NORTHRIM BANCORP INC
Form 10-K
March 13, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-K
(Mark One)
þ Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2014
o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from_____to____
Commission File Number 000-33501
NORTHRIM BANCORP, INC.
(Exact name of registrant as specified in its charter)

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

3111 C Street
Anchorage, Alaska 99503
(Address of principal executive offices) (Zip Code)
(907) 562-0062
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act: N/A
Securities registered pursuant to Section 12(g) of the Act:

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ¨ Yes ý No
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ¨ Yes ý No
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ý Yes ¨ No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ý Yes ¨ No
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨ Yes ý No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large Accelerated Filer ¨ Accelerated Filer ý Non-accelerated Filer ¨ (Do not check if a smaller reporting company) Smaller Reporting Company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). ¨ Yes ý No

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

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

DOCUMENTS INCORPORATED BY REFERENCE

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

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PART I

Cautionary Note Regarding Forward Looking Statements

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

ITEM 1. BUSINESS

General

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

The Company has four wholly-owned subsidiaries:

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

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

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

The Bank has two wholly-owned subsidiaries:

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

Segments

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

Business Strategy

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

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

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

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

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

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

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

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

Employees

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

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

Products and Services

Community Banking

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

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

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

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

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

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

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

Home Mortgage Lending

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

Alaska Economy

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

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

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

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

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

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

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

Competition

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

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

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Supervision and Regulation

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Available Information

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

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

ITEM 1A. RISK FACTORS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Our loan loss allowance may not be adequate to cover future loan losses, which may adversely affect our earnings.
We have established a reserve for probable losses we expect to incur in connection with loans in our credit portfolio. This allowance reflects our estimate of the collectability of certain identified loans, as well as an overall risk assessment of total loans outstanding. Our determination of the amount of loan loss allowance is highly subjective; although management personnel apply criteria such as risk ratings and historical loss rates, these factors may not be adequate predictors of future loan performance. Accordingly, we cannot offer assurances that these estimates ultimately will prove correct or that the loan loss allowance will be sufficient to protect against losses that ultimately may occur. If our loan loss allowance proves to be inadequate, we may suffer unexpected charges to income, which would adversely impact our results of operations and financial condition. Moreover, bank regulators frequently monitor banks' loan loss allowances, and if regulators were to determine that the allowance is inadequate, they may require us to increase the allowance, which also would adversely impact our net income and financial condition.
We have a significant concentration in real estate lending. A downturn in real estate within our markets has a negative impact on our results of operations.
Approximately 74% of the Bank’s loan portfolio at December 31, 2014 consisted of loans secured by commercial and residential real estate located in Alaska. In recent years, the slowdown in the residential sales cycle in our major markets and a constriction in the availability of mortgage financing have negatively impacted residential real estate sales, which has resulted in customers’ inability to repay loans. Although non-performing assets have decreased over the past several years following the financial crisis, we could see an increase in non-performing assets if more borrowers fail to perform according to loan terms and if we take possession of real estate properties. Additionally, if real estate values decline, the value of real estate collateral securing our loans could be significantly reduced. If any of these effects continue or become more pronounced, loan losses will increase more than we expect and our financial condition and results of operations would be adversely impacted.
Further, approximately 47% of the Bank’s loan portfolio at December 31, 2014 consisted of commercial real estate loans. Nationally, delinquencies in these types of portfolios have increased significantly in recent years. While our investments in these types of loans have not been as adversely impacted as residential construction and land development loans, there can be no assurance that the credit quality in these portfolios will remain stable. Commercial construction and commercial real estate loans typically involve larger loan balances to single borrowers or groups of related borrowers. Consequently, an adverse development with respect to one commercial loan or one credit relationship exposes us to significantly greater risk of loss compared to an adverse development with respect to a consumer loan. The credit quality of these loans may deteriorate more than expected which may result in losses that exceed the estimates that are currently included in our loan loss allowance, which could adversely affect our financial conditions and results of operations.
Real estate values may decrease leading to additional and greater than anticipated loan charge-offs and valuation write downs on our other real estate owned (“OREO”) properties.
Real estate owned by the Bank and not used in the ordinary course of its operations is referred to as “other real estate owned” or “OREO” property. We foreclose on and take title to the real estate serving as collateral for defaulted loans as part of our business. At December 31, 2014, the Bank held $4.6 million of OREO properties, many of which relate to residential construction and land development loans. Increased OREO balances lead to greater expenses as we incur costs to manage and dispose of the properties. Our ability to sell OREO properties is affected by public perception that banks are inclined to accept large discounts from market value in order to quickly liquidate properties. Any decrease in market prices may lead to OREO write downs, with a corresponding expense in our income statement. We evaluate OREO property values periodically and write down the carrying value of the properties if the results of our evaluations require it. Further write-downs on OREO or an inability to sell OREO properties could have a material adverse effect on our results of operations and financial condition.
Changes in the FRB’s monetary or fiscal policies could adversely affect our results of operations and financial condition.
Our earnings will be affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The FRB has, and is likely to continue to have, an important impact on the operating results of depository institutions through its power to implement national monetary policy, among other

things, in order to curb inflation or combat a recession. The FRB affects the levels of bank loans, investments and deposits through its control over the issuance of United States government securities, its regulation of the discount rate applicable to member banks and its influence over reserve requirements to which member banks are subject. We cannot predict the nature or impact of future changes in monetary and fiscal policies.

Changes in market interest rates could adversely impact the Company.

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

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

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

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

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

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

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

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The soundness of other financial institutions could adversely affect us.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

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

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

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

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

ITEM 3. LEGAL PROCEEDINGS

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

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

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

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

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

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

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

Repurchase of Securities

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

Equity Compensation Plan Information

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

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

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

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

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

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Stock Performance Graph

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

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

ITEM 6. SELECTED FINANCIAL DATA [1]

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

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

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

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

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

Reconciliation of Selected Financial Data to GAAP Financial Measures

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

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

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

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

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

Calculation of efficiency ratio

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

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

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

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

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

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

Executive Overview

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

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

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

("Allowance") totaled

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

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

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

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

Critical Accounting Estimates

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

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

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

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

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

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

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

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

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

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

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

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

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

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

RESULTS OF OPERATIONS

Income Statement

Net Income

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

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

Net Interest Income / Net Interest Margin

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Provision for Loan Losses

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

Other Operating Income

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

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

2014 Compared to 2013

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

2013 Compared to 2012

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

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Other Operating Expense

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

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

2014 Compared to 2013

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

2013 Compared to 2012

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

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

Results of Segment Operations

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

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

The following tables present each segment's financial information:

December 31, 2014

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

December 31, 2013

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

Income Taxes

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

Financial Condition

Investment Securities

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

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

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

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

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

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

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

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

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

Loans

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Credit Quality and Nonperforming Assets

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

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

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

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

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

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

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

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

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

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

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

The following summarizes OREO activity for the periods indicated:

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

Allowance for Loan Losses

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

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

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

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

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

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

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

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

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

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

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

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

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

(In Thousands)	2014	2013	2012	2011	2010
Balance at beginning of year	$16,282	$16,408	$16,503	$14,406	$13,108
Charge-offs:					
Commercial	(319)	(1,018)	(496)	(1,225)	(3,919)
Real estate construction one-to-four family	—	—	—	—	(79)
Real estate construction other	—	—	—	(133)	(1,440)
Real estate term owner occupied	—	—	(274)	—	(222)
Real estate term non-owner occupied	(160)	—	—	—	—
Real estate term other	—	—	(280)	(90)	(120)
Consumer secured by 1st deeds of trust	(59)	(14)	—	—	—
Consumer other	(87)	(164)	(122)	(71)	(322)
Total charge-offs	(625)	(1,196)	(1,172)	(1,519)	(6,102)
Recoveries:					
Commercial	1,041	1,049	2,518	1,426	