NORTHRIM BANCORP INC
Form 10-K
March 13, 2019

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, 2018
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, 2018 (the last business day of the registrant’s most recently completed second fiscal quarter) was $267,274,985.

Indicate the number of shares outstanding of each of the registrant’s classes of common stock, as of the latest practicable date. 6,879,902 shares of Common Stock, $1.00 par value, as of March 12, 2019.

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 23, 2019, 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 $1.2 billion in total deposits and $1.5 billion in total assets at December 31, 2018. Through our fifteen banking branches and twelve 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 fifteen branch locations in Alaska; eight 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 a commercial loan production office in Soldotna.We operate in Washington State through Northrim Funding Services (“NFS”), a factoring business that the Bank started in 2004. We offer a wide array of commercial and consumer loan and deposit products, investment products, and electronic banking services over the Internet;

- Northrim Investment Services Company (“NISC”) was formed in November 2002. 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. PWA is a holding company that owns Pacific Portfolio Consulting, LLC and Pacific Portfolio Trust Company;

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- Northrim Statutory Trust 2 ("NST2"), an entity that we formed in December of 2005 to facilitate a trust preferred securities offering by the Company.

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 twelve 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 its interest in the assets of NBG.
- 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 2019 will be 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 produce 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 areas.

We consider our relations with our employees to be highly satisfactory. We had 430 full-time equivalent employees at December 31, 2018. None of our employees are covered by a collective bargaining agreement. Of the 430 full-time equivalent employees, 320 were Community Banking employees and 110 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, the Kenai Peninsula, 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 2019, 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, home equity advantage access card, 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, account reconciliation and positive pay, merchant services, cash management programs to meet the specialized needs of business customers, annuity products, and long term investment portfolios.

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 our interest in 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 6, 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, 2018 approximately 6% of portfolio loans have direct exposure to the oil and gas industry in Alaska. Additionally, approximately 40% of our loan portfolio at December 31, 2018 is attributable to 27 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 somewhat 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, Sitka, and to a lessor extent, the Kenai Peninsula.

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 air cargo and transportation link between the United States and international business in Asia and Europe. The economy of Alaska is dependent upon natural resource industries. Key sectors of the Alaska economy are the oil industry, government and military spending, and the fishing, mining, tourism, air cargo, transportation, and construction industries, as well as health 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 2018 approximately 80% of the unrestricted revenues that funded the Alaska state government in the fiscal year ending June 30, 2018 were generated through various taxes and royalties on the oil industry. This is up from approximately 65% in 2017 and 72% in 2016 due to an increase in the price of oil compared to these periods but is still below historical levels. In 2016 and 2017, following a decrease in the price of oil in 2014 and 2015, the State of Alaska used savings from previous years to fund its budget deficits. As oil prices have stabilized at current levels, we believe the level of revenues to support

current state government spending continues to be a serious concern. 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 and potential oil exploration in the Arctic National Wildlife Refuge. 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. As of December 31, 2018, Alaska's Constitutional Budget Reserve was $1.7 billion and the Alaska Permanent Fund had a balance of $61.8 billion. The Alaska Permanent Fund pays an annual dividend to every eligible Alaskan citizen. According to a January 18, 2019 press release from the Alaska Department of Labor and Workforce Development, the seasonally adjusted unemployment rates in the United States and Alaska were 6.3% and 3.9%, respectively, in December 2018. 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 recovery of 1,400 jobs, or an approximately 0.4% increase in total employment in 2019, following job losses of approximately 0.7% of total employment in 2018 and 1.3% in 2017. While it is an improvement compared to job losses in the last 2 years, the most recent budget proposal by the Governor may result in uncertainty in job growth. The Company anticipates these factors 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. ("Alaska Pacific") 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, 2018, were secured by real estate located in greater Anchorage, Matanuska-Susitna Valley, Fairbanks, and Southeast Alaska. Twenty-nine percent of our revenue in 2018 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 30% and 36% in 2017 and 2016, 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, 2018, $342.4 million, or 35%, 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 $1,600 per eligible resident in 2018 for an aggregate distribution of approximately $726 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 44% share of total deposits held in banks and credit unions in the state as of June 30, 2018. 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 PWA and through retail investment advisory services and annuity investment products that we offer through a third-party vendor.

Currently, there are seven commercial banks operating in Alaska. At June 30, 2018, the date of the most recently available information, Northrim Bank had approximately an 11% share of the Alaska commercial bank deposits, 15% in the Anchorage area, 14% in Juneau, 12% 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, 2018, 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[1]	14[3]	$1,222,336	6	%	11	%
Wells Fargo Bank Alaska[1]	47	5,977,132	28	%	50	%
First National Bank Alaska[1]	28	2,413,401	11	%	20	%
Key Bank[1]	15	1,206,420	6	%	10	%
First Bank[1]	9	504,670	2	%	4	%
Mt. McKinley Bank[1]	5	324,165	2	%	3	%
Denali State Bank[1]	5	260,068	1	%	2	%
Total bank branches	123	$11,908,192	56	%	100	%
Credit unions[2]	98	$9,278,777	44	%	NA	
Total financial institution branches	221	$21,186,969	100	%	100	%

(1) FDIC Summary of Deposits as of June 30, 2018.

(2) SNL Financial Deposit Market Share Summary as of June 30, 2018.

(3) Additional branch opened subsequent to June 30, 2018.

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 from time to time 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 have 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 took 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.

Following the enactment of certain federal legislation in 2018, the federal banking regulators (including the FDIC and FRB) have proposed a rule intended to simplify capital rules for certain community banks and their holding companies. Qualifying community banking organizations could elect to be under a new capital requirement rather than the current capital framework. To be eligible to make this election, the community banking organization would have to have less than $10 billion in assets, have a community bank leverage ratio of at least 9.00% and meet certain other criteria (including limits on off-balance sheet exposures, trading assets and liabilities, mortgage servicing assets, and deferred tax assets). The community bank leverage ratio would generally be the ratio of the organization's total bank equity capital to average assets, subject to certain adjustments. The intent of the proposal is to simplify but not weaken capital requirements for qualifying community banks.

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 2019 that exceed the FDIC’s requirements for the “well-capitalized” capital requirement classification. 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 more in regulatory capital than the Bank at December 31, 2018 and 2017, 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, 2018.

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 which began in 2014 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 in the near term. 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 and results of operations.

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

Substantially all of our business is derived from the Anchorage, Matanuska-Susitna Valley, Fairbanks, and Southeast areas of Alaska. The majority of our lending has been with Alaska businesses and individuals. At December 31, 2018, approximately 73% of the Bank's loans are secured by real estate and 2% are unsecured. Approximately 25% 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 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 financial condition and results of operation.

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. Since December 2015, the RB has increased short-term interest rates eight times and may consider additional rate increases in 2019. 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 took 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.

Our information systems or those of our third party vendors may be subject to an interruption or breach in security, including as a result of cyber attacks.

The Company’s technologies, systems, networks and software, and those of other financial institutions have been, and are likely to continue to be, the target of cybersecurity threats and attacks, which may range from uncoordinated individual attempts to sophisticated and targeted measures directed at us. These cybersecurity threats and attacks may include, but are not limited to, breaches, unauthorized access, misuse, malicious code, computer viruses and denial of service attacks that could result in unauthorized access, misuse, loss or destruction of data (including confidential customer information), account takeovers, unavailability of service or other events. These types of threats may result from human error, fraud or malice on the part of external or internal parties, or from accidental technological failure. Further, to access our products and services our customers may use computers and mobile devices that are beyond our security control systems. The risk of a security breach or disruption, particularly through cyber-attack or cyber intrusion, including by computer hackers, has increased as the number, intensity and sophistication of attempted attacks and intrusions from around the world have increased.

Our business requires the collection and retention of large volumes of customer data, including payment card numbers and other personally identifiable information in various information systems that we maintain and in those maintained by third parties with whom we contract to provide data services. We also maintain important internal company data such as personally identifiable information about our employees and information relating to our operations. The integrity and protection of that customer and company data is important to us. As customer, public, legislative and regulatory expectations and requirements regarding operational and information security have increased, our operations systems and infrastructure must continue to be safeguarded and monitored for potential failures, disruptions and breakdowns.

Our customers and employees have been, and will continue to be, targeted by parties using fraudulent e-mails and other communications in attempts to misappropriate passwords, payment card numbers, bank account information or other personal information or to introduce viruses or other malware through “trojan horse” programs to our customers’ computers. These communications may appear to be legitimate messages sent by the Bank or other businesses, but direct recipients to fake websites operated by the sender of the e-mail or request that the recipient send a password or

other confidential information via e-mail or download a program. Despite our efforts to mitigate these threats through product improvements, use of encryption and authentication technology to secure online transmission of confidential consumer information, and customer and employee education, such attempted frauds against us or our merchants and our third party service providers remain a serious issue. The pervasiveness of cyber security incidents in general and the risks of cyber-crime are complex and continue to evolve. In light of

several recent high-profile data breaches involving customer personal and financial information, we believe the potential impact of a cyber security incident involving the Company, any exposure to consumer losses and the cost of technology investments to improve security could cause customer and/or Bank losses, damage to our brand, and increase our costs.

Although we make significant efforts to maintain the security and integrity of our information systems and have implemented various measures to manage the risk of a security breach or disruption, there can be no assurance that our security efforts and measures will be effective or that attempted security breaches or disruptions would not be successful or damaging. Even the most well-protected information, networks, systems and facilities remain potentially vulnerable because attempted security breaches, particularly cyber-attacks and intrusions, or disruptions will occur in the future, and because the techniques used in such attempts are constantly evolving and generally are not recognized until launched against a target, and in some cases are designed not to be detected and, in fact, may not be detected. Accordingly, we may be unable to anticipate these techniques or to implement adequate security barriers or other preventative measures, and thus it is virtually impossible for us to entirely mitigate this risk. A security breach or other significant disruption could: disrupt the proper functioning of our networks and systems and therefore our operations and/or those of certain of our customers; result in the unauthorized access to, and destruction, loss, theft, misappropriation or release of confidential, sensitive or otherwise valuable information of ours or our customers, including account numbers and other financial information; result in a violation of applicable privacy, data breach and other laws, subjecting the Bank to additional regulatory scrutiny and exposing the Bank to civil litigation, governmental fines and possible financial liability; require significant management attention and resources to remedy the damages that result; or harm our reputation or cause a decrease in the number of customers that choose to do business with us or reduce the level of business that our customers do with us. The occurrence of any such failures, disruptions or security breaches could have a negative impact on our financial condition and results of operations.

A failure in or breach of the Company's operational systems, information systems, or infrastructure, or those of the Company's third party vendors and other service providers,may result in financial losses, or loss of customers.

The Company relies heavily on communications and information systems to conduct our business. In addition, we rely on third parties to provide key components of our infrastructure, including the processing of sensitive consumer and business customer data, internet connections, and network access. These types of information and related systems are critical to the operation of our business and essential to our ability to perform day-to-day operations, and, in some cases, are critical to the operations of many of our customers. These third parties with which the Company does business or that facilitate our business activities, including exchanges, financial intermediaries or vendors that provide services or security solutions for our operations, could also be sources of operational and information security risk to us, including breakdowns or failures of their own systems or capacity constraints. Although the Company has implemented safeguards and business continuity plans, our business operations may be adversely affected by significant and widespread disruption to our physical infrastructure or operating systems that support our business and our customers, resulting in financial losses or loss of customers.

Our business is highly reliant on third party vendor.

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.

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.

Certain hedging strategies that we use to mange interest rate risk may be ineffective to offset any adverse changes in the fair value of these assets due to changes in interest rates and market liquidity.

We use derivative instruments to economically hedge the interest rate risk in our residential mortgage loan commitments. Our hedging strategies are susceptible to prepayment risk, basis risk, market volatility and changes in the shape of the yield curve, among other factors. In addition, hedging strategies rely on assumptions and projections regarding assets and general market factors. If these assumptions and projections prove to be incorrect or our hedging strategies do not adequately mitigate the impact of changes in interest rates, we may incur losses that would adversely impact our financial condition and results of operations.

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 financial condition and results of operations.

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 73% of the Bank’s loan portfolio at December 31, 2018 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 50% of the Bank's loan portfolio at December 31, 2018 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, 2018, the Bank held $8.0 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.

Natural disasters and adverse weather could negatively affect real estate property values and Bank operations.

Real estate and real estate property values play an important role for the Bank in several ways. The Bank owns or leases many real estate properties in connection with its operations, located in Anchorage, Juneau, Fairbanks, the Matanuska-Susitna Valley, Ketchikan, Sitka, and to a lessor extent, the Kenai Peninsula. Real estate is also utilized as collateral for many of our loans. A natural disaster could cause property values to fall, which could require the Bank to record an impairment on its financial statements. A natural disaster could also impact collateral values, which would increase our exposure to loan defaults. Our business operations could also suffer to the extent the Bank cannot utilize its branch network due to a natural disaster or other weather-related damage.

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. Since December 2015, the FRB has increased short-term interest rates eight times and may consider additional increases in 2019. 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 went 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.

There can be no assurance that the Company will continue to declare cash dividends or repurchase stock.

During 2018, the Company repurchased 15,468 shares of common stock at an average price of $31.90 per share under its previously announced share repurchase program. The Company also paid cash dividends of $1.02 per diluted share in 2018. On February 28, 2019, the Board of Directors approved payment of a $0.30 per share dividend on the Company's outstanding shares.

Whether we continue, and the amount and timing of, such dividends and/or stock repurchases is subject to capital availability and periodic determinations by our Board. The Company continues to evaluate the potential impact that regulatory proposals may have on our liquidity and capital management strategies, including Basel III and those required under the Dodd-Frank Act. The actual amount and timing of future dividends and share repurchases, if any, will depend on market and economic conditions, applicable SEC rules, federal and state regulatory restrictions, and various other factors. In addition, the amount we spend and the number of shares we are able to repurchase under our stock repurchase program may further be affected by a number of other factors, including the stock price and blackout periods in which we are restricted from repurchasing shares. Our dividend payments and/or stock repurchases may change from time to time, and we cannot provide assurance that we will continue to declare dividends and/or repurchase stock in any particular amounts or at all. A reduction in or elimination of our dividend payments and/or stock repurchases could have a negative effect on our stock price.

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, Martin, and Ballard in the amounts of $2 million each, we may not be able to timely replace Mr. Schierhorn, Mr. Martin, or Mr. Ballard 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 financial condition and 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	In-store	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
Eastside Community Branch 7905 Creekside Center Drive, Suite 100, 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
Soldotna Loan Production Office 44296 Sterling Highway, Suite 1, Soldotna, AK	Loan production	Leased
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
Eagle River Office 11901 Business Boulevard, #203, Eagle River, AK	Leased
Fairbanks Office 308 Old Steese Highway, Suite 7, Fairbanks, AK	Leased
Fairbanks Northrim Office 360 Merhar Avenue, Fairbanks, AK	Leased
Fairbanks Office 711 Gaffney Road, Suite 202, Fairbanks, AK	Leased
Juneau Office 8800 Glacier Highway, #232, Juneau, AK	Leased
Kodiak Office 2011 Mill Bay Road, #101, Kodiak, 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 12, 2019, the number of shareholders of record of our common stock was 246. 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
2018				
High	$36.05	$40.45	$45.35	$43.00
Low	$32.80	$34.05	$38.80	$30.70
2017				
High	$32.40	$32.55	$35.35	$37.90
Low	$27.50	$29.25	$26.45	$32.50

In 2018, we paid cash dividends of $0.24 per share in the first and second quarters and $0.27 per share in the third and fourth quarters. 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. Cash dividends totaled $7.1 million, $6.0 million, and $5.4 million in 2018, 2017, and 2016, respectively. On February 28, 2019, the Board of Directors approved payment of a $0.30 per share cash dividend on March 22, 2019, to shareholders of record on March 14, 2019. 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 2019. Beginning in 2016, a requirement to have a capital conservation buffer began to be phased in and is now in full effect, 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, 2018, there are 153,433 shares available under the stock repurchase program. The Company repurchased 15,468 shares in 2018 and 58,341 shares in 2017. 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, 2018. Additional information regarding the Company's equity plans is presented in Note 21 of the Notes to Consolidated Financial Statements included in Item 8 of this report.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a) [(2)]	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	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]	222,447	$19.26	176,199
Total	222,447	$19.26	176,199

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

[2] Includes 129,933 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, 2013, and ending December 31, 2018. 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, 2013, and that all dividends were reinvested.

	Period Ending					
Index	12/31/13	12/31/14	12/31/15	12/13/16	12/31/17	12/31/18
Northrim BanCorp, Inc.	100.00	102.77	107.11	131.15	144.42	144.01
Russell 3000	100.00	112.56	113.1	127.50	154.44	146.34
SNL Bank $1B-$5B	100.00	104.56	117.04	168.38	179.51	157.27

ITEM 6. SELECTED FINANCIAL DATA [1]

	Years Ended December 31, (In thousands, except per share data and shares outstanding amounts)						
	2018	2017	2016	2015	2014	2013	Five Year Compound Growth Rate
	(Unaudited)						
Net interest income	$61,208	$57,678	$56,357	$56,909	$52,293	$44,034	7 %
Provision (benefit) for loan losses	(500)	3,200	2,298	1,754	(636)	(635)	NM
Other operating income	32,167	40,474	43,263	44,608	20,034	12,886	20 %
Compensation expense, RML acquisition payments	—	130	4,775	4,094	—	—	NM
Other operating expense	69,800	71,023	71,505	68,551	46,923	38,897	12 %
Income before provision for income taxes	$24,075	$23,799	$21,042	$27,118	$26,040	$18,658	5 %
Provision for income taxes	4,071	10,321	6,052	8,784	8,173	6,246	(8)%
Net Income	20,004	13,478	14,990	18,334	17,867	12,412	10 %
Less: Net income attributable to noncontrolling interest	—	327	579	551	459	87	NM
Net income attributable to Northrim Bancorp, Inc.	$20,004	$13,151	$14,411	$17,783	$17,408	$12,325	10 %
Year End Balance Sheet							
Assets	$1,502,988	$1,518,596	$1,525,851	$1,498,691	$1,448,327	$1,213,740	4 %
Portfolio loans	984,346	954,953	974,074	979,682	923,122	768,750	5 %
Deposits	1,228,088	1,258,283	1,267,653	1,240,792	1,179,747	1,003,723	4 %
Securities sold under repurchase agreements	34,278	27,746	27,607	31,420	19,843	21,143	10 %
Borrowings	7,241	7,362	4,338	2,120	26,304	6,527	2 %
Junior subordinated debentures	10,310	10,310	18,558	18,558	18,558	18,558	(11)%
Shareholders' equity	205,947	192,802	186,712	177,214	164,441	144,318	7 %
Common shares outstanding	6,883,216	6,871,963	6,897,890	6,877,140	6,854,189	6,537,652	1 %
Average Balance Sheet							
Assets	$1,493,385	$1,511,052	$1,506,522	$1,480,913	$1,335,929	$1,156,500	5 %
Earning assets	1,346,449	1,367,203	1,361,913	1,334,102	1,212,291	1,041,268	5 %
Portfolio loans	971,548	981,001	976,613	968,752	893,031	734,427	6 %
Deposits	1,227,272	1,248,333	1,250,243	1,219,445	1,111,594	953,925	5 %
Securities sold under repurchase agreements	29,940	29,690	27,322	24,447	20,909	19,454	9 %
Borrowings	7,309	5,767	4,215	14,552	4,697	6,130	4 %
Junior subordinated debentures	10,310	15,066	18,558	18,558	18,558	18,558	(11)%
Shareholders' equity	201,022	193,129	181,628	169,802	155,591	140,924	7 %
Basic common shares outstanding	6,877,573	6,889,621	6,883,663	6,859,209	6,761,328	6,518,772	1 %
Diluted common shares outstanding	6,981,557	6,977,910	6,974,864	6,948,474	6,852,267	6,609,950	1 %
Per Common Share Data							

Basic earnings	$2.91	$1.91	$2.09	$2.59	$2.57	$1.89	9	%
Diluted earnings	$2.86	$1.88	$2.06	$2.56	$2.54	$1.87	9	%
Book value per share	$29.92	$28.06	$27.07	$25.77	$23.99	$22.07	6	%
Tangible book value per share[(2)]	$27.57	$25.70	$24.70	$22.31	$20.48	$20.86	6	%
Cash dividends per share	$1.02	$0.86	$0.78	$0.74	$0.70	$0.64	10	%

	Years Ended December 31,						
	2018	2017	2016	2015	2014	2013	Five Year Compound Growth Rate
	(Unaudited)						
Performance Ratios							
Return on average assets	1.34%	0.87%	0.96%	1.20%	1.30%	1.07%	5%
Return on average equity	9.95%	6.81%	7.93%	10.47%	11.19%	8.75%	3%
Equity/assets	13.70%	12.70%	12.24%	11.82%	11.35%	11.89%	3%
Tangible common equity/tangible assets[3]	12.76%	11.75%	11.29%	10.40%	9.86%	11.31%	2%
Net interest margin	4.55%	4.22%	4.14%	4.27%	4.31%	4.23%	1%
Net interest margin (tax equivalent)[4]	4.60%	4.28%	4.20%	4.32%	4.36%	4.29%	1%
Non-interest income/total revenue	34.45%	41.24%	43.43%	43.94%	27.70%	22.64%	9%
Efficiency ratio [5]	74.68%	72.39%	76.44%	71.31%	64.48%	67.94%	2%
Dividend payout ratio	35.08%	45.44%	37.59%	28.81%	27.40%	34.18%	1%
Asset Quality							
Nonperforming loans, net of government guarantees	$14,694	$21,411	$12,936	$2,125	$3,496	$1,814	52%
Nonperforming assets, net of government guarantees	22,619	28,729	19,315	5,178	7,231	4,216	40%
Nonperforming loans/portfolio loans, net of government guarantees	1.49%	2.24%	1.33%	0.22%	0.38%	0.24%	44%
Net charge-offs (recoveries)/average loans	0.15%	0.15%	0.08%	0.03%	(0.12)%	(0.07)%	NM
Allowance for loan losses/portfolio loans	1.98%	2.25%	2.02%	1.85%	1.81%	2.11%	(1)%
Nonperforming assets/assets, net of government guarantees	1.50%	1.89%	1.27%	0.35%	0.50%	0.35%	34%
Other Data							
Effective tax rate [6]	17%	43%	29%	32%	31%	33%	(12)%
Number of banking offices[7]	16	14	14	14	14	10	10%
Number of employees (FTE) [8]	430	429	451	441	426	269	10%

[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 28.43% in 2018 and 41.11% in all other 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. In 2018, the Company finalized changes related to the reduction in the federal tax rate which resulted in a $470,000 reduction in tax expense.
[7]Number of banking offices includes 15 full service branches and 1 loan production office. Does not include RML locations.
[8]FTE includes 320 employees of the Bank and 110 employees of RML in 2018, 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, and 256 employees of the Bank and 13 employees of NBG in 2013.

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)	2018	2017	2016	2015	2014	2013
Total shareholders' equity	$205,947	$192,802	$186,712	$177,214	$164,441	$144,318
Total assets	1,502,988	1,518,596	1,525,851	1,498,691	1,448,327	1,213,740
Total shareholders' equity to total assets ratio	13.70 %	12.70 %	12.24 %	11.82 %	11.35 %	11.89 %

(In Thousands)	2018	2017	2016	2015	2014	2013
Total shareholders' equity	$205,947	$192,802	$186,712	$177,214	$164,441	$144,318
Less: goodwill and other intangible assets, net	16,154	16,224	16,324	23,776	24,035	7,942
Tangible common shareholders' equity	$189,793	$176,578	$170,388	$153,438	$140,406	$136,376
Total assets	$1,502,988	$1,518,596	$1,525,851	$1,498,691	$1,448,327	$1,213,740
Less: goodwill and other intangible assets, net	16,154	16,224	16,324	23,776	24,035	7,942
Tangible assets	$1,486,834	$1,502,372	$1,509,527	$1,474,915	$1,424,292	$1,205,798
Tangible common equity to tangible assets ratio	12.76 %	11.75 %	11.29 %	10.40 %	9.86 %	11.31 %

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

(In thousands, except per share data)	2018	2017	2016	2015	2014	2013
Total shareholders' equity	$205,947	$192,802	$186,712	$177,214	$164,441	$144,318
Divided by common shares outstanding	6,883,216	6,871,963	6,897,890	6,877,140	6,854,189	6,537,652
Book value per share	$29.92	$28.06	$27.07	$25.77	$23.99	$22.07

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(In thousands, except per share data)	2018	2017	2016	2015	2014	2013
Total shareholders' equity	$205,947	$192,802	$186,712	$177,214	$164,441	$144,318
Less: goodwill and intangible assets, net	16,154	16,224	16,324	23,776	24,035	7,942
	$189,793	$176,578	$170,388	$153,438	$140,406	$136,376
Divided by common shares outstanding	6,883,216	6,871,963	6,897,890	6,877,140	6,854,189	6,537,652
Tangible book value per share	$27.57	$25.70	$24.70	$22.31	$20.48	$20.86

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

(In Thousands)	2018	2017	2016	2015	2014	2013
Net interest income[9]	$61,208	$57,678	$56,357	$56,909	$52,293	$44,034
Divided by average interest-bearing assets	1,346,449	1,367,203	1,361,913	1,334,102	1,212,291	1,041,268
Net interest margin	4.55 %	4.22 %	4.14 %	4.27 %	4.31 %	4.23 %
(In Thousands)	2018	2017	2016	2015	2014	2013
Net interest income[9]	$61,208	$57,678	$56,357	$56,909	$52,293	$44,034
Plus: reduction in tax expense related to tax-exempt interest income	726	872	808	722	583	585
	$61,934	$58,550	$57,165	$57,631	$52,876	$44,619
Divided by average interest-bearing assets	1,346,449	1,367,203	1,361,913	1,334,102	1,212,291	1,041,268
Tax-equivalent net interest margin	4.60 %	4.28 %	4.20 %	4.32 %	4.36 %	4.29 %

Calculation of efficiency ratio

(In Thousands)	2018	2017	2016	2015	2014	2013
Net interest income[9]	$61,208	$57,678	$56,357	$56,909	$52,293	$44,034
Other operating income	32,167	40,474	43,263	44,608	20,034	12,886
Total revenue	93,375	98,152	99,620	101,517	72,327	56,920
Other operating expense	69,800	71,153	76,280	72,645	46,923	38,897
Less intangible asset amortization	70	100	135	258	289	228
Adjusted other operating expense	$69,730	$71,053	$76,145	$72,387	$46,634	$38,669
Efficiency ratio	74.68 %	72.39 %	76.44 %	71.31 %	64.48 %	67.94 %

[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, 2018, 2017 and 2016 included in Item 8 of 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 increased 52% to $20.0 million or $2.86 per diluted share for the year ended December 31, 2018, from $13.2 million, or $1.88 per diluted share, for the year ended December 31, 2017. Significant items contributing to the increase in 2018 compared to 2017 were:

- an increase in net interest income due to increases in interest rates
- a decrease in the provision for income taxes due to a lower federal corporate income tax rate in 2018 arising from the Tax Cuts Jobs Act, and
- a decrease in the provision for loan losses primarily resulting from improvements in credit quality.

The following are other significant items for the year ended December 31, 2018:

- Total revenues, which include net interest income plus other operating income, decreased 5% to $93.4 million in 2018 from $98.2 million in 2017 and decreased 6% from $99.6 million in 2016. This decrease mainly reflects decreased mortgage banking income and employee benefit plan income, as well as the fact that the company recognized a gain on the sale of NBG in 2017. These declines were partially offset by an increase in net interest income, a one-time immaterial gain on commercial servicing rights, and increases in purchased receivable income and bankcard fees.
- The net interest margin increased to 4.55% in 2018 from 4.22% in 2017 and 4.14% in 2016 despite a decline in average loans to $971.5 million in 2018 compared to $981.0 million in 2017 and $976.6 million in 2016. This increase is primarily the result of increases in interest rates as the Company's interest-earning assets have repriced faster than interest-bearing liabilities.
- The provision for loan losses decreased in 2018 to a benefit of $500,000 from provisions of $3.2 million in 2017 and $2.3 million in 2016. Our nonperforming loans, net of government guarantees, decreased to $14.7 million at the end of 2018 compared to $21.4 million at the end of 2017 and increased from $12.9 million at the end of 2016, while total adversely classified loans, net of government guarantees at December 31, 2018 decreased to $27.2 million from $33.8 million at December 31, 2017 and $35.6 million at December 31, 2016. The allowance for loan losses ("Allowance") totaled 1.98% of total portfolio loans at December 31, 2018, compared to 2.25% at December 31, 2017 and 2.02% at December 31, 2016. The Allowance compared to nonperforming loans, net of government guarantees, was 133% at December 31, 2018 compared to 100% the end of 2017 and 152% the end of 2016.
- Return on average assets was 1.34% in 2018 compared to 0.87% in 2017 and 0.96% in 2016.
- The Company continued to maintain strong capital ratios with Tier 1 Capital to Risk Adjusted Assets of 15.47% at December 31, 2018 as compared to 14.65% at December 31, 2017.
- The aggregate cash dividends paid by the Company in 2018 rose 19% to $1.02 per diluted share from $0.86 per diluted share paid in 2017.
- The Company repurchased 15,468 shares of its common stock in 2018 at an average price of $31.90 per share, leaving 153,433 shares available under the previously announced repurchase authorization.

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 accounting 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

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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, 2018 and 2017 in accordance with the policy described in Note 1 to the financial statements included with this report. At December 31, 2018, the Company performed its annual impairment test by performing a qualitative assessment. Significant positive inputs to the qualitative assessment included the Company’s increasing net income as compared to historical trends, the Company's stable budget-to-actual results of operations; results of regulatory examinations; peer comparisons of the Company's net interest margin; trends in the Company’s cash flows; and improvements in the Alaskan economy in 2018. Significant negative inputs to the qualitative assessment included the recent decline in oil prices and in the company's stock price, as well as the decline in the volume of mortgage originations in Alaska and the decrease in net income in the Company's Home Mortgage Lending segment. For the Community Banking segment, we believe that the positive inputs to the qualitative assessment noted above outweigh the negative inputs, and we therefore concluded that it is more likely than not that the fair value of the Company exceeds its carrying value at December 31, 2018 and that no potential impairment existed at that time. After review of these qualitative inputs, the Company determined that performing a quantitative goodwill impairment test for the Home Mortgage Lending segment as of December 31, 2018 was appropriate. The Company estimated the fair value of the Home Mortgage Lending segment using a discounted cash flow approach. We then compared the estimated fair value of the Home Mortgage Lending segment to the carrying value as of December 31, 2018 and concluded that no potential impairment existed at that time.
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.
Servicing rights: The Company measures mortgage servicing rights ("MSRs") and commercial servicing rights ("CSRs") at fair value on a recurring basis with changes in fair value going through earnings in the period in which the change occurs. Changes in the fair value of MSRs are recorded in mortgage banking income, and changes in the fair value of CSRs are recorded in commercial servicing revenue. 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 servicing rights 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 servicing rights, 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 for MSRs 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 our interest in the assets of NBG), service charges and fees, and bankcard fees. 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 $20.0 million in 2018, compared to net income of $13.2 million in 2017, and $14.4 million in 2016. During these periods, net income per diluted share was $2.86, $1.88, and $2.06, respectively. The increase in net income in 2018 compared to 2017 was primarily due to a decrease of $6.3 million in provision for income taxes, a decrease of $3.7 in the provision for loan losses, and a $3.5 million increase in net interest income. These changes were only partially offset by a decrease of $8.3 million in other operating income, which was primarily due to the sale of our interest in the assets of NBG in August 2017 and a decrease in mortgage banking income. 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.
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. 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.
Net interest income in 2018 was $61.2 million, compared to $57.7 million in 2017, and $56.4 million in 2016. The increase in 2018 as compared to 2017 and 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 resulting from increases in interest rates in both 2018 and 2017 compared to the prior year. During 2018, 2017, and 2016, net interest margins were 4.55%, 4.22%, and 4.14%, respectively. The increase in net interest margin in both 2017 and 2018 compared to the prior year is the result of increases in the spread between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.

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,	2018			2017			2016		
(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]	$971,548	$55,526	5.72 %	$981,001	$53,301	5.43 %	$976,613	$52,905	5.42 %
Loans held for sale	46,089	2,016	4.37 %	44,047	1,740	3.95 %	52,012	1,872	3.60 %
Long-term Investments[3]	286,426	5,829	2.04 %	305,211	4,634	1.52 %	296,214	3,936	1.33 %
Short-term investments[4]	42,386	806	1.90 %	36,944	433	1.17 %	37,074	205	0.55 %
Total interest-earning assets	$1,346,449	$64,177	4.77 %	$1,367,203	$60,108	4.40 %	$1,361,913	$58,918	4.33 %
Noninterest-earning assets	146,936			143,849			144,609		
Total	$1,493,385			$1,511,052			$1,506,522		
Interest-bearing deposits	$809,808	$2,307	0.28 %	$829,918	$1,707	0.21 %	$803,877	$1,870	0.23 %
Borrowings	47,570	662	1.37 %	50,523	723	1.43 %	50,095	691	1.38 %
Total interest-bearing liabilities	$857,378	$2,969	0.35 %	$880,441	$2,430	0.28 %	$853,972	$2,561	0.30 %
Noninterest-bearing demand deposits	417,464			418,415			446,366		
Other liabilities	17,521			19,067			24,556		
Equity	201,022			193,129			181,628		
Total	$1,493,385			$1,511,052			$1,506,522		
Net interest income		$61,208			$57,678			$56,357	
Net interest margin			4.55 %			4.22 %			4.14 %
Average portfolio loans to average-earnings assets	72.16	%		71.75	%		71.71	%	
Average portfolio loans to average total deposits	79.16	%		78.58	%		78.11	%	
Average non-interest deposits to average total deposits	34.02	%		33.52	%		35.70	%	
Average interest-earning assets to average interest-bearing liabilities	157.04	%		155.29	%		159.48	%	

[1]Interest income includes loan fees. Loan fees recognized during the period and included in the yield calculation totaled $3.0 million, $3.2 million and $3.1 million for 2018, 2017 and 2016, respectively.

[2]Nonaccrual loans are included with a zero effective yield. Average nonaccrual loans included in the computation of the average loans were $17.5 million, $18.1 million, and $7.2 million in 2018, 2017 and 2016, respectively.

[3]Consists of investment securities available for sale, investment securities held to maturity, marketable equity securities, 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:

	2018 compared to 2017 Increase (decrease) due to			2017 compared to 2016 Increase (decrease) due to		
(In Thousands)	Volume	Rate	Total	Volume	Rate	Total
Interest Income:						
Loans	($508)	$2,733	$2,225	$238	$158	$396
Loans held for sale	83	193	276	(364)	232	(132)
Long-term investments	(264)	1,459	1,195	123	575	698
Short term investments	71	302	373	(1)	229	228
Total interest income	($618)	$4,687	$4,069	($4)	$1,194	$1,190
Interest Expense:						
Interest-bearing deposits	($40)	$640	$600	$64	($227)	($163)
Borrowings	(35)	(26)	(61)	6	26	32
Total interest expense	($75)	$614	$539	$70	($201)	($131)

Provision for Loan Losses

We recorded a benefit for loan losses in 2018 of $500,000, compared to a provision for loan losses of $3.2 million and $2.3 million in 2017 and 2016, respectively. The loan loss provision decreased in 2018 compared to 2017 primarily due to an improvement in credit quality as nonperforming loans, adversely classified loans, and specific impairment on loans decreased in 2018. The loan loss provision increased in 2017 compared to 2016 primarily due to an increase in nonperforming loans as well as an increase in specific impairment on loans. See the “Allowance for Loan Losses” section under “Financial Condition” and Note 7 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)	2018	$ Change	% Change	2017	$ Change	% Change	2016
Other Operating Income							
Mortgage banking income	$20,844	($2,443)	(10)%	$23,287	($6,220)	(21)%	$29,507
Employee benefit plan income	—	(2,506)	(100)%	2,506	(1,264)	(34)%	3,770
Bankcard fees	2,811	214	8%	2,597	(73)	(3)%	2,670
Purchased receivable income	3,255	280	9%	2,975	628	27%	2,347
Service charges on deposit accounts	1,508	(106)	(7)%	1,614	(384)	(19)%	1,998
Commercial servicing revenue	1,422	1,050	282%	372	50	16%	322
Other loan fees	584	18	3%	566	38	7%	528
Rental income	692	160	30%	532	108	25%	424
Gain on loans acquired - APB	257	68	36%	189	18	11%	171
Gain (loss) on sale of securities	—	(11)	(100)%	11	22	(200)%	(11)
Gain on sale of Northrim Benefits Group	—	(4,445)	NM	4,445	4,445	NM	—
Loss on marketable equity securities	(625)	(625)	NM	—	—	NM	—
Other income	1,419	39	3%	1,380	(157)	(10)%	1,537
Total other operating income	$32,167	($8,307)	(21)%	$40,474	($2,789)	(6)%	$43,263

2018 Compared to 2017

The most significant changes in other operating income in 2018 were decreases in mortgage banking income and employee benefit plan income, as well as a $4.4 million decrease in gain on the sale of our interest in the assets of NBG. Mortgage banking income consists of gross income from the origination and sale of mortgages as well as mortgage loan servicing fees and is the largest component of other operating income at 65% of total other operating income in 2018. Mortgage banking income decreased in 2018 compared to 2017 mainly due to a decrease in the yield and amount of mortgage loans originated and sold as this volume decreased to $528 million in 2018 from $554 million in 2017. The overall decline in mortgage originations is primarily the result of the slowing of the Alaskan economy and rising interest rates while yields have decreased due to market competition. Employee benefit plan income decreased in 2018 compared to 2017 due to the sale of the assets of NBG in August 2017. Lastly, the Company recorded for the first time in other operating income the fair value of its commercial loan servicing portfolio of $1.0 million. Going forward, only changes in the fair value of the Company's commercial loan servicing portfolio will be reflected in other operating income and are not expected to be material to the Company's net income.

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 our interest in the assets of NBG. Mortgage banking income decreased in 2017 compared to 2016 mainly due to a decrease in mortgage loans originated and sold to $554 million in 2017 from $736 million in 2016.The overall decline in mortgage originations in 2017 was 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 our interest in 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.

Other Operating Expense

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

(In Thousands)	2018	$ Change	% Change	2017	$ Change	% Change	2016
Other Operating Expense							
Salaries and other personnel expense	$44,650	($71)	—%	$44,721	($2,031)	(4)%	$46,752
Occupancy expense	6,136	(616)	(9)%	6,752	290	4%	6,462
Data processing expense	6,035	486	9%	5,549	670	14%	4,879
Marketing expense	2,318	(248)	(10)%	2,566	117	5%	2,449
Professional and outside services	2,453	88	4%	2,365	(432)	(15)%	2,797
Insurance expense	862	(299)	(26)%	1,161	138	13%	1,023
Intangible asset amortization	70	(30)	(30)%	100	(35)	(26)%	135
Loss on sale of premise and equipment	2	(1)	NM	3	(349)	(99)%	352
Compensation expense - RML acquisition payments	—	(130)	(100)%	130	(4,645)	(97)%	4,775
OREO (income) expense, net rental income and gains on sale:							
OREO operating expense	802	382	91%	420	116	38%	304
Impairment on OREO	—	(904)	(100)%	904	717	383%	187
Rental income on OREO	(541)	(425)	(366)%	(116)	(18)	(18)%	(98)
Gains on sale of OREO	(3)	368	99%	(371)	(76)	(26)%	(295)
Subtotal	258	(579)	69%	837	739	754%	98
Other expenses	7,016	47	1%	6,969	411	6%	6,558
Total other operating expense	$69,800	($1,353)	(2)%	$71,153	($5,127)	(7)%	$76,280

2018 Compared to 2017

Other operating expense decreased in 2018 as compared to the prior year primarily due to decreases in occupancy expense and OREO expense, net of OREO gains on sale and rental income. In 2018, occupancy expense included a one-time technical correction that decreased depreciation expense by $670,000. OREO expenses net of gains and rental income decreased due to no impairment charges on OREO properties in 2018 and an increase in rental income on OREO properties associated with one commercial property. These decreases were partially offset by increases in OREO operating costs associated with the commercial property, and lower gains on the sale of OREO properties in 2018. Lastly, salaries and other personnel expense in the Home Mortgage Lending segment decreased $935,000 in 2018 as compared to 2017, primarily due to a reduction in full-time equivalent employees as mortgage origination volume has declined. This decrease was offset by an $864,000 increase in salaries and other personnel expense in the Community Banking segment in 2018 compared to 2017, primarily due to an increase in full time equivalent employees and an increase in benefits costs associated with the Company's self-insured group health plan due to higher medical claims.

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.

Income Taxes

The provision for income taxes decreased $6.3 million or 61%, to $4.1 million in 2018 as compared to 2017 and increased $4.3 million or 71%, to $10.3 million in 2017 as compared to 2016. The decrease in 2018 is primarily due to a decrease in the corporate tax rate included in federal tax legislation enacted in December 2017. In addition to reducing the Company's federal tax rate from 35% in 2017 to 21% in 2018, this change also resulted in $2.7 million in expense in 2017 for the revaluation of the Company's net deferred tax asset. In 2018, the Company finalized its valuation of net deferred tax assets related to the decrease in the federal tax rate after completing a fixed asset cost segregation study for tax planning purposes which resulted in a $470,000 decrease in tax expense. The Company's effective tax rates were 17%, 43%, and 29% in 2018, 2017, and 2016, respectively. The changes in the Company's effective tax rates for 2018 and 2017 are primarily due to the items discussed regarding the changes in tax expense for these periods.

FINANCIAL CONDITION

Investment Securities

The composition of our investment securities portfolio, which includes securities available for sale, securities held to maturity, and marketable equity securities, 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 97% of the portfolio as of December 31, 2018 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, 2018 decreased $33.9 million, or 11%, to $278.9 million

from $312.8 million at December 31, 2017. The decrease at December 31, 2018 as compared to December 31, 2017 is primarily due to a portion of the proceeds from sales, maturities, and security calls being reinvested in loans as of December 31, 2018. The average maturity of the investment portfolio was approximately two and a half years at December 31, 2018.

Investment securities may be pledged as collateral to secure public deposits or borrowings. At December 31, 2018 and 2017, $58.4 million and $51.6 million in securities were pledged for deposits and borrowings, respectively. Pledged securities increased at December 31, 2018 as compared to December 31, 2017 because the Company had increased balances in tri-party accounts at December 31, 2018.
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:		
2018:		
U.S. Treasury and government sponsored entities	$209,908	$208,860
Municipal Securities	9,089	9,084
Corporate Bonds	40,139	39,780
Collateralized Loan Obligations	13,990	13,886
Total	$273,126	$271,610
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
Marketable Equity Securities:		
2018:		
Preferred Stock	$7,580	$7,265
Total	$7,580	$7,265
2017:		
Preferred Stock	$—	$—
Total	$—	$—
2016:		
Preferred Stock	$—	$—
Total	$—	$—
Securities Held to Maturity:		
2018:		
Municipal Securities	$—	$—
Total	$—	$—
2017:		
Municipal Securities	$—	$—
Total	$—	$—
2016:		
Municipal Securities	$899	$922
Total	$899	$922

The following table sets forth the market value, maturities, and weighted average pretax yields of our investment portfolio as of December 31, 2018:

(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	$67,798	$141,062	$—	$—	$208,860
Weighted average yield	1.41 %	2.36 %	— %	— %	2.05 %
Municipal securities					
Balance	$1,861	$7,223	$—	$—	$9,084
Weighted average yield	1.64 %	2.64 %	— %	— %	2.43 %
Corporate bonds					
Balance	$—	$30,103	$9,677	$—	$39,780
Weighted average yield	— %	3.45 %	3.51 %	— %	3.46 %
Collateralized loan obligations					
Balance	$—	$—	$2,990	$10,896	$13,886
Weighted average yield	— %	— %	3.86 %	3.78 %	3.80 %
Total					
Balance	$69,659	$178,388	$12,667	$10,896	$271,610
Weighted average yield	1.41 %	2.55 %	3.59 %	3.78 %	2.36 %
Marketable Equity Securities					
Preferred Stock					
Balance	$—	$—	$—	$7,265	$7,265
Weighted average yield	— %	— %	— %	4.75 %	4.75 %

The Company’s investment in marketable equity securities does not have a maturity date but it has been included in the over 10 years column above. At December 31, 2018, 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 $27.9 million at December 31, 2018. At December 31, 2018, the Company had two relationships whose total direct and indirect commitments exceeded $27.9 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

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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, have developed processes to analyze and manage various concentrations of credit within the overall loan portfolio. The Credit 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 following table sets forth the composition of our loan portfolio by loan segment:

	December 31, 2018		December 31, 2017		December 31, 2016		December 31, 2015		December 31, 2014	
(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	$342,420	34.8 %	$313,514	32.8 %	$277,802	28.5 %	$271,946	27.8 %	$271,986	29.5 %
Real estate construction one-to-four family	37,111	3.8 %	31,201	3.3 %	26,061	2.7 %	44,488	4.5 %	34,842	3.8 %
Real estate construction other	72,256	7.3 %	80,093	8.4 %	72,159	7.4 %	74,956	7.7 %	91,162	9.9 %
Real estate term owner occupied	126,414	12.8 %	132,042	13.8 %	152,112	15.6 %	143,667	14.7 %	120,621	13.1 %
Real estate term non-owner occupied	325,720	33.1 %	319,313	33.4 %	356,411	36.6 %	347,284	35.4 %	301,544	32.7 %
Real estate term other	42,039	4.3 %	40,411	4.2 %	45,402	4.7 %	46,672	4.8 %	44,385	4.8 %
Consumer secured by 1st deeds of trust	19,228	2.0 %	22,616	2.4 %	23,280	2.4 %	26,369	2.7 %	31,640	3.4 %
Consumer other	23,645	2.4 %	19,919	2.1 %	25,281	2.6 %	28,912	3.0 %	31,493	3.4 %
Subtotal	$988,833		$959,109		$978,508		$984,294		$927,673	
Less: Unearned origination fee, net of origination costs	(4,487)	(0.5)%	(4,156)	(0.4)%	(4,434)	(0.5)%	(4,612)	(0.5)%	(4,551)	(0.5)%
Total portfolio loans	$984,346		$954,953		$974,074		$979,682		$923,122	

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 $342.4 million at December 31, 2018 from $313.5 million at December 31, 2017 and represented approximately 35% and 33% of our total loans outstanding as of December 31, 2018 and December 31, 2017, 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, 2018, commercial real estate loans increased to $494.2 million from $491.8 million at December 31, 2017, and represented

approximately 50% and 52% of our loan portfolio as of December 31, 2018 and December 31, 2017, 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 decreased in 2018 to $109.4 million, down from $111.3 million in 2017, and represented approximately 11% and 12% of our loan portfolio in December 31, 2018 and December 31, 2017, respectively. As of December 31, 2018, approximately $43.1 million or 39%, of the Company's construction loans were for low income housing tax credit projects as compared to $30.5 million or 27% as of December 31, 2017.

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 $62.3 million, or approximately 6% of loans as of December 31, 2018 have direct exposure to the oil and gas industry as compared to $70.8 million, or approximately 7% of loans as of December 31, 2017. The Company has no loans to oil producers or drilling and exploration companies as of the end of 2018 or 2017, but the $62.3 million outstanding as of December 31, 2018 noted above does include $9.6 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 $32.5 million and $53.5 million at December 31, 2018 and 2017, 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 $1.4 million and $1.8 million as of December 31, 2018 and 2017, 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, 2018									
AQR Pass	$44,512	$—	$—	$5,216	$—	$—	$—	$399	$50,127
AQR Special Mention	857	—	—	2,242	7,364	—	—	—	10,463
AQR Substandard	1,723	—	—	—	—	—	—	—	1,723
Total loans	$47,092	$—	$—	$7,458	$7,364	$—	$—	$399	$62,313
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

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, 2018:

(In Thousands)	Maturity Within 1 Year	1-5 Years	Over 5 Years	Total
Commercial	$146,127	$81,009	$115,284	$342,420
Real estate construction one-to-four family	36,367	744	—	37,111
Real estate construction other	43,005	19,092	10,159	72,256
Real estate term owner occupied	8,966	22,979	94,469	126,414
Real estate term non-owner occupied	27,801	119,627	178,292	325,720
Real estate term other	9,442	11,392	21,205	42,039
Consumer secured by 1st deeds of trust	55	1,766	17,407	19,228
Consumer other	1,477	5,576	16,592	23,645
Total	$273,240	$262,185	$453,408	$988,833
Fixed interest rate	$113,168	$82,084	$57,591	$252,843
Floating interest rate	160,072	180,101	395,817	735,990
Total	$273,240	$262,185	$453,408	$988,833

At December 31, 2018, 61% of the portfolio was scheduled to mature or reprice in 2019 with 36% scheduled to mature or reprice between 2020 and 2023.

As of December 31, 2018, approximately 70% of commercial loans are variable rate loans, of which 69% 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, 2018, the interest rates for approximately 85% of commercial real estate loans are variable, of which 52% reset within one year. Approximately 42% 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 2018 and 2017 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 Freddie Mac Home Loan Corporation ("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 32% and 26% of the mortgages originated by RML in 2018 and 2017, 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)	2018	2017	2016	2015	2014
Nonperforming loans					
Nonaccrual loans	$15,210	$21,626	$13,893	$3,686	$4,674
Loans 90 days past due and accruing	—	252	456	—	—
Government guarantees on nonperforming loans	(516)	(467)	(1,413)	(1,561)	(1,178)
Net nonperforming loans	$14,694	$21,411	$12,936	$2,125	$3,496
Other real estate owned	7,962	8,651	6,574	3,053	4,607
Repossessed assets	1,242	—	—	—	19
Other real estate owned guaranteed by government	(1,279)	(1,333)	(195)	—	(891)
Net nonperforming assets	$22,619	$28,729	$19,315	$5,178	$7,231
Nonperforming loans, net of government guarantees to portfolio loans	1.49%	2.24%	1.33%	0.22%	0.38%
Nonperforming assets, net of government guarantees to total assets	1.50%	1.89%	1.27%	0.35%	0.50%
Performing restructured loans	$3,413	$7,668	$6,131	$11,804	$5,353
Nonperforming loans plus performing restructured loans, net of government guarantees	$18,107	$29,079	$19,067	$13,929	$8,849
Nonperforming loans plus performing restructured loans to portfolio loans, net of government guarantees	1.84%	3.05%	1.96%	1.42%	0.96%
Nonperforming assets plus performing restructured loans to total assets, net of government guarantees	1.73%	2.40%	1.67%	1.13%	0.87%
Adversely classified loans, net of government guarantees	$27,217	$33,845	$35,634	$30,825	$5,878
Loans 30-89 days past due and accruing, net of government guarantees to portfolio loans	0.36%	0.22%	0.22%	0.12%	—%
Allowance for loan losses to portfolio loans	1.98%	2.25%	2.02%	1.85%	1.81%
Allowance for loan losses to nonperforming loans, net of government guarantees	133%	100%	152%	854%	478%

The Company’s nonperforming loans, net of government guarantees decreased in 2018 to $14.7 million as compared to $21.4 million in 2017. This decrease was due to the transfer of one borrowing relationship to repossessed assets, principal paydowns including one large nonaccrual loan payoff, and charge-offs on nonaccrual loans in 2018. There was interest income of $213,000, $142,000, and $181,000 recognized in net income for 2018, 2017, and 2016, respectively, related to interest collected on nonaccrual loans whose principal has been paid down to zero. The Company had five relationships that represented more than 10% of nonaccrual loans as of December 31, 2018.

The Company had $3.4 million and $7.7 million in loans classified as troubled debt restructuring loans ("TDRs") that were performing as of December 31, 2018 and 2017, respectively. Additionally, there were $11.4 million and $16.2 million in TDRs included in nonaccrual loans at December 31, 2018 and 2017 for total TDRs of $14.8 million and $23.8 million at December 31, 2018 and 2017, respectively. The decrease in TDRs at December 31, 2018 as compared to 2017 was primarily due to several payoffs and paydowns on loans classified as TDRs that were only partially offset by additions to TDRs in 2018. See Note 6 of the Notes to Consolidated Financial Statements included

in Item 8 of this report for further discussion of TDRs.
At December 31, 2018, management had identified potential problem loans of $17.1 million as compared to potential problem loans of $9.5 million at December 31, 2017. 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 $7.6 million increase in potential problem loans at December 31, 2018 from December 31, 2017 was primarily due to the addition of three relationships totaling $9.1 million. These increases were partially offset by the payoff of one loan totaling $883,000 and other loan paydowns in 2018.
The Company acquired other assets consisting of aircraft totaling $1.2 million in the fourth quarter of 2018 through foreclosure proceedings related to one lending relationship.
The following summarizes OREO activity for the periods indicated:

(In Thousands)	2018	2017	2016
Balance, beginning of the year	$8,651	$6,574	$3,053
Transfers from loans	686	5,912	4,036
Investment in other real estate owned	144	—	311
Proceeds from the sale of other real estate owned	(1,522)	(3,302)	(934)
Gain on sale of other real estate owned, net	3	371	295
Impairment on other real estate owned	—	(904)	(187)
Balance, end of year	7,962	8,651	6,574
Government guarantees	(1,279)	(1,333)	(195)
Balance, end of year, net of government guarantees	$6,683	$7,318	$6,379

At December 31, 2018 and 2017 the Company held $6.7 million and $7.3 million, respectively, of OREO assets, net of government guarantees. At December 31, 2018, OREO consists of $2.2 million in residential lots in various stages of development, a $151,000 single-family residence, and a $5.6 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 2018, additions to OREO totaled $686,000 which included four single-family residences. During 2018, the Company received approximately $1.5 million in proceeds from the sale of OREO which included $806,000 from the sale of lots and land, $645,000 from the sale of single-family residences, and $71,000 from the sale of a commercial building. The Company recognized $144,000, $391,000, and $295,000 in gains and $141,000, $19,000, and $0 in losses on the sale of OREO properties in 2018, 2017, and 2016, respectively, for net gains of $3,000, $371,000, and $295,000 in 2018, 2017, and 2016, respectively. The Company had remaining accumulated deferred gains on the sale of OREO properties of $262,000 at both December 31, 2018 and 2017.
The Company did not make any loans to facilitate the sale of OREO in 2018, 2017, or 2016. 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 zero, $904,000 and $187,000 in 2018, 2017, and 2016, 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 24 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 6 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 2018.

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, 2018 and 2017, the unallocated allowance as a percentage of the total Allowance was 13% and 16%, respectively.
The following table shows the allocation of the Allowance for the years indicated:

	2018		2017		2016		2015		2014	
		% of		% of		% of		% of		% of
(In Thousands)	Amount	Loans[1]	Amount	Loans[1]	Amount	Loans[1]	Amount	Loans[1]	Amount	Loans[1]
Commercial	$5,660	35 %	$6,172	34 %	$5,535	28 %	$5,906	28 %	$5,643	33 %
Real estate construction one-to-four family	675	4 %	629	3 %	550	3 %	854	4 %	644	4 %
Real estate construction other	1,275	7 %	1,566	8 %	1,465	7 %	1,439	8 %	1,653	10 %
Real estate term owner occupied	2,027	13 %	2,194	14 %	2,358	16 %	1,657	15 %	1,580	12 %
Real estate term non-owner occupied	5,799	33 %	6,043	33 %	6,853	37 %	5,515	35 %	4,704	31 %
Real estate term other	716	4 %	725	4 %	819	5 %	628	4 %	656	4 %
Consumer secured by 1st deeds of trust	306	2 %	315	2 %	313	2 %	264	3 %	285	3 %
Consumer other	426	2 %	307	2 %	408	2 %	397	3 %	410	3 %
Unallocated	2,635	— %	3,510	— %	1,396	— %	1,493	— %	1,148	— %
Total	$19,519	100 %	$21,461	100 %	$19,697	100 %	$18,153	100 %	$16,723	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)	2018	2017	2016	2015	2014
Balance at beginning of year	$21,461	$19,697	$18,153	$16,723	$16,282
Charge-offs:					
Commercial	(1,716)	(1,611)	(903)	(616)	(319)
Real estate construction one-to-four family	—	—	(535)	—	—
Real estate term non-owner occupied	—	—	—	—	(160)
Real estate term other	(28)	(5)	—	(81)	—
Consumer secured by 1st deeds of trust	(143)	(85)	(36)	(28)	(59)
Consumer other	(39)	(43)	(8)	(101)	(87)
Total charge-offs	(1,926)	(1,744)	(1,482)	(826)	(625)
Recoveries:					
Commercial	442	293	699	379	1,041
Real estate construction one-to-four family	—	—	—	—	625
Real estate term other	3	2	—	107	—
Consumer secured by 1st deeds of trust	12	2	—	3	4
Consumer other	27	11	29	13	32
Total recoveries	484	308	728	502	1,702
Net, recoveries (charge-offs)	(1,442)	(1,436)	(754)	(324)	1,077
Provision (benefit) for loan losses	(500)	3,200	2,298	1,754	(636)
Balance at end of year	$19,519	$21,461	$19,697	$18,153	$16,723
Ratio of net charge-offs to average loans outstanding during the period	0.15 %	0.15 %	0.08 %	(0.03)%	(0.12)%

In accordance with GAAP, loans acquired in connection with our acquisition of Alaska Pacific 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 Alaska Pacific 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 charge-offs, and movement in loan balances within the risk classifications. As of December 31, 2018, $220,000 of the original $141.5 million of purchased loans, or 0.16%, had migrated from pass grade loans to substandard loans. These loans are included in impaired loans as of December 31, 2018, 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, 2018 or 2017. There was no Allowance related to acquired loans at December 31, 2017, however, the Company included these loans in the Allowance at December 31, 2018 due to the the amount of time that has passed since the loans were purchased. The purchase discount related to these acquired credit impaired loans was $375,000 and $803,000 as of December 31, 2018 and 2017, respectively.

The provision for loan losses in 2018 as compared to 2017 decreased $3.7 million to a benefit of $500,000 compared to a provision of $3.2 million in 2017. This decrease is primarily due to a decrease in nonperforming loans and the portion of the Allowance specific to impaired loans. The Company determined that an Allowance of $19.5 million, or 1.98% of portfolio loans, is appropriate as of December 31, 2018 based on our analysis of the current credit quality of the portfolio and current economic conditions. 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 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 to 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.

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. Purchased receivables are recorded on the balance sheet net of a reserve for purchased receivable losses.

Purchased receivable balances decreased at December 31, 2018 to $14.4 million from $22.2 million at December 31, 2017, and year-to-date average purchased receivable balances were $17.4 million, $15.9 million, and $13.3 million in 2018, 2017, and 2016, respectively. Purchased receivable income was $3.3 million, $3.0 million, and $2.3 million in 2018, 2017, and 2016, respectively. The increase in purchased receivable income in 2018 is attributable to increased average balances, as well as higher yields.

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

(In Thousands)	2018	2017	2016
Balance at beginning of year	$200	$171	$181
Charge-offs	—	—	—
Recoveries	—	—	—
Net recoveries (charge-offs)	—	—	—
Reserve for (recovery from) purchased receivables	(10)	29	(10)
Balance at end of year	$190	$200	$171
Ratio of net charge-offs (recoveries) to average purchased receivables during the period	— %	— %	— %

Deposits

Deposits are our primary source of funds. Total deposits decreased 2% to $1.228 billion at December 31, 2018 from $1.258 billion at December 31, 2017. 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:

	2018		2017		2016	
(In Thousands)	Average balance	Average rate paid	Average balance	Average rate paid	Average balance	Average rate paid
Interest-bearing demand accounts	$243,000	0.07 %	$220,449	0.03 %	$192,512	0.04 %
Money market accounts	225,014	0.31 %	238,830	0.17 %	242,025	0.17 %
Savings accounts	241,807	0.31 %	249,641	0.21 %	234,347	0.21 %
Certificates of deposit	99,987	0.70 %	120,998	0.57 %	134,993	0.66 %
Total interest-bearing accounts	809,808	0.28 %	829,918	0.21 %	803,877	0.23 %
Noninterest-bearing demand accounts	417,464		418,415		446,366	
Total average deposits	$1,227,272		$1,248,333		$1,250,243	

Certificates of Deposit: The only deposit category with stated maturity dates is certificates of deposit. At December 31, 2018, we had $113.3 million in certificates of deposit, of which $57.4 million, or 51%, are scheduled to mature in 2019. The Company’s certificates of deposit increased to $113.3 million during 2018 as compared to $100.5 million at December 31, 2017. The aggregate amount of certificates of deposit in amounts of $100,000 or more at December 31, 2018 and 2017, was $70.7 million and $61.4 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, 2018:

	Time Certificates of Deposits of $100,000 or More	
(In Thousands)	Amount	Percent of Total Deposits
Amounts maturing in:		
Three months or less	$8,237	12 %
Over 3 through 6 months	5,724	8 %
Over 6 through 12 months	20,850	29 %
Over 12 months	35,906	51 %
Total	$70,717	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, 2018 and 2017, the Company had no 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, 2018, our maximum borrowing line from the FHLB was $667.8

million, approximately 45% of the Bank's assets, subject to the FHLB's collateral requirements. The Company has outstanding advances of $7.2 million as of December 31, 2018 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 $78.6 million of loans as collateral to secure advances made through the discount window as of December 31, 2018. There were no discount window advances outstanding at December 31, 2018 or 2017.

Other Short-term Borrowings: Securities sold under agreements to repurchase were $34.3 million and $27.7 million, as of December 31, 2018 and 2017, respectively. The average balance outstanding of securities sold under agreements to repurchase during 2018 and 2017 was $29.9 million and $29.0 million, respectively, and the maximum outstanding at any month-end was $36.5 million and $32.6 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 limit the amount of outstanding debt to 15% of total assets or $222.6 million and $225.8 million at December 31, 2018 and 2017, respectively.

Long-term Borrowings: The Company had no long-term borrowings outstanding other than the FHLB advances noted above as of December 31, 2018 or 2017.

Contractual Obligations

The following table references contractual obligations of the Company for the periods indicated. This table does not include interest payments:

	Payments Due by Period				
(In Thousands)	Within 1 Year	1-3 Years	3-5 Years	Over 5 Years	Total
December 31, 2018:					
Certificates of deposit	$57,451	$52,529	$1,494	$1,799	$113,273
Short-term borrowings	34,278	—	—	—	34,278
Long-term borrowings	167	351	373	6,350	7,241
Junior subordinated debentures	—	—	—	10,310	10,310
Operating lease obligations	2,668	4,908	3,750	8,121	19,447
Other long-term liabilities[1]	1,010	1,703	1,453	3,196	7,362
Capital commitments	57	—	—	—	57
Total	$95,631	$59,491	$7,070	$29,776	$191,968
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	6,230	1,556	718	3,482	11,986
Capital commitments	47	—	—	—	47
Total	$102,894	$37,700	$6,001	$31,570	$178,165

[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 17 of

the Notes to the Consolidated Financial Statements in Item 8 below.

Short and long-term borrowings included in the table above are described in the "Borrowings" section above. Junior subordinated debentures include $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 Northrim Statutory Trust 2 ("NST2") at 3.72% through its maturity date. Operating lease obligations are more fully described in Note 18 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 was 95% funded at the end of 2018 and 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 at 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 was 94% funded at the end of 2018 and is expected to be 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, 2018, we had commitments to extend credit of $260.6 million, which were not reflected on our balance sheet, compared to $283.9 million as of December 31, 2017. 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, 2018, we had commitments to originate loans held for sale of $45.0 million, which were not reflected in the balance sheet compared to $43.6 million as of December 31, 2017. 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, 2018, we had standby letters of credit of $3.2 million, which were not reflected on our balance sheet compared to $7.6 million as of December 31, 2017. 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, 2018, which includes commitments to extend credit, commitments to originate loans held for sale and standby letters of credit, were $308.8 million, compared to $335.1 million as of December 31, 2017. 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 $130,000 and $152,000 at December 31, 2018 and 2017, 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 18 and 19 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 it 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 2019. A requirement to have a conservation buffer began being phased-in in 2016 and is now in full effect, 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, 2018, were $308.8 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, 2018, were $1.2 billion.

As shown in the Consolidated Statements of Cash Flows, net cash provided by operating activities was $25.2 million, $19.3 million, and $20.1 million in 2018, 2017, and 2016 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 increased in 2018 as compared to 2017 was that the Company had net proceeds of $24.1 million in 2018 compared to $17.8 million in 2017 from sales of loans held for sale. Net cash of $5.6 million and $30.4 million was provided by investing activities in 2018 and 2017, respectively, as the Company's proceeds from security sales, maturities, and calls were greater than funds used to purchase additional investment securities in those years. $47.5 million of cash was used in investing activities in 2016 as the Company invested available cash primarily in available for sale securities and portfolio loans. Financing activities used cash of $31.1 million and $22.4 million in 2018 and 2017, respectively, and provided cash of $19.3 million in 2016. Financing activities used net cash in 2018 primarily as a result of a decrease in deposit balances in 2018 compared to 2017. Financing activities used net cash in 2017 primarily due to a decrease in deposit balances and the redemption of $8.3 million in junior subordinated debentures.

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, 2018, our current assets were $439.7 million and our funds available for borrowing under our existing lines of credit were $739.5 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 2018, the Company's Board of Directors approved a quarterly cash dividend of $0.24 per common share for the first and second quarters and $0.27 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 dividend payments 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 28, 2019, the Board of Directors approved payment of a $0.30 per share dividend on March 22, 2019, to shareholders of record on March 14, 2019. This dividend is $0.03, or 11%, higher than the Company’s dividend of $0.27 that was paid in the fourth quarter of 2018.

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. In 2018, we purchased an aggregate of 15,468 shares at an average price of $31.90, which leaves a balance of 153,433 shares available under the stock repurchase plan as of December 31, 2018. 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
2018	$2.86	$2.56
2017	$1.88	$1.69
2016	$2.06	$1.87
2015	$2.56	$2.31
2014	$2.54	$2.29

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.

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 $368,000 in 2018. At December 31, 2018, the securities had an interest rate of 4.16%. 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, 2018, was $205.9 million, as compared to $192.8 million at December 31, 2017. The Company earned net income of $20.0 million during 2018 and issued 26,721 shares through the exercise of stock options. At December 31, 2018, 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, 2018, 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 2018 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 2019, 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 $10 million trust preferred securities offering that the Company completed in the fourth quarter of 2005 is 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 more in regulatory capital than the Bank at December 31, 2018 and 2017, respectively, which explains most of the difference in the capital ratios for the two entities.

December 31, 2018	Minimum Required Capital	Well-Capitalized	Actual Ratio Company	Actual Ratio Bank
Total risk-based capital	8.00%	10.00%	16.73%	14.30%
Tier 1 risk-based capital	6.00%	8.00%	15.47%	13.05%
Common equity tier 1 capital	4.50%	6.50%	14.73%	13.05%
Leverage ratio	4.00%	5.00%	13.40%	11.28%

See Note 22 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 19 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, 2018. The amounts shown below could be significantly affected by external factors such as changes in prepayment assumptions, early withdrawals of deposits, and competition.

	Estimated maturity or repricing at December 31, 2018			
(In Thousands)	Within 1 year	1-5 years	>5 years	Total
Interest -Earning Assets:				
Interest bearing deposits in other banks	$50,767	$—	$—	$50,767
Portfolio investments and FHLB Stock	146,445	134,531	—	280,976
Portfolio loans	590,753	354,519	28,351	973,623
Loans held for sale	34,710	—	—	34,710
Total interest-earning assets	$822,675	$489,050	$28,351	$1,340,076
Percent of total interest-earning assets	61.4 %	36.5 %	2.1 %	100.0 %
Interest-Bearing Liabilities:				
Interest-bearing demand accounts	$248,056	$—	$—	$248,056
Money market accounts	206,717	—	—	206,717
Savings accounts	239,054	—	—	239,054
Certificates of deposit	57,541	54,377	1,355	113,273
Securities sold under repurchase agreements	34,278	—	—	34,278
Borrowings	355	1,534	5,352	7,241
Junior subordinated debentures	—	—	10,310	10,310
Total interest-bearing liabilities	$786,001	$55,911	$17,017	$858,929
Percent of total interest-bearing liabilities	91.5 %	6.5 %	2.0 %	100.0 %
Interest sensitivity gap	$36,674	$433,139	$11,334	$481,147
Cumulative interest sensitivity gap	$36,674	$469,813	$481,147	
Cumulative interest sensitivity gap as a percentage of total interest-earning assets	2.7 %	35.1 %	35.9 %	

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, down

100 basis points, and down 200 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.

The following table shows the estimated impact on net interest income under for the stated interest rate scenarios:

(In Thousands)	1st Year Change in net interest income from base scenario	Percentage change	2nd Year Change in net interest income from base scenario	Percentage change
Scenario:				
Up 400 basis points	$9,228	13.74 %	$21,247	30.40 %
Up 300 basis points	$6,999	10.42 %	$16,082	23.01 %
Up 200 basis points	$4,769	7.10 %	$10,941	15.66 %
Up 100 basis points	$2,440	3.63 %	$5,605	8.02 %
Up 50 basis points	$1,199	1.78 %	$2,765	3.96 %
Down 50 basis points	($2,350)	(3.50)%	($3,837)	(5.49)%
Down 100 basis points	($4,594)	(6.84)%	($7,725)	(11.05)%
Down 200 basis points	($10,306)	(15.34)%	($16,778)	