HERITAGE FINANCIAL CORP /WA/
Form 10-Q
August 08, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number 000-29480

HERITAGE FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Washington	91-1857900
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
201 Fifth Avenue SW, Olympia, WA	98501
(Address of principal executive offices)	(Zip Code)

(360) 943-1500
(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 ý 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 ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	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 13(a) of the Exchange Act. ¨

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the last practicable date:

As of August 1, 2017 there were 29,930,530 shares of the registrant's common stock, no par value per share, outstanding.

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FORWARD LOOKING STATEMENTS:

“Safe Harbor” statement under the Private Securities Litigation Reform Act of 1995: This Quarterly Report on Form 10-Q ("Form 10-Q") contains forward-looking statements that are subject to risks and uncertainties, including, but not limited to: the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and changes in our allowance for loan losses and provision for loan losses that may be effected by deterioration in the housing and commercial real estate markets, which may lead to increased losses and nonperforming assets in our loan portfolio, and may result in our allowance for loan losses no longer being adequate to cover actual losses, and require us to increase our allowance for loan losses; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates, and the relative differences between short and long term interest rates, deposit interest rates, our net interest margin and funding sources; risks related to acquiring assets in or entering markets in which we have not previously operated and may not be familiar; fluctuations in the demand for loans, the number of unsold homes and other properties and fluctuations in real estate values in our market areas; results of examinations of us by the Board of Governors of the Federal Reserve System and of our bank subsidiary by the Federal Deposit Insurance Corporation ("FDIC"), the Washington State Department of Financial Institutions, Division of Banks or other regulatory authorities, including the possibility that any such regulatory authority may, among other things, initiate an enforcement action against the Company or our bank subsidiary which could require us to increase our allowance for loan losses, write-down assets, change our regulatory capital position, affect our ability to borrow funds or maintain or increase deposits, or impose additional requirements on us, any of which could affect our ability to continue our growth through mergers, acquisitions or similar transactions and adversely affect our liquidity and earnings; legislative or regulatory changes; our ability to control operating costs and expenses; increases in premiums for deposit insurance; the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation; difficulties in reducing risk associated with the loans on our Condensed Consolidated Statements of Financial Condition; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our workforce and potential associated charges; failure or security breach of computer systems on which we depend; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; our ability to implement our growth strategies; our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we may acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames or at all, and any goodwill charges related thereto and costs or difficulties relating to integration matters, including but not limited to customer and employee retention, which might be greater than expected; increased competitive pressures among financial service companies; changes in consumer spending, borrowing and savings habits; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board ("FASB"), including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; and other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services and other risks detailed from time to time in our filings with the Securities and Exchange Commission including our Annual Report on Form 10-K for the year ended December 31, 2016.

The Company cautions readers not to place undue reliance on any forward-looking statements. Moreover, you should treat these statements as speaking only as of the date they are made and based only on information then actually known to the Company. The Company does not undertake and specifically disclaims any obligation to revise any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements. These risks could cause our actual results for future periods to differ materially from those expressed in any forward-looking statements by, or on behalf of, us, and could negatively affect the Company’s operating results and stock price performance.

As used throughout this report, the terms “we”, “our”, “us”, or the “Company” refer to Heritage Financial Corporation and its consolidated subsidiaries, unless the context otherwise requires.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HERITAGE FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Unaudited)

	June 30, 2017	December 31, 2016
	(Dollars in thousands)	
ASSETS		
Cash on hand and in banks	$81,912	$77,117
Interest earning deposits	42,322	26,628
Cash and cash equivalents	124,234	103,745
Investment securities available for sale, at fair value	790,594	794,645
Loans held for sale	5,787	11,662
Loans receivable, net	2,749,507	2,640,749
Allowance for loan losses	(32,751)	(31,083)
Total loans receivable, net	2,716,756	2,609,666
Other real estate owned	786	754
Premises and equipment, net	60,603	63,911
Federal Home Loan Bank stock, at cost	9,083	7,564
Bank owned life insurance	71,112	70,355
Accrued interest receivable	11,081	10,925
Prepaid expenses and other assets	75,162	79,351
Other intangible assets, net	6,727	7,374
Goodwill	119,029	119,029
Total assets	$3,990,954	$3,878,981
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits	$3,291,250	$3,229,648
Federal Home Loan Bank advances	110,900	79,600
Junior subordinated debentures	19,863	19,717
Securities sold under agreement to repurchase	21,255	22,104
Accrued expenses and other liabilities	47,638	46,149
Total liabilities	3,490,906	3,397,218
Stockholders’ equity:		
Preferred stock, no par value, 2,500,000 shares authorized; no shares issued and outstanding at June 30, 2017 and December 31, 2016	—	—
Common stock, no par value, 50,000,000 shares authorized; 29,928,232 and 29,954,931 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively	359,535	359,060
Retained earnings	138,956	125,309
Accumulated other comprehensive income (loss), net	1,557	(2,606)
Total stockholders’ equity	500,048	481,763
Total liabilities and stockholders’ equity	$3,990,954	$3,878,981

See accompanying Notes to Condensed Consolidated Financial Statements.

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HERITAGE FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars in thousands, except per share amounts)			
INTEREST INCOME				
Interest and fees on loans	$31,500	$30,503	$61,985	$60,680
Taxable interest on investment securities	3,141	2,838	6,190	5,634
Nontaxable interest on investment securities	1,304	1,193	2,572	2,364
Interest and dividends on other interest earning assets	142	58	203	149
Total interest income	36,087	34,592	70,950	68,827
INTEREST EXPENSE				
Deposits	1,407	1,242	2,673	2,496
Junior subordinated debentures	249	216	487	426
Other borrowings	251	49	464	60
Total interest expense	1,907	1,507	3,624	2,982
Net interest income	34,180	33,085	67,326	65,845
Provision for loan losses	1,131	1,120	1,998	2,259
Net interest income after provision for loan losses	33,049	31,965	65,328	63,586
NONINTEREST INCOME				
Service charges and other fees	4,426	3,476	8,639	6,832
Gain on sale of investment securities, net	117	201	117	761
Gain on sale of loans, net	4,138	1,242	5,333	1,971
Interest rate swap fees	282	227	415	363
Other income	1,700	1,430	3,508	3,639
Total noninterest income	10,663	6,576	18,012	13,566
NONINTEREST EXPENSE				
Compensation and employee benefits	16,272	14,898	32,296	30,019
Occupancy and equipment	3,818	4,111	7,628	7,947
Data processing	2,002	1,829	3,917	3,621
Marketing	805	781	1,612	1,509
Professional services	1,053	833	2,062	1,678
State and local taxes	639	604	1,188	1,211
Federal deposit insurance premium	357	528	657	1,020
Other real estate owned, net	21	61	52	472
Amortization of intangible assets	323	363	647	698
Other expense	2,519	2,469	4,973	4,671
Total noninterest expense	27,809	26,477	55,032	52,846
Income before income taxes	15,903	12,064	28,308	24,306
Income tax expense	4,075	3,169	7,164	6,320
Net income	$11,828	$8,895	$21,144	$17,986
Basic earnings per common share	$0.40	$0.30	$0.71	$0.60
Diluted earnings per common share	$0.39	$0.30	$0.70	$0.60
Dividends declared per common share	$0.13	$0.12	$0.25	$0.23

See accompanying Notes to Condensed Consolidated Financial Statements.

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HERITAGE FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars in thousands)			
Net income	$11,828	$8,895	$21,144	$17,986
Change in fair value of investment securities available for sale, net of tax of $1,491, $2,267, $2,285 and $5,553, respectively	2,766	4,203	4,239	10,278
Reclassification adjustment for net gain from sale of investment securities available for sale included in income, net of tax of $(41), $(71), $(41) and $(267), respectively	(76)	(130)	(76)	(494)
Other comprehensive income	2,690	4,073	4,163	9,784
Comprehensive income	$14,518	$12,968	$25,307	$27,770

See accompanying Notes to Condensed Consolidated Financial Statements.

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HERITAGE FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)

	Number of common shares	Common stock	Retained earnings	Accumulated other comprehensive income, net	Total stock-holders' equity
	(Dollars in thousands, except per share amounts)				
Balance at December 31, 2015	29,975	$359,451	$107,960	$ 2,559	$469,970
Restricted stock awards granted, net of forfeitures	115	—	—	—	—
Exercise of stock options (including excess tax benefits from nonqualified stock options)	26	390	—	—	390
Stock-based compensation expense	—	872	—	—	872
Net excess tax benefits from vesting of restricted stock	—	76	—	—	76
Common stock repurchased	(124)	(2,126)	—	—	(2,126)
Net income	—	—	17,986	—	17,986
Other comprehensive income, net of tax	—	—	—	9,784	9,784
Cash dividends declared on common stock ($0.23 per share)	—	—	(6,894)	—	(6,894)
Balance at June 30, 2016	29,992	$358,663	$119,052	$ 12,343	$490,058
Balance at December 31, 2016	29,955	$359,060	$125,309	$ (2,606)	$481,763
Restricted stock awards forfeited	(7)	—	—	—	—
Exercise of stock options	8	109	—	—	109
Stock-based compensation expense	—	1,040	—	—	1,040
Common stock repurchased	(28)	(674)	—	—	(674)
Net income	—	—	21,144	—	21,144
Other comprehensive income, net of tax	—	—	—	4,163	4,163
Cash dividends declared on common stock ($0.25 per share)	—	—	(7,497)	—	(7,497)
Balance at June 30, 2017	29,928	$359,535	$138,956	$ 1,557	$500,048

See accompanying Notes to Condensed Consolidated Financial Statements.

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HERITAGE FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30,	
	2017	2016
	(Dollars in thousands)	
Cash flows from operating activities:		
Net income	$21,144	$17,986
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,459	6,483
Changes in net deferred loan costs, net of amortization	(509)	(455)
Provision for loan losses	1,998	2,259
Net change in accrued interest receivable, prepaid expenses and other assets, accrued expenses and other liabilities	3,482	(3,071)
Stock-based compensation expense	1,040	872
Net excess tax benefit from exercise of stock options and vesting of restricted stock	—	(97)
Amortization of intangible assets	647	698
Gain on sale of investment securities, net	(117)	(761)
Origination of loans held for sale	(54,449)	(57,975)
Gain on sale of loans, net	(5,333)	(1,971)
Proceeds from sale of loans	71,436	60,498
Earnings on bank owned life insurance	(747)	(695)
Valuation adjustment on other real estate owned	—	383
Gain on sale of assets held for sale	(53)	—
Gain on sale of other real estate owned, net	—	(42)
Loss on sale or write-off of furniture, equipment and leasehold improvements	12	244
Net cash provided by operating activities	44,010	24,356
Cash flows from investing activities:		
Loans originated, net of principal payments	(114,390)	(126,335)
Maturities of other interest earning deposits	—	1,248
Maturities, calls and payments of investment securities available for sale	52,461	60,803
Purchase of investment securities available for sale	(57,972)	(128,046)
Purchase of premises and equipment	(1,382)	(1,088)
Proceeds from sales of other real estate owned	—	770
Proceeds from sales of investment securities available for sale	15,032	75,837
Proceeds from sale of assets held for sale	265	—
Proceeds from redemption of Federal Home Loan Bank stock	16,456	10,460
Purchases of Federal Home Loan Bank stock	(17,975)	(12,012)
Investment in low-income housing tax credit partnership	(7)	(2,254)
Net cash used in investing activities	(107,512)	(120,617)
Cash flows from financing activities:		
Net increase in deposits	61,602	50,619
Federal Home Loan Bank advances	442,700	294,500
Repayments of Federal Home Loan Bank advances	(411,400)	(261,500)
Common stock cash dividends paid	(7,497)	(6,894)
Net decrease in securities sold under agreement to repurchase	(849)	(6,499)

Proceeds from exercise of stock options	109	369
Net excess tax benefit from exercise of stock options and vesting of restricted stock	—	97
Repurchase of common stock	(674)	(2,126)
Net cash provided by financing activities	83,991	68,566

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	Six Months Ended June 30,	
	2017	2016
	(Dollars in thousands)	
Net increase (decrease) in cash and cash equivalents	20,489	(27,695)
Cash and cash equivalents at beginning of period	103,745	126,640
Cash and cash equivalents at end of period	$124,234	$98,945
Supplemental disclosures of cash flow information:		
Cash paid for interest	$3,688	$3,008
Cash paid for income taxes	1,007	6,000
Supplemental non-cash disclosures of cash flow information:		
Transfers of loans receivable to other real estate owned	$32	$652
Transfers of loans receivable to loans held for sale	5,779	—
Transfers of premises and equipment, net to prepaid expenses and other assets for properties held for sale	2,687	—
Investment in low income housing tax credit partnership and related funding commitment	—	10,224
Purchases of investment securities available for sale not settled	2,268	1,164

See accompanying Notes to Condensed Consolidated Financial Statements.

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HERITAGE FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) Description of Business, Basis of Presentation, Significant Accounting Policies and Recently Issued Accounting Pronouncements

(a) Description of Business

Heritage Financial Corporation ("Heritage" or the “Company”) is a bank holding company that was incorporated in the State of Washington in August 1997. The Company is primarily engaged in the business of planning, directing and coordinating the business activities of its wholly-owned subsidiary, Heritage Bank (the “Bank”). The Bank is a Washington-chartered commercial bank and its deposits are insured by the FDIC. The Bank is headquartered in Olympia, Washington and conducts business from its 59 branch offices located throughout Washington State and the greater Portland, Oregon area. The Bank’s business consists primarily of commercial lending and deposit relationships with small businesses and their owners in its market areas and attracting deposits from the general public. The Bank also makes real estate construction and land development loans, consumer loans and originates first mortgage loans on residential properties primarily located in its market areas.

The Company has expanded its footprint through mergers and acquisitions. The largest of these transactions was the strategic merger with Washington Banking Company (“Washington Banking”) and its wholly owned subsidiary bank, Whidbey Island Bank ("Whidbey"). Effective May 1, 2014, Washington Banking merged with and into Heritage and Whidbey merged with and into Heritage Bank and this transaction is referred to herein as the "Washington Banking Merger". In connection with the Washington Banking Merger, Heritage also acquired as a subsidiary the Washington Banking Master Trust, a Delaware statutory business trust ('Trust"). Pursuant to the merger agreement, Heritage assumed the performance and observance of the covenants to be performed by Washington Banking under an indenture relating to $25.0 million in trust preferred securities issued in 2007 and the due and punctual payment of the principal of and premium and interest on such trust preferred securities. For additional information, see Note (8) Junior Subordinated Debentures.

(b) Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the accounting principles generally accepted in the United States (“U.S. GAAP”) for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. It is recommended that these unaudited Condensed Consolidated Financial Statements and accompanying Notes be read with the audited Consolidated Financial Statements and the accompanying Notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 (“2016 Annual Form 10-K”). In management's opinion, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. In preparing the unaudited Condensed Consolidated Financial Statements, management is required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. Management believes that the judgments, estimates and assumptions used in the preparation of the financial statements are appropriate based on the facts and circumstances at the time. Actual results, however, could differ from those estimates.

(c) Significant Accounting Policies

The significant accounting policies used in preparation of the Company's Condensed Consolidated Financial Statements are disclosed in the 2016 Annual Form 10-K. There have not been any material changes in the Company's significant accounting policies from those contained in the 2016 Annual Form 10-K, except for accounting policies for stock-based compensation relating to the issuance of restricted stock units, including grants subject to performance-based and market-based vesting conditions, adopted January 1, 2017 as discussed below.

Stock-Based Compensation

Compensation cost is recognized for stock options, restricted stock awards and restricted stock units issued to employees and directors, based on the fair value of these awards at the date of grant. Compensation cost is recognized over the requisite service period, generally defined as the vesting period, on a straight-line basis. Compensation cost for restricted stock units with market-based vesting is recognized over the service period to the extent the restricted stock units are expected to vest. With the adoption of FASB ASU 2016-09 on January 1, 2017, forfeitures are recognized as they occur.

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The market price of the Company’s common stock at the date of grant is used to fair value the restricted stock awards and restricted stock units. The fair value of stock options granted is estimated based on the date of grant using the Black-Scholes-Merton option pricing model. Certain restricted stock unit grants are subject to performance-based vesting as well as other approved vesting conditions and cliff vest based on those conditions, and the fair value is estimated using a Monte Carlo simulation pricing model. The assumptions used in the Black-Scholes-Merton option pricing model and the Monte Carlo simulation pricing model include the expected term based on the valuation date and the remaining contractual term of the award; the risk-free interest rate based on the U.S. Treasury curve at the valuation date of the award; the expected dividend yield based on expected dividends being payable to the holders; and the expected stock price volatility over the expected term based on the historical volatility over the equivalent historical term.

(d) Recently Issued Accounting Pronouncements

FASB Accounting Standards Update ("ASU" or "Update") 2014-09, Revenue from Contracts with Customers, was issued in May 2014. Under this Update, FASB created a new Topic 606 which is in response to a joint initiative of FASB and the International Accounting Standards Board to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and international financial reporting standards that would:

- Remove inconsistencies and weaknesses in revenue requirements.
- Provide a more robust framework for addressing revenue issues.
- Improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets.
- Provide more useful information to users of financial statements through improved disclosure requirements.
- Simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer.

The original effective date for this Update was deferred in FASB ASU 2015-14 below.

FASB ASU 2015-14, Revenue from Contracts with Customers (Topic 606), was issued in August 2015 and defers the effective date of the above-mentioned FASB ASU 2014-09 for certain entities. Public business entities, certain not-for-profit entities and certain employee benefit plans should apply the guidance in Update 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is now permitted, but only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The Company expects to adopt the revenue recognition guidance on January 1, 2018 using the modified retrospective approach. A significant amount of the Company’s revenues are derived from net interest income on financial assets and liabilities, which are excluded from the scope of the amended guidance. With respect to noninterest income and related disclosures, the Company is in its preliminary stages of identifying and evaluating the revenue streams and underlying revenue contracts within the scope of the guidance. The Company is expecting to begin developing processes and procedures during 2017 to ensure it is fully compliant with these amendments. To date, the Company has not yet identified any significant changes in the timing of revenue recognition when considering the amended accounting guidance; however, the Company’s implementation efforts are ongoing and such assessments may change prior to the January 1, 2018 implementation date.

FASB ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10), was issued in January 2016, to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. This Update contains several provisions, including but not limited to 1) requiring equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income; 2) simplifying the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; 3) eliminating the requirement to disclose the method(s) and significant assumptions used to estimate fair value; and 4) requiring separate presentation of financial assets and liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements. The Update also changes certain financial statement disclosure requirements, including requiring disclosures of the fair value of financial instruments be made on the basis of exit price. The Update is effective for public entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company does not expect the adoption of this Update will have a

significant impact on the Company’s statements of financial condition or income. Management is in the planning stages of developing processes and procedures to comply with the disclosures requirements of this Update, which could impact the disclosures the Company makes related to fair value of its financial instruments.

FASB ASU 2016-02, Leases (Topic 842), was issued in February 2016, to increase transparency and comparability of leases among organizations and to disclose key information about leasing arrangements. The Update

sets out the principles for the recognition, measurement, presentation and disclosure of leases for both lessees and lessors. The Update requires lessees to apply a dual approach, classifying leases as either a finance or operating lease. This classification will determine whether the lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term greater than 12 months regardless of their classification. All cash payments will be classified within operating activities in the statement of cash flows. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The Update is effective for public entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company anticipates adopting the Update on January 1, 2019. Upon adoption of the guidance, the Company expects to report increased assets and increased liabilities on its Condensed Consolidated Statements of Financial Condition as a result of recognizing right-of-use assets and lease liabilities related to certain banking offices and certain equipment under noncancelable operating lease agreements, which currently are not reflected in its Condensed Consolidated Statements of Financial Condition. The Company is anticipating electing an accounting policy to not recognize lease assets and lease liabilities for leases with a term of twelve months or less. The Company was committed to $14.7 million of minimum lease payments under noncancelable operating lease agreements at December 31, 2016. The Company does not expect the adoption of this amendment will have a significant impact to its Condensed Consolidated Financial Statements.

FASB ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations, was issued in March 2016 and it clarifies the implementation guidance of the above-mentioned FASB ASU 2014-09 as it relates to principal versus agent considerations. The Update addresses identifying the unit of account and nature of the goods or services as well as applying the control principle and interactions with the control principle. The amendments to the Update do not change the core principle of the guidance. The effective date, transition requirements and impact on the Company's Condensed Consolidated Financial Statements for this Update are the same as those described in FASB ASU 2015-14 above.

FASB ASU 2016-09, Stock Compensation (Topic 718), issued in March 2016, is intended to simplify several aspects of the accounting for share-based payment award transactions. For public business entities, the guidance is effective for annual periods after December 15, 2016, including interim periods within those annual periods with early adoption permitted. Certain amendments are required to be applied using a modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted. Other amendments are applied retroactively (such as presentation of employee taxes paid on the statement of cash flows) or prospectively (such as recognition of excess tax benefits on the income statement). The Company adopted this standard effective January 1, 2017. The Company made an accounting policy election to account for forfeitures as they occur and this change resulted in a cumulative adjustment that was immaterial to all periods presented. Changes to the statement of cash flows have been applied prospectively and the Company recorded excess tax benefits in its income tax expense. Adoption of all other changes under this Update did not have a material impact on the Condensed Consolidated Financial Statements.

FASB ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, was issued in April 2016 which clarifies the implementation guidance of the above-mentioned FASB ASU 2014-09 as it relates to identifying performance obligations and licensing. The effective date, transition requirements and impact on the Company's Condensed Consolidated Financial Statements for this Update are the same as those described in FASB ASU 2015-14 above.

FASB ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-scope Improvements and Practical Expedients, was issued in May 2016. The amendments in this Update do not change the core principle of the guidance in Topic 606. Rather, the amendments in this Update affect only the narrow aspects of Topic 606. The effective date, transition requirements and impact on the Company's Condensed Consolidated Financial Statements for this Update are the same as those described in FASB ASU 2015-14 above.

FASB ASU 2016-13, Financial Instruments: Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, was issued in June 2016. Commonly referred to as the current expected credit loss model ("CECL"), this

Update requires financial assets measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset to present the net carrying value at the amount expected to be collected on the financial asset. The measurement of expected credit losses is based on relevant information about past events including historical experience, current conditions and reasonable and supportable forecasts that affect the collectibility of the reported amount. The amendment affects loans, debt securities, trade receivables, net investments in leases, off-balance-sheet credit exposures, reinsurance receivables and any other financial asset not excluded from the scope that have the contractual right to receive cash. The Update replaces the incurred loss impairment methodology, which

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generally only considered past events and current conditions, with a methodology that reflects the expected credit losses and required consideration of a broader range of reasonable and supportable information to estimate all expected credit losses. The Update additionally addresses purchased assets and introduces the purchased financial asset with a more-than-insignificant amount of credit deterioration since origination ("PCD"). The accounting for these PCD assets is similar to the existing accounting guidance of FASB Accounting Standards Codification ("ASC") 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, for purchased credit impaired ("PCI") assets, except the subsequent improvements in estimated cash flows will be immediately recognized into income, similar to the immediate recognition of subsequent deteriorations in cash flows. Current guidance only allows for the prospective recognition of these cash flow improvements. Because the terminology has been changed to a "more-than-insignificant" amount of credit deterioration, the presumption is that more assets might qualify for this accounting under the Update than those under current guidance. For public business entities, the Update is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years with early adoption permitted for fiscal years after December 15, 2018. An entity will apply the Update through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. A prospective transition approach is required for debt securities. An entity that has previously applied the guidance of FASB ASC 310-30 will prospectively apply the guidance in this Update for PCD assets. A prospective transition approach should be used for PCD assets where upon adoption, the amortized cost basis should be adjusted to reflect the addition of the allowance for credit losses. The Company is anticipating adopting the Update on January 1, 2020. Upon adoption, the Company expects a change in the processes and procedures to calculate the allowance for loan losses, including changes in assumptions and estimates to consider expected credit losses over the life of the loan versus the current accounting practice that utilizes the incurred loss model. The new guidance may result in an increase in the allowance for loan losses which will also reflect the new requirement to include the nonaccretable principal differences on PCI loans; however, the Company is still in the process of determining the magnitude of the increase and its impact on the Condensed Consolidated Financial Statements. In addition, the current accounting policy and procedures for other-than-temporary impairment on investment securities available for sale will be replaced with an allowance approach. The Company created a CECL steering committee which will begin developing and implementing processes and procedures to ensure it is fully compliant with the amendments at the adoption date.

FASB ASU 2016-15, Statement of Cash Flows (Topic 213): Classification of Certain Cash Receipts and Cash Payments, was issued in August 2016. The Update addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. For public business entities, the guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted and must be applied using a retrospective transitional method to each period presented. The Company has evaluated the new guidance and does not anticipate that its adoption of this Update on January 1, 2018 will have a significant impact on its Condensed Consolidated Financial Statements.

FASB ASU 2017-03, Accounting Changes and Error Corrections (Topic 250) and Investments—Equity Method and Joint Ventures (Topic 323): Amendments to SEC Paragraphs Pursuant to Staff Announcements at the September 22, 2016 and November 17, 2016 EITF Meetings (SEC Update), was issued in January 2017. The SEC staff view is that a registrant should evaluate FASB ASC Updates that have not yet been adopted to determine the appropriate financial disclosures about the potential material effects of the updates on the financial statements when adopted. If a registrant does not know or cannot reasonably estimate the impact of an update, then in addition to making a statement to that effect, the registrant should consider additional qualitative financial statement disclosures to assist the reader in assessing the significance of the impact. The staff expects the additional qualitative disclosures to include a description of the effect of the accounting policies expected to be applied compared to current accounting policies. Also, the registrant should describe the status of its process to implement the new standards and the significant implementation matters yet to be addressed. The amendments specifically addressed recent FASB ASC amendments to Topic 326, Financial Instruments - Credit Losses; Topic 842, Leases; and Topic 606, Revenue from Contracts with Customers; although, the amendments apply to any subsequent amendments to guidance in the FASB ASC. The

Company adopted the amendments in this Update during the fourth quarter of 2016 and appropriate disclosures have been included in this Note for each recently issued accounting standard.

FASB ASU 2017-04, Goodwill (Topic 350), was issued in January 2017 and eliminates Step 2 from the goodwill impairment test. Under the amendments, an entity should perform its goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The loss recognized, however, should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. The Update is effective for annual periods or any interim goodwill impairment tests beginning after

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December 15, 2019 using a prospective transition method and early adoption is permitted. The Company does not expect the Update will have a material impact on its Condensed Consolidated Financial Statements.

FASB ASU 2017-09, Compensation--Stock Compensation (Topic 718): Scope of Modification Accounting was issued in May 2017 to provide clarity as to when to apply modification accounting when there is a change in the terms or conditions of a share-based payment award. According to this Update, an entity should account for the effects of a modification unless the fair value, vesting conditions and balance sheet classification of the award is the same after the modification as compared to the original award prior to the modification. The standard is effective for reporting periods beginning after December 15, 2017, with early adoption permitted. The Company does not expect the Update will have a material impact on its Condensed Consolidated Financial Statements.

(2) Investment Securities

The Company's investment policy is designed primarily to provide and maintain liquidity, generate a favorable return on assets without incurring undue interest rate and credit risk, and complement the Bank's lending activities.

(a) Securities by Type and Maturity

The amortized cost, gross unrealized gains, gross unrealized losses and fair values of investment securities available for sale at the dates indicated were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
June 30, 2017				
U.S. Treasury and U.S. Government-sponsored agencies	$9,468	$ 9	$ (29)	$9,448
Municipal securities	239,881	5,313	(864)	244,330
Mortgage-backed securities and collateralized mortgage obligations[(1)]:				
Residential	282,997	851	(2,012)	281,836
Commercial	210,079	825	(2,245)	208,659
Collateralized loan obligations	6,798	14	(17)	6,795
Corporate obligations	13,552	213	—	13,765
Other securities	25,406	360	(5)	25,761
Total	$788,181	$ 7,585	$ (5,172)	$790,594
December 31, 2016				
U.S. Treasury and U.S. Government-sponsored agencies	$1,563	$ 6	$ —	$1,569
Municipal securities	237,305	2,427	(2,476)	237,256
Mortgage-backed securities and collateralized mortgage obligations[(1)]:				
Residential	310,391	985	(2,200)	309,176
Commercial	211,259	599	(3,540)	208,318
Collateralized loan obligations	10,505	4	(31)	10,478
Corporate obligations	16,611	104	(9)	16,706
Other securities	11,005	156	(19)	11,142
Total	$798,639	$ 4,281	$ (8,275)	$794,645

(1) Issued and guaranteed by U.S. Government-sponsored agencies.

There were no securities classified as trading or held to maturity at June 30, 2017 or December 31, 2016.

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The amortized cost and fair value of investment securities available for sale at June 30, 2017, by contractual maturity, are set forth below. Actual maturities may differ from contractual maturities because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(In thousands)	
Due in one year or less	$5,612	$5,653
Due after one year through five years	110,610	111,912
Due after five years through ten years	248,162	248,257
Due after ten years	423,752	424,644
Investment securities with no stated maturities	45	128
Total	$788,181	$790,594

(b) Unrealized Losses and Other-Than-Temporary Impairments

The following table shows the gross unrealized losses and fair value of the Company's investment securities available for sale that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that the individual securities have been in continuous unrealized loss positions as of June 30, 2017 and December 31, 2016:

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
June 30, 2017						
U.S. Treasury and U.S. Government-sponsored agencies	$4,533	$(29)	$—	$—	$4,533	$(29)
Municipal securities	36,220	(812)	2,498	(52)	38,718	(864)
Mortgage-backed securities and collateralized mortgage obligations[1]:						
Residential	145,878	(1,897)	12,541	(115)	158,419	(2,012)
Commercial	129,184	(2,148)	6,820	(97)	136,004	(2,245)
Collateralized loan obligations	2,883	(17)	—	—	2,883	(17)
Other Securities	2,933	(5)	—	—	2,933	(5)
Total	$321,631	$(4,908)	$21,859	$(264)	$343,490	$(5,172)
December 31, 2016						
Municipal securities	$90,188	$(2,476)	$—	$—	$90,188	$(2,476)
Mortgage-backed securities and collateralized mortgage obligations[1]:						
Residential	181,562	(2,148)	10,854	(52)	192,416	(2,200)
Commercial	157,055	(3,446)	12,597	(94)	169,652	(3,540)
Collateralized loan obligations	2,976	(1)	2,969	(30)	5,945	(31)
Corporate obligations	4,032	(9)	—	—	4,032	(9)
Other Securities	6,998	(19)	—	—	6,998	(19)
Total	$442,811	$(8,099)	$26,420	$(176)	$469,231	$(8,275)

[1] Issued and guaranteed by U.S. Government-sponsored agencies.

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The Company has evaluated these investment securities available for sale as of June 30, 2017 and December 31, 2016 and has determined that the decline in their value is temporary. The unrealized losses are primarily due to increases in market interest rates and larger spreads in the market for mortgage-related products. The fair value of these securities is expected to recover as the securities approach their maturity date and/or as the pricing spreads narrow on mortgage-related securities. None of the underlying issuers of the municipal securities had credit ratings that were below investment grade levels at June 30, 2017 or December 31, 2016. The Company has the ability and intent to hold the investments until recovery of the securities' amortized cost, which may be the maturity date of the securities.
For the three and six months ended June 30, 2017 and 2016, there were no investment securities determined to be other-than-temporarily impaired.

(c) Pledged Securities
The following table summarizes the amortized cost and fair value of investment securities available for sale that are pledged as collateral for the following obligations at June 30, 2017 and December 31, 2016:

	June 30, 2017		December 31, 2016	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)			
Washington and Oregon state to secure public deposits	$208,907	$210,420	$214,834	$215,247
Repurchase agreements	32,731	32,591	29,481	29,294
Other securities pledged	3,534	3,536	3,557	3,546
Total	$245,172	$246,547	$247,872	$248,087

(3) Loans Receivable
The Company originates loans in the ordinary course of business and has also acquired loans through FDIC-assisted and open bank transactions. Disclosures related to the Company's recorded investment in loans receivable generally exclude accrued interest receivable and net deferred costs because they are insignificant.
Loans acquired in a business combination are further classified as “purchased” loans. Loans purchased with evidence of credit deterioration since origination for which it is probable that not all contractually required payments will be collected are accounted for under FASB ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. These loans are identified as "PCI" loans. Loans purchased that are not accounted for under FASB ASC 310-30 are accounted for under FASB ASC 310-20, Receivables—Nonrefundable Fees and Other Costs, and are referred to as "non-PCI" loans.
(a) Loan Origination/Risk Management
The Company categorizes loans in one of the four segments of the total loan portfolio: commercial business, one-to-four family residential, real estate construction and land development and consumer. Within these segments are classes of loans for which management monitors and assesses credit risk in the loan portfolios. The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and nonperforming and potential problem loans. The Company also conducts internal loan reviews and validates the credit risk assessment on a periodic basis and presents the results of these reviews to management. The loan review process complements and reinforces the risk identification and assessment decisions made by loan officers and credit personnel, as well as the Company’s policies and procedures.

A discussion of the risk characteristics of each loan portfolio segment is as follows:
Commercial Business:
There are three significant classes of loans in the commercial business portfolio segment: commercial and industrial, owner-occupied commercial real estate and non-owner occupied commercial real estate. The owner and non-owner occupied commercial real estate are both considered commercial real estate loans. As the commercial and industrial loans carry different risk characteristics than the commercial real estate loans, they are discussed separately below.
Commercial and industrial. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may include a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. Commercial and Industrial loans carry more risk than other loans because the borrowers' cash flow is less predictable, and in the event of a default, loss given default is potentially greater because the value of the collateral securing these loans is more difficult to quantify.
Commercial real estate. The Company originates commercial real estate loans within its primary market areas. These loans are subject to underwriting standards and processes similar to commercial and industrial loans, in that these loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate properties. Commercial real estate lending typically involves higher loan principal amounts and payments on loans, and repayment is dependent on successful operation and management of the properties. The value of the real estate securing these loans can be adversely affected by conditions in the real estate market or the economy. There is little difference in risk between owner-occupied commercial real estate loans and non-owner occupied commercial real estate loans.
One-to-Four Family Residential:
The majority of the Company's one-to-four family residential loans are secured by single-family residences located in its primary market areas. The Company's underwriting standards require that single-family portfolio loans generally are owner-occupied and do not exceed 80% of the lower of appraised value at origination or cost of the underlying collateral. Terms of maturity typically range from 15 to 30 years. The Company sells most of its single-family loans in the secondary market and retains a smaller portion in its loan portfolio.
Real Estate Construction and Land Development:
The Company originates construction loans for one-to-four family residential and for five or more family residential and commercial properties. The one-to-four family residential construction loans generally include construction of custom homes whereby the home buyer is the borrower. The Company also provides financing to builders for the construction of pre-sold homes and, in selected cases, to builders for the construction of speculative residential property. Substantially all construction loans are short-term in nature and priced with variable rates of interest. Construction lending can involve a higher level of risk than other types of lending because funds are advanced partially based upon the value of the project, which is uncertain prior to the project's completion. Because of the uncertainties inherent in estimating construction costs as well as the market value of a completed project and the effects of governmental regulation of real property, the Company's estimates with regard to the total funds required to complete a project and the related loan-to-value ratio may vary from actual results. As a result, construction loans often involve the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project and the ability of the borrower to sell or lease the property or refinance the indebtedness. If the Company's estimate of the value of a project at completion proves to be overstated, it may have inadequate security for repayment of the loan and may incur a loss if the borrower does not repay the loan. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being dependent upon successful completion of the construction project, interest rate changes, government regulation

of real property, general economic conditions and the availability of long-term financing.

Consumer:

The Company originates consumer loans and lines of credit that are both secured and unsecured. The underwriting process for these loans ensures a qualifying primary and secondary source of repayment. Underwriting standards for home equity loans are significantly influenced by statutory requirements, which include, but are not limited

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to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time and documentation requirements. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed. The majority of consumer loans are for relatively small amounts disbursed among many individual borrowers which reduces the credit risk for this type of loan. To further reduce the risk, trend reports are reviewed by management on a regular basis.

The Company also originates indirect consumer loans. These loans are for new and used automobile and recreational vehicles that are originated indirectly by selected dealers located in the Company's market areas. The Company has limited its purchase of indirect loans primarily to dealerships that are established and well known in their market areas and to applicants that are not classified as sub-prime.

Loans receivable at June 30, 2017 and December 31, 2016 consisted of the following portfolio segments and classes:

	June 30, 2017	December 31, 2016
	(In thousands)	
Commercial business:		
Commercial and industrial	$659,621	$637,773
Owner-occupied commercial real estate	586,236	558,035
Non-owner occupied commercial real estate	904,195	880,880
Total commercial business	2,150,052	2,076,688
One-to-four family residential	80,941	77,391
Real estate construction and land development:		
One-to-four family residential	49,479	50,414
Five or more family residential and commercial properties	135,959	108,764
Total real estate construction and land development	185,438	159,178
Consumer	330,215	325,140
Gross loans receivable	2,746,646	2,638,397
Net deferred loan costs	2,861	2,352
Loans receivable, net	2,749,507	2,640,749
Allowance for loan losses	(32,751)	(31,083)
Total loans receivable, net	$2,716,756	$2,609,666

(b) Concentrations of Credit

Most of the Company’s lending activity occurs within Washington State and to a lesser extent Oregon. The Company’s primary market areas are concentrated along the I-5 corridor from Whatcom County to Clark County in Washington State and Multnomah County in Oregon, as well as other contiguous markets. The majority of the Company’s loan portfolio consists of (in order of balances at June 30, 2017) non-owner occupied commercial real estate, commercial and industrial and owner-occupied commercial real estate. As of June 30, 2017 and December 31, 2016, there were no concentrations of loans related to any single industry in excess of 10% of the Company’s total loans.

(c) Credit Quality Indicators

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 related to (i) the risk grade of the loans, (ii) the level of classified loans, (iii) net charge-offs, (iv) nonperforming loans and (v) the general economic conditions of the United States of America, and specifically the states of Washington and Oregon. The Company utilizes a risk grading matrix to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 10. A description of the general characteristics of the risk grades is as follows:

- Grades 1 to 5: These grades are considered “pass grade” and include loans with negligible to above average but acceptable risk. These borrowers generally have strong to acceptable capital levels and consistent earnings and debt service capacity. Loans with the higher grades within the “pass” category may include borrowers who are experiencing unusual operating difficulties, but have acceptable

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payment performance to date. Increased monitoring of financial information and/or collateral may be appropriate. Loans with this grade show no immediate loss exposure.

- Grade 6: This grade includes "Watch" loans and is considered a “pass grade”. The grade is intended to be utilized on a temporary basis for pass grade borrowers where a potentially significant risk-modifying action is anticipated in the near term.
- Grade 7: This grade includes “Other Assets Especially Mentioned” (“OAEM”) loans in accordance with regulatory guidelines, and is intended to highlight loans with elevated risks. Loans with this grade show signs of deteriorating profits and capital, and the borrower might not be strong enough to sustain a major setback. The borrower is typically higher than normally leveraged, and outside support might be modest and likely illiquid. The loan is at risk of further decline unless active measures are taken to correct the situation.
- Grade 8: This grade includes “Substandard” loans in accordance with regulatory guidelines, which the Company has determined have a high credit risk. These loans also have well-defined weaknesses which make payment default or principal exposure likely, but not yet certain. The borrower may have shown serious negative trends in financial ratios and performance. Such loans may be dependent upon collateral liquidation, a secondary source of repayment or an event outside of the normal course of business. Loans with this grade can be placed on accrual or nonaccrual status based on the Company’s accrual policy.
- Grade 9: This grade includes “Doubtful” loans in accordance with regulatory guidelines, and the Company has determined these loans to have excessive credit risk. Such loans are placed on nonaccrual status and may be dependent upon collateral having a value that is difficult to determine or upon some near-term event which lacks certainty. Additionally, these loans generally have a specific valuation allowance or have been partially charged-off for the amount considered uncollectible.
- Grade 10: This grade includes “Loss” loans in accordance with regulatory guidelines, and the Company has determined these loans have the highest risk of loss. Such loans are charged-off or charged-down when payment is acknowledged to be uncertain or when the timing or value of payments cannot be determined. “Loss” is not intended to imply that the loan or some portion of it will never be paid, nor does it in any way imply that there has been a forgiveness of debt.

Numerical loan grades for loans are established at the origination of the loan. Loan grades are reviewed on a quarterly basis, or more frequently if necessary, by the credit department. The Bank follows the FDIC’s Uniform Retail Credit Classification and Account Management Policy for subsequent classification in the event of payment delinquencies or default. Typically, an individual loan grade will not be changed from the prior period unless there is a specific indication of credit deterioration or improvement. Credit deterioration is evidenced by delinquency, direct communications with the borrower, or other borrower information that becomes known to management. Credit improvements are evidenced by known facts regarding the borrower or the collateral property.

The loan grades relate to the likelihood of losses in that the higher the grade, the greater the loss potential. Loans with a pass grade may have some estimated inherent losses, but to a lesser extent than the other loan grades. The OAEM loan grade is transitory in that the Company is waiting on additional information to determine the likelihood and extent of the potential loss. The likelihood of loss for OAEM graded loans, however, is greater than Watch graded loans because there has been measurable credit deterioration. Loans with a Substandard grade are generally loans for which the Company has individually analyzed for potential impairment. For Doubtful and Loss graded loans, the Company is almost certain of the losses, and the outstanding principal balances are generally charged-off to the realizable value.

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The following tables present the balance of the loans receivable by credit quality indicator as of June 30, 2017 and December 31, 2016.

	June 30, 2017			
	Pass	OAEM	Substandard	Total
	(In thousands)			
Commercial business:				
Commercial and industrial	$619,060	$9,349	$ 31,212	$659,621
Owner-occupied commercial real estate	561,816	6,198	18,222	586,236
Non-owner occupied commercial real estate	872,877	14,157	17,161	904,195
Total commercial business	2,053,753	29,704	66,595	2,150,052
One-to-four family residential	79,602	—	1,339	80,941
Real estate construction and land development:				
One-to-four family residential	44,510	493	4,476	49,479
Five or more family residential and commercial properties	133,102	1,128	1,729	135,959
Total real estate construction and land development	177,612	1,621	6,205	185,438
Consumer	325,000	—	5,215	330,215
Gross loans receivable	$2,635,967	$31,325	$ 79,354	$2,746,646

	December 31, 2016			
	Pass	OAEM	Substandard	Total
	(In thousands)			
Commercial business:				
Commercial and industrial	$601,273	$5,048	$ 31,452	$637,773
Owner-occupied commercial real estate	532,585	4,437	21,013	558,035
Non-owner occupied commercial real estate	841,383	14,573	24,924	880,880
Total commercial business	1,975,241	24,058	77,389	2,076,688
One-to-four family residential	76,020	—	1,371	77,391
Real estate construction and land development:				
One-to-four family residential	44,752	500	5,162	50,414
Five or more family residential and commercial properties	105,723	1,150	1,891	108,764
Total real estate construction and land development	150,475	1,650	7,053	159,178
Consumer	320,140	—	5,000	325,140
Gross loans receivable	$2,521,876	$25,708	$ 90,813	$2,638,397

Potential problem loans are loans classified as OAEM or worse that are currently accruing interest and are not considered impaired, but which management is monitoring because the financial information of the borrower causes concern as to their ability to meet their loan repayment terms. Potential problem loans may include PCI loans as these loans continue to accrete loan discounts established at acquisition based on the guidance of FASB ASC 310-30. Potential problem loans as of June 30, 2017 and December 31, 2016 were $84.1 million and $87.8 million, respectively. The balance of potential problem loans guaranteed by a governmental agency, which guarantee reduces the Company's credit exposure, was $3.5 million and $1.1 million as of June 30, 2017 and December 31, 2016, respectively.

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(d) Nonaccrual Loans

Nonaccrual loans, segregated by segments and classes of loans, were as follows as of June 30, 2017 and December 31, 2016:

	June 30, 2017	December 31, 2016
	(In thousands)	
Commercial business:		
Commercial and industrial	$3,613	$ 3,531
Owner-occupied commercial real estate	3,795	3,728
Non-owner occupied commercial real estate	1,271	1,321
Total commercial business	8,679	8,580
One-to-four family residential	87	94
Real estate construction and land development:		
One-to-four family residential	2,008	2,008
Five or more family residential and commercial properties	—	—
Total real estate construction and land development	2,008	2,008
Consumer	199	227
Nonaccrual loans	$10,973	$ 10,909

The Company had $1.6 million and $2.8 million of nonaccrual loans guaranteed by governmental agencies at June 30, 2017 and December 31, 2016, respectively.

PCI loans are not included in the nonaccrual loan table above because these loans are accounted for under FASB ASC 310-30, which provides that accretable yield is calculated based on a loan's expected cash flow even if the loan is not performing under its contractual terms.

(e) Past due loans

The Company performs an aging analysis of past due loans using the categories of 30-89 days past due and 90 or more days past due. This policy is consistent with regulatory reporting requirements.

The balances of past due loans, segregated by segments and classes of loans, as of June 30, 2017 and December 31, 2016 were as follows:

	June 30, 2017				
	30-89 Days	90 Days or Greater	Total Past Due	Current	Total
	(In thousands)				
Commercial business:					
Commercial and industrial	$440	$ 1,866	$ 2,306	$657,315	$659,621
Owner-occupied commercial real estate	—	1,338	1,338	584,898	586,236
Non-owner occupied commercial real estate	—	3,052	3,052	901,143	904,195
Total commercial business	440	6,256	6,696	2,143,356	2,150,052
One-to-four family residential	—	—	—	80,941	80,941
Real estate construction and land development:					
One-to-four family residential	100	865	965	48,514	49,479
Five or more family residential and commercial properties	366	—	366	135,593	135,959
Total real estate construction and land development	466	865	1,331	184,107	185,438
Consumer	1,442	673	2,115	328,100	330,215
Gross loans receivable	$2,348	$ 7,794	$ 10,142	$2,736,504	$2,746,646

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	December 31, 2016				
	30-89 Days	90 Days or Greater	Total Past Due	Current	Total
	(In thousands)				
Commercial business:					
Commercial and industrial	$2,687	$ 1,733	$ 4,420	$633,353	$637,773
Owner-occupied commercial real estate	1,807	2,915	4,722	553,313	558,035
Non-owner occupied commercial real estate	733	—	733	880,147	880,880
Total commercial business	5,227	4,648	9,875	2,066,813	2,076,688
One-to-four family residential	523	—	523	76,868	77,391
Real estate construction and land development:					
One-to-four family residential	90	2,008	2,098	48,316	50,414
Five or more family residential and commercial properties	—	377	377	108,387	108,764
Total real estate construction and land development	90	2,385	2,475	156,703	159,178
Consumer	2,292	105	2,397	322,743	325,140
Gross loans receivable	$8,132	$ 7,138	$ 15,270	$2,623,127	$2,638,397

There were no loans 90 days or more past due that were still accruing interest as of June 30, 2017 or December 31, 2016, excluding PCI loans.

(f) Impaired loans

Impaired loans include nonaccrual loans and performing troubled debt restructured ("TDR") loans. The balances of impaired loans as of June 30, 2017 and December 31, 2016 are set forth in the following tables.

	June 30, 2017				
	Recorded Investment With No Specific Valuation Allowance	Recorded Investment With Specific Valuation Allowance	Total Recorded Investment	Unpaid Contractual Principal Balance	Related Specific Valuation Allowance
	(In thousands)				
Commercial business:					
Commercial and industrial	$1,912	$ 8,930	$ 10,842	$ 11,311	$ 1,338
Owner-occupied commercial real estate	1,094	3,726	4,820	5,083	696
Non-owner occupied commercial real estate	4,796	6,495	11,291	11,410	907
Total commercial business	7,802	19,151	26,953	27,804	2,941
One-to-four family residential	—	310	310	316	95
Real estate construction and land development:					
One-to-four family residential	1,671	1,082	2,753	3,438	59
Five or more family residential and commercial properties	—	1,062	1,062	1,063	64
Total real estate construction and land development	1,671	2,144	3,815	4,501	123
Consumer	—	259	259	280	66
Total	$9,473	$ 21,864	$ 31,337	$ 32,901	$ 3,225

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	December 31, 2016				
	Recorded Investment With No Specific Valuation Allowance	Recorded Investment With Specific Valuation Allowance	Total Recorded Investment	Unpaid Contractual Principal Balance	Related Specific Valuation Allowance
	(In thousands)				
Commercial business:					
Commercial and industrial	$1,739	$ 10,636	$ 12,375	$ 13,249	$ 1,199
Owner-occupied commercial real estate	1,150	3,574	4,724	5,107	511
Non-owner occupied commercial real estate	4,905	6,413	11,318	11,386	797
Total commercial business	7,794	20,623	28,417	29,742	2,507
One-to-four family residential	—	321	321	325	97
Real estate construction and land development:					
One-to-four family residential	2,243	828	3,071	3,755	6
Five or more family residential and commercial properties	—	1,079	1,079	1,079	60
Total real estate construction and land development	2,243	1,907	4,150	4,834	66
Consumer	48	262	310	325	64
Total	$10,085	$ 23,113	$ 33,198	$ 35,226	$ 2,734

The Company had governmental guarantees of $1.9 million and $3.5 million related to the impaired loan balances at June 30, 2017 and December 31, 2016, respectively.

The average recorded investment of impaired loans for the three and six months ended June 30, 2017 and 2016 are set forth in the following table.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(In thousands)			
Commercial business:				
Commercial and industrial	$6,925	$10,192	$8,742	$9,933
Owner-occupied commercial real estate	3,278	5,209	3,760	4,904
Non-owner occupied commercial real estate	11,252	11,665	11,274	11,287
Total commercial business	21,455	27,066	23,776	26,124
One-to-four family residential	312	269	315	271
Real estate construction and land development:				
One-to-four family residential	2,636	3,310	2,781	3,438
Five or more family residential and commercial properties	1,067	1,816	1,070	1,864
Total real estate construction and land development	3,703	5,126	3,851	5,302
Consumer	235	977	260	716
Total	$25,705	$33,438	$28,202	$32,413

For the three and six months ended June 30, 2017 and 2016, no interest income was recognized subsequent to a loan's classification as nonaccrual. For the three and six months ended June 30, 2017, the Bank recorded $281,000 and $646,000, respectively, of interest income related to performing TDR loans. For the three and six months ended June 30, 2016, the Bank recorded $167,000 and $345,000, respectively, of interest income related to performing TDR loans.

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(g) Troubled Debt Restructured Loans

A TDR loan is a restructuring in which the Bank, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. TDRs are considered impaired and are separately measured for impairment under FASB ASC 310-10-35, whether on accrual ("performing") or nonaccrual ("nonperforming") status. The Company has more stringent definitions of concessions and impairment measures for PCI loans as these loans have known credit deterioration and are generally accreting income at a lower discounted rate as compared to the contractual note rate based on the guidance of FASB ASC 310-30.

The majority of the Bank's TDR loans are a result of granting extensions of maturity on troubled credits which have already been adversely classified. The Bank grants such extensions to reassess the borrower's financial status and to develop a plan for repayment. The second most prevalent concessions are certain modifications with extensions that also include interest rate reductions. Certain TDRs were additionally re-amortized over a longer period of time. These modifications would all be considered a concession for a borrower that could not obtain similar financing terms from another source other than from the Bank.

The financial effects of each modification will vary based on the specific restructure. For the majority of the Bank's TDR loans, the loans were interest-only with a balloon payment at maturity. If the interest rate is not adjusted and the modified terms are consistent with other similar credits being offered, the Bank may not experience any loss associated with the restructure. If, however, the restructure involves forbearance agreements or interest rate modifications, the Bank may not collect all the principal and interest based on the original contractual terms. The Bank estimates the necessary allowance for loan losses on TDRs using the same guidance as used for other impaired loans.

The recorded investment balance and related allowance for loan losses of performing and nonaccrual TDR loans as of June 30, 2017 and December 31, 2016 were as follows:

	June 30, 2017		December 31, 2016	
	Performing TDRs	Nonaccrual TDRs	Performing TDRs	Nonaccrual TDRs
	(In thousands)			
TDR loans	$20,364	$ 6,455	$22,288	$ 6,900
Allowance for loan losses on TDR loans	2,163	432	1,965	437

The unfunded commitment to borrowers related to TDRs was $129,000 and $249,000 at June 30, 2017 and December 31, 2016, respectively.

Loans that were modified as TDRs during the three and six months ended June 30, 2017 and 2016 are set forth in the following tables:

	Three Months Ended June 30,			
	2017		2016	
	Number of Contracts (1)	Outstanding Principal Balance (1)(2)	Number of Contracts (1)	Outstanding Principal Balance (1)(2)
	(Dollars in thousands)			
Commercial business:				
Commercial and industrial	5	$ 3,439	5	$ 325
Non-owner occupied commercial real estate	1	947	—	—
Total commercial business	6	4,386	5	325
Real estate construction and land development:				
One-to-four family residential	2	745	0	—
Five or more family residential and commercial properties	—	—	1	1,633
Total real estate construction and land development	2	745	1	1,633

Consumer	1		10	2		28
Total TDR loans	9	$	5,141	8	$	1,986

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	Six Months Ended June 30,			
	2017		2016	
	Number of Contracts (1)	Outstanding Principal Balance (1)(2)	Number of Contracts (1)	Outstanding Principal Balance (1)(2)
	(Dollars in thousands)			
Commercial business:				
Commercial and industrial	10	$ 4,913	13	$ 1,225
Owner-occupied commercial real estate	1	54	0	—
Non-owner occupied commercial real estate	1	948	1	834
Total commercial business	12	5,915	14	2,059
Real estate construction and land development:				
One-to-four family residential	4	1,889	5	2,349
Five or more family residential and commercial properties	—	—	1	1,633
Total real estate construction and land development	4	1,889	6	3,982
Consumer	2	18	5	67
Total TDR loans	18	$ 7,822	25	$ 6,108

(1) Number of contracts and outstanding principal balance represent loans which have balances as of period end as certain loans may have been paid-down or charged-off during the three and six months ended June 30, 2017 and 2016.

(2) Includes subsequent payments after modifications and reflects the balance as of period end. As the Bank did not forgive any principal or interest balance as part of the loan modification, the Bank's recorded investment in each loan at the date of modification (pre-modification) did not change as a result of the modification (post-modification).

Of the nine loans modified during the three months ended June 30, 2017, six loans with a total outstanding principal balance of $2.8 million had no prior modifications. Of the 18 loans modified during the six months ended June 30, 2017, 11 loans with a total outstanding principal balance of $4.0 million had no prior modifications. Of the eight loans modified during the three months ended June 30, 2016, three loans with a total outstanding principal balance of $61,000 had no prior modifications. Of the 25 loans modified during the six months ended June 30, 2016, ten loans with a total outstanding principal balance of $571,000 had no prior modifications. The remaining loans included in the table above for the three and six months ended June 30, 2017 and 2016 were previously reported as TDRs. The Bank typically grants shorter extension periods to continually monitor these TDRs despite the fact that the extended date might not be the date the Bank expects sufficient cash flow from these borrowers. The Company does not consider these modifications a subsequent default of a TDR as new loan terms, specifically new maturity dates, were granted. The potential losses related to these loans would have been considered in the period the loan was first reported as a TDR and are adjusted, as necessary, in the current period based on more recent information. The related specific valuation allowance at June 30, 2017 was $776,000 for loans that were modified as TDRs during the six months ended June 30, 2017.

There was one commercial and industrial loan and three consumer loans of $234,000 and $36,000, respectively, at June 30, 2017 that were modified during the previous twelve months that subsequently defaulted during the three and six months ended June 30, 2017 because the borrowers were more than 90 days delinquent on their scheduled payments. There were no loans that were modified during the previous twelve months that subsequently defaulted during the three and six months ended June 30, 2016.

(h) Purchased Credit Impaired Loans
The Company acquired loans and designated them as PCI loans, which are accounted for under FASB ASC 310-30, in the Washington Banking Merger on May 1, 2014 and in previously completed acquisitions, including the FDIC-assisted acquisitions of Cowlitz Bank ("Cowlitz") and Pierce Commercial Bank ("Pierce") on July 30, 2010 and November 8, 2010, respectively, and the acquisitions of Northwest Commercial Bank ("NCB") on January 9, 2013 and Valley Community Bancshares, Inc. ("Valley") on July 15, 2013.

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The following table reflects the outstanding principal balance and recorded investment of the PCI loans at June 30, 2017 and December 31, 2016:

	June 30, 2017		December 31, 2016	
	Outstanding Principal	Recorded Investment	Outstanding Principal	Recorded Investment
	(In thousands)			
Commercial business:				
Commercial and industrial	$11,263	$ 7,425	$13,067	$ 9,317
Owner-occupied commercial real estate	14,201	13,035	17,639	15,973
Non-owner occupied commercial real estate	18,173	16,800	25,037	23,360
Total commercial business	43,637	37,260	55,743	48,650
One-to-four family residential	4,553	4,367	5,120	4,905
Real estate construction and land development:				
One-to-four family residential	2,759	1,975	2,958	2,123
Five or more family residential and commercial properties	2,421	2,322	2,614	2,488
Total real estate construction and land development	5,180	4,297	5,572	4,611
Consumer	4,267	5,362	5,296	6,282
Gross PCI loans	$57,637	$ 51,286	$71,731	$ 64,448

On the acquisition dates, the amount by which the undiscounted expected cash flows of the PCI loans exceeded the estimated fair value of the loan is the “accretable yield.” The accretable yield is then measured at each financial reporting date and represents the difference between the remaining undiscounted expected cash flows and the current carrying value of the PCI loans.

The following table summarizes the accretable yield on the PCI loans for the three and six months ended June 30, 2017 and 2016.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(In thousands)			
Balance at the beginning of the period	$13,132	$16,276	$13,860	$17,592
Accretion	(935)	(1,305)	(1,929)	(2,722)
Disposal and other	(653)	(821)	(1,143)	(2,430)
Change in accretable yield	752	1,209	1,508	2,919
Balance at the end of the period	$12,296	$15,359	$12,296	$15,359

(4) Allowance for Loan Losses

The allowance for loan losses is maintained at a level deemed appropriate by management to provide for probable incurred credit losses in the loan portfolio. The following tables detail the activity in the allowance for loan losses disaggregated by segment and class for the three and six months ended June 30, 2017:

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	Balance at Beginning of Period	Charge-offs	Recoveries	Provision for Loan Losses	Balance at End of Period
	(In thousands)				
Three Months Ended June 30, 2017					
Commercial business:					
Commercial and industrial	$10,091	$ (63)	$ 452	$ 171	$10,651
Owner-occupied commercial real estate	4,216	(78)	2	14	4,154
Non-owner occupied commercial real estate	7,601	—	—	108	7,709
Total commercial business	21,908	(141)	454	293	22,514
One-to-four family residential	1,052	—	1	20	1,073
Real estate construction and land development:					
One-to-four family residential	791	—	—	30	821
Five or more family residential and commercial properties	1,546	—	—	120	1,666
Total real estate construction and land development	2,337	—	—	150	2,487
Consumer	5,195	(398)	110	803	5,710
Unallocated	1,102	—	—	(135)	967
Total	$31,594	$ (539)	$ 565	$ 1,131	$32,751
Six Months Ended June 30, 2017					
Commercial business:					
Commercial and industrial	$10,968	$ (358)	$ 675	$ (634)	$10,651
Owner-occupied commercial real estate	3,661	(85)	151	427	4,154
Non-owner occupied commercial real estate	7,753	—	—	(44)	7,709
Total commercial business	22,382	(443)	826	(251)	22,514
One-to-four family residential	1,015	—	1	57	1,073
Real estate construction and land development:					
One-to-four family residential	797	—	10	14	821
Five or more family residential and commercial properties	1,359	—	—	307	1,666
Total real estate construction and land development	2,156	—	10	321	2,487
Consumer	5,024	(941)	217	1,410	5,710
Unallocated	506	—	—	461	967
Total	$31,083	$ (1,384)	$ 1,054	$ 1,998	$32,751

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The following table details the allowance for loan losses disaggregated on the basis of the Company's impairment method as of June 30, 2017.

	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	PCI Loans	Total Allowance for Loan Losses
	(In thousands)			
Commercial business:				
Commercial and industrial	$1,338	$ 7,729	$1,584	$ 10,651
Owner-occupied commercial real estate	696	2,286	1,172	4,154
Non-owner occupied commercial real estate	907	5,168	1,634	7,709
Total commercial business	2,941	15,183	4,390	22,514
One-to-four family residential	95	724	254	1,073
Real estate construction and land development:				
One-to-four family residential	59	519	243	821
Five or more family residential and commercial properties	64	1,483	119	1,666
Total real estate construction and land development	123	2,002	362	2,487
Consumer	66	4,549	1,095	5,710
Unallocated	—	967	—	967
Total	$3,225	$ 23,425	$6,101	$ 32,751

The following table details the recorded investment balance of the loan receivables disaggregated on the basis of the Company’s impairment method as of June 30, 2017:

	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	PCI Loans	Total Gross Loans Receivable
	(In thousands)			
Commercial business:				
Commercial and industrial	$10,842	$641,354	$7,425	$659,621
Owner-occupied commercial real estate	4,820	568,381	13,035	586,236
Non-owner occupied commercial real estate	11,291	876,104	16,800	904,195
Total commercial business	26,953	2,085,839	37,260	2,150,052
One-to-four family residential	310	76,264	4,367	80,941
Real estate construction and land development:				
One-to-four family residential	2,753	44,751	1,975	49,479
Five or more family residential and commercial properties	1,062	132,575	2,322	135,959
Total real estate construction and land development	3,815	177,326	4,297	185,438
Consumer	259	324,594	5,362	330,215
Total	$31,337	$2,664,023	$51,286	$2,746,646

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The following tables detail activity in the allowance for loan losses disaggregated by segment and class for the three and six months ended June 30, 2016.

	Balance at Beginning of Period	Charge-offs	Recoveries	Provision for Loan Losses	Balance at End of Period
	(In thousands)				
Three Months Ended June 30, 2016					
Commercial business:					
Commercial and industrial	$9,830	$ (1,392)	$ 85	$ 1,447	$9,970
Owner-occupied commercial real estate	4,092	(398)	—	(116)	3,578
Non-owner occupied commercial real estate	7,557	(350)	—	(283)	6,924
Total commercial business	21,479	(2,140)	85	1,048	20,472
One-to-four family residential	1,087	—	1	(138)	950
Real estate construction and land development:					
One-to-four family residential	804	—	—	(50)	754
Five or more family residential and commercial properties	1,067	(1)	—	211	1,277
Total real estate construction and land development	1,871	(1)	—	161	2,031
Consumer	4,756	(467)	161	366	4,816
Unallocated	474	—	—	(317)	157
Total	$29,667	$ (2,608)	$ 247	$ 1,120	$28,426
Six Months Ended June 30, 2016					
Commercial business:					
Commercial and industrial	$9,972	$ (2,570)	$ 359	$ 2,209	$9,970
Owner-occupied commercial real estate	4,370	(450)	—	(342)	3,578
Non-owner occupied commercial real estate	7,722	(350)	—	(448)	6,924
Total commercial business	22,064	(3,370)	359	1,419	20,472
One-to-four family residential	1,157	—	2	(209)	950
Real estate construction and land development:					
One-to-four family residential	1,058	(100)	83	(287)	754
Five or more family residential and commercial properties	813	(54)	—	518	1,277
Total real estate construction and land development	1,871	(154)	83	231	2,031
Consumer	4,309	(798)	299	1,006	4,816
Unallocated	345	—	—	(188)	157
Total	$29,746	$ (4,322)	$ 743	$ 2,259	$28,426

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The following table details the allowance for loan losses disaggregated on the basis of the Company's impairment method as of December 31, 2016.

	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	PCI Loans	Total Allowance for Loan Losses
	(In thousands)			
Commercial business:				
Commercial and industrial	$1,199	$ 8,048	$1,721	$ 10,968
Owner-occupied commercial real estate	511	1,834	1,316	3,661
Non-owner occupied commercial real estate	797	5,142	1,814	7,753
Total commercial business	2,507	15,024	4,851	22,382
One-to-four family residential	97	643	275	1,015
Real estate construction and land development:				
One-to-four family residential	6	538	253	797
Five or more family residential and commercial properties	60	1,168	131	1,359
Total real estate construction and land development	66	1,706	384	2,156
Consumer	64	3,912	1,048	5,024
Unallocated	—	506	—	506
Total	$2,734	$ 21,791	$6,558	$ 31,083

The following table details the recorded investment balance of the loan receivables disaggregated on the basis of the Company’s impairment method as of December 31, 2016:

	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	PCI Loans	Total Gross Loans Receivable
	(In thousands)			
Commercial business:				
Commercial and industrial	$12,375	$616,081	$9,317	$637,773
Owner-occupied commercial real estate	4,724	537,338	15,973	558,035
Non-owner occupied commercial real estate	11,318	846,202	23,360	880,880
Total commercial business	28,417	1,999,621	48,650	2,076,688
One-to-four family residential	321	72,165	4,905	77,391
Real estate construction and land development:				
One-to-four family residential	3,071	45,220	2,123	50,414
Five or more family residential and commercial properties	1,079	105,197	2,488	108,764
Total real estate construction and land development	4,150	150,417	4,611	159,178
Consumer	310	318,548	6,282	325,140
Total	$33,198	$2,540,751	$64,448	$2,638,397

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(5) Other Real Estate Owned

Changes in other real estate owned during the three and six months ended June 30, 2017 and 2016 were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(In thousands)			
Balance at the beginning of the period	$786	$1,826	$754	$2,019
Additions	—	—	32	652
Proceeds from dispositions	—	(227)	—	(770)
Gain on sales, net	—	32	—	42
Valuation adjustment	—	(71)	—	(383)
Balance at the end of the period	$786	$1,560	$786	$1,560

At June 30, 2017, the carrying amount of other real estate owned that was the result of foreclosure and obtaining physical possession of residential real estate properties was $555,000. At June 30, 2017, the recorded investment of consumer mortgage loans secured by residential real estate properties (included in the one-to-four family residential loan class in Note (3) Loans Receivable) for which formal foreclosure proceedings were in process was $656,000.

(6) Goodwill and Other Intangible Assets

(a) Goodwill

The Company’s goodwill represents the excess of the purchase price over the fair value of net assets acquired in the Washington Banking Merger on May 1, 2014, and the acquisitions of Valley on July 15, 2013, Western Washington Bancorp in 2006 and North Pacific Bank in 1998. The Company’s goodwill is assigned to the Bank and is evaluated for impairment at the Bank level (reporting unit).

There were no additions to goodwill during the three and six months ended June 30, 2017 and 2016.

At June 30, 2017, the Company’s step-one analysis concluded that the reporting unit’s fair value was greater than its carrying value and therefore no goodwill impairment charges were required, or recorded, for the three and six months ended June 30, 2017. Similarly, no goodwill impairment charges were required, or recorded, for the three and six months ended June 30, 2016. Even though there was no goodwill impairment at June 30, 2017, adverse events may impact the recoverability of goodwill and could result in a future impairment charge which could have a material impact on the Company’s operating results.

(b) Other Intangible Assets

The other intangible assets represent the core deposit intangible ("CDI") acquired in business combinations. The useful life of the CDI related to the Washington Banking Merger, the acquisitions of Valley, NCB and Cowlitz were estimated to be ten, ten, five and nine years, respectively.

The following table presents the change in the other intangible assets for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(In thousands)			
Balance at the beginning of the period	$7,050	$8,454	$7,374	$8,789
Less: Amortization	323	363	647	698
Balance at the end of the period	$6,727	$8,091	$6,727	$8,091

(7) Other Borrowings

(a) Federal Home Loan Bank Advances

The Federal Home Loan Bank ("FHLB") of Des Moines functions as a member-owned cooperative providing credit for member financial institutions. Advances are made pursuant to several different programs. Each credit program has its own interest rate and range of maturities. Limitations on the amount of advances are based on a percentage

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of the Bank's assets or on the FHLB's assessment of the institution's creditworthiness. At June 30, 2017, the Bank maintained a credit facility with the FHLB of Des Moines for $623.8 million and had short-term FHLB advances outstanding of $110.9 million. At December 31, 2016 there were FHLB advances outstanding of $79.6 million.
The following table sets forth the details of FHLB advances during the three and six months ended June 30, 2017 and 2016:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars in thousands)			
Average balance during the period	$107,125	$29,272	$104,144	$14,636
Maximum month-end balance during the period	$137,450	$57,300	$137,450	$57,300
Weighted average rate during the period	0.89 %	0.54 %	0.86 %	0.54 %

Advances from the FHLB are collateralized by a blanket pledge on FHLB stock owned by the Bank, deposits at the FHLB, certain one-to-four single family residential loans or other assets, principally investment securities which are obligations of or guaranteed by the United States or other assets. In accordance with the pledge agreement, the Company must maintain unencumbered collateral in an amount equal to varying percentages ranging from 100% to 160% of outstanding advances depending on the type of collateral.

(b) Federal Funds Purchased
The Bank maintains advance lines with Wells Fargo Bank, US Bank, The Independent Bankers Bank and Pacific Coast Bankers' Bank to purchase federal funds of up to $90.0 million as of June 30, 2017. The lines generally mature annually or are reviewed annually. As of June 30, 2017 and December 31, 2016, there were no federal funds purchased.
(c) Credit facilities
The Bank maintains a credit facility with the Federal Reserve Bank of San Francisco for $46.5 million as of June 30, 2017, on which there were no borrowings outstanding as of June 30, 2017 or December 31, 2016. Any advances on the credit facility would have to be first secured by the Bank's investment securities or loans receivable.

(8) Junior Subordinated Debentures
As part of the Washington Banking Merger, the Company assumed trust preferred securities and junior subordinated debentures with a total fair value of $18.9 million at the May 1, 2014 merger date.
Washington Banking Master Trust, a Delaware statutory business trust, was a wholly-owned subsidiary of Washington Banking created for the exclusive purposes of issuing and selling capital securities and utilizing sale proceeds to acquire junior subordinated debt issued by Washington Banking. During 2007, the Trust issued $25.0 million of trust preferred securities with a 30-year maturity, callable after the fifth year by Washington Banking. The trust preferred securities have a quarterly adjustable rate based upon the three-month London Interbank Offered Rate ("LIBOR") plus 1.56%. On the Washington Banking Merger date of May 1, 2014, the Company acquired the Trust, which retained the Washington Banking Master Trust name, and assumed the performance and observance of the covenants under the indenture related to the trust preferred securities.
The adjustable rate of the trust preferred securities at June 30, 2017 was 2.86%. The weighted average rate of the junior subordinated debentures was 5.04% and 4.96% for the three and six months ended June 30, 2017, respectively, and 4.45% and 4.40% for the three and six months ended June 30, 2016, respectively. The weighted average rate includes the accretion of the discount established at the merger date which is amortized over the life of the trust preferred securities.
The junior subordinated debentures are the sole assets of the Trust and payments under the junior subordinated debentures are the sole revenues of the Trust. At June 30, 2017 and December 31, 2016, the balance of the junior subordinated debentures, net of unaccreted discount, was $19.9 million and $19.7 million, respectively. All of the common securities of the Trust are owned by the Company. Heritage has fully and unconditionally guaranteed the

capital securities along with all obligations of the Trust under the trust agreements.

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(9) Repurchase Agreements

The Company utilizes repurchase agreements with one-day maturities as a supplement to funding sources. Repurchase agreements are secured by pledged investment securities available for sale. Under the repurchase agreements, the Company is required to maintain an aggregate market value of securities pledged greater than the balance of the repurchase agreements. The Company is required to pledge additional securities to cover any declines below the balance of the repurchase agreements. For additional information on the total value of investment securities pledged for repurchase agreements see Note (2) Investment Securities.

The following table presents the Company's repurchase agreement obligations by class of collateral pledged:

	June 30, 2017	December 31, 2016
	(In thousands)	
U.S. Treasury and U.S. Government-sponsored agencies	$754	$ 2,944
Mortgage-backed securities and collateralized mortgage obligations[1]:		
Residential	12,399	5,191
Commercial	8,102	13,969
Total repurchase agreements	$21,255	$ 22,104

[1] Issued and guaranteed by U.S. Government-sponsored agencies.

(10) Derivative Financial Instruments

The Company has entered into certain interest rate swap contracts that are not designated as hedging instruments. The purpose of these derivative contracts is primarily to provide commercial business loan customers the ability to convert their loans from variable to fixed interest rates. Upon the origination of a derivative contract with a customer, the Company simultaneously enters into an offsetting derivative contract with a third party in order to offset its exposure on the variable and fixed rate components of the customer agreement. The Company recognizes immediate income based upon the difference in the bid/ask spread of the underlying transactions with its customers and the third party, which is recorded in interest rate swap fees on the Condensed Consolidated Statements of Income. Because the Company acts only as an intermediary for its customer, subsequent changes in the fair value of the underlying derivative contracts offset each other and do not significantly impact the Company’s results of operations.

The notional amounts and estimated fair values of interest rate derivative contracts outstanding at June 30, 2017 and December 31, 2016 are presented in the following table.

	June 30, 2017		December 31, 2016	
	Notional Amounts	Estimated Fair Value	Notional Amounts	Estimated Fair Value
	(In thousands)			
Non-hedging interest rate derivatives				
Interest rate swaps with customer [1]	$120,117	$ 288	$102,709	$ 1,099
Interest rate swap with third party [1]	120,117	(288)	102,709	(1,099)

(1) The estimated fair value of the derivative included in prepaid and other assets on the Condensed Consolidated Statements of Financial Condition was $3.1 million and $2.8 million as of June 30, 2017 and December 31, 2016, respectively. The estimated fair value of the derivative included in accrued expenses and other liabilities on the Condensed Consolidated Statements of Financial Condition was $3.1 million and $2.8 million as of June 30, 2017 and December 31, 2016, respectively.

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(11) Stockholders’ Equity

(a) Earnings Per Common Share

The following table illustrates the reconciliation of weighted average shares used for earnings per common share computations for the three and six months ended June 30, 2017 and 2016:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars in thousands)			
Net income:				
Net income	$11,828	$ 8,895	$21,144	$ 17,986
Less: Dividends and undistributed earnings allocated to participating securities	(83)	(91)	(164)	(177)
Net income allocated to common shareholders	$11,745	$ 8,804	$20,980	$ 17,809
Basic:				
Weighted average common shares outstanding	29,939,280	29,976,644	29,945,641	29,970,947
Less: Restricted stock awards	(183,082)	(307,786)	(215,446)	(300,584)
Total basic weighted average common shares outstanding	29,756,198	29,668,858	29,730,195	29,670,363
Diluted:				
Basic weighted average common shares outstanding	29,756,198	29,668,858	29,730,195	29,670,363
Effect of potentially dilutive common shares [1]	83,411	12,225	64,042	13,230
Total diluted weighted average common shares outstanding	29,839,609	29,681,083	29,794,237	29,683,593

(1) Represents the effect of the assumed exercise of stock options and vesting of restricted stock units.

Potential dilutive shares are excluded from the computation of earnings per share if their effect is anti-dilutive. For the three and six months ended June 30, 2017, there were no anti-dilutive shares outstanding related to options to acquire common stock. For the three months ended June 30, 2016, there were no anti-dilutive shares outstanding related to options to acquire common stock. For the six months ended June 30, 2016, anti-dilutive shares outstanding related to options to acquire common stock totaled 874 as the assumed proceeds from exercise price, tax benefits and future compensation were in excess of the market value.

(b) Dividends

The timing and amount of cash dividends paid on the Company's common stock depends on the Company’s earnings, capital requirements, financial condition and other relevant factors. Dividends on common stock from the Company depend substantially upon receipt of dividends from the Bank, which is the Company’s predominant source of income. The following table summarizes the dividend activity for the six months ended June 30, 2017 and calendar year 2016.

Declared	Cash Dividend per Share	Record Date	Paid Date
January 27, 2016	$0.11	February 10, 2016	February 24, 2016
April 20, 2016	$0.12	May 5, 2016	May 19, 2016
July 20, 2016	$0.12	August 4, 2016	August 18, 2016
October 26, 2016	$0.12	November 8, 2016	November 22, 2016
October 26, 2016	$0.25	November 8, 2016	November 22, 2016 *
January 25, 2017	$0.12	February 9, 2017	February 23, 2017
April 25, 2017	$0.13	May 10, 2017	May 24, 2017

* Denotes a special dividend.

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The FDIC and the Washington State Department of Financial Institutions, Division of Banks have the authority under their supervisory powers to prohibit the payment of dividends by the Bank to the Company. Additionally, current guidance from the Board of Governors of the Federal Reserve System ("Federal Reserve Board") provides, among other things, that dividends per share on the Company’s common stock generally should not exceed earnings per share, measured over the previous four fiscal quarters. Current regulations allow the Company and the Bank to pay dividends on their common stock if the Company’s or the Bank’s regulatory capital would not be reduced below the statutory capital requirements set by the Federal Reserve Board and the FDIC.

(c) Stock Repurchase Program

The Company has had various stock repurchase programs since March 1999. On October 23, 2014, the Company's Board of Directors authorized the repurchase of up to 5% of the Company's outstanding common shares, or approximately 1,513,000 shares, under the eleventh stock repurchase plan. The number, timing and price of shares repurchased will depend on business and market conditions and other factors, including opportunities to deploy the Company's capital.

The following table provides total repurchased shares and average share prices under the plan for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,		Plan Total [1]
	2017	2016	2017	2016	
Eleventh Plan					
Repurchased shares	—	—	—	100,000	579,996
Stock repurchase average share price	$ —	$ —	$ —	$ 17.05	$ 16.76

(1) Represents shares repurchased and average price per share paid during the duration of the plan.

In addition to the stock repurchases disclosed in the table above, the Company repurchased shares to pay withholding taxes on the vesting of restricted stock. During the three and six months ended June 30, 2017, the Company repurchased 11,476 and 27,367 shares of common stock at an average price per share of $25.50 and $24.60 to pay withholding taxes on the vesting of restricted stock that vested during the respective periods. During the three and six months ended June 30, 2016, the Company repurchased 12,684 and 23,939 shares of common stock at an average price per share of $17.54 and $17.57 to pay withholding taxes on the vesting of restricted stock that vested during the respective periods.

(12) Accumulated Other Comprehensive Income

The changes in accumulated other comprehensive income (loss) (“AOCI”) by component, during the three and six months ended June 30, 2017 and 2016 are as follows:

	Three Months Ended June 30, 2017 [1]	Six Months Ended June30, 2017 [1]
	(In thousands)	
Balance of AOCI at the beginning of period	$(1,133)	$(2,606)
Other comprehensive income before reclassification	2,766	4,239
Amounts reclassified from AOCI for gain on sale of investment securities included in net income	(76)	(76)
Net current period other comprehensive income	2,690	4,163
Balance of AOCI at the end of period	$1,557	$1,557

(1) All amounts are due to the changes in fair value of available for sale securities and are net of tax.

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	Three Months Ended June 30, 2016 [(1)]	Six Months Ended June 30, 2016 [(1)]
	(In thousands)	
Balance of AOCI at the beginning of period	$8,270	$2,559
Other comprehensive income before reclassification	4,203	10,278
Amounts reclassified from AOCI for gain on sale of investment securities available for sale included in net income	(130)	(494)
Net current period other comprehensive income	4,073	9,784
Balance of AOCI at the end of period	$12,343	$12,343

(1) All amounts are due to the changes in fair value of available for sale securities and are net of tax.

(13) Stock-Based Compensation

Stock options generally vest ratably over three years and expire five years after they become exercisable or vest ratably over four years and expire ten years from date of grant. Restricted stock awards issued generally have a four-year cliff vesting or four-year ratable vesting schedule. Restricted stock units vest ratably over three years. Performance restricted stock units issued generally have a three-year cliff vesting schedule. Additionally, performance restricted stock unit grants may be subject to performance-based vesting as well as other approved vesting conditions. The Company issues new shares of common stock to satisfy share option exercises, restricted stock awards and restricted stock units.

On July 24, 2014, the Company's shareholders approved the Heritage Financial Corporation 2014 Omnibus Equity Plan (the "Plan") that provides for the issuance of 1,500,000 shares of the Company's common stock in the form of stock options, stock appreciation rights, stock awards (which includes restricted stock units, restricted stock, performance units, performance shares or bonus shares) and cash incentive awards.

Under the Company's stock-based compensation plans, 1,069,529 shares remain available for future issuance as of June 30, 2017.

(a) Stock Option Awards

For the three and six months ended June 30, 2017 and 2016, the Company did not recognize any compensation expense or related tax benefit related to stock options as all of the compensation expense related to the outstanding stock options had been previously recognized. The intrinsic value and cash proceeds from options exercised during the six months ended June 30, 2017 was $98,000 and $109,000, respectively. The intrinsic value and cash proceeds from options exercised during the six months ended June 30, 2016 was $90,000 and $369,000, respectively.

The following table summarizes the stock option activity for the six months ended June 30, 2017 and 2016:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2015	79,408	$ 14.19		
Exercised	(25,574)	14.43		
Forfeited or expired	(4,200)	16.80		
Outstanding at June 30, 2016	49,634	$ 13.84	3.05	$ 185
Outstanding at December 31, 2016	37,495	$ 13.77		
Exercised	(8,372)	13.03		
Forfeited or expired	(1,308)	13.53		
	27,815	$ 14.00	2.63	$ 348

Outstanding, vested and expected to vest and exercisable at
June 30, 2017

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(b) Restricted Stock Awards

For the three and six months ended June 30, 2017, the Company recognized compensation expense related to restricted stock awards of $359,000 and $804,000, respectively, and a related tax benefit of $126,000 and $282,000, respectively. For the three and six months ended June 30, 2016, the Company recognized compensation expense related to restricted stock awards of $427,000 and $872,000, respectively, and a related tax benefit of $150,000 and $305,000, respectively. As of June 30, 2017, the total unrecognized compensation expense related to non-vested restricted stock awards was $2.2 million and the related weighted average period over which the compensation expense is expected to be recognized is approximately 2.03 years. The vesting date fair value of the restricted stock awards that vested during the six months ended June 30, 2017 and 2016 was $2.6 million and $1.7 million, respectively.

The following table summarizes the restricted stock award activity for the six months ended June 30, 2017 and 2016:

	Shares	Weighted-Average Grant Date Fair Value
Nonvested at December 31, 2015	264,521	$ 15.92
Granted	119,383	17.52
Vested	(96,009)	15.83
Forfeited	(4,221)	16.38
Nonvested at June 30, 2016	283,674	$ 16.62
Nonvested at December 31, 2016	261,296	$ 16.80
Granted	—	—
Vested	(105,972)	16.47
Forfeited	(7,704)	16.78
Nonvested at June 30, 2017	147,620	$ 17.04

(c) Restricted Stock Units

For the three and six months ended June 30, 2017, the Company recognized compensation expense related to restricted stock units of $171,000 and $236,000, respectively. As of June 30, 2017, the total unrecognized compensation expense related to non-vested restricted stock units was $2.1 million and the related weighted average period over which the compensation expense is expected to be recognized is approximately 2.52 years.

The following table summarizes the restricted stock unit activity for the six months ended June 30, 2017:

	Shares	Weighted-Average Grant Date Fair Value
Nonvested at December 31, 2016	—	$ —
Granted	92,019	25.29
Vested	—	—
Forfeited	(909)	25.35
Nonvested at June 30, 2017	91,110	$ 25.29

The following table summarizes the assumptions used in the Monte Carlo model for restricted stock unit grants with market-based conditions:

Grant Period Ending	Expected Term in Years	Weighted-Average Risk Free Interest Rate	Expected Volatility	Expected Dividend Yield	Weighted-Average Fair Value
June 30, 2017	2.85	1.40 %	21.8 %	—%	$ 24.39

(14) Fair Value Measurements

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1: Valuations for assets and liabilities traded in active exchange markets, or interest in open-end mutual funds that allow the Company to sell its ownership interest back to the fund at net asset value on a daily basis. Valuations are obtained from readily available pricing sources for market transactions involving identical assets, liabilities, or funds.

Level 2: Valuations for assets and liabilities traded in less active dealer or broker markets, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or valuations using methodologies with observable inputs.

Level 3: Valuations for assets and liabilities that are derived from other valuation methodologies, such as option pricing models, discounted cash flow models and similar techniques using unobservable inputs, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

(a) Recurring and Nonrecurring Basis

The Company used the following methods and significant assumptions to measure the fair value of certain assets on a recurring and nonrecurring basis:

Investment Securities Available for Sale:

The fair values of all investment securities are based upon the assumptions that market participants would use in pricing the security. If available, fair values of investment securities are determined by quoted market prices (Level 1). For investment securities where quoted market prices are not available, fair values are calculated based on market prices on similar securities (Level 2). For investment securities where quoted prices or market prices of similar securities are not available, fair values are calculated by using observable and unobservable inputs such as discounted cash flows or other market indicators (Level 3). Security valuations are obtained from third party pricing services for comparable assets or liabilities.

Impaired Loans:

At the time a loan is considered impaired, its impairment is measured based on the present value of expected future cash flows discounted at the loan’s effective interest rate, observable market price, or fair market value of the collateral if the loan is collateral-dependent. Impaired loans for which impairment is measured using the discounted cash flow approach are not considered to be measured at fair value because the loan’s effective interest rate is generally not a fair value input, and for the purposes of fair value disclosures, the fair value of these loans are measured commensurate with non-impaired loans. If the Company utilizes the fair market value of the collateral method, the fair value used to measure impairment is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value based on the borrower’s financial statements, or aging reports, adjusted or discounted based on management’s historical knowledge, changes in market conditions from the time of the valuation and management’s expertise and knowledge of the client and client’s business (Level 3). Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Other Real Estate Owned:

Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals. These appraisals may utilize a

single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in Level 3 classification of the inputs for determining fair value.

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Appraisals for both collateral-dependent impaired loans and other real estate owned are performed by certified general appraisers for commercial properties or certified residential appraisers for residential properties whose qualifications and licenses have been reviewed and verified by the Company. Once received, the Company reviews the assumptions and approaches utilized in the appraisal as well as the resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On a quarterly basis, the Company compares the actual selling price of collateral that has been liquidated to the most recent appraised value to determine what additional adjustment should be made to the appraisal value to arrive at fair value.

Derivative Financial Instruments:

The Company obtains broker or dealer quotes to value its interest rate derivative contracts, which use valuation models using observable market data as of the measurement date (Level 2).

The following tables summarize the balances of assets and liabilities measured at fair value on a recurring basis as of June 30, 2017 and December 31, 2016.

	June 30, 2017			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Assets				
Investment securities available for sale:				
U.S. Treasury and U.S. Government-sponsored agencies	$9,448	$ —		