NORTHRIM BANCORP INC
Form 10-Q
November 07, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2011

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

(907) 562-0062

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act:

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The number of shares of the issuer's Common Stock outstanding at November 7, 2011 was 6,442,733.

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PART I. FINANCIAL INFORMATION

These consolidated financial statements should be read in conjunction with the financial statements, accompanying notes and other relevant information included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

ITEM 1. FINANCIAL STATEMENTS

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CONSOLIDATED FINANCIAL STATEMENTS

NORTHRIM BANCORP, INC.

Consolidated Balance Sheets

September 30, 2011, December 31, 2010 and September 30, 2010

	September 30, 2011 *(Unaudited)*	December 31, 2010	September 30, 2010 *(Unaudited)*
	(In Thousands, Except Share Data)		
ASSETS			
Cash and due from banks	$ 34,365	$ 15,953	$ 22,367
Interest bearing deposits in other banks	94,205	50,080	60,939
Investment securities available for sale	211,819	214,010	206,342
Investment securities held to maturity	4,385	6,125	6,692
Total portfolio investments	216,204	220,135	213,034
Investment in Federal Home Loan Bank stock	2,003	2,003	2,003
Loans held for sale		5,558	20,082
Loans	629,664	671,812	635,475
Allowance for loan losses	(16,093)	(14,406)	(14,711)
Net loans	613,571	662,964	640,846
Purchased receivables, net	25,536	16,531	8,654
Accrued interest receivable	3,030	3,401	3,234
Premises and equipment, net	28,320	29,048	28,769
Goodwill and intangible assets	8,486	8,697	8,767
Other real estate owned	5,838	10,355	11,019
Other assets	34,053	35,362	38,302
Total assets	$ 1,065,611	$ 1,054,529	$ 1,037,934
LIABILITIES			
Deposits:			
Demand	$ 307,529	$ 289,061	$ 281,972
Interest-bearing demand	133,495	138,072	126,056
Savings	76,847	77,411	77,971
Alaska CDs	95,481	100,315	111,526
Money market	153,924	149,104	132,349
Certificates of deposit less than $100,000	51,264	53,858	56,984
Certificates of deposit greater than $100,000	75,027	84,315	91,870
Total deposits	893,567	892,136	878,728
Securities sold under repurchase agreements	17,034	12,874	9,996
Borrowings	4,662	5,386	5,506
Junior subordinated debentures	18,558	18,558	18,558
Other liabilities	8,445	8,453	8,290
Total liabilities	942,266	937,407	921,078

SHAREHOLDERS EQUITY

Preferred stock, $1 par value, 2,500,000 shares authorized, none issued or outstanding			
Common stock, $1 par value, 10,000,000 shares authorized, 6,440,241, 6,427,237 and 6,409,799 shares issued and outstanding at September 30, 2011, December 31, 2010, and September 30, 2010, respectively	6,440	6,427	6,410
Additional paid-in capital	53,091	52,658	52,660
Retained earnings	63,071	57,339	56,268
Accumulated other comprehensive income	680	648	1,476
Total Northrim BanCorp shareholders equity	123,282	117,072	116,814
Noncontrolling interest	63	50	42
Total shareholders equity	123,345	117,122	116,856
Total liabilities and shareholders equity	$ 1,065,611	$ 1,054,529	$ 1,037,934

See notes to the consolidated financial statements

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NORTHRIM BANCORP, INC.

Consolidated Statements of Income

For the Three and Nine Months Ended September 30, 2011 and 2010

	Three Months Ended September 30, 2011 (Unaudited)	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011 (Unaudited)	Nine Months Ended September 30, 2010
	(In Thousands, Except Per Share Data)			
Interest Income				
Interest and fees on loans	$ 10,392	$ 11,249	$ 31,788	$ 33,883
Interest on investment securities-available for sale	717	895	2,251	3,394
Interest on investment securities-held to maturity	49	68	169	213
Interest on deposits in other banks	72	54	160	119
Total Interest Income	11,230	12,266	34,368	37,609
Interest Expense				
Interest expense on deposits, borrowings and junior subordianted debentures	876	1,370	2,757	4,306
Net Interest Income	10,354	10,896	31,611	33,303
Provision for loan losses	550	417	1,649	3,167
Net Interest Income After Provision for Loan Losses	9,804	10,479	29,962	30,136
Other Operating Income				
Purchased receivable income	695	485	1,886	1,394
Service charges on deposit accounts	609	659	1,727	2,121
Employee benefit plan income	536	466	1,629	1,417
Electronic banking income	508	449	1,424	1,284
Equity in earnings from RML	357	570	575	679
Gain on sale of securities	33	58	296	471
Equity in earnings (loss) from Elliott Cove	(5)	(4)	(16)	(1)
Other income	629	517	1,689	1,650
Total Other Operating Income	3,362	3,200	9,210	9,015
Other Operating Expense				
Salaries and other personnel expense	5,230	5,394	15,746	16,416
Occupancy	914	1,016	2,821	2,832
Marketing expense	435	445	1,315	1,323
Insurance expense	391	502	1,122	1,482
Professional and outside services	370	338	1,045	903
Equipment expense	291	304	887	821
Software expense	257	256	774	691
Amortization of low income housing tax investments	224	201	675	652
Internet banking expense	162	144	473	455
Intangible asset amortization expense	70	76	211	229
Operational losses, net	37	123	198	325
Impairment (recovery) on purchased receivables, net		(3)	2	404
OREO (income) expense, net of rental income and gains on sale	(14)	(969)	(895)	(907)

Other operating expense	1,062	883	2,970	2,766
Total Other Operating Expense	9,429	8,710	27,344	28,392
Income Before Provision for Income Taxes	3,737	4,969	11,828	10,759
Provision for income taxes	1,125	1,629	3,357	3,243
Net Income	2,612	3,340	8,471	7,516
Less: Net income attributable to the noncontrolling interest	106	162	328	298
Net Income Attributable to Northrim BanCorp	$ 2,506	$ 3,178	$ 8,143	$ 7,218
Earnings Per Share, Basic	$ 0.39	$ 0.50	$ 1.27	$ 1.13
Earnings Per Share, Diluted	$ 0.38	$ 0.49	$ 1.24	$ 1.11
Weighted Average Shares Outstanding, Basic	6,436,178	6,401,069	6,431,989	6,391,252
Weighted Average Shares Outstanding, Diluted	6,554,776	6,479,813	6,553,462	6,473,915

See notes to the consolidated financial statements

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NORTHRIM BANCORP, INC.

Consolidated Statements of Changes in

Shareholders Equity and Comprehensive Income

For the Nine Months Ended September 30, 2011 and 2010

	Common Stock Number of Shares	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Noncontrolling Interest	Total
				(Unaudited) *(In Thousands)*			
Nine months ending September 30, 2010:							
Balance as of January 1, 2010	6,371	$ 6,371	$ 52,139	$ 51,121	$ 1,341	$ 48	$ 111,020
Cash dividend declared				(2,071)			(2,071)
Stock option expense			387				387
Exercise of stock options	39	39	(43)				(4)
Excess tax benefits from share-based payment arrangements			177				177
Distributions to noncontrolling interest						(304)	(304)
Comprehensive income:							
Change in unrealized holding gain (loss) on available for sale securities, net of tax					135		135
Net income attributable to the noncontrolling interest						298	298
Net income attributable to Northrim BanCorp				7,218			7,218
Total Comprehensive Income							7,651
Balance as of September 30, 2010	6,410	$ 6,410	$ 52,660	$ 56,268	$ 1,476	$ 42	$ 116,856
Nine months ending September 30, 2011:							
Balance as of January 1, 2011	6,427	$ 6,427	$ 52,658	$ 57,339	$ 648	$ 50	$ 117,122
Cash dividend declared				(2,411)			(2,411)
Stock option expense			381				381
Exercise of stock options	13	13	(32)				(19)
Excess tax benefits from share-based payment arrangements			84				84
Distributions to noncontrolling interest						(315)	(315)
Comprehensive income:							
Change in unrealized holding gain (loss) on available for sale securities, net of tax					32		32
Net income attributable to the noncontrolling interest						328	328
Net income attributable to Northrim BanCorp				8,143			8,143
Total Comprehensive Income							8,503
Balance as of September 30, 2011	6,440	$ 6,440	$ 53,091	$ 63,071	$ 680	$ 63	$ 123,345

See notes to the consolidated financial statements

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NORTHRIM BANCORP, INC.

Consolidated Statement of Cash Flows

For the Nine Months Ended September 30, 2011 and 2010

	Nine Months Ended September 30, 2011	2010
	(Unaudited) *(In Thousands)*	
Operating Activities:		
Net income	$ 8,471	$ 7,516
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Security (gains), net	(296)	(471)
Depreciation and amortization of premises and equipment	1,299	1,165
Amortization of software	155	130
Intangible asset amortization	211	229
Amortization of investment security premium, net of discount accretion	144	306
Deferred tax (benefit) liability	(1,311)	2,054
Stock-based compensation	381	387
Excess tax benefits from share-based payment arrangements	(84)	(177)
Deferral of loan fees and costs, net	(240)	153
Provision for loan losses	1,649	3,167
Purchased receivable loss	2	404
Purchases of loans held for sale		(43,593)
Proceeds from the sale of loans held for sale	5,558	23,530
Gain on sale of loans held for sale		(19)
Gain on sale of other real estate owned	(859)	(1,443)
Impairment on other real estate owned		250
Proceeds in excess of earnings (earnings in exess of proceeds) from RML	200	(242)
Equity in loss (income) from Elliott Cove	16	1
Decrease in accrued interest receivable	371	752
(Increase) decrease in other assets	2,105	654
(Decrease) in other liabilities	(226)	742
Net Cash Provided (Used) by Operating Activities	17,546	(4,505)
Investing Activities:		
Investment in securities:		
Purchases of investment securities-available-for-sale	(113,242)	(169,199)
Purchases of investment securities-held-to-maturity		(517)
Proceeds from sales/maturities of securities-available-for-sale	115,644	141,416
Proceeds from calls/maturities of securities-held-to-maturity	1,735	1,105
Purchases of domestic certificates of deposit		
Investment in (repayment from) purchased receivables	(9,007)	(1,797)
Loan paydowns, net of new advances	40,171	15,857
Proceeds from sale of other real estate owned	7,912	9,225
Investment in Elliott Cove		(100)
Investment in other real estate owned	(29)	(34)
Loan to Elliott Cove, net of repayments	122	60
Purchases of premises and equipment	(571)	(1,556)
Net Cash Provided (Used) by Investing Activities	42,735	(5,540)

Financing Activities:		
Increase in deposits	1,431	25,620
Increase in securities sold under repurchase agreements	4,160	3,263
(Decrease) in borrowings	(724)	(81)
Distributions to noncontrolling interest	(315)	(304)
Excess tax benefits from share-based payment arrangements	84	177
Cash dividends paid	(2,380)	(2,045)
Net Cash Provided by Financing Activities	2,256	26,630
Net Increase in Cash and Cash Equivalents	62,537	16,585
Cash and Cash Equivalents at Beginning of Period	66,033	66,721
Cash and Cash Equivalents at End of Period	$ 128,570	$ 83,306
Supplemental Information:		
Income taxes paid	$ 2,880	$ 1,263
Interest paid	$ 3,009	$ 4,310
Transfer of loans to other real estate owned	$ 2,255	$ 1,990
Loans made to facilitate sales of other real estate owned	$ 1,362	$ 5,967
Cash dividends declared but not paid	$ 31	$ 26

See notes to the consolidated financial statements

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

September 30, 2011 and 2010

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared by Northrim BanCorp, Inc. (the Company) in accordance with accounting principles generally accepted in the United States of America (GAAP) and with instructions to Form 10-Q under the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Certain reclassifications have been made to prior year amounts to maintain consistency with the current year with no impact on net income or total shareholders equity. The Company determined that it operates as a single operating segment. Operating results for the interim period ended September 30, 2011, are not necessarily indicative of the results anticipated for the year ending December 31, 2011. These consolidated financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

2. Significant Accounting Policies and Recent Accounting Pronouncements

The Company s significant accounting policies are discussed in Note 1 to the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

In April 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-02, A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructuring (ASU 2011-02). ASU 2011-02 provides guidance on a creditor s evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties in order to determine when a restructured loan is a troubled debt restructuring. This ASU was effective for the Company s financial statements for annual and interim periods beginning on or after June 15, 2011, and has been applied retrospectively to the beginning of the period of adoption. The adoption of this standard did not have a material impact on the Company s consolidated financial position or results of operations.

In May 2011, the FASB issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASU 2011-04). Some of the amendments contained in ASU 2011-04 clarify FASB s intent about the application of existing fair value measurement requirements, and other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. This ASU is effective for the Company s financial statements for annual and interim periods beginning on or after December 15, 2011, and must be applied prospectively. The adoption of this standard is not expected to have a material impact on the Company s consolidated financial position or results of operations.

In June 2011, the FASB issued ASU 2011-05, Presentation of Comprehensive Income (ASU 2011-05). ASU 2011-05 amends Topic 220, Comprehensive Income , to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income, nor does it change the option for an entity to present components of other comprehensive income either net of related tax effects or before related tax effects. This ASU is effective for the Company s financial statements for annual and interim periods beginning on or after December 15, 2011, and must be applied prospectively. The adoption of this standard is not expected to have a material impact on the Company s consolidated financial position or results of operations.

In September 2011, the FASB issued ASU 2011-08, Testing Goodwill for Impairment (ASU 2011-08). ASU 2011-08 amends Topic 350, Intangibles Goodwill and Other , to simplify how entities, both

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public and nonpublic, test goodwill for impairment. The amendments in ASU 2011-08 permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Previous guidance under Topic 350 required an entity to test goodwill for impairment, on at least an annual basis, by comparing the fair value of a reporting unit with its carrying amount, including goodwill (step one). If the fair value of a reporting unit is less than its carrying amount, then the second step of the test must be performed to measure the amount of the impairment loss, if any. Under the amendments in this update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. This ASU is effective for the Company s financial statements for annual and interim periods beginning on or after December 15, 2011, and must be applied prospectively. The adoption of this standard is not expected to have a material impact on the Company s consolidated financial position or results of operations.

3. Investment Securities

The carrying values and approximate fair values of investment securities at September 30, 2011 and 2010, respectively, are presented below. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the amortized cost of the investment. There were ten and eight securities with unrealized losses as of September 30, 2011 and 2010, respectively, that have been in a loss position for less than twelve months. There were no securities with unrealized losses as of September 30, 2011 and 2010 that have been in a loss position for more than twelve months. Because the Company does not intend to sell, nor is it required to sell these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

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At September 30, 2011, $30.3 million in securities, or 14%, of the investment portfolio was pledged, as compared to $26.2 million, or 12%, at December 31, 2010, and $19.7 million, or 9%, at September 30, 2010. We held no securities of any single issuer (other than government sponsored entities) that exceeded 10% of our shareholders equity at September 30, 2011, December 31, 2010 or September 30, 2010.

September 30,	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In Thousands)		
2011:				
Securities available for sale				
U.S. Treasury and government sponsored entities	$ 153,017	$ 831	$ 22	$ 153,826
Muncipal securities	14,002	536		14,538
U.S. Agency mortgage-backed securities	56	2		58
Corporate bonds	43,593	439	635	43,397
Total securities available for sale	$ 210,668	$ 1,808	$ 657	$ 211,819
Securities held to maturity				
Municipal securities	$ 4,385	$ 234	$	$ 4,619
Total securities held to maturity	$ 4,385	$ 234	$	$ 4,619
2010:				
Securities available for sale				
U.S. Treasury and government sponsored entities	$ 151,614	$ 805	$ 7	$ 152,411
Muncipal securities	6,169	300		6,469
U.S. Agency mortgage-backed securities	76	3		79
Corporate bonds	45,980	1,440	37	47,383
Total securities available for sale	$ 203,839	$ 2,548	$ 44	$ 206,342
Securities held to maturity				
Municipal securities	$ 6,692	$ 304	$	$ 6,996
Total securities held to maturity	$ 6,692	$ 304	$	$ 6,996

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The amortized cost and fair values of debt securities at September 30, 2011, are distributed by contractual maturity as shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value	Weighted Average Yield
		(In Thousands)	
US Treasury and government sponsored entities			
Within 1 year	$ 53,227	$ 53,514	1.10%
1-5 years	99,790	100,312	0.91%
Total	$ 153,017	$ 153,826	0.97%
U.S. Agency mortgage-backed securities			
5-10 years	$ 56	$ 58	4.45%
Total	$ 56	$ 58	4.45%
Corporate bonds			
1-5 years	$ 43,593	$ 43,397	2.38%
Total	$ 43,593	$ 43,397	2.38%
Municipal securities			
Within 1 year	$ 2,349	$ 2,370	2.76%
1-5 years	4,969	5,135	2.92%
5-10 years	7,919	8,340	4.51%
Over 10 years	3,150	3,312	4.79%
Total	$ 18,387	$ 19,157	3.90%

The proceeds and resulting gains and losses, computed using specific identification, from sales of investment securities for the nine months ending September 30, 2011 and 2010, respectively, are as follows:

September 30,	Proceeds	Gross Gains	Gross Losses
		(In Thousands)	
2011:			
Available for sale securities	$ 17,030	$ 296	$
2010:			
Available for sale securities	$ 20,261	$ 471	$

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A summary of interest income for the nine months ending September 30, 2011 and 2010 on available for sale investment securities is as follows:

September 30,	2011	2010
	(In Thousands)	
US Treasury and government sponsored entities	$ 1,197	$ 2,096
U.S. Agency mortgage-backed securities	2	3
Other	683	1,080
Total taxable interest income	$ 1,882	$ 3,179
Municipal securities	369	215
Total tax-exempt interest income	369	215
Total	$ 2,251	$ 3,394

For the periods ending September 30, 2011, December 31, 2010 and September 30, 2010, we held Federal Home Loan Bank of Seattle (FHLB) stock with a book value approximately equal to its market value in the amount of $2.0 million for each period. The Company evaluated its investment in FHLB stock for other-than-temporary impairment as of September 30, 2011, consistent with its accounting policy. Based on the Company s evaluation of the underlying investment, including the long-term nature of the investment, the liquidity position of the FHLB of Seattle, the actions being taken by the FHLB of Seattle to address its regulatory capital situation, and the Company s intent and ability to hold the investment for a period of time sufficient to recover the par value, the Company did not recognize an other-than-temporary impairment loss. Even though the Company did not recognize an other-than-temporary impairment loss during the nine-month period ending September 30, 2011, continued deterioration in the FHLB of Seattle s financial position may result in future impairment losses.

4. Loans

The composition of the loan portfolio by segment, excluding loans held for resale, is presented below:

	September 30, 2011		December 31, 2010		September 30, 2010	
	Dollar Amount	Percent of Total	Dollar Amount	Percent of Total	Dollar Amount	Percent of Total
			(In Thousands)			
Commercial	$ 228,538	36.3%	$ 256,971	38.3%	$ 237,647	37.4%
Real estate construction	45,984	7.3%	62,620	9.3%	50,979	8.0%
Real estate term	316,463	50.3%	312,128	46.5%	305,808	48.1%
Home equity lines and other consumer	41,609	6.6%	43,264	6.4%	43,992	6.9%
Subtotal	$ 632,594		$ 674,983		$ 638,426	
Less: Unearned origination fee,						
net of origination costs	(2,930)	-0.5%	(3,171)	-0.5%	(2,951)	-0.5%
Total loans	$ 629,664		$ 671,812		$ 635,475	

At September 30, 2011, approximately 31% of the portfolio was scheduled to mature over the next 12 months, and 23% was scheduled to mature between October 1, 2012, and September 30, 2016.

As part of the on-going monitoring of the credit quality of the Company s 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. The Company utilizes a risk grading matrix to assign a risk classification to each of its loans. Loans are graded on a scale of 1 to 8. A description of the general characteristics of the 8 risk classifications are as follows:

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Risk Code 1 Excellent: Loans in this grade are those where the borrower has substantial financial capacity, above average profit margins, and excellent liquidity. Cash flow has been consistent and is well in excess of debt servicing requirements. Loans in this grade may be secured by cash and/or negotiable securities having a readily ascertainable market value and may also be fully guaranteed by the U.S. Government, and other approved governments and financial institutions. Loans in this grade have borrowers with exceptional credit ratings and would compare to AA ratings as established by Standard & Poor's.

Risk Code 2 Good: Loans in this grade are those to borrowers who have demonstrated satisfactory asset quality, earnings history, liquidity and other adequate margins of creditor protection. Borrowers exhibit positive fundamentals in terms of working capital, cash flow sufficient to service the debt, and debt to worth ratios. Borrowers for loans in this grade are capable of absorbing normal economic or other setbacks without difficulty. The borrower may exhibit some weaknesses or varying historical profitability. Management is considered adequate in all cases. Borrowing facilities may be unsecured or secured by customary acceptable collateral with well-defined market values. Additional support for the loan is available from secondary repayment sources and/or adequate guarantors.

Risk Code 3 Satisfactory: Loans in this grade represent moderate credit risk due to some instability in borrower capacity and financial condition. These loans generally require average loan officer attention. Characteristics of assets in this classification may include: marginal debt service coverage, newly established ventures, limited or unstable earnings history, some difficulty in absorbing normal setbacks, and atypical maturities, collateral or other exceptions to established loan policies. In all cases, such weaknesses are offset by well secured collateral positions and/or acceptable guarantors.

Risk Code 4 Watch List: Loans in this grade are acceptable, but additional attention is needed. This is an interim classification reserved for loans that are intrinsically creditworthy but which require specific attention. Loans may have documentation deficiencies that are deemed correctable, may be contrary to current lending policies, or may have insufficient credit or financial information. Loans in this grade may also be characterized by borrower failure to comply with loan covenants or to provide other required information. If such conditions are not resolved within 90 days from the date of the assignment of Risk Code 4, the loan may warrant further downgrade.

Risk Code 5 Special Mention: Loans in this grade have had a deterioration of financial condition or collateral value, but are still reasonably secured by collateral or net worth of the borrower. Although the Company is presently protected from loss, potential weaknesses are apparent which, if not corrected, could cause future problems. Loans in this classification warrant more than the ordinary amount of attention but have not yet reached the point of concern for loss. Loans in this category have deteriorated sufficiently that they would have difficulty in refinancing. Loans in this classification may show one or more of the following characteristics: inadequate loan documentation, deteriorating financial condition or control over collateral, economic or market conditions which may adversely impact the borrower in the future, unreliable or insufficient credit or collateral information, adverse trends in operations that are not yet jeopardizing repayment, or adverse trends in secondary repayment sources.

Risk Code 6 Substandard: Loans in this grade are no longer adequately protected due to declining net worth of the borrower, lack of earning capacity, or insufficient collateral. The possibility for loss of some portion of the loan principal cannot be ruled out. Loans in this grade exhibit well-defined weaknesses that bring normal repayment into doubt. Some of these weaknesses may include: unprofitable or poor earnings trends of the borrower or property, declining liquidity, excessive debt, significant unfavorable industry comparisons, secondary repayment sources are not available, or there is a possibility of a protracted work-out.

Risk Code 7 Doubtful: Loans in this grade exhibit the same weaknesses as those classified Substandard, but the traits are more pronounced. Collection in full is improbable, however the extent of the loss may be indeterminable due to pending factors which may yet occur that could salvage the loan, such as possible pledge of additional collateral, sale of assets, merger, acquisition or refinancing. Borrowers in this grade may be on the verge of insolvency or bankruptcy, and stringent action is required on the part of the loan officer.

Risk Code 8 Loss: Loans in this grade are those that are largely non-collectible or those in which ultimate recovery is too distant in the future to warrant continuance as a bankable asset. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer charging the loan off even though recovery may be affected in the future.

A risk rating is assigned for each loan at origination. The risk ratings for commercial, real estate construction, and real estate term loans may change throughout the life of the loan as a multitude of risk factors change. The risk rating for consumer loans may change as loans become delinquent. Delinquent loans are those that are thirty days or more past due.

The loan portfolio, segmented by risk class at September 30, 2011, is shown below:

	Commercial	Real estate construction	Real estate term	Home equity lines and other consumer	Total
			(In Thousands)		
Risk Code 1 - Excellent	$ 1,074	$	$	$ 569	$ 1,643
Risk Code 2 - Good	69,961		58,293	902	129,156
Risk Code 3 - Satisfactory	133,002	31,650	244,526	36,754	445,932
Risk Code 4 - Watch	9,582	5,004	980	2,463	18,029
Risk Code 5 - Special Mention	9,556		3,408	453	13,417
Risk Code 6 - Substandard	4,674	9,330	9,256	468	23,728
Risk Code 7 - Doubtful	689				689
Subtotal	$ 228,538	$ 45,984	$ 316,463	$ 41,609	$ 632,594
Less: Unearned origination fees, net of origination costs					(2,930)
					$ 629,664

Loans are carried at their principal amount outstanding, net of charge-offs, unamortized fees and direct loan origination costs. Loan balances are charged to the Allowance when management believes that collection of principal is unlikely. Interest income on loans is accrued and recognized on the principal amount outstanding except for loans in a nonaccrual status. All classes of loans are placed on nonaccrual and considered impaired when management believes doubt exists as to the collectability of the interest or principal. Cash payments received on nonaccrual loans are directly applied to the principal balance. Generally, a loan may be returned to accrual status when the delinquent principal and interest are brought current in accordance with the terms of the loan agreement and certain ongoing performance criteria have been met. Loans are reported as past due when installment payments, interest payments, or maturity payments are past due based on contractual terms.

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Nonaccrual loans totaled $7.9 million, $11.4 million and $13.9 million at September 30, 2011, December 31, 2010, and September 30, 2010, respectively. Nonaccrual loans at September 30, 2011, by major loan type, are presented below:

	(In Thousands)
Commercial	$ 4,058
Real estate construction	1,568
Real estate term	2,061
Home equity lines and other consumer	179
Total	$ 7,866

Past due loans and nonaccrual loans at September 30, 2011 are presented below by loan class:

	30-59 DaysPast Due Still Accruing	60-89 Days Past Due Still Accruing	Greater Than 90 Days Still Accruing	Nonaccrual	Total Past Due and Nonaccrual	Total Current	Total Financing Receivables
				(In Thousands)			
Risk Code 1 - Excellent	$	$	$	$	$	$ 1,643	$ 1,643
Risk Code 2 - Good						129,156	129,156
Risk Code 3 - Satisfactory	454				454	445,478	445,932
Risk Code 4 - Watch	89				89	17,940	18,029
Risk Code 5 - Special Mention	53			177	230	13,187	13,417
Risk Code 6 - Substandard	3,064	3		7,000	10,067	13,661	23,728
Risk Code 7 - Doubtful				689	689		689
Subtotal	$ 3,660	$ 3	$	$ 7,866	$ 11,529	$ 621,065	$ 632,594
Less: Unearned origination fees, net of origination costs							(2,930)
							$ 629,664

Past due loans greater than 90 days and still accruing were zero and $200,000 at December 31, 2010 and September 30, 2010, respectively.

The Company considers a loan to be impaired when it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan agreement. Once a loan is determined to be impaired, the impairment is measured based on the present value of the expected future cash flows discounted at the loan s effective interest rate, except that if the loan is collateral dependent, the impairment is measured by using the fair value of the loan s collateral. Nonperforming loans greater than $50,000 are individually evaluated for impairment based upon the borrower s overall financial condition, resources, and payment record, and the prospects for support from any financially responsible guarantors.

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At September 30, 2011, December 31, 2010 and September 30, 2010, the recorded investment in loans that are considered to be impaired was $10.9 million, $18.3 million, and $22.2 million, respectively. The following table presents information about impaired loans as of September 30, 2011:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
			(In Thousands)		
With no related allowance recorded					
Commercial - risk code 5 special mention	$ 374	$ 374	$	$ 453	$ 18
Commercial - risk code 6 substandard	2,558	3,156		2,717	28
Real estate construction - risk code 6 substandard	431	431		432	
Real estate term - risk code 6 substandard	3,477	3,566		3,389	89
Home equity lines and other consumer - risk code 5 special mention	98	98		49	4
Home equity lines and other consumer - risk code 6 substandard	201	201		208	7
	$ 7,139	$ 7,826	$	$ 7,248	$ 146
With an allowance recorded					
Commercial - risk code 6 substandard					