NORTHRIM BANCORP INC
Form 10-Q
May 07, 2018

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q
(Mark One)
þ Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2018
o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from_____to____
Commission File Number 000-33501
NORTHRIM BANCORP, INC.
(Exact name of registrant as specified in its charter)

Alaska	92-0175752
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

(907) 562-0062

(Registrant's telephone number, including area code)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
ý Yes ¨ No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
ý Yes ¨ No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:
Large Accelerated Filer ¨ Accelerated Filer ý Non-accelerated Filer ¨
Smaller Reporting Company ¨ Emerging Growth Company ¨

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
¨ Yes ý No
The number of shares of the issuer's Common Stock, par value $1 per share, outstanding at May 7, 2018 was 6,871,963.

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PART I. FINANCIAL INFORMATION

These consolidated financial statements should be read in conjunction with the financial statements, accompanying notes and other relevant information included in Northrim BanCorp, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2017.

ITEM 1. FINANCIAL STATEMENTS

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

(In Thousands, Except Share Data)	March 31, 2018	December 31, 2017
ASSETS		
Cash and due from banks	$15,170	$25,016
Interest bearing deposits in other banks	68,792	52,825
Investment securities available for sale, at fair value	297,573	307,019
Marketable securities	5,527	5,731
Investment in Federal Home Loan Bank stock	2,105	2,115
Loans held for sale	41,216	43,979
Loans	967,575	954,953
Allowance for loan losses	(20,449)	(21,461)
Net loans	947,126	933,492
Purchased receivables, net	19,412	22,231
Other real estate owned, net	8,815	8,651
Premises and equipment, net	37,331	37,867
Mortgage servicing rights, at fair value	8,039	7,305
Goodwill	15,017	15,017
Other intangible assets, net	1,190	1,207
Other assets	57,428	56,141
Total assets	$1,524,741	$1,518,596
LIABILITIES		
Deposits:		
Demand	$433,046	$414,686
Interest-bearing demand	244,601	252,009
Savings	246,981	247,458
Money market	239,242	243,603
Certificates of deposit less than $250,000	67,684	69,283
Certificates of deposit $250,000 and greater	29,236	31,244
Total deposits	1,260,790	1,258,283
Securities sold under repurchase agreements	31,018	27,746
Borrowings	7,338	7,362
Junior subordinated debentures	10,310	10,310
Other liabilities	20,312	22,093
Total liabilities	1,329,768	1,325,794
SHAREHOLDERS' EQUITY		
Preferred stock, $1 par value, 2,500,000 shares authorized, none issued or outstanding	—	—
Common stock, $1 par value, 10,000,000 shares authorized, 6,871,963 issued and outstanding at March 31, 2018 and December 31, 2017	6,872	6,872
Additional paid-in capital	62,046	61,793
Retained earnings	126,934	124,407
Accumulated other comprehensive loss	(879)	(270)
Total shareholders' equity	194,973	192,802
Total liabilities and shareholders' equity	$1,524,741	$1,518,596

See notes to consolidated financial statements

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

(In Thousands, Except Per Share Data)	Three Months Ended March 31, 2018	2017
Interest Income		
Interest and fees on loans and loans held for sale	$13,263	$13,238
Interest on investment securities available for sale	1,254	1,078
Dividends on marketable securities	82	86
Interest on investment securities held to maturity	12	15
Interest on deposits in other banks	184	48
Total Interest Income	14,795	14,465
Interest Expense		
Interest expense on deposits	372	445
Interest expense on securities sold under agreements to repurchase	9	8
Interest expense on borrowings	58	38
Interest expense on junior subordinated debentures	93	141
Total Interest Expense	532	632
Net Interest Income	14,263	13,833
Provision for loan losses	—	400
Net Interest Income After Provision for Loan Losses	14,263	13,433
Other Operating Income		
Mortgage banking income	4,944	5,450
Employee benefit plan income	—	936
Purchased receivable income	840	689
Bankcard fees	625	581
Service charges on deposit accounts	354	439
Gain on sale of securities, net	—	14
Other income	699	796
Total Other Operating Income	7,462	8,905
Other Operating Expense		
Salaries and other personnel expense	10,585	10,842
Occupancy expense	1,700	1,621
Data processing expense	1,548	1,247
Marketing expense	632	510
Professional and outside services	499	622
Insurance expense	296	253
OREO expense, net rental income and gains on sale	103	177
Intangible asset amortization expense	18	26
Compensation expense - RML acquisition payments	—	174
Other operating expense	1,414	1,143
Total Other Operating Expense	16,795	16,615
Income Before Provision for Income Taxes	4,930	5,723
Provision for income taxes	868	1,801
Net Income	4,062	3,922
Less: Net income attributable to the noncontrolling interest	—	97
Net Income Attributable to Northrim BanCorp, Inc.	$4,062	$3,825
Earnings Per Share, Basic	$0.59	$0.55

Earnings Per Share, Diluted	$0.58	$0.55
Weighted Average Shares Outstanding, Basic	6,871,963	6,909,780
Weighted Average Shares Outstanding, Diluted	6,968,082	6,993,726

See notes to consolidated financial statements

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

(In Thousands)	Three Months Ended March 31, 2018	2017
Net income	$4,062	$3,922
Other comprehensive income (loss), net of tax:		
Securities available for sale:		
Unrealized gains (losses) arising during the period	($1,145)	$597
Reclassification of net (gains) losses included in net income (net of tax (benefit) expense) of $0 and $6 for the first quarter of 2018 and 2017, respectively	—	(8)
Derivatives and hedging activities:		
Unrealized gains arising during the period	467	—
Income tax benefit (expense) related to unrealized gains and losses	260	(223)
Other comprehensive income (loss), net of tax	(418)	366
Comprehensive income	3,644	4,288
Less: comprehensive income attributable to the noncontrolling interest	—	97
Comprehensive income attributable to Northrim BanCorp, Inc.	$3,644	$4,191

See notes to consolidated financial statements

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NORTHRIM BANCORP, INC.
Consolidated Statements of Changes in Shareholders' Equity
(Unaudited)

	Common Stock				Accumulated		
(In Thousands)	Number of Shares	Par Value	Additional Paid-in Capital	Retained Earnings	Other Comprehensive Income (Loss)	Non-controlling Interest	Total
Balance as of January 1, 2017	6,898	$6,898	$62,952	$117,141	($397)	$118	$186,712
Cash dividend declared	—	—	—	(5,970)	—	—	(5,970)
Stock-based compensation expense	—	—	665	—	—	—	665
Exercise of stock options and vesting of restricted stock units, net	32	32	(275)	—	—	—	(243)
Treasury stock buy-back	(58)	(58)	(1,549)	—	—	—	(1,607)
Distributions to noncontrolling interest	—	—	—	—	—	(445)	(445)
Other comprehensive income, net of tax	—	—	—	—	212	—	212
Reclassification for remeasuring of deferred tax assets related to investment securities	—	—	—	85	(85)	—	—
Net income attributable to the noncontrolling interest	—	—	—	—	—	327	327
Net income attributable to Northrim BanCorp, Inc.	—	—	—	13,151	—	—	13,151
Twelve Months Ended December 31, 2017	6,872	$6,872	$61,793	$124,407	($270)	$—	$192,802
Cash dividend declared	—	—	—	(1,664)	—	—	(1,664)
Stock-based compensation expense	—	—	253	—	—	—	253
Other comprehensive loss, net of tax	—	—	—	—	(418)	—	(418)
Cumulative effect of adoption of accounting principles related to premium amortization of investment securities	—	—	—	(62)	—	—	(62)
Reclassification for cumulative effect of adoption of accounting principles related to fair value measurement of equity securities	—	—	—	191	(191)	—	—
Net income attributable to Northrim BanCorp, Inc.	—	—	—	4,062	—	—	4,062
Three Months Ended March 31, 2018	6,872	$6,872	$62,046	$126,934	($879)	$—	$194,973

See notes to consolidated financial statements

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

	Three Months Ended March 31,	
(In Thousands)	2018	2017
Operating Activities:		
Net income	$4,062	$3,922
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Gain on sale of securities, net	—	(14)
Gain on disposal of premises and equipment	(28)	(80)
Depreciation and amortization of premises and equipment	716	644
Amortization of software	303	32
Intangible asset amortization	18	26
Amortization of investment security premium, net of discount accretion	55	60
Deferred tax liability	(260)	398
Stock-based compensation	253	128
Deferral of loan fees and costs, net	(48)	(41)
Provision for loan losses	—	400
Reserve for purchased receivables	9	12
Additions to mortgage servicing rights carried at fair value	(760)	(886)
Change in fair value of mortgage servicing rights carried at fair value	26	(282)
Gain on sale of loans	(3,346)	(3,721)
Proceeds from the sale of loans held for sale	115,178	134,347
Origination of loans held for sale	(109,069)	(115,058)
Gain on sale of other real estate owned	—	(41)
Impairment on other real estate owned	—	166
Net changes in assets and liabilities:		
Increase in accrued interest receivable	(383)	(273)
(Increase) decrease in other assets	(220)	1,698
Decrease in other liabilities	(1,797)	(428)
Net Cash Provided by Operating Activities	4,709	21,009
Investing Activities:		
Investment in securities:		
Purchases of investment securities available for sale	(10,000)	(11,283)
Purchases of FHLB stock	—	(1,318)
Proceeds from sales/calls/maturities of securities available for sale	18,388	18,898
Proceeds from redemption of FHLB stock	9	1,290
Decrease in purchased receivables, net	2,810	5,994
(Increase) decrease in loans, net	(13,821)	14,020
Proceeds from sale of other real estate owned	71	647
Proceeds from sale of premises and equipment	—	34
Purchases of premises and equipment	(152)	(962)
Net Cash Provided (Used) by Investing Activities	(2,695)	27,320
Financing Activities:		
Increase (decrease) increase in deposits	2,507	(20,580)
Increase in securities sold under repurchase agreements	3,272	4,176
Increase in borrowings	(24)	(12)
Distributions to noncontrolling interest	—	(87)

Cash dividends paid	(1,648)	(1,445)
Net Cash (Used) Provided by Financing Activities	4,107	(17,948)
Net Change in Cash and Cash Equivalents	6,121	30,381
Cash and Cash Equivalents at Beginning of Period	77,841	50,551
Cash and Cash Equivalents at End of Period	$83,962	$80,932

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Supplemental Information:		
Interest paid	$498	$596
Transfer of loans to other real estate owned	$235	$—
Cash dividends declared but not paid	$16	$12

See notes to consolidated financial statements

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

The accompanying unaudited consolidated financial statements and corresponding footnotes have been prepared by Northrim BanCorp, Inc. (the "Company") in accordance with accounting principles generally accepted in the United States of America ("GAAP") and with instructions to Form 10-Q under the Securities Exchange Act of 1934, as amended. The year-end Consolidated Balance Sheet data was derived from the Company's audited financial statements. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The Company owns a 100% interest in Residential Mortgage Holding Company, LLC ("RML"), the parent company of Residential Mortgage, LLC ("Residential Mortgage") and consolidates their balance sheets and income statement into its financial statements. The Company owned a 50.1% interest in Northrim Benefits Group, LLC ("NBG") through August 14, 2017, and consolidates NBG's balance sheets and income statements into its financial statements through the date of the sale on August 14, 2017. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Certain immaterial reclassifications have been made to prior year amounts to maintain consistency with the current year with no impact on net income or total shareholders' equity. The Company determined that it operates in two primary operating segments: Community Banking and Home Mortgage Lending. The Company has evaluated subsequent events and transactions for potential recognition or disclosure. Operating results for the interim period ended March 31, 2018, are not necessarily indicative of the results anticipated for the year ending December 31, 2018. These consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2017. The Company's significant accounting policies are discussed in Note 1 to the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Reclassification of Prior Year Presentation

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

Recent Accounting Pronouncements

Accounting pronouncements implemented in 2018

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

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

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

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

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

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

Accounting pronouncements to be implemented in future periods

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) (“ASU 2016-02”). ASU 2016-02 requires lessees, among other things, to recognize lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous authoritative guidance. This update also introduces new disclosure requirements for leasing arrangements. ASU 2016-02 is effective for the Company’s financial statements for annual

and interim periods beginning on or after December 15, 2018, and must be applied prospectively. Although an estimate of the impact of the new leasing standard has not yet been determined, the Company expects a significant new lease asset and related lease liability on the balance sheet due to the number of leased properties the Company currently has that are accounted for under current operating lease guidance.
In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses ("ASU 2016-13"). ASU 2016-13 is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The standard requires the measurement of all expected credit losses for certain financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable

forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates, but will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. ASU 2016-13 requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early application will be permitted for specified periods. ASU 2016-13 is effective for the Company’s financial statements for annual and interim periods beginning on or after December 15, 2019, and must be applied prospectively. The Company has formed a cross-functional team to begin implementation efforts of this new guidance. The team is evaluating the data elements and modeling options that are expected to be critical to the new process. Additionally, the Company is considering engaging external consulting services related to this effort in 2018. An estimate of the impact of this standard on the Company's consolidated financial position and results of operations has not yet been determined, however, the impact is expected to be significant and the impact on the Company's process for calculating the Allowance is also expected to be significant.
In January 2017, the FASB issued ASU 2017-04, Intangibles-Goodwill and Other (“ASU 2017-04”). ASU 2017-04 simplifies how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. ASU 2017-04 is effective for the Company’s financial statements for annual and interim periods beginning on or after December 15, 2019, and must be applied on a prospective basis. The Company does not believe that the adoption of this standard will have a material impact on the Company’s consolidated financial position or results of operations.

2. Revenue
The Company's revenue is included in net interest income and other operating income on its Consolidated Statements of Income. ASU 2014-09, which amends Topic 606 in the Accounting Standards Codification ("ASC"), establishes principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts to provide goods or services to customers. The core principle requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it expects to be entitled to receive in exchange for those goods or services recognized as performance obligations are satisfied.
The majority of our ongoing revenue-generating transactions are not subject to ASC 606, including revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, purchased receivable income, financial guarantees, and derivatives are also not in scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as deposit related fees, interchange fees, merchant services income, and commissions from the sales of mutual funds and other investments. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Company’s revenue is generated from contracts with customers. Noninterest revenue streams in-scope of Topic 606 are discussed below.
Bankcard fees
Bankcard fees are primarily comprised of debit card income and ATM fees. Debit card income is primarily comprised of interchange fees earned whenever the Company’s debit cards are processed through card payment networks such as Visa or MasterCard. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. The Company’s performance obligation for bankcard fees are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payments are typically received immediately or in the following month.
Service charges on deposit accounts
Service charges on deposit accounts consist of general service fees for monthly account maintenance, activity- or transaction-based fees, and account analysis fees (i.e., net fees earned on analyzed business and public checking

accounts), and other deposit account related fees and consist of transaction-based revenue, time-based revenue (service period), item-based revenue or some other individual attribute-based revenue. Revenue is recognized when our performance obligation is completed which is generally monthly for account maintenance services or when a transaction has been completed. Payments for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts.

Other

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

The following presents other operating income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the three months ended March 31, 2018 and 2017:

(In Thousands)	Three months ended	
Other operating income	2018	2017
In-scope of Topic 606:		
Bankcard fees	$625	$581
Service charges on deposit accounts	354	439
Other	363	375
Other operating income (in-scope of Topic 606)	$1,342	$1,395
Other operating income (out-of-scope of Topic 606)	6,120	7,510
Total other operating income	$7,462	$8,905

Contract Balances

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

Contract Acquisition Costs

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

3. Cash and Cash Equivalents

The Company is required to maintain a $1.0 million minimum average daily balance with the Federal Reserve Bank of San Francisco ("Federal Reserve Bank") for purposes of settling financial transactions and charges for Federal Reserve Bank services. The Company is also required to maintain cash balances or deposits with the Federal Reserve Bank sufficient to meet its statutory reserve requirements.

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

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

4. Investment Securities

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

(In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2018				
Securities available for sale				
U.S. Treasury and government sponsored entities	$245,429	$—	$2,111	$243,318
Municipal securities	13,805	18	47	13,776
Corporate bonds	34,152	317	—	34,469
Collateralized loan obligations	6,000	11	1	6,010
Total securities available for sale	$299,386	$346	$2,159	$297,573
December 31, 2017				
Securities available for sale				
U.S. Treasury and government sponsored entities	$250,794	$3	$1,336	$249,461
Municipal securities	14,395	72	46	14,421
Corporate bonds	36,654	478	—	37,132
Collateralized loan obligations	6,000	5	—	6,005
Total securities available for sale	$307,843	$558	$1,382	$307,019

Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2018 and December 31, 2017 were as follows:

(In Thousands)	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
March 31, 2018:						
Securities Available for Sale						
U.S. Treasury and government sponsored entities	$120,700	$1,269	$122,618	$842	$243,318	$2,111
Collateralized loan obligations	3,000	1	—	—	3,000	1
Municipal securities	4,697	18	2,294	29	6,991	47
Total	$128,397	$1,288	$124,912	$871	$253,309	$2,159
December 31, 2017:						
Securities Available for Sale						
U.S. Treasury and government sponsored entities	$116,331	$496	$122,605	$840	$238,936	$1,336
Municipal securities	3,994	17	2,298	29	6,292	46
Total	$120,325	$513	$124,903	$869	$245,228	$1,382

The unrealized losses on investments in U.S. treasury and government sponsored entities, collateralized loan obligations, and municipal securities in both periods were caused by changes in interest rates. At March 31, 2018 and December 31, 2017, respectively, there were 26 and 24 available-for-sale securities with unrealized losses that have been in a loss position for less than twelve months. There were 17 securities as of March 31, 2018 and December 31, 2017 that have been in an unrealized loss position for more than twelve months. The contractual terms of the investments in a loss position do not permit the issuer to settle the securities at a price less than the amortized cost of the investment. Because it is more likely than not that the Company will hold these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

At March 31, 2018 and December 31, 2017, $51.9 million and $51.6 million in securities were pledged for deposits and borrowings, respectively.

The amortized cost and estimated fair values of debt securities and preferred stock at March 31, 2018, are distributed by contractual maturity as shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Although preferred stock has no stated maturity, it is aggregated in the calculation of weighted average yields presented below in the category of investments that mature in ten years or more.

(In Thousands)	Amortized Cost	Fair Value	Weighted Average Yield	
US Treasury and government sponsored entities				
Within 1 year	$97,714	$97,467	1.08	%
1-5 years	147,715	145,851	1.71	%
Total	$245,429	$243,318	1.46	%
Corporate bonds				
Within 1 year	$2,000	$2,000	2.37	%
1-5 years	21,703	21,891	2.63	%
5-10 years	10,449	10,578	3.05	%
Total	$34,152	$34,469	2.74	%
Collateralized loan obligations				
1-5 years	$3,000	$2,999	3.04	%
Over 10 years	3,000	3,011	3.51	%
Total	$6,000	$6,010	3.27	%
Preferred stock				
Over 10 years	$5,373	$5,527	6.36	%
Total	$5,373	$5,527	6.36	%
Municipal securities				
Within 1 year	$3,202	$3,198	1.80	%
1-5 years	10,603	10,578	2.67	%
Total	$13,805	$13,776	2.47	%

The proceeds and resulting gains and losses, computed using specific identification, from sales of investment securities for the three months ending March 31, 2018 and 2017, are as follows:

(In Thousands)	Proceeds	Gross Gains	Gross Losses
Three Months Ended March 31, 2018			
Available for sale securities	$—	$—	$—
Three Months Ended March 31, 2017			
Available for sale securities	$10,010	$14	$—

A summary of interest income for the three months ending March 31, 2018 and 2017, on available for sale investment securities and marketable securities is as follows:

(In Thousands)	2018	2017
US Treasury and government sponsored entities	$890	$778
Other	360	289
Total taxable interest income	$1,250	$1,067
Municipal securities	$86	$97
Total tax-exempt interest income	$86	$97
Total	$1,336	$1,164

5. Loans and Credit Quality

The following table presents total portfolio loans by portfolio segment and class of financing receivable, based on the Company's asset quality rating ("AQR") criteria:

(In Thousands)	Commercial	Real estate construction one-to-four family	Real estate construction other	Real estate term owner occupied	Real estate term non-owner occupied	Real estate term other	Consumer secured by 1st deeds of trust	Consumer other	Total
March 31, 2018									
AQR Pass	$278,743	$30,310	$54,947	$125,930	$328,144	$55,081	$21,227	$19,914	$914,296
AQR Special Mention	6,101	—	—	2,052	11,000	1,213	138	20	20,524
AQR Substandard	31,168	—	—	4,607	477	—	531	11	36,794
AQR Doubtful	69	—	—	—	—	—	—	—	69
Subtotal	$316,081	$30,310	$54,947	$132,589	$339,621	$56,294	$21,896	$19,945	$971,683
Less: Unearned origination fees, net of origination costs									(4,108)
Total loans									$967,575
December 31, 2017									
AQR Pass	$277,371	$31,201	$80,093	$127,059	$307,780	$39,777	$21,846	$19,895	$905,022
AQR Special Mention	4,921	—	—	2,095	11,051	634	3	22	18,726
AQR Substandard	31,222	—	—	2,888	482	—	767	2	35,361
Subtotal	$313,514	$31,201	$80,093	$132,042	$319,313	$40,411	$22,616	$19,919	$959,109
Less: Unearned origination fees, net of origination costs									(4,156)
Total loans									$954,953

Loans are carried at their principal amount outstanding, net of charge-offs, unamortized fees and direct loan origination costs. Loan balances are charged-off to the allowance for loan losses ("Allowance") when management believes that collection of principal is unlikely. Interest income on loans is accrued and recognized on the principal amount outstanding except for loans in a nonaccrual status. All classes of loans are placed on nonaccrual and considered impaired when management believes doubt exists as to the collectability of the interest or principal. Cash payments received on nonaccrual loans are directly applied to the principal balance. Generally, a loan may be returned to accrual status when the delinquent principal and interest is brought current in accordance with the terms of the loan agreement. Additionally, certain ongoing performance criteria, which generally includes a performance period of six months, must be met in order for a loan to be returned to accrual status. Loans are reported as past due when installment payments, interest payments, or maturity payments are past due based on contractual terms.

Nonaccrual loans: Nonaccrual loans net of government guarantees totaled $18.5 million and $21.2 million at March 31, 2018 and December 31, 2017, respectively. Nonaccrual loans at the periods indicated are presented below by segment:

(In Thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Current	Total
March 31, 2018					
Commercial	$15	$—	$1,933	$15,320	$17,268
Real estate term owner occupied	—	—	1,331	—	1,331
Consumer secured by 1st deeds of trust	—	—	285	—	285
Consumer other	—	—	11	—	11
Total nonperforming loans	15	—	3,560	15,320	18,895
Government guarantees on nonaccrual loans	—	—	(73)	(339)	(412)
Net nonaccrual loans	$15	$—	$3,487	$14,981	$18,483
December 31, 2017					
Commercial	$810	$—	$2,652	$16,455	$19,917
Real estate term owner occupied	—	—	—	1,331	1,331
Consumer secured by 1st deeds of trust	—	—	378	—	378
Total nonperforming loans	810	—	3,030	17,786	21,626
Government guarantees on nonaccrual loans	—	—	(94)	(373)	(467)
Net nonaccrual loans	$810	$—	$2,936	$17,413	$21,159

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

(In Thousands)	30-59 Days Past Due Still Accruing	60-89 Days Past Due Still Accruing	Greater Than 90 Days Still Accruing	Total Past Due	Nonaccrual	Current	Total
March 31, 2018							
Commercial	$5,506	$223	$—	$5,729	$17,268	$293,084	$316,081
Real estate construction one-to-four family	—	—	—	—	—	30,310	30,310
Real estate construction other	—	—	—	—	—	54,947	54,947
Real estate term owner occupied	1,914	—	—	1,914	1,331	129,344	132,589
Real estate term non-owner occupied	645	—	—	645	—	338,976	339,621
Real estate term other	—	—	—	—	—	56,294	56,294
Consumer secured by 1st deed of trust	468	—	—	468	285	21,143	21,896
Consumer other	64	64	84	212	11	19,722	19,945
Subtotal	$8,597	$287	$84	$8,968	$18,895	$943,820	$971,683
Less: Unearned origination fees, net of origination costs							(4,108)
Total							$967,575
December 31, 2017							
Commercial	$503	$—	$240	$743	$19,917	$292,854	$313,514
Real estate construction one-to-four family	—	—	—	—	—	31,201	31,201
Real estate construction other	90	—	—	90	—	80,003	80,093
Real estate term owner occupied	966	—	—	966	1,331	129,745	132,042
Real estate term non-owner occupied	—	—	—	—	—	319,313	319,313
Real estate term other	—	—	—	—	—	40,411	40,411
Consumer secured by 1st deed of trust	363	—	—	363	378	21,875	22,616
Consumer other	161	53	12	226	—	19,693	19,919
Subtotal	$2,083	$53	$252	$2,388	$21,626	$935,095	$959,109
Less: Unearned origination fees, net of origination costs							(4,156)
Total							$954,953

Impaired Loans: The Company considers a loan to be impaired when it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan agreement. Once a loan is determined to be impaired, the impairment is measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate, except that if the loan is collateral dependent, the impairment is measured by using the fair value of the loan's collateral. Nonperforming loans with an outstanding balance of $50,000 or greater are individually evaluated for impairment based upon the borrower's overall financial condition, resources, and payment record, and the prospects for support from any financially responsible guarantors.

At March 31, 2018 and December 31, 2017, the recorded investment in loans that are considered to be impaired was $33.2 million and $32.0 million, respectively. The following table presents information about impaired loans by class as of the periods indicated:

(In Thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
March 31, 2018			
With no related allowance recorded			
Commercial - AQR special mention	$2,233	$2,233	$—
Commercial - AQR substandard	17,271	19,306	—
Real estate term owner occupied- AQR substandard	4,584	4,584	—
Real estate term non-owner occupied- AQR pass	295	295	—
Real estate term non-owner occupied- AQR special mention	89	89	—
Real estate term non-owner occupied- AQR substandard	477	477	—
Real estate term other - AQR pass	541	541	—
Consumer secured by 1st deeds of trust - AQR pass	135	135	—
Consumer secured by 1st deeds of trust - AQR substandard	246	246	—
Subtotal	$25,871	$27,906	$—
With an allowance recorded			
Commercial - AQR substandard	$7,073	$7,073	$316
Commercial - AQR doubtful	54	54	54
Consumer secured by 1st deeds of trust - AQR substandard	241	294	2
Subtotal	$7,368	$7,421	$372
Total			
Commercial - AQR special mention	$2,233	$2,233	$—
Commercial - AQR substandard	24,344	26,379	316
Commercial - AQR doubtful	54	54	54
Real estate term owner-occupied - AQR substandard	4,584	4,584	—
Real estate term non-owner occupied - AQR pass	295	295	—
Real estate term non-owner occupied - AQR special mention	89	89	—
Real estate term non-owner occupied - AQR substandard	477	477	—
Real estate term other - AQR pass	541	541	—
Consumer secured by 1st deeds of trust - AQR pass	135	135	—
Consumer secured by 1st deeds of trust - AQR substandard	487	540	2
Total	$33,239	$35,327	$372

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

The unpaid principal balance included in the tables above represents the recorded investment at the dates indicated, plus amounts charged off for book purposes.

The following tables summarize our average recorded investment and interest income recognized on impaired loans for the three month periods ended March 31, 2018 and 2017:

Three Months Ended March 31,	2018		2017	
(In Thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded				
Commercial - AQR special mention	$2,242	$31	$52	$1
Commercial - AQR substandard	18,549	85	17,544	76
Real estate term owner occupied- AQR pass	—	—	250	5
Real estate term owner occupied- AQR substandard	4,592	24	5,325	84
Real estate term non-owner occupied- AQR pass	299	5	384	14
Real estate term non-owner occupied- AQR substandard	480	7	696	20
Real estate term other - AQR pass	550	10	624	11
Real estate term other - AQR substandard	—	—	663	11
Consumer secured by 1st deeds of trust - AQR special mention	—	—	142	3
Consumer secured by 1st deeds of trust - AQR substandard	248	4	455	3
Consumer other - AQR substandard	—	—	52	1
Subtotal	$27,185	$171	$26,187	$229
With an allowance recorded				
Commercial - AQR substandard	$7,205	$—	$11,285	$—
Commercial - AQR doubtful	55	—	—	—
Consumer secured by 1st deeds of trust - AQR substandard	242	—	—	—
Subtotal	$7,502	$—	$11,285	$—
Total				
Commercial - AQR special mention	$2,242	$31	$52	$1
Commercial - AQR substandard	25,754	85	28,829	76
Real estate construction one-to-four family - AQR substandard	—	—	—	—
Real estate construction other - AQR substandard	—	—	—	—
Real estate term owner-occupied - AQR pass	—	—	250	5
Real estate term owner-occupied - AQR substandard	4,592	24	5,325	84
Real estate term non-owner occupied - AQR pass	299	5	384	14
Real estate term non-owner occupied - AQR substandard	480	7	696	20
Real estate term other - AQR pass	550	10	624	11
Real estate term other - AQR substandard	—	—	663	11
Consumer secured by 1st deeds of trust - AQR special mention	—	—	142	3
Consumer secured by 1st deeds of trust - AQR substandard	490	4	455	