269) | 10.25   |
| Forfeited                                  | (4,910)  | 20.45   |
| Outstanding at December 31, 2006           | 411,037  | \$14.28 |
| Options exercisable at December 31, 2006   | 338,100  | \$11.98 |
| Unexercisable options at December 31, 2006 | 72,937   | \$24.92 |

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Restricted stock grants outstanding at December 31, 2006 are as follows:

|                                  | Number of<br>Shares | Weighted<br>Average Fair<br>Value |
|----------------------------------|---------------------|-----------------------------------|
| Outstanding at January 1, 2006   | 15,488              | \$22.77                           |
| Changes during the period:       |                     |                                   |
| Granted                          | 13,809              | 26.44                             |
| Vested                           |                     |                                   |
| Forfeited                        | (1,307)             | 22.77                             |
| Outstanding at December 31, 2006 | 27,990              | \$24.58                           |

At December 31, 2006, all restricted stock units were unexercisable. Restricted stock units will start to vest in December of 2007. No options or restricted stock units expired unexercised in 2006.

At December 31, 2006, 2005, and 2004, the weighted-average remaining contractual life of outstanding options and restricted stock units was 5.3 years, 5.8 years, and 6.4 years, respectively.

At December 31, 2006, 2005, and 2004, the number of options exercisable was 338,100, 327,707, and 303,714, respectively, and the weighted-average exercise price of those options was \$11.98, \$10.75, and \$9.78, respectively.

The aggregate intrinsic value of options outstanding, exercisable, and unexercisable at December 31, 2006 was \$5.1 million, \$4.9 million, and \$123,000, respectively. The weighted average remaining life of options outstanding and options exercisable at December 31, 2006 is 5.5 and 4.7 years, respectively. The weighted average remaining life of restricted stock units outstanding at December 31, 2006 is 2 years. No units are exercisable.

At December 31, 2006, there were 173,734 additional shares available for grant under the plan. The per share fair value of stock options granted during 2006, 2005, and 2004, were calculated on the date of grant using a Black-Scholes option-pricing model with the following weighted-average assumptions:

|                              | Granted   |           |           |
|------------------------------|-----------|-----------|-----------|
| Options:                     | Nov. 2006 | Nov. 2005 | Dec. 2004 |
| Expected option life (years) | 7.4       | 7.5       | 7.7       |
| Risk free rate               | 4.57%     | 4.45%     | 4.09%     |
| Dividends per Share          | \$0.56    | \$0.50    | \$0.44    |
| Expected volatility factor   | 37.44%    | 37.06%    | 39.28%    |

The expected life represents the weighted average period of time that options granted are expected to be outstanding when considering vesting periods and the exercise history of the Company. The risk free rate is based upon the equivalent yield of a United States Treasury zero-coupon issue with a term equivalent to the expected life of the option. The expected dividends are based on projected dividends for the Company at the date of the option grant taking into account projected net income growth, dividend pay-out ratios, and other factors. The expected volatility is based upon the historical price volatility of the Company's stock.

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The weighted average fair value of stock option grants, the fair value of shares vested during the period, and the intrinsic value of options exercised during the years ended December 31, 2006, 2005 and 2004 are as follows:

| Years Ended December 31,                                         | 2006                          | 2005    | 2004    |
|------------------------------------------------------------------|-------------------------------|---------|---------|
|                                                                  | <i>(Dollars in Thousands)</i> |         |         |
| Options:                                                         |                               |         |         |
| Weighted-average grant-date fair value of stock options granted: | \$9.79                        | \$8.28  | \$8.49  |
| Total fair value of shares vested during the period:             | 256                           | 173     | 163     |
| Total intrinsic value of options exercised:                      | 672                           | 340     | 999     |
| Restricted stock units:                                          |                               |         |         |
| Weighted-average grant-date fair value of stock options granted: | \$26.44                       | \$20.21 | \$21.88 |
| Total fair value of shares vested during the period:             |                               |         |         |
| Total intrinsic value of options exercised:                      |                               |         |         |

The Company recognizes the fair value of the stock options and restricted stock units as expense over the required service period, net of estimated forfeitures, using the straight line attribution method for stock-based payment grants previously granted but not fully vested at January 1, 2006 as well as grants made after January 1, 2006 as prescribed in FASB 123R. As a result, the Company recognized expense of \$256,000 on the fair value of stock options and \$134,000 on the fair value of restricted stock units for a total of \$390,000 in stock-based compensation expense for the year ending December 31, 2006. The Company recognized \$68,000 on the fair value of restricted stock units in stock-based compensation expense for the year ending December 31, 2005.

The unamortized stock-based payment and the weighted average expense period remaining at December 31, 2006 are as follows:

|                  | Unamortized<br>Expense        | Average Period<br>to Expense<br>(years) |
|------------------|-------------------------------|-----------------------------------------|
|                  | <i>(Dollars in Thousands)</i> |                                         |
| Stock options    | \$632                         | 1.8                                     |
| Restricted stock | 455                           | 2.0                                     |
| Total            | \$1,087                       | 1.8                                     |

The Company withheld \$270,000 to pay for stock option exercises or income taxes that resulted from the exercise of stock options for the year ended December 31, 2006. The Company recognized a \$230,000 tax deduction related to the exercise of these stock options during the year ending December 31, 2006. The intrinsic value of the options that were exercised during 2006 was \$672,000, which represents the difference between the fair market value of the options at the date of exercise and their exercise price. A portion of these options with an intrinsic value of \$113,000 at the date of exercise was incentive stock options that were exercised and held by the optionee and not eligible for a tax deduction. Thus, the Company's tax deduction was based on options exercised and sold during 2006 with a total intrinsic value of \$559,000.

FASB Statement No. 123R requires that an entity that used the intrinsic value method under APB 25 prior to implementation of FASB Statement No. 123R must calculate the amount of excess tax benefits available to offset a tax deficiency as the net amount of excess tax benefits that would have been recognized in additional paid in capital had the entity adopted FASB Statement No. 123 for recognition purposes for awards granted for reporting periods ended after December 14, 1994. The Company used the intrinsic value method to calculate share-based compensation cost prior to January 1, 2006. FASB Staff Position No. FAS No. 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards* ( *FSP 123R-3* ), effective November 10, 2005, provides for a practical transition method that may be elected to calculate the pool of excess tax benefits available to absorb tax deficiencies upon the adoption of FASB 123R. The Company has elected to use the long haul method to calculate the beginning balance of the APIC pool as opposed to electing this simplified method. At December 31, 2006, the amount of excess tax benefits available to offset a tax deficiency is \$711,000.



**Table of Contents****NOTE 18 Commitments and Contingent Liabilities**

Rental expense under leases for equipment and premises was \$1.9 million, \$1.7 million, and \$1.6 million in 2006, 2005, and 2004, respectively. Required minimum rentals on non-cancelable leases as of December 31, 2006, are as follows:

Year Ending December 31:

*(In Thousands)*

|            |              |
|------------|--------------|
| 2007       | \$1,434      |
| 2008       | 1,462        |
| 2009       | 1,466        |
| 2010       | 1,455        |
| 2011       | 1,412        |
| Thereafter | 3,711        |
| <br>Total  | <br>\$10,940 |

The Company leases the main office facility from an entity in which a director has an interest. Rent expense under this lease agreement was \$975,000, \$929,000, and \$810,000 for 2006, 2005, and 2004, respectively. The Company believes that the lease agreement is at market terms.

The Company is self-insured for medical, dental, and vision plan benefits provided to employees. The Company has obtained stop-loss insurance to limit total medical claims in any one year to \$75,000 per covered individual and \$2.1 million for all medical claims. The Company has established a liability for outstanding claims and incurred, but unreported, claims. While management uses what it believes are pertinent factors in estimating the liability, it is subject to change due to claim experience, type of claims, and rising medical costs.

**Off-Balance Sheet Financial Instruments:** In the ordinary course of business, the Company enters into various types of transactions that involve financial instruments with off-balance sheet risk. These instruments include commitments to extend credit and standby letters of credit and are not reflected in the accompanying balance sheets. These transactions may involve to varying degrees credit and interest rate risk in excess of the amount, if any, recognized in the balance sheets. Management does not anticipate any loss as a result of these commitments.

The Company's off-balance sheet credit risk exposure is the contractual amount of commitments to extend credit and standby letters of credit. The Company applies the same credit standards to these contracts as it uses in its lending process.

|              |      |      |
|--------------|------|------|
| December 31, | 2006 | 2005 |
|--------------|------|------|

*(In Thousands)*

## Off-balance sheet commitments:

|                              |           |           |
|------------------------------|-----------|-----------|
| Commitments to extend credit | \$144,364 | \$151,316 |
| Standby letters of credit    | 27,685    | 20,788    |

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. Although currently subject to draw down, many of the commitments do not necessarily represent future cash requirements. Collateral held relating to these commitments varies, but generally includes real estate, inventory, accounts receivable, and equipment.

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.

**NOTE 19 Regulatory Matters**

The Company and Northrim Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and

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Northrim Bank must meet specific capital guidelines that involve quantitative measures of the Company's and Northrim Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory practices. The Company's and Northrim Bank's capital amounts and classification are also subject to qualitative judgment by the regulators about components, risk weightings, and other factors.

Federal banking agencies have established minimum amounts and ratios of total and Tier I capital to risk-weighted assets, and of Tier I capital to average assets. The regulations set forth the definitions of capital, risk-weighted and average assets. As of December 15, 2006, the most recent notification from the FDIC categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. Management believes, as of December 31, 2006, that the Company and Northrim Bank met all capital adequacy requirements.

The tables below illustrate the capital requirements for the Company and the Bank and the actual capital ratios for each entity that exceed these requirements. 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. The capital ratios for the Company exceed those for the 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 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 and \$8 million more in regulatory capital than the Bank at December 31, 2006 and 2005, respectively, which explains most of the difference in the capital ratios for the two entities.

| Consolidated                             | Actual    |        | Adequately-Capitalized |       | Well-Capitalized |       |
|------------------------------------------|-----------|--------|------------------------|-------|------------------|-------|
|                                          | Amount    | Ratio  | Amount                 | Ratio | Amount           | Ratio |
| <i>(In Thousands)</i>                    |           |        |                        |       |                  |       |
| <b>As of December 31, 2006:</b>          |           |        |                        |       |                  |       |
| Total Capital (to risk-weighted assets)  | \$116,991 | 14.21% | \$65,864               | 8.0%  | \$82,330         | 10.0% |
| Tier I Capital (to risk-weighted assets) | \$106,674 | 12.95% | \$32,949               | 4.0%  | \$49,424         | 6.0%  |
| Tier I Capital (to average assets)       | \$106,674 | 11.71% | \$36,439               | 4.0%  | \$45,548         | 5.0%  |
| <b>As of December 31, 2005:</b>          |           |        |                        |       |                  |       |
| Total Capital (to risk-weighted assets)  | \$106,587 | 13.35% | \$63,872               | 8.0%  | \$79,840         | 10.0% |
| Tier I Capital (to risk-weighted assets) | \$96,598  | 12.10% | \$31,933               | 4.0%  | \$47,900         | 6.0%  |
| Tier I Capital (to average assets)       | \$96,598  | 10.81% | \$35,744               | 4.0%  | \$44,680         | 5.0%  |

| Northrim Bank                           | Actual    |        | Adequately-Capitalized |       | Well-Capitalized |       |
|-----------------------------------------|-----------|--------|------------------------|-------|------------------|-------|
|                                         | Amount    | Ratio  | Amount                 | Ratio | Amount           | Ratio |
| <i>(In Thousands)</i>                   |           |        |                        |       |                  |       |
| <b>As of December 31, 2006:</b>         |           |        |                        |       |                  |       |
| Total Capital (to risk-weighted assets) | \$101,520 | 12.35% | \$65,762               | 8.0%  | \$82,202         | 10.0% |

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|                                          |          |        |          |      |          |      |
|------------------------------------------|----------|--------|----------|------|----------|------|
| Tier I Capital (to risk-weighted assets) | \$91,220 | 11.09% | \$32,902 | 4.0% | \$49,353 | 6.0% |
| Tier I Capital (to average assets)       | \$91,220 | 10.06% | \$36,270 | 4.0% | \$45,338 | 5.0% |

**As of December 31, 2005:**

|                                          |          |        |          |      |          |       |
|------------------------------------------|----------|--------|----------|------|----------|-------|
| Total Capital (to risk-weighted assets)  | \$92,004 | 11.57% | \$63,616 | 8.0% | \$79,519 | 10.0% |
| Tier I Capital (to risk-weighted assets) | \$82,056 | 10.32% | \$31,805 | 4.0% | \$47,707 | 6.0%  |
| Tier I Capital (to average assets)       | \$82,056 | 9.24%  | \$35,522 | 4.0% | \$44,403 | 5.0%  |

**NOTE 20 Fair Value of Financial Instruments**

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

**Cash and Money Market Investments:** The carrying amounts reported in the balance sheet represent their fair values.

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

**Loans:** For variable-rate loans that reprice frequently, fair values are based on carrying amounts. An estimate of the fair value of the remaining portfolio is based on discounted cash flow analyses applied to pools of similar loans, using weighted average coupon rate, weighted average maturity, and interest rates currently being offered for similar loans. The carrying amount of accrued interest receivable approximates its fair value.

**Purchased Receivables:** Fair values for purchased receivables are based on their carrying amounts due to their short duration and repricing frequency.

**Deposit Liabilities:** The fair values of demand and savings deposits are equal to the carrying amount at the reporting date. The carrying amount for variable-rate time deposits approximate their fair value. Fair values for fixed-rate time deposits are estimated using a discounted cash flow calculation that applies currently offered interest rates to a schedule of aggregate expected monthly maturities of time deposits. The carrying amount of accrued interest payable approximates its fair value.

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

**Junior Subordinated Debentures:** The junior subordinated debentures have variable rates that adjust on a quarterly basis, thus their carrying amounts approximate their fair values.

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

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

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| December 31,                               | 2006               |               | 2005               |               |
|--------------------------------------------|--------------------|---------------|--------------------|---------------|
|                                            | Carrying<br>Amount | Fair<br>Value | Carrying<br>Amount | Fair<br>Value |
| <i>(In Thousands)</i>                      |                    |               |                    |               |
| <b>Financial Assets:</b>                   |                    |               |                    |               |
| Cash and money market investments          | \$44,282           | \$44,282      | \$89,690           | \$89,690      |
| Investment securities                      | 100,325            | 100,324       | 54,975             | 54,996        |
| Net loans                                  | 704,931            | 698,346       | 694,353            | 686,984       |
| Purchased receivables                      | 21,183             | 21,183        | 12,198             | 12,198        |
| Accrued interest receivable                | 4,916              | 4,916         | 4,397              | 4,397         |
| <b>Financial Liabilities:</b>              |                    |               |                    |               |
| Deposits                                   | \$794,904          | \$794,520     | \$779,866          | \$779,677     |
| Accrued interest payable                   | 577                | 577           | 469                | 469           |
| Borrowings                                 | 6,502              | 6,395         | 8,415              | 8,271         |
| Junior subordinated debentures             | 18,558             | 18,558        | 18,558             | 18,558        |
| <b>Unrecognized Financial Instruments:</b> |                    |               |                    |               |
| Commitments to extend credit               | \$144,364          | \$1,444       | \$151,316          | \$1,513       |
| Standby letters of credit                  | 27,685             | 277           | 20,788             | 208           |

**NOTE 21 Quarterly Results of Operations (Unaudited)**

| 2006 Quarter Ended                               | Dec. 31  | Sept. 30 | June 30  | March 31 |
|--------------------------------------------------|----------|----------|----------|----------|
| <i>(In Thousands Except Per Share Amounts)</i>   |          |          |          |          |
| Total interest income                            | \$18,653 | \$17,841 | \$16,963 | \$16,064 |
| Total interest expense                           | 5,893    | 5,904    | 5,437    | 4,765    |
| Net interest income                              | 12,760   | 11,937   | 11,526   | 11,299   |
| Provision for loan losses                        | 800      | 850      | 860      | 54       |
| Other operating income                           | 2,076    | 2,203    | 1,951    | 1,428    |
| Other operating expense                          | 8,028    | 7,661    | 7,715    | 7,964    |
| Income before income taxes and minority interest | 6,008    | 5,629    | 4,902    | 4,709    |

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|                                   |         |         |         |         |
|-----------------------------------|---------|---------|---------|---------|
| Minority interest in subsidiaries | 78      | 70      | 103     | 45      |
| Pre tax income                    | 5,930   | 5,559   | 4,799   | 4,664   |
| Income taxes                      | 2,241   | 2,108   | 1,860   | 1,769   |
| Net Income                        | \$3,689 | \$3,451 | \$2,939 | \$2,895 |
| Earnings per share, basic         | \$0.60  | \$0.56  | \$0.48  | \$0.47  |
| Earnings per share, diluted       | \$0.59  | \$0.56  | \$0.47  | \$0.47  |

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| <b>2005 Quarter Ended</b>                      | <b>Dec. 31</b> | <b>Sept. 30</b> | <b>June 30</b> | <b>March 31</b> |
|------------------------------------------------|----------------|-----------------|----------------|-----------------|
| <i>(In Thousands Except Per Share Amounts)</i> |                |                 |                |                 |
| Total interest income                          | \$16,344       | \$15,047        | \$14,078       | \$13,312        |
| Total interest expense                         | 4,730          | 3,910           | 3,403          | 2,83            |
| Net interest income                            | 11,614         | 11,137          | 10,675         | 10,482          |
| Provision for loan losses                      | 642            | 428             | 100            |                 |
| Other operating income                         | 1,426          | 1,494           | 1,065          | 848             |
| Other operating expense                        | 7,371          | 7,605           | 7,373          | 7,128           |
| Income before income taxes                     | 5,027          | 4,598           | 4,267          | 4,202           |
| Income taxes                                   | 1,935          | 1,756           | 1,611          | 1,622           |
| Net Income                                     | \$3,092        | \$2,842         | \$2,656        | \$2,580         |
| Earnings per share, basic                      | \$0.51         | \$0.46          | \$0.42         | \$0.40          |
| Earnings per share, diluted                    | \$0.49         | \$0.44          | \$0.40         | \$0.39          |

The sum may not necessarily tie to Consolidated Statements of Income due to rounding.

**NOTE 22 Disputes and Claims**

The Company from time to time may be involved with disputes, claims, and litigation related to the conduct of its banking business. In December of 2006, the Company became aware of a lawsuit related to its purchase of NBG. The Company believes that this claim is without merit and intends to vigorously defend against it. In the opinion of management, the resolution of these matters will not have a material effect on the Company's financial position, results of operations, and cash flows.



**Table of Contents****NOTE 23 Parent Company Financial Information**

Condensed financial information for Northrim BanCorp, Inc. (unconsolidated parent company only) is as follows:

| Balance Sheets for December 31,                                                                         | 2006                  | 2005             | 2004            |
|---------------------------------------------------------------------------------------------------------|-----------------------|------------------|-----------------|
|                                                                                                         | <i>(In Thousands)</i> |                  |                 |
| <b>Assets</b>                                                                                           |                       |                  |                 |
| Cash                                                                                                    | \$12,629              | \$11,014         | \$8,735         |
| Investment in Northrim Bank                                                                             | 97,806                | 87,922           | 80,797          |
| Investment in NISC                                                                                      | 2,530                 | 2,484            | 552             |
| Investment in NCT1                                                                                      | 248                   | 248              | 248             |
| Investment in NST2                                                                                      | 310                   | 310              |                 |
| Other assets                                                                                            | 440                   | 891              | 252             |
| <b>Total Assets</b>                                                                                     | <b>\$113,963</b>      | <b>\$102,869</b> | <b>\$90,584</b> |
| <b>Liabilities</b>                                                                                      |                       |                  |                 |
| Junior subordinated debentures                                                                          | \$18,558              | \$18,558         | \$8,248         |
| Taxes payable and other payables                                                                        | (84)                  | (252)            | (1,084)         |
| Other liabilities                                                                                       | 71                    | 89               | 62              |
| <b>Total Liabilities</b>                                                                                | <b>18,395</b>         | <b>18,395</b>    | <b>7,226</b>    |
| <b>Shareholders' Equity</b>                                                                             |                       |                  |                 |
| Common stock                                                                                            | 6,114                 | 5,803            | 6,089           |
| Additional paid-in capital                                                                              | 46,379                | 39,161           | 45,876          |
| Retained earnings                                                                                       | 43,212                | 39,999           | 31,389          |
| Accumulated other comprehensive income-net unrealized gains on available for sale investment securities | (287)                 | (489)            | 4               |
| <b>Total Shareholders' Equity</b>                                                                       | <b>95,418</b>         | <b>84,474</b>    | <b>83,358</b>   |
| <b>Total Liabilities and Shareholders' Equity</b>                                                       | <b>\$113,963</b>      | <b>\$102,869</b> | <b>\$90,584</b> |

|                                       |      |      |      |
|---------------------------------------|------|------|------|
| Statements of Income for Years Ended: | 2006 | 2005 | 2004 |
|---------------------------------------|------|------|------|

|                                   | <i>(In Thousands)</i> |              |              |
|-----------------------------------|-----------------------|--------------|--------------|
| Income                            |                       |              |              |
| Interest income                   | \$578                 | \$229        | \$177        |
| Net income from Northrim Bank     | 14,432                | 12,118       | 11,659       |
| Net loss from NISC                | (170)                 | (233)        | (269)        |
| Other income                      |                       |              | 1            |
| <br>Total Income                  | <br>14,840            | <br>12,114   | <br>11,568   |
| Expense                           |                       |              |              |
| Interest expense                  | 1,360                 | 565          | 387          |
| Administrative and other expenses | 1,262                 | 846          | 954          |
| <br>Total Expense                 | <br>2,622             | <br>1,411    | <br>1,341    |
| Net Income Before Income Taxes    | 12,218                | 10,703       | 10,227       |
| Income tax expense (benefit)      | (756)                 | (467)        | (473)        |
| <br>Net Income                    | <br>\$12,974          | <br>\$11,170 | <br>\$10,700 |

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| Statements of Cash Flows for Years Ended:                      | 2006         | 2005<br>(In Thousands) | 2004        |
|----------------------------------------------------------------|--------------|------------------------|-------------|
| Operating Activities:                                          |              |                        |             |
| Net income                                                     | \$12,974     | \$11,170               | \$10,700    |
| Adjustments to Reconcile Net Income to Net Cash:               |              |                        |             |
| Equity in undistributed earnings from subsidiaries             | (9,512)      | (7,385)                | (8,015)     |
| Stock-based compensation                                       | 390          | 68                     |             |
| Changes in other assets and liabilities                        | 583          | 220                    | 398         |
| <br>Net Cash Used from Operating Activities                    | <br>4,435    | <br>4,073              | <br>3,083   |
| Investing Activities:                                          |              |                        |             |
| Investment in NISC & NCT1 & NST2                               | (210)        | (2,165)                | (250)       |
| <br>Net Cash Used by Investing Activities                      | <br>(210)    | <br>(2,165)            | <br>(250)   |
| Financing Activities:                                          |              |                        |             |
| Dividends paid to shareholders                                 | (2,768)      | (2,560)                | (2,308)     |
| Proceeds from issuance of trust preferred securities           |              | 10,000                 |             |
| Proceeds from issuance of common stock and excess tax benefits | 568          | 269                    | 300         |
| Repurchase of common stock                                     | (410)        | (7,338)                |             |
| <br>Net Cash Provided by Financing Activities                  | <br>(2,610)  | <br>371                | <br>(2,008) |
| <br>Net Increase by Cash and Cash Equivalents                  | <br>1,615    | <br>2,279              | <br>825     |
| <br>Cash and Cash Equivalents at beginning of period           | <br>11,014   | <br>8,735              | <br>7,910   |
| <br>Cash and Cash Equivalents at end of period                 | <br>\$12,629 | <br>\$11,014           | <br>\$8,735 |

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**Annual Report on Form 10-K**

Annual Report Under Section 13 of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2006.

Commission File Number 0-33501

Northrim BanCorp, Inc.  
State of Incorporation: Alaska  
Employer ID Number: 92-0175752  
3111 C Street  
Anchorage, Alaska 99503  
Telephone Number: (907) 562-0062

Securities Registered Pursuant to Section 12(b) of the Act: None

Securities Registered Pursuant to Section 12(g) of the Act: Common Stock, \$1.00 Par Value

Northrim BanCorp, Inc. has filed all reports required to be filed by Section 13 of the Securities and Exchange Act of 1934 during the preceding 12 months and has been subject to such filing requirements for the past 90 days.

Northrim BanCorp, Inc. is an accelerated filer within the meaning of Rule 12b-2 promulgated under the Securities Exchange Act.

Northrim BanCorp, Inc. is not a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Northrim BanCorp, Inc. is required to file reports pursuant to Section 13 of the Securities Exchange Act.

Northrim BanCorp, Inc. is not a shell company (as defined in Rule 12b-2 of the Securities Exchange Act).

Disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (17 C.F.R. 229.405) is in our definitive proxy statement, which is incorporated by reference in Part III of this Form 10-K.

The aggregate market value of common stock held by non-affiliates of Northrim BanCorp, Inc. at June 30, 2006, was \$133,680,506.

The number of shares of Northrim BanCorp's common stock outstanding at March 1, 2007, was 6,115,822.

This Annual Report on Form 10-K incorporates into a single document the requirements of the accounting profession and the SEC. Only those sections of the Annual Report required in the following cross reference index and the information under the caption "Forward Looking Statements" are incorporated into this Form 10-K.

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\*Northrim's definitive proxy statement for the 2007 Annual Shareholders' Meeting is incorporated herein by reference other than the section entitled "Report of the Compensation Committee on Executive Compensation", "Report of the Audit Committee," with attached Charter of the Audit Committee, and "Fees Billed by KPMG During Fiscal Years 2006 and 2005."

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### **General**

Northrim BanCorp, Inc. (the Company) is a publicly traded bank holding company with four wholly-owned subsidiaries, Northrim Bank (the Bank), a state chartered, full-service commercial bank; Northrim Investment Services Company (NISC), which we formed in November 2002 to hold the Company's 47% equity interest in Elliott Cove Capital Management LLC (Elliott Cove), an investment advisory services company; Northrim Capital Trust 1 (NCT1), an entity that we formed in May of 2003 to facilitate a trust preferred security offering by the Company, and Northrim Statutory Trust 2 (NST2), an entity that we formed in December of 2005 to facilitate a trust preferred security offering by the Company. The Company is regulated by the Board of Governors of the Federal Reserve System, and Northrim Bank is regulated by the Federal Deposit Insurance Corporation, and the State of Alaska Department of Community and Economic Development, Division of Banking, Securities and Corporations. We began banking operations in Anchorage in December 1990, and formed the Company in connection with our reorganization into a holding company structure; that reorganization was completed effective December 31, 2001.

### **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. Credit unions in Alaska have a 35% share of total statewide deposits of banks and credit unions. Recent changes in their regulations have eliminated the common bond of membership requirement and liberalized their lending authority to include business and real estate loans on a 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.

Management believes that Wells Fargo's acquisition of National Bank of Alaska (NBA), which occurred in 2000 and was completed in 2001, has opened up new opportunities for us to increase our market share in all of our markets. Long-time NBA customers have stated that our expanded branch network and product line are an excellent local alternative to an out-of-state bank. The Bank completed an extensive and comprehensive sales training program in 2003 that formed the basis for an aggressive, targeted calling effort to sell the benefits of banking with us to those potential customers. In 2006, the Bank continued with its sales calling and training efforts and plans to continue with this program in 2007. In addition, in the first part of 2005, the Bank launched its High Performance Checking product consisting of several consumer accounts tailored to the needs of specific segments of its market, including a Totally Free Checking account. The Bank supported this product with a targeted marketing program and extensive branch sales promotions and plans to continue with these efforts in 2007 and also promote a High Performance business checking product.

In the late 1980s, eight of the 13 commercial banks and savings and loan associations in Alaska failed, resulting in the largest commercial banks gaining significant market share. Currently, there are eight commercial banks operating in Alaska. Our management believes that we have benefited from the consolidation of larger financial institutions in Alaska as customers have sought the responsive and personalized service that we offer, resulting in consistency in achieving market share growth. Both our portfolio loans (excluding real estate loans for sale) and deposits increased 2% from year-end 2005 to year-end 2006. At June 30, 2006, the date of the most recently available information, we had approximately a 21% share of the Anchorage commercial bank deposits, approximately 9% in Fairbanks, and

10% in the Matanuska Valley.



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The following table sets forth market share data for the commercial banks having a presence in the greater Anchorage area as of June 30, 2006, the most recent date for which comparative deposit information is available.

**Market Share in Greater Anchorage Area**

| Financial institution         | Number of<br>branches | Total<br>deposits | Market share<br>of deposits |
|-------------------------------|-----------------------|-------------------|-----------------------------|
| <i>(Dollars in thousands)</i> |                       |                   |                             |
| Northrim Bank                 | 8 <sup>(1)</sup>      | \$656,735         | 21%                         |
| Wells Fargo Bank Alaska       | 14                    | 1,260,082         | 40%                         |
| First National Bank Alaska    | 10                    | 805,796           | 25%                         |
| Key Bank                      | 4                     | 411,111           | 13%                         |
| Alaska First Bank & Trust     | 2                     | 45,917            | 1%                          |
| Total                         | 47                    | \$3,179,641       | 100%                        |

(1) Does not reflect our Fairbanks or Wasilla branches

**Employees and Key Personnel**

We had 277 full-time equivalent employees at December 31, 2006. None of our employees are covered by a collective bargaining agreement. We consider our relations with our employees to be satisfactory.

We will be dependent for the foreseeable future on the services of R. Marc Langland, our Chairman of the Board, President and Chief Executive Officer; Christopher N. Knudson, our Executive Vice President and Chief Operating Officer; Joseph M. Schierhorn, our Executive Vice President and Chief Financial Officer, Joseph M. Beedle, our Executive Vice President and Chief Lending Officer; Steven L. Hartung, our Executive Vice President and Quality Assurance Officer; Victor P. Mollozzi, our Senior Vice President and Senior Credit Officer; and Robert L. Shake, our Senior Vice President and Executive Loan Manager. While we maintain keyman life insurance on the lives of Messrs. Langland, Knudson, Schierhorn, Beedle, Mollozzi, and Shake in the amounts of \$2.5 million, \$2.1 million, \$1 million, \$2 million, \$1 million, and \$1 million, respectively, we may not be able to timely replace Mr. Langland, Mr. Knudson, Mr. Schierhorn, Mr. Mollozzi, or Mr. Shake 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 Mr. Hartung.

**Alaska Economy**

All of our operations are in the greater Anchorage, Matanuska Valley, and Fairbanks, areas of Alaska. Because of our geographic concentration, our operations and growth depend on economic conditions in Alaska, generally, and the greater Anchorage, Matanuska Valley, and Fairbanks areas in particular. A material portion of our loans at December 31, 2006, were secured by real estate located in greater Anchorage, Matanuska Valley, and Fairbanks,

Alaska. Moreover, 30% 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 Holding Company, our mortgage real estate affiliate. 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. Any decline in real estate values in the greater Anchorage, Matanuska Valley, and Fairbanks 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. In addition, at December 31, 2006, \$287.3 million, or 40%, 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, and for the past 24 years, 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 \$1,107 per eligible resident in 2006 for an aggregate distribution of approximately \$667 million. The Anchorage Economic Development Corporation estimates that, for most Anchorage households, distributions from the Alaska Permanent Fund exceed other taxes to which those households are subject (primarily real estate taxes).

Alaska is strategically located on the Pacific Rim, nine hours by air from 95% of the industrialized world, and has become a worldwide cargo and transportation link between the United States and international business in Asia and Europe. Anchorage's airport is now rated first in the nation in terms of landed tonnage of international cargo. Key sectors of the Alaska economy are the oil

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industry, government and military spending, and the construction, fishing, forest products, tourism, mining, air cargo, and transportation industries, as well as medical services.

The petroleum industry plays a significant role in the economy of Alaska. Royalty payments and tax revenue related to North Slope oil fields provide over 86% of the revenue used to fund state government operations. Although oil prices increased to above \$60 per barrel during 2006, the state's largest producers, ConocoPhillips and British Petroleum, both kept exploration drilling at approximately the same levels as they were in 2005. In addition, 2002 marked the entry of several independent and international oil companies onto the North Slope of Alaska that now include EnCana, Armstrong Resources, Pioneer, Tailsman, and Winstar Petroleum. Also, Shell Oil recently returned to Alaska with plans to explore several large regions of the state. Several of the independents drilled wells over the last several years and have plans to continue with their drilling efforts in 2007. Finally, British Petroleum increased their capital spending on maintenance of the Prudhoe Bay oil field due to environmental concerns. As a result, total spending and employment by the industry appears to have increased in 2006.

Another major development in the petroleum industry in 2004 was passage of legislation by the United States Congress that provides incentives for the construction of a pipeline to transport natural gas from the North Slope of Alaska to the Continental United States. This project is estimated to cost in excess of \$20 billion and would provide Alaska with additional revenue from severance taxes on the natural gas. The oil companies that own the natural gas, namely ConocoPhillips, Exxon, and British Petroleum negotiated a contract with the State of Alaska in 2006. However, that contract was never finally approved by the state. The current state administration is in the process of drafting legislation to establish guidelines for negotiating a new pipeline construction contract, which could further delay the start of this project.

Tourism is another major employment sector of the Alaska economy. The events of September 11, 2001 had a negative effect on bookings for 2002. The industry reported further declines in 2003 as a result of a slower national economy in the first part of 2003. However, in 2005 and 2006, the industry reported increases due in part to an improving national economy.

In addition to the challenges in several of Alaska's major industries, the state has faced a fiscal gap in prior years because its operating expenditures have exceeded the revenues it collects in the form of taxes and royalty payments that have come mainly from the oil industry for several years. The fiscal gap has been filled by the Constitutional Budget Reserve fund ( CBR ) that was created for this situation. Although the state has recently experienced budget surpluses in 2004, 2005, and 2006 due to the recent rise in oil prices and projects a larger budget surplus for the fiscal year ending June 30, 2007, it still projects that the fiscal gap will continue to widen in future years and that the CBR could be depleted within several years. Over the past several years, the public and the legislature have debated a number of proposals to solve the fiscal gap that include the following: 1) implementing a personal income tax (currently Alaska has only a corporate income tax), 2) assessing a state-wide sales tax (sales tax rates vary by community, and Anchorage, Alaska's largest city, does not have a sales tax), 3) utilizing a portion of the earnings from the Alaska Permanent Fund, which would decrease the size of the annual dividend paid to all Alaska residents, and/or 4) a reduction in state expenditures. While Alaska appears to have the resources to solve the fiscal gap, political decisions are required to solve the problem. We cannot predict the type nor the timing of the solution and the ultimate impact on the Alaska economy.

## **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 in that capacity also regulates Northrim Bank. The Company's affiliated investment company, Elliott Cove, is subject to and regulated under the Investment Advisors Act of 1940 and applicable state investment advisor rules and regulations.

The Company's earnings and activities are affected by legislation, by actions of the FRB, the Division, the FDIC and other regulators, and by local legislative and administrative bodies and decisions of courts in Alaska. For example, 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.

Congress enacted major federal financial institution legislation in 1999. Title I of the Gramm-Leach-Bliley Act (the GLB Act), which became effective March 11, 2000, allows bank holding companies to elect to become financial holding companies. 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. It is likely that the Company will utilize the new structure to accommodate an expansion of its products and services.

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The activities of bank holding companies, such as the Company, that are not financial holding companies, are generally limited to managing or controlling banks. 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 activities of a bank holding company are also generally limited to the acquisition of up to 5% of the voting shares 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 the most extensive consumer privacy provisions ever enacted by Congress. 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 have adopted privacy regulations. In addition, the states are permitted to adopt more extensive privacy protections through legislation or regulation.

Additional legislation may be enacted or regulations imposed to further regulate banking and financial services or to limit finance charges or other fees or charges earned in such activities. There can be no assurance whether any such legislation or regulation will place additional limitations on the Company's operations or adversely affect its earnings.

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 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.

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 expressly permitted by the 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 and unsound practices.

Specifically with regard to the payment of dividends, there 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. Additionally, depending upon the circumstances, the FDIC or the Division could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

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

The Company and Northrim Bank are subject to risk-based capital and leverage guidelines issued by federal banking agencies for banks and bank holding companies. These agencies are required by law to take specific prompt corrective actions with respect to institutions that do not meet minimum capital standards and have defined five capital tiers, the highest of which is well-capitalized.

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, deposits in offices and certain claims for administrative expenses and employee compensation 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.

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

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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 financial institutions, such as 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, 2006.

Our earnings are affected by general economic conditions and the conduct of monetary policy by the U.S. government.

## **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.

***Adequacy of Loan Loss Allowance:*** 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 collectibility 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 revenues and financial condition.

***Growth and Management:*** Our financial performance and profitability will depend on our ability to manage recent and possible future growth. Although we believe that we have substantially integrated the business and operations of past acquisitions, there can be no assurance that unforeseen issues relating to the acquisitions will not adversely affect us. In addition, any future acquisitions and continued growth may present operating and other problems that could have an adverse effect on our business, financial condition and results of operations. Accordingly, there can be no assurance that we will be able to execute our growth strategy or maintain the level of profitability that we have experienced in the past.

***Changes in Market Interest Rates:*** 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. Given our current volume and mix of interest bearing liabilities and interest-earning assets, net interest margin could be expected to decrease during times

when interest rates rise in a parallel shift along the yield curve and, conversely, to increase during times of similar falling interest rates. Exposure to interest rate risk is managed by monitoring the re-pricing 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 affect on our business, financial condition and results of operations.

**Geographic Concentration:** Substantially all of our business is derived from the Anchorage, Matanuska Valley, and Fairbanks, areas of Alaska. 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. 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.

**Regulation:** We are subject to government regulation that could limit or restrict our activities, which in turn could adversely impact our operations. The financial services industry is regulated extensively. Federal and state regulation is designed primarily to protect the deposit insurance funds and consumers, as well as our shareholders. These regulations can sometimes impose significant



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limitations on our operations. In addition, these regulations are constantly evolving and may change significantly over time. Significant new laws or changes in existing laws or repeal of existing laws may cause our results to differ materially. Further, federal monetary policy, particularly as implemented through the Federal Reserve System, can significantly affect credit availability. Federal legislation such as Sarbanes-Oxley can dramatically shift resources and costs to insure adequate compliance.

**Competition:** Competition may adversely affect our performance. 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. Our results may differ in future periods depending upon the nature and/or level of competition.

**Credit Risk:** 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 the allowance for credit 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.

**Table of Contents****Properties**

The following sets forth information about our branch locations:

| <b>Locations</b>                                                            | <b>Type</b> | <b>Leased/Owned</b>         |
|-----------------------------------------------------------------------------|-------------|-----------------------------|
| Midtown Financial Center: Northrim Headquarters3111 C Street, Anchorage, AK | Traditional | Leased                      |
| SouthSide Financial Center8730 Old Seward Highway, Anchorage, AK            | Traditional | Land leased; building owned |
| 36th Avenue Branch811 East 36th Avenue, Anchorage, AK                       | Traditional | Owned                       |
| Huffman Branch1501 East Huffman Road, Anchorage, AK                         | Supermarket | Leased                      |
| Jewel Lake Branch9170 Jewel Lake Road, Anchorage, AK                        | Traditional | Leased                      |
| Seventh Avenue Branch550 West Seventh Avenue, Anchorage, AK                 | Traditional | Leased                      |
| West Anchorage Branch/Small Business Center2709 Spenard Road, Anchorage, AK | Traditional | Owned                       |
| Eagle River Branch12812 Old Glenn Highway, Fire Lake Plaza, Eagle River, AK | Traditional | Leased                      |
| Fairbanks Financial Center714 Fourth Avenue, Suite 100, Fairbanks, AK       | Traditional | Leased                      |
| Wasilla Financial Center850 E. USA Circle, Suite A, Wasilla, AK             | Traditional | Owned                       |

**Financial Statements and Exhibits****Financial Statements**

The following financial statements of the Company, included in the Annual Report to Shareholders for the year ended December 31, 2006, are incorporated by reference in Item 8:

Consolidated Balance Sheets as of December 31, 2006 and 2005

Consolidated Statements of Income for the years ended December 31, 2006, 2005, and 2004

Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Income for the years ended December 31, 2006, 2005, and 2004

Consolidated Statements of Cash Flows for the years ended December 31, 2006, 2005, and 2004

Notes to Consolidated Financial Statements

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**Exhibits**

Index to Exhibits

| <b>Exhibit<br/>Number</b> | <b>Name of Document</b>                                                                                                                                                                                                                                                 |
|---------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1                       | Amended and Restated Articles of Incorporation <sup>(1)</sup>                                                                                                                                                                                                           |
| 3.2                       | Bylaws <sup>(1)</sup>                                                                                                                                                                                                                                                   |
| 4.1                       | Form of Common Stock Certificate <sup>(1)</sup>                                                                                                                                                                                                                         |
| 4.2                       | Pursuant to Section 6.0(b)(4)(iii)(A) of Regulation S-K, copies of instruments defining rights of holders of long-term debt and preferred securities are not filed. The Company agrees to furnish a copy thereof to the Securities and Exchange Commission upon request |
| 4.3                       | Indenture dated as of December 16, 2006 <sup>(5)</sup>                                                                                                                                                                                                                  |
| 4.4                       | Form of Junior Subordinated Debt Security due 2036 <sup>(5)</sup>                                                                                                                                                                                                       |
| 10.1                      | Employee Stock Option and Restricted Stock Award Plan <sup>(1)</sup>                                                                                                                                                                                                    |
| 10.2                      | 2000 Employee Stock Incentive Plan <sup>(1)</sup>                                                                                                                                                                                                                       |
| 10.7                      | Plan and Agreement of Reorganization between the Registrant and Northrim Bank dated as of March 7, 2001 <sup>(2)</sup>                                                                                                                                                  |
| 10.8                      | Supplemental Executive Retirement Plan dated July 1, 1994, as amended January 8, 2004 <sup>(3)</sup>                                                                                                                                                                    |
| 10.9                      | Supplemental Executive Retirement Deferred Compensation Plan <sup>(2)</sup>                                                                                                                                                                                             |
| 10.10                     | 2004 Stock Incentive Plan <sup>(3)</sup>                                                                                                                                                                                                                                |
| 10.11                     | Employment Agreement with Robert Shake <sup>(4)</sup>                                                                                                                                                                                                                   |
| 10.12                     | Capital Securities Purchase Agreement dated December 14, 2005 <sup>(5)</sup>                                                                                                                                                                                            |
| 10.13                     | Amended and Restated Declaration of Trust Northrim Statutory Trust 2 dated as of December 16, 2005 <sup>(5)</sup>                                                                                                                                                       |
| 10.14                     | Amended and Restated Employment Agreement with Joseph M. Beedle <sup>(6)</sup>                                                                                                                                                                                          |
| 10.15                     | Amended and Restated Employment Agreement with R. Marc Langland <sup>(7)</sup>                                                                                                                                                                                          |
| 10.16                     | Amended and Restated Employment Agreement with R. Marc Langland <sup>(8)</sup>                                                                                                                                                                                          |
| 10.17                     | Amended and Restated Employment Agreement with Joseph M. Schierhorn <sup>(8)</sup>                                                                                                                                                                                      |
| 10.18                     | Amended and Restated Employment Agreement with Christopher N. Knudson <sup>(8)</sup>                                                                                                                                                                                    |
| 10.19                     | Amended and Restated Employment Agreement with Joseph M. Beedle <sup>(8)</sup>                                                                                                                                                                                          |
| 10.20                     | Amended and Restated Employment Agreement with Victor P. Mollozzi <sup>(8)</sup>                                                                                                                                                                                        |
| 21                        | Subsidiaries                                                                                                                                                                                                                                                            |
|                           | Northrim Bank                                                                                                                                                                                                                                                           |
|                           | Northrim Investment Services Company                                                                                                                                                                                                                                    |
|                           | Northrim Capital Trust 1                                                                                                                                                                                                                                                |
| 23                        | Consent of KPMG LLP <sup>(8)</sup>                                                                                                                                                                                                                                      |
| 24                        | Power of Attorney <sup>(8)</sup>                                                                                                                                                                                                                                        |
| 31.1                      | Certification of Chief Executive Officer pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 <sup>(8)</sup>                                                                                                              |
| 31.2                      | Certification of Chief Financial Officer pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 <sup>(8)</sup>                                                                                                              |
| 32.1                      | Certification of Chief Executive Officer pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 <sup>(8)</sup>                                                                                                              |
| 32.2                      | Certification of the Chief Financial Officer pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 <sup>(8)</sup>                                                                                                          |

- (1) Incorporated by reference to the Company's Form 8-A, filed with the SEC on January 14, 2002
- (2) Incorporated by reference to the Company's Form 10-K for the year ended December 31, 2002, filed with the SEC on March 19, 2003
- (3) Incorporated by reference to the Company's Form 10-K for the year ended December 31, 2003, filed with the SEC on March 15, 2004
- (4) Incorporated by reference to the Company's Form 10-K for the year ended December 31, 2004, filed with the SEC on March 15, 2005
- (5) Incorporated by reference to the Company's Form 10-K for the year ended December 31, 2005, filed with the SEC on March 16, 2006
- (6) Incorporated by reference to the Company's Form 8-K, filed with the SEC on May 19, 2006
- (7) Incorporated by reference to the Company's Form 8-K, filed with the SEC on June 2, 2006
- (8) Filed with this Form 10-K

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**Signatures**

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 12th day of March, 2007.

**Northrim BanCorp, Inc.**

By /s/ R. Marc Langland

R. Marc Langland  
Chairman, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated, on the 12th day of March, 2007.

Principal Executive Officer:

/s/ R. Marc Langland  
R. Marc Langland  
Chairman, President and Chief Executive Officer

Principal Financial Officer:

/s/ Joseph M. Schierhorn  
Joseph M. Schierhorn  
Executive Vice President, Chief Financial Officer,  
Compliance Manager

R. Marc Langland, pursuant to powers of attorney, which are being filed with this Annual Report on Form 10-K, has signed this report on March 12, 2007, as attorney-in-fact for the following directors who constitute a majority of the Board of Directors.

Larry S. Cash  
Mark G. Copeland  
Frank A. Danner  
Anthony Drabek  
Christopher N. Knudson

R. Marc Langland  
Richard L. Lowell  
Irene Sparks Rowan  
John C. Swalling  
David G. Wight

By /s/ R. Marc Langland

R. Marc Langland  
as Attorney-in-fact

March 12, 2007

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**Investor Information**

**Annual Meeting**

Date: Thursday, May 3, 2007  
Time: 9 a.m.  
Location: Hilton Anchorage Hotel  
500 West Third Avenue  
Anchorage, AK 99501

**Stock Symbol**

Northrim BanCorp, Inc. s stock is traded on the Nasdaq Stock Market under the symbol, NRIM.

**Auditor**

KPMG LLP

**Transfer Agent and Registrar**

American Stock Transfer & Trust Company: 1-800-937-5449 info@amstock.com

**Legal Counsel**

Davis Wright Tremaine LLP

**Information Requests**

Below are options for obtaining Northrim s investor information:

Visit our home page, [www.northrim.com](http://www.northrim.com), and click on the *For Investors* section for stock information and copies of earnings and dividend releases.

If you would like to be added to Northrim s investor e-mail list or have investor information mailed to you, send a request to [investors@nrim.com](mailto:investors@nrim.com) or call our Corporate Secretary at (907) 261-3301.

*Written requests should be mailed to the following address:*

Corporate Secretary  
Northrim Bank  
P.O. Box 241489  
Anchorage, Alaska 99524-1489

Telephone: (907) 562-0062  
Fax: (907) 562-1758  
E-mail: [investors@nrim.com](mailto:investors@nrim.com)  
Web site: <http://www.northrim.com>