NORTHRIM BANCORP INC
Form 10-Q
May 06, 2013
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, 2013

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.

Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act:

Large accelerated filer o Accelerated filer þ Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

The number of shares of the issuer's Common Stock, par value $1 per share, outstanding at May 6, 2013 was 6,514,414.

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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, 2012.

ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED FINANCIAL STATEMENTS

NORTHRIM BANCORP, INC.

Consolidated Balance Sheets

(In Thousands, Except Share Data)	March 31, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$ 28,648	$ 40,834
Interest bearing deposits in other banks	73,879	113,979
Investment securities available for sale	221,460	203,918
Investment securities held to maturity	2,747	2,749
Total portfolio investments	224,207	206,667
Investment in Federal Home Loan Bank stock	1,950	1,967
Loans held for sale	11,454	11,705
Loans	721,609	704,213
Allowance for loan losses	(16,641)	(16,408)
Net loans	716,422	699,510
Purchased receivables, net	18,683	19,022
Accrued interest receivable	2,970	2,618
Other real estate owned, net	4,516	4,543
Premises and equipment, net	27,912	27,908
Goodwill and intangible assets, net	8,111	8,170
Other assets	43,860	34,889
Total assets	$ 1,151,158	$ 1,160,107
LIABILITIES		
Deposits:		
Demand	$ 344,012	$ 361,167
Interest-bearing demand	144,683	146,262
Savings	92,227	87,241
Alaska CDs	102,584	101,165
Money market	179,138	181,598
Certificates of deposit less than $100,000	38,078	39,343
Certificates of deposit greater than $100,000	54,191	53,353
Total deposits	954,913	970,129
Securities sold under repurchase agreements	13,411	19,038

Borrowings	6,675	4,479
Junior subordinated debentures	18,558	18,558
Other liabilities	19,497	11,550
Total liabilities	1,013,054	1,023,754
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, 6,513,096 and 6,511,649 shares		
issued and outstanding at March 31, 2013 and December 31, 2012, respectively	6,513	6,512
Additional paid-in capital	53,753	53,638
Retained earnings	76,431	74,742
Accumulated other comprehensive income	1,328	1,368
Total Northrim BanCorp shareholders' equity	138,025	136,260
Noncontrolling interest	79	93
Total shareholders' equity	138,104	136,353
Total liabilities and shareholders' equity	$ 1,151,158	$ 1,160,107

See notes to consolidated financial statements

NORTHRIM BANCORP, INC.

Consolidated Statements of Income

(In Thousands, Except Per Share Data)	Three Months Ended March 31, 2013	2012
Interest Income		
Interest and fees on loans	$ 10,342	$ 10,225
Interest on investment securities available for sale	659	749
Interest on investment securities held to maturity	29	38
Interest on deposits in other banks	62	40
Total Interest Income	11,092	11,052
Interest Expense		
Interest expense on deposits, borrowings and junior subordinated debentures	530	698
Net Interest Income	10,562	10,354
Provision for loan losses	150	89
Net Interest Income After Provision for Loan Losses	10,412	10,265
Other Operating Income		
Purchased receivable income	702	712
Employee benefit plan income	569	540
Service charges on deposit accounts	525	568
Electronic banking income	504	483
Equity in earnings from RML	242	301
Gain on sale of securities	218	27
Rental income	28	198
Other income	351	378
Total Other Operating Income	3,139	3,207
Other Operating Expense		
Salaries and other personnel expense	5,735	5,706
Occupancy expense	888	996
Marketing expense	447	437
Professional and outside services	349	418
Equipment expense	278	294
Software expense	265	251
Amortization of low income housing tax investments	245	228
Internet banking expense	184	172
Insurance expense	144	118
Reserve for purchased receivables	84	-
Intangible asset amortization expense	58	64

OREO (income) expense, net rental income and gains on sale	(6)	97
Other operating expense	1,026	977
Total Other Operating Expense	9,697	9,758
Income Before Provision for Income Taxes	3,854	3,714
Provision for income taxes	1,090	1,026
Net Income	2,764	2,688
Less: Net income attributable to the noncontrolling interest	90	112
Net Income Attributable to Northrim BanCorp	$ 2,674	$ 2,576
Earnings Per Share, Basic	$ 0.41	$ 0.40
Earnings Per Share, Diluted	$ 0.41	$ 0.39
Weighted Average Shares Outstanding, Basic	6,512,455	6,467,540
Weighted Average Shares Outstanding, Diluted	6,590,807	6,567,654

See notes to consolidated financial statements

NORTHRIM BANCORP, INC.

Consolidated Statements of Comprehensive Income

(In Thousands)	Three Months Ended March 31, 2013	2012
Net income	$ 2,764	$ 2,688
Other comprehensive income, net of tax:		
Securities available for sale:		
Unrealized gains (losses) arising during the period	$ 151	$ 1,525
Reclassification of net gains included in net income (net of tax expense $90,000 and $9,000 in 2013 and 2012, respectively	(128)	(16)
Income tax benefit (expense) related to unrealized (losses) gains	(63)	(627)
Total other comprehensive income (loss)	(40)	882
Comprehensive income	2,724	3,570
Less: comprehensive income attributable to the noncontrolling interest	90	112
Total comprehensive income attributable to Northrim BanCorp	$ 2,634	$ 3,458

See notes to consolidated financial statements

NORTHRIM BANCORP, INC.

Consolidated Statements of Changes in Shareholders' Equity

(In Thousands)	Common Stock Number of Shares	Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Non-controlling Interest	Total
Balance as of January 1, 2012	6,467	$ 6,467	$ 53,164	$ 65,469	$ 283	$ 52	$ 125,435
Cash dividend declared	-	-	-	(3,673)	-	-	(3,673)
Stock based compensation expense	-	-	454	-	-	-	454
Exercise of stock options	45	45	(213)	-	-	-	(168)
Excess tax benefits from share-based payment arrangements	-	-	233	-	-	-	233
Distributions to noncontrolling interest	-	-	-	-	-	(471)	(471)
Other comprehensive income	-	-	-	-	1,085	-	1,085
Net income attributable to the noncontrolling interest	-	-	-	-	-	512	512
Net income attributable to Northrim BanCorp	-	-	-	12,946	-	-	12,946
Twelve Months Ended December 31, 2012	6,512	$ 6,512	$ 53,638	$ 74,742	$ 1,368	$ 93	$ 136,353
Cash dividend declared	-	-	-	(985)	-	-	(985)
Stock based compensation expense	-	-	112	-	-	-	112
Exercise of stock options	1	1	(7)	-	-	-	(6)
Excess tax benefits from share-based payment arrangements	-	-	10	-	-	-	10
Distributions to noncontrolling interest	-	-	-	-	-	(104)	(104)
Other comprehensive income	-	-	-	-	(40)	-	(40)
Net income attributable to the noncontrolling interest	-	-	-	-	-	90	90
Net income attributable to Northrim BanCorp	-	-	-	2,674	-	-	2,674
Three Months Ended March 31, 2013	6,513	$ 6,513	$ 53,753	$ 76,431	$ 1,328	$ 79	$ 138,104

See notes to consolidated financial statements

NORTHRIM BANCORP, INC.

Consolidated Statements of Cash Flows

(In Thousands)	Three Months Ended March 31, 2013	2012
Operating Activities:		
Net income	$ 2,764	$ 2,688
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Gain on sale of securities, net	(218)	(27)
Depreciation and amortization of premises and equipment	443	405
Amortization of software	49	47
Intangible asset amortization	58	64
Amortization of investment security premium, net of discount accretion	32	91
Deferred tax liability	370	161
Stock-based compensation	112	113
Excess tax benefits from share-based payments	(10)	-
Deferral of loan fees and costs, net	30	272
Provision for loan losses	150	89
Reserve for purchased receivables	84	-
Purchases of loans held for sale	(20,242)	(39,620)
Proceeds from the sale of loans held for sale	20,493	55,176
Gain on sale of other real estate owned	(21)	(19)
Equity in undistributed earnings from mortgage affiliate	192	(8)
Net changes in assets and liabilities:		
Decrease in accrued interest receivable	(352)	(259)
(Increase) decrease in other assets	1,015	272
Increase (decrease) in other liabilities	(2,724)	(859)
Net Cash Provided by Operating Activities	2,225	18,586
Investing Activities:		
Investment in securities:		
Purchases of investment securities available for sale	(40,951)	(7,101)
Proceeds from sales/maturities of securities available for sale	23,528	13,736
Proceeds from calls/maturities of securities held to maturity	-	510
Proceeds from redemption of FHLB stock	17	-
Decrease in purchased receivables, net	255	7,864
(Increase) in loans, net	(17,504)	(20,771)
Proceeds from sale of other real estate owned	201	50
Investment in other real estate owned	-	(17)
Decrease in loan to Elliott Cove, net	106	33
Purchases of premises and equipment	(447)	(282)
Net Cash (Used) by Investing Activities	(34,795)	(5,978)
Financing Activities:		

(Decrease) in deposits	(15,216)	(9,842)
(Decrease) in securities sold under repurchase agreements	(5,627)	(881)
Increase (decrease) in borrowings	2,196	(36)
Distributions to noncontrolling interest	(104)	(108)
Excess tax benefits from share-based payments	10	-
Cash dividends paid	(975)	(842)
Net Cash (Used) by Financing Activities	(19,716)	(11,709)
Net Increase (Decrease) in Cash and Cash Equivalents	(52,286)	899
Cash and Cash Equivalents at Beginning of Period	141,313	79,530
Cash and Cash Equivalents at End of Period	$ 89,027	$ 80,429
Supplemental Information:		
Income taxes paid	$ 2	$ 2
Interest paid	$ 529	$ 700
Transfer of loans to other real estate owned	$ 161	$ 1,499
Loans made to facilitate sales of other real estate owned	$ -	$ 50
Cash dividends declared but not paid	$ 10	$ 10

See notes to consolidated financial statements

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements 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. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Certain reclassifications have been made to prior year amounts to maintain consistency with the current year with no impact on net income or total shareholders' equity. The Company determined that it operates as a single operating segment. Operating results for the interim period ended March 31, 2013, are not necessarily indicative of the results anticipated for the year ending December 31, 2013. 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, 2012.

2. Significant Accounting Policies and Recent Accounting Pronouncements

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, 2012.

In February 2013, the Financial Accounting Standards Board ("FASB") issued ASU 2013-02, Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income ("ASU 2013-02"). The amendments to the Codification in ASU 2013-02 do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. This ASU was effective for the Company's financial statements for annual and interim periods beginning on or after December 15, 2012, and has been applied prospectively. The adoption of this standard did not have a material impact on the Company's consolidated financial position or results of operations.

3. Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits with other banks, banker's acceptances, commercial paper, securities purchased under agreement to resell, federal funds sold, and securities with maturities of less than 90 days at acquisition. As of March 31, 2013, the Company had two certificates of deposit totaling $13.5 million in another bank. Cash and cash equivalent balances placed with the Federal Reserve of San Francisco is the only concentration representing more than 10% of the Company's equity.

4. Investment Securities

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

(In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2013				
Securities available for sale				
U.S. Treasury and government sponsored entities	$ 139,155	$ 410	$ -	$ 139,565
Municipal securities	21,626	541	16	22,151
U.S. Agency mortgage-backed securities	33	1	-	34
Corporate bonds	55,889	1,195	3	57,081
Preferred stock	2,501	128	-	2,629
Total securities available for sale	$ 219,204	$ 2,275	$ 19	$ 221,460
Securities held to maturity				
Municipal securities	$ 2,747	$ 220	$ -	$ 2,967
Total securities held to maturity	$ 2,747	$ 220	$ -	$ 2,967
December 31, 2012				
Securities available for sale				
U.S. Treasury and government sponsored entities	$ 123,959	$ 455	$ -	$ 124,414
Municipal securities	21,124	613	9	21,728
U.S. Agency mortgage-backed securities	35	1	-	36
Corporate bonds	52,951	1,081	50	53,982
Preferred stock	3,524	234	-	3,758
Total securities available for sale	$ 201,593	$ 2,384	$ 59	$ 203,918
Securities held to maturity				
Municipal securities	$ 2,749	$ 229	$ -	$ 2,978
Total securities held to maturity	$ 2,749	$ 229	$ -	$ 2,978

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. There were five and six securities with unrealized losses as of March 31, 2013 and December 31, 2012, respectively, that have been in a loss position for less than twelve months. There were no securities with unrealized losses as of March 31, 2013 and December 31, 2012 that have been in an unrealized loss position for more than twelve months. Because the Company does not intend to sell, nor is it required to sell these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

At March 31, 2013, $31.7 million in securities, or 14%, of the investment portfolio was pledged, as compared to $42.7 million, or 20%, at December 31, 2012. We held no securities of any single issuer (other than government sponsored entities) that exceeded 10% of our shareholders' equity at March 31, 2013 and December 31, 2012.

The amortized cost and fair values of debt securities at March 31, 2013, 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. 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.

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(In Thousands)	Amortized Cost	Fair Value	Weighted Average Yield
US Treasury and government sponsored entities			
Within 1 year	$ 59,466	$ 59,782	0.80 %
1-5 years	79,689	79,783	0.49 %
Total	$ 139,155	$ 139,565	0.62 %
U.S. Agency mortgage-backed securities			
5-10 years	$ 33	$ 34	4.45 %
Total	$ 33	$ 34	4.45 %
Corporate bonds			
Within 1 year	$ 5,173	$ 5,209	1.25 %
1-5 years	50,716	51,872	2.16 %
Total	$ 55,889	$ 57,081	2.07 %
Preferred stock			
Over 10 years	2,501	2,629	5.19 %
Total	$ 2,501	$ 2,629	5.19 %
Municipal securities			
Within 1 year	$ 2,605	$ 2,621	1.86 %
1-5 years	12,784	13,022	1.70 %
5-10 years	8,984	9,475	4.71 %
Total	$ 24,373	$ 25,118	2.82 %

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

(In Thousands)	Proceeds	Gross Gains	Gross Losses
2013			
Available for sale securities	$ 23,528	$ 218	$ -
2012			
Available for sale securities	$ 13,736	$ 27	$ -

A summary of interest income for the three months ending March 31, 2013 and 2012 on available for sale investment securities is as follows:

(In Thousands)	2013	2012
US Treasury and government sponsored entities	$ 207	$ 307
U.S. Agency mortgage-backed securities	-	1
Other	307	300
Total taxable interest income	$ 514	$ 608
Municipal securities	$ 145	$ 141
Total tax-exempt interest income	145	141
Total	$ 659	$ 749

For the periods ending March 31, 2013 and December 31, 2012, we held Federal Home Loan Bank of Seattle ("FHLB") stock with a book value approximately equal to its market value in the amount of $2.0 million for each period. The Company evaluated its investment in FHLB stock for other-than-temporary impairment as of March 31, 2013, consistent with its accounting policy. Based on the Company's evaluation of the underlying investment, including the fact that the FHLB of Seattle recently began redeeming stock at par, the long-term nature of the investment, the liquidity position of the FHLB of Seattle, and the Company's intent and ability to hold the investment for a period of time sufficient to recover the par value, the Company did not recognize an other-than-temporary impairment loss.

5. Loans Held for Sale

From time to time, the Company has purchased residential loans from our mortgage affiliate, Residential Mortgage Holding Company LLC ("RML"). The Company then sells these loans in the secondary market. The Company purchased $20.2 million and sold $20.5 million in loans during the three-month period ending March 31, 2013. The Company purchased $39.6 million and sold $55.2 million in loans during the three-month period ending March 31, 2012.

6. Loans

The following table presents total portfolio loans by portfolio segment and class of financing receivable, based on our risk classification 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, 2013									
AQR Pass	$ 281,060	$ 25,437	$ 20,763	$ 72,265	$ 234,815	$ 30,021	$ 16,332	$ 17,402	$ 698,095
AQR Special Mention	6,681	2,342	1,748	3,897	2,504	-	501	276	17,949
AQR Substandard	1,450	2,505	-	287	2,058	1,605	203	315	8,423
AQR Doubtful	14	-	-	-	-	-	-	-	14
AQR Loss	184	-	-	405	-	-	-	-	589
Subtotal	$ 289,389	$ 30,284	$ 22,511	$ 76,854	$ 239,377	$ 31,626	$ 17,036	$ 17,993	$ 725,070
Less: Unearned origination fees, net of origination costs									(3,461)
									$ 721,609
December 31, 2012									
AQR Pass	$ 265,562	$ 28,780	$ 21,061	$ 73,985	$ 230,010	$ 28,304	$ 16,911	$ 17,817	$ 682,430
AQR Special Mention	6,064	1,282	-	2,522	2,546	126	620	238	13,398
AQR Substandard	1,597	2,511	-	1,600	2,087	3,379	183	250	11,607
AQR Doubtful	189	-	-	-	-	-	-	-	189

AQR Loss	20	-	-	-	-	-	-	-	20
Subtotal	$ 273,432	$ 32,573	$ 21,061	$ 78,107	$ 234,643	$ 31,809	$ 17,714	$ 18,305	$ 707,644
Less: Unearned origination fees, net of origination costs									(3,431)
									$ 704,213

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

Nonaccrual loans totaled $4.3 million and $4.5 million at March 31, 2013 and December 31, 2012, respectively. Nonaccrual loans at the periods indicated, by segment are presented below:

(In Thousands)	March 31, 2013	December 31, 2012
Commercial	$ 999	$ 1,214
Real estate construction one-to-four family	1,240	1,264
Real estate term non-owner occupied	174	185
Real estate term other	1,448	1,451
Consumer secured by 1st deeds of trust	203	183
Consumer other	228	234
Total	$ 4,292	$ 4,531

Past due loans and nonaccrual loans at the periods indicated are presented below by loan class:

(In Thousands)	30-59 Days Past Due Still Accruing	60-89 Days Past Due Still Accruing	Greater Than 90 Days Still Accruing	Nonaccrual	Total Past Due	Current	Total
March 31, 2013							
AQR Pass	$ 903	$ 61	$ -	$ -	$ 964	$ 697,131	$ 698,095
AQR Special Mention	811	405	112	470	1,798	16,151	17,949
AQR Substandard	195	-	-	3,625	3,820	4,603	8,423
AQR Doubtful	-	-	-	14	14	-	14
AQR Loss	-	-	-	183	183	406	589
Subtotal	$ 1,909	$ 466	$ 112	$ 4,292	$ 6,779	$ 718,291	$ 725,070
Less: Unearned origination fees, net of origination costs							(3,461)
							$ 721,609
December 31, 2012							
AQR Pass	$ 401	$ -	$ -	$ -	$ 401	$ 682,029	$ 682,430
AQR Special Mention	534	-	-	596	1,130	12,268	13,398
AQR Substandard	-	-	-	3,726	3,726	7,881	11,607
AQR Doubtful	-	-	-	189	189	-	189
AQR Loss	-	-	-	20	20	-	20
Subtotal	$ 935	$ 0	$ -	$ 4,531	$ 5,466	$ 702,178	$ 707,644
Less: Unearned origination fees, net of origination costs							(3,431)

$ 704,213

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 greater than $50,000 are individually evaluated for impairment based upon the borrower's overall financial condition, resources, and payment record, and the prospects for support from any financially responsible guarantors.

At March 31, 2013 and December 31, 2012, the recorded investment in loans that are considered to be impaired was $11.6 million and $13.1 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, 2013			
With no related allowance recorded			
Commercial - AQR special mention	$ 523	$ 523	$ -
Commercial - AQR substandard	941	986	-
Real estate construction one-to-four family - AQR special mention	470	470	-
Real estate construction other - AQR pass	2,497	2,498	-
Real estate term owner occupied- AQR special mention	1,081	1,081	-
Real estate term owner occupied- AQR loss	405	405	-
Real estate term non-owner occupied- AQR special mention	546	546	-
Real estate term non-owner occupied- AQR substandard	1,677	1,677	-
Real estate term other - AQR substandard	1,605	1,964	-
Consumer secured by 1st deeds of trust - AQR pass	91	91	-
Consumer secured by 1st deeds of trust - AQR special mention	86	86	-
Consumer other - AQR substandard	230	312	-
Subtotal	$ 10,152	$ 10,639	$ -

With an allowance recorded			
Commercial - AQR substandard	$ 309	$ 309	$ 244
Commercial - AQR loss	183	183	151
Real estate construction one-to-four family - AQR substandard	770	770	242
Consumer secured by 1st deeds of trust - AQR substandard	197	197	22
Subtotal	$ 1,459	$ 1,459	$ 659

Total			
Commercial - AQR special mention	$ 523	$ 523	$ -
Commercial - AQR substandard	1,250	1,295	244
Commercial - AQR loss	183	183	151
Real estate construction one-to-four family - AQR special mention	470	470	-
Real estate construction one-to-four family - AQR substandard	770	770	242
Real estate construction other - AQR pass	2,497	2,498	-
Real estate term owner-occupied - AQR special mention	1,081	1,081	-
Real estate term owner-occupied - AQR loss	405	405	-
Real estate term non-owner occupied - AQR special mention	546	546	-
Real estate term non-owner occupied - AQR substandard	1,677	1,677	-
Real estate term other - AQR substandard	1,605	1,964	-
Consumer secured by 1st deeds of trust - AQR pass	91	91	-
Consumer secured by 1st deeds of trust - AQR special mention	86	86	-
Consumer secured by 1st deeds of trust - AQR substandard	197	197	22
Consumer other - AQR substandard	230	312	-
Total Impaired Loans	$ 11,611	$ 12,098	$ 659

(In Thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
December 31, 2012			
With no related allowance recorded			
Commercial - AQR pass	$ 53	$ 53	$ -
Commercial - AQR special mention	332	332	-
Commercial - AQR substandard	981	1,064	-
Real estate construction one-to-four family - AQR special mention	470	470	-
Real estate construction other - AQR pass	2,748	2,748	-
Real estate term owner occupied - AQR special mention	1,083	1,083	-
Real estate term non-owner occupied - AQR special mention	555	555	-
Real estate term non-owner occupied - AQR substandard	1,705	1,705	-
Real estate term other - AQR special mention	126	205	-
Real estate term other - AQR substandard	3,379	3,659	-
Consumer secured by 1st deeds of trust - AQR pass	93	93	-
Consumer other - AQR doubtful	158	240	-
Subtotal	$ 11,683	$ 12,207	$ -

With an allowance recorded			
Commercial - AQR substandard	$ 427	$ 427	$ 284
Commercial - AQR doubtful	189	189	160
Real estate construction one-to-four family - AQR doubtful	794	794	215
Subtotal	$ 1,410	$ 1,410	$ 659

Total			
Commercial - AQR pass	$ 53	$ 53	$ -
Commercial - AQR special mention	332	332	-
Commercial - AQR substandard	1,408	1,491	284
Commercial - AQR doubtful	189	189	160
Real estate construction one-to-four family - AQR special mention	470	470	-
Real estate construction one-to-four family - AQR doubtful	794	794	215
Real estate construction other - AQR pass	2,748	2,748	-
Real estate term owner occupied - AQR special mention	1,083	1,083	-
Real estate term non-owner occupied - AQR special mention	555	555	-
Real estate term non-owner occupied - AQR substandard	1,705	1,705	-
Real estate term other - AQR special mention	126	205	-
Real estate term other - AQR substandard	3,379	3,659	-
Consumer secured by 1st deeds of trust - AQR pass	93	93	-

Consumer other - AQR doubtful	158	240	-
Total Impaired Loans	$ 13,093	$ 13,617	$ 659

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

The following table summarizes our average recorded investment and interest income recognized on impaired loans for the three months ended March 31, 2013 and 2012, respectively:

Three Months Ended March 31,	2013		2012	
(In Thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded				
Commercial - AQR pass	$ -	$ -	$ 744	$ 14
Commercial - AQR special mention	486	11	178	2
Commercial - AQR substandard	962	14	803	3
Commercial - AQR doubtful	-	-	1,074	-
Commercial - AQR loss	-	-	112	-
Real estate construction one-to-four family - AQR special mention	470	-	-	-
Real estate construction other - AQR pass	2,623	-	-	-
Real estate term owner occupied- AQR special mention	1,082	20	505	7
Real estate term owner occupied - AQR doubtful	-	-	373	-
Real estate term owner occupied- AQR loss	406	5	-	-
Real estate term non-owner occupied - AQR pass	-	-	1,651	31
Real estate term non-owner occupied- AQR special mention	550	9	-	-
Real estate term non-owner occupied- AQR substandard	1,691	33	2,278	44
Real estate term other - AQR pass	-	-	161	6
Real estate term other - AQR special mention	-	-	164	-
Real estate term other - AQR substandard	1,607	7	2,488	-
Consumer secured by 1st deeds of trust - AQR pass	92	1	96	1
Consumer secured by 1st deeds of trust - AQR special mention	86	1	-	-
Consumer other - AQR pass	-	-	121	2
Consumer other - AQR substandard	232	1	52	-
Subtotal	$ 10,287	$ 102	$ 10,800	$ 110
With an allowance recorded				
Commercial - AQR pass	$ -	$ -	$ 180	$ -
Commercial - AQR special mention	-	-	258	-
Commercial - AQR substandard	315	-	207	-
Commercial - AQR doubtful	-	-	221	-
Commercial - AQR loss	187	-	218	-
Real estate construction one-to-four family - AQR substandard	782	-	964	-
Consumer secured by 1st deeds of trust - AQR substandard	199	-	-	-
Subtotal	$ 1,483	$ -	$ 2,048	$ -
Total				
Commercial - AQR pass	$ -	$ -	$ 924	$ 14
Commercial - AQR special mention	486	11	436	2
Commercial - AQR substandard	1,277	14	1,010	3
Commercial - AQR doubtful	-	-	1,295	-
Commercial - AQR loss	187	-	330	-
Real estate construction one-to-four family - AQR special mention	470	-	-	-
Real estate construction one-to-four family - AQR substandard	782	-	964	-
Real estate construction other - AQR pass	2,623	-	-	-
Real estate term owner-occupied - AQR special mention	1,082	20	505	7

Real estate term owner-occupied - AQR doubtful	-	-	373	-
Real estate term owner-occupied - AQR loss	406	5	-	-
Real estate term non-owner occupied - AQR pass	-	-	1,651	31
Real estate term non-owner occupied - AQR special mention	550	9	-	-
Real estate term non-owner occupied - AQR substandard	1,691	33	2,278	44
Real estate term other - AQR pass	-	-	161	6
Real estate term other - AQR special mention	-	-	164	-
Real estate term other - AQR substandard	1,607	7	2,488	-
Consumer secured by 1st deeds of trust - AQR pass	92	1	96	1
Consumer secured by 1st deeds of trust - AQR special mention	86	1	-	-
Consumer secured by 1st deeds of trust - AQR substandard	199	-	-	-
Consumer other - AQR pass	-	-	121	2
Consumer other - AQR substandard	232	1	52	-
Total	$ 11,770	$ 102	$ 12,848	$ 110

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Loans classified as troubled debt restructurings (“TDR”) totaled $9.9 million and $12.1 million at March 31, 2013 and December 31, 2012, respectively. A troubled debt restructuring is a loan to a borrower that is experiencing financial difficulty that has been modified from its original terms and conditions in such a way that the Company is granting the borrower a concession that is would not grant otherwise. The Company has granted a variety of concessions to borrowers in the form of loan modifications. The modifications granted can generally be described in the following categories:

Rate Modification: A modification in which the interest rate is changed.

Term Modification: A modification in which the maturity date, timing of payments, or frequency of payments is changed.

Payment Modification: A modification in which the dollar amount of the payment is changed, or in which a loan is converted to interest only payments for a period of time is included in this category.

Combination Modification: Any other type of modification, including the use of multiple categories above.

The Company did not have any newly restructured loans during the three months ended March 31, 2013.

The loans in the following table are past due, and they are nonaccrual loans. The following table presents TDRs that occurred during the last twelve months that have subsequently defaulted, for the periods ending March 31, 2013 and 2012, respectively:

(In Thousands)	Number of Contracts	March 31, 2013 Recorded Investment	March 31, 2012 Recorded Investment
Troubled Debt Restructurings that Subsequently Defaulted:			
Commercial - AQR substandard	1	$ -	$ 138
Commercial - AQR doubtful	1	-	218
Total	2	$ -	$ 356

AQR pass graded loans included above in the impaired loan data are loans classified as TDRs. By definition, TDRs are considered impaired loans except in very rare circumstances. All of the Company’s TDRs are included in impaired loans. The Company had no commitments to extend additional credit to borrowers owing receivables whose terms have been modified in TDRs. All TDRs are also classified as impaired loans and are included in the loans individually evaluated for impairment in the calculation of the Allowance. There were no charge offs in the three months ended March 31, 2013 on loans that were later classified as TDRs. Four TDRs with a total recorded investment of $1.3 million had a specific impairment amount totaling $637,000 at March 31, 2013.

7. Allowance for Loan Losses

The following tables detail activity in the Allowance for the periods indicated:

Three Months Ended March 31,	Commercial	Real estate construction one-to-four family	Real estate construction other	Real estate term owner occupied	Real estate term non-owner occupied	Real estate term other	Consumer secured by 1st deeds of trust	Consumer other	Unallocated	Total
	(In Thousands)									
2013										
Balance, beginning of period	$ 6,308	$ 1,029	$ 326	$ 1,441	$ 4,065	$ 539	$ 344	$ 388	$ 1,968	$ 16,408
Charge-Offs	-	-	-	-	-	-	-	(14)	-	(14)
Recoveries	76	-	18	-	-	-	-	3	-	97
Provision (benefit)	533	(303)	227	(7)	377	116	7	25	(825)	150
Balance, end of period	$ 6,917	$ 726	$ 571	$ 1,434	$ 4,442	$ 655	$ 351	$ 402	$ 1,143	$ 16,641
Balance, end of period: Individually evaluated for impairment	$ 395	$ 242	$ -	$ -	$ -	$ -	$ 22	$ -	$ -	$ 659
Balance, end of period: Collectively evaluated for impairment	$ 6,522	$ 484	$ 571	$ 1,434	$ 4,442	$ 655	$ 329	$ 402	$ 1,143	$ 15,982
2012										
Balance, beginning of period	$ 6,783	468	$ 1,169	$ 1,272	2,975	788	374	$ 418	$ 2,256	$ 16,503
Charge-Offs	(231)	-	-	(146)	-	(280)	-	-	-	(657)
Recoveries	349	-	-	-	-	-	-	4	-	353
Provision (benefit)	(818)	260	(679)	48	455	85	(77)	(120)	935	89
Balance, end of period	$ 6,083	$ 728	$ 490	$ 1,174	$ 3,430	$ 593	$ 297	$ 302	$ 3,191	$ 16,288
Balance, end of period: Individually evaluated for impairment	$ 436	$ -	$ 342	$ -	$ -	$ -	$ -	$ -	$ -	$ 778
Balance, end of period: Collectively evaluated for impairment	$ 5,647	$ 728	$ 148	$ 1,174	$ 3,430	$ 593	$ 297	$ 302	$ 3,191	$ 15,510

The following is a detail of the recorded investment in the loan portfolio, segregated by amounts evaluated individually or collectively in the Allowance at the periods indicated:

(In Thousands)	Commercial	Real estate construction one-to-four family	Real estate construction other	Real estate term owner occupied	Real estate term non-owner occupied	Real estate term other	Consumer secured by 1st deeds of trust	Consumer other	Total
March 31, 2013									
Balance, end of period	$ 289,389	$ 30,284	$ 22,511	$ 76,854	$ 239,377	$ 31,626	$ 17,036	$ 17,993	$ 725,070
Balance, end of period: Individually evaluated for impairment	$ 1,956	$ 1,240	$ 2,497	$ 1,486	$ 2,223	$ 1,605	$ 374	$ 230	$ 11,611
Balance, end of period: Collectively evaluated for impairment	$ 287,433	$ 29,044	$ 20,014	$ 75,368	$ 237,154	$ 30,021	$ 16,662	$ 17,763	$ 713,459
December 31, 2012									
Balance, end of period	$ 273,432	$ 32,573	$ 21,061	$ 78,107	$ 234,643	$ 31,809	$ 17,714	$ 18,305	$ 707,644
Balance, end of period: Individually evaluated for impairment	$ 2,452	$ 794	$ 2,748	$ 1,083	2,260	$ 3,505	93	$ 158	$ 13,093
Balance, end of period: Collectively evaluated for impairment	$ 270,980	$ 31,779	$ 18,313	$ 77,024	$ 232,383	$ 28,304	$ 17,621	$ 18,147	$ 694,551

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

(In Thousands)	Total	Commercial	Real estate construction 1-4 family	Real estate construction other	Real estate term owner occupied	Real estate term non-owner occupied	Real estate term other	Consumer secured by 1st deeds of trust	Consumer other	Unallocated
March 31, 2013										
Individually evaluated for impairment:										
AQR Substandard	$ 508	$ 244	$ -	$ 242	$ -	$ -	$ -	$ 22	$ -	$ -
AQR Loss	151	151	-	-	-	-	-	-	-	-
Collectively evaluated for impairment:										
AQR Pass	14,012	6,163	599	297	1,304	4,338	655	291	365	-
AQR Special Mention	592	332	37	32	103	36	-	38	14	-
AQR Substandard	231	23	90	-	27	68	-	-	23	-
AQR Doubtful	4	4	-	-	-	-	-	-	-	-
Unallocated	1,143	-	-	-	-	-	-	-	-	1,143
	$ 16,641	$ 6,917	$ 726	$ 571	$ 1,434	$ 4,442	$ 655	$ 351	$ 402	$ 1,143
December 31, 2012										
Individually evaluated for impairment:										
AQR Substandard	$ 284	$ 284	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
AQR Doubtful	374	160	214	-	-	-	-	-	-	-
Collectively evaluated for impairment:										
AQR Pass	12,930	5,520	711	326	1,242	3,961	539	280	351	-
AQR Special Mention	490	321	16	-	51	34	-	56	12	-
AQR Substandard	362	23	88	-	148	70	-	8	25	-
Unallocated	1,968	-	-	-	-	-	-	-	-	1,968
	$ 16,408	$ 6,308	$ 1,029	$ 326	$ 1,441	$ 4,065	$ 539	$ 344	$ 388	$ 1,968

8. Goodwill and Intangible Assets

The Company performs goodwill impairment testing annually in accordance with the policy described in Note 1 of the Company's Annual Report on Form 10-K for the year ended December 31, 2012. There was no indication of impairment as of March 31, 2013. The Company continues to monitor the Company's goodwill for potential impairment on an ongoing basis. No assurance can be given that there will not be an impairment charge to earnings during 2013 for goodwill impairment, if, for example, our stock price declines and trades at a significant discount to its book value, although there are many qualitative and quantitative factors that we analyze in determining the impairment of goodwill.

9. Deposit Activities

Total deposits at March 31, 2013 and December 31, 2012 were $954.9 million and $970.1 million, respectively. The only deposit category with stated maturity dates is certificates of deposit. At March 31, 2013, the Company had $92.3 million in certificates of deposit as compared to certificates of deposit of $92.7 million at December 31, 2012. At March 31, 2013, $69.0 million, or 75%, of the Company's certificates of deposits are scheduled to mature over the next 12 months as compared to $67.7 million, or 73%, of total certificates of deposit at December 31, 2012.

10. Stock Incentive Plan

The Company adopted the 2010 Stock Option Plan (“2010 Plan”) following shareholder approval of the 2010 Plan at the 2010 Annual Meeting. Subsequent to the adoption of the 2010 Plan, no additional grants may be issued under the prior plans. The 2010 Plan provides for grants of up to 348,232 shares, which includes any shares subject to stock awards under the previous stock option plans.

Stock Options: Under the 2010 Plan and previous plans, 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 the then fair 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.

The Company measures the fair value of each stock option at the date of grant using the Black-Scholes option pricing model. For the quarters ended March 31, 2013 and 2012, the Company recognized $17,000 and $15,000, respectively, in stock option compensation expense as a component of salaries and other personnel expense.

Proceeds from the exercise of stock options in the three months ended March 31, 2013 and 2012, were $48,000 and $63,000, respectively. The Company withheld $54,000 and $63,000 to pay for stock option exercises or income taxes that resulted from the exercise of stock options in the three months ended March 31, 2013 and 2012, respectively.

There were no stock options granted in the first quarter of 2013.

Restricted Stock Units: The Company grants restricted stock units to certain key employees periodically. Recipients of restricted stock units do not pay any cash consideration to the Company for the shares and receive all dividends with respect to such shares when the shares vest. Restricted stock units cliff vest at the end of a three-year time period. For the three months ended March 31, 2013 and 2012, the Company recognized $95,000 and $98,000, respectively, in restricted stock unit compensation expense as a component of salaries and other personnel expense.

There were no restricted stock units in the first quarter of 2013.

11. Fair Value of Assets and Liabilities

The Company groups its assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1: Valuation is based upon quoted prices for identical instruments traded in active exchange markets, such as the New York Stock Exchange. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2: Valuation is based upon quoted market prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company’s estimation of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

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

Cash and cash equivalents: Due to the short term nature of these instruments, the carrying amounts reported in the balance sheet represent their fair values.

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 value.

Loans held for sale: Due to the short term nature of these instruments, the carrying amounts reported in the balance sheet represent their fair values.

Loans: Fair value adjustments for loans are mainly related to credit risk, interest rate risk, required equity return, and liquidity risk. Credit risk is primarily addressed in the financial statements through the Allowance (see Note 7). Loans are valued using a discounted cash flow methodology and are pooled based on type of interest rate (fixed or adjustable) and maturity. A discount rate was developed based on the relative risk of the cash flows, taking into account the maturity of the loans and liquidity risk. Impaired loans are carried at fair value. Specific valuation allowances are included in the Allowance.

Purchased receivables: Fair values for purchased receivables are based on their carrying amounts due to their short duration and repricing frequency. Generally, purchased receivables have a duration of less than one year.

Accrued interest receivable: Due to the short term nature of these instruments, the carrying amounts reported in the balance sheet represent their fair values.

Deposits: 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.

Accrued interest payable: Due to the short term nature of these instruments, the carrying amounts reported in the balance sheet represent their fair values.

Securities sold under repurchase agreements: Fair values for securities sold under repurchase agreements are based on their carrying amounts due to their short duration and repricing frequency.

Borrowings: Due to the short term nature of these instruments, 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: Fair value adjustments for junior subordinated debentures are based on discounted cash flows to maturity using current interest rates for similar financial instruments. Management utilized a market approach to determine the appropriate discount rate for junior subordinated debentures.

Assets subject to nonrecurring adjustment to fair value: The Company is also required to measure certain assets such as equity method investments, goodwill, intangible assets, impaired loans, and other real estate owned ("OREO") at fair value on a nonrecurring basis in accordance with GAAP. Any nonrecurring adjustments to fair value usually result from the write down of individual assets.

The Company uses either in-house evaluations or external appraisals to estimate the fair value of OREO and impaired loans as of each reporting date. In-house appraisals are considered Level 3 inputs and external appraisals are considered Level 2 inputs. The Company's determination of which method to use is based upon several factors. The Company takes into account compliance with legal and regulatory guidelines, the amount of the loan, the size of the assets, the location and type of property to be valued and how critical the timing of completion of the analysis is to the assessment of value. Those factors are balanced with the level of internal expertise, internal experience and market information available, versus external expertise available such as qualified appraisers, brokers, auctioneers and equipment specialists.

The Company uses external sources to estimate fair value for projects that are not fully constructed as of the date of valuation. These projects are generally valued as if complete, with an appropriate allowance for cost of completion, including contingencies developed from external sources such as vendors, engineers and contractors. The Company believes that recording other real estate owned that is not fully constructed based on as if complete values is more appropriate than recording other real estate owned that is not fully constructed using as is values. We concluded that as if complete values are appropriate for these types of projects based on the accounting guidance for capitalization of project costs and subsequent measurement of the value of real estate. GAAP specifically states that estimates and cost allocations must be reviewed at the end of each reporting period and reallocated based on revised estimates. The Company adjusts the carrying value of other real estate owned in accordance with this guidance for increases in estimated cost to complete that exceed the fair value of the real estate at the end of each reporting period.

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.

Estimated fair values as of the periods indicated are as follows:

	March 31, 2013		December 31, 2012	
(In Thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Level 1 inputs:				
Cash, due from banks and deposits in other banks	$ 102,527	$ 102,527	$ 154,813	$ 154,813
Level 2 inputs:				
Investment securities	226,157	226,377	208,634	208,863
Accrued interest receivable	2,970	2,970	2,618	2,618
Level 3 inputs:				
Loans and loans held for sale, net	716,422	712,964	699,510	696,951
Purchased receivables, net	18,683	18,683	19,022	19,022
Financial liabilities:				
Level 2 inputs:				
Deposits	$ 954,913	$ 954,724	$ 970,129	$ 969,958
Securities sold under repurchase agreements	13,411	13,411	19,038	19,038
Borrowings	6,675	6,350	4,479	4,193
Junior subordinated debentures	18,558	18,198	18,558	18,590
Accrued interest payable	48	48	47	47
Unrecognized financial instruments:				
Commitments to extend credit[1]	$ 214,026	$ 2,140	$ 208,328	$ 2,083
Standby letters of credit[1]	22,042	220	22,132	221

[1] Carrying amounts reflect the notional amount of credit exposure under these financial instruments.

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The following table sets forth the balances as of the periods indicated of assets measured at fair value on a recurring basis:

(In Thousands)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
March 31, 2013				
Available for sale securities				
U.S. Treasury and government sponsored entities	$ 139,565	$ -	$ 139,565	$ -
Municipal securities	22,151	-	22,151	-
U.S. Agency mortgage-backed securities	34	-	34	-
Corporate bonds	57,081	-	57,081	-
Preferred stock	2,629	-	2,629	-
Total	$ 221,460	$ -	$ 221,460	$ -
December 31, 2012				
Available for sale securities				
U.S. Treasury and government sponsored entities	$ 124,414	$ -	$ 124,414	$ -
Municipal securities	21,728	-	21,728	-
U.S. Agency mortgage-backed securities	36	-	36	-
Corporate bonds	53,982	-	53,982	-
Preferred stock	3,758	-	3,758	-
Total	$ 203,918	$ -	$ 203,918	$ -

As of and for the three months ending March 31, 2013 and 2012, no impairment or valuation adjustment was recognized for assets recognized at fair value on a nonrecurring basis, except for certain assets as shown in the following table. For loans measured for impairment, the Company classifies fair value measurements using observable inputs, such as external appraisals, as level 2 valuations in the fair value hierarchy, and unobservable inputs, such as in-house evaluations, as level 3 valuations in the fair value hierarchy.

(In Thousands)	Total	Quoted Prices in Active Markets for	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total (gains) losses

		Identical Assets (Level 1)			
March 31, 2013					
Loans measured for impairment[1]	$ 1,459	$ -	$ 770	$ 689	$ -
Total	$ 1,459	$ -	$ 770	$ 689	$ -
March 31, 2012					
Loans measured for impairment[1]	$ 1,993	$ -	$ 921	$ 1,072	$ (403)
Total	$ 1,993	$ -	$ 921	$ 1,072	$ (403)

[1] Relates to certain impaired collateral dependent loans. The impairment was measured based on the fair value of collateral, in accordance with U.S. GAAP. The unobservable inputs for Level 3 impaired loans did not change between December 31, 2012 and March 31, 2013. The $403,000 gain noted above for 2012 arose primarily from principal paydowns on impaired loans during the period.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion should be read in conjunction with the unaudited consolidated financial statements of Northrim BanCorp, Inc. (the “Company”) and the notes thereto presented elsewhere in this report and with the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

Note Regarding Forward Looking-Statements

This quarterly report on Form 10-Q includes “forward-looking statements,” as that term is defined for purposes of Section 21D of the Securities Exchange Act, which are not historical facts. These forward-looking statements describe management’s expectations about future events and developments such as future operating results, growth in loans and deposits, continued success of the Company’s style of banking, and the strength of the local economy. All statements other than statements of historical fact, including statements regarding industry prospects and future results of operations or financial position, made in this report are forward-looking. We use words such as “anticipate,” “believe,” “expect,” “intend” and similar expressions in part to help identify forward-looking statements. Forward-looking statements reflect management’s current plans and expectations and are inherently uncertain. Our actual results may differ significantly from management’s expectations, and those variations may be both material and adverse. Forward-looking statements are subject to various risks and uncertainties that may cause our actual results to differ materially and adversely from our expectations as indicated in the forward-looking statements. These risks and uncertainties include: the general condition of, and changes in, the Alaska economy; factors that impact our net interest margin; and our ability to maintain asset quality. Further, actual results may be affected by competition on price and other factors with other financial institutions; customer acceptance of new products and services; the regulatory environment in which we operate; and general trends in the local, regional and national banking industry and economy. Many of these risks, as well as other risks that may have a material adverse impact on our operations and business, are identified in Part II. Item 1A Risk Factors of this report, and in our other filings with the Securities and Exchange Commission. However, you should be aware that these factors are not an exhaustive list, and you should not assume these are the only factors that may cause our actual results to differ from our expectations. In addition, you should note that we do not intend to update any of the forward-looking statements or the uncertainties that may adversely impact those statements, other than as required by law.

Critical Accounting Policies

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

The accounting policies that involve significant estimates and assumptions by management, which have a material impact on the carrying value of certain assets and liabilities, are considered critical accounting policies. The Company’s critical accounting policies include those that address the accounting for the Allowance, the valuation of goodwill and other intangible assets, and the valuation of other real estate owned. These critical accounting policies are further described in Item 7, Management's Discussion and Analysis, and in Note 1, Summary of Significant Accounting Policies, of the Notes to Consolidated Financial Statements in the Company's Form 10-K for the year ended December 31, 2012. Management has applied its critical accounting policies and estimation methods consistently in all periods presented in these consolidated financial statements.

Update on Economic Conditions

According to the Associated General Contractors of Alaska annual Alaska Construction Spending Forecast (the "Forecast"), construction spending in Alaska in 2013 is estimated to be about $8.4 billion, up 8% from spending in 2012. In addition according to the Forecast, increased spending in the oil and gas sector is expected to account for most of this growth. Spending in the oil and gas sector is expected to be up 13%, from $3.2 billion last year to $3.6 billion in 2013, according to the Forecast. Also adding to expected growth, as stated in the Forecast, is a large state capital budget for fiscal year 2013 and $453 million in general obligation bonds that voters approved for transportation projects in the November 2012 election.

Highlights and Summary of Performance – First Quarter of 2013

- Diluted earnings per share in the first quarter of 2013 were $0.41, compared to $0.39 per diluted share in the quarter ended March 31, 2012.
- Net interest income increased to $10.6 million in the first quarter of 2013, compared to $10.4 million in the quarter ended March 31, 2012.
- Tangible book value was $19.95 per share at quarter end as compared to $19.67 per share at December 31, 2012. Tangible book value is a non-GAAP ratio that represents total shareholders' equity less goodwill and intangible assets divided by the number of shares outstanding. The GAAP measure of book value is total shareholders' equity divided by the number of shares outstanding. Book value per share was $21.19 at March 31, 2013, compared to $19.80 at December 31, 2012.
- Asset quality improved slightly with nonperforming assets declining to $8.9 million, or 0.77% of total assets at March 31, 2013, compared to $9.1 million, or 0.78% of total assets at December 31, 2012.
- The allowance for loan losses totaled 2.31% of gross loans at March 31, 2013, compared to 2.33% at December 31, 2012. The allowance for loan losses to nonperforming loans increased to 378% at March 31, 2013, from 362% at December 31, 2012.
- The Company remains well-capitalized with Tier 1 Capital to Risk Adjusted Assets at March 31, 2013, of 15.07%, compared to 15.34% at December 31, 2012. Tangible common equity to tangible assets was 11.37% at March 31, 2013, compared to 11.12% December 31, 2012. Tangible common equity to tangible assets is a non-GAAP ratio that represents total equity less goodwill and intangible assets divided by total assets less goodwill and intangible assets. The GAAP measure of equity to assets is total equity divided by total assets. Total equity to total assets was 12.00% at March 31, 2013 as compared to 11.75% at December 31, 2012.

The Company reported net income and diluted earnings per share of $2.7 million and $0.41, respectively, for the first quarter of 2013 compared to net income and diluted earnings per share of $2.6 million and $0.39, respectively, for the first quarter of 2012. The increase in net income for the first quarter of 2013 as compared to the first quarter of 2012 was the result of an increase in net interest income and a decrease in other operating expenses. These changes were only partially offset by increases in the provision for loan losses and the provision for income taxes as well as a decrease in other operating income.

The Company's total assets decreased by 1% at March 31, 2013 as compared to December 31, 2012, with decreases in interest bearing deposits in other banks and cash and due from banks which were only partially offset by increases in loans and investment securities available for sale. Net loans increased to $716.4 million at March 31, 2013 as compared to $699.5 million at December 31, 2012

Credit Quality

Nonperforming assets: Nonperforming assets at March 31, 2013 decreased $154,000, or 2% as compared to December 31, 2012. Nonaccrual loans decreased $239,000, loans 90 days past due but still accruing interest increased $112,000, and OREO decreased $27,000 at March 31, 2013 as compared to December 31, 2012.

The following table summarizes total OREO activity for the three month periods ending March 31, 2013 and 2012:

	Three Months Ended March 31,	
	2013	2012
Balance, beginning of the period	$ 4,543	$ 5,183

Transfers from loans, net	161	1,499
Investment in other real estate owned	-	17
Proceeds from the sale of other real estate owned	(201)	(50)
Gain on sale of other real estate owned, net	21	19
Deferred gain on sale of other real estate owned	(8)	(11)
Balance at end of period	$ 4,516	$ 6,657

Potential problem loans: Potential problem loans are loans which are currently performing that have developed negative indications that the borrower may not be able to comply with present payment terms and which may later be included in nonaccrual, past due, or impaired loans. At March 31, 2013, management had identified potential problem loans of $3.2 million as compared to potential problem loans of $2.7 million at December 31, 2012. The change in potential problem loans during this period is primarily due to the addition of four loans from four borrowers. These additions were partially offset by paydowns on existing potential problem loans.

Troubled debt restructurings ("TDRs"): TDRs are those loans for which concessions, including the reduction of interest rates below a rate otherwise available to that borrower, have been granted due to the borrower's weakened financial condition. Interest on TDRs will be accrued at the restructured rates when it is anticipated that no loss of original principal will occur, and the interest can be collected, which is generally after a period of six months. The Company had $6.6 million in loans classified as TDRs that were performing as of March 31, 2013. Additionally, there were $3.3 million in TDRs included in nonaccrual loans at March 31, 2013 for a total of $9.9 million. At December 31, 2012 there were $8.6 million, respectively, in loans classified as TDRs that were performing and $3.5 million in TDRs included in nonaccrual loans. See Note 6 of the Notes to Consolidated Financial Statements included in Item 1 of this report for further discussion of TDRs.

RESULTS OF OPERATIONS

Income Statement

Net Income

Net income attributable to Northrim BanCorp for the first quarter of 2013 increased $98,000, or 4%, to $2.7 million as compared to $2.6 million for the same period in 2012. This increase was due to an increase in net interest income, which is discussed in detail below, and a slight decrease in other operating expenses. These changes were only partially offset by increases in the provision for loan losses and the provision for income taxes as well as a slight decrease in other operating income.

Net Interest Income / Net Interest Margin

Net interest income for the first quarter of 2013 increased $208,000, or 2%, as compared to the first quarter in 2012. This increase arose from an increase in interest income on loans and a decrease in interest expense, which was partially offset by a decrease in interest income on investment securities. The increase in interest income on loans was due to increased average balances, which was partially offset by lower rates on loans, while the decreases in both interest income on investments and interest expense on deposits and borrowings were primarily the result of decreased interest rates. The Company's net interest income as a percentage of average interest-earning assets on a tax equivalent basis decreased by 21 basis points to 4.32% for the three-month period ending March 31, 2013 as compared to the same period in 2012.

Average loans, the largest category of interest-earning assets, increased by $47.6 million, or 7% to $716.8 million in the three-month period ending March 31, 2013 as compared to the same period in 2012. Average commercial loans, real estate term loans, and real estate construction loans increased while consumer loans and loans held for sale decreased during this period. Total interest income from loans increased $117,000 for the first quarter of 2013 as compared to the same period in 2012 due to increased average balances. This increase was only partially offset by the decrease in interest income from loans due to decreased yields.

Average investments increased 9% for the three-month period ending March 31, 2013 as compared to the same period in 2012. Interest income from investments decreased 9% due to decreased average yields for the three-month period ending March 31, 2013 as compared to the same period in the prior year.

Average interest-bearing liabilities increased $20.2 million, or 3%, to $645.4 million during the first quarter of 2013 as compared to $625.2 million for the same period in 2012. This increase is primarily the result of increased average interest-bearing deposit balances. In addition to this increase, the Company incurred a $2.2 million long term borrowing from the Federal Home Loan Bank of Seattle in the first quarter of 2013 to fund a loan to one borrower for the purpose of constructing a low-income housing project.

The average cost of interest-bearing liabilities decreased $168,000, or 7 basis points, for the three month period ending March 31, 2013 as compared to the same period in 2012, primarily due to declining market rates across all deposit types, and due to a change in the mix of deposits with a decrease in higher cost certificates of deposit and an increase in lower cost transaction accounts.

Components of Net Interest Margin

The following table compares average balances and rates as well as net tax equivalent margins on earning assets for the three month periods ending March 31, 2013 and 2012:

(Dollars in Thousands)	Three Months Ended March 31,									
					Interest income/				Average Yiel	
	Average Balances		Change		expense		Change		Tax Equivaler	
	2013	2012	$	%	2013	2012	$	%	2013	2012
Loans[1,2]	$ 716,797	$ 669,196	$ 47,601	7 %	$ 10,342	$ 10,225	$ 117	1 %	5.88 %	6.18
Short-term investments	73,849	43,044	30,805	72 %	62	40	22	55 %	0.33 %	0.37
Long-term investments	214,158	221,891	(7,733)	(3) %	688	787	(99)	(13) %	1.46 %	1.59
Total investments	288,007	264,935	23,072	9 %	750	827	(77)	(9) %	1.19 %	1.40
Interest-earning assets	1,004,804	934,131	70,673	8 %	11,092	11,052	40	0 %	4.54 %	4.82
Nonearning assets	109,572	112,741	(3,169)	(3) %						
Total	$ 1,114,376	$ 1,046,872	$ 67,504	6 %						
Interest-bearing deposits	$ 603,273	$ 586,665	$ 16,608	3 %	$ 338	$ 484	$ (146)	(30) %	0.23 %	0.33
Borrowings	42,168	38,531	3,637	9 %	192	214	(22)	(10) %	1.81 %	2.19
Total interest-bearing liabilities	645,441	625,196	20,245	3 %	530	698	(168)	(24) %	0.38 %	0.45
Demand deposits and other noninterest-bearing liabilities	331,042	294,335	36,707	12 %						
Equity	137,893	127,341	10,552	8 %						
Total	$ 1,114,376	$ 1,046,872	$ 67,504	6 %						
Net interest income					$ 10,562	$ 10,354	$ 208	2 %		
Net tax equivalent margin on interest earning assets[3]									4.32 %	4.53

[1] Loan fees recognized during the period and included in the yield calculation totaled $706,000 and $612,000 in the first quarte 2012, respectively.

[2] Average nonaccrual loans included in the computation of the average loans were $4.4 million and $6.8 million in the first qu and 2012, respectively.

[3] Tax-equivalent net interest margin is a non-GAAP performance measurement in which interest income on non-taxable inves loans is presented on a tax-equivalent basis using
a combined federal and state statutory rate of 41.11% in both 2013 and 2012.

The following table sets forth the changes in consolidated net interest income attributable to changes in volume and to changes in interest rates for the three-month periods ending March 31, 2013 and 2012. 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 rates.

(In Thousands)	Quarter ended March 31, 2013 vs. 2012 Increase (decrease) due to	
	Volume	Rate