

NORTHWEST BANCORPORATION INC
Form 10-Q
November 09, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

(Mark One)

- Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2011.**
- Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from to .**

Commission File Number: 000-24151

NORTHWEST BANCORPORATION, INC.

(Exact name of registrant as specified in its charter)

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Washington
(State or other jurisdiction of
incorporation or organization)
421 West Riverside, Spokane, WA 99201-0403
(Address of principal executive offices) (Zip Code)
(509) 456-8888
(Registrant's telephone number, including area code)

91-1574174
(I.R.S. Employer
Identification No.)

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

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

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

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The Registrant has a single class of common stock, of which there were 3,081,748 shares issued and outstanding as of October 31, 2011.

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NORTHWEST BANCORPORATION, INC.

FORM 10-Q

For the three-month and nine-month periods ended September 30, 2011

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited)****NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****Consolidated Statements of Financial Condition**

(\$ in thousands)

	September 30, 2011	December 31, 2010
ASSETS		
Cash and due from banks	\$ 16,349	\$ 10,813
Federal funds sold and other interest bearing deposits	11,971	5,028
Total cash and cash equivalents	28,320	15,841
Securities available for sale, at fair value	69,587	69,730
Federal Home Loan Bank stock, at cost	1,261	1,261
Loans receivable, net of allowance for loan losses \$6,552 and \$6,918	262,504	274,416
Loans held for sale	2,816	2,371
Premises and equipment, net	16,668	17,316
Accrued interest receivable	1,633	1,507
Foreclosed real estate	2,869	3,963
Bank owned life insurance	3,882	3,792
Other assets	3,825	4,378
TOTAL ASSETS	\$ 393,365	\$ 394,575
LIABILITIES		
Deposits	\$ 338,223	\$ 346,237
Securities sold under agreements to repurchase		135
Accrued interest payable	482	464
Borrowed funds	13,651	9,518
Other liabilities	3,842	2,534
Total liabilities	356,198	358,888
SHAREHOLDERS EQUITY		
Preferred stock Series A Cumulative Perpetual; \$1,000 par value; \$1,000 liquidation value; 10,500 shares authorized and issued	10,219	10,131
Preferred stock Series B Cumulative Perpetual; \$0.01 par value; \$1,000 liquidation value; 525 shares authorized and issued	557	566
Common stock, no par value, 5,000,000 shares authorized; 3,081,748 shares issued and outstanding	25,956	25,896
Accumulated deficit	(822)	(175)
Accumulated other comprehensive income (loss), net of tax effect of \$-648 and \$376	1,257	(731)
Total shareholders equity	37,167	35,687
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	\$ 393,365	\$ 394,575

See accompanying notes.

Table of Contents**NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****Consolidated Statements of Operations**

(\$ in thousands, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Interest income:				
Loans, including fees	\$ 4,129	\$ 4,868	\$ 13,012	\$ 14,730
Investment securities	537	356	1,717	1,063
Federal funds sold and interest bearing deposits	6	5	12	18
Total interest income	4,672	5,229	14,741	15,811
Interest expense:				
Deposits	924	1,345	3,021	4,377
Borrowed funds	99	108	247	474
Total interest expense	1,023	1,453	3,268	4,851
Net interest income	3,649	3,776	11,473	10,960
Provision for loan losses	2,531	600	4,893	2,050
Net interest income after provision for loan losses	1,118	3,176	6,580	8,910
Noninterest income:				
Service charges on deposits	392	399	1,115	1,032
Gain from sale of loans, net	238	237	548	553
Gain on investment securities, net	232	64	265	382
Other noninterest income	320	263	968	956
Total noninterest income	1,182	963	2,896	2,923
Noninterest expense:				
Salaries and employee benefits	1,510	1,619	4,841	4,719
Occupancy and equipment	330	305	978	918
Depreciation and amortization	298	289	901	859
Advertising and promotion	97	65	271	227
(Gain) loss on foreclosed real estate, net	(54)	86	29	289
FDIC assessments	129	203	451	619
Other noninterest expenses	863	806	2,558	2,249
Total noninterest expense	3,173	3,373	10,029	9,880
Income (loss) before income taxes	(873)	766	(553)	1,953
Income tax expense (benefit)	(383)	238	(414)	570
Net income (loss)	\$ (490)	\$ 528	\$ (139)	\$ 1,383
Preferred stock dividends and discount accretion, net	169	170	508	508
Net income (loss) applicable to common shares	\$ (659)	\$ 358	\$ (647)	\$ 875
Earnings (loss) per common share basic	\$ (0.21)	\$ 0.12	\$ (0.21)	\$ 0.34

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Earnings (loss) per common share diluted	\$ (0.21)	\$ 0.12	\$ (0.21)	\$ 0.34
Weighted average shares outstanding basic	3,081,748	2,967,984	3,079,594	2,579,769
Weighted average shares outstanding diluted	3,081,748	2,970,334	3,079,594	2,581,447

See accompanying notes.

Table of Contents**NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****Consolidated Statements of Comprehensive Income (Loss)***(\$ in thousands)*

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Net income (loss)	(\$ 490)	\$ 528	(\$ 139)	\$ 1,383
Other comprehensive income (loss), net of tax:				
Unrealized gains (losses) on securities	475	192	1,813	(52)
Less: reclassification adjustment for gains included in net income	153	42	175	252
Other comprehensive income	628	234	1,988	200
Comprehensive income	\$ 138	\$ 762	\$ 1,849	\$ 1,583

See accompanying notes.

Table of Contents**NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****Consolidated Statements of Changes in Shareholders' Equity***(\$ in thousands)*

	Preferred Stock	Common Stock	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2009	\$ 10,592	\$ 23,269	(\$ 443)	\$ 388	\$ 33,806
Net income	0	0	945	0	945
Stock issued to directors	0	22	0	0	22
Issuance of common stock, net of issuance costs of \$162	0	2,585	0	0	2,585
Dividends on preferred stock	0	0	(572)	0	(572)
Accretion of preferred stock discount, net	105	0	(105)	0	0
Equity-based compensation expense	0	34	0	0	34
Tax effect of vested stock awards	0	(14)	0	0	(14)
Change in unrealized gain on securities available for sale, net of taxes	0	0	0	(1,119)	(1,119)
Comprehensive loss					
Balance, December 31, 2010	10,697	25,896	(175)	(731)	35,687
Net loss	0	0	(139)	0	(139)
Stock issued to directors	0	21	0	0	21
Dividends on preferred stock	0	0	(429)	0	(429)
Accretion of preferred stock discount, net	79	0	(79)	0	0
Equity-based compensation expense	0	39	0	0	39
Change in unrealized loss on securities available for sale, net of taxes	0	0	0	1,988	1,988
Comprehensive income					
Balance, September 30, 2011	\$ 10,776	\$ 25,956	(\$ 822)	\$ 1,257	\$ 37,167

See accompanying notes.

Table of Contents**NORTHWEST BANCORPORATION, INC. AND SUBSIDIARY****Consolidated Statements of Cash Flows**

(\$ in thousands)

	Nine months ended September 30,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	(\$ 139)	\$ 1,383
Adjustments to reconcile net income to cash provided by operating activities:		
Amortization of securities discounts and premiums, net	337	(25)
Gain on sale of securities, net	(265)	(382)
Accretion of net deferred loan fees	(179)	(165)
Provision for loan losses	4,893	2,050
Origination of loans held for sale	(27,238)	(31,368)
Proceeds from sales of loans held for sale	27,341	28,888
Gain on sale of loans held for sale, net	(548)	(553)
Depreciation and amortization	901	859
Loss on disposal of premises and equipment	5	
Provision for losses on foreclosed real estate	429	439
Gain on sale of foreclosed real estate, net	(400)	(150)
Increase in cash surrender value of bank owned life insurance	(90)	(92)
Decrease in deferred income taxes, net	288	(94)
Equity-based compensation expense	39	26
Issuance of common stock under directors' compensation arrangements	21	22
Change in assets and liabilities:		
Accrued interest receivable	(126)	(119)
Other assets	(759)	1,670
Accrued interest payable	18	(193)
Other liabilities	879	116
Net cash provided by operating activities	5,407	2,312
CASH FLOWS FROM INVESTING ACTIVITIES		
Securities available for sale:		
Purchases	(23,534)	(45,120)
Proceeds from maturities, calls and principal repayments	20,150	22,409
Proceeds from sales	6,467	6,529
Proceeds from sale of equity investment		189
Net decrease in loans	6,439	20,769
Purchase of premises and equipment	(258)	(460)
Proceeds from sale of foreclosed real estate, net of capital improvements	1,824	1,986
Net cash provided by investing activities	11,088	6,302
CASH FLOWS FROM FINANCING ACTIVITIES		
Net decrease in deposits	(8,014)	(1,900)
Decrease in securities sold under agreement to repurchase	(135)	(97)
Proceeds from borrowed funds	7,000	
Repayment of borrowed funds	(2,867)	(6,058)
Proceeds from issuance of common stock		2,585
Dividends paid on preferred stock		(72)
Net cash used by financing activities	(4,016)	(5,542)

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NET CHANGE IN CASH AND CASH EQUIVALENTS	12,479	3,072
Cash and cash equivalents, beginning of period	15,841	18,119
Cash and cash equivalents, end of period	\$ 28,320	\$ 21,191

SUPPLEMENTAL DISCLOSURES:

Cash paid during the year for:		
Interest	\$ 3,250	\$ 5,044
Income taxes	329	574
Noncash investing and financing activities:		
Increase in fair value of securities available for sale, net	1,988	200
Acquisition of real estate in settlement of loans	993	2,539
Foreclosed real estate financed in-house	234	99
Preferred stock dividend accrued but not paid	429	358

See accompanying notes.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Summary of Significant Accounting Policies

Basis of presentation and consolidation: The consolidated financial statements include the accounts of Northwest Bancorporation, Inc. (the Company) and its wholly-owned subsidiary, Inland Northwest Bank (the Bank). All material intercompany balances and transactions have been eliminated.

The foregoing unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the Securities and Exchange Commission (the SEC). Accordingly, these financial statements do not include all of the disclosures required by accounting principles generally accepted in the United States of America (GAAP) for complete financial statements. These unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the accompanying notes as disclosed in the annual report on Form 10-K for the year ended December 31, 2010.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities known to exist as of the date the financial statements are published, and the reported amounts of revenues and expenses during the reporting period. Uncertainties with respect to such estimates and assumptions are inherent in the preparation of the Company s consolidated financial statements; accordingly, it is possible that the actual results could differ from these estimates and assumptions, which could have a material effect on the reported amounts of the Company s consolidated financial position and results of operations.

In preparing these financial statements, the Company has evaluated events and transactions subsequent to September 30, 2011 for potential recognition or disclosure. In management s opinion, all accounting adjustments necessary to accurately reflect the financial position and results of operations on the accompanying financial statements have been made. The adjustments include normal and recurring accruals considered necessary for a fair and accurate presentation. The results for interim periods are not necessarily indicative of results for the full year or any other interim period. Certain reclassifications of prior period amounts have been made to conform to current classifications. These reclassifications had no effect on retained earnings or net income as previously presented.

Segment reporting: The Company has not established any independent business activity apart from acting as the parent company of the Bank. The Company and the Bank are managed as a single entity and not by departments or lines of business. Based on management s analysis, no department or line of business meets the criteria established in Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) 280, Segment Reporting, for reporting of selected information about operating segments.

New accounting pronouncements: In addition to other established accounting policies, the following is a discussion of recent accounting pronouncements:

ASU No. 2011-02 Receivables (Topic 310) A Creditor s Determination of Whether a Restructuring Is a Troubled Debt Restructuring. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude that the restructuring constitutes a concession, and the debtor is experiencing financial difficulties. The amendments to Topic 310 clarify the guidance on a creditor s evaluation of whether it has granted a concession as follows: 1) if a debtor does not otherwise have access to funds at a market rate for debt with similar risk characteristics as the restructured debt, the restructuring would be considered to be at a below-market rate, which may indicate that the creditor has granted a concession; 2) a temporary or permanent increase in the contractual interest rate as a result of a restructuring does not preclude the restructuring from being considered a concession because the new contractual interest rate on the restructured debt could still be below the market interest rate for new debt with similar risk characteristics. In both of these situations, a creditor should consider all aspects of the restructuring in determining whether it has granted a concession. If a creditor determines that it has granted a concession, the creditor must make a separate assessment about whether the debtor is experiencing financial difficulties to determine whether the restructuring constitutes a troubled debt restructuring. Additionally, ASU 2011-02 clarifies that a restructuring that results in a delay in payment that is insignificant is not a concession. However, an entity should consider various factors in assessing whether a restructuring resulting in a delay in payment is insignificant.

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The amendments to Topic 310 also clarify the guidance on a creditor's evaluation of whether a debtor is experiencing financial difficulties. A creditor may conclude that a debtor is experiencing financial difficulties, even though the debtor is not currently in payment default. A creditor should evaluate whether it is probable that the debtor would be in payment default on any of its debt in the foreseeable future without the modification. In addition, the amendments to Topic 310 clarify that a creditor is precluded from using the effective interest rate test in the debtor's guidance on restructuring of payables when evaluating whether a restructuring constitutes a troubled debt restructuring.

ASU No. 2011-02 is effective beginning in the third quarter of 2011 and will be applied retrospectively to the entire year. As a result of applying these amendments, an entity may identify receivables that are newly considered impaired. For purposes of measuring impairment of those receivables, an entity is expected to apply the amendments prospectively. An entity is also expected to disclose the total amount of receivables and the allowance for credit losses as of the end of the period of adoption related to those receivables that are newly considered impaired because of the provisions of this amendment. This amendment had no impact on the Company's consolidated financial statements.

ASU No. 2011-03, Transfers and Servicing (Topic 860) – Reconsideration of Effective Control for Repurchase Agreements. In a typical repurchase transaction, an entity transfers financial assets to a counterparty in exchange for cash with an agreement for the counterparty to return the same or equivalent financial assets for a fixed price in the future. This ASU prescribes when an entity may or may not recognize a sale upon the transfer of financial assets subject to repurchase agreements. That determination is based, in part, on whether the entity has maintained effective control over the transferred financial assets. One of the relevant considerations for assessing effective control is the transferor's ability to repurchase or redeem financial assets before maturity. Under this criterion, an entity must consider whether there is an exchange of collateral in sufficient amount so as to reasonably assure the arrangement's completion on substantially the agreed terms, even in the event of the transferee's default. That is, in order for the transferor to assert that it maintained effective control over the transferred assets, the transferor must have the ability to repurchase the same or substantially the same assets. The FASB determined that the criterion pertaining to an exchange of collateral should not be a determining factor in assessing effective control; the assessment of effective control should focus on a transferor's contractual rights and obligations with respect to transferred financial assets, not on whether the transferor has the practical ability to perform in accordance with those rights or obligations. The FASB also concluded that the remaining criteria are sufficient to determine effective control. Consequently, the amendments remove the transferor's ability criterion from the consideration of effective control for repurchase agreements and other agreements that both entitle and obligate the transferor to repurchase or redeem financial assets before their maturity. The provisions of this ASU are effective beginning in the first quarter of 2012 and will be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. This ASU is not expected to have a significant impact on the Company's consolidated financial statements.

ASU No. 2011-04, Fair Value Measurement (Topic 820) – Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The amendments in this ASU result in common fair value measurement and disclosure requirements between GAAP and International Financial Reporting Standards (IFRS). Consequently, the amendments change the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements. For many of the requirements, the FASB does not intend for the amendments in this ASU to result in a change in the application of the requirements in Topic 820. Some of the amendments clarify the FASB's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendments in this ASU explain how to measure fair value. They do not require additional fair value measurements and are not intended to establish valuation standards or affect valuation practices outside of financial reporting. The provisions of this ASU are effective beginning in the first quarter of 2012 and will be applied prospectively. This ASU is not expected to have a significant impact on the Company's consolidated financial statements.

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ASU No. 2011-05, *Comprehensive Income (Topic 220) Presentation of Comprehensive Income*. Current GAAP provides three alternatives for presenting other comprehensive income and its components in financial statements. One of those presentation options is to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. This ASU eliminates that option and also requires consecutive presentation of the statement of net income and other comprehensive income. Finally, this ASU also requires an entity to present reclassification adjustments on the face of the financial statements from other comprehensive income to net income, rather than presenting other comprehensive income in a footnote. The provisions of this ASU are effective beginning in the first quarter of 2012 and will be applied retrospectively. The Company's presentation of consolidated comprehensive income changed in order to comply with the provisions of this ASU.

NOTE 2. Investment Securities

Securities held by the Bank have been classified in the consolidated statements of financial condition according to management's intent, and all securities were classified as available for sale at September 30, 2011 and December 31, 2010.

The amortized cost of securities and their approximate fair values at September 30, 2011 and December 31, 2010 were as follows:

	Amortized Cost	September 30, 2011		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
		(\$ in thousands)		
State and municipal securities	\$ 24,132	\$ 1,526	\$ (5)	\$ 25,653
Corporate debt obligations	14,378	192	(176)	14,394
U.S. government agency securities	10,461	120		10,581
Collateralized mortgage obligations	8,459	74	(42)	8,491
SBA participation certificates	7,904	91	(5)	7,990
Mortgage backed securities	2,348	130		2,478
	\$ 67,682	\$ 2,133	\$ (228)	\$ 69,587

	Amortized Cost	December 31, 2010		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
		(\$ in thousands)		
State and municipal securities	\$ 23,332	\$ 343	\$ (676)	\$ 22,999
Corporate debt obligations	11,060	40	(302)	10,798
U.S. government agency securities	30,787	16	(679)	30,124
Collateralized mortgage obligations	269		(3)	266
SBA participation certificates	3,243	135		3,378
Mortgage backed securities	2,146	47	(28)	2,165
	\$ 70,837	\$ 581	\$ (1,688)	\$ 69,730

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The following tables show the investments' gross unrealized losses and fair values, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

	Less Than 12 Months		September 30, 2011 12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	<i>(\$ in thousands)</i>					
State and municipal securities	\$ 1,284	\$ 3	\$ 259	\$ 2	\$ 1,543	\$ 5
Corporate debt obligations	3,137	88	1,697	88	4,834	176
Collateralized mortgage obligations	5,292	42			5,292	42
SBA participation certificates	2,458	5			2,458	5
	\$ 12,171	\$ 138	\$ 1,956	\$ 90	\$ 14,127	\$ 228

	Less Than 12 Months		December 31, 2010 12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	<i>(\$ in thousands)</i>					
State and municipal securities	\$ 13,313	\$ 625	\$ 878	\$ 51	\$ 14,191	\$ 676
Corporate debt obligations	9,223	302			9,223	302
U.S. government agency securities	22,098	679			22,098	679
Collateralized mortgage obligations	266	3			266	3
Mortgage backed securities	1,728	28			1,728	28
	\$ 46,628	\$ 1,637	\$ 878	\$ 51	\$ 47,506	\$ 1,688

Management has evaluated the above securities and does not believe that any individual unrealized loss as of September 30, 2011, represents an other-than-temporary impairment (OTTI). The decline in fair market value of these securities was generally due to changes in market interest rates or the widening of market spreads since purchase and was not related to any known decline in the creditworthiness of the issuer.

Management does not intend to sell any impaired securities nor does available evidence suggest it is more likely than not that management will be required to sell any impaired securities. Management believes there is a high probability of collecting all contractual amounts due, because the majority of the securities in the Bank's investment portfolio are backed by government agencies or government-sponsored enterprises. However, a recovery in value may not occur for some time, if at all, and may be delayed for greater than the one-year time horizon or perhaps even until maturity. At September 30, 2011, 27 of the Bank's securities had unrealized losses. At December 31, 2010, 112 of the Bank's securities had unrealized losses.

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Scheduled maturities of securities available for sale at September 30, 2011, are listed below according to contractual maturity date. Expected or actual maturities may differ from contractual maturities, because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(\$ in thousands)	
Due within one year	\$ 325	\$ 327
Due after one year through five years	8,426	8,562
Due after five years through ten years	3,570	3,691
Due after ten years	36,650	38,048
Mortgage backed, collateralized mortgage obligation, and SBA participation certificates	18,711	18,959
	\$ 67,682	\$ 69,587

At September 30, 2011 and December 31, 2010, securities with an amortized cost of \$6.3 million and \$11.2 million, respectively, were pledged to secure public deposits, repurchase agreements, and for other purposes as required or permitted by law. The market value for these securities was \$6.4 million and \$11.0 million at September 30, 2011 and December 31, 2010, respectively.

Seven securities were sold in the nine-month period ended September 30, 2011, resulting in gross gains of \$267 thousand. Eleven securities were sold in the nine-month period ended September 30, 2010, resulting in gross gains of \$443 thousand and gross losses of \$61 thousand.

When a security is called by the issuer prior to maturity, any remaining premium or discount is reported in noninterest income as a gain or loss. During the nine-month period ended September 30, 2011, one security was called and the unamortized premium of \$2 thousand was included in the total gain on sale of securities. During the nine-month period ended September 30, 2010, all securities with early calls had no remaining unamortized premiums or discounts and therefore, the early calls had no impact on income.

Management reviews investment securities on an ongoing basis for the presence of OTTI, taking into consideration current market conditions, fair value in relationship to cost, extent and nature of the change in fair value, issuer rating changes and trends, whether we intend to sell a security or if it is likely that we will be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity, and other factors. The evaluation includes a consideration of the risk profile specific to each class of security; for example, the contractual terms of U.S. government agency securities do not permit the issuer to settle the securities at a price less than par. The Bank's securities portfolio does not include any private label mortgage backed securities or investments in trust preferred securities.

For debt securities, if we intend to sell the security or it is likely that we will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If we do not intend to sell the security and it is not likely that we will be required to sell the security but we do not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income (OCI). Impairment losses related to all other factors are presented as separate categories within OCI. If there is an indication of additional credit losses, the security is re-evaluated accordingly to the procedures described above.

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At September 30, 2011, the Bank owned \$1.3 million of stock of the Federal Home Loan Bank of Seattle (FHLB). As a condition of membership in the FHLB, the Bank is required to purchase and hold a certain amount of FHLB stock, which is based, in part, upon the outstanding principal balance of advances from the FHLB and is calculated in accordance with the Capital Plan of the FHLB. FHLB stock has a par value of \$100 per share, is carried at cost, and is subject to impairment testing per Accounting Standards Codification (ASC) 320-10-35. The FHLB has a risk-based capital deficiency under the regulations of the Federal Housing Finance Agency (FHFA), its primary regulator, and therefore has suspended future dividends and the repurchase and redemption of outstanding capital stock. The FHLB has communicated that it believes the calculation of risk-based capital under the current rules of the FHFA significantly overstates the market risk of the FHLB's private-label mortgage-backed securities in the current market environment and that it has enough capital to cover the risks reflected in the FHLB's balance sheet. As a result, an OTTI has not been recorded for the Bank's investment in FHLB stock. However, continued deterioration in the FHLB's financial position may result in impairment in the value of those securities. Management will continue to monitor the financial condition of the FHLB as it relates to, among other things, the recoverability of the Bank's investment.

NOTE 3. Loans Receivable and Allowance for Loan Losses

The Bank originates residential mortgage loans intended for sale in the secondary market. Loans held for sale are stated at the lower of cost or estimated fair value determined on an aggregate basis. Any net unrealized losses on loans held for sale are recognized through a valuation allowance by charges to income. The Bank also originates construction and land, commercial and multifamily real estate, commercial business, agricultural and consumer loans for portfolio investment. Loans receivable that have not been designated as held for sale are recorded at the principal amount outstanding. Deferred loan fees, net of costs, are amortized to maturity using the level-yield method.

Interest is accrued as earned unless management determines that the collectability of the loan or the unpaid interest is doubtful. Interest accruals are generally discontinued when loans become 90 days past due on scheduled interest payments. All previously accrued but uncollected interest is deducted from interest income upon transfer to nonaccrual status. Future collection of interest is included in interest income based upon an assessment of the likelihood that the loans will be repaid or recovered.

The following table presents the Bank's loan balances for the periods indicated:

	September 30, 2011	December 31, 2010
	<i>(\$ in thousands)</i>	
Real estate:		
Commercial	\$ 148,737	\$ 150,373
Construction and land development	28,643	40,145
Residential	31,865	35,061
Commercial and industrial	53,146	47,345
Consumer	7,097	9,026
	269,488	281,950
Allowance for loan losses	(6,552)	(6,918)
Net deferred loan fees	(432)	(616)
	\$ 262,504	\$ 274,416

Loan origination/risk management: The Bank has 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, nonperforming loans and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions. In general, loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and prudently and to repay their obligations as agreed. Cash flows of borrowers, however, may not be as expected, and the collateral securing these loans may fluctuate in value. Most loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and typically incorporate 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. In the case of loans secured by real estate, the properties are diverse in terms of type, but are concentrated to a large extent in the Bank's primary market area, which is Spokane County, Washington and Kootenai County,

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Idaho. This concentration may increase the Bank's exposure to adverse economic events that affect a single market or industry. Construction loans are generally based upon estimates of costs and value associated with the complete project with repayment substantially dependent on the success of the ultimate project such as sales of developed property or an interim loan commitment from the Bank 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 sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

The Bank originates consumer loans utilizing an individualized underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified as needed. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk.

The Bank's internal audit department performs an independent review to validate the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by the Bank's loan officers and credit personnel, as well as the Bank's policies and procedures.

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Past due and nonaccrual loans: The following table presents an age analysis of past due loans, segregated by class of loans:

	September 30, 2011			Total Past Due Loans	Current Loans	Total Loans
	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 or More Days Past Due			
<i>(\$ in thousands)</i>						
Real estate:						
Commercial	\$ 1,106	\$	\$ 5,624	\$ 6,730	\$ 142,007	\$ 148,737
Construction and land development	4,203		275	4,478	24,165	28,643
Residential	794	20		814	31,051	31,865
Commercial and industrial	1,176			1,176	51,970	53,146
Consumer	156	21	28	205	6,892	7,097
	\$ 7,435	\$ 41	\$ 5,927	\$ 13,403	\$ 256,085	\$ 269,488

	December 31, 2010			Total Past Due Loans	Current Loans	Total Loans
	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 or More Days Past Due			
<i>(\$ in thousands)</i>						
Real estate:						
Commercial	\$ 1,202	\$ 132	\$ 3,394	\$ 4,728	\$ 145,645	\$ 150,373
Construction and land development	272	262	1,691	2,225	37,920	40,145
Residential	662	31	269	962	34,099	35,061
Commercial and industrial			21	21	47,324	47,345
Consumer	49	96	3	148	8,878	9,026
	\$ 2,185	\$ 521	\$ 5,378	\$ 8,084	\$ 273,866	\$ 281,950

No loans over 90 days past due were still on accrual status as of September 30, 2011 and December 31, 2010.

Nonaccrual loans, segregated by class of loans, were as follows:

	September 30, 2011	December 31, 2010
<i>(\$ in thousands)</i>		
Real estate:		
Commercial	\$ 6,521	\$ 8,661
Construction and land development	3,481	2,613
Residential	1,004	1,362
Commercial and industrial	659	21
Consumer	74	