

NORTHRIM BANCORP INC  
Form 10-Q  
May 06, 2013  
UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2013

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

(State or other jurisdiction of incorporation or organization)

92-0175752

(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  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).

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  Non-accelerated filer  Smaller reporting company

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

Yes  No

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.

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## ITEM 1. FINANCIAL STATEMENTS

## CONSOLIDATED FINANCIAL STATEMENTS

## NORTHRIM BANCORP, INC.

## Consolidated Balance Sheets

| (In Thousands, Except Share Data)              | March 31,<br>2013 | December<br>31,<br>2012 |
|--|-------------------|-------------------------|
| <b>ASSETS</b>                                  |                   |                         |
| 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            |
| <b>LIABILITIES</b>                             |                   |                         |
| 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                  |

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|                                |           |           |
|--------------------------------|-----------|-----------|
| 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<br>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        |

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|  |           |           |
|--|-----------|-----------|
| 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<br>Ended<br>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<br>\$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        |              | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated                      | Non-<br>controlling<br>Interest | Total      |
|---|---------------------|--------------|----------------------------------|----------------------|----------------------------------|---------------------------------|------------|
|   | Number<br>of Shares | Par<br>Value |                                  |                      | Other<br>Comprehensive<br>Income |                                 |            |
| 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

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## NORTHRIM BANCORP, INC.

## Consolidated Statements of Cash Flows

| (In Thousands)  | Three Months Ended<br>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:   |                                 |          |

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|   |           |           |
|---|-----------|-----------|
| (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)  |
| <br>  |           |           |
| 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

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<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>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<br>Cost | Fair Value | Weighted<br>Average<br>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<br>Gains | Gross<br>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 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        |

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|   |            |           |           |           |            |           |           |           |            |
|---|------------|-----------|-----------|-----------|------------|-----------|-----------|-----------|------------|
| 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.

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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<br>31, 2013 | December<br>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<br>Days<br>Past Due<br>Still<br>Accruing | 60-89<br>Days<br>Past Due<br>Still<br>Accruing | Greater<br>Than<br>90 Days<br>Still<br>Accruing | Nonaccrual | Total<br>Past<br>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<br>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<br>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<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>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 |

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| (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    | -    |



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|                               |           |           |        |
|-------------------------------|-----------|-----------|--------|
| 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.

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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 |
| <b>With no related allowance recorded</b>                         |                             |                            |                             |                            |
| 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                          | -                          |
| <b>Subtotal</b>   | <b>\$ 10,287</b>            | <b>\$ 102</b>              | <b>\$ 10,800</b>            | <b>\$ 110</b>              |
| <b>With an allowance recorded</b>                                 |                             |                            |                             |                            |
| 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                         | -                          | -                           | -                          |
| <b>Subtotal</b>   | <b>\$ 1,483</b>             | <b>\$ -</b>                | <b>\$ 2,048</b>             | <b>\$ -</b>                |
| <b>Total</b>  |                             |                            |                             |                            |
| 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                          |

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|  |           |        |           |        |
|--|-----------|--------|-----------|--------|
| 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 |

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<br>of Contracts | March 31,<br>2013<br>Recorded<br>Investment | March 31,<br>2012<br>Recorded<br>Investment |
|--|------------------------|---|---|
| <b>Troubled Debt Restructurings that Subsequently Defaulted:</b> |                        |   |   |
| 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<br>March 31,       | Commercial<br>(In Thousands) | Real<br>estate<br>construction<br>one-to-four<br>family | Real<br>estate<br>construction<br>other | Real<br>estate<br>term<br>owner<br>occupied | Real<br>estate<br>term<br>non-owner<br>occupied | Real<br>estate<br>term<br>other | Consumer<br>secured<br>by 1st<br>deeds of<br>trust | Consumer<br>other | Unallocated | Total     |
|---------------------------------------|------------------------------|---|---|---|---|---------------------------------|--|-------------------|-------------|-----------|
| 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<br>construction<br>one-to-four<br>family | Real estate<br>construction<br>other | Real<br>estate<br>term<br>owner<br>occupied | Real estate<br>term<br>non-owner<br>occupied | Real<br>estate<br>term<br>other | Consumer<br>secured<br>by 1st<br>deeds of<br>trust | Consumer<br>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:<br>Individually<br>evaluated<br>for impairment | \$ 1,956   | \$ 1,240   | \$ 2,497                             | \$ 1,486                                    | \$ 2,223                                     | \$ 1,605                        | \$ 374   | \$ 230            | \$ 11,611  |
| Balance, end of period:<br>Collectively<br>evaluated<br>for impairment | \$ 287,433 | \$ 29,044  | \$ 20,014                            | \$ 75,368                                   | \$ 237,154                                   | \$ 30,021                       | \$ 16,662  | \$ 17,763         | \$ 713,459 |
| December 31,<br>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:<br>Individually<br>evaluated<br>for impairment | \$ 2,452   | \$ 794   | \$ 2,748                             | \$ 1,083                                    | 2,260  | \$ 3,505                        | 93   | \$ 158            | \$ 13,093  |
| Balance, end of period:<br>Collectively<br>evaluated<br>for impairment | \$ 270,980 | \$ 31,779  | \$ 18,313                            | \$ 77,024                                   | \$ 232,383                                   | \$ 28,304                       | \$ 17,621  | \$ 18,147         | \$ 694,551 |



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

| (In Thousands)                         | Total     | Commercial | Real estate construction | Real estate family | Real estate other | Real estate term owner occupied | Real estate term non-owner occupied | Real estate term other | Consumer secured deeds of trust | Consumer other | Unallocated |
|--|-----------|------------|--------------------------|--------------------|-------------------|---------------------------------|-------------------------------------|------------------------|---------------------------------|----------------|-------------|
| <b>March 31, 2013</b>                  |           |            |                          |                    |                   |                                 |                                     |                        |                                 |                |             |
| 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    |
| <b>December 31, 2012</b>               |           |            |                          |                    |                   |                                 |                                     |                        |                                 |                |             |
| 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:

| (In Thousands)                                   | March 31, 2013  |            | December 31, 2012 |            |
|--|-----------------|------------|-------------------|------------|
|  | 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 <sup>1</sup>        | \$ 214,026      | \$ 2,140   | \$ 208,328        | \$ 2,083   |
| Standby letters of credit <sup>1</sup>           | 22,042          | 220        | 22,132            | 221        |

<sup>1</sup> Carrying amounts reflect the notional amount of credit exposure under these financial instruments.





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<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs (Level<br>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<br>Prices in<br>Active<br>Markets<br>for | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs (Level<br>3) | Total<br>(gains)<br>losses |
|----------------|-------|---|---|--|----------------------------|
|----------------|-------|---|---|--|----------------------------|

|  |          | Identical<br>Assets<br>(Level 1) |        |          |          |
|--|----------|----------------------------------|--------|----------|----------|
| March 31, 2013                             |          |                                  |        |          |          |
| Loans measured for impairment <sup>1</sup> | \$ 1,459 | \$ -                             | \$ 770 | \$ 689   | \$ -     |
| Total                                      | \$ 1,459 | \$ -                             | \$ 770 | \$ 689   | \$ -     |
| March 31, 2012                             |          |                                  |        |          |          |
| Loans measured for impairment <sup>1</sup> | \$ 1,993 | \$ -                             | \$ 921 | \$ 1,072 | \$ (403) |
| Total                                      | \$ 1,993 | \$ -                             | \$ 921 | \$ 1,072 | \$ (403) |

<sup>1</sup> 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<br>Ended March 31,<br>2013      2012 |          |
|----------------------------------|---|----------|
| Balance, beginning of the period | \$ 4,543  | \$ 5,183 |

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|   |          |          |
|---|----------|----------|
| 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/<br>expense |           | Change          |  | Average Yield<br>Tax Equivalent |        |
|---|------------------------------|--------------|----------------|--|-----------------------------|-----------|-----------------|--|---------------------------------|--------|
|   | Average Balances<br>2013     | 2012         | Change<br>\$ % |  | 2013                        | 2012      | \$ %            |  | 2013                            | 2012   |
| Loans <sup>1,2</sup>                                      | \$ 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<sup>3</sup> 4.32 % 4.53 %

<sup>1</sup> Loan fees recognized during the period and included in the yield calculation totaled \$706,000 and \$612,000 in the first quarter of 2013 and 2012, respectively.

<sup>2</sup> Average nonaccrual loans included in the computation of the average loans were \$4.4 million and \$6.8 million in the first quarter of 2013 and 2012, respectively.

<sup>3</sup> Tax-equivalent net interest margin is a non-GAAP performance measurement in which interest income on non-taxable investment 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<br>31, 2013 vs. 2012 |          |          |
|---------------------------|--|----------|----------|
|                           | Increase<br>(decrease) due<br>to         |          |          |
|                           | Volume                                   | Rate     | Total    |
| <b>Interest Income:</b>   |  |          |          |
| Loans                     | \$ 403                                   | \$ (286) | \$ 117   |
| Long-term investments     | (29)                                     | (70)     | (99)     |
| Short-term investments    | 26                                       | (4)      | 22       |
| Total interest income     | \$ 400                                   | \$ (360) | \$ 40    |
| <b>Interest Expense:</b>  |  |          |          |
| Interest-bearing deposits | \$ 16                                    | \$ (162) | \$ (146) |
| Borrowings                | 28                                       | (50)     | (22)     |
| Total interest expense    | \$ 43                                    | \$ (212) | \$ (168) |

The provision for loan losses was \$150,000 and \$89,000 for the three-month periods ending March 31, 2013 and 2012, respectively. The increase in the provision for loan losses in the first quarter of 2013 is primarily the result of increased loan balances. At March 31, 2013, the Allowance was \$16.6 million, or 2.31%% of total loans as compared to \$16.4 million, or 2.33% of total loans at December 31, 2012. Nonperforming loans compared to total portfolio loans decreased to 0.61% at March 31, 2013 from 0.64% at December 31, 2012, and the Allowance compared to nonperforming loans increased to 378% at March 31, 2013 from 362% at December 31, 2012. See additional analysis of the Allowance in the Balance Sheet Overview section.

### Other Operating Income

Other operating income for the first quarter of 2013 decreased \$68,000, or 2%, to \$3.1 million as compared to \$3.2 million for the first quarter of 2012. This decrease is primarily due to decreases of \$170,000 and \$59,000, respectively, in rental income and in equity in earnings from RML, the Company's mortgage affiliate. The decrease in rental income is the result of vacancies in leased space in the Company's corporate office building as areas recently vacated by previous tenants are undergoing capital improvements. The Company expects that this space will remain vacant for 2013 with new tenants leasing the space in 2014. The decrease in earnings from RML is due to decreased refinance activity at RML. These decreases were partially offset by an increase in gains on the sale of securities of \$191,000 in the first quarter of 2013 as compared to the same period in 2012.

### Other Operating Expense

Other operating expense for the first quarter of 2013 decreased \$61,000, or 1%, to \$9.7 million as compared to \$9.8 million for the first quarter of 2012. This decrease was primarily due to the following: a decrease of \$108,000 in occupancy expense which is primarily the result of lower rent expense due to the Company's termination of a lease for additional office space in the fourth quarter of 2012; a decrease of \$103,000 in OREO expense, net of rental income and gains on the sale of OREO properties, which primarily resulted from decreased operating costs attributable to OREO properties; and a \$69,000 decrease in professional and outside services due to decreased consulting fees related to the Company's salaries and other personnel benefits programs. These decreases were partially offset by an increase of \$84,000 for the reserve for purchased receivables, which was established in September of 2012, and slight increases in most other operating expense categories.

### Income Taxes

The provision for income taxes for the three-month period ending March 31, 2013 increased \$64,000, or 6%, as compared to the same period in 2012 primarily due to an increase in net income before the provision for income taxes. The effective tax rate for the first quarter of both 2013 and 2012 was 28%.

### Financial Condition

#### Balance Sheet Overview

#### Investment Securities

Investment securities at March 31, 2013 increased \$17.5 million, or 8%, to \$224.2 million from \$206.7 million at December 31, 2012. This increase is primarily due to purchases of available for sale securities.

#### Loans and Lending Activities

Our loan products include short and medium-term commercial loans, commercial credit lines, construction and real estate loans, and consumer loans. From our inception, we have emphasized commercial, land development and home construction, and commercial real estate lending. This type of lending has provided us with market opportunities and higher net interest margins than other types of lending. However, it also involves greater risks, including greater exposure to changes in local economic conditions, than certain other types of lending.

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The loan portfolio increased by \$17.4 million, or 2%, to \$721.6 million at March 31, 2013 from \$704.2 million at December 31, 2012 primarily due to a higher level of commercial and non-owner occupied real estate term loans. The following table details the changes in loan balances by loan type:

| (Dollars In Thousands)                                      | March 31,<br>2013 |                     | December 31,<br>2012 |                     |
|---|-------------------|---------------------|----------------------|---------------------|
|   | Dollar<br>Amount  | Percent<br>of Total | Dollar<br>Amount     | Percent<br>of Total |
| Commercial  | \$ 289,389        | 40.0 %              | \$ 273,432           | 38.8 %              |
| Real estate construction one-to-four family                 | 30,284            | 4.2 %               | 32,573               | 4.6 %               |
| Real estate construction other                              | 22,511            | 3.1 %               | 21,061               | 3.0 %               |
| Real estate term owner occupied                             | 76,854            | 10.7 %              | 78,107               | 11.1 %              |
| Real estate term non-owner occupied                         | 239,377           | 33.2 %              | 234,643              | 33.3 %              |
| Real estate term other                                      | 31,626            | 4.4 %               | 31,809               | 4.5 %               |
| Consumer secured by 1st deeds of trust                      | 17,036            | 2.4 %               | 17,714               | 2.5 %               |
| Consumer other  | 17,993            | 2.5 %               | 18,305               | 2.6 %               |
| Subtotal  | \$ 725,070        |                     | \$ 707,644           |                     |
| Less: Unearned origination fee,<br>net of origination costs | (3,461)           | (0.5) %             | (3,431)              | (0.4) %             |
| Total loans   | \$ 721,609        |                     | \$ 704,213           |                     |

Due to its efforts to capitalize on market opportunities, the Company expects its loan portfolio to increase during 2013 mainly in the commercial and real estate term areas.

#### Analysis of Allowance for Loan Losses

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

A specific allocation for impaired loans. Management determined the fair value of the majority of these loans based on the underlying collateral values. This analysis is based upon a specific analysis for each impaired loan, including external appraisals on loans secured by real property, management's assessment of the current market, recent payment history, and an evaluation of other sources of repayment. In-house evaluations of fair value are used in the impairment analysis in some situations. Inputs to the in-house evaluation process include information about sales of comparable properties in the appropriate markets and changes in tax assessed values. The Company obtains appraisals on real and personal property that secure its loans during the loan origination process in accordance with regulatory guidance and its loan policy. The Company obtains updated appraisals on loans secured by real or personal property based upon its assessment of changes in the current market or particular projects or properties, information from other current appraisals, and other sources of information. Appraisals may be adjusted downward by the Company based on its evaluation of the facts and circumstances on a case by case basis. External appraisals may be discounted when management believes that the absorption period used in the appraisal is unrealistic, when expected liquidation costs exceed those included in the appraisal, or when management's evaluation of deteriorating market conditions warrants an adjustment. Additionally, the Company may also adjust appraisals in the above circumstances between appraisal dates. The Company uses the information provided in these updated appraisals along with its evaluation of all other information available on a particular property as it assesses the collateral coverage on its

performing and nonperforming loans and the impact that may have on the adequacy of its Allowance. The specific allowance for impaired loans, as well as the overall Allowance, may increase based on the Company's assessment of updated appraisals. When the Company determines that a loss has occurred on an impaired loan, a charge-off equal to the difference between carrying value and fair value is recorded. If a specific allowance is deemed necessary for a loan, and then that loan is partially charged off, the loan remains classified as a nonperforming loan after the charge-off is recognized. Loans measured for impairment based on collateral value and all other loans measured for impairment are accounted for in the same way. As of March 31, 2013 and 2012, 35% and 42% of nonperforming loans, which totaled \$4.4 million and \$6.8 million, respectively, had partially charged off balances.

A general allocation. The Company has identified segments and classes of loans not considered impaired for purposes of establishing the general allocation allowance. The Company determined the disaggregation of the loan portfolio into segments and classes based on its assessment of how different pools of loans with like characteristics in the portfolio behave over time.

This determination is based on historical experience and management's assessment of how current facts and circumstances are expected to affect the loan portfolio.

The Company has the following loan segments: commercial, real estate construction one-to-four family, real estate construction other, real estate term owner occupied, real estate term non-owner occupied, real estate term other, consumer secured by 1st deeds of trust, and other consumer loans. The Company has five loan classes: pass, special mention, substandard, doubtful, and loss.

After the portfolio has been disaggregated into segments and classes, the Company calculates a general reserve for each segment and class based on the average year loss history for each segment and class using a five year look-back period.

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

An unallocated reserve. The unallocated portion of the Allowance provides for other credit losses inherent in the Company's loan portfolio that may not have been contemplated in the specific and general components of the Allowance, and it acknowledges the inherent imprecision of all loss prediction models. The unallocated component is reviewed periodically based on trends in credit losses and overall economic conditions.

At March 31, 2013, the unallocated portion of the Allowance as a percentage of the total Allowance was 7%. The unallocated portion of the Allowance as a percentage of the total Allowance was 12% at December 31, 2012.

Further discussion of the enhancement to the Company's Allowance methodology can be found in Item 7 in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

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

|  | Three Months<br>Ended<br>March 31,<br>2013      2012<br>(In Thousands) |           |
|--|--|-----------|
| Balance at beginning of period         | \$ 16,408  | \$ 16,503 |
| Charge-offs:                           |  |           |
| Commercial                             | -  | 231       |
| Real estate term owner occupied        | -  | 146       |
| Real estate term other                 | -  | 280       |
| Consumer secured by 1st deeds of trust | 14   | -         |
| Total charge-offs                      | 14   | 657       |
| Recoveries:                            |  |           |
| Commercial                             | 76   | 349       |

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|                                     |           |           |
|-------------------------------------|-----------|-----------|
| Real estate construction other      | 18        | -         |
| Consumer other                      | 3         | 4         |
| Total recoveries                    | 97        | 353       |
| Net, (recoveries) charge-offs       | (83)      | 304       |
| Provision (benefit) for loan losses | 150       | 89        |
| Balance at end of period            | \$ 16,641 | \$ 16,288 |

While management believes that it uses the best information available to determine the Allowance, unforeseen market conditions and other events could result in adjustment to the Allowance, and net income could be significantly affected if circumstances differed substantially from the assumptions used in making the final determination of the Allowance. Moreover, bank regulators frequently monitor banks' loan loss allowances, and if regulators were to determine that the Company's Allowance is inadequate, they may require the Company to increase the Allowance, which may adversely impact the Company's net income and financial condition.

## Deposits

Deposits are the Company's primary source of funds. Total deposits decreased \$15.2 million to \$954.9 million at March 31, 2013, from \$970.1 million at December 31, 2012. Noninterest-bearing demand deposits at March 31, 2013, decreased 5% from December 31, 2012. However, the Company's mix of deposits continues to contribute to a low cost of funds with balances in transaction accounts representing 90% of total deposits at March 31, 2013 and December 31, 2012, respectively. Savings account balances at March 31, 2013 were up 6% as compared to December 31, 2012. At the end of the first quarter of 2013, noninterest-bearing demand deposits accounted for 36% of total deposits, interest-bearing demand accounts were 15%, savings deposits were 10%, money market balances accounted for 19%, the Alaska CD accounted for 10% and time certificates were 10% of total deposits. There were no depositors with deposits representing 10% or more of total deposits at March 31, 2013 or December 31, 2012.

## Borrowings

At March 31, 2013, the Company's maximum borrowing line from the FHLB was \$159.2 million, approximately 14% of the Company's assets. The Company has an outstanding FHLB advance of \$2.2 million as of March 31, 2013 that was originated in the first quarter of 2013. The Company did not have any outstanding FHLB advances at December 31, 2012. FHLB advances are dependent on the availability of acceptable collateral such as marketable securities or real estate loans, although all FHLB advances are secured by a blanket pledge of the Company's assets. The \$2.2 million FHLB advance that the Company drew in the first quarter of 2013 was to match fund a \$2.2 million loan to one borrower for the construction of a low income housing project that qualifies for a long term fixed interest rate of 3.12%. This is an eighteen year loan with a 30 year amortization period.

The Company purchased its main office facility for \$12.9 million on July 1, 2008. In this transaction, the Company, through Northrim Building LLC, assumed an existing loan secured by the building in an amount of \$5.1 million. At March 31, 2013 and December 31, 2012, the outstanding balance on this loan was \$4.4 million and \$4.5 million, respectively. This loan has a maturity date of April 1, 2014 and a fixed interest rate of 5.95%.

At March 31, 2013 and December 31, 2012, the Company had no short-term (original maturity of one year or less) borrowings that exceeded 30% of shareholders' equity.

## Liquidity and Capital Resources

The Company manages its liquidity through its Asset and Liability Committee. In addition to the \$102.5 million of cash and due from banks and interest bearing deposits in other banks and \$192.5 million in unpledged available for sale securities held at March 31, 2013, the Company had additional funding sources which include fed fund borrowing lines and advances available at the FHLB of Seattle and the Federal Reserve Bank of approximately \$121.9 million as of March 31, 2013.

At March 31, 2013, \$31.7 million in securities, or 14%, of the investment portfolio was pledged, as compared to \$42.7 million, or 21%, at December 31, 2012. As shown in the Consolidated Statements of Cash Flows, net cash provided by operating activities was \$2.2 million for the first three months of 2013. Net cash used by investing activities was \$34.8 million for the same period, primarily due to purchases of available for sale securities and increased loan balances during the period. Net cash used by financing activities was \$19.7 million, primarily due to a decrease in deposits.

The Company issued 1,447 shares of its common stock through the exercise of stock options in the first quarter of 2013 and did not repurchase any shares of its common stock under the Company's publicly announced repurchase program. At March 31, 2013, the Company had 6,513,096 shares of its common stock outstanding.

## Capital Requirements and Ratios



The Company and its wholly-owned subsidiary, Northrim Bank (the “Bank”), are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum regulatory capital requirements can result in certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material adverse effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by regulators about the components of regulatory capital, risk weightings, and other factors. The regulatory agencies may establish higher minimum requirements if, for example, a bank or bank holding company has previously received special attention or has a high susceptibility to interest rate risk.

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The requirements address both risk-based capital and leverage capital. At March 31, 2013, all capital ratios of the Company and the Bank exceeded the ratios required for a “well-capitalized” institution.

The following table illustrates the actual capital ratios for the Company and the Bank as calculated under regulatory guidelines, compared to the regulatory minimum capital ratios and the regulatory minimum capital ratios needed to be eligible to qualify as a “well-capitalized” institution as of March 31, 2013.

|                           | Adequately-<br>Capitalized |   | Well-<br>Capitalized |   | Actual<br>Ratio<br>Northrim<br>BanCorp,<br>Inc. | Actual<br>Ratio<br>Northrim<br>Bank |
|---------------------------|----------------------------|---|----------------------|---|---|-------------------------------------|
| March 31, 2013            |                            |   |                      |   |   |                                     |
| Tier 1 risk-based capital | 4.00                       | % | 6.00                 | % | 15.07 %   | 13.55 %                             |
| Total risk-based capital  | 8.00                       | % | 10.00                | % | 16.32 %   | 14.81 %                             |
| Leverage ratio            | 4.00                       | % | 5.00                 | % | 13.41 %   | 12.08 %                             |
| December 31, 2012         |                            |   |                      |   |   |                                     |
| Tier 1 risk-based capital | 4.00                       | % | 6.00                 | % | 15.34 %   | 13.87 %                             |
| Total risk-based capital  | 8.00                       | % | 10.00                | % | 16.60 %   | 15.12 %                             |
| Leverage ratio            | 4.00                       | % | 5.00                 | % | 12.99 %   | 11.74 %                             |

The regulatory capital ratios for the Company exceed those for the Bank primarily because the \$18.6 million junior subordinated debenture offerings that the Company completed in the third quarter of 2003 and the fourth quarter of 2005 are included in the Company’s capital for regulatory purposes although such securities are accounted for as a long-term debt in its financial statements. The junior subordinated debentures are not accounted for on the Bank’s financial statements nor are they included in its capital. As a result, the Company has \$18.6 million more in regulatory capital than the Bank, which explains the significant difference in the capital ratios for the two entities.

### Off-Balance Sheet Items

The Company is a party to financial instruments with off-balance sheet risk. Among the off-balance sheet items entered into in the ordinary course of business are commitments to extend credit and the issuance of letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized on the balance sheet. Certain commitments are collateralized. As of March 31, 2013 and December 31, 2012, the Company’s commitments to extend credit and to provide letters of credit which are not reflected on its balance sheet amounted to \$236.1 million and \$230.5 million, respectively. Since many of the commitments are expected to expire without being drawn upon, these total commitment amounts do not necessarily represent future cash requirements.

### Capital Expenditures and Commitments

As of March 31, 2013, the Company has capital commitments of \$934,000 related to the planned improvements to the Company’s corporate office building. The Company expects these capital expenditures to be incurred in the second quarter of 2013.

## ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our assessment of market risk as of March 31, 2013 indicates that there are no material changes in the quantitative and qualitative disclosures from those in our Annual Report on Form 10-K for the year ended December 31, 2012.

#### ITEM 4. CONTROLS AND PROCEDURES

##### Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, we evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934). Our principal executive and financial officers supervised and participated in this evaluation. Based on this evaluation, our principal executive and financial officers each concluded that as of March 31, 2013, the disclosure controls and procedures are effective in timely alerting them to material information required to be included in the periodic reports to the Securities and Exchange Commission. The design of any system of controls is based in part upon various assumptions about the likelihood of future events, and there can be no

assurance that any of our plans, products, services or procedures will succeed in achieving their intended goals under future conditions.

#### Changes in Internal Control over Disclosure and Reporting

There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) and 15-d-15(f) of the Securities Exchange Act of 1934) that occurred during the quarterly period ended March 31, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II – OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

During the normal course of its business, the Company is a party to various debtor-creditor legal actions, disputes, claims, and litigation related to the conduct of its banking business. These include cases filed as a plaintiff in collection and foreclosure cases, and the enforcement of creditors' rights in bankruptcy proceedings. Management does not expect that the resolution of these matters will have a material effect on the Company's business, financial position, results of operations, or cash flows.

### ITEM 1A. RISK FACTORS

For information regarding risk factors, please refer to Item 1A in the Company's Annual Report on Form 10-K for the year ended December 31, 2012. These risk factors have not materially changed as of March 31, 2013.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a)-(b) Not applicable

(c) There were no stock repurchases by the Company during the three months ending March 31, 2013.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

### ITEM 4. MINE SAFETY DISCLOSURES

Note applicable.

### ITEM 5. OTHER INFORMATION

(a) Not applicable

(b) There have been no material changes to the procedures by which shareholders may nominate directors to the Company's board of directors.

ITEM 6. EXHIBITS

- 31.1 Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a)
- 31.2 Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a)
- 32.1 Certification of Chief Executive Officer required by Rule 13a-14(b) or Rule 15d-14(b) and Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350
- 32.2 Certification of Chief Financial Officer required by Rule 13a-14(b) or Rule 15d-14(b) and Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350
- 101.INS XBRL Instance Document
- 101.SCH XBRL Schema Document
- 101.CAL XBRL Calculation Linkbase Document
- 101.LAB XBRL Labels Linkbase Document
- 101.PRE XBRL Presentation Linkbase Document
- 101.DEF XBRL Definition Linkbase Document

Notes to Exhibits List:

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheet, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income and Changes in Shareholders' Equity, (iv) Consolidated Statements of Cash Flows, and (v) Notes to the Consolidated Financial Statements. In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NORTHRIM BANCORP, INC.

May 6, 2013 By: /s/ R. Marc Langland

R. Marc Langland  
Chairman, President, and CEO  
(Principal Executive Officer)

May 6, 2013 By: /s/ Joseph M. Schierhorn

Joseph M. Schierhorn  
Executive Vice President, Chief Financial Officer  
(Principal Financial and Accounting Officer)