NORTHRIM BANCORP INC
Form 10-K
March 13, 2018

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, 2017
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.
¨

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 ¨ Emerging Growth Company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 12(a) of the

Exchange Act. ¨

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, 2017 (the last business day of the registrant's most recently completed second fiscal quarter) was $205,581,946.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date. 6,871,963 shares of Common Stock, $1.00 par value, as of March 13, 2018.

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 24, 2018, 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 outlook of the local economy in which we operate. 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; 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

In this document, please note that references to "we", "our", "us", or the "Company" mean Northrim BanCorp, Inc. and its subsidiaries, unless the context suggests otherwise.

General

We are 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 $1.3 billion in total deposits and $1.5 billion in total assets at December 31, 2017. Through our fourteen banking branches and fourteen mortgage origination offices, we are accessible to approximately 90% of the Alaska population.

The Company has three direct 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 (the "FDIC") 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 in 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;
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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 the first quarter of 2006, through NISC, we purchased an equity interest in Pacific Wealth Advisors, LLC (“PWA”), an investment advisory, trust, and wealth management business located in Seattle, Washington, in which we hold

24% of PWA's total outstanding equity interests. Although we still sell their products, in May 2015, we sold all of our equity interest in ECCM held by NISC;

- 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 three direct 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 fourteen 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 holds a 30% investment in Homestate Mortgage, LLC. In March and December of 2005, NCIC purchased ownership interests totaling 50.1% in Northrim Benefits Group, LLC (“NBG”), an insurance brokerage company that focused on the sale and servicing of employee benefit plans. In August 2017, the Company sold all of the assets of NBG. In the fourth quarter of 2011, NCIC purchased an equity interest in Elliott Cove Insurance Agency LLC (“ECIA”); an insurance agency that offers annuity and other insurance products. Although we still sell their products, we sold all of our equity interests in ECIA held by NCIC in May 2015.
- 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.
- Northrim Building LO, LLC is a wholly-owned subsidiary of the Bank that owns and operates the Company’s community branch facility at 2270 E. 37th Avenue in Anchorage.

Segments

The Company operates in two primary segments: Community Banking and Home Mortgage Lending. Measures of the revenues, profit or loss, and total assets for each of the Company's segments are included in this report, Item 8. "Financial Statements and Supplementary Data", which is 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 asset 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.

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 Alaska. Because of our relatively small size, our experienced senior management team can be more involved with serving customers and making credit decisions, all of which are made in Alaska, allowing us to compete more favorably with larger competitors for business lending relationships. Our business strategy also emphasizes the origination of a variety of home mortgage loan products, which we sell to the secondary market. We retain servicing for home mortgages that we originate and sell to the Alaska Housing Finance Corporation. 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.

Management believes that our real estate construction and term real estate loan departments have developed a strong level of expertise and will continue to compete favorably in our markets. We have also 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. In addition to lending products, in many cases commercial customers also require multiple deposit and affiliate services that add franchise value to the Company. While we

expect that opportunities for growth in 2018 will to be

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muted mainly due to the lower oil prices compared to pre-2014 levels, which has led to a slower economy in Alaska, we believe that these strategies will continue to benefit the Company and we intend to grow our balance sheet through increasing our market share. The Company benefits from solid capital and liquidity positions, and management believes that this provides a competitive advantage in the current business environment. (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 more 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. Continued success in maintaining or further improving the credit quality of our loan portfolio and managing 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. The Company continues to enhance our company-wide employee training program which focuses on Northrim culture, Customer First Service, general sales skills, and various technical focus areas.
We consider our relations with our employees to be satisfactory. We had 429 full-time equivalent employees at December 31, 2017. None of our employees are covered by a collective bargaining agreement. Of the 429 full-time equivalent employees, 314 were Community Banking employees and 115 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".)
Purchase of accounts receivable: 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 2018, we expect NFS to continue to penetrate these markets and to continue to contribute to the Company's profitability.
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.
Several of our deposit services and products are:

- A 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;

- A savings account that is priced like a money market account 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, Business Mobile App and Business Mobile Deposit, Personal Finance, Online Documents, Consumer Debit Cards, Business Debit Cards, 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 and commercial drive-up banking at many locations, automatic transfers and payments, People Pay (a peer to peer payment functionality), external transfers, Bill Pay, wire transfers, direct payroll deposit, electronic tax payments, Automated Clearing House origination and receipt, remote deposit capture, merchant services, cash management programs to meet the specialized needs of business customers, annuity products, long term investment portfolios, and in some markets, courier agents who pick up noncash deposits from business customers.

Other Services Provided Through Affiliates and Former Affiliates Whom We Continue To Work With: Prior to August of 2017, the Company sold and serviced employee benefit plans for small and medium sized businesses in Alaska through NBG, an insurance brokerage company. In August 2017, we sold the assets of NBG, but we have continued our relationship with Acrisure, LLC, who purchased the assets of NBG, through an ongoing referral agreement. 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 these 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 ("NAICS"), there are no segments that exceed 10% of portfolio loans, except for real estate (see Note 5, Loans and Credit Quality, 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 one specialized industry. We estimate that as of December 31, 2017 approximately 7% of portfolio loans have direct exposure to the oil and gas industry in Alaska. Additionally, approximately 36% of our loan portfolio at December 31, 2017 is attributable to 26 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 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; Veterans Affairs, or "VA" loans; Jumbo loans; and various conventional mortgages. The Company retains servicing rights on loans sold to the Alaska Housing Finance Corporation since implementing a new loan servicing program in July 2015.

Alaska Economy

Our growth and operations depend upon the economic conditions of Alaska and the specific markets we serve. Significant changes in the Alaska economy and the markets we serve eventually could have a positive or negative impact on the Company. Alaska is strategically located on the Pacific Rim, within nine hours by air from 95% of the northern hemisphere, 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 natural resources industries. Key sectors of the Alaska economy are the oil industry, government and military spending, and the fishing, mining, tourism, air cargo, transportation, construction, and forest products industries, as well as medical services.

The oil industry plays a significant role in the economy of Alaska, and revenues for the State of Alaska are sensitive to the volatility in oil prices. According to the State of Alaska Department of Revenue, in 2017 approximately 65% of the unrestricted revenues that funded the Alaska state government in the fiscal year ending June 30, 2017 were

generated through various taxes and royalties on the oil industry. This is down from approximately 72% in 2016 and 90% in the last several years prior to 2016 due to a decrease in the price of oil, causing the state of Alaska to use savings from previous years to fund its budget deficit. As oil prices have stabilized at relatively low-levels, we believe the reduction in various taxes and royalties on the oil industry is now a serious concern for state revenues as it is projected that Alaska's savings will be depleted within two years at current prices. If oil prices remain at their current relatively low levels in the longer term, we anticipate it will be a concern for Alaska's long-term economic growth. However, we believe Alaska's economy is less sensitive to oil 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, we believe that 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. While we believe that subcontractors who provide oil field services and transportation for the large, multi-national companies that produce oil in Alaska experienced a slowdown in revenues in 2017 and 2016 as a result of the decrease in prices, we are encouraged by recent announcements by several oil exploration companies announcing new oil fields on the North Slope and increased exploration activity in 2018 that could lead to future increases in oil production over time.

We believe the long-term growth of the Alaska economy will most likely be determined by large scale natural resource development projects. Several multi-billion dollar projects can potentially advance in the moderate-term. Some of these projects include copper, gold and molybdenum production at the Donlin mine and continued exploration in the National Petroleum Reserve Alaska. Because of their size, we believe each of these projects faces tremendous challenges. We believe 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, we believe state revenues will probably continue to decline with falling oil production from older fields on the North Slope of Alaska. We anticipate the decline in state revenues will likely have a negative effect on Alaska’s economy.

Prior to the decline in oil prices that began in 2014, Alaska's economy had been stronger 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 October, 2015, Alaska's Statutory Budget Reserve Fund was liquidated and its assets were transferred to the General Fund. As of December 31, 2017, Alaska's Constitutional Budget Reserve was $3.1 billion and the Alaska Permanent Fund had a balance of $64.5 billion. The Alaska Permanent Fund pays an annual dividend to every eligible Alaskan citizen. According to a January 19, 2018 press release from the Alaska Department of Labor and Workforce Development, the seasonally adjusted unemployment rates in the United States and Alaska were 4.1% and 7.3%, respectively, in December 2017. 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 significantly declined, Alaska's unemployment rate now exceeds that of the United States as a whole. The Alaska Department of Labor predicts a loss of 1,800 jobs, or an approximately 0.5% reduction in total employment in 2018, following job losses of approximately 1.1% of total employment in 2017 and 1.9% in 2016. The Company anticipates that the estimated decrease in jobs in Alaska in 2017 and 2018 will have an impact on our ability to grow organically in the next few years.

We believe our exposure to the tourism industry, which increased following our acquisition of Alaska Pacific Bancshares, Inc in Southeast Alaska in 2014, diversifies the Company's customer base. We believe this helps mitigate the effect that the decline in natural resource industries, specifically the oil industry, in Alaska has had on the Company's operations. Southeast Alaska is the primary destination for cruise ships that visit Alaska. Based on the latest information from Rain Coast Data, approximately one million cruise ship tourists visited Southeast Alaska in recent years.

A material portion of our loans at December 31, 2017, were secured by real estate located in greater Anchorage, Matanuska-Susitna Valley, Fairbanks, and Southeast Alaska. Thirty percent of our revenue in 2017 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 as compared to 36% and 38% in 2016 and 2015, respectively. 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, 2017, $313.8 million, or 33%, of our loan portfolio was represented by commercial loans in Alaska.

Alaska’s residents are not subject to any state income or state sales taxes. For over 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 $1,100 per eligible resident in 2017 for an aggregate distribution of approximately $674 million. The Anchorage Economic Development Corporation estimates that, for most Anchorage households, distributions from the Alaska Permanent Fund Corporation 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 41% share of total deposits held in banks and credit unions in the state as of June 30, 2017. 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 via a computer or wireless device, 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.

Currently, there are seven commercial banks operating in Alaska. At June 30, 2017, the date of the most recently available information, Northrim Bank had approximately a 10% share of the Alaska commercial bank deposits, 15% in the Anchorage area, 14% in Juneau, 13% in Sitka, 11% in Matanuska-Susitna, 6% in Fairbanks, and 5% in Ketchikan.

The following table sets forth market share data for the commercial banks and credit unions having a presence in Alaska as of June 30, 2017, the most recent date for which comparative deposit information is available.

Financial institution	Number of branches	Total deposits (in thousands)	Market share of total financial institution deposits		Market share of total bank deposits	
Northrim Bank	14	$1,252,795	7	%	10	%
Wells Fargo Bank Alaska	49	6,146,255	30	%	51	%
First National Bank Alaska	30	2,471,896	12	%	20	%
Key Bank	15	1,259,141	6	%	10	%
First Bank	9	481,114	2	%	4	%
Mt. McKinley Bank	5	307,284	1	%	3	%
Denali State Bank	5	250,469	1	%	2	%
Total bank branches	127	$12,168,954	59	%	100	%
Credit unions[(1)]	98	$8,610,059	41	%	NA	
Total financial institution branches	225	$20,779,013	100	%	100	%

[(1)] SNL Financial Deposit Market Share Summary as of June 30, 2017.

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 advisory and wealth management company, Pacific Portfolio Consulting, LLC, is 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 and is subject to supervision and examination by the Department of Financial Institutions of Washington State.

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.
Regulation of banks and the financial services industry has been undergoing major changes in recent years, including 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.
The Dodd-Frank Act has significantly affected Northrim Bank and its business and operations. 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.
The Trump administration and various members of Congress have expressed a desire to modify or repeal parts of the Dodd-Frank Act. We cannot predict whether any modification or repeal will be enacted or, if so, any effect they would have on our business, operation or financial condition or on the financial services industry in general.
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 unless the FRB has previously determined that the nonbank activities are closely related to banking, or 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 net income available over the past year and only if the prospective rate of earnings retention is consistent with the organization's current and expected future capital needs, asset quality and overall 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. Additionally, the Alaska Corporations Code generally prohibits the Company from making any distributions to the Company's shareholders unless the amount of the retained earnings of the Company immediately before the distribution equals or exceeds the amount of the proposed distribution. The Alaska Corporations Code also prohibits the Company from making any distribution to the Company's shareholders if the Company or a subsidiary of the Company making the distribution is, or as a result of the distribution would be, likely to be unable to meet its liabilities as they mature. Under Alaska law, the Bank is not permitted to pay or declare a dividend in an amount greater than its undivided profits.

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. In July 2013, federal banking regulators (including the FDIC and the FRB) adopted new capital requirement 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. The Rules have applied to both the Company and the Bank since the beginning of 2015.

The Rules recognize three types, or tiers, of capital: common equity Tier 1 capital, additional Tier 1 capital and Tier 2 capital. 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. Additional Tier 1 capital generally includes noncumulative perpetual preferred stock and related surplus subject to certain adjustments and limitations. Tier 2 capital generally includes certain capital instruments (such as subordinated debt) and portions of the amounts of the allowance for loan and lease losses, subject to certain requirements and deductions. The term "Tier 1 capital" means common equity Tier 1 capital plus additional Tier 1 capital, and the term "total capital" means Tier 1 capital plus Tier 2 capital.

The Rules generally measure an institution's capital using four capital measures or ratios. The common equity Tier 1 capital ratio is the ratio of the institution's common equity Tier 1 capital to its total risk-weighted assets. The Tier 1 capital ratio is the ratio of the institution's total Tier 1 capital to its total risk-weighted assets. The total capital ratio is the ratio of the institution's total capital to its total risk-weighted assets. The leverage ratio is the ratio of the institution's Tier 1 capital to its average total consolidated assets. To determine risk-weighted assets, assets of an institution are generally placed into a risk category and given a percentage weight based on the relative risk of that category. The percentage weights range from 0% to 1,250%. An asset's risk-weighted value will generally be its percentage weight multiplied by the asset's value as determined under generally accepted accounting principles. 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 risk categories. An institution's federal regulator may require the institution to hold more capital than would otherwise be required under the Rules if the regulator determines that the institution's capital requirements under the Rules are not commensurate with the institution's credit, market, operational or other risks.

Both the Company and the Bank are 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 set forth 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 made 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 were required to begin compliance with the Rules on January 1, 2015. The conservation buffer started to 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; under the Rules, a bank generally 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.

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 the Bank in 2018 that exceed the FDIC’s new requirements for the “well-capitalized” capital requirement classification under the Basel Committee on Banking Supervision rules which took 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 the Bank primarily because the 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 the Bank's financial statements nor are they included in its capital (although the Company did contribute to the Bank a portion of the cash proceeds from the sale of those securities). The Company redeemed $8 million trust preferred securities in August 2017. As a result, the Company has $10 million and $18 million more in regulatory capital than the Bank at December 31, 2017 and 2016, respectively, which explains most of the difference in the capital ratios for the two entities.

The 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 the 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, 2017.

In addition, the Company and its affiliates are subject to a broad array of financial and state consumer protection laws and regulations. Among other things, these laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions deal with their customers.

Available Information

The Company's annual report on Form 10-K and quarterly reports on Form 10-Q, as well as its current reports on Form 8-K and proxy statement 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.

Current economic conditions in the State of Alaska pose significant challenges for us and could adversely affect our financial condition and results of operations.

We are operating in an uncertain economic environment. The decrease in the price of oil from 2014 through 2016 has led to a significant deficit in the budget for the State of Alaska, and we believe that absent action by the Alaska state legislature, these deficits are expected to exhaust cash savings of the state within approximately a year. In the longer term, relatively low oil prices are expected to negatively impact the overall economy in Alaska on a larger scale as we estimate that one third of the Alaskan economy is related to oil. 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 United States housing market from 2008 through 2012, with falling home prices and increasing foreclosures and unemployment, resulted in significant writedowns of asset values by financial institutions. While conditions have improved nationally, 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.

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 develop, we could experience adverse effects on our financial condition.

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, 2017, approximately 71% of the Bank's loans are secured by real estate and 3% are unsecured. Approximately 26% are for general commercial uses, including professional, retail, and small businesses, and are secured by non-real estate assets. 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 and government and U.S. military spending for their economic success. In particular, the oil industry plays a significant role in the Alaskan economy. We believe that the dramatic decline in the global price of oil from 2014 through 2016 poses a significant risk for the Alaskan economy which is heavily dependent on the petroleum industry and if the global price of oil continues to remain at the current relatively low level, the Alaskan economy would likely be adversely affected. We estimate that one third of Alaska's gross state product is currently derived from the oil industry.

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 our 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.

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. These impacts

may negatively impact our ability to attract deposits, make loans, and achieve satisfactory interest rate spreads, which could adversely affect our financial condition or results of operations. In particular, increases in interest rates will likely reduce RML's revenues by further reducing the market for refinancings, as well as the demand for RML's other residential loan products. Additionally, increases in interest rates may impact our borrowers' ability to make loan payments, particularly in our commercial loan portfolio.

Interest rates may be affected by many factors beyond our control, including general and economic conditions and the monetary and fiscal policies of various governmental and regulatory authorities. Market volatility in interest rates can be difficult to predict, as unexpected interest rate changes may result in a sudden impact while anticipated changes in interest rates generally impact the mortgage rate market prior to the actual rate change. 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.

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 SEC and NASDAQ. 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 Dodd-Frank Act created a new Consumer Financial Protection Bureau with broad powers to regulate consumer financial products such as credit cards and mortgages, created a Financial Stability Oversight Council comprised of the heads of other regulatory agencies, has resulted in new capital requirements from federal banking agencies, placed new limits on electronic debt card interchange fees, and requires banking regulators, the SEC and national stock exchanges to adopt significant new corporate governance and executive compensation reforms.

Certain provisions of these new rules have phase-in periods, including a 2.5% conservation buffer, which began to be phased-in in 2016 and is scheduled to 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 or future 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 are subject to more stringent capital and liquidity requirements which may adversely affect our net income and future growth.

In July 2013, the FRB and the FDIC announced the new capital rules, which 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” these rules created increased capital requirements for United States depository institutions and their holding companies. These rules include risk-based and leverage capital ratio

requirements, which became effective on January 1, 2015. These 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.

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.

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.

The network and computer systems on which we depend could fail.

Our computer systems could be vulnerable to unforeseen problems. Because we conduct a part of our business over the Internet and outsource several critical functions to third parties, operations will depend on our ability, as well as the ability of third party service providers, to protect computer systems and network infrastructure against damage from fire, power loss, telecommunications failure, physical break-ins or similar catastrophic events. Any damage or failure that causes interruptions in operations may compromise our ability to perform critical functions in a timely manner and could have a material adverse effect on our business, financial condition and results of operations as well as our reputation and customer or vendor relationships.

Our business is highly reliant on third party vendors and our ability to manage the operational risks associated with outsourcing those services.

We rely on third parties to provide services that are integral to our operations. These vendors provide services that support our operations, including the storage and processing of sensitive consumer and business customer data. The loss of these vendor relationships, or a failure of these vendors' systems, could disrupt the services we provide to our customers and cause us to incur significant expense in connection with replacing these services. Further, a cyber security breach of a vendor's system may result in theft of our data or disruption of business processes. A material breach of customer data security at a service provider's site may negatively impact our business reputation and cause a loss of customers; result in increased expense to contain the event and/or require that we provide credit monitoring services for affected customers, result in regulatory fines and sanctions and/or result in litigation. In most cases, we will remain primarily liable to our customers for losses arising from a breach of a vendor's data security system. We rely on our outsourced service providers to implement and maintain prudent cyber security controls. We have procedures in place to assess a vendor's cyber security controls prior to establishing a contractual relationship and to periodically review assessments of those control systems; however, these procedures are not infallible and a vendor's system can be breached despite the procedures we employ.

We continually encounter technological change, and we may have fewer resources than many of our competitors to continue to invest in technological improvements.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success will depend, in part, upon our ability to address the needs of our clients by using technology to provide products and services that will satisfy client demands for convenience, as well as to create additional efficiencies in our operations. Many national vendors provide turn-key services to community banks, such as Internet banking

and remote deposit capture that allow smaller banks to compete with institutions that have substantially greater resources to invest in technological improvements. We may not be able, however, to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers.

Residential mortgage lending is a market sector that experiences significant volatility and is influenced by many factors beyond our control.

The Company earns revenue from the residential mortgage lending activities primarily in the form of gains on the sale of mortgage loans that we originate and sell to the secondary market. Residential mortgage lending in general has experienced substantial volatility in recent periods primarily due to changes in interest rates and other market forces beyond our control. Interest rate changes, such as rate increases implemented by the FRB, may result in lower rate locks and closed loan volume, which may adversely impact the earnings and results of operations of RML. In addition, an increase in interest rates may materially and adversely affect our future loan origination volume and margins.

If we do not comply with the agreements governing servicing of loans or if others allege non-compliance, our business and results of operations may be harmed.

We have contractual obligations under the servicing agreements pursuant to which we service mortgage loans. Many of our servicing agreements require adherence to general servicing standards, and certain contractual provisions delegate judgment over various servicing matters to us. Our servicing practices, and the judgments that we make in our servicing of loans, could be questioned by parties to these agreements. We could also become subject to litigation claims seeking damages or other remedies arising from alleged breaches of our servicing agreements.

Additionally, under our loan servicing program we retain servicing rights on mortgage loans originated by RML and sold to the Alaska Housing Finance Corporation. If we breach any of the representations and warranties in our servicing agreements with the Alaska Housing Finance Corporation, we may be required to repurchase any loan sold under this program and record a loss upon repurchase and/or bear any subsequent loss on the loan. We may not have any remedies available to us against third parties for such losses, or the remedies might not be as broad as the remedies available to the Alaska Housing Finance Corporation against us.

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 results of operations and financial condition.

We have a significant concentration in real estate lending. A downturn in real estate within our markets would have a negative impact on our results of operations.

Approximately 71% of the Bank’s loan portfolio at December 31, 2017 consisted of loans secured by commercial and residential real estate located in Alaska. Additionally, all of the Company's loans held for sale are secured by residential real estate. A slowdown in the residential sales cycle in our major markets and a constriction in the availability of mortgage financing, such as what occurred during the financial crisis in the United States housing market from 2008 through 2012, would negatively impacted residential real estate sales, which would result in customers’ inability to repay loans. This would result in an increase in our 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 51% of the Bank's loan portfolio at December 31, 2017 consisted of commercial real estate loans. 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 writedowns 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, 2017, the Bank held $8.7 million of OREO properties, most of which relate to a commercial real estate loan. 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 writedowns, with a corresponding expense in our income statement. We evaluate OREO property values periodically and writedown the carrying value of the properties if the results of our evaluations require it. Further writedowns 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.

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 and their ability to pay dividends.

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. In 2016, a requirement to have a capital conservation buffer started to be phased in and this requirement, which is scheduled to come into full effect on January 1, 2019 could adversely affect the Bank's ability to pay dividends.

Various statutory provisions restrict the amount of dividends the Bank can pay to us without regulatory approval. Under Alaska law, a bank may not declare or pay a dividend in an amount greater than its net undivided profits then on hand. In addition, 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 net income available over the past year and only if prospective rate of earnings retention is consistent with the organization's current and expected future capital needs, asset quality and overall 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 Joseph M. Schierhorn, our Chairman of the Board, President, Chief Executive Officer, and Chief Operating Officer of the Company; Michael Martin, our Executive Vice President, General Counsel and Corporate Secretary; and Jed W. Ballard, our Executive Vice President and Chief Financial Officer. While we maintain keyman life insurance on the lives of Messrs. Schierhorn and Martin in the amounts of $2 million each, we may not be able to timely replace Mr. Schierhorn or Mr. Martin with a person of comparable ability and experience should the need to do so arise, causing losses in excess of the insurance proceeds. 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 in place laws and regulations relating to residential and consumer lending, as well as other activities with customers, that create significant 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
Lake Otis Community Branch 2270 East 37th Avenue, Anchorage, AK	Traditional	Land leased, building owned
Huffman Branch 1501 East Huffman Road, Anchorage, AK	Instore	Leased
Jewel Lake Branch 9170 Jewel Lake Road Suite 101, Anchorage, AK	Traditional	Leased
Seventh Avenue Branch 517 West Seventh Avenue, Suite 300, Anchorage, AK	Traditional	Leased
West Anchorage Branch 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	Leased
Sitka Financial Center 315 Lincoln Street, Suite 206, Sitka, AK	Traditional	Leased
Ketchikan Financial Center 2491 Tongass Avenue, Ketchikan, AK	Traditional	Owned

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
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
Fairbanks Office 711 Gaffney Road, Suite 202, Fairbanks, AK	Leased
Juneau Office 8800 Glacier Highway, #232, Juneau, AK	Leased
Ketchikan Office 2491 Tongass Avenue, Ketchikan, 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
Wasilla Remax Dynamic Branch 892 E USA Circle, Suite 105, Wasilla, AK	Leased
Wasilla Northrim Branch 850 E USA Circle, Suite B, Wasilla, 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 Global Select Stock Market under the symbol, "NRIM." At March 13, 2018, the number of shareholders of record of our common stock was 250. As many of our shares of common stock are held of record in "street name" by brokers and other institutions on behalf of shareholders, we are unable to estimate the total number of beneficial holders of our common stock represented by these record holders.

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
2017				
High	$32.40	$32.55	$35.35	$37.90
Low	$27.50	$29.25	$26.45	$32.50
2016				
High	$26.72	$27.52	$28.76	$32.55
Low	$21.83	$23.27	$25.05	$24.45

In 2017, we paid cash dividends of $0.21 per share in the first and second quarters and $0.22 per share in the third and fourth quarters. In 2016, we paid cash dividends of $0.19 per share in the first and second quarters and $0.20 per share in the third and fourth quarters. Cash dividends totaled $6.0 million, $5.4 million, and $5.1 million in 2017, 2016, and 2015, respectively. On February 22, 2018, the Board of Directors approved payment of a $0.24 per share cash dividend on March 16, 2018, to shareholders of record on March 8, 2018. The Company and the Bank are subject to restrictions on the payment of dividends pursuant to applicable federal and state banking regulations and Alaska corporate law. 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 believes it will remain "well-capitalized"; the Company expects to receive dividends from the Bank in 2018. Beginning in 2016, a requirement to have a capital conservation buffer began to be phased in, and this requirement could adversely affect the Bank's ability to pay dividends. See "Item 1 Business - Supervision and Regulation" in this report.

Repurchase of Securities

At December, 31, 2017, there are 168,901 shares available under the stock repurchase program. The Company repurchased 58,341 shares in the first nine months of 2017, while no repurchases occurred in the fourth quarter of 2017 or during 2016. The Company intends to continue to repurchase its stock from time to time depending upon market conditions, but we can make no assurances that we will continue this program or that we will repurchase all of the authorized shares.

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, 2017. Additional information regarding the Company’s equity plans is presented in Note 20 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	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by security holders[1]	209,328	$18.36	277,072
Total	209,328	$18.36	277,072

[1]Consists of the Company's 2017 Stock Incentive Plan, which replaced the 2014 Stock Incentive Plan (the "2014 Plan")

[2] Includes 165,361 options awarded under the 2014 Plan and other previous stock option plans.

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

Stock Performance Graph

The graph shown below depicts the total return to shareholders during the period beginning after December 31, 2012, and ending December 31, 2017. 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, 2012, and that all dividends were reinvested.

	Period Ending					
Index	12/31/12	12/31/13	12/31/14	12/31/15	12/13/16	12/31/17
Northrim BanCorp, Inc.	100.00	119.09	122.39	127.55	156.18	171.98
Russell 3000	100.00	133.55	150.32	151.04	170.28	206.26
SNL Bank $1B-$5B	100.00	145.41	152.04	170.20	244.85	261.04

ITEM 6. SELECTED FINANCIAL DATA [1]

	Years Ended December 31, (In thousands, except per share data and shares outstanding amounts)						
	2017	2016	2015	2014	2013	2012	Five Year Compound Growth Rate
	(Unaudited)						
Net interest income	$57,678	$56,357	$56,909	$52,293	$44,034	$42,223	6 %
Provision (benefit) for loan losses	3,200	2,298	1,754	(636)	(635)	(1,559)	NM
Other operating income	40,474	43,263	44,608	20,034	12,886	15,432	21 %
Compensation expense, RML acquisition payments	130	4,775	4,094	—	—	—	NM
Other operating expense	71,023	71,505	68,551	46,923	38,897	38,679	13 %
Income before provision for income taxes	$23,799	$21,042	$27,118	$26,040	$18,658	$20,535	3 %
Provision for income taxes	10,321	6,052	8,784	8,173	6,246	7,077	8 %
Net Income	13,478	14,990	18,334	17,867	12,412	13,458	— %
Less: Net income attributable to noncontrolling interest	327	579	551	459	87	512	(9)%
Net income attributable to Northrim Bancorp, Inc.	$13,151	$14,411	$17,783	$17,408	$12,325	$12,946	— %
Year End Balance Sheet							
Assets	$1,519,109	$1,526,540	$1,499,492	$1,449,349	$1,215,006	$1,160,107	6 %
Portfolio loans	955,667	975,015	980,787	924,504	770,016	704,213	6 %
Deposits	1,258,283	1,267,653	1,240,792	1,179,747	1,003,723	970,129	5 %
Securities sold under repurchase agreements	27,746	27,607	31,420	19,843	21,143	19,038	8 %
Borrowings	7,362	4,338	2,120	26,304	6,527	4,479	10 %
Junior subordinated debentures	10,310	18,558	18,558	18,558	18,558	18,558	(11)%
Shareholders' equity	192,802	186,712	177,214	164,441	144,318	136,353	7 %
Common shares outstanding	6,871,963	6,897,890	6,877,140	6,854,189	6,537,652	6,511,649	1 %
Average Balance Sheet							
Assets	$1,511,052	$1,506,522	$1,480,913	$1,335,929	$1,156,500	$1,088,419	7 %
Earning assets	1,367,203	1,361,913	1,334,102	1,212,291	1,041,268	973,741	7 %
Portfolio loans	981,001	976,613	968,752	893,031	734,427	668,014	8 %
Deposits	1,248,333	1,250,243	1,219,445	1,111,594	953,925	909,129	7 %
Securities sold under repurchase agreements	29,690	27,322	24,447	20,909	19,454	16,490	12 %
Borrowings	5,767	4,215	14,552	4,697	6,130	4,548	5 %
Junior subordinated debentures	15,066	18,558	18,558	18,558	18,558	18,558	(4)%
Shareholders' equity	193,129	181,628	169,802	155,591	140,924	131,368	8 %
Basic common shares outstanding	6,889,621	6,883,663	6,859,209	6,761,328	6,518,772	6,477,266	1 %
Diluted common shares outstanding	6,977,910	6,974,864	6,948,474	6,852,267	6,609,950	6,574,993	1 %
Per Common Share Data							

Basic earnings	$1.91	$2.09	$2.59	$2.57	$1.89	$2.00	(1)%
Diluted earnings	$1.88	$2.06	$2.56	$2.54	$1.87	$1.97	(1)%
Book value per share	$28.06	$27.07	$25.77	$23.99	$22.07	$20.94	6 %
Tangible book value per share(2)	$25.70	$24.70	$22.31	$20.48	$20.86	$19.69	5 %
Cash dividends per share	$0.86	$0.78	$0.74	$0.70	$0.64	$0.56	9 %

	Years Ended December 31,						
	2017	2016	2015	2014	2013	2012	Five Year Compound Growth Rate
	(Unaudited)						
Performance Ratios							
Return on average assets	0.87%	0.96%	1.20%	1.30%	1.07%	1.19%	(6)%
Return on average equity	6.81%	7.93%	10.47%	11.19%	8.75%	9.85%	(7)%
Equity/assets	12.69%	12.23%	11.82%	11.35%	11.88%	11.75%	2%
Tangible common equity/tangible assets[3]	11.75%	11.28%	10.40%	9.85%	11.30%	11.12%	1%
Net interest margin	4.22%	4.14%	4.27%	4.31%	4.23%	4.34%	(1)%
Net interest margin (tax equivalent)[4]	4.28%	4.20%	4.32%	4.36%	4.29%	4.40%	(1)%
Non-interest income/total revenue	41.24%	43.43%	43.94%	27.70%	22.64%	26.77%	9%
Efficiency ratio [5]	72.39%	76.44%	71.31%	64.48%	67.94%	66.65%	2%
Dividend payout ratio	45.44%	37.59%	28.81%	27.40%	34.18%	28.39%	10%
Asset Quality							
Nonperforming loans, net of government guarantees	$21,411	$12,936	$2,125	$3,496	$1,814	$4,529	36%
Nonperforming assets, net of government guarantees	28,729	19,315	5,178	7,231	4,216	9,072	26%
Nonperforming loans/portfolio loans, net of government guarantees	2.24%	1.33%	0.22%	0.38%	0.24%	0.64%	28%
Net charge-offs (recoveries)/average loans	0.15%	0.08%	0.03%	(0.12)%	(0.07)%	(0.21)%	NM
Allowance for loan losses/portfolio loans	2.25%	2.02%	1.85%	1.81%	2.11%	2.33%	(1)%
Nonperforming assets/assets, net of government guarantees	1.89%	1.27%	0.35%	0.50%	0.35%	0.78%	19%
Other Data							
Effective tax rate [6]	43%	29%	32%	31%	33%	34%	5%
Number of banking offices[7]	14	14	14	14	10	10	7%
Number of employees (FTE) [8]	429	451	441	426	269	252	11%

[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 it excludes the effect of intangible assets on the Company’s equity. See reconciliation to book value per share, the most comparable GAAP measurement below.

[3]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. Management believes this ratio is important as it has received more attention over the past several years from stock analysts and regulators. The most comparable GAAP measure of shareholders' equity to total assets is calculated by dividing total shareholders' equity by total assets. See reconciliation to shareholders' equity to total assets below.

[4]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 net interest margin, the comparable GAAP measurement below.

[5]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 Operations" of this report. See reconciliation to comparable GAAP measurement below.
[6]The Company’s 2017 results included the impact of the enactment of the Tax Cuts and Jobs Act, which was signed into law on December 22, 2017. The law includes significant changes to the U.S. corporate tax system, including a Federal corporate rate reduction from 35% to 21%. In 2017, the Company applied the newly enacted corporate federal income tax rate of 21%, reducing the value of the Company's net deferred tax asset, resulting in approximately a $2.7 million increase in tax expense. The final impact of the tax rate change may differ due to changes in assumptions made by the Company or actions the Company may take as a result of tax reform.
[7]Number of banking offices does not include RML locations
[8]FTE includes 314 employees of the Bank and 115 employees of RML in 2017, 304 employees of the Bank, 130 employees of RML, and 17 employees of NBG in 2016, 303 employees of the Bank, 124 employees of RML, and 14 employees of NBG in 2015, 294 employees of the Bank, 117 employees of RML, and 15 employees of NBG in 2014, 256 employees of the Bank and 13 employees of NBG in 2013 and 245 employees of the Bank and 7 employees of NBG in 2012.

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 total shareholders equity to tangible common shareholders’ equity (Non-GAAP) and total assets to tangible assets:

(In Thousands)	2017	2016	2015	2014	2013	2012
Total shareholders' equity	$192,802	$186,712	$177,214	$164,441	$144,318	$136,353
Total assets	1,519,109	1,526,540	1,499,492	1,449,349	1,215,006	1,160,107
Total shareholders' equity to total assets ratio	12.69 %	12.23 %	11.82 %	11.35 %	11.88 %	11.75 %

(In Thousands)	2017	2016	2015	2014	2013	2012
Total shareholders' equity	$192,802	$186,712	$177,214	$164,441	$144,318	$136,353
Less: goodwill and other intangible assets, net	16,224	16,324	23,776	24,035	7,942	8,170
Tangible common shareholders' equity	$176,578	$170,388	$153,438	$140,406	$136,376	$128,183
Total assets	$1,519,109	$1,526,540	$1,499,492	$1,449,349	$1,215,006	$1,160,107
Less: goodwill and other intangible assets, net	16,224	16,324	23,776	24,035	7,942	8,170
Tangible assets	$1,502,885	$1,510,216	$1,475,716	$1,425,314	$1,207,064	$1,151,937
Tangible common equity to tangible assets ratio	11.75 %	11.28 %	10.40 %	9.85 %	11.30 %	11.12 %

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

(In thousands, except per share data)	2017	2016	2015	2014	2013	2012
Total shareholders' equity	$192,802	$186,712	$177,214	$164,441	$144,318	$136,353
Divided by common shares outstanding	6,871,963	6,897,890	6,877,140	6,854,189	6,537,652	6,511,649
Book value per share	$28.06	$27.07	$25.77	$23.99	$22.07	$20.94

(In thousands, except per share data)	2017	2016	2015	2014	2013	2012
Total shareholders' equity	$192,802	$186,712	$177,214	$164,441	$144,318	$136,353
Less: goodwill and intangible assets, net	16,224	16,324	23,776	24,035	7,942	8,170
	$176,578	$170,388	$153,438	$140,406	$136,376	$128,183
Divided by common shares outstanding	6,871,963	6,897,890	6,877,140	6,854,189	6,537,652	6,511,649
Tangible book value per share	$25.70	$24.70	$22.31	$20.48	$20.86	$19.69

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

(In Thousands)	2017	2016	2015	2014	2013	2012
Net interest income[9]	$57,678	$56,357	$56,909	$52,293	$44,034	$42,223
Divided by average interest-bearing assets	1,367,203	1,361,913	1,334,102	1,212,291	1,041,268	973,741
Net interest margin	4.22 %	4.14 %	4.27 %	4.31 %	4.23 %	4.34 %

(In Thousands)	2017	2016	2015	2014	2013	2012
Net interest income[9]	$57,678	$56,357	$56,909	$52,293	$44,034	$42,223
Plus: reduction in tax expense related to tax-exempt interest income	872	808	722	583	585	626
	$58,550	$57,165	$57,631	$52,876	$44,619	$42,849
Divided by average interest-bearing assets	1,367,203	1,361,913	1,334,102	1,212,291	1,041,268	973,741
Tax-equivalent net interest margin	4.28 %	4.20 %	4.32 %	4.36 %	4.29 %	4.40 %

Calculation of efficiency ratio

(In Thousands)	2017	2016	2015	2014	2013	2012
Net interest income[9]	$57,678	$56,357	$56,909	$52,293	$44,034	$42,223
Other operating income	40,474	43,263	44,608	20,034	12,886	15,432
Total revenue	98,152	99,620	101,517	72,327	56,920	57,655
Other operating expense	71,153	76,280	72,645	46,923	38,897	38,679
Less intangible asset amortization	100	135	258	289	228	252
Adjusted other operating expense	$71,053	$76,145	$72,387	$46,634	$38,669	$38,427
Efficiency ratio	72.39 %	76.44 %	71.31 %	64.48 %	67.94 %	66.65 %

[9]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, 2017, 2016 and 2015 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

Net income attributable to the Company decreased 9% to $13.2 million or $1.88 per diluted share for the year ended December 31, 2017, from $14.4 million, or $2.06 per diluted share, for the year ended December 31, 2016. Significant items contributing to the decline in 2017 compared to 2016 were:

- the revaluation of the Company's deferred tax assets to comply with recently enacted federal tax legislation,
- a decline in net income attributable to the Company in the Home Mortgage Lending segment due primarily to the relative general weakness of the Alaska economy and a writedown in the carrying value of the Company's minority ownership interest in a mortgage origination business owned by RML,
- an increase in the provision for loan losses mostly as a result of an increase in nonperforming loans, net of government guarantees, as well as an increase in the portion of the allowance for loan losses specific to impaired loans,
- one-time costs associated with the conversion of the Company's core system, and
- an increase in expenses associated with OREO, net of gains on the sale of OREO and rental income on OREO properties.

These items were partially offset by a $4.4 million gain recognized on the sale of the assets of NBG and a decrease in compensation expense for acquisition payments related to the Company's 2014 acquisition of RML.

The following are other significant items for the year ended December 31, 2017:

- Total revenues, which include net interest income plus other operating income, decreased 1% to $98.2 million in 2017 from $99.6 million in 2016. This decrease mainly reflects decreased mortgage banking income, which was partially offset by the gain on the sale of the assets of NBG.
- Average portfolio loans increased slightly to $981.0 million in 2017 compared to $976.6 in 2016, primarily reflecting growth in the commercial and construction loan portfolios which was partially offset by a decrease in the commercial real estate loan portfolio.
- The provision for loan losses increased in 2017 to $3.2 million from $2.3 million in 2016. We experienced net charge-offs of $1.4 million in 2017 as compared to $754,000 in 2016; additionally, nonperforming loans, net of government guarantees, increased to $21.4 million at the end of 2017 compared to $12.9 million at the end of 2016, while total adversely classified loans, net of government guarantees at December 31, 2017 decreased from $35.6 million at December 31, 2016 to $33.8 million at December 31, 2017. The allowance for loan losses ("Allowance") totaled 2.25% of total portfolio loans at December 31, 2017, compared to 2.02% at December 31, 2016. The Allowance compared to nonperforming loans, net of government guarantees, decreased to 100% at December 31, 2017 from 152% at December 31, 2016.
- The Company continued to maintain strong capital ratios with Tier 1 Capital to Risk Adjusted Assets of 14.65% at December 31, 2017 as compared to 14.54% at December 31, 2016.
- Book value per share increased 3.7% to $28.06 per share at December 31, 2017 compared to $27.07 per share at December 31, 2016 while tangible book value increased 4.0% to $25.70 per share at December 31, 2017, compared to $24.70 per share at December 31, 2016. 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 it excludes the effect of intangible assets on the Company's equity. See reconciliation to book value per share, the most comparable GAAP measurement under "Selected Financial Data - Reconciliation of Selected Financial Data to GAAP Financial Measures" in this report.
- The aggregate cash dividends paid by the Company in 2017, rose 10% to $0.86 per diluted share from $0.78 per diluted share paid in 2016.
-

The Company repurchased 58,341 shares of its common stock in the third quarter of 2017 at an average price of $27.56 per share, leaving 168,901 shares available under the previously announced repurchase authorization.

- The Company redeemed $8.0 million in junior subordinated debt held at Northrim Capital Trust 1. This liability bore interest at a floating rate of 90-day LIBOR plus 3.15%, or 4.33% at the time it was redeemed, and had a final maturity

of May 15, 2033. In 2016, total interest expense on this debt was $310,000. Interest expense on this debt in 2017 through the date of redemption on August 15, 2017 was $212,000. This redemption decreased Tier 1 Capital to Risk Adjusted Assets and Total Capital to Risk Adjusted Assets by 62 basis points each.

An interest rate swap executed in September 2017 effectively converts the floating rate of interest on the remaining $10.0 million in outstanding junior subordinated debt from 90-day LIBOR plus 1.37%, or 2.96% as of December 31, 2017, to a fixed rate of 3.72% through the junior subordinated debt's final maturity date of March 15, 2036.

Critical Accounting Policies

The SEC defines "critical accounting policies" as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in future periods. Our significant accounting policies are described in Note 1 in the Notes to Consolidated Financial Statements in Item 8 of this report. Not all of these significant accounting policies require management to make difficult, subjective or complex judgments or estimates. Management believes that the following policies would be considered critical under the SEC's definition.

Allowance for loan losses: The Company maintains an Allowance to reflect inherent losses in its loan portfolio as of the balance sheet date. The Company performs regular credit reviews of the loan portfolio to determine the credit quality and adherence to underwriting standards. When loans are originated, they are assigned a risk rating that is reassessed periodically during the term of the loan through the credit review process. The Company's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. These risk ratings are then consolidated into five classes, which include pass, special mention, substandard, doubtful and loss. These classes are a primary factor in determining an appropriate amount for the allowance for loan losses. Each class is assessed an inherent credit loss factor that determines an amount of allowance for loan losses provided for that group of loans. This allowance 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.

Regular credit reviews of the portfolio also identify loans that are considered potentially impaired. A loan is considered impaired when based on current information and events, we determine that we will probably not be able to collect all amounts due according to the loan contract, including scheduled interest payments. When we identify a loan as impaired, we measure the impairment using discounted cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral. In these cases, we use the current fair value of the collateral, less selling costs, instead of discounted cash flows. The analysis of collateral dependent loans includes 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.

If we determine that the value of the impaired loan is less than the recorded investment in the loan, we either recognize an impairment reserve as a specific component to be provided for in the Allowance or charge-off the impaired balance on collateral dependent loans if it is determined that such amount represents a confirmed loss. The combination of the risk rating-based allowance component and the impairment reserve allowance component lead to an allocated allowance for loan losses.

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 segments, 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. In addition, a substantial percentage of our loan portfolio is secured by real estate; as a result, a significant decline in real estate market values may require an increase in the Allowance.

Valuation of goodwill and other intangibles: Goodwill and other intangible assets with indefinite lives are not amortized but instead are periodically tested for impairment. Management performs an impairment analysis for the intangible assets with indefinite lives on an annual basis as of December 31. Additionally, goodwill and other intangible assets with indefinite lives are evaluated on an interim basis when events or circumstances indicate impairment potentially exists. The impairment analysis requires management to make subjective judgments. Events and factors that may significantly affect the estimates include, among others, competitive forces, customer behaviors and attrition, changes in revenue growth trends, cost structures, technology, changes in discount rates and specific industry and market conditions. There can be no assurance that changes in circumstances, estimates or assumptions may result in additional impairment of all, or some portion of, goodwill or other intangible assets. The Company performed its annual goodwill impairment testing at December 31, 2017 and 2016 in accordance with the policy described in Note 1 to the financial statements included with this report. At December 31, 2017, the Company performed its annual impairment test by performing the first step of the comprehensive impairment analysis. The Company estimated the fair value of the Company using four valuation methodologies including a comparable transactions approach, a control premium approach, a public market peers approach and a discounted cash flow approach. We then compared the estimated fair value of the Company to the carrying value and concluded that no potential impairment existed as of December 31, 2017.

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. Management's evaluation of fair value is based on appraisals or discounted cash flows of anticipated sales. The amounts ultimately recovered from the sale of OREO may differ from the carrying value of the assets because of market factors beyond the Company's control or due to changes in the Company's strategies for recovering the investment.

Mortgage servicing rights: The Company measures mortgage servicing rights ("MSRs") at fair value on a recurring basis and reports changes in fair value through earnings in mortgage banking income in the period in which the change occurs. Fair value adjustments encompass market-driven valuation changes and the decrease in value that

occurs from the passage of time, which are separately reported. Retained MSRs are measured at fair value as of the date of sale. Initial and subsequent fair value measurements are determined using a discounted cash flow model. In order to determine the fair value of the MSR, the present value of expected net future cash flows is estimated. Assumptions used include market discount rates, anticipated prepayment speeds, escrow calculations, delinquency rates and ancillary fee income net of servicing costs. The model assumptions are also compared to publicly filed information from several large MSR holders, as available.

Fair Value: A hierarchical disclosure framework associated with the level of pricing observability is utilized in measuring financial instruments at fair value. The degree of judgment utilized in measuring the fair value of financial instruments generally correlates to the level of pricing observability. Financial instruments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of pricing observability and a lesser degree of judgment utilized in measuring fair value. Conversely, financial instruments rarely traded or not quoted will generally have little or no pricing observability and a higher degree of judgment utilized in measuring fair value. Pricing observability is impacted

by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established and the characteristics specific to the transaction.

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 mortgage banking income, purchased receivables products, sales of employee benefit plans (through August of 2017, when we sold the assets of NBG), service charges and fees, bankcard fees and rental income. Our operating expenses consist in large part of salaries and other personnel costs, occupancy, data processing, marketing, and professional services expenses and compensation expense for RML acquisition payments. Interest income and cost of funds, or interest expense, 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 attributable to the Company of $13.2 million in 2017, compared to net income of $14.4 million in 2016, and $17.8 million in 2015. During these periods, net income per diluted share was $1.88, $2.06, and $2.56, respectively. The decrease in net income in 2017 compared to 2016 was primarily due to an increase of $4.3 million in provision for income taxes and an increase of $902,000 in the provision for loan losses, as well as a decrease of $2.8 million in other operating income, which was primarily driven by a reduction in mortgage banking income. These changes were only partially offset by a $1.3 million increase in net interest income and a $4.6 million decrease in compensation expense - RML acquisition payments in 2017 compared to 2016. The decrease in net income in 2016 compared to 2015 was primarily due to an increase of $2.9 million in salaries and other personnel expense and an increase of $554,000 in the provision for loan losses, as well as decreases of $1.3 million and $552,000 in other operating income and net interest income, respectively, in 2016 as compared to 2015.

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 2017 was $57.7 million, compared to $56.4 million in 2016, and $56.9 million in 2015. The increase in 2017 as compared to 2016 was mainly due to increased interest income earned on long- and short-term investments and loans primarily due to higher yields in 2017 compared to the prior year. The decrease in 2016 as compared to 2015 was primarily due to decreased interest income earned on loans and loans held for sale mainly due to lower yields, which was only partially offset by increased interest income on long-term investments due to higher balances.

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 years ended December 31, 2017, 2016, and 2015, net interest margins were 4.22%, 4.14%, and 4.27%, respectively. The increase in the net interest margin in 2017 as compared to 2016 is primarily the result of higher yields on all interest-earning assets. The decrease in net interest margin in 2016 as compared to 2015 is primarily the result of lower yields on portfolio loans as well as an unfavorable change in the mix of interest-earning assets as average portfolio loans decreased as a percentage of total interest-earning assets. 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. Average yields or costs, net interest income, and net interest margin are also presented:

Years ended December 31,	2017			2016			2015		
(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]	$981,001	$53,301	5.43 %	$976,613	$52,905	5.42 %	$968,752	$54,070	5.58 %
Loans held for sale	44,047	1,740	3.95 %	52,012	1,872	3.60 %	55,243	2,096	3.79 %
Long-term Investments[3]	305,211	4,634	1.52 %	296,214	3,936	1.33 %	252,354	3,461	1.37 %
Short-term investments[4]	36,944	433	1.17 %	37,074	205	0.55 %	57,753	153	0.26 %
Total interest-earning assets	$1,367,203	$60,108	4.40 %	$1,361,913	$58,918	4.33 %	$1,334,102	$59,780	4.48 %
Noninterest-earning assets	143,849			144,609			146,811		
Total	$1,511,052			$1,506,522			$1,480,913		
Interest-bearing deposits	$829,918	$1,707	0.21 %	$803,877	$1,870	0.23 %	$788,916	$1,939	0.25 %
Borrowings	50,523	723	1.43 %	50,095	691	1.38 %	57,557	932	1.62 %
Total interest-bearing liabilities	$880,441	$2,430	0.28 %	$853,972	$2,561	0.30 %	$846,473	$2,871	0.34 %
Noninterest-bearing demand deposits	418,415			446,366			430,529		
Other liabilities	19,067			24,556			34,109		
Equity	193,129			181,628			169,802		
Total	$1,511,052			$1,506,522			$1,480,913		
Net interest income		$57,678			$56,357			$56,909	
Net interest margin			4.22 %			4.14 %			4.27 %
Average portfolio loans to average-earnings assets	71.75 %			71.71 %			72.61 %		
Average portfolio loans to average total deposits	78.58 %			78.11 %			79.44 %		
Average non-interest deposits to average total deposits	33.52 %			35.70 %			35.31 %		
Average interest-earning assets to average interest-bearing liabilities	155.29 %			159.48 %			157.61 %		

[1]Interest income includes loan fees. Loan fees recognized during the period and included in the yield calculation totaled $3.2 million, $3.1 million and $3.5 million for 2017, 2016 and 2015, respectively.

[2]Nonaccrual loans are included with a zero effective yield. Average nonaccrual loans included in the computation of the average loans were $18.1 million, $7.2 million, and $4.3 million in 2017, 2016 and 2015, respectively.

[3]Consists of investment securities available for sale, investment securities held to maturity, and investment in Federal Home Loan Bank stock.
[4]Consists of interest bearing deposits in other banks and domestic CDs.

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:

	2017 compared to 2016			2016 compared to 2015		
	Increase (decrease) due to			Increase (decrease) due to		
(In Thousands)	Volume	Rate	Total	Volume	Rate	Total
Interest Income:						
Loans	$238	$158	$396	$444	($1,609)	($1,165)
Loans held for sale	(364)	232	(132)	(119)	(105)	(224)
Long-term investments	123	575	698	579	(104)	475
Short term investments	(1)	229	228	(26)	78	52
Total interest income	($4)	$1,194	$1,190	$878	($1,740)	($862)
Interest Expense:						
Interest-bearing deposits	$64	($227)	($163)	$38	($107)	($69)
Borrowings	6	26	32	(113)	(128)	(241)
Total interest expense	$70	($201)	($131)	($75)	($235)	($310)

Provision for Loan Losses

We recorded a provision for loan losses in 2017 of $3.2 million, compared to $2.3 million and $1.8 million in 2016 and 2015, respectively. The loan loss provision increased in 2017 compared to 2016 primarily due to an increase in nonperforming loans and an increase in the portion of the Allowance specific to impaired loans in 2017 compared to 2016. The loan loss provision increased in 2016 compared to 2015 primarily due to an increase in nonperforming loans as well as increases in qualitative factors mostly due to softening in the Alaskan economy in 2016 compared to 2015. See the “Allowance for Loan Losses” section under “Financial Condition” and Note 6 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

The following table details the major components of other operating income for the years ended December 31:

(In Thousands)	2017	$ Change	% Change	2016	$ Change	% Change	2015
Other Operating Income							
Mortgage banking income	$23,287	($6,220)	(21)%	$29,507	($106)	—%	$29,613
Gain on sale of Northrim Benefits Group	4,445	4,445	NM	—	—	NM	—
Purchased receivable income	2,975	628	27%	2,347	60	3%	2,287
Bankcard fees	2,597	(73)	(3)%	2,670	(1)	—%	2,671
Employee benefit plan income	2,506	(1,264)	(34)%	3,770	119	3%	3,651
Service charges on deposit accounts	1,614	(384)	(19)%	1,998	(105)	(5)%	2,103
Other loan fees	566	38	7%	528	88	20%	440
Rental income	532	108	25%	424	(23)	(5)%	447
Gain on loans acquired - APB	189	18	11%	171	(742)	(81)%	913
Gain (loss) on sale of securities	11	22	(200)%	(11)	(282)	(104)%	271
Other income	1,752	(107)	(6)%	1,859	(353)	(16)%	2,212
Total other operating income	$40,474	($2,789)	(6)%	$43,263	($1,345)	(3)%	$44,608

2017 Compared to 2016

The most significant changes in other operating income in 2017 were decreases in mortgage banking income and employee benefit plan income, which were partially offset by a $4.4 million gain on the sale of the assets of NBG. Mortgage banking income, which is the largest component of other operating income and represented 58% of total other operating income in 2017 and consists of gross income from the origination and sale of mortgages as well as mortgage loan servicing fees, decreased to $23.3 million in 2017 from $29.5 million in 2016, mainly due to lower mortgage production revenue resulting from lower realized gains on the sale of mortgage loans, which was partially offset by increased mortgage servicing revenue. The overall decline in mortgage banking income is primarily the result of the slowing of the Alaskan economy. Employee benefit plan income decreased in 2017 compared to 2016 primarily due to the sale of the assets of NBG in August 2017. Lastly, purchased receivable income increased mostly due to higher yields and balances in 2017 compared to 2016 and service charges on deposit accounts decreased primarily due to lower non-sufficient funds fees.

2016 Compared to 2015

The most significant changes in other operating income in 2016 were a decrease in gains on the disposition of loans acquired in the APB transaction at a discount to par values and in gains on the sale of investment securities. Mortgage banking income, which is the largest component of other operating income and represented 68% of total other operating income in 2016 and consists of gross income from the origination and sale of mortgages as well as mortgage loan servicing fees, decreased slightly to $29.5 million in 2016 from $29.6 million in 2015 mainly due to lower mortgage production revenue resulting from lower realized gains on the sale of mortgage loans and the change in fair value of mortgage loan commitments, which was mostly offset by increased mortgage servicing revenue. Service charges on deposit accounts also decreased in 2016 compared to 2015 in part due to lower non-sufficient funds fees. These decreases were partially offset by an increase in employee benefit plan income mostly due to growth in NBG's core business operations, higher other loan fees due to increased commercial loan servicing revenue, and higher purchased receivable income mostly due to higher yields in 2016 compared to 2015 .

Other Operating Expense

The following table details the major components of other operating expense for the years ended December 31:

(In Thousands)	2017	$ Change	% Change	2016	$ Change	% Change	2015
Other Operating Expense							
Salaries and other personnel expense	$44,721	($2,031)	(4)%	$46,752	$2,821	6%	$43,931
Occupancy expense	6,752	290	4%	6,462	130	2%	6,332
Data processing expense	5,549	670	14%	4,879	566	13%	4,313
Marketing expense	2,566	117	5%	2,449	(279)	(10)%	2,728
Professional and outside services	2,365	(432)	(15)%	2,797	(183)	(6)%	2,980
Insurance expense	1,161	138	13%	1,023	(316)	(24)%	1,339
Compensation expense - RML acquisition payments	130	(4,645)	(97)%	4,775	681	17%	4,094
Intangible asset amortization	100	(35)	(26)%	135	(123)	(48)%	258
Loss on sale of premise and equipment	3	(349)	NM	352	315	851%	37
OREO (income) expense, net rental income and gains on sale:							
OREO operating expense	420	116	38%	304	81	36%	223
Impairment on OREO	904	717	383%	187	(174)	(48)%	361
Rental income on OREO	(116)	(18)	(18)%	(98)	(18)	(23)%	(80)
Gains on sale of OREO	(371)	(76)	(26)%	(295)	19	6%	(314)
Subtotal	837	739	(754)%	98	(92)	(48)%	190
Other expenses	6,969	411	6%	6,558	115	2%	6,443
Total other operating expense	$71,153	($5,127)	(7)%	$76,280	$3,635	5%	$72,645

2017 Compared to 2016

Other operating expense decreased in 2017 as compared to the prior year primarily due to decreased costs in compensation expense - RML acquisition payments and salaries and other personnel expense, and, to a lesser extent, professional and outside services expense and loss on sale of premises and equipment. Compensation expense - RML acquisition payments decreased $4.6 million in 2017 as compared to 2016 due in part to the fact that 2016 included a $2.3 million non-cash error correction that covered the period from December 1, 2014, through June 30, 2016. The remainder of the decrease in compensation expense - RML acquisition payments resulted from a decrease in net income from RML. Salaries and other personnel expense decreased primarily due to lower originator commission expense in the home mortgage lending segment due to lower home mortgage loan originations. These decreases were partially offset by increases in impairment on OREO expense and data processing expense in 2017 compared to 2016. Impairment on OREO increased in 2017 as compared to 2016 due to writedowns on two OREO properties resulting from a decrease in sales price assumptions. Data processing expense increased in 2017 as compared to 2016 mostly due to higher software amortization and maintenance expense.

2016 Compared to 2015

Other operating expense increased in 2016 as compared to the prior year primarily due to increased costs in salaries and other personnel expense and compensation expense - RML acquisition payments, and, to a lesser extent, data processing expense, occupancy expense and professional and outside services. Salaries and other personnel expenses increased on an approximately equal basis in both the community banking segment and home mortgage lending segment in 2016. Salaries and other personnel expense related to the operations of the community banking segment increased $1.4 million mainly due to higher medical costs and increases in various other benefits costs, as well as normal cost of living and performance based annual salary increases. The home mortgage lending segment had an increase in salaries and other personnel expense primarily attributable to an increase in full-time equivalent employees for new management and marketing positions and the addition of a new location in Wasilla. While compensation expense - RML acquisition payments increased $681,000 in 2016 as compared to 2015. This expense item in 2016 included a $2.3 million non-cash error correction that covered the period from December 1, 2014, through June 30, 2016. Additionally, the change in the accounting treatment of these payments also increased compensation expense - RML acquisition payments in the third and fourth quarters of 2016. The total increase in compensation expense - RML acquisition payments in 2016 resulting from the error correction and prospective change in accounting was $3.0 million. These increases were partially offset by slight decreases in insurance expense and marketing expense in 2016 compared to 2015.

Income Taxes

The provision for income taxes increased $4.3 million or 71%, to $10.3 million in 2017 as compared to 2016 and decreased $2.7 million or 31%, to $6.1 million in 2016 as compared to 2015. The increase in 2017 includes $2.7 million in expense for the revaluation of the Company's net deferred tax asset resulting from a decrease in the corporate tax rate included in federal tax legislation enacted in December 2017. Additionally, the changes in total income tax expense for these periods are due primarily to the 13% increase in income before income taxes in 2017 compared to the previous year and a 22% decrease in income before income taxes in 2016 compared to 2015. Additionally, the Company's effective tax rates were 43%, 29%, and 32% in 2017, 2016, and 2015, respectively. The increase in the effective tax rate in 2017 compared to 2016 is mainly due to the increase in expense resulting from the revaluation of the Company's net deferred tax asset. The decrease in effective tax rate in 2016 compared to 2015 is mainly due to higher tax credits and tax-exempt income as a percentage of pre-tax income in 2016 as compared to 2015. The Company believes its effective tax rate will decline to between 19% and 20% due to the new federal tax legislation in 2018.

FINANCIAL CONDITION

Investment Securities

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. Investment securities designated as available for sale comprised 100% of the portfolio as of December 31, 2017 and are available to meet liquidity requirements.

Our investment portfolio consists primarily of government sponsored entity securities, corporate securities, and municipal securities. Investment securities at December 31, 2017 decreased $19.4 million, or 6%, to $312.8 million from $332.1 million at December 31, 2016. The decrease at December 31, 2017 as compared to December 31, 2016 is primarily due to a portion of the proceeds from sales, maturities, and security calls being held in short-term investment funds at December 31, 2017. The average maturity of the investment portfolio was approximately two years at December 31, 2017.

Investment securities may be pledged as collateral to secure public deposits or borrowings. At December 31, 2017 and 2016, $51.6 million and $50.9 million in securities were pledged for deposits and borrowings, respectively. Pledged securities decreased at December 31, 2017 as compared to December 31, 2016 because the Company had decreased balances in tri-party accounts at December 31, 2017.

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:		
2017:		
U.S. Treasury and government sponsored entities	$250,794	$249,461
Municipal Securities	14,395	14,421
Corporate Bonds	36,654	37,132
Collateralized Loan Obligations	6,000	6,005
Preferred Stock	5,422	5,731
Total	$313,265	$312,750
2016:		
U.S. Treasury and government sponsored entities	$264,267	$263,361
Municipal Securities	18,184	18,157
U.S. Agency Mortgage-backed Securities	2	2
Corporate Bonds	44,437	44,732
Preferred Stock	4,922	4,967
Total	$331,812	$331,219
2015:		
U.S. Treasury and government sponsored entities	$238,116	$237,436
Municipal Securities	10,227	10,326
U.S. Agency Mortgage-backed Securities	818	809
Corporate Bonds	39,049	39,018
Preferred Stock	3,549	3,524
Total	$291,759	$291,113
Securities Held to Maturity:		
2017:		
Municipal Securities	$—	$—
Total	$—	$—
2016:		
Municipal Securities	$899	$922
Total	$899	$922
2015:		
Municipal Securities	$903	$959
Total	$903	$959

The following table sets forth the market value, maturities, and weighted average pretax yields of our investment portfolio as of December 31, 2017:

(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	$112,755	$136,706	$—	$—	$249,461
Weighted average yield	1.08 %	1.63 %	— %	— %	1.38 %
Municipal securities					
Balance	$3,728	$10,693	$—	$—	$14,421
Weighted average yield	1.64 %	2.66 %	— %	— %	2.40 %
Corporate bonds					
Balance	$4,504	$21,952	$10,676	$—	$37,132
Weighted average yield	2.10 %	2.14 %	2.58 %	— %	2.26 %
Collateralized loan obligations					
Balance	$—	$—	$3,000	$3,005	$6,005
Weighted average yield	— %	— %	3.03 %	3.09 %	3.06 %
Preferred Stock					
Balance	$—	$—	$—	$5,731	$5,731
Weighted average yield	— %	— %	— %	6.37 %	6.37 %
Total					
Balance	$120,987	$169,351	$13,676	$8,736	$312,750
Weighted average yield	1.14 %	1.76 %	2.68 %	5.20 %	1.65 %

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, 2017, 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 wholly-owned subsidiary RML, we also originate mortgage loans which we sell to the secondary market. We also retain servicing rights on mortgage loans originated by RML and sold to the Alaska Housing Finance Corporation ("AHFC"). 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 $27.5 million at December 31, 2017. At December 31, 2017, the Company had two relationships whose total direct and indirect commitments exceeded $27.5 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” for further discussion of the Company's concentration of loans to large borrowers.

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 Senior Credit Officer of the Bank and others in the Loan Administration department, have developed processes to analyze and manage various

concentrations of credit within the overall loan portfolio. The Loan Administration Department monitors the procedures and processes for both the analysis and reporting of problem loans, and also develops strategies to resolve problem loans based on the facts and circumstances for each loan. 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 APB on April 1, 2014. The following table sets forth the composition of our loan portfolio by loan segment:

	December 31, 2017		December 31, 2016		December 31, 2015		December 31, 2014		December 31, 2013	
(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	$313,769	32.8 %	$278,178	28.5 %	$272,441	27.8 %	$272,605	29.5 %	$273,272	35.5 %
Real estate construction one-to-four family	31,201	3.3 %	26,061	2.7 %	44,488	4.5 %	34,842	3.8 %	30,161	3.9 %
Real estate construction other	80,093	8.4 %	72,159	7.4 %	74,956	7.6 %	91,195	9.9 %	32,599	4.2 %
Real estate term owner occupied	132,098	13.8 %	152,178	15.6 %	143,741	14.7 %	120,720	13.1 %	99,894	13.0 %
Real estate term non-owner occupied	319,459	33.4 %	356,601	36.6 %	347,516	35.4 %	301,815	32.6 %	269,749	35.0 %
Real estate term other	40,411	4.2 %	45,402	4.7 %	46,672	4.8 %	44,385	4.8 %	33,821	4.4 %
Consumer secured by 1st deeds of trust	22,873	2.4 %	23,589	2.4 %	26,673	2.7 %	32,000	3.5 %	16,483	2.1 %
Consumer other	19,919	2.1 %	25,281	2.6 %	28,912	2.9 %	31,493	3.4 %	18,058	2.3 %
Subtotal	$959,823		$979,449		$985,399		$929,055		$774,037	
Less: Unearned origination fee,										
net of origination costs	(4,156)	(0.4)%	(4,434)	(0.5)%	(4,612)	(0.5)%	(4,551)	(0.5)%	(4,021)	(0.5)%
Total portfolio loans	$955,667		$975,015		$980,787		$924,504		$770,016	

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 to a lesser extent guaranteed by the United States Department of Agriculture, as well as commercial real estate loans that are purchased by the Alaska Industrial Development and Export Authority ("AIDEA"). Commercial loans increased to $313.8 million at December 31, 2017 from $278.2 million at December 31, 2016 and represented approximately 33% and 29% of our total loans outstanding as of December 31, 2017 and December 31, 2016, 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.
Commercial Real Estate: We are an active lender in the commercial real estate market. At December 31, 2017, commercial real estate loans decreased to $492.0 million from $554.2 million at December 31, 2016, and represented approximately 51% and 57% of our loan portfolio as of December 31, 2017 and December 31, 2016, 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.

We may sell all or a portion of a commercial real estate loan to two State of Alaska entities, AIDEA and 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.

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 2017 to $111.3 million, up from $98.2

million in 2016, and represented approximately 12% and 10% of our loan portfolio in December 31, 2017 and December 31, 2016, respectively. As of December 31, 2017, approximately $30.5 million or 27%, of the Company's construction loans were for low income housing tax credit projects as compared to $31.7 million or 32% as of December 31, 2016.

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.

Loans Directly Exposed to the Oil and Gas Industry: The Company defines "direct exposure" to the oil and gas industry as companies that it has identified as significantly reliant upon activity related to the oil and gas industry, such as oil producers or drilling and exploration companies, and companies who provide oilfield services, lodging, equipment rental, transportation, and other logistic services specific to the industry. The Company estimates that $70.8 million, or approximately 7% of loans as of December 31, 2017 have direct exposure to the oil and gas industry as compared to $57.4 million, or approximately 6% of loans as of December 31, 2016. The Company has no loans to oil producers or drilling and exploration companies as of the end of 2017 or 2016, but the $70.8 million outstanding as of December 31, 2017 noted above does include $9.2 million related to the construction of an oil rig. The Company's unfunded commitments to borrowers that have direct exposure to the oil and gas industry were $53.5 million and $52.1 million at December 31, 2017 and 2016, respectively. The portion of the Company's allowance for loan losses that related to the loans with direct exposure to the oil and gas industry was estimated at $1.8 million and $1.5 million as of December 31, 2017 and 2016, respectively.

The following table details loan balances by loan segment asset quality rating ("AQR") and class of financing receivable for loans with direct oil and gas exposure as of the dates indicated:

(In Thousands)	Commercial	Real estate construction one-to-four family	Real estate construction other	Real estate term owner occupied	Real estate term non-owner occupied	Real estate term other	Consumer secured by 1st deeds of trust	Consumer other	Total
December 31, 2017									
AQR Pass	$48,601	$—	$—	$9,731	$7,778	$—	$—	$435	$66,545
AQR Substandard	4,234	—	—	—	—	—	—	—	4,234
Total loans	$52,835	$—	$—	$9,731	$7,778	$—	$—	$435	$70,779
December 31, 2016									
AQR Pass	$34,746	$—	$—	$10,120	$8,173	$—	$—	$—	$53,039
AQR Substandard	$4,386	$—	$—	$—	$—	$—	$—	$—	$4,386
Total loans	$39,132	$—	$—	$10,120	$8,173	$—	$—	$—	$57,425

Maturities and Sensitivities of Loans to Change in Interest Rates: The following table presents the aggregate maturity data of our loan portfolio, excluding loans held for sale, at December 31, 2017:

(In Thousands)	Maturity Within 1 Year	1-5 Years	Over 5 Years	Total
Commercial	$129,799	$93,977	$89,993	$313,769
Real estate construction one-to-four family	29,361	1,840	—	31,201
Real estate construction other	45,855	24,282	9,956	80,093
Real estate term owner occupied	3,628	27,695	100,775	132,098
Real estate term non-owner occupied	23,903	111,254	184,302	319,459
Real estate term other	8,173	7,861	24,377	40,411
Consumer secured by 1st deeds of trust	227	1,683	20,963	22,873
Consumer other	282	5,446	14,191	19,919
Total	$241,228	$274,038	$444,557	$959,823
Fixed interest rate	$123,459	$73,371	$60,018	$256,848

Floating interest rate	117,769	200,667	384,539	702,975
Total	$241,228	$274,038	$444,557	$959,823

At December 31, 2017, 62% of the portfolio was scheduled to mature or reprice in 2018 with 36% scheduled to mature or reprice between 2019 and 2022.

As of December 31, 2017, approximately 70% of commercial loans are variable rate loans, of which 70% reprice within one year. The majority of these loans reprice to an index based upon the prime rate of interest or the respective Federal Home Loan Bank of Boston (the "Boston FHLB") rate. The Company also uses floors in its commercial loan pricing as loans are originated or renewed during the year.

At December 31, 2017, the interest rates for approximately 89% of commercial real estate loans are variable, of which 51% reset within one year. Approximately 45% 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 Boston FHLB rate. The Company also uses floors in its commercial real estate loan pricing as loans are originated or renewed during the year.

Loans Held for Sale and Mortgage Servicing Rights: The Company originates residential mortgage loans and sells them in the secondary market through our wholly-owned subsidiary, RML. All residential mortgage loans originated and sold in 2017 and 2016 were newly originated loans that did not affect nonperforming loans. The Company also has a mortgage servicing portfolio which is comprised of 1-4 family loans serviced for FHLMC and AHFC. The Company retains servicing rights on all mortgage loans originated by RML and sold to AHFC. Mortgages originated by RML and sold to AHFC represent approximately 26% and 20% of the mortgages originated by RML in 2017 and 2016, respectively. Mortgage servicing rights are adjusted to fair value quarterly with the change recorded in mortgage banking income. The value of mortgage servicing rights is impacted by market rates for mortgage loans primarily due to how changes in interest rates affect prepayments of mortgage loans. To the extent loans are prepaid sooner than estimated at the time servicing assets are originally recorded, it is possible that certain residential mortgage servicing rights assets may decrease in value. Generally, the fair value of our residential mortgage servicing rights are expected to increase as market rates for mortgage loans rise and decrease if market rates fall.

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)	2017	2016	2015	2014	2013
Nonperforming loans					
Nonaccrual loans	$21,626	$13,893	$3,686	$4,674	$1,815
Accruing loans past due 90 days or more	252	456	—	—	—
Government guarantees on nonperforming loans	(467)	(1,413)	(1,561)	(1,178)	(1)
Nonperforming loans, net of government guarantees	$21,411	$12,936	$2,125	$3,496	$1,814
Real estate owned & repossessed assets	8,651	6,574	3,053	4,626	2,402
Government guarantees on nonperforming assets	(1,333)	(195)	—	(891)	—
Total nonperforming assets	$28,729	$19,315	$5,178	$7,231	$4,216
Performing restructured loans	$7,668	$6,131	$11,804	$5,353	$6,635
Loans measured for impairment	$31,967	$38,656	$34,640	$11,297	$8,751
Government guarantees on loans measured for impairment	(1,475)	(1,635)	(1,838)	(2,807)	—
Loans measured for impairment, net of government guarantees	$30,492	$37,021	$32,802	$8,490	$8,751
Allowance for loan losses to portfolio loans	2.25%	2.02%	1.85%	1.81%	2.11%
Allowance for loan losses to nonperforming loans, net of government guarantees	100%	152%	854%	478%	898%
Nonperforming loans, net of government guarantees to portfolio loans	2.24%	1.33%	0.22%	0.38%	0.24%

Nonperforming assets, net of government guarantees to total assets	1.89 %	1.27 %	0.35 %	0.50 %	0.35 %

The Company's nonperforming loans, net of government guarantees increased in 2017 to $21.4 million as compared to $12.9 million in 2016. This increase was primarily due to the addition of two borrowing relationships to nonaccrual status in 2017. There was interest income of $142,000, $181,000, and $617,000 recognized in net income for 2017, 2016, and 2015 respectively, related to interest collected on nonaccrual loans whose principal has been paid down to zero. The Company had three relationships that represented more than 10% of nonaccrual loans as of December 31, 2017.

The Company had $7.7 million and $6.1 million in loans classified as troubled debt restructuring loans ("TDRs") that were performing as of December 31, 2017 and 2016, respectively. Additionally, there were $16.2 million and $10.1 million in TDRs included in nonaccrual loans at December 31, 2017 and 2016 for total TDRs of $23.8 million and $16.2 million at December 31, 2017 and 2016, respectively. The increase in TDRs at December 31, 2017 as compared to 2016 was primarily due to several additions to loans classified as TDRs that were only partially offset by paydowns on TDRs in 2017. See Note 5 of the Notes to Consolidated Financial Statements included in Item 8 of this report for further discussion of TDRs.

At December 31, 2017, the Company had $30.5 million in loans measured for impairment, net of government guarantees as compared to $37.0 million in loans measured for impairment, net of government guarantees at December 31, 2016. The decrease of $6.5 million is mostly attributable to the transfer of one large borrowing relationship from loans to OREO. The total amount of loans measured for impairment for this borrower was $5.9 million.

At December 31, 2017, management had identified potential problem loans of $9.5 million as compared to potential problem loans of $18.2 million at December 31, 2016. 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 $8.7 million decrease in potential problem loans at December 31, 2017 from December 31, 2016 was primarily due to one $11.4 million relationship that was upgraded and a $4.6 million relationship which moved to OREO. These decreases were partially offset by the addition of one $6.3 million relationship.

The following summarizes OREO activity for the periods indicated:

(In Thousands)	2017	2016	2015
Balance, beginning of the year	$6,574	$3,053	$4,607
Transfers from loans	5,912	4,036	1,259
Investment in other real estate owned	—	311	—
Proceeds from the sale of other real estate owned	(3,302)	(934)	(2,733)
Gain on sale of other real estate owned, net	371	295	315
Deferred gain on sale of other real estate owned	—	—	(34)
Impairment on other real estate owned	(904)	(187)	(361)
Balance, end of year	$8,651	$6,574	$3,053

At December 31, 2017 and 2016 the Company held $8.7 million and $6.6 million, respectively, of OREO assets. At December 31, 2017, OREO consists of $3.0 million in residential lots in various stages of development and a $5.7 million commercial building. 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 2017, additions to OREO totaled $5.9 million which included a $5.7 million commercial building and a $167,000 single-family residence. During 2017, the Company received approximately $3.3 million in proceeds from the sale of OREO which included $672,000 from the sale of multi-family residential units, $1.4 million from the sale of lots and land, $832,000 from the sale of single-family residences, $360,000 from the sale of a commercial building,

and $33,000 from recovery of guarantees on previously disposed OREO properties. The Company recognized $391,000, $295,000, and $284,000 in gains and $19,000, $0, and $0 in losses on the sale of OREO properties in 2017, 2016, and 2015, respectively.

The Company also recognized $0, $0, and $34,000 in gains on sales previously deferred resulting in net gains of $371,000, $295,000, and $315,000 in 2017, 2016, and 2015, respectively. The Company had remaining accumulated deferred gains on the sale of OREO properties of $262,000 at December 31, 2017 and 2016.

The Company did not make any loans to facilitate the sale of OREO in 2017, 2016, or 2015. Our underwriting policies and procedures for loans to facilitate the sale of OREO are no different than our standard loan policies and procedures.

The Company recognized impairments of $904,000, $187,000 and $361,000 in 2017, 2016, and 2015, 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, decrease in expected sales prices, and changes in the Anchorage, Fairbanks, and the Southeastern Alaska real estate markets.

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:

- 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 23 of the Notes to Consolidated Financial Statements included in Item 8 of this report for further discussion of the Company's estimation of impaired loans measured at fair value.

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.

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

The Company first disaggregates the loan portfolio into the following eight 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.

After division of the loan portfolio into segments, the Company then further disaggregates each of the segments into classes. The Company has a total of five classes, which are based off of the Company's loan risk grading system known as the Asset Quality Rating ("AQR") system. The risk ratings are discussed in Note 5 to the Consolidated Financial Statements included in Item 8 of this report. There are five loan classes: pass (pass AQR grades, which

are grades 1 – 6), special mention, substandard, doubtful, and loss. There have been no changes to these loan classes in 2017.

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. The Company utilizes a look-back period of five years in the calculation of average historical loss rates.

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, 2017 and 2016, the unallocated allowance as a percentage of the total Allowance was 16% and 7%, respectively.

The following table shows the allocation of the Allowance for the years indicated:

	2017			2016			2015			2014			2013		
		% of			% of			% of			% of			% of	
(In Thousands)	Amount	Loans[1]		Amount	Loans[1]		Amount	Loans[1]		Amount	Loans[1]		Amount	Loans[1]	
Commercial	$6,172	34	%	$5,535	28	%	$5,906	28	%	$5,643	33	%	$5,779	39	%
Real estate construction one-to-four family	629	3	%	550	3	%	854	4	%	644	4	%	557	4	%
Real estate construction other	1,566	8	%	1,465	7	%	1,439	8	%	1,653	10	%	539	4	%
Real estate term owner occupied	2,194	14	%	2,358	16	%	1,657	15	%	1,580	12	%	1,583	12	%
Real estate term non-owner occupied	6,043	33	%	6,853	37	%	5,515	35	%	4,704	31	%	4,297	33	%
Real estate term other	725	4	%	819	5	%	628	4	%	656	4	%	537	4	%
Consumer secured by 1st deeds of trust	315	2	%	313	2	%	264	3	%	285	3	%	322	2	%
Consumer other	307	2	%	408	2	%	397	3	%	410	3	%	390	2	%
Unallocated	3,510	—	%	1,396	—	%	1,493	—	%	1,148	—	%	2,278	—	%
Total	$21,461	100	%	$19,697	100	%	$18,153	100	%	$16,723	100	%	$16,282	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)	2017	2016	2015	2014	2013
Balance at beginning of year	$19,697	$18,153	$16,723	$16,282	$16,408
Charge-offs:					
Commercial	(1,611)	(903)	(616)	(319)	(1,018)
Real estate construction one-to-four family	—	(535)	—	—	—
Real estate term non-owner occupied	—	—	—	(160)	—
Real estate term other	(5)	—	(81)	—	—
Consumer secured by 1st deeds of trust	(85)	(36)	(28)	(59)	(14)
Consumer other	(43)	(8)	(101)	(87)	(164)
Total charge-offs	(1,744)	(1,482)	(826)	(625)	(1,196)
Recoveries:					
Commercial	293	699	379	1,041	1,049
Real estate construction one-to-four family	—	—	—	625	77
Real estate construction other	—	—	—	—	79
Real estate term non-owner occupied	—	—	—	—	488
Real estate term other	2	—	107	—	—
Consumer secured by 1st deeds of trust	2	—	3	4	—
Consumer other	11	29	13	32	12
Total recoveries	308	728	502	1,702	1,705
Net, recoveries (charge-offs)	(1,436)	(754)	(324)	1,077	509
Provision (benefit) for loan losses	3,200	2,298	1,754	(636)	(635)
Balance at end of year	$21,461	$19,697	$18,153	$16,723	$16,282
Ratio of net charge-offs to average loans outstanding during the period	0.15 %	0.08 %	0.03 %	(0.12)%	(0.07)%

In accordance with GAAP, loans acquired in connection with our acquisition of APB on April 1, 2014 were recorded at their fair value at the acquisition date. Credit discounts were included in the determination of fair value; therefore, an allowance for loan losses was not recorded at the acquisition date. Purchased credit impaired loans were evaluated on a loan by loan basis and the valuation allowance for these loans was netted against the carrying value. Deterioration in credit quality of the acquired loans subsequent to acquisition date results in the establishment of an allowance. Management assesses the credit impairment for the loans that were acquired in connection with the acquisition of APB as part of the on-going monitoring of the credit quality of the Company's entire loan portfolio. Management tracks certain credit quality indicators including trends in past due and nonaccrual loans, gross and net chargeoffs, and movement in loan balances within the risk classifications. As of December 31, 2017, $629,000 of the original $141.5 million of purchased loans, or 0.44%, had migrated from pass grade loans to substandard loans. These loans are included in impaired loans as of December 31, 2017, and have been evaluated for specific impairment as part of the calculation of the Allowance. There was no specific impairment on these loans at December 31, 2017 or 2016, respectively. There was no Allowance related to acquired loans at December 31, 2017 or 2016, however, the purchase discount related to these acquired credit impaired loans was $803,000 and $1.1 million as of December 31, 2017 and 2016, respectively.

The provision for loan losses in 2017 as compared to 2016 increased $902,000 to $3.2 million compared to $2.3 million in 2016. This increase is primarily due to an increase in nonperforming loans and the portion of the Allowance specific to impaired loans. The Company determined that an Allowance of $21.5 million, or 2.25% of portfolio loans, is appropriate as of December 31, 2017 based on our analysis of the current credit quality of the portfolio and current economic conditions. The provision for loan losses in 2016 as compared to 2015 increased $544,000 to $2.3 million compared to $1.8 million in 2015. This increase was primarily due an increase in nonperforming loans in 2016 compared to the prior year as well as an increase in qualitative factors mostly due to softening in the Alaska economy in 2016. The provision for loan losses in 2015 as compared to 2014 increased $2.4 million to $1.8 million compared to

a benefit, or negative expense, of $636,000 in 2014. This increase was primarily due to net recoveries on loans in 2014 that led to a negative loan loss provision in that year. The provision for loan losses in 2014 as compared to 2013 was relatively flat despite an increase in net recoveries in 2014 primarily due to an increase in loan volume that same year.

While management believes that it uses the best information available to determine the Allowance, unforeseen market conditions and other events could result in an adjustment to the Allowance, and net income could be significantly affected if circumstances differed substantially from the assumptions used in making the final determination of the Allowance.

Purchased Receivables

We purchase accounts receivable from our business customers and provide them with short-term working capital. We provide this service to our customers in Alaska, Washington, Oregon, and some other states through NFS.

Our purchased receivable activity is guided by policies that outline risk management, documentation, and approval limits. The policies are reviewed and approved annually by the Company's Board of Directors. In 2012, the Company established a reserve for purchased receivable losses. Purchased receivables are recorded on the balance sheet net of this reserve.

Purchased receivable balances increased at December 31, 2017 to $22.2 million from $20.5 million at December 31, 2016, and year-to-date average purchased receivable balances were $15.9 million, $13.3 million, and $13.4 million in 2017, 2016, and 2015, respectively. The increase in 2017 is attributable to increased average balances, as well as higher yields. Purchased receivable income was $3.0 million, $2.3 million, and $2.3 million in 2017, 2016, and 2015, respectively.

The following table sets forth information regarding changes in the purchased receivable reserve for the years indicated:

(In Thousands)	2017	2016	2015
Balance at beginning of year	$171	$181	$289
Charge-offs	—	—	—
Recoveries	—	—	30
Net recoveries (charge-offs)	—	—	30
Reserve for (recovery from) purchased receivables	29	(10)	(138)
Balance at end of year	$200	$171	$181
Ratio of net charge-offs (recoveries) to average purchased receivables during the period	— %	— %	(0.23)%

Deposits

Deposits are our primary source of funds. Total deposits decreased 1% to $1.258 billion at December 31, 2017 from $1.268 billion at December 31, 2016. Our deposits generally are expected to fluctuate according to the level of our market share, economic conditions, and normal seasonal trends.

The following table sets forth the average balances outstanding and average interest rates for each major category of our deposits, for the periods indicated:

	2017		2016		2015	
(In Thousands)	Average balance	Average rate paid	Average balance	Average rate paid	Average balance	Average rate paid
Interest-bearing demand accounts	$220,449	0.03 %	$192,512	0.04 %	$184,671	0.03 %
Money market accounts	238,830	0.17 %	242,025	0.17 %	233,052	0.17 %
Savings accounts	249,641	0.21 %	234,347	0.21 %	226,061	0.21 %
Certificates of deposit	120,998	0.57 %	134,993	0.66 %	145,132	0.69 %
Total interest-bearing accounts	829,918	0.21 %	803,877	0.23 %	788,916	0.25 %
Noninterest-bearing demand accounts	418,415		446,366		430,529	
Total average deposits	$1,248,333		$1,250,243		$1,219,445	

Certificates of Deposit: The only deposit category with stated maturity dates is certificates of deposit. At December 31, 2017, we had $100.5 million in certificates of deposit, of which $66.0 million, or 66%, are scheduled to mature in 2018. The Company's certificates of deposit decreased to $100.5 million during 2017 as compared to $131.7 million at December 31, 2016. The aggregate amount of certificates of deposit in amounts of $100,000 or more at December 31, 2017 and 2016, was $61.4 million and $85.5 million, respectively. The following table sets forth the amount outstanding of certificates of deposits in amounts of $100,000 or more by time remaining until maturity and percentage of total deposits as of December 31, 2017:

	Time Certificates of Deposits of $100,000 or More		
(In Thousands)	Amount	Percent of Total Deposits	
Amounts maturing in:			
Three months or less	$8,487	14	%
Over 3 through 6 months	6,440	10	%
Over 6 through 12 months	27,216	45	%
Over 12 months	19,246	31	%
Total	$61,389	100	%

The Company is also a member of the Certificate of Deposit Account Registry System ("CDARS") which is a network of over 3,000 banks throughout the United States. The CDARS system was founded in 2003 and allows participating banks to exchange FDIC insurance coverage so that 100% of the balance of their customers' certificates of deposit is fully subject to FDIC insurance. At December 31, 2017 and 2016, the Company had nothing in CDARS certificates of deposit.

Borrowings

FHLB: The Bank is a member of the Federal Home Loan Bank of Des Moines (the "FHLB"). As a member, the Bank is eligible to obtain advances from the FHLB. FHLB advances are dependent on the availability of acceptable collateral such as marketable securities or real estate loans, although all FHLB advances are secured by a blanket pledge of the Company's assets. At December 31, 2017, our maximum borrowing line from the FHLB was $531.7 million, approximately 35% of the Company's assets, subject to the FHLB's collateral requirements. The Company has outstanding advances of $7.4 million as of December 31, 2017 which were originated to match fund low income housing projects that qualify for long term fixed interest rates. The first advance is a $2.2 million FHLB Community Investment Program advance which was originated on March 22, 2013. It has an eighteen year term with a 30 year amortization period, which mirrors the term of the term real estate loan made to the borrower, and a fixed rate of 3.12%. The second advance is a $2.3 million FHLB Community Investment Cash Advance Program advance that was originated in the second quarter of 2016. This advance has a 20 year term with a 30 year amortization period, which mirrors the term of the term real estate loan made to the borrower, and a fixed interest rate of 2.61%. The last advance is a $3.1 million FHLB Community Investment Cash Advance Program advance that was originated in the third quarter of 2017. This advance has a 20 year term with a 30 year amortization period and a fixed interest rate of 3.25%, which mirrors the term of the loan made to the borrower. All of these FHLB advances are included in borrowings.

Federal Reserve Bank: The Federal Reserve Bank of San Francisco (the "Federal Reserve Bank") is holding $73.6 million of loans as collateral to secure advances made through the discount window on December 31, 2017. There were no discount window advances outstanding at December 31, 2017 or 2016.

Other Short-term Borrowings: Securities sold under agreements to repurchase were $27.7 million and $27.6 million, for December 31, 2017 and 2016, respectively. The average balance outstanding of securities sold under agreements to repurchase during 2017 and 2016 was $29.0 million and $27.2 million, respectively, and the maximum outstanding at any month-end was $32.6 million and $30.5 million, respectively, during the same time periods. The securities sold

under agreements to repurchase are held by the FHLB under the Company's control.

The Company is subject to provisions under Alaska state law which generally limits the amount of outstanding debt to 15% of total assets or $225.8 million and $227.4 million at December 31, 2017 and 2016, respectively.

Long-term Borrowings: The Company had no long-term borrowings outstanding other than the FHLB advance noted above as of December 31, 2017 or 2016.

Contractual Obligations

The following table references contractual obligations of the Company for the periods indicated:

	Payments Due by Period				
(In Thousands)	Within 1 Year	1-3 Years	3-5 Years	Over 5 Years	Total
December 31, 2017:					
Certificates of deposit	$66,013	$31,470	$1,159	$1,885	$100,527
Short-term borrowings	27,746	—	—	—	27,746
Long-term borrowings	121	340	362	6,539	7,362
Junior subordinated debentures	—	—	—	10,310	10,310
Operating lease obligations	2,737	4,334	3,762	9,354	20,187
Other long-term liabilities[1]	6,230	1,556	718	3,482	11,986
Capital commitments	47	—	—	—	47
Total	$102,894	$37,700	$6,001	$31,570	$178,165
December 31, 2016:					
Certificates of deposit	$97,675	$32,495	$1,359	$186	$131,715
Short-term borrowings	27,607	—	—	—	27,607
Long-term borrowings	74	205	219	3,840	4,338
Junior subordinated debentures	—	—	—	18,558	18,558
Operating lease obligations	2,658	4,541	3,652	11,094	21,945
RML acquisition payments	186	—	—	—	186
Other long-term liabilities	2,279	6,624	1,723	4,215	14,841
Capital commitments	61	—	—	—	61
Total	$130,540	$43,865	$6,953	$37,893	$219,251

[1] Includes principal payments related to employee benefit plans. If a benefit payment schedule is established, payments are recorded in the corresponding dates listed in the table above. Unscheduled payments for all remaining benefits are recorded "Over 5 Years". Additional information about employee benefit plans is provided in Note 16 of the Notes to the Consolidated Financial Statements in Item 8 below.

The table above does not include interest payments.

Short and long-term borrowings included in the table above are described in the "Borrowings" section above. Junior subordinated debentures include $8.2 million that was originated on May 8, 2003, was redeemed on August 15, 2017, and bore interest at a rate of 90-day LIBOR plus 3.15%, adjusted quarterly, and $10.3 million that was originated on December 16, 2005, matures on March 15, 2036, and bears interest at a rate of 90-day LIBOR plus 1.37%, adjusted quarterly. The Company entered into an interest rate swap in the third quarter of 2017 to hedge the variability in cash flows arising out of its junior subordinated debentures, by swapping the cash flows with an interest rate swap which receives floating and pays fixed. The Company has designated this interest rate swap as a hedging instrument. The interest rate swap effectively fixes the Company's interest payments on the $10 million of junior subordinated debentures held under NST2 at 3.72% through its maturity date. Operating lease obligations are more fully described in Note 17 of the Company’s Consolidated Financial Statements included in Item 8 of this report. Other long-term liabilities consist of amounts that the Company owes for its investments in Delaware limited partnerships that develop low-income housing projects throughout the United States. The Company purchased a $10.7 million interest in R4 Frontier Housing Partners L.P., Coronado Park Senior Village L.P. ("R4-Coronado") in March 2013. The investment in R4-Coronado is expected to be fully funded in 2029. The Company also purchased an $8.5 million interest in R4 Frontier Housing Partners L.P., Mountain View Village V L.P. ("R4-MVV") in May 2014. The investment in R4-MVV was 97% funded by the end of 2017 and is expected to be fully funded in 2030. The Company also

purchased a $6.8 million interest in R4 Frontier Housing Partners L.P., PJ33 L.P. ("R4-PJ33") in June 2016. The investment in R4-PJ33 is expected to be 95% funded by the end of 2018 and fully funded in 2032.

Off-Balance Sheet Arrangements

The Company is a party to financial instruments with off-balance sheet risk. Among the off-balance sheet items entered into in the ordinary course of business are commitments to extend credit, commitments to originate loans held for sale and the issuance of letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized on the balance sheet. Certain commitments are collateralized. We apply the same credit standards to these commitments as in all of our lending activities and include these commitments in our lending risk evaluations.

As of December 31, 2017, we had commitments to extend credit of $283.9 million which were not reflected on our balance sheet compared to $236.6 million as of December 31, 2016. Commitments to extend credit are agreements to lend to customers. These commitments have specified interest rates and generally have fixed expiration dates but may be terminated by the Company if certain conditions of the contract are violated. Collateral held relating to these commitments varies, but generally includes real estate, inventory, accounts receivable, and equipment. Our exposure to credit loss under commitments to extend credit is represented by the amount of these commitments. Since many of the commitments are expected to expire without being drawn upon, these total commitment amounts do not necessarily represent future cash requirements.

As of December 31, 2017, we had commitments to originate loans held for sale of $43.6 million, which were not reflected in the balance sheet compared to $62.4 million as of December 31, 2016. Mortgage loans sold to investors may be sold with servicing rights released, for which the Company makes only standard legal representations and warranties as to meeting certain underwriting and collateral documentation standards. In the past two years, the Company has had to repurchase one loan due to deficiencies in underwriting or loan documentation and has not realized significant losses related to this repurchase. Management currently believes that any liabilities that may result from such recourse provisions are not significant.

As of December 31, 2017, we had standby letters of credit of $7.6 million which were not reflected on our balance sheet compared to $9.9 million as of December 31, 2016. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Credit risk arises in these transactions from the possibility that a customer may not be able to repay the Company upon default of performance. Collateral held for standby letters of credit is based on an individual evaluation of each customer's creditworthiness.

Our total unfunded lending commitments at December 31, 2017, which includes commitments to extend credit, commitments to originate loans held for sale and standby letters of credit, were $335.1 million, compared to $309.0 million as of December 31, 2016. We do not expect that all of these commitments are likely to be fully drawn upon at any one time. The Company has established reserves of $152,000 and $122,000 at December 31, 2017 and 2016, respectively, for losses related to these commitments that are recorded in other liabilities on the consolidated balance sheet.

Additional information regarding Off-Balance Sheet Arrangements is included in Notes 17 and 18 of the Notes to Consolidated Financial Statements included in Item 8 of this report.

Liquidity and Capital Resources

The Company is a single bank holding company and its primary ongoing source of liquidity is from dividends received from the Bank. Such dividends arise from the cash flow and earnings of the Bank. Banking regulations and regulatory authorities may limit the amount of, or require the Bank to obtain certain approvals before paying, dividends to the Company. Given that the Bank currently meets and the Bank anticipates that they will continue to meet, all applicable capital adequacy requirements for a "well-capitalized" institution by regulatory standards, the Company expects to continue to receive dividends from the Bank during 2018. A requirement to have a conservation buffer began being phased-in in 2016 and this requirement could adversely affect the Bank's ability to pay dividends.

The Bank manages its liquidity through its Asset and Liability Committee. Our primary sources of funds are customer deposits and advances from the FHLB. These funds, together with loan repayments, loan sales, other borrowed funds, retained earnings, and equity are used to make loans, to acquire securities and other assets, and to fund deposit flows and continuing operations. The primary sources of demands on our liquidity are customer demands for withdrawal of deposits and borrowers' demands that we advance funds against unfunded lending commitments. Our total unfunded commitments to fund loans, loans held for sale, and letters of credit at December 31, 2017, were $335.1 million. We do not expect that all of these loans are likely to be fully drawn upon at any one time. Additionally, as noted above, our total deposits at December 31, 2017, were $1.3 billion.

As shown in the Consolidated Statements of Cash Flows, net cash provided by operating activities was $19.3 million, $20.1 million, and $10.6 million in 2017, 2016, and 2015 respectively. The primary source of cash provided by operating activities for all periods presented was positive net income in each of these periods. The primary reason that net cash provided by operating

activities decreased in 2017 as compared to 2016 was that the Company had a net proceeds of $17.8 million in 2017 compared to $32.4 million in 2016 from sales of loans held for sale. Net cash of $30.4 million was provided by investing activities in 2017 as the Company's proceeds from security sales, maturities, and calls were greater than funds used to purchase additional investment securities in 2017. $47.5 million and $63.5 million of cash were used in investing activities in 2016 and 2015, respectively, as the Company invested available cash primarily in available for sale securities and portfolio loans. Financing activities used cash of $22.4 million in 2017, and provided cash of $19.3 million, and $42.9 million in 2016 and 2015, respectively. Financing activities used net cash in 2017 as compared to providing cash in 2016 primarily as a result of a decrease in deposit balances in 2017 compared to 2016, as well as the use of cash to redeem $8.2 million in junior subordinated debt in 2017.

The sources by which we meet the liquidity needs of our customers are current assets and borrowings available through our correspondent banking relationships and our credit lines with the Federal Reserve Bank and the FHLB. At December 31, 2017, our current assets were $466.6 million and our funds available for borrowing under our existing lines of credit were $593.4 million. Given these sources of liquidity and our expectations for customer demands for cash and for our operating cash needs, we believe our sources of liquidity to be sufficient in the foreseeable future.

During 2017, the Company's Board of Directors approved a quarterly cash dividend of $0.21 per common share for the first and second quarters and $0.22 per common share for the third and fourth quarters. These dividends were made pursuant to our existing dividend policy and in consideration of, among other things, earnings, regulatory capital levels, liquidity, asset quality, and the overall payout ratio. We expect that the dividend rate will be reassessed on a quarterly basis by the Board of Directors in accordance with the dividend policy. The payment of cash dividends is subject to regulatory limitations as described under the Supervision and Regulation section of Part I of this report. There is no assurance that future cash dividends on common shares will be declared or increased.

On February 22, 2018, the Board of Directors approved payment of a $0.24 per share dividend on March 16, 2018, to shareholders of record on March 8, 2018. This dividend is consistent with the Company’s dividends that were declared and paid in 2017.

In September 2002, our Board of Directors approved a plan whereby we would periodically repurchase for cash up to approximately 5% of our shares of common stock in the open market. We purchased an aggregate of 688,442 shares of our stock under this program through December 31, 2009 at a total cost of $14.2 million at an average price of $20.65, which left a balance of 227,242 shares available under the stock repurchase program. The Company did not repurchase any of its shares in 2010 through 2016. In 2017, we purchased an aggregate of 58,341 shares at an average price of $27.56, which leaves a balance of 168,901 shares available under the stock repurchase program as of December 31, 2017. We intend to continue to repurchase our stock from time-to-time depending upon market conditions, but we can make no assurances that we will continue this program or that we will repurchase all of the authorized shares. The table below shows this effect on diluted earnings per share.

Years Ending:	Diluted EPS as Reported	Diluted EPS without Stock Repurchase
2017	$1.88	$1.69
2016	$2.06	$1.87
2015	$2.56	$2.31
2014	$2.54	$2.29
2013	$1.87	$1.67

On May 8, 2003, the Company’s subsidiary, NCT1, issued trust preferred securities in the principal amount of $8 million. These securities carried an interest rate of 90-day LIBOR plus 3.15% per annum that was initially set at 4.45% adjusted quarterly. The securities had a maturity date of May 15, 2033, and were callable by the Company on or after May 15, 2008. These securities were treated as Tier 1 capital by the Company’s regulators for capital adequacy calculations. The Company redeemed these trust preferred securities on August 15, 2017. The interest cost to the Company of the trust preferred securities was $219,000 in 2017.

On December 16, 2005, the Company's subsidiary, NST2, issued trust preferred securities in the principal amount of $10 million. These securities carry an interest rate of 90-day LIBOR plus 1.37% per annum that was initially set at 5.86% adjusted quarterly. The securities have a maturity date of March 15, 2036, and are callable by the Company on or after March 15, 2011. These securities are treated as Tier 1 capital by the Company's regulators for capital adequacy calculations. The interest cost to the Company of these securities was $268,000 in 2017. At December 31, 2017, the securities had an interest rate of 2.96%. The

Company entered into an interest rate swap in the third quarter of 2017 to hedge the variability in cash flows arising out of its junior subordinated debentures, by swapping the cash flows with an interest rate swap which receives floating and pays fixed. The Company has designated this interest rate swap as a hedging instrument. The interest rate swap effectively fixes the Company's interest payments on the $10 million of junior subordinated debentures held under NST2 at 3.72% through its maturity date.

Our shareholders' equity at December 31, 2017, was $192.8 million, as compared to $186.7 million at December 31, 2016. The Company earned net income of $13.2 million during 2017 and issued 32,414 shares through the exercise of stock options. At December 31, 2017, the Company had approximately 6.9 million shares of its common stock outstanding.

We are subject to minimum capital requirements. Federal banking agencies have adopted regulations establishing minimum requirements for the capital adequacy of banks and bank holding companies. The requirements address both risk-based capital and leverage capital. We believe as of December 31, 2017, that the Company and the Bank met all applicable capital adequacy requirements for a "well-capitalized" institution by regulatory standards.

The table below illustrates the capital requirements in effect in 2017 for the Company and the Bank and the actual capital ratios for each entity that exceed these requirements. Management intends to maintain capital ratios for the Bank in 2018, exceeding the FDIC's new requirements for the "well-capitalized" classification. The capital ratios for the Company exceed those for the Bank primarily because the $8 million trust preferred securities offering that the Company completed in the second quarter of 2003 and redeemed in the third quarter of 2017 and another offering of $10 million completed in the fourth quarter of 2005 are included in the Company's capital for regulatory purposes, although they are accounted for as a long-term debt in our financial statements. The trust preferred securities are not accounted for on the Bank's financial statements nor are they included in its capital. As a result, the Company has $10 million and $18 million more in regulatory capital than the Bank at December 31, 2017 and 2016, respectively, which explains most of the difference in the capital ratios for the two entities.

December 31, 2017	Minimum Required Capital	Well-Capitalized	Actual Ratio Company	Actual Ratio Bank
Total risk-based capital	8.00%	10.00%	15.90%	14.08%
Tier 1 risk-based capital	6.00%	8.00%	14.65%	12.83%
Common equity tier 1 capital	4.50%	6.50%	13.89%	12.83%
Leverage ratio	4.00%	5.00%	12.41%	10.87%

See Note 21 of the Consolidated Financial Statements for a detailed discussion of the capital ratios. The requirements for "well-capitalized" come from the Prompt Correction Action rules. See Item 1 Supervision and Regulation. These rules apply to the Bank but not to the Company. Under the rules of the Federal Reserve Bank, a bank holding company such as the Company is generally defined to be "well capitalized" if its Tier 1 risk-based capital ratio is 8.0% or more and its total risk-based capital ratio is 10.0% or more.

Effects of Inflation and Changing Prices: The primary impact of inflation on our operations is increased operating costs. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Although interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services, increases in inflation generally have resulted in increased interest rates, which could affect the degree and timing of the repricing of our assets and liabilities. In addition, inflation has an impact on our customers' ability to repay their loans.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is defined as the sensitivity of income, expense, fair value measurements, and capital to changes in interest rates, foreign currency rates, commodity prices, and other relevant market rates or prices. The primary market risks that we are exposed to are interest rate and price risks, in addition to risk in the Alaska economy due to our

community banking focus. Price risk is the risk to current or future earnings or capital arising from changes in the value of either assets or liabilities that are entered into as part of distributing or managing risk. Interest rate risk is the risk to current or future earnings or capital arising from changes in interest rates. Generally, there are four sources of interest rate risk as described below:

- Re-pricing Risk: Generally, re-pricing risk is the risk of adverse consequences from a change in interest rates that arises because of differences in the timing of when those interest rate changes affect an institution's assets and liabilities.

- Basis Risk: Basis risk is the risk of adverse consequences resulting from unequal changes in the spread between two or more rates for different instruments with the same maturity.
- Yield Curve Risk: Also called yield curve twist risk, yield curve risk is the risk of adverse consequences resulting from unequal changes in the spread between two or more rates for different maturities for the same instrument.
- Option Risk: In banking, option risks are known as borrower options to prepay loans and depositor options to make deposits, withdrawals, and early redemptions. Option risk arises whenever bank products give customers the right, but not the obligation, to alter the quantity of the timing of cash flows.

The Company is exposed to price and interest rate risks in the financial instruments and positions we hold. This includes investment securities, loans, loans held for sale, mortgage servicing rights, deposits, borrowings, and derivative financial instruments. Market risks such as foreign currency exchange risk and commodity price risk do not arise in the normal course of the Company's business.

The Company's price and interest rate risk are managed by the Asset and Liability Committee, a management committee that identifies and manages the sensitivity of earnings and capital to changing interest rates to achieve our overall financial objectives. Based on economic conditions, asset quality and various other considerations, the Asset and Liability Committee establishes overall balance sheet management policies as well as tolerance ranges for interest rate sensitivity and manages within these ranges.

A number of measures are used to monitor and manage interest rate risk, including interest sensitivity (gap) analysis and income simulations. An income simulation model is the primary tool used to assess the direction and magnitude of changes in net interest income resulting from changes in interest rates. Key assumptions in the model include loan and deposit volumes and pricing, prepayment speeds on fixed rate assets, and cash flows and maturities of investment securities. These assumptions are inherently uncertain and, as a result, the model cannot precisely estimate net interest income or precisely predict the impact of higher or lower interest rates on net interest income. Actual results will differ from simulated results due to timing, magnitude and frequency of interest rate changes, changes in market conditions and management strategies, among other factors.

Although analysis of interest rate gap (the difference between the repricing of interest-earning assets and interest-bearing liabilities during a given period of time) is one standard tool for the measurement of exposure to interest rate risk, we believe that because interest rate gap analysis does not address all factors that can affect earnings performance it should not be used as the primary indicator of exposure to interest rate risk and the related volatility of net interest income in a changing interest rate environment. Interest rate gap analysis is primarily a measure of liquidity based upon the amount of change in principal amounts of assets and liabilities outstanding, as opposed to a measure of changes in the overall net interest margin.

The Company uses derivatives in the Home Mortgage Lending segment, including commitments to originate residential mortgage loans at fixed prices, and it enters into forward delivery contracts to sell mortgage-backed securities to broker/dealers at specific prices and dates in order to hedge the interest rate risk in its residential mortgage loan commitments. The Company does not use derivatives outside of these activities in the Home Mortgage Lending segment to manage our interest rate risk exposures. However, the Company does enter into commercial loan interest rate swap agreements in its Community Banking segment in order to provide commercial loan customers the ability to convert from variable to fixed interest rates. Commercial loan interest rate swap agreements are offset with corresponding swap agreements with a third party swap dealer in order to offset the Company's exposure on the fixed component of the customer’s interest rate swap. Additional information regarding the Company’s customer interest rate swap program is presented in Note 18 of the Notes to Consolidated Financial Statements included in Item 8 of this report.

The following table sets forth the estimated maturity or repricing, and the resulting interest rate gap, of our interest-earning assets (which exclude nonaccrual loans) and interest-bearing liabilities at December 31, 2017. The amounts shown below could be significantly affected by external factors such as changes in prepayment assumptions, early withdrawals of deposits, and competition.

(In Thousands)	Estimated maturity or repricing at December 31, 2017			
	Within 1 year	1-5 years	>5 years	Total
Interest -Earning Assets:				
Interest bearing deposits in other banks	$52,825	$—	$—	$52,825
Portfolio investments and FHLB Stock	164,204	145,261	5,400	314,865
Portfolio loans	563,830	351,704	22,663	938,197
Loans held for sale	43,778	—	—	43,778
Total interest-earning assets	$824,637	$496,965	$28,063	$1,349,665
Percent of total interest-earning assets	61.1 %	36.8 %	2.1 %	100.0 %
Interest-Bearing Liabilities:				
Interest-bearing demand accounts	$252,009	$—	$—	$252,009
Money market accounts	243,603	—	—	243,603
Savings accounts	247,458	—	—	247,458
Certificates of deposit	52,757	45,079	2,691	100,527
Securities sold under repurchase agreements	27,746	—	—	27,746
Borrowings	250	1,150	5,962	7,362
Junior subordinated debentures	10,310	—	—	10,310
Total interest-bearing liabilities	$834,133	$46,229	$8,653	$889,015
Percent of total interest-bearing liabilities	93.8 %	5.2 %	1.0 %	100.0 %
Interest sensitivity gap	($9,496)	$450,736	$19,410	$460,650
Cumulative interest sensitivity gap	($9,496)	$441,240	$460,650	
Cumulative interest sensitivity gap as a percentage of total interest-earning assets	(0.7)%	32.7 %	34.1 %	

As stated previously, certain shortcomings, including those described below, are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or periods of repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market interest rates. Additionally, certain assets have features that restrict changes in their interest rates, both on a short-term basis and over the lives of the assets. Further, in the event of a change in market interest rates, prepayment and early withdrawal levels could deviate significantly from those assumed in calculating the tables as can the relationship of rates between different loan and deposit categories. Moreover, the ability of many borrowers to service their adjustable-rate debt may decrease in the event of an increase in market interest rates.

While the analysis above sets forth the estimated maturity or repricing and the resulting interest rate gap of our interest-earning assets and interest-bearing liabilities, the following tables show the estimated impact on net interest income and net income at one and two year time horizons with instantaneous parallel rate shocks of up 400 basis points, up 300 basis points, up 200 basis points, up 100 basis points, up 50 basis points, down 50 basis points, and down 100 basis points. Due to the various assumptions used for this modeling and potential balance sheet strategies management may implement to mitigate interest rate risk, no assurance can be given that projections will reflect actual results.

(In Thousands)	1st Year Change in net interest income from	Percentage change	2nd Year Change in net interest income from	Percentage change

	base scenario			base scenario		
Scenario:						
Up 400 basis points	$6,829	11.51	%	$19,247	31.56	%
Up 300 basis points	$5,202	8.77	%	$14,511	23.80	%
Up 200 basis points	$3,545	5.98	%	$9,780	16.04	%
Up 100 basis points	$1,786	3.01	%	$4,953	8.12	%
Up 50 basis points	$1,262	2.13	%	$2,852	4.68	%
Down 50 basis points	($2,745)	(4.63	)%	($4,763)	(7.81	)%
Down 100 basis points	($5,360)	(9.04	)%	($9,074)	(14.88	)%

(In Thousands)	1st Year Change in net income from base scenario	Percentage change	2nd Year Change in net income from base scenario	Percentage change
Scenario:				
Up 400 basis points	$4,014	24.46 %	$14,046	79.16 %
Up 300 basis points	$3,134	19.10 %	$10,654	60.04 %
Up 200 basis points	$2,073	12.63 %	$7,111	40.07 %
Up 100 basis points	$1,086	6.62 %	$3,646	20.54 %
Up 50 basis points	$790	4.82 %	$2,075	11.69 %
Down 50 basis points	($1,989)	(12.12)%	($3,619)	(20.39)%
Down 100 basis points	($3,974)	(24.22)%	($6,974)	(39.30)%

Impact of Inflation and Changing Prices: The primary impact of inflation on the Company's operations is increased operating costs. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature and as a result, interest rates generally have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Although interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services, increases in inflation generally have resulted in increased interest rates.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following report, audited consolidated financial statements and the notes thereto are set forth in this Annual Report on Form 10-K on the pages indicated:

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Report of Independent Registered Public Accounting Firm

To The Shareholders and the Board of Directors of
Northrim BanCorp, Inc. and Subsidiaries

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Northrim BanCorp, Inc. and Subsidiaries (the "Company") as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2017 and 2016, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by COSO.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures to respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those

policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Moss Adams LLP

Portland, Oregon
March 13, 2018

We have served as the Company's auditor since 2010.

CONSOLIDATED FINANCIAL STATEMENTS

NORTHRIM BANCORP, INC.
Consolidated Balance Sheets
December 31, 2017 and 2016

(In Thousands, Except Share Data)	December 31, 2017	December 31, 2016
ASSETS		
Cash and due from banks	$25,016	$34,485
Interest bearing deposits in other banks	52,825	16,066
Investment securities available for sale	312,750	331,219
Investment securities held to maturity	—	899
Total portfolio investments	312,750	332,118
Investment in Federal Home Loan Bank stock	2,115	1,965
Loans held for sale	43,778	43,596
Loans	955,667	975,015
Allowance for loan losses	(21,461)	(19,697)
Net loans	934,206	955,318
Purchased receivables, net	22,231	20,491
Mortgage servicing rights, at fair value	7,305	4,157
OREO, net	8,651	6,574
Premises and equipment, net	37,867	39,318
Goodwill	15,017	15,017
Other intangible assets, net	1,207	1,307
Other assets	56,141	56,128
Total assets	$1,519,109	$1,526,540
LIABILITIES		
Deposits:		
Demand	$414,686	$449,206
Interest-bearing demand	252,009	201,349
Savings	247,458	241,088
Money market	243,603	244,295
Certificates of deposit less than $250,000	69,283	86,053
Certificates of deposit $250,000 and greater	31,244	45,662
Total deposits	1,258,283	1,267,653
Securities sold under repurchase agreements	27,746	27,607
Borrowings	7,362	4,338
Junior subordinated debentures	10,310	18,558
Other liabilities	22,606	21,672
Total liabilities	1,326,307	1,339,828
COMMITMENTS AND CONTINGENTCIES (NOTE 17)		
SHAREHOLDERS' EQUITY		
Preferred stock, $1 par value, 2,500,000 shares authorized, none issued or outstanding	—	—
Common stock, $1 par value, 10,000,000 shares authorized, 6,871,963 and 6,897,890 shares issued and outstanding at December 31, 2017 and December 31, 2016, respectively	6,872	6,898

Additional paid-in capital	61,793	62,952
Retained earnings	124,407	117,141
Accumulated other comprehensive loss	(270)	(397)
Total Northrim BanCorp, Inc. shareholders' equity	192,802	186,594
Noncontrolling interest	—	118
Total shareholders' equity	192,802	186,712
Total liabilities and shareholders' equity	$1,519,109	$1,526,540

See notes to consolidated financial statements

NORTHRIM BANCORP, INC.
Consolidated Statements of Income
Years Ended December 31, 2017, 2016, and 2015

(In Thousands, Except Share and Per Share Data)	2017	2016	2015
Interest Income			
Interest and fees on loans and loans held for sale	$55,041	$54,777	$56,166
Interest on investment securities available for sale	4,575	3,895	3,393
Interest on investment securities held to maturity	59	41	68
Interest on deposits in other banks	433	205	153
Total Interest Income	60,108	58,918	59,780
Interest Expense			
Interest expense on deposits	1,707	1,870	1,939
Interest expense on securities sold under agreements to repurchase	34	30	23
Interest expense on borrowings	173	127	446
Interest expense on junior subordinated debentures	516	534	463
Total Interest Expense	2,430	2,561	2,871
Net Interest Income	57,678	56,357	56,909
Provision for loan losses	3,200	2,298	1,754
Net Interest Income After Provision for Loan Losses	54,478	54,059	55,155
Other Operating Income			
Mortgage banking income	23,287	29,507	29,613
Gain on sale of Northrim Benefits Group	4,445	—	—
Purchased receivable income	2,975	2,347	2,287
Bankcard fees	2,597	2,670	2,671
Employee benefit plan income	2,506	3,770	3,651
Service charges on deposit accounts	1,614	1,998	2,103
Gain (loss) on sale of securities	11	(11)	271
Other income	3,039	2,982	4,012
Total Other Operating Income	40,474	43,263	44,608
Other Operating Expense			
Salaries and other personnel expense	44,721	46,752	43,931
Occupancy expense	6,752	6,462	6,332
Data processing expense	5,549	4,879	4,313
Marketing expense	2,566	2,449	2,728
Professional and outside services	2,365	2,797	2,980
Insurance expense	1,161		