NORTHRIM BANCORP INC
Form 10-Q
November 06, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q
(Mark One)
þ Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2015
o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from_____to____
Commission File Number 000-33501
NORTHRIM BANCORP, INC.
(Exact name of registrant as specified in its charter)

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

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

(907) 562-0062

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
¨ Yes ý No
The number of shares of the issuer's Common Stock, par value $1 per share, outstanding at November 6, 2015 was 6,862,916.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

These consolidated financial statements should be read in conjunction with the financial statements, accompanying notes and other relevant information included in Northrim BanCorp, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2014.

ITEM 1. FINANCIAL STATEMENTS

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

(In Thousands, Except Share Data)	September 30, 2015	December 31, 2014
ASSETS		
Cash and due from banks	$42,257	$36,036
Interest bearing deposits in other banks	102,309	36,020
Investment securities available for sale	234,273	281,730
Investment securities held to maturity	904	2,201
Total portfolio investments	235,177	283,931
Investment in Federal Home Loan Bank stock	1,816	3,404
Loans held for sale	66,597	43,866
Loans	973,680	924,504
Allowance for loan losses	(17,848)	(16,723)
Net loans	955,832	907,781
Purchased receivables, net	13,732	15,254
Accrued interest receivable	3,476	3,373
Other real estate owned, net	3,511	4,607
Premises and equipment, net	39,434	35,643
Goodwill	22,334	22,334
Other intangible assets, net	1,483	1,701
Other assets	51,295	55,399
Total assets	$1,539,253	$1,449,349
LIABILITIES		
Deposits:		
Demand	$485,304	$403,523
Interest-bearing demand	179,080	185,114
Savings	221,205	222,324
Money market	236,488	226,574
Certificates of deposit less than $100,000	53,386	58,249
Certificates of deposit greater than $100,000	89,456	83,963
Total deposits	1,264,919	1,179,747
Securities sold under repurchase agreements	33,413	19,843
Borrowings	12,458	26,304
Junior subordinated debentures	18,558	18,558
Other liabilities	34,569	40,456
Total liabilities	1,363,917	1,284,908
SHAREHOLDERS' EQUITY		
Preferred stock, $1 par value, 2,500,000 shares authorized, none issued or outstanding	—	—
Common stock, $1 par value, 10,000,000 shares authorized, 6,859,351 and 6,854,189 shares issued and outstanding at September 30, 2015 and December 31, 2014, respectively	6,859	6,854
Additional paid-in capital	62,183	61,729
Retained earnings	105,363	95,493

Accumulated other comprehensive income	784	247
Total Northrim BanCorp shareholders' equity	175,189	164,323
Noncontrolling interest	147	118
Total shareholders' equity	175,336	164,441
Total liabilities and shareholders' equity	$1,539,253	$1,449,349

See notes to consolidated financial statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In Thousands, Except Per Share Data)	2015	2014	2015	2014
Interest Income				
Interest and fees on loans	$14,484	$13,437	$42,086	$37,390
Interest on investment securities available for sale	844	696	2,488	2,176
Interest on investment securities held to maturity	13	24	61	69
Interest on deposits in other banks	47	55	82	145
Total Interest Income	15,388	14,212	44,717	39,780
Interest Expense				
Interest expense on deposits, borrowings and junior subordinated debentures	706	487	2,208	1,411
Net Interest Income	14,682	13,725	42,509	38,369
Provision for loan losses	676	—	1,378	(1,136)
Net Interest Income After Provision for Loan Losses	14,006	13,725	41,131	39,505
Other Operating Income				
Mortgage banking income	8,113	—	23,235	—
Employee benefit plan income	1,004	899	2,712	2,653
Electronic banking income	721	590	2,043	1,694
Purchased receivable income	587	582	1,738	1,547
Service charges on deposit accounts	559	599	1,617	1,682
Gain on sale of securities, net	4	15	134	461
Gain on sale of premises and equipment	—	1,115	—	1,115
Equity in earnings from RML	—	384	—	608
Other income	1,419	750	3,026	2,014
Total Other Operating Income	12,407	4,934	34,505	11,774
Other Operating Expense				
Salaries and other personnel expense	11,440	7,107	33,115	19,866
Occupancy expense	1,522	1,041	4,720	3,030
Change in fair value, RML earn-out liability	780	—	2,869	—
Professional and outside services	642	323	2,184	947
Marketing expense	565	417	1,824	1,425
Insurance expense	406	319	1,075	788
Equipment expense	387	405	1,249	1,062
Software expense	298	383	947	997
Internet banking expense	229	264	676	677
Intangible asset amortization expense	73	81	218	214
Merger and acquisition expense	—	1,031	—	1,736
Reserve for (recovery from) purchased receivables	(23)	241	(95)	447
OREO (income) expense, net rental income and gains on sale	152	(68)	328	(315)
Other operating expense	1,732	1,235	5,308	3,494
Total Other Operating Expense	18,203	12,779	54,418	34,368
Income Before Provision for Income Taxes	8,210	5,880	21,218	16,911
Provision for income taxes	2,678	1,982	7,111	5,848
Net Income	5,532	3,898	14,107	11,063
Less: Net income attributable to the noncontrolling interest	197	191	431	329

Net Income Attributable to Northrim BanCorp, Inc.	$5,335	$3,707	$13,676	$10,734
Earnings Per Share, Basic	$0.78	$0.54	$2.00	$1.59
Earnings Per Share, Diluted	$0.77	$0.53	$1.97	$1.57
Weighted Average Shares Outstanding, Basic	6,856,059	6,831,976	6,854,862	6,733,175
Weighted Average Shares Outstanding, Diluted	6,952,209	6,919,993	6,941,861	6,822,288

See notes to consolidated financial statements

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

(In Thousands)	Three Months Ended September 30, 2015	2014	Nine Months Ended September 30, 2015	2014
Net income	$5,532	$3,898	$14,107	$11,063
Other comprehensive income (loss), net of tax:				
Securities available for sale:				
Unrealized gains (losses) arising during the period	$217	($307)	$953	$400
Reclassification of net gains included in net income (net tax expense of $2 and $6 for the third quarter of 2015 and 2014, respectively and $55 and $190 for the first nine months of 2015 and 2014, respectively)	(2)	(9)	(79)	(271)
Income tax (benefit) expense related to unrealized gains and losses	(74)	108	(337)	(152)
Other comprehensive income (loss)	141	(208)	537	(23)
Comprehensive income	5,673	3,690	14,644	11,040
Less: comprehensive income attributable to the noncontrolling interest	197	191	431	329
Comprehensive income attributable to Northrim BanCorp, Inc.	$5,476	$3,499	$14,213	$10,711

See notes to consolidated financial statements

5

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

(In Thousands)	Common Stock Number of Shares	Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Non-controlling Interest	Total
Balance as of January 1, 2014	6,538	$6,538	$54,089	$82,855	$669	$167	$144,318
Purchase of Alaska Pacific	290	290	7,156	—	—	—	7,446
Cash dividend declared	—	—	—	(4,770)	—	—	(4,770)
Stock-based compensation expense	—	—	360	—	—	—	360
Exercise of stock options	26	26	28	—	—	—	54
Excess tax benefits from stock based payment arrangements	—	—	96	—	—	—	96
Distributions to noncontrolling interest	—	—	—	—	—	(508)	(508)
Other comprehensive loss, net of tax	—	—	—	—	(422)	—	(422)
Net income attributable to the noncontrolling interest	—	—	—	—	—	459	459
Net income attributable to Northrim BanCorp, Inc.	—	—	—	17,408	—	—	17,408
Twelve Months Ended December 31, 2014	6,854	$6,854	$61,729	$95,493	$247	$118	$164,441
Cash dividend declared	—	—	—	(3,806)	—	—	(3,806)
Stock-based compensation expense	—	—	357	—	—	—	357
Exercise of stock options	5	5	92	—	—	—	97
Excess tax benefits from share-based payment arrangements	—	—	5	—	—	—	5
Distributions to noncontrolling interest	—	—	—	—	—	(402)	(402)
Other comprehensive income, net of tax	—	—	—	—	537	—	537
Net income attributable to the noncontrolling interest	—	—	—	—	—	431	431
Net income attributable to Northrim BanCorp, Inc.	—	—	—	13,676	—	—	13,676
Nine Months Ended September 30, 2015	6,859	$6,859	$62,183	$105,363	$784	$147	$175,336

See notes to consolidated financial statements

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

	Nine Months Ended September 30,	
(In Thousands)	2015	2014
Operating Activities:		
Net income	$14,107	$11,063
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Gain on sale of securities, net	(134)	(461)
Gain on sale of premises and equipment	—	(1,115)
Depreciation and amortization of premises and equipment	1,670	1,355
Amortization of software	136	136
Intangible asset amortization	218	214
Amortization of investment security premium, net of discount accretion	(196)	(126)
Deferred tax liability	(314)	(1,503)
Stock-based compensation	357	254
Excess tax benefits from share-based payment arrangements	(5)	(5)
Deferral of loan fees and costs, net	(203)	627
Provision (benefit) for loan losses	1,378	(1,136)
Reserve for (recovery from) purchased receivables	(95)	447
Purchases of loans held for sale	—	(117,225)
Proceeds from the sale of loans held for sale	571,494	118,201
Origination of loans held for sale	(594,225)	—
Gain on sale of other real estate owned	(136)	(470)
Impairment on other real estate owned	360	45
Equity in undistributed earnings from mortgage affiliate	—	(239)
Net changes in assets and liabilities:		
(Increase) in accrued interest receivable	(103)	(754)
Decrease in other assets	3,836	1,685
Decrease in other liabilities	(5,937)	(2,606)
Net Cash (Used) Provided by Operating Activities	(7,792)	8,387
Investing Activities:		
Investment in securities:		
Purchases of investment securities available for sale	(107,873)	(156,014)
Proceeds from sales/maturities of securities available for sale	156,491	173,239
Proceeds from calls/maturities of securities held to maturity	1,285	—
Purchases of domestic certificates of deposit	—	(3,500)
Proceeds from maturities of domestic certificates of deposit	3,500	13,500
Proceeds from redemption of FHLB stock	1,588	129
Alaska Pacific acquisition, net of cash received	—	6,367
Decrease in purchased receivables, net	1,617	1,250
Increase in loans, net	(50,359)	(28,899)
Proceeds from sale of other real estate owned	1,971	1,828
Elliott Cove divestiture, net of cash received	219	—
Decrease in loan to Elliott Cove, net	—	189
Purchases of premises and equipment	(5,461)	(4,104)
Net Cash (Used) Provided by Investing Activities	2,978	3,985
Financing Activities:		

Increase in deposits	85,172	37,206
Increases (decrease) in securities sold under repurchase agreements	13,570	(1,212)
Decrease in borrowings	(13,846)	(4,352)
Distributions to noncontrolling interest	(402)	(341)
Proceeds from the issuance of common stock	97	75
Excess tax benefits from share-based payment arrangements	5	5

Cash dividends paid	(3,772)	(3,503)
Net Cash Provided (Used) by Financing Activities	80,824	27,878
Net Change in Cash and Cash Equivalents	76,010	40,250
Cash and Cash Equivalents at Beginning of Period	68,556	85,591
Cash and Cash Equivalents at End of Period	$144,566	$125,841
Supplemental Information:		
Income taxes paid	$4,136	$3,627
Interest paid	$2,174	$1,408
Noncash commitments to invest in Low Income Housing Tax Credit Partnerships	$55	$8,518
Transfer of loans to other real estate owned	$1,133	$1,158
Transfer of premises to other real estate owned	$—	$904
Cash dividends declared but not paid	$34	$23
Acquisitions:		
Assets acquired	$—	$167,199
Liabilities assumed	$—	$153,172

See notes to consolidated financial statements

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements and corresponding footnotes have been prepared by Northrim BanCorp, Inc. (the "Company") in accordance with accounting principles generally accepted in the United States of America ("GAAP") and with instructions to Form 10-Q under the Securities Exchange Act of 1934, as amended. The year-end Consolidated Balance Sheet data was derived from the Company's audited financial statements. Accordingly, they do not include all of the information and footnotes required by Generally Accepted Accounting Principles ("GAAP") for complete financial statements. The Company owns a 100% interest in Residential Mortgage Holding Company, LLC ("RML"), the parent company of Residential Mortgage, LLC ("Residential Mortgage") and a 50.1% interest in Northrim Benefits Group, LLC ("NBG") and consolidates their balance sheets and income statements into its financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Certain immaterial reclassifications have been made to prior year amounts to maintain consistency with the current year with no impact on net income or total shareholders' equity. The Company determined that it operates in two primary operating segments: Community Banking and Home Mortgage Lending. Prior to December 2014, the Company operated in a single segment: Community Banking. The Company has evaluated events and transactions through November 6, 2015 for potential recognition or disclosure. Operating results for the interim period ended September 30, 2015, are not necessarily indicative of the results anticipated for the year ending December 31, 2015. These consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

2. Significant Accounting Policies and Recent Accounting Pronouncements

The Company's significant accounting policies are discussed in Note 1 to the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

In January 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-01, Accounting for Investments in Qualified Affordable Housing Projects. ASU 2014-01 permits an entity to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2014 and should be applied prospectively. The Company adopted ASU 2014-01 in its consolidated financial statements as of January 1, 2015. As a result, amortization expense related to the Company's investments in low income housing tax credit partnerships has been included in the line item entitled "Provision for income taxes" in the Consolidated Statements of Income for all periods presented.

In February 2015, the Financial Accounting Standards Board ("FASB") issued ASU 2015-02, Amendments to the Consolidation Analysis ("ASU 2015-02"). The amendments to the Codification in ASU 2015-02 affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. The amendments in this update affect the following areas: 1) the effect of related parties on the primary beneficiary determination, 2) evaluating fees paid to a decision maker or a service provider as a variable interest, 3) the effect of fee arrangements on the primary beneficiary determination, and 4) certain investment funds. This ASU is effective for the Company's financial statements for annual and interim periods beginning on or after December 15, 2015, and must be applied prospectively. The Company does not believe that the adoption of this standard will have a material impact on the Company's consolidated financial position or results of operations.

In April 2015, the Financial Accounting Standards Board ("FASB") issued ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs ("ASU 2015-03"). The amendments to the Codification in ASU 2015-03 identify, evaluate, and

improve areas of generally accepted accounting principles (GAAP) for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements. To simplify presentation of debt issuance costs, the amendments in this Update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this Update. This ASU is effective for the Company’s financial statements for annual and interim periods beginning on or after December 15, 2015, and must be applied prospectively. The Company does not believe that the adoption of this standard will have a material impact on the Company’s consolidated financial position or results of operations.
In August 2015, the Financial Accounting Standards Board (“FASB”) issued ASU 2015-14, Revenue from Contracts with Customers (“ASU 2015-14”). The amendments to the Codification in ASU 2015-14 defer the effective date of Update 2014-09

for all entities by one year. This ASU is effective for the Company's financial statements for annual and interim periods beginning on or after December 15, 2017, and must be applied prospectively. The Company does not believe that the adoption of this standard will have a material impact on the Company's consolidated financial position or results of operations.

In September 2015, the Financial Accounting Standards Board ("FASB") issued ASU 2015-16, Business Combinations ("ASU 2015-16"). The amendments to the Codification in ASU 2015-16 require that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The amendments in this update require that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. The amendments in this update require an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. This ASU is effective for fiscal years beginning on or after December 15, 2015, and must be applied prospectively. The Company does not believe that the adoption of this standard will have a material impact on the Company's consolidated financial position or results of operations.

3. Business Combinations

Alaska Pacific Bancshares, Inc.

On April 1, 2014, the Company completed the acquisition of 100% of the outstanding shares of Alaska Pacific Bancshares, Inc. ("Alaska Pacific") for a total purchase price of $13.9 million, which was comprised of the issuance of 290,212 shares of the Company's common stock (at a volume weighted average closing price of $25.66 per share) and $6.4 million in cash. The assets acquired and liabilities assumed have been accounted for under the acquisition method of accounting and were recorded at their estimated fair values as of the April 1, 2014 acquisition date. Estimated fair values recorded in the transaction were subject to change for up to one year after the closing date of the acquisition. The primary reason for the acquisition was to expand the Company's geographic footprint in Alaska.

The application of the acquisition method of accounting resulted in the recognition of a bargain purchase gain of $170,000 and a core deposit intangible of $623,000, or 0.5% of core deposits. The bargain purchase gain represents the excess of the estimated fair value of the net assets acquired in excess of the purchase price and is included in Other Income in the Consolidated Statements of Income in this Form 10-Q. This acquisition resulted in a bargain purchase gain primarily due to the inclusion of certain adjustments to the purchase price for potential risks identified by the Company during the due diligence and price negotiation stages of the acquisition that were concluded in October of 2013. The Company has concluded that the potential risks identified at that time do not represent a liability to the Company and, accordingly, they have not been allocated any value in the application of the acquisition method of accounting.

A summary of the net assets acquired and the estimated fair value adjustments of Alaska Pacific are presented below:

(In Thousands)	Alaska Pacific April 1, 2014	
Cost basis net assets	$14,733	
Cash payment made	(6,423	)
Common stock issued	(7,446	)
Fair value adjustments:		
Net loans	(1,137	)
Premises and equipment	547	
Other intangible assets	623	
Mortgage servicing rights	(119	)

Deposits	(844)
Other	236
Bargain purchase gain	$170

10

A summary of assets acquired and liabilities assumed at their estimated fair values are presented below:

(In Thousands)	Alaska Pacific April 1, 2014
Assets Acquired:	
Cash and equivalents	$12,956
Investment securities	7,240
Loans	138,432
Premises and equipment	3,436
Other intangibles	623
Mortgage servicing rights	1,170
Other real estate owned	1,709
Other assets	1,645
Total assets acquired	$167,211
Liabilities Assumed:	
Deposits	$151,438
Other liabilities	1,734
Total liabilities assumed	$153,172

Alaska Pacific purchased loans not subject to the requirements of FASB ASC 310-30 Loans and Debt Securities Acquired with Deteriorated Credit Quality ("ASC 310-30") are presented below at acquisition:

(In Thousands)	April 1, 2014
Contractually required principal payments	$133,921
Purchase adjustment for credit, interest rate, and liquidity	612
Fair value of purchased non-credit impaired loans	$134,533

Alaska Pacific purchased loans subject to the requirements of FASB ASC 310-30 Loans and Debt Securities Acquired with Deteriorated Credit Quality. The Company identified eighteen purchased credit impaired loans as of April 1, 2014. This group of loans consists primarily of commercial and commercial real estate loans, and unlike a pool of consumer mortgages, it is not practicable for the Company to analyze the accretable yield of these loans. As such, the Company has elected the cost recovery method of income recognition for these loans, and thus no accretable difference has been identified for these loans.

Purchased credit impaired loans at acquisition are presented below:

(In Thousands)	April 1, 2014
Contractually required principal payments	$7,553
Nonaccretable difference	(3,654)
Fair value of purchased credit impaired loans	$3,899

The acquisition of Alaska Pacific is not considered significant to the Company’s financial statements. The operations of Alaska Pacific are included in our operating results from April 1, 2014, and the Company estimates that these operations added revenue of $6.7 million, non-interest expense of $3.9 million, and net income of $2.8 million, before taxes, for the nine months ended September 30, 2015. Alaska Pacific’s results of operations prior to the acquisition are not included in our operating results. Additionally, merger-related costs of $1.3 million for the nine months ended September 30, 2014 were incurred and expensed in connection with the acquisition of Alaska Pacific and recognized within the merger and acquisition expense on the Consolidated Statements of Income.

The following table presents unaudited pro forma results of operations for the nine month period ended September 30, 2014 as if the acquisition of Alaska Pacific had occurred on January 1, 2014. The proforma results have been prepared for comparative purposes only and are not necessarily indicative of the results that would have been obtained had the acquisition actually occurred on January 1, 2014.

(In Thousands, except earnings per share data)	Nine Months Ended September 30, 2014	
	Pro Forma	Pro Forma