NORTHRIM BANCORP INC
Form 10-K
March 13, 2009

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

ANNUAL REPORT UNDER SECTION 13 OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2008

Commission File Number 0-33501

Northrim BanCorp, Inc.
(Exact name of registrant as specified in its charter)

Alaska	**92-0175752**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification Number)*

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

Registrant s Telephone Number, Including Area Code:
(907) 562-0062

Securities Registered Pursuant to Section 12(b) of the Act:
None

Securities Registered Pursuant to Section 12(g) of the Act:
Common Stock, $1.00 Par Value
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (17 C.F.R. 229.405) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. Yes o No þ

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. (Check one):

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The aggregate market value of common stock held by non-affiliates of registrant at June 30, 2008, was $110,642,670.

The number of shares of registrant s common stock outstanding at March 1, 2009, was 6,332,236.

Documents incorporated by reference and parts of Form 10-K into which incorporated: The portions of the Proxy Statement for Northrim BanCorp s Annual Shareholders Meeting to be held on May 14, 2009, referenced in Part III of this Form 10-K are incorporated by reference therein.

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Note Regarding Forward-Looking Statements

This report includes forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements describe Northrim Bancorp, Inc. s (the Company) management s expectations about future events and developments such as future operating results, growth in loans and deposits, continued success of the Company s style of banking, and the strength of the local economy. All statements other than statements of historical fact, including statements regarding industry prospects and future results of operations or financial position, made in this report are forward-looking. We use words such as anticipates, believes, expects, intends and similar expressions in part to help identify forward-looking statements. Forward-looking statements reflect management s current plans and expectations and are inherently uncertain. Our actual results may differ significantly from management s expectations, and those variations may be both material and adverse. Forward-looking statements are subject to various risks and uncertainties that may cause our actual results to differ materially and adversely from our expectations as indicated in the forward-looking statements. These risks and uncertainties include: the general condition of, and changes in, the Alaska economy; factors that impact our net interest margins; and our ability to maintain asset quality. Further, actual results may be affected by competition on price and other factors with other financial institutions; customer acceptance of new products and services; the regulatory environment in which we operate; and general trends in the local, regional and national banking industry and economy. Many of these risks, as well as other risks that may have a material adverse impact on our operations and business, are identified in our filings with the SEC. However, you should be aware that these factors are not an exhaustive list, and you should not assume these are the only factors that may cause our actual results to differ from our expectations. In addition, you should note that we do not intend to update any of the forward-looking statements or the uncertainties that may adversely impact those statements.

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Northrim BanCorp, Inc.
About the Company

Overview

Northrim BanCorp, Inc. (the Company) is a publicly traded bank holding company with five wholly-owned subsidiaries, Northrim Bank (the Bank), a state chartered, full-service commercial bank; Northrim Investment Services Company (NISC), which we formed in November 2002 to hold the Company s equity interest in Elliott Cove Capital Management LLC, (Elliott Cove), an investment advisory services company; Northrim Capital Trust 1 (NCT1), an entity that we formed in May of 2003 to facilitate a trust preferred security offering by the Company; Northrim Statutory Trust 2 (NST2), an entity that we formed in December of 2005 to facilitate a trust preferred security offering by the Company, and Northrim Building LLC (NBL), which owns and operates the Company s main office facility at 3111 C Street in Anchorage. We also hold a 24% interest in the profits and losses of a residential mortgage holding company, Residential Mortgage Holding Company LLC (RML Holding Company) through Northrim Bank s wholly-owned subsidiary, Northrim Capital Investments Co. (NCIC). The predecessor of RML Holding Company, Residential Mortgage LLC (RML), was formed in 1998 and has offices throughout Alaska. We also operate in the Washington and Oregon market areas through Northrim Funding Services (NFS), a division of the Bank that was formed in 2004. In March and December of 2005, NCIC purchased ownership interests totaling 50.1% in Northrim Benefits Group, LLC (NBG), an insurance brokerage company that focuses on the sale and servicing of employee benefit plans. Finally, in the first quarter of 2006, through NISC, we purchased a 24% interest in Pacific Wealth Advisors, LLC (PWA), an investment advisory, trust and wealth management business located in Seattle, Washington.

The Company is regulated by the Board of Governors of the Federal Reserve System, and the Bank is regulated by the Federal Deposit Insurance Corporation (FDIC), and the State of Alaska Department of Community and Economic Development, Division of Banking, Securities and Corporations. We began banking operations in Anchorage in December 1990, and formed the Company in connection with our reorganization into a holding company structure; that reorganization was completed effective December 31, 2001. We make our Securities Exchange Act reports available free of charge on our Internet web site, www.northrim.com. Our reports can also be obtained through the Securities and Exchange Commission s EDGAR database at www.sec.gov.

We opened for business in 1990 shortly after the dramatic consolidation of the Alaska banking industry in the late 1980s that left three large commercial banks with over 93% of commercial bank deposits in greater Anchorage. Through the successful implementation of our Customer First Service philosophy of providing our customers with the highest level of service, we capitalized on the opportunity presented by this consolidation and carved out a market niche among small business and professional customers seeking more responsive and personalized service.

We grew substantially in 1999 when we completed a public stock offering in which we raised $18.5 million and acquired eight branches from Bank of America. The Bank of America branch acquisition was completed in June 1999 and increased our outstanding loans by $114 million, our deposits by $124 million, and provided us fixed assets valued at $2 million, for a purchase price of $5.9 million, in addition to the net book value of the loans and fixed assets. The stock offering allowed us to achieve the Bank of America acquisition while remaining well-capitalized under bank regulatory guidelines.

In October 2007, we acquired 100% of the outstanding shares of Alaska First Bank & Trust, N.A. (Alaska First) for a purchase price of $6.3 million and merged it into Northrim Bank. The Company did not acquire Alaska First s subsidiary, Hagen Insurance, Inc., nor did it retain the two Alaska First branches. The Alaska First acquisition

increased our cash by $18.8 million, investments by $23.8 million, outstanding loans by $13.2 million and other assets by $1.6 million. We assumed $47.7 million of deposits, $5.1 million of borrowings and $900,000 of other liabilities.

We have grown to be the third largest commercial bank in Alaska and the second largest in Anchorage in terms of deposits, with $843.3 million in total deposits and over $1 billion in total assets at December 31, 2008. Through our 11 branches, we are accessible by approximately 67% of the Alaska population.

Anchorage: We have two major financial centers in Anchorage, four smaller branches, and one supermarket branch. We continue to explore for future branching opportunities in this market.

Fairbanks: We opened our financial center in Fairbanks, Alaska s second largest city, in mid-1996. This branch has given us a strong foothold in Interior Alaska, and management believes that there is significant potential to increase our share of that market. In the second quarter of 2008, we opened another branch in Fairbanks that is located within a large newly developed retail area.

Eagle River: We also serve Eagle River, a community outside of Anchorage. In January of 2002, we moved from a supermarket branch into a full-service branch to provide a higher level of service to this growing market.

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Wasilla: Wasilla is a rapidly growing market in the Matanuska Valley outside of Anchorage where we completed construction of a new financial center in December of 2002 and moved from our supermarket branch and loan production office into this new facility.

Elliott Cove Capital Management LLC

As of December 31, 2008, the Company owned a 48% equity interest in Elliott Cove, an investment advisory services company, through its wholly owned subsidiary, NISC. Elliott Cove began active operations in the fourth quarter of 2002 and has had start-up losses since that time as it continues to build its assets under management. In addition to its ownership interest, the Company provides Elliott Cove with a line of credit that has a committed amount of $750,000 and an outstanding balance of $557,000 as of December 31, 2008.

As of December 31, 2008, there are eight Northrim Bank employees who are licensed as Investment Advisor Representatives and actively selling the Elliott Cove investment products. We plan to continue to use the Elliott Cove products to strengthen our existing customer relationships and bring new customers into the Bank.

Northrim Funding Services

In the third quarter of 2004, we formed NFS as a division of the Bank. NFS is based in Bellevue, Washington and provides short-term working capital to customers in the states of Washington and Oregon by purchasing their accounts receivable. In 2009, we expect NFS to continue to penetrate its market and increase its market share in the purchased receivables business and to continue to contribute to the Company s net income.

Business Strategies

In addition to our acquisition strategy, we are pursuing a strategy to increase our market share within our different business areas. Our success will depend on our ability to manage our credit risks and control our costs while providing competitive products and services. To achieve our objectives, we are pursuing the following business strategies:

Providing Customer First Service: We believe that we provide a high level of customer service. Our guiding principle is to serve our market areas by operating with a Customer First Service philosophy, affording our customers the highest priority in all aspects of our operations. To achieve this objective, our management emphasizes the hiring and retention of competent and highly motivated employees at all levels of the organization. Management believes that a well-trained and highly motivated core of employees allows maximum personal contact with customers in order to understand and fulfill customer needs and preferences. This Customer First Service philosophy is combined with our emphasis on personalized, local decision making.

High Performance Checking: In the first part of 2005, we launched our High Performance Checking (HPC) product consisting of several consumer checking accounts tailored to the needs of specific segments of our market, including a totally free checking product. We supported the new products with a targeted marketing program and extensive branch sales promotions. Through the concentrated efforts of our branch employees, we increased the number of our deposit accounts and the balances in them. In the fourth quarter of 2006, we introduced HPC for our business checking accounts. In 2007 and 2008, we continued to market the HPC products through a targeted mailing program and branch promotions, which helped us to increase the number of these accounts. In 2009, we plan to continue to support the HPC consumer and business checking products with a similar marketing and sales program in an effort to continue to expand our core deposits.

Emphasizing Business and Professional Lending: We endeavor to provide commercial lending products and services, and to emphasize relationship banking with businesses and professional individuals. Management believes that our focus on providing financial services to businesses and professional individuals has and may continue to increase lending and core deposit volumes.

Providing Competitive and Responsive Real Estate Lending: We estimate that we are a major land development and residential construction lender and an active lender in the commercial real estate market in our Alaskan markets. Management believes that our willingness to provide these services in a professional and responsive manner has contributed significantly to our growth. Because of our relatively small size, our experienced senior management can be more involved with serving customers and making credit decisions, allowing us to compete more favorably for lending relationships. In 2009, we will make a substantial effort to decrease our loans measured for impairment and other real estate owned (OREO), many of which consist of residential construction and land development loans. As a result of these efforts and continued projected slowness in the residential real estate market, our loan balances in the residential construction sector are projected to decline in 2009.

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Pursuing Strategic Opportunities for Additional Growth: Management believes that the Bank of America branch acquisition in 1999 significantly strengthened our local market position and enabled us to further capitalize on expansion opportunities resulting from the demand for a locally based banking institution providing a high level of service. Not only did the acquisition increase our size, number of branch offices, and lending capacity, but it also expanded our consumer lending, further diversifying our loan portfolio. Although to a lesser degree than the Bank of America branch acquisition, we believe that the Alaska First acquisition also strengthened our position in the Anchorage market. We expect to continue seeking similar opportunities to further our growth while maintaining a high level of credit quality. We plan to affect our growth strategy through a combination of growth at existing branch locations, new branch openings, primarily in Anchorage, Wasilla and Fairbanks, and strategic banking and non-banking acquisitions in the future.

Developing a Sales Culture: In 2003, we conducted extensive sales training throughout the Company and developed a comprehensive approach to sales. In 2007 and 2008, the Company continued with its sales calling and training efforts and plans to continue with this program in 2009. Our goal throughout this process is to increase and broaden the relationships that we have with new and existing customers and to continue to increase our market share within our existing markets.

Improving Credit Quality: In 2007, we formed a Quality Assurance department to provide independent, detailed financial analysis of our largest, most complex loans. In addition, this department, along with the Chief Lending Officer and others in the Loan Administration department, has developed processes to analyze and manage various concentrations of credit within the overall loan portfolio. The Loan Administration department has also enhanced the procedures and processes for the analysis and reporting of problem loans along with the development of strategies to resolve them. In 2009, we plan to continue with these initiatives. In addition, we will devote more resources towards the reduction of our nonperforming assets and substandard loans.

Services

We provide a wide range of banking services in Southcentral and Interior Alaska to businesses, professionals, and individuals with high service expectations.

Deposit Services: Our deposit services include noninterest-bearing checking accounts and interest-bearing time deposits, checking accounts, and savings accounts. Our interest-bearing accounts generally earn interest at rates established by management based on competitive market factors and management s desire to increase or decrease certain types or maturities of deposits. We have two deposit products that are indexed to specific U.S. Treasury rates.

Several of our innovative deposit services and products are:

An indexed money market deposit account;

A Jump-Up certificate of deposit (CD) that allows additional deposits with the opportunity to increase the rate to the current market rate for a similar term CD;

An indexed CD that allows additional deposits, quarterly withdrawals without penalty, and tailored maturity dates; and

Arrangements to courier noncash deposits from our customers to their branch.

Lending Services: We are an active lender with an emphasis on commercial and real estate lending. We also believe we have a significant niche in construction and land development lending in Anchorage, Fairbanks, and the Matanuska Valley (near Anchorage). To a lesser extent, we provide consumer loans. See Lending Activities.

Other Customer Services: In addition to our deposit and lending services, we offer our customers several 24-hour services: Telebanking, faxed account statements, Internet banking for individuals and businesses, and automated teller services. Other special services include personalized checks at account opening, overdraft protection from a savings account, extended banking hours (Monday through Friday, 9 a.m. to 6 p.m. for the lobby, and 8 a.m. to 7 p.m. for the drive-up, and Saturday 10 a.m. to 3 p.m.), commercial drive-up banking with coin service, automatic transfers and payments, wire transfers, direct payroll deposit, electronic tax payments, Automated Clearing House origination and receipt, cash management programs to meet the specialized needs of business customers, and courier agents who pick up noncash deposits from business customers.

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Directors and Executive Officers: The following table presents the names and occupations of our directors and executive officers.

Executive Officers/Age	Occupation
*R. Marc Langland, 67	Chairman, President, & CEO of the Company and the Bank; Director, Alaska Air Group; Director, Usibelli Coal Mine, Inc.
*Christopher N. Knudson, 55	Executive Vice President and Chief Operating Officer of the Company and the Bank
Joseph M. Schierhorn, 51	Executive Vice President, Chief Financial Officer, and Compliance Manager of the Company and the Bank
Joseph M. Beedle, 57	Executive Vice President of the Company and Chief Lending Officer of the Bank
Steven L. Hartung, 62	Executive Vice President of the Company and Quality Assurance Officer of the Bank

*Indicates individual serving as both director and executive officer.

Directors/Age	Occupation
Larry S. Cash, 57	President and CEO, RIM Architects (Alaska, Guam, Hawaii and California)
Mark G. Copeland, 66	Owner and sole member of Strategic Analysis, LLC, a management consulting firm
Ronald A. Davis, 76	Former Vice President, Acordia of Alaska Insurance (full service insurance agency)
Anthony Drabek, 61	President and CEO, Natives of Kodiak, Inc. (Alaska Native Corporation), Chairman and President, Koncor Forest Products Co.; Secretary/Director, Atikon Forest Products Co.
Richard L. Lowell, 68	Former Chairman, Ribelin Lowell & Company (insurance brokerage firm)
Irene Sparks Rowan, 67	Former Chairman and Director, Klukwan, Inc. (Alaska Native Corporation) and its subsidiaries
John C. Swalling, 59	President, Swalling & Associates, P.C. (accounting firm)
David G. Wight, 68	Former President and CEO, Alyeska Pipeline Service Company, and Director, Storm Cat Energy Corporation

Selected Financial Data

	2008	2007	2006	2005	2004
	Unaudited *(In Thousands Except Per Share Amounts)*				
Net interest income	$45,814	$49,830	$47,522	$43,908	$41,271
Provision for loan losses	7,199	5,513	2,564	1,170	1,601
Other operating income	11,399	9,954	7,766	4,933	3,893
Other operating expense	40,439	35,063	31,476	29,577	26,636
Income before income taxes and minority interest	9,575	19,208	21,248	18,094	16,927
Minority interest in subsidiaries	370	290	296		
Pre tax income	9,205	18,918	20,952	18,094	16,927
Income taxes	3,122	7,260	7,978	6,924	6,227
Net income	$6,083	$11,658	$12,974	$11,170	$10,700
Earnings per share:					
Basic	$0.96	$1.82	$2.02	$1.70	$1.60
Diluted	0.95	1.80	1.99	1.64	1.55
Cash dividends per share	0.66	0.57	0.45	0.40	0.36
Assets	$1,006,392	$1,014,714	$925,620	$895,580	$800,726
Loans	711,286	714,801	717,056	705,059	678,269
Deposits	843,252	867,376	794,904	779,866	699,061
Long-term debt	15,986	1,774	2,174	2,574	2,974
Junior subordinated debentures	18,558	18,558	18,558	18,558	8,000
Shareholders equity	104,648	101,391	95,418	84,474	83,358
Book value	$16.53	$16.09	$15.61	$13.86	$13.01
Tangible book value	$15.06	$14.51	$14.48	$12.65	$11.97
Net interest margin (tax equivalent)	5.26%	5.89%	5.89%	5.66%	5.88%
Efficiency ratio[1]	70.07%	58.09%	56.06%	59.80%	58.16%
Return on assets	0.62%	1.24%	1.46%	1.33%	1.41%
Return on equity	5.85%	11.70%	14.45%	13.17%	13.50%
Equity/assets	10.40%	10.00%	10.31%	9.44%	10.41%
Dividend payout ratio	68.93%	30.54%	21.43%	22.92%	21.57%
Nonperforming loans/portfolio loans	3.66%	1.59%	0.92%	0.86%	0.97%
Net charge-offs/average loans	0.86%	0.86%	0.16%	0.18%	0.16%
Allowance for loan losses/portfolio loans	1.81%	1.64%	1.69%	1.52%	1.59%
Nonperforming assets/assets	3.84%	1.56%	0.79%	0.69%	0.82%
Tax rate	34%	38%	38%	38%	37%

Number of banking offices	11	10	10	10	10
Number of employees (FTE)	290	302	277	272	272

(1) In managing our business, we review the efficiency ratio exclusive of intangible asset amortiztion (see definition in table below), which is not defined in accounting principles generally accepted in the United States (GAAP). The efficiency ratio is calculated by dividing noninterest expense, exclusive of intangible asset amortization, by the sum of net interest income and noninterest income. Other companies may define or calculate this data differently. We believe this presentation provides investors with a more accurate picture of our operating efficiency. In this presentation, noninterst expense is adjusted for intangible asset amortization. For additional information see the Noninterest Expense section in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operation of this report.

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Reconciliation of Selected Financial Data to GAAP Financial Measures[2]

Years Ended December 31,	2008	2007	2006	2005	2004
Net interest income[1]	$45,814	$49,830	$47,522	$43,908	$41,271
Noninterest income	11,399	9,954	7,766	4,933	3,893
Noninterest expense	40,439	35,063	31,476	29,577	26,636
Less intangible asset amortization	347	337	482	368	368
Adjusted noninterest expense	$40,092	$34,726	$30,994	$29,209	$26,268
Efficiency ratio	70.07%	58.09%	56.06%	59.80%	58.16%

(1) Amount represents net interest income before provision for loan losses.
(2) These unaudited schedules provide selected financial information concerning the Company that should be read in conjunction with Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations of this report.

Management s Discussion and Analysis of Financial Condition and Results of Operation

Overview

We are a publicly traded bank holding company with five wholly-owned subsidiaries: the Bank, a state chartered, full-service commercial bank; NISC, a company formed to invest in both Elliott Cove, an investment advisory services company, and PWA, an investment advisory, trust and wealth management business located in Seattle, Washington; NCT1 and NST2, entities formed to facilitate two trust preferred securities offerings; and NBL, which owns and operates the Company s main office facility at 3111 C Street in Anchorage. The Bank in turn has a wholly-owned subsidiary, NCIC, which has an interest in RML Holding Company, a residential mortgage holding company and NBG, an insurance brokerage company that provides employee benefit plans to businesses throughout Alaska. We are headquartered in Anchorage and have 11 branch locations, seven in Anchorage, two in Fairbanks, and one each in Eagle River and Wasilla. The Bank also operates Northrim Funding Services, a division headquartered in Bellevue, Washington with operations in the Washington and Oregon markets. We offer a wide array of commercial and consumer loan and deposit products, investment products, and electronic banking services over the Internet.

We opened the Bank for business in Anchorage in 1990. The Bank became the wholly-owned subsidiary of the Company effective December 31, 2001, when we completed our bank holding company reorganization. We opened our first branch in Fairbanks in 1996, and our second location in Anchorage in 1997. During the second quarter of 1999, we purchased eight branches located in Anchorage, Eagle River and Wasilla from Bank of America. This acquisition resulted in us acquiring $114 million in loans, $124 million in deposits and $2 million in fixed assets for a purchase price of $5.9 million. Then, in October of 2007, we acquired 100% of the outstanding stock of another local bank, Alaska First. This acquisition resulted in us acquiring cash equivalents and investments of $42.6 million, outstanding loans of $13.2 million, deposits of $47.7 million and borrowings of $5.1 million.

One of our major objectives is to increase our market share in Anchorage, Fairbanks, and the Matanuska Valley, Alaska s three largest urban areas. We estimate that we hold a 24% share of the commercial bank deposit market in Anchorage, 7% share of the Fairbanks market, and a 10% share of the Matanuska Valley market as of June 30, 2008.

Our growth and operations depend upon the economic conditions of Alaska and the specific markets we serve. The economy of Alaska is dependent upon the natural resources industries, in particular oil production, as well as tourism, government, and U.S. military spending. According to the State of Alaska Department of Revenue, approximately 86% of the Alaska state government is funded through various taxes and royalties on the oil industry. Any significant changes in the Alaska economy and the markets we serve eventually could have a positive or negative impact on the Company.

At December 31, 2008, we had assets of over $1 billion, a decrease of less than 1% from December 31, 2007. Also, we had gross loans of $711.3 million at December 31, 2008, a decrease of less than 1% from $714.8 million at December 31, 2007. Our net income and diluted earnings per share for 2008 were $6.1 million and $0.95, respectively, a decrease of 48% for each item, respectively, from $11.7 million and $1.80 at year end 2007. During the same time period, our net interest income decreased by $4.0 million, or 8%, to $45.8 million, from $49.8 million for the year ended 2007. Our provision for loan losses in 2008 increased by $1.7 million, or 31% to $7.2 million, from $5.5 million in 2007, as our nonperforming loans for 2008 increased by $14.7 million, or 129%, from $11.3 million in 2007 to $26.0 million in 2008. In 2008 our other operating income increased by $1.4 million, or 15%, to $11.4 million from $10 million in 2007.

Critical Accounting Estimates

The preparation of the consolidated financial statements requires us to make a number of estimates and assumptions that affect the reported amounts and disclosures in the consolidated financial statements. On an ongoing basis, we evaluate our estimates and assumptions based upon historical experience and various other factors and circumstances. We believe that our estimates and assumptions are reasonable; however, actual results may differ significantly from these estimates and assumptions which could have a material impact on the carrying value of assets and liabilities at the balance sheet dates and on our results of operations for the reporting periods.

The accounting policies that involve significant estimates and assumptions by management, which have a material impact on the carrying value of certain assets and liabilities, are considered critical accounting policies. We believe that our most critical accounting policies upon which our financial condition depends, and which involve the most complex or subjective decisions or assessments are as follows:

Allowance for loan losses (the   Allowance): The Company maintains an Allowance to reflect inherent losses from its loan portfolio as of the balance sheet date. The Allowance is decreased by loan charge-offs and increased by loan recoveries and

provisions for loan losses. On a quarterly basis, the Company calculates the Allowance based on an established methodology which has been consistently applied.

In determining its total Allowance, the Company first estimates a specific allowance for impaired loans. This analysis is based upon a specific analysis for each impaired loan, including appraisals on loans secured by real property, management s assessment of the current market, recent payment history and an evaluation of other sources of repayment. With regard to our appraisal process, the Company obtains appraisals on real and personal property that secure its loans during the loan origination process in accordance with regulatory guidance and its loan policy. The Company obtains updated appraisals on loans secured by real or personal property based upon its assessment of changes in the current market or particular projects or properties, information from other current appraisals, and other sources of information. The Company uses the information provided in these updated appraisals along with its evaluation of all other information available on a particular property as it assesses the collateral coverage on its performing and nonperforming loans and the impact that may have on the adequacy of its Allowance.

The Company then estimates an allowance for all loans that are not impaired. This allowance is based on loss factors applied to loans that are quality graded according to an internal risk classification system (classified loans). The Company s internal risk classifications are based in large part upon regulatory definitions for classified loans. The loss factors that the Company applies to each group of loans within the various risk classifications are based on industry standards, historical experience and management s judgment.

Portfolio components also receive specific attention in the Allowance analysis when those components constitute a significant concentration as a percentage of the Company s capital, when current market or economic conditions point to increased scrutiny, or when historical or recent experience suggests that additional attention is warranted in the analysis process.

Once the Allowance is determined using the methodology described above, management assesses the adequacy of the overall Allowance through an analysis of the size and mix of the loan portfolio, historical and recent credit performance of the loan portfolio (including the absolute level and trends in delinquencies and impaired loans), industry metrics and ratio analysis.

We recognize the determination of the Allowance is sensitive to the assigned credit risk ratings and inherent loss rates at any given point in time. Therefore, we perform a sensitivity analysis to provide insight regarding the impact of adverse changes in risk ratings may have on our Allowance. The sensitivity analysis does not imply any expectation of future deterioration in our loans risk ratings and it does not necessarily reflect the nature and extent of future changes in the Allowance due to the numerous quantitative and qualitative factors considered in determining our Allowance. At December 31, 2008, in the event that 1 percent of our loans were downgraded from the pass category to the special mention category within our current allowance methodology, the Allowance would have increased by approximately $336,000.

Based on our methodology and its components, management believes the resulting Allowance is adequate and appropriate for the risk identified in the Company s loan portfolio. Given current processes employed by the Company, management believes the risk ratings and inherent loss rates currently assigned are appropriate. It is possible that others, given the same information, may at any point in time reach different reasonable conclusions that could be material to the Company s financial statements. In addition, current risk ratings and fair value estimates of collateral are subject to change as we continue to review loans within our portfolio and as our borrowers are impacted by economic trends within their market areas. Although we have established an Allowance that we consider adequate, there can be no assurance that the established Allowance will be sufficient to offset losses on loans in the future.

Goodwill and other intangibles: Net assets of entities acquired in purchase transactions are recorded at fair value at the date of acquisition. Identified intangibles are amortized over the period benefited either on a straight-line basis or on an accelerated basis depending on the nature of the intangible. Goodwill is not amortized, although it is reviewed for impairment on an annual basis or if events or circumstances indicate a potential impairment. Goodwill impairment testing is performed at the reporting unit level. The Company has only one reporting unit.

Under applicable accounting standards, goodwill impairment analysis is a two-step test. The first step, used to identify potential impairment, involves comparing each reporting unit s fair value to its carrying value including goodwill. If the fair value of a reporting unit exceeds its carrying value, applicable goodwill is considered not to be impaired. If the carrying value exceeds fair value, there is an indication of impairment and the second step is performed to measure the amount of impairment.

The second step involves calculating an implied fair value of goodwill for each reporting unit for which the first step indicated impairment. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination, which is the excess of the fair value of the reporting unit, as determined in the first step, over the aggregate fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill in the pro forma business combination accounting as described above exceeds the goodwill assigned to the reporting unit, there is no impairment. If the goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss recognized cannot exceed the

amount of goodwill, and the loss establishes a new basis in the goodwill. Subsequent reversal of goodwill impairment losses is not permitted under applicable accounting standards.

At December 31, 2008, we utilized two methods of estimating the fair value of the Company: an income method that incorporates discounted cash flows and a market comparison method. As our market capitalization declined and financial sector volatility increased, we weighted these methods based on how we believe they best represent a market participant s view of fair value. The income and market comparison were given weights of 70% and 30%, respectively. As a result, at December 31, 2008, we relied primarily on the income method, using management projections and risk-adjusted discount rates, as we considered it to be most reflective of a market participant s view of fair value given the current market conditions.

The income method used at December 31, 2008 utilized discount rates that we believe adequately reflected the risk and uncertainty in the financial markets generally and specifically in our internally developed earnings projections. This method employs a capital asset pricing model in estimating the discount rate (i.e., cost of equity financing). The inputs to this model include: risk-free rate of return; beta; market equity risk premium; and an unsystematic (company-specific) risk factor. The unsystematic risk factor is the input that specifically addresses uncertainty related to our projections of earnings and growth, including the uncertainty related to loss expectations. In the market comparison approach used at December 31, 2008, management selected a set of comparable companies located in the Western region of the United States with similar asset size and that are publicly-traded on a national exchange. The market value on an adjusted control basis was measured based on the market capitalization of comparable companies and the application of a control premium that represents the potential additional value which would be received from a market participant acquirer assuming the sale of the Company. Investors are willing to pay a premium for control of a company, as evidenced by the historically sizeable premiums typically paid in mergers and acquisitions. Management applied a control premium of 35% to these values based on observation of historically observable control premiums and the current market environment.

For the December 31, 2008, goodwill impairment test, we calculated a total company fair value of $89 million based on the analysis described above. The table below details estimated fair values using each method as well as market capitalization. Estimating the fair value of a reporting unit is a very subjective process that involves the use of estimates and judgments, particularly related to cash flows, the appropriate discount rates and an applicable control premium.

	Equity Value	Weight	Weighted Value
	(In thousands)		
Income approach Management forecasts	$90,150	70%	$63,105
Market approach Western publicly traded guideline companies	86,580	30%	25,974
Concluded fair value of equity (weighted)			$89,079
Market capitalization plus control premium of 35%			$87,864

At December 31, 2008, the Company performed both step 1 and step 2 of the annual impairment test and concluded that no impairment existed at that time. The Company continues to monitor the Company s goodwill for potential impairment on an ongoing basis. Note 10 to the Consolidated Financial Statements has further information on the goodwill impairment analysis as of December 31, 2008. No assurance can be given that we will not charge earnings during 2009 for goodwill impairment, if, for example, our stock price declines further and continues to trade at a significant discount to its book value, although there are many factors that we analyze in determining the impairment of goodwill.

Valuation of other real estate owned: Other real estate owned represents properties acquired through foreclosure or its equivalent. Prior to foreclosure, the carrying value is adjusted to the fair value, less cost to sell, of the real estate to be acquired by an adjustment to the allowance for loan loss. The amount by which the fair value less cost to sell is greater than the carrying amount of the loan plus amounts previously charged off is recognized in earnings up to the original cost of the asset. Any subsequent reduction in the carrying value at acquisition is charged against earnings.

Reductions in the carrying value of other real estate owned subsequent to acquisition are determined based on management s estimate of the fair value of individual properties. Significant inputs into this estimate include estimated costs to complete projects, as well as our assessment of current market conditions. During 2008, $2 million in impairment was recognized on OREO due to adjustments to the Company s estimate of the fair value of certain properties based on changes in estimated costs to complete the projects.

Results of Operations

Net Income

We earned net income of $6.1 million in 2008, compared to net income of $11.7 million in 2007, and $13 million in 2006. During these periods, net income per diluted share was $0.95, $1.80, and $1.99, respectively.

Net Interest Income

Our results of operations are dependent to a large degree on our net interest income. We also generate other income, primarily through service charges and fees, purchased receivables products, employee benefit plan income, electronic banking income, earnings from our mortgage affiliate, and other sources. Our operating expenses consist in large part of compensation, employee benefits expense, occupancy, expenses related to OREO, insurance, marketing, and professional and outside services. Interest income and cost of funds are affected significantly by general economic conditions, particularly changes in market interest rates, and by government policies and the actions of regulatory authorities.

Net interest income is the difference between interest income from loan and investment securities portfolios and interest expense on customer deposits and borrowings. Net interest income in 2008 was $45.8 million, compared to $49.8 million in 2007 and $47.5 million in 2006, reflecting the effect of the 400 basis point drop in interest rates that occurred in 2008.

Changes in net interest income result from changes in volume and spread, which in turn affect our margin. For this purpose, volume refers to the average dollar level of interest-earning assets and interest-bearing liabilities, spread refers to the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, and margin refers to net interest income divided by average interest-earning assets. Changes in net interest income are influenced by the level and relative mix of interest-earning assets and interest-bearing liabilities. During the fiscal years ended December 31, 2008, 2007, and 2006, average interest-earning assets were $876.9 million, $849.3 million, and $810.9 million, respectively. During these same periods, net interest margins were 5.22%, 5.87%, and 5.86%, respectively, which reflect our balance sheet mix and premium pricing on loans compared to other community banks and an emphasis on construction lending, which generally produces a higher yield than other interest earning assets. Our average yield on earning-assets was 6.81% in 2008, 8.60% in 2007, and 8.57% in 2006, while the average cost of interest-bearing liabilities was 2.11% in 2008, 3.67% in 2007 and 3.63% in 2006.

Our net interest margin decreased in 2008 from 2007 mainly due to the fact that the cost of interest-bearing liabilities decreased by 156 basis points while the yield on interest-earning assets decreased by 179 basis points. During this time, the average balance of our interest-bearing deposits increased by $14.7 million to $617.3 million at December 31, 2008 from $602.7 million at December 31, 2007 and the average balance of interest-earning assets increased $27.6 million to $876.9 million at December 31, 2008 from $849.3 million at December 31, 2007.

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The following table sets forth for the periods indicated, information with regard to average balances of assets and liabilities, as well as the total dollar amounts of interest income from interest-earning assets and interest expense on interest-bearing liabilities. Resultant yields or costs, net interest income, and net interest margin are also presented:

Years Ended December 31,	2008			2007			2006		
	Average outstanding balance	Interest earned/ paid[(1)]	Yield/ rate	Average outstanding balance	Interest earned/ paid[(1)]	Yield/ rate	Average outstanding balance	Interest earned/ paid[(1)]	Yield/ rate
					(In Thousands)				
Assets:									
Loans[(2)]	$702,117	$53,287	7.59%	$710,959	$66,463	9.35%	$712,116	$65,347	9.18%
Securities	134,705	5,493	4.08%	98,578	4,619	4.69%	71,164	2,799	3.93%
Short term investments	40,082	936	2.34%	39,726	1,985	5.00%	27,665	1,375	4.97%
Total interest-earning assets	876,904	59,716	6.81%	849,263	73,067	8.60%	810,945	69,521	8.57%
Noninterest-earning assets	108,140			92,065			77,920		
Total assets	$985,044			$941,328			$888,865		
Liabilities and Shareholders Equity:									
Deposits:									
Interest-bearing demand accounts	$97,171	$578	0.59%	$85,192	$1,188	1.39%	$78,872	$830	1.05%
Money market accounts	187,779	3,306	1.76%	186,722	7,378	3.95%	151,871	6,053	3.99%
Savings accounts	187,225	3,444	1.84%	234,780	8,756	3.73%	254,209	10,113	3.98%
Certificates of deposit	145,153	4,851	3.34%	95,961	4,080	4.25%	94,595	3,322	3.51%
Total interest-bearing deposits	617,328	12,179	1.97%	602,655	21,402	3.55%	579,547	20,318	3.51%
Borrowings	41,567	1,723	4.15%	30,337	1,835	6.05%	26,052	1,681	6.45%
Total interest-bearing liabilities	658,895	13,902	2.11%	632,992	23,237	3.67%	605,599	21,999	3.63%
Demand deposits and other noninterest-bearing liabilities	222,247			208,671			193,461		
Total liabilities	881,142			841,663			799,060		

Shareholders equity	103,902		99,665		89,805	
Total liabilities and shareholders equity	$985,044		$941,328		$888,865	
Net interest income		$45,814		$49,830		$47,522
Net interest margin(3)		5.22%		5.87%		5.86%

(1) Interest income included loan fees.
(2) Nonaccrual loans are included with a zero effective yield.
(3) The net interest margin on a tax equivalent basis was 5.26%, 5.89%, and 5.89%, respectively, for 2008, 2007, and 2006.

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The following table sets forth the changes in consolidated net interest income attributable to changes in volume and to changes in interest rates. Changes attributable to the combined effect of volume and interest rate have been allocated proportionately to the changes due to volume and the changes due to interest rate.

	2008 compared to 2007			2007 compared to 2006		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest Income:						
Loans	$(817)	$(12,359)	$(13,176)	$(106)	$1,222	$1,116
Securities	1,352	(478)	874	1,217	603	1,820
Short term investments	18	(1,066)	(1,049)	603	7	610
Total interest income	$553	$(13,904)	$(13,351)	$1,714	$1,832	$3,546
Interest Expense:						
Deposits:						
Interest-bearing demand accounts	$198	$(808)	$(610)	$71	$287	$358
Money market accounts	42	(4,114)	(4,072)	1,378	(53)	1,325
Savings accounts	(1,517)	(3,795)	(5,312)	(747)	(610)	(1,357)
Certificates of deposit	1,325	(553)	771	49	709	758
Total interest on deposits	48	(9,270)	(9,223)	751	333	1,084
Borrowings	689	(577)	(112)	249	(95)	154
Total interest expense	$737	$(9,848)	$(9,335)	$1,000	$238	$1,238

Other Operating Income

Total other operating income increased $1.4 million, or 15%, in 2008, after increasing $2.2 million, or 28%, in 2007, and increasing $2.8 million, or 57%, in 2006. The following table separates the more routine (operating) sources of other income from those that can fluctuate significantly from period to period:

Years Ended December 31,	2008	2007	2006	2005	2004
			(In Thousands)		

Other Operating Income					
Deposit service charges	$3,283	$3,116	$1,975	$1,800	$1,718
Purchased receivable income	2,560	2,521	1,855	993	201
Employee benefit plan income	1,451	1,194	1,113		
Electronic banking fees	1,193	914	790	632	608
Equity in earnings from RML	595	454	649	493	438
Loan service fees	476	516	531	374	379
Merchant credit card transaction fees	451	509	531	444	414
Rental income	463	134	108	100	101
Equity in loss from Elliott Cove	(106)	(93)	(230)	(424)	(457)
Other transaction fees	380	267	227	214	204
Other income	462	312	217	298	136
Operating sources	11,208	9,844	7,766	4,924	3,742
Gain on sale of securities available for sale, net	146			9	151
Gain on sale of other real estate owned, net	45	110			
Other sources	191	110		9	151
Total other operating income	$11,399	$9,954	$7,766	$4,933	$3,893

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Total operating sources of other operating income in 2008 increased $1.4 million, or 15% over 2007 levels. In 2007, this income increased $2.2 million, or 28%, and in 2006, it increased $2.8 million, or 57% as compared to 2005 levels. The main reasons for the increase in operating income in 2008 was the increase in income from rental income, electronic banking fees and employee benefit plan income.

Deposit service charges increased $167,000, or 5%, in 2008 as compared to 2007, and increased $1.1 million, or 58%, in 2007 as compared to 2006. The increase in 2007 was primarily from the April 2007 implementation of non-sufficient funds (NSF) fees on point-of-sale transactions. The new point-of-sale NSF fees represented $1.1 million of the increase in service charges in 2007.

Income from the Company s purchased receivable products increased by $39,000, or 2%, in 2008 as compared to 2007, and increased $666,000, or 36%, in 2007 as compared to 2006. The Company uses these products to purchase accounts receivable from its customers and provide them with working capital for their businesses. While the customers are responsible for collecting these receivables, the Company mitigates this risk with extensive monitoring of the customers transactions and control of the proceeds from the collection process. The Company earns income from the purchased receivable product by charging finance charges to its customers for the purchase of their accounts receivable. The income from this product has grown as the Company has used it to purchase more receivables from its customers. In 2008, the Company stopped offering one of its purchased receivable products in Alaska, which accounts for the slower growth rate for this product during that time.

In December of 2005, the Company, through its wholly-owned subsidiary NCIC, purchased an additional 40.1% interest in NBG, which brought its ownership interest in this company to 50.1%. As a result of this increase in ownership, the Company now consolidates the balance sheet and income statement of NBG into its financial statements. The Company included employee benefit plan income from NBG for the first time in its other operating income in 2006. In 2008, the income from employee benefit plan income from NBG increased by $257,000, or 22%, from 2007, due in part to premium increases by the largest insurance carrier represented by NBG which corresponded to higher commission income for NBG in 2008. In 2007, the Company recorded an $81,000 increase for this item, or 7%, compared to the initial $1.1 million income recorded in 2006. In contrast, the Company did not record any income for this item in its other operating income in 2005 as it purchased a 10% interest in NBG in March of 2005 and accounted for this interest according to the equity method in 2005.

The Company s electronic banking fees increased by $279,000, or 31%, in 2008 as compared to 2007, and increased by $124,000, or 16%, in 2007 as compared to 2006. These increases resulted from additional fees collected from increased point of sale and ATM transactions. The point of sale and ATM fees have increased as a result of the increased number of deposit accounts that the Company has acquired through the marketing of the HPC product and overall continued increased usage of point of sale by the entire customer base.

Included in operating sources of other operating income in 2008, 2007, and 2006 were $595,000, $454,000, and $649,000, respectively, of income from our share of the earnings from RML, which we account for according to the equity method. RML was formed in 1998 and has offices throughout Alaska. During the third quarter of 2004, RML reorganized and became a wholly-owned subsidiary of a newly formed holding company, RML Holding Company. In this process, RML Holding Company acquired another mortgage company, Pacific Alaska Mortgage Company (PAM). In the first quarter of 2005, PAM was merged into RML. Prior to the reorganization, the Company, through Northrim Bank s wholly-owned subsidiary, NCIC, owned a 30% interest in the profits and losses of RML. Following the reorganization, the Company s interest in RML Holding Company decreased to 24%.

Earnings from RML and RML Holding Company have fluctuated with activity in the housing market, which has been affected by local economic conditions and changes in mortgage interest rates. In 2005 and 2006, RML Holding Company began to realize some efficiencies from its merger and increased its income from its combined operations.

However, the decline in mortgage applications due to the slowdown in the Alaskan housing market had a direct effect on RML s operating income in 2007. In 2008, earnings from RML increased due to an increase in mortgage loan originations and a reduction in its costs. The Company expects that its income from RML will increase in 2009 as refinance activity that started in late 2008 continues into 2009.

Loan service fees decreased by $40,000, or 8% in 2008 as compared to 2007 due to decreased service fees as loan volume decreased in 2008. These fees decreased by $15,000, or 3% in 2007 as compared to 2006 primarily due to the collection of past due late fees in 2006 on non performing loans that paid off in 2006.

Merchant credit card transaction fees decreased by $58,000, or 11%, in 2008 as compared to 2007 and decreased by $22,000, or 4%, in 2007 as compared to 2006 due to decreased sales at merchants utilizing the Company s credit card system.

Rental income increased by $329,000, or 246% to $463,000 from $134,000 in 2007 due to the purchase of the Company s main office facility through NBL in July 2008. The Company leases approximately 40% of the building to other companies and earned $399,000 from these leases in 2008. Rental income increased by $26,000, or 24% in 2007 to $134,000 from $108,000 in 2006 due mainly due to increased rental income received for space rented at the Wasilla branch.

Our share of the loss from Elliott Cove in 2008 remained consistent with 2007 at $106,000 as compared to $93,000 in 2007. Losses in 2006 and 2005 were $230,000 and $424,000, respectively, as Elliott Cove continued to increase its assets under management, which provided it with increased revenues.

Other income increased by $150,000, or 48%, to $462,000 at December 31, 2008 from $312,000 at December 31, 2007. In the first quarter of 2006, through our subsidiary, NISC, the Company purchased a 24% interest in PWA. PWA is a holding company that owns Pacific Portfolio Consulting, LLC (PPC) and Pacific Portfolio Trust Company (PPTC). PPC is an investment advisory company with an existing client base while PPTC is a start-up operation. The Company had income of $36,000 in 2008 and incurred a loss of $105,000 on its investment in PWA in 2007, which it accounts for according to the equity method. The increase in income from PWA accounts for a large part of the increase in other income for the Company in 2008.

Included in other sources of income is gain on sale of OREO and gain on available for sale securities. At December 31, 2008, the gain on sale of OREO was $45,000 compared to a gain of $110,000 in 2007 and a loss of less than $1,000 at the end of 2006. Additionally, there was $432,000 of deferred gain on the sale of OREO included in other liabilities at December 31, 2008. This gain will be recognized using the installment method. Finally, there were security gains of $146,000 in 2008, and none were recorded in 2007 or 2006.

Expenses

Provision for Loan Losses: The provision for loan losses in 2008 was $7.2 million, compared to $5.5 million in 2007 and $2.6 million in 2006. We increased the provision for loan losses in 2008 due to an increase in our nonperforming loans and to address the impact of the current economic environment on our loan portfolio. In 2008, nonperforming loans increased to $26.0 million from a balance of $11.3 million at December 31, 2007. In addition, net loan charge-offs were $6 million, or 0.86% of average loans, in 2008 as compared to $6.1 million, or 0.86% of average loans, in 2007 and $1.1 million, or 0.16% of average loans, in 2006. The allowance for loan losses increased in 2008 as a result of the increase in the provision for loan losses. At December 31, 2008, the allowance was $12.9 million, or 1.81% of portfolio loans as compared to $11.7 million, or 1.64% of portfolio loans at December 31, 2007 and $12.1 million, or 1.69% of portfolio loans, at December 31, 2006. The coverage ratio of the allowance for loan losses versus nonperforming loans decreased to 50% in 2008 as compared to a coverage ratio of 104% in 2007 and 183% in 2006. The Company will devote more resources towards the reduction of our nonperforming assets and substandard loans in 2009.

Other Operating Expense: Other operating expense increased $5.4 million, or 15%, in 2008, $3.6 million, or 11%, in 2007, and $1.9 million, or 6%, in 2006. The following table breaks out the other operating expense categories:

Years ended December 31,	2008	2007	2006	2005	2004
			(In Thousands)		
Other Operating Expense					
Salaries and other personnel expense	$20,996	$20,700	$19,277	$17,656	$15,708
Occupancy, net	3,399	2,957	2,611	2,517	2,231
OREO expense, including impairment	2,558	(20)	(5)		
Insurance expense	1,779	465	378	451	318
Marketing	1,558	1,617	1,641	1,657	1,201
Professional and outside services	1,498	1,167	840	923	905

Equipment	1,233	1,350	1,350	1,371	1,372
Intangible asset amortization	347	337	482	368	368
Other expenses	7,071	6,490	4,902	4,634	4,533
Total other operating expense	$40,439	$35,063	$31,476	$29,577	$26,636

Salaries and other personnel expense increased $296,000, or 1%, in 2008, $1.4 million, or 7%, in 2007, and $1.6 million, or 9%, in 2006. Salary and other personnel expenses remained consistent with 2007 in 2008 due in part to the fact that the Company did not pay most management and officer incentives that were paid in 2007 as the Company s net income decreased by 48% in 2008 as compared to 2007. Additionally, deferred compensation expense decreased $668,000 from the prior year as the Company s liability under this plan decreased due to market losses incurred on plan assets. The Company incurs a liability to pay deferred compensation according to the level of assets held in variable annuity life insurance plans on certain key executives. As the value of these assets declined in 2008, the Company s liability and expenses for that plan also decreased during the year. The increase in 2007 from 2006 reflects increases in salary and benefit costs throughout this time due in part to ongoing competition for our employees, which placed upward pressure on our salary structure. In addition, as noted above, the Company now accounts for NBG on a consolidated basis. In 2007, NBG s salary and benefit costs included in the Company s own salary and benefit costs increased by $82,000 to $528,000 from

$446,000 in 2006. In 2008, NBG s salary and benefit costs included in the Company s own salary and benefit costs increased by $52,000 to $580,000. The acquisition of Alaska First in the fourth quarter of 2007 also added salary and benefits costs. Lastly, stock-based compensation expense increased to $597,000 in 2008 from $578,000 in 2007 and $390,000 in 2006. In the first quarter of 2006, the Company adopted FASB 123R, *Share-Based Payment.* As a result, in 2006, the Company recorded $256,000 in additional expense associated with its stock options. Prior to 2006, the Company s stock-based compensation expense was associated with the fair value of restricted stock granted to its employees and expensed over the required service period.

During 2008, our occupancy expenses increased by $442,000, or 15%, to $3.4 million from $3 million in 2007. This increase is primarily the result of a $254,000 increase in depreciation expense, a $197,000 increase in repairs and maintenance, a $151,000 increase in real estate taxes, a $132,000 increase in utility expense, and a $71,000 increase in janitorial costs. These increases are the result of the Company taking on additional space in both Anchorage and Fairbanks as well as the purchase of the Company s main office facility in July 2008. Additionally, these increases were offset by a $386,000 decrease in rent expense which also resulted from the purchase of the main office facility. During 2007, occupancy expenses increased by $346,000, or 13%, to $3 million from $2.6 million, as we incurred higher costs in repair and maintenance as well as increased utility expenses. In addition to this, the Company incurred a $233,000 increase in rent expense due to expenses associated with the Alaska First buildings, as well as an overall increase in rents. The Company closed the two Alaska First branches in December of 2007 and February of 2008. In 2008, the Company incurred $31,000 in rent expense associated with these branches. The Company does not expect to incur expenses on these branches in 2009. In 2006, occupancy expense increased by $94,000, or 4%, to $2.6 million from $2.5 million as we incurred higher costs in one of our branch locations.

OREO expenses increased to $2.6 million in 2008 from negative $20,000 in 2007. This includes $2.0 million in impairment charges that arose from adjustments to the Company s estimate of the fair value of certain properties based on changes in estimated costs to complete the projects. The Company also incurred $365,000 in taxes and insurance costs, $133,000 in legal expense and $91,000 in property management expense related to OREO properties in 2008. In 2007 and 2006, the Company did not incur any expenses related to OREO properties. Additionally, the Company recognized rental income on OREO properties of $1,000, $20,000 and $5,000 in 2008, 2007 and 2006, respectively. In 2009, the Company expects to incur lower overall OREO expenses due in large part to lower expected impairment charges on its OREO properties. Although we cannot guarantee that we will be successful, by December 31, 2009, the Company intends to reduce its loans measured for impairment and OREO by 20% from December 31, 2008 levels.

Insurance expense increased by $1.3 million, or 283% to $1.8 million in 2008 from $465,000 in 2007. This increase is attributable to a $805,000 increase in Keyman insurance expense that arose from decreases in the cash surrender value of assets held under the Company s policies and a $472,000 increase in FDIC insurance expense that was due to changes in the assessment of FDIC insurance premiums. The Company expects further increases in its FDIC insurance costs in 2009 as the FDIC assesses higher insurance premiums on the entire financial services industry. Insurance expense increased by $87,000, or 23% in 2007 to $465,000 from $378,000 in 2006 due to changes in the assessment of FDIC insurance premiums.

Marketing costs decreased by $59,000, or 5%, in 2008, decreased by $24,000, or 1%, in 2007, and decreased $16,000, or 1%, in 2006. Although the Company has incurred additional marketing expenses due to promoting its HPC Program in 2008, 2007 and 2006, those costs have been offset by a decrease in other marketing expenses such as advertising for some of the Company s other products. The Company plans to continue to market its HPC Program as it has since the second quarter of 2005. Furthermore, the Company expects that the additional deposit accounts will continue to generate increased fee income that will offset a majority of the increased marketing costs associated with the HPC Program.

Professional and outside services expense increased by $331,000, or 28% to $1.5 million in 2008 from $1.2 million in 2007. The majority of this increase is due to fees paid for services rendered by former Alaska First employees to facilitate the transition of Alaska First operations to the Company, increased fees related to tax services, increased investment management fees due to higher average investment security balances in 2008, and the outsourcing of internal audit work. Professional and outside services expense increased by $327,000, or 39% in 2007 to $1.2 million from $840,000 in 2006 due to increased legal fees, increased audit fees and fees related to tax services, the outsourcing of internal audit work, and fees paid for services rendered by former Alaska First employees to facilitate the transition of Alaska First operations to the Company,

Equipment expense decreased $117,000, or 9% to $1.2 million in 2008 from $1.4 million in 2007. This decrease is primarily the result of decreased rental costs related on some of the Company s office equipment. Equipment expense is $1.4 million for both 2007 and 2006.

Intangible asset amortization increased by $10,000 or 3% to $347,000 during 2008 from $337,000 during 2007. In 2007, the Company finished amortizing the core deposit intangible (CDI) related to the accounts it acquired in 1999 from the Bank of America transaction. The Company had no amortization related to this CDI in 2008 and $163,000 in 2007. Additionally, the Company recognized amortization on the CDI associated with the Alaska First acquisition of $232,000 in 2008 and $60,000 in 2007.

In 2007, amortization expense decreased by $145,000, or 30%, to $337,000 from $482,000 in 2006 as the Company finished amortizing the core deposit intangible related to the accounts it acquired in 1999 from the Bank of America transaction. The amortization expense on the NBG intangible asset was $115,000 in 2008, 2007 and 2006. Prior to the Company s additional investment in NBG in December of 2005, the Company accounted for its investment in NBG according to the equity method and did not record its amortization expense on the NBG investment on a separate basis.

Other expenses, which includes software expenses, amortization of low income housing tax credit partnerships, ATM and debit card processing fees, internet banking fees and other operational expenses, increased $581,000, or 9%, in 2008 as compared to 2007 and increased $1.6 million, or 33%, in 2007 as compared to 2006 due to changes in a variety of expense accounts. The largest increases in 2008 can be attributed to a $382,000 increase in costs associated with loan collection, and a $122,000 increase in correspondent bank charges due to the Company converting to Check 21. In addition, the amortization expense associated with the Company s investments in partnerships that develop low-income housing increased by $118,000 in 2008.

Income Taxes: The provision for income taxes decreased $4.1 million, or 57%, to $3.1 million in 2008, decreased $718,000, or 9%, to $7.3 million in 2007, and increased $1.1 million, or 15%, to $8 million in 2006. The effective tax rates for 2008, 2007 and 2006 were 34%, 38%, and 38%. The decrease in the tax rate for 2008 was primarily due to increased tax exempt income on investments and tax credits relative to the level of taxable income.

Financial Condition

Assets

Loans and Lending Activities

General: Our loan products include short and medium-term commercial loans, commercial credit lines, construction and real estate loans and consumer loans. We emphasize providing financial services to small and medium-sized businesses and to individuals. From our inception, we have emphasized commercial, land development and home construction, and commercial real estate lending. These types of lending have provided us with needed market opportunities and higher net interest margins than other types of lending. However, they also involve greater risks, including greater exposure to changes in local economic conditions, than certain other types of lending.

Loans are the highest yielding component of earning assets. Average loans were $8.8 million, or 1% lower in 2008 than in 2007. Average loans were $1.2 million, or less than 1% lower in 2007 than in 2006. Average loans comprised 80% of total earning assets on average in 2008, 84% in 2007 and 88% in 2006. The yield on loans averaged 7.59% in 2008, 9.35% in 2007, and 9.18% in 2006.

The reduction in the loan portfolio during 2008 was $3.5 million, or less than 1%. Commercial loans increased $8.3 million, or 3%, commercial real estate loans increased $25.6 million, or 11%, and construction loans decreased $37.6 million, or 27%, in 2008. In light of recent market conditions in the construction loan sector, we expect further declines in construction loans in 2009. Home equity and consumer loans increased $173,000, or less than 1%.

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Nonperforming Loans; Other Real Estate Owned: Nonperforming assets consist of nonaccrual loans, accruing loans that are 90 days or more past due, restructured loans, and other real estate owned. We had other real estate owned property of $12.6 million at December 31, 2008, as compared to $4.4 million at December 31, 2007. The Company expects to expend $2.2 million during 2009 to complete these projects with an estimated completion date of September 30, 2009. The following table sets forth information regarding our nonperforming loans and total nonperforming assets:

December 31,	2008	2007	2006	2005	2004
			(In Thousands)		
Nonperforming loans					
Nonaccrual loans	$20,593	$9,673	$5,176	$5,090	$5,876
Accruing loans past due 90 days or more	5,411	1,665	708	981	290
Restructured loans			748		424
Total nonperforming loans	26,004	11,338	6,632	6,071	6,590
Real estate owned	12,617	4,445	717	105	
Total nonperforming assets	$38,621	$15,783	$7,349	$6,176	$6,590
Allowance for loan losses to portfolio loans	1.81%	1.64%	1.69%	1.52%	1.59%
Allowance for loan losses to nonperforming loans	50%	104%	183%	176%	163%
Nonperforming loans to portfolio loans	3.66%	1.59%	0.92%	0.86%	0.97%
Nonperforming assets to total assets	3.84%	1.56%	0.79%	0.69%	0.82%

Nonaccrual, Accruing Loans 90 Days or More Past Due, and Restructured Loans: The Company s financial statements are prepared on the accrual basis of accounting, including recognition of interest income on its loan portfolio, unless a loan is placed on a nonaccrual basis. Loans are placed on a nonaccrual basis when management believes serious doubt exists about the collectability of principal or interest. Our policy generally is to discontinue the accrual of interest on all loans 90 days or more past due unless they are well secured and in the process of collection. Cash payments on nonaccrual loans are directly applied to the principal balance. The amount of unrecognized interest on nonaccrual loans was $1.9 million, $865,000, and $437,000, in 2008, 2007, and 2006, respectively.

Restructured loans are those for which concessions, including the reduction of interest rates below a rate otherwise available to that borrower, have been granted due to the borrower s weakened financial condition. Interest on restructured loans will be accrued at the restructured rates when it is anticipated that no loss of original principal will occur, and the interest can be collected.

Total nonperforming loans at December 31, 2008, were $26 million, or 3.66% of portfolio loans, an increase of $14.7 million from $11.3 million at December 31, 2007, and an increase of $4.7 million from $6.6 million at December 31, 2006. The increase in nonperforming loans at December 31, 2008 as compared to December 31, 2007 is

due in large part to the addition of $10.9 million in nonaccrual loans. This increase is primarily tied to lending relationships with seven customers.

Potential Problem Loans: At December 31, 2008, management had identified potential problem loans of $21.6 million as compared to potential problem loans of $13.5 million at December 31, 2007. Potential problem loans are loans which are currently performing and are not included in nonaccrual, accruing loans 90 days or more past due, or restructured loans that have developed negative indications that the borrower may not be able to comply with present payment terms and which may later be included in nonaccrual, past due, or restructured loans.

Loans Measured for Impairment and OREO: At December 31, 2008, the Company had $79.7 million in loans measured for impairment and OREO. Management is aggressively attempting to reduce the outstanding loans measured for impairment and OREO and, although we cannot guarantee that we will be successful, by December 31, 2009, the Company intends to reduce its loans measured for impairment and OREO by 20% from December 31, 2008 levels.

Analysis of Allowance for Loan Losses: The Company maintains an Allowance to reflect inherent losses from its loan portfolio as of the balance sheet date. The Allowance is decreased by loan charge-offs and increased by loan recoveries and provisions for loan losses. On a quarterly basis, the Company calculates the Allowance based on an established methodology which has been consistently applied.

In determining its total Allowance, the Company first estimates a specific allowance for impaired loans. This analysis is based upon a specific analysis for each impaired loan, including appraisals on loans secured by real property, management s assessment of the current market, recent payment history and an evaluation of other sources of repayment. With regard to our appraisal process, the Company obtains appraisals on real and personal property that secure its loans during the loan origination process in accordance with regulatory guidance and its loan policy. The Company obtains updated appraisals on loans secured by

real or personal property based upon its assessment of changes in the current market or particular projects or properties, information from other current appraisals, and other sources of information. The Company uses the information provided in these updated appraisals along with its evaluation of all other information available on a particular property as it assesses the collateral coverage on its performing and nonperforming loans and the impact that may have on the adequacy of its Allowance.

The Company then estimates an allowance for all loans that are not impaired. This allowance is based on loss factors applied to loans that are quality graded according to an internal risk classification system (classified loans). The Company s internal risk classifications are based in large part upon regulatory definitions for classified loans. The loss factors that the Company applies to each group of loans within the various risk classifications are based on industry standards, historical experience and management s judgment.

Portfolio components also receive specific attention in the Allowance analysis when those components constitute a significant concentration as a percentage of the Company s capital, when current market or economic conditions point to increased scrutiny, or when historical or recent experience suggests that additional attention is warranted in the analysis process.

Once the Allowance is determined using the methodology described above, management assesses the adequacy of the overall Allowance through an analysis of the size and mix of the loan portfolio, historical and recent credit performance of the loan portfolio (including the absolute level and trends in delinquencies and impaired loans), industry metrics and ratio analysis. The unallocated portion of the Allowance at December 31, 2008 increased to $5.2 million from $2.6 million at December 31, 2007. This increase reflects management s assumption that there is higher inherent risk in the remaining portfolio in today s lending environment.

Our banking regulators, as an integral part of their examination process, periodically review the Company s Allowance. Our regulators may require the Company to recognize additions to the allowance based on their judgments related to information available to them at the time of their examinations.

At December 31, 2008, nonperforming loans increased to $26 million, or 3.66% of portfolio loans as compared to $11.3 million, or 1.59% of portfolio loans at December 31, 2007. In addition, the coverage ratio of the allowance for loan losses verses nonperforming loans decreased to 50% in 2008 as compared to a coverage ratio of 104% in 2007. The increase in nonperforming loans and potential problem loans has been factored into the Company s methodology for analyzing its allowance on a consistent basis. The Company has also taken steps to improve its credit quality including the formation of a Quality Assurance department to provide independent, detailed financial analysis of its largest, most complex loans, which it believes will help to improve its credit quality in the future. Management believes that at December 31, 2008, the allowance is adequate to cover losses that are probable in light of our current loan portfolio and existing economic conditions.

In October 2007, the Company acquired $13.2 million in loans as a part of its acquisition of Alaska First. The company has determined that acquisition of these loans did not cause any material changes in the risk characteristics of the Company s loan portfolio.

The increase in nonperforming loans between December 31, 2007 and December 31, 2008 in general has been caused by an increase in nonperforming residential construction and land development loans which have increased due to several factors. First, there has been a slowdown in the residential real estate sales cycle in the Company s major markets that has been caused in part by more restrictive mortgage lending standards that has decreased the number of eligible purchasers for residential properties. In addition, there has been a decrease in new construction activity. As a result, inventory levels have remained approximately constant over the last year. Second, the slowdown in the sales cycle and the decrease in new construction have led to slower absorption of residential lots. Third, a number of the

Company s residential construction and land development borrowers have been unable to profitably operate in this slower real estate market. As a result of the slower residential real estate market, the Company expects that its level of lending in this sector will decrease which will lead to a lower level of earnings from this portion of its loan portfolio.

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

The following table shows the allocation of the allowance for loan losses for the periods indicated:

ember 31,	2008		2007		2006		2005		2004	
nce applicable to:	Amount	% of Total Loans(1)	Amount	% of Total Loans(1)	Amount	% of Total Loans(1)	Amount	% of Total Loans(1)	Amount	% of T Loans
	(Dollars in Thousands)									
nmercial	$5,558	41%	$6,496	40%	$8,208	40%	$6,913	41%	$5,130	3
struction	1,736	14%	940	19%	330	21%	246	19%	276	1
l estate term	306	38%	1,661	34%	964	33%	1,214	35%	1,634	3
ne equity lines and r consumer	61	7%	16	7%	6	6%	37	5%		
llocated	5,239	0%	2,622	0%	2,617	0%	2,296	0%	3,724	
l	$12,900	100%	$11,735	100%	$12,125	100%	$10,706	100%	$10,764	10

(1) Represents percentage of this category of loans to total loans.

The following table sets forth for the periods indicated information regarding changes in our allowance for loan losses:

December 31,	2008	2007	2006	2005	2004
			(In Thousands)		
Balance at beginning of period	$11,735	$12,125	$10,706	$10,764	$10,186
Charge-offs:					
Commercial loans	(4,187)	(4,291)	(2,545)	(1,552)	(1,387)
Construction loans	(1,004)	(2,982)		(100)	
Real estate loans	(1,402)	(599)			
Home equity and other consumer loans	(132)	(45)	(72)	(63)	(84)
Total charge-offs	(6,725)	(7,917)	(2,617)	(1,715)	(1,471)
Recoveries:					
Commercial loans	577	1,723	1,086	418	200
Construction loans	61	50		15	185
Real estate loans	3		355	15	
Home equity and other consumer loans	50	21	31	39	63

Total recoveries	691	1,794	1,472	487	448
Charge-offs net of recoveries	(6,034)	(6,123)	(1,145)	(1,228)	(1,023)
Allowance aquired with Alaska First acquisition		220			
Provision for loan losses	7,199	5,513	2,564	1,170	1,601
Balance at end of period	$12,900	$11,735	$12,125	$10,706	$10,764
Ratio of net charge-offs to average loans outstanding during the period	0.86%	0.86%	0.16%	0.18%	0.16%

The increase in real estate charge offs in 2008 and 2007 relate to two borrowers. Management has consistently applied its methodology for calculating the allowance for loan losses from period-to-period, and the unallocated portion of the allowance has increased in 2008 to address the impact of the current economic environment on our loan portfolio.

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Credit Authority and Loan Limits: All of our loans and credit lines are subject to approval procedures and amount limitations. These limitations apply to the borrower s total outstanding indebtedness and commitments to us, including the indebtedness of any guarantor.

Generally, we are permitted to make loans to one borrower of up to 15% of the unimpaired capital and surplus of the Bank. The loan-to-one-borrower limitation for the Bank was $19.1 million at December 31, 2008. At December 31, 2008, the Company had four relationships whose total direct and indirect commitments exceeded $19.1 million, however no individual direct relationship exceeded the limit. See Management s Discussion and Analysis of Financial Condition and Results of Operations Provision for Loan Losses.

Loan Policy: Our lending operations are guided by loan policies, which outline the basic policies and procedures by which lending operations are conducted. Generally, the policies address our desired loan types, target markets, underwriting and collateral requirements, terms, interest rate and yield considerations, and compliance with laws and regulations. The policies are reviewed and approved annually by the Board of Directors. We supplement our own supervision of the loan underwriting and approval process with periodic loan reviews by experienced officers who examine quality, loan documentation, and compliance with laws and regulations. Our Quality Assurance department also provides independent, detailed financial analysis of our largest, most complex loans. In addition, the department, along with the Chief Lending Officer and others in the Loan Administration department, has developed processes to analyze and manage various concentrations of credit within the overall loan portfolio. The Loan Administration department has also enhanced the procedures and processes for the analysis and reporting of problem loans along with the development of strategies to resolve them.

Loans Receivable: Loans receivable decreased to $711.3 million at December 31, 2008, compared to $714.8 million and $717.1 million at December 31, 2007 and 2006, respectively. At December 31, 2008, 67% of the portfolio was scheduled to mature or reprice in 2009 with 28% scheduled to mature or reprice between 2010 and 2013. Future growth in loans is generally dependent on new loan demand and deposit growth, constrained by our policy of being well-capitalized as determined by the FDIC.

Loan Portfolio Composition: The following table sets forth at the dates indicated our loan portfolio composition by type of loan:

er 31,	2008		2007		2006		2005		2004	
	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total	Amount	P o
					(Dollars in Thousands)					
rcial loans	$293,249	41.23%	$284,956	39.87%	$287,281	40.06%	$287,617	40.79%	$267,737	3
ate loans:										
ction	100,438	14.12%	138,070	19.32%	153,059	21.35%	131,532	18.66%	122,873	1
ate term	268,864	37.80%	243,245	34.03%	237,599	33.14%	252,395	35.80%	252,358	3
quity lines er er	51,447	7.23%	51,274	7.17%	42,140	5.88%	36,519	5.18%	38,166	
	713,998	100.38%	717,545	100.38%	720,079	100.42%	708,063	100.43%	681,134	10
		0.00%		0.00%		0.00%		0.00%	(44)	

ed purchase t ed loan fees rigination	(2,712)	-0.38%	(2,744)	-0.38%	(3,023)	-0.42%	(3,004)	-0.43%	(2,821)	
ns	$711,286	100.00%	$714,801	100.00%	$717,056	100.00%	$705,059	100.00%	$678,269	10

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The following table presents at December 31, 2008, the aggregate maturity and repricing data of our loan portfolio:

	Maturity			
	Within 1 Year	1-5 Years	Over 5 Years	Total
		(In Thousands)		
Commercial	$164,052	$79,059	$50,099	$293,210
Construction	80,140	20,301		100,441
Real estate term	46,990	87,758	134,116	268,864
Home equity lines and other consumer	2,223	9,526	39,734	51,483
Total	$293,405	$196,644	$223,949	$713,998
Fixed interest rate	$95,662	$77,390	$52,935	$225,987
Floating interest rate	197,743	119,254	171,014	488,011
Total	$293,405	$196,644	$223,949	$713,998

Commercial Loans: Our commercial loan portfolio includes both secured and unsecured loans for working capital and expansion. Short-term working capital loans generally are secured by accounts receivable, inventory, or equipment. We also make longer-term commercial loans secured by equipment and real estate. We also make commercial loans that are guaranteed in large part by the Small Business Administration or the Bureau of Indian Affairs and commercial real estate loans that are participated with the Alaska Industrial Development and Export Authority (AIDEA). Commercial loans represented 41% of our total loans outstanding as of December 31, 2008 and reprice more frequently than other types of loans, such as real estate loans. More frequent repricing means that commercial loans are more sensitive to changes in interest rates. In a rising interest rate environment, our philosophy is to emphasize the pricing of loans on a floating rate basis, which allows these loans to reprice more frequently and to contribute positively to our net interest margin. The majority of these loans reprice to an index based upon the prime rate of interest. In 2008, the Company began to implement floors in its loans as they were originated or renewed during the year.

Construction Loans:

Land Development: We believe we are a major land development and residential construction lender. At December 31, 2008 and 2007, we had $39 million and $46.9 million, respectively, of residential subdivision land development loans outstanding, or 5% and 7% of total loans.

One-to-Four-Family Residences: We financed approximately one-fifth of the single-family houses constructed in Anchorage in 2008. We originated one-to-four-family residential construction loans to builders for construction of homes. At December 31, 2008 and 2007, we had $39.8 million and $71.5 million, respectively, of one-to-four-family residential and condominium construction loans, or 6% and 10%of total loans. Of the homes under construction at December 31, 2008 and 2007, for which these loans had been made, 33% and 33% were subject to sale contracts

between the builder and homebuyers who were pre-qualified for loans, usually with other financial institutions.

The Company s construction loans decreased from $138.1 million to $100.4 million in 2008 due to the continued decrease in new construction activity. The Company expects continued slowness in residential construction in 2009, which, along with management s efforts to decrease loans measured for impairment and OREO, much of which is secured by residential construction and land development loans, should lead to further decreases in its construction loan balances.

Commercial Construction: We also provide construction lending for commercial real estate projects. Such loans generally are made only when there is a firm take-out commitment upon completion of the project by a third party lender.

Commercial Real Estate: We believe we are an active lender in the commercial real estate market. At December 31, 2008, our commercial real estate loans were $268.9 million, or 38% of our loan portfolio, an increase over $243.2 million, or 34% of our loan portfolio at December 31, 2007. These loans are typically secured by office buildings, apartment complexes or warehouses. Loan maturities range from 10 to 25 years, ordinarily subject to our right to call the loan within 10 to 15 years of its origination. The interest rate for approximately 54% of these loans originated by Northrim resets every one to five years based on the spread over an index rate, and 23% reset on either a daily or monthly basis. The indices for these loans have historically been prime or the respective

Treasury rate. In 2008, the Company began to use the interest rates of the Federal Home Loan Bank of Seattle as an additional index. In addition, the Company began to implement floors in its interest rates for loans originated or renewed during the year.

We may sell all or a portion of our commercial real estate loans to two State of Alaska entities that were established to provide long-term financing in the State, AIDEA, and the Alaska Housing Finance Corporation (AHFC). We may sell up to a 90% loan participation to AIDEA. AIDEA s portion of the participated loan typically features a maturity twice that of the portion retained by us and bears a lower interest rate. The blend of our and AIDEA s loan terms allows us to provide competitive long-term financing to our customers, while reducing the risk inherent in this type of lending. We also originate and sell to AHFC loans secured by multifamily residential units. Typically, 100% of these loans are sold to AHFC and we provide ongoing servicing of the loans for a fee. AIDEA and AHFC make it possible for us to originate these commercial real estate loans and enhance fee income while reducing our exposure to risk.

Home Equity Lines and Other Consumer Loans: We provide personal loans for automobiles, recreational vehicles, boats, and other larger consumer purchases. We provide both secured and unsecured consumer credit lines to accommodate the needs of our individual customers, with home equity lines of credit serving as the major product in this area.

Off-Balance Sheet Arrangements Commitments and Contingent Liabilities: In the ordinary course of business, we enter into various types of transactions that include commitments to extend credit that are not reflected on our balance sheet. We apply the same credit standards to these commitments as in all of our lending activities and include these commitments in our lending risk evaluations. Our exposure to credit loss under commitments to extend credit is represented by the amount of these commitments. See Note 20 to Notes to Consolidated Financial Statements in our Annual Report for the year ended December 31, 2008. See also Liquidity and Capital Resources.

Investments and Investment Activities

General: Our investment portfolio consists primarily of government sponsored entity securities, corporate bonds, and municipal securities. Investment securities totaled $152.4 million at December 31, 2008, an increase of $9.3 million, or 6%, from year-end 2007. The average maturity of the investment portfolio was approximately two years at December 31, 2008.

Investment securities designated as available for sale comprised 93% of the portfolio and are available to meet liquidity requirements. Both available for sale and held to maturity securities may be pledged as collateral to secure public deposits. At December 31, 2008 and 2007, $67.4 and $32.4 million in securities were pledged for deposits and borrowings, respectively.

Investment Portfolio Composition: Our investment portfolio is divided into two classes:

Securities Available For Sale: These are securities we may hold for indefinite periods of time. These securities include those that management intends to use as part of our asset/liability management strategy and that may be sold in response to changes in interest rates and/or significant prepayment risks. We carry these securities at fair value with any unrealized gains or losses reflected as an adjustment to shareholders equity.

Securities Held To Maturity: These are securities that we have the ability and the intent to hold to maturity. Events that may be reasonably anticipated are considered when determining our intent to hold investment securities to maturity. These securities are carried at amortized cost.

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The following tables set forth the composition of our investment portfolio at the dates indicated:

December 31,	Amortized Cost	Fair Value
	(In Thousands)	
Securities Available for Sale:		
2008:		
Government Sponsored Entities	$115,936	$117,465
Mortgage-backed Securities	345	361
Corporate Bonds	23,203	23,184
Total	$139,484	$141,010
2007:		
U.S. Treasury	$4,977	$4,982
Government Sponsored Entities	134,370	134,738
Mortgage-backed Securities	466	465
Corporate Bonds	7,813	7,824
Total	$147,626	$148,009
2006:		
U.S. Treasury	$16,860	$16,840
Government Sponsored Entities	70,438	69,971
Mortgage-backed Securities	183	182
Total	$87,481	$86,993
Securities Held to Maturity:		
2008:		
Municipal securities	$9,431	$9,502
Total	$9,431	$9,502
2007:		
Municipal securities	$11,701	$11,748

Total	$11,701	$11,748
2006:		
Municipal securities	$11,776	$11,775
Total	$11,776	$11,775

For the periods ending December 31, 2008, 2007, and 2006, we held Federal Home Loan Bank (FHLB) stock with a book value approximately equal to its market value in the amounts of $2.0 million, $2.0 million, and $1.6 million, respectively.

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Fair Value, Maturities and Weighted Average Yields: The following table sets forth the market value, maturities and weighted average yields of our investment portfolio for the periods indicated as of December 31, 2008:

	Maturity				
	Within 1 Year	1-5 Years	5-10 Years	Over 10 Years	Total
	(Dollars in Thousands)				
Securities Available for Sale:					
Government Sponsored Entities					
Balance	$5,001	$105,236	$5,109	$2,119	$117,465
Weighted Average Yield	4.15%	3.37%	4.95%	4.74%	3.50%
Mortgage-Backed Securities					
Balance	255		106		361
Weighted Average Yield	5.65%	0.00%	4.32%	0.00%	5.22%
Corporate Bonds					
Balance	3,932	19,252			23,184
Weighted Average Yield	1.55%	5.13%	0.00%	0.00%	4.51%
Total					
Balance	$9,188	$124,488	$5,215	$2,119	$141,010
Weighted Average Yield	3.06%	3.65%	4.94%	4.74%	3.67%
Securities Held to Maturity:					
Municipal Securities					
Balance	$3,389	$5,484	$629	$	$9,502
Weighted Average Yield	3.86%	3.90%	4.02%	0.00%	3.89%

At December 31, 2008, we held no securities of any single issuer (other than government sponsored entities) that exceeded 10% of our shareholders equity.

Purchased Receivables

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

Our purchased receivable balances decreased slightly in 2008 to $19.1 million, as compared to $19.4 million in 2007 due in part to the fact that the Company stopped offering one of its purchased receivable products in Alaska in 2008. The Company expects that purchased receivable balances will increase in the future as NFS continues to expand its customer base.

Policy and Authority Limits: Our purchased receivable activity is guided by policies that outline risk management, documentation, and approval limits. The policies are reviewed and approved annually by the Board of Directors.

Liabilities

Deposits

General: Deposits are our primary source of funds. Total deposits decreased 3% to $843.3 million at December 31, 2008, compared with $867.4 million at December 31, 2007, and $794.9 million at December 31, 2006. Our deposits generally are expected to fluctuate according to the level of our market share, economic conditions, and normal seasonal trends.

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

ecember 31,	2008		2007		2006		2005		2004	
	Average balance	Average rate paid	Average balance	Average rate paid	Average balance	Average rate paid	Average balance	Average rate paid	Average balance	Avera rate pa
					(Dollars in Thousands)					
terest-bearing mand accounts	$97,171	0.59%	$85,192	1.39%	$78,872	1.05%	$65,890	0.56%	$57,373	0.39
oney market counts	187,779	1.76%	186,722	3.95%	151,871	3.99%	139,331	2.78%	126,567	1.21
vings accounts	187,225	1.84%	234,780	3.73%	254,209	3.98%	207,277	3.02%	139,876	1.64
rtificates of posit	145,153	3.34%	95,961	4.25%	94,595	3.51%	138,284	2.52%	155,134	1.72
tal terest-bearing counts	617,328	1.97%	602,655	3.55%	579,547	3.51%	550,782	2.54%	478,950	1.40
oninterest-bearing mand accounts	212,447		196,313		185,958		182,535		181,731	
tal average posits	$829,775		$798,968		$765,505		$733,317		$660,681	

Certificates of Deposit: The only deposit category with stated maturity dates is certificates of deposit. At December 31, 2008, we had $173.4 million in certificates of deposit, of which $144.7 million, or 83%, are scheduled to mature in 2009. At December 31, 2008, the Company s certificates of deposit increased to $173.4 million as compared to $103.5 million at December 31, 2007 due in part to an increase in certificates of deposit sold to the Alaska Permanent Fund as described more fully below. The Company is also a member of the Certificate of Deposit Account Registry System (CDARS) which is a network of approximately 3,000 banks throughout the United States. The CDARS system was founded in 2003 and allows participating banks to exchange FDIC insurance coverage so that 100% of the balance of their customers certificates of deposit are fully subject to FDIC insurance. At December 31, 2008, the Company had $12.2 million in CDARS certificates of deposits as compared to $1 million at December 31, 2007.

Alaska Certificates of Deposit: The Alaska Certificate of Deposit (Alaska CD) is a savings deposit product with an open-ended maturity, interest rate that adjusts to an index that is tied to the two-year United States Treasury Note, and limited withdrawals. The total balance in the Alaska CD at December 31, 2008, was $108.1 million, a decrease of $63.2 million as compared to the balance of $171.3 million at December 31, 2007 as customers moved from the Alaska CD account to other interest bearing accounts such as certificates of deposit.

Alaska Permanent Fund: The Alaska Permanent Fund may invest in certificates of deposit at Alaska banks in an aggregate amount with respect to each bank, not to exceed its capital and at specified rates and terms. The depository bank must collateralize the deposit. At December 31, 2008, we held $45 million in certificates of deposit for the Alaska Permanent Fund. We did not hold any certificates of deposit for the Alaska Permanent Fund at December 31, 2007 or December 31, 2006.

Borrowings

FHLB: At December 31, 2008, our maximum borrowing line from the FHLB was equal to $121 million, approximately 12% of the Company s assets. FHLB advances are subject to collateral criteria that require the Company to pledge assets under a blanket pledge arrangement as collateral for its borrowings from the FHLB. At December 31, 2008 and 2007 there was $11.0 million and $1.8 million outstanding on the line respectively. The increase in the outstanding balance at December 31, 2008 as compared to the same period in 2007 results in part from an additional draw on the line to fund the Company s acquisition of its main office facility on July 1, 2008.

The Company purchased its main office facility for $12.9 million on July 1, 2008. In this transaction, the Company, through NBL, assumed an existing loan secured by the building in an amount of approximately $5.0 million. At December 31, 2008, the outstanding balance on this loan was $5.0 million. This loan has a maturity date of April 1, 2014.

Federal Reserve Bank: The Company entered into a note agreement with the Federal Reserve Bank on the payment of tax deposits. The Federal Reserve has the option to call the note at any time. The balance at December 31, 2008, and 2007, was $490,000 and $1 million, respectively, which was secured by investment securities.

The Federal Reserve Bank is holding $65.7 million of loans as collateral to secure advances made through the discount window on December 31, 2008. There were no discount window advances outstanding at December 31, 2008 and 2007.

Other Short-term Borrowing: At December 31, 2008, the Company had $12 million in overnight advances outstanding from correspondent banks. These advances were repaid on January 2, 2009. There were no short-term (original maturity of one year or less) borrowings that exceeded 30% of shareholders equity at December 31, 2008.

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Contractual Obligations

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

	Payments Due by Period				
December 31, 2008	Within 1 Year	1-3 Years	3-5 Years	Over 5 Years	Total
	(In Thousands)				
Certificates of deposit	$144,726	$27,815	$804	$22	$173,367
Short-term debt obligations	14,120				14,120
Long-term debt obligations	1,517	3,056	2,502	8,911	15,986
Junior subordinated debentures				18,558	18,558
Operating lease obligations	844	1,563	845	5,089	8,341
Other long-term liabilities	1,811				1,811
Total	$163,018	$32,434	$4,151	$32,580	$232,183

	Payments Due by Period				
December 31, 2007	Within 1 Year	1-3 Years	3-5 Years	Over 5 Years	Total
	(In Thousands)				
Certificates of deposit	$71,065	$31,859	$545	$21	$103,490
Short-term debt obligations	14,996				14,996
Long-term debt obligations	400	800	574		1,774
Junior subordinated debentures				18,558	18,558
Operating lease obligations	1,867	3,652	3,377	3,209	12,105
Other long-term liabilities	950	2,368			3,318
Total	$89,278	$38,679	$4,496	$21,788	$154,241

Long-term debt obligations consist of (a) $1.4 million advance from the FHLB that was originated on May 7, 2002, matures on May 7, 2012, and bears interest at 5.46%, (b) $9.6 million advance from the FHLB that was originated on July 3, 2008 and matures on July 3, 2018 and bears interest at 4.99%, (c) $5.0 million amortizing note that was

assumed by the NBL on July 1, 2008, when the Company s main office facility was purchased that matures on April 1, 2014 and bears interest at 5.95%, (d) $8.2 million junior subordinated debentures that were originated on May 8, 2003, mature on May 15, 2033, and bears interest at a rate of 90-day LIBOR plus 3.15%, adjusted quarterly, and (e) $10.3 million junior subordinated debentures that were originated on December 16, 2005, mature on March 15, 2036, and bears interest at a rate of 90-day LIBOR plus 1.37%, adjusted quarterly. The operating lease obligations are more fully described at Note 20 of the Company s annual report. Other long-term liabilities consist of amounts that the Company owes for its investments in Delaware limited partnerships that develop low-income housing projects throughout the United States. The Company purchased a $3 million interest in CharterMac Corporate Partners XXXIII, L.P., (CharterMac), in September 2006. The Company also purchased a $3 million interest in U.S.A. Institutional Tax Credit Fund LVII L.P. (USA 57) in December 2006. CharterMac changed its name to Centerline in April 2007 and the investment was subsequently renamed Centerline XXXIII, L.P., (Centerline). The investments in Centerline and USA 57 will be fully funded in 2009.

Liquidity and Capital Resources

Our primary sources of funds are customer deposits and advances from the Federal Home Loan Bank of Seattle. These funds, together with loan repayments, loan sales, other borrowed funds, retained earnings, and equity are used to make loans, to acquire securities and other assets, and to fund deposit flows and continuing operations. The primary sources of demands on our liquidity are customer demands for withdrawal of deposits and borrowers demands that we advance funds against unfunded lending commitments. Our total unfunded lending commitments at December 31, 2008, were $147 million, and we do not expect that all of these loans are likely to be fully drawn upon at any one time. Additionally, as noted above, our total deposits at December 31, 2008, were $843.3 million.

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On February 5, 2009, the Board of Directors approved payment of a $0.10 per share dividend on February 27, 2009, to shareholders of record on February 19, 2009. This is a decrease of $0.07 per share from the Company s last dividend of $0.17 per share that was declared in October 2008. The Company reduced the dividend to reflect a payout level more consistent with 2008 earnings. Additionally, management believes that the decrease is the prudent course of action considering the uncertain economic and regulatory environment.

The sources by which we meet the liquidity needs of our customers are current assets and borrowings available through our correspondent banking relationships and our credit lines with the Federal Reserve Bank and the FHLB. At December 31, 2008, our current assets were $379.4 million and our funds available for borrowing under our existing lines of credit were $168.8 million. Given these sources of liquidity and our expectations for customer demands for cash and for our operating cash needs, we believe our sources of liquidity to be sufficient in the foreseeable future. However, continued deterioration in the FHLB of Seattle s financial position may result in impairment in the value of our FHLB stock, the requirement that the Company contribute additional funds to recapitalize the FHLB of Seattle, or a reduction in the Company s ability to borrow funds from the FHLB of Seattle, impairing the Company s ability to meet liquidity demands.

In September 2002, our Board of Directors approved a plan whereby we would periodically repurchase for cash up to approximately 5%, or 306,372, of our shares of common stock in the open market. In August of 2004, the Board of Directors amended the stock repurchase plan and increased the number of shares available under the program by 5% of total shares outstanding, or 304,283 shares. In June of 2007, the Board of Directors amended the stock repurchase plan and increased the number of shares available under the program by 5% of total shares outstanding, or 305,029 shares. We have purchased 688,442 shares of our stock under this program through December 31, 2008 at a total cost of $14.2 million at an average price of $20.65, which leaves a balance of 227,242 shares available under the stock repurchase program. No shares were repurchased on 2008. We intend to continue to repurchase our stock from time to time depending upon market conditions, but we can make no assurances that we will continue this program or that we will repurchase all of the authorized shares.

The stock repurchase program had an effect on earnings per share because it decreased the total number of shares outstanding in 2007, 2006, and 2005, by 137,500, 17,500, and 308,642 shares respectively. The Company did not repurchase any of its shares in 2008 or 2004. The table below shows this effect on diluted earnings per share.

Years Ending:	Diluted EPS as Reported	Diluted EPS without Stock Repurchase
2008	$0.95	$0.83
2007	$1.80	$1.64
2006	$1.99	$1.83
2005	$1.64	$1.56
2004	$1.55	$1.50

On May 8, 2003, the Company s newly formed subsidiary, Northrim Capital Trust 1, issued trust preferred securities in the principal amount of $8 million. These securities carry an interest rate of 90-day LIBOR plus 3.15% per annum that was initially set at 4.45% adjusted quarterly. The securities have a maturity date of May 15, 2033, and are callable by the Company on or after May 15, 2008. These securities are treated as Tier 1 capital by the Company s regulators for capital adequacy calculations. The interest cost to the Company of the trust preferred securities was $503,000 in 2008.

At December 31, 2008, the securities had an interest rate of 5.50%.

On December 16, 2005, the Company s newly formed subsidiary, Northrim Statutory Trust 2, issued trust preferred securities in the principal amount of $10 million. These securities carry an interest rate of 90-day LIBOR plus 1.37% per annum that was initially set at 5.86% adjusted quarterly. The securities have a maturity date of March 15, 2036, and are callable by the Company on or after March 15, 2011. These securities are treated as Tier 1 capital by the Company s regulators for capital adequacy calculations. The interest cost to the Company of these securities was $465,000 in 2008. At December 31, 2008, the securities had an interest rate of 3.37%.

Our shareholders equity at December 31, 2008, was $104.6 million, as compared to $101.4 million at December 31, 2007. The Company earned net income of $6.1 million during 2008 and issued 31,000 shares through the exercise of stock options. The Company did not repurchase any shares of its common stock in 2008. At December 31, 2008, the Company had 6.3 million shares of its common stock outstanding.

We are subject to minimum capital requirements. Federal banking agencies have adopted regulations establishing minimum requirements for the capital adequacy of banks and bank holding companies. The requirements address both risk-based capital and

leverage capital. We believe as of December 31, 2008, that the Company and Northrim Bank met all applicable capital adequacy requirements.

The FDIC has in place qualifications for banks to be classified as well-capitalized. As of December 15, 2008, the most recent notification from the FDIC categorized Northrim Bank as well-capitalized. There were no conditions or events since the FDIC notification that we believe have changed Northrim Bank s classification.

The table below illustrates the capital requirements for the Company and the Bank and the actual capital ratios for each entity that exceed these requirements. Based on recent turmoil in the financial markets and the increase in the Company s loans measured for impairment and OREO, management intends to maintain a Tier 1 risk-based capital ration for the Bank in excess of 10% in 2009, exceeding the FDIC s well-capitalized capital requirement classification. The capital ratio for the Company exceed those for the Bank primarily because the $8 million trust preferred securities offering that the Company completed in the second quarter of 2003 and another offering of $10 million completed in the fourth quarter of 2006 are included in the Company s capital for regulatory purposes although they are accounted for as a long-term debt in our financial statements. The trust preferred securities are not accounted for on the Bank s financial statements nor are they included in its capital. As a result, the Company has $18 million more in regulatory capital than the Bank, which explains most of the difference in the capital ratios for the two entities.

December 31, 2008	Adequately - Capitalized	Well - Capitalized	Actual Ratio BHC	Actual Ratio Bank
Tier 1 risk-based capital	4.00%	6.00%	12.65%	11.79%
Total risk-based capital	8.00%	10.00%	13.90%	13.04%
Leverage ratio	4.00%	5.00%	11.54%	10.77%

(See Note 21 of the Consolidated Financial Statements for a detailed discussion of the capital ratios.)

Effects of Inflation and Changing Prices

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

Market for Common Stock

Our common stock trades on the Nasdaq Stock Market under the symbol, NRIM. We are aware that large blocks of our stock are held in street name by brokerage firms. At December 31, 2008, the number of shareholders of record of our common stock was 171.

We began paying regular cash dividends of $0.05 per share in the second quarter of 1996. In the second quarters of 2008, 2007, and 2006, we began paying cash dividends of $0.17, $0.15, and $0.125 per share, respectively. Cash

dividends totaled $4.2 million, $3.6 million, and $2.8 million in 2008, 2007, and 2006, respectively. On February 5, 2009, the Board of Directors approved payment of a $0.10 per share dividend on February 27, 2009, to shareholders of record on February 19, 2009. The Company and the Bank are subject to restrictions on the payment of dividends pursuant to applicable federal and state banking regulations.

The following are high and low sales prices as reported by Nasdaq. Prices do not include retail markups, markdowns or commissions.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2008				
High	$ 23.01	$ 20.13	$ 17.28	$ 16.14
Low	$ 17.75	$ 18.11	$ 14.15	$ 10.05
2007				
High	$ 28.71	$ 28.73	$ 28.29	$ 24.20
Low	$ 25.26	$ 24.46	$ 23.37	$ 18.42

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Market Price of and Dividends on the Registrant s Common Equity and Related Stockholder Matters

Stock Performance Graph

The graph shown below depicts the total return to shareholders during the period beginning after December 31, 2002, and ending December 31, 2008. The definition of total return includes appreciation in market value of the stock, as well as the actual cash and stock dividends paid to shareholders. The comparable indices utilized are the Russell 3000 Index, representing approximately 98% of the U.S. equity market, and the SNL Financial Bank Stock Index, comprised of publicly traded banks with assets of $500 million to $1 billion, which are located in the United States. The graph assumes that the value of the investment in the Company s common stock and each of the three indices was $100 on December 31, 2003, and that all dividends were reinvested.

Total Return Performance

	Period Ending					
Index	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08
Northrim BanCorp, Inc.	100.00	104.31	105.51	128.12	110.19	55.32
Russell 3000	100.00	111.95	118.80	137.47	144.54	90.61
SNL Bank $1B-$5B	100.00	123.42	121.31	140.38	102.26	84.81

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Repurchase of Securities

The Company did not repurchase any of its common stock during the fourth quarter of 2008.

Equity Compensation Plan Information

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by security holders	493,894	$13.16	63,298
Total	493,894	$13.16	63,298

Recent Accounting Pronouncements

On January 1, 2008, the Company adopted the following new accounting pronouncements:

FASB Statement No. 157 (SFAS 157), *Fair Value Measurements*

FASB Statement No. 159 (SFAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*

The adoption of SFAS 157 and SFAS 159 did not have any affect on the Company s financial statements at the date of adoption. For additional information, see Note 22.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141R, *Business Combinations* (SFAS 141R). This statement establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for the Company s financial statements for the year beginning on January 1, 2009 and must be adopted prospectively. The Company does not expect that adoption of SFAS 141R will impact its financial condition and results of operations.

In December 2007, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 160, *Noncontrolling Interests in Consolidated Financial Statements (as amended)* (SFAS 160). The FASB issued FAS 160 during 2007 to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a non-controlling interest in a subsidiary, which is sometimes referred to as minority interest, is an ownership interest in the consolidated entity that should be reported as a component of equity in the consolidated financial statements. Among other requirements, SFAS 160 requires consolidated net income to be reported at amounts that included the amounts attributable to both the parent and the non-controlling interest. It also requires disclosure, on the face of the consolidated income statement, of the amounts of consolidated net income attributable to the parent and to the non-controlling interest. SFAS 160 is effective for the Company s financial statements for the year beginning on January 1, 2009 and must be adopted prospectively. The Company does not expect that adoption of SFAS 160 to have a significant impact its financial condition and results of operations.

In March 2008, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB No. 133* (SFAS 161). SFAS 161 requires expanded qualitative, quantitative and credit-risk disclosures about derivatives and hedging activities and their effects on the Company s financial position, financial performance and cash flows. SFAS 161 also clarifies that derivatives are subject to credit risk disclosures as required by SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*. SFAS 161 is effective for the Company s financial statements for the year beginning on January 1, 2009 and must be adopted prospectively. The Company does not expect that adoption of SFAS 161 will impact its financial condition and results of operations.

In April 2008, the FASB issued FASB Staff Position (FSP) No. 142-3, *Determination of the Useful Life of Intangible Assets* (FSP 142-3). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142, *Goodwill and Other Intangible Assets* (SFAS 142).

The intent of FSP 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141 (revised 2007), *Business Combinations*, and other GAAP. FSP 142-3 is effective for the Company s financial statements for the year beginning on January 1, 2009 and will be adopted prospectively. The Company does not expect that adoption of FSP 142-3 will impact its financial condition and results of operations.

In June 2008, the FASB issued Financial Accounting Staff Position Emerging Issues Task Force No. 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP 03-6-1). FSP 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share (EPS) under the two-class method described in paragraphs 60 and 61 of SFAS No. 128, *Earnings Per Share* . FSP 03-6-1 is effective for the Company s financial statements for the year beginning on January 1, 2009 and must be adopted retrospectively for all earnings per share calculations. The Company does not expect that adoption of FSP 03-6-1 will have a material impact its financial condition and results of operations.

In October 2008, the FASB issued Financial Accounting Staff Position FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (FSP 157-3). FSP 157-3 clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP 157-3 was effective upon issuance and must be adopted prospectively. The adoption of FSP 157-3 did not impact the Company s financial condition and results of operations.

On December 31, 2008, the Company adopted Financial Accounting Staff Position FAS 140-4 and FIN 46(R)-8, *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities* (FSP 140-4 and FIN 46(R)-8). FSP 140-4 and FIN 46(R)-8 amends SFAS No. 140 and FIN No. 46(R) to require public companies to disclose additional information regarding transfers of financial assets and interests in variable interest entities. FSP 140-4 and FIN 46(R)-8 is effective for all reporting periods that end after December 15, 2008. The adoption of FSP 140-4 and FIN 46(R)-8 did not have any affect on the Company s financial statements at the date of adoption.

Quantitative and Qualitative Disclosure About Market Risk

Our results of operations depend substantially on our net interest income. Like most financial institutions, our interest income and cost of funds are affected by general economic conditions, levels of market interest rates, and by competition, and in addition, our community banking focus makes our results of operations particularly dependent on the Alaska economy.

The purpose of asset/liability management is to provide stable net interest income growth by protecting our earnings from undue interest rate risk, which arises from changes in interest rates and changes in the balance sheet mix, and by managing the risk/return relationships between liquidity, interest rate risk, market risk, and capital adequacy. We maintain an asset/liability management policy that provides guidelines for controlling exposure to interest rate risk by setting a target range and minimum for the net interest margin and running simulation models under different interest rate scenarios to measure the risk to earnings over the next 12-month period.

In order to control interest rate risk in a rising interest rate environment, our philosophy is to shorten the average maturity of the investment portfolio and emphasize the pricing of new loans on a floating rate basis in order to achieve a more asset sensitive position, therefore, allowing quicker repricings and maximizing net interest margin. Conversely, in a declining interest rate environment, our philosophy is to lengthen the average maturity of the investment portfolio and emphasize fixed rate loans, thereby becoming more liability sensitive. In each case, the goal

is to exceed our targeted net interest margin range without exceeding earnings risk parameters.

Our excess liquidity not needed for current operations has generally been invested in short-term assets or securities, primarily securities issued by government sponsored entities. The securities portfolio contributes to our profits and plays an important part in the overall interest rate management. The primary tool used to manage interest rate risk is determination of mix, maturity, and repricing characteristics of the loan portfolios. The loan and securities portfolios must be used in combination with management of deposits and borrowing liabilities and other asset/liability techniques to actively manage the applicable components of the balance sheet. In doing so, we estimate our future needs, taking into consideration historical periods of high loan demand and low deposit balances, estimated loan and deposit increases, and estimated interest rate changes.

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

The following table sets forth the estimated maturity or repricing, and the resulting interest rate gap, of our interest-earning assets and interest-bearing liabilities at December 31, 2008. The amounts in the table are derived from internal data based upon regulatory reporting formats and, therefore, may not be wholly consistent with financial information appearing elsewhere in the audited financial statements that have been prepared in accordance with generally accepted accounting principles. The amounts shown below could also be significantly affected by external factors such as changes in prepayment assumptions, early withdrawals of deposits, and competition.

	Estimated maturity or repricing at December 31, 2008			
	Within 1 year	1-5 years	³5 years	Total
		(In Thousands)		
Interest -Earning Assets:				
Money market investments	$6,905	$	$	$6,905
Domestic certificates of deposit	9,500			9,500
Investment securities	87,699	59,977	4,768	152,444
Loans:				
Commercial	229,136	53,955	1,346	284,437
Real estate construction	84,943	7,989		92,932
Real estate term	143,281	118,276	3,142	264,699
Installment and other consumer	18,767	17,679	14,891	51,337
Total interest-earning assets	$580,231	$257,876	$24,147	$862,254
Percent of total interest-earning assets	67%	30%	3%	100%
Interest-Bearing Liabilities:				
Interest-bearing demand accounts	$101,065	$	$	$101,065
Money market accounts	158,114			158,114
Savings accounts	166,315			166,315
Certificates of deposit	144,148	29,197	22	173,367
Short-term borrowings	14,120			14,120
Long-term borrowings	2,167	8,741	5,078	15,986
Junior subordinated debentures	18,558			18,558
Total interest-bearing liabilities	$604,487	$37,938	$5,100	$647,525
Percent of total interest-bearing liabilities	93%	6%	1%	100%
Interest sensitivity gap	$(24,256)	$219,938	$19,047	$214,729
Cumulative interest sensitivity gap	$(24,256)	$195,682	$214,729	
Cumulative interest sensitivity gap as a percentage of total assets	-2%	19%	21%	

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

We utilize a simulation model to monitor and manage interest rate risk within parameters established by our internal policy. The model projects the impact of a 100 basis point increase and a 100 basis point decrease, from prevailing interest rates, on the balance sheet over a period of 12 months. Generalized assumptions are made on how investment securities, classes of loans and various deposit products might respond to the interest rate changes. These assumptions are inherently uncertain, and as a result, the model cannot precisely estimate net interest income nor precisely predict the impact of higher or lower interest rates on net interest income. Actual results would differ from simulated results due to factors such as timing, magnitude and frequency of rate changes, customer reaction to rate changes, changes in market conditions and management strategies, among other factors.

Based on the results of the simulation models at December 31, 2008, we expect a decrease in net interest income of $851,000 and an increase of $1.7 million in net interest income over a 12-month period, if interest rates decreased or increased an immediate 100 basis points, respectively. As indicated in the table above, at December 31, 2008, the Company s interest-bearing liabilities reprice or mature faster than the Company s earning assets by a margin of $24.3 million over the next 12 months. The results of the simulation model indicate a decrease in net interest income in a falling rate environment and an increase in net interest income in a rising rate environment because the repricing of interest-bearing liabilities will lag the repricing of earning assets. Additionally, in some instances, the extent to which interest-bearing liabilities reprice may not reach that of earning assets due in part to the historically low level of interest rates.

Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

As of the end of the period covered by this report, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Our principal executive and financial officers supervised and participated in this evaluation. Based on this evaluation, our principal executive and financial officers each concluded that our disclosure controls and procedures were effective in timely alerting them to material information required to be included in our periodic reports to the Securities and Exchange Commission. The design of any system of controls is based in part upon various assumptions about the likelihood of future events, and there can be no assurance that any of our plans, products, services or procedures will succeed in achieving their intended goals under future conditions. There were no changes in the Company s internal controls over financial reporting that occurred during the period covered by this report that have materially affected, or are likely to materially affect, the Company s internal control over financial reporting.

Management s Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining internal control over financial reporting as defined in Rules 13a-15(f) and 15(d)-15(f) of the Securities Exchange Act of 1934. The Company s internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

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

Management assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2008. In making this assessment management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control Integrated Framework*.

Based on our assessment and the criteria discussed above, management believes that, as of December 31, 2008, the Company maintained effective internal control over financial reporting.

The Company s registered public accounting firm has issued an attestation report on the Company s effectiveness of internal control over financial reporting. This report follows below.

Report of Independent Registered Public Accounting Firm

The Board of Directors
Northrim BanCorp, Inc.:

We have audited Northrim BanCorp, Inc. and subsidiaries (the Company) internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Effectiveness of internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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

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

In our opinion, Northrim BanCorp, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Northrim BanCorp, Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, shareholders equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2008, and our report dated March 11, 2009 expressed an unqualified opinion on those consolidated financial statements.

Anchorage, Alaska
March 11, 2009

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Report of Independent Registered Public Accounting Firm

The Board of Directors of
Northrim BanCorp, Inc.:

We have audited the accompanying consolidated balance sheets of Northrim BanCorp, Inc. and subsidiaries (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of income, shareholders equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Northrim BanCorp, Inc. and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Northrim BanCorp, Inc. s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 11, 2009 expressed an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

Anchorage, Alaska
March 11, 2009

Consolidated Financial Statements

NORTHRIM BANCORP, INC.
Consolidated Balance Sheets
December 31, 2008 and 2007

	2008	2007
	(In Thousands Except Share Amounts)	
Assets		
Cash and due from banks	$30,925	$30,767
Money market investments	6,905	33,039
Domestic certificates of deposit	9,500	
Investment securities held to maturity	9,431	11,701
Investment securities available for sale	141,010	148,009
Investment in Federal Home Loan Bank stock	2,003	2,003
Total Portfolio Investments	152,444	161,713
Loans	711,286	714,801
Allowance for loan losses	(12,900)	(11,735)
Net Loans	698,386	703,066
Purchased receivables	19,075	19,437
Accrued interest receivable	4,812	5,232
Premises and equipment, net	29,733	15,621
Goodwill and intangible assets	9,320	9,946
Other real estate owned	12,617	4,445
Other assets	32,675	31,448
Total Assets	$1,006,392	$1,014,714
Liabilities		
Deposits:		
Demand	$244,391	$224,986
Interest-bearing demand	101,065	96,455
Savings	58,214	55,285
Alaska CDs	108,101	171,341
Money market	158,114	215,819
Certificates of deposit less than $100,000	76,738	61,586
Certificates of deposit greater than $100,000	96,629	41,904

Total Deposits	843,252	867,376
Borrowings	30,106	16,770
Junior subordinated debentures	18,558	18,558
Other liabilities	9,792	10,595
Total Liabilities	901,708	913,299
Minority interest in subsidiaries	36	24
Shareholders Equity		
Common stock, $1 par value, 10,000,000 shares authorized, 6,331,372 and 6,300,256 shares issued and outstanding at December 31, 2008 and 2007, respectively	6,331	6,300
Additional paid-in capital	51,458	50,798
Retained earnings	45,958	44,068
Accumulated other comprehensive income-net unrealized gains/losses on available for sale on investment securities	901	225
Total Shareholders Equity	104,648	101,391
Commitments and contingencies		
Total Liabilities and Shareholders Equity	$1,006,392	$1,014,714

See accompanying notes to the consolidated financial statements.

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NORTHRIM BANCORP, INC.
Consolidated Statements of Income
Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
	(In Thousands Except Per Share Amounts)		
Interest Income			
Interest and fees on loans	$53,287	$66,463	$65,347
Interest on investment securities-available for sale	5,066	4,120	2,396
Interest on investment securities-held to maturity	427	499	403
Interest on money market investments	429	2	
Interest on domestic certificates of deposit	507	1,983	1,375
Total Interest Income	59,716	73,067	69,521
Interest Expense			
Interest expense on deposits and borrowings	13,902	23,237	21,999
Net Interest Income	45,814	49,830	47,522
Provision for loan losses	7,199	5,513	2,564
Net Interest Income After Provision for Loan Losses	38,615	44,317	44,958
Other Operating Income			
Service charges on deposit accounts	3,283	3,116	1,975
Purchased receivable income	2,560	2,521	1,855
Employee benefit plan income	1,451	1,194	1,113
Electronic banking income	1,193	914	790
Equity in earnings from mortgage affiliate	595	454	649
Equity in loss from Elliott Cove	(106)	(93)	(230)
Other income	2,423	1,848	1,614
Total Other Operating Income	11,399	9,954	7,766
Other Operating Expense			
Salaries and other personnel expense	20,996	20,700	19,277
Occupancy, net	3,399	2,957	2,611
OREO expense net, including impairment	2,558	(20)	(5)
Insurance expense	1,779	465	378
Marketing expense	1,558	1,617	1,641
Professional and outside services	1,498	1,167	840
Equipment expense	1,233	1,350	1,350

Intangible asset amortization expense	347	337	482
Other expense	7,071	6,490	4,902
Total Other Operating Expense	40,439	35,063	31,476
Income Before Income Taxes and Minority Interest	9,575	19,208	21,248
Minority interest in subsidiaries	370	290	296
Income Before Income Taxes	9,205	18,918	20,952
Provision for income taxes	3,122	7,260	7,978
Net Income	$6,083	$11,658	$12,974
Earnings Per Share, Basic	$0.96	$1.82	$2.02
Earnings Per Share, Diluted	$0.95	$1.80	$1.99
Weighted Average Shares Outstanding, Basic	6,358,595	6,400,974	6,426,002
Weighted Average Shares Outstanding, Diluted	6,388,681	6,485,972	6,516,117

See accompanying notes to the consolidated financial statements.

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NORTHRIM BANCORP, INC.
Consolidated Statements of Changes in
Shareholders Equity and Comprehensive Income
Years Ended December 31, 2008, 2007 and 2006

	Common Stock Number of Shares	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
			(In Thousands)			
Balance as of January 1, 2006	5,803	$5,803	$39,161	$39,999	$(489)	$84,474
Cash dividend declared				(2,780)		(2,780)
Stock dividend	291	291	6,690	(6,981)		
Stock option expense			390			390
Exercise of stock options	38	38	300			338
Excess tax benefits from share-based payment arrangements			230			230
Treasury stock buy-back	(18)	(18)	(392)			(410)
Comprehensive income:						
Change in unrealized holding (gain/loss) on available for sale investment securities, net of related income tax effect					202	202
Net Income				12,974		12,974
Total Comprehensive Income						13,176
Balance as of December 31, 2006	6,114	$6,114	$46,379	$43,212	$(287)	$95,418
Cash dividend declared				(3,560)		(3,560)
Stock dividend	301	301	6,941	(7,242)		
Stock option expense			578			578
Exercise of stock options	23	23	50			73
Excess tax benefits from share-based payment arrangements			108			108
Treasury stock buy-back	(138)	(138)	(3,258)			(3,396)
Comprehensive income:						
Change in unrealized holding (gain/loss) on available for sale investment securities, net of related income tax effect					512	512
Net Income				11,658		11,658

Total Comprehensive Income						12,170
Balance as of December 31, 2007	6,300	$6,300	$50,798	$44,068	$225	$101,391
Cash dividend declared				(4,193)		(4,193)
Stock option expense			597			597
Exercise of stock options	31	31	(3)			28
Excess tax benefits from share-based payment arrangements			66			66
Comprehensive income:						
Change in unrealized holding (gain/loss) on available for sale investment securities, net of related income tax effect					676	676
Net Income				6,083		6,083
Total Comprehensive Income						6,759
Balance as of December 31, 2008	6,331	$6,331	$51,458	$45,958	$901	$104,648

See accompanying notes to the consolidated financial statements.

NORTHRIM BANCORP, INC.
Consolidated Statements of Cash Flows
Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
		(In Thousands)	
Operating Activities:			
Net income	$6,083	$11,658	$12,974
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Security gains	(146)		
Depreciation and amortization of premises and equipment	1,384	1,123	1,116
Amortization of software	176	240	354
Intangible asset amortization	347	337	482
Amortization of investment security premium, net of discount accretion	72	(500)	(133)
Deferred tax benefit	(3,638)	(393)	(1,862)
Stock-based compensation	597	578	390
Excess tax benefits from share-based payment arrangements	(66)	(108)	(230)
Deferral of loan fees and costs, net	(32)	(279)	19
Provision for loan losses	7,199	5,513	2,564
Purchased receivable loss	193	245	
Gain on sale of other real estate owned	(45)	(110)	
Impairment on other real estate owned	1,958		
Earnings in RML, net of distributions	49	118	(124)
Equity in loss from Elliott Cove	106	93	230
Minority interest in subsidiaries	370	290	296
(Increase) decrease in accrued interest receivable	420	(316)	(519)
(Increase) decrease in other assets	1,985	(2,283)	(6,794)
Increase (decrease) of other liabilities	(748)	(22)	6,196
Net Cash Provided by Operating Activities	16,264	16,184	14,959
Investing Activities:			
Investment in securities:			
Purchases of investment securities available-for-sale	(134,237)	(136,393)	(40,643)
Purchases of investment securities held-to-maturity	(1,001)		(10,905)
Proceeds from sales/maturities of securities available-for-sale	142,464	100,126	6,608
Proceeds from calls/maturities of securities held-to-maturity	3,265	70	65
Investment in domestic certificates of deposit	(9,500)		
(Investment in) cash proceeds from purchased receivables, net	169	1,501	(8,985)
Investments in loans:			
Sales of loans and loan participations	8,477	8,886	22,601
Loans made, net of repayments	(20,359)	(2,502)	(35,762)
Proceeds from sale of other real estate owned	2,583	266	

Investment in other real estate owned	(3,273)		
Alaska First acquisition, net of cash received		12,699	
Investment in Elliott Cove	(100)	(100)	(210)
Loan to Elliott Cove, net of repayments	108	(48)	58
Loan to PWA, net of repayments			385
Purchases of premises and equipment	(15,496)	(3,861)	(3,387)
Purchases of software, net of disposals	(106)	(183)	(440)
Net Cash Used by Investing Activities	(27,006)	(19,539)	(70,615)
Financing Activities:			
Increase (decrease) in deposits	(24,124)	24,786	15,038
Proceeds from borrowings	15,124	5,546	
Paydowns on borrowings	(1,788)	(401)	(1,913)
Distributions to minority interests	(358)	(295)	(267)
Proceeds from issuance of common stock	28	73	338
Excess tax benefits from share-based payment arrangements	66	108	230
Repurchase of common stock		(3,396)	(410)
Cash dividends paid	(4,182)	(3,542)	(2,768)
Net Cash Provided (Used) by Financing Activities	(15,234)	22,879	10,248
Net Increase (Decrease) by Cash and Cash Equivalents	(25,976)	19,524	(45,408)
Cash and cash equivalents at beginning of period	63,806	44,282	89,690
Cash and Cash Equivalents at End of Year	$37,830	$63,806	$44,282
Supplemental Information:			
Income taxes paid	$5,657	$8,740	$9,296
Interest paid	$13,708	$23,105	$21,891
Transfer of loans to other real estate owned	$9,395	$4,445	$717
Cash dividends declared but not paid	$39	$28	$12

See accompanying notes to the consolidated financial statements.

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Notes to Consolidated Financial Statements

NOTE 1 Organization and Summary of Significant Accounting Policies

Northrim BanCorp, Inc. (the Company) is a bank holding company whose subsidiaries are Northrim Bank (the Bank), which serves Anchorage, Eagle River, the Matanuska Valley, Fairbanks, Alaska, and the Pacific Northwest through its Northrim Funding Services division (NFS); Northrim Investment Services Company (NISC) which holds the Company s interest in both Elliott Cove Capital Management LLC (Elliott Cove), an investment advisory services company, and Pacific Wealth Advisors (PWA), an investment advisory, trust and wealth management business located in Seattle, Washington; Northrim Building LLC (NBL), which owns and operates the Company s main office facility at 3111 C Street in Anchorage; and Northrim Capital Trust 1 (NCT1) and Northrim Statutory Trust 2 (NST2), entities that were formed to facilitate trust preferred securities offerings by the Company. NBL purchased the main office facility in the third quarter of 2008. The Company has evaluated the requirements of Financial Accounting Standards Board (FASB) Statement No. 131, Disclosures about Segments of an Enterprise and Related Information (as amended) and determined that the Company operates as a single operating segment. The Company is regulated by the State of Alaska and the Federal Reserve Board. The Company was incorporated in Alaska, and its primary market areas include Anchorage, the Matanuska Valley, and Fairbanks, Alaska, where the majority of its lending and deposit activities have been with Alaska businesses and individuals.

Effective December 31, 2001, Northrim Bank became a wholly-owned subsidiary of a new bank holding company, Northrim BanCorp, Inc. The Bank s shareholders agreed to exchange their ownership in the Bank for ownership in the Company. The ownership interests in the Company are the same as the ownership interests in the Bank prior to the exchange. The exchange has been accounted for similarly to a pooling of interests.

The Bank formed a wholly-owned subsidiary, Northrim Capital Investments Co. (NCIC), in 1998. This subsidiary owns a 24% profit interest in Residential Mortgage Holding Company LLC (RML Holding Company), a residential mortgage holding company that owns one mortgage company, Residential Mortgage LLC (RML). RML has branches throughout Alaska. The Company accounts for RML Holding Company using the equity method. In addition, NCIC owns a 50.1% interest in Northrim Benefits Group, LLC (NBG), an insurance brokerage company that provides employee benefit plans to businesses throughout Alaska. The Company consolidates NBG in its financial results.

Estimates and Assumptions: In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenue and expenses for the period and the disclosure of contingent assets and liabilities in accordance with generally accepted accounting principles. Actual results could differ from those estimates. Significant estimates include the allowance for loan losses, valuation of goodwill and other intangibles, and valuation of other real estate owned.

Cash and Cash Equivalents: For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing balances with other banks, money market investments including interest-bearing balances with the FHLB, banker s acceptances, commercial paper, securities purchased under agreement to resell, federal funds sold, and securities with maturities of less than 90 days at acquisition.

Investment Securities: Securities available-for-sale are stated at fair value with unrealized holding gains and losses, net of tax, excluded from earnings and reported as a separate component of other comprehensive income, unless an unrealized loss is deemed other than temporary. Gains and losses on available-for-sale securities sold are determined on a specific identification basis.

Held-to-maturity securities are stated at cost, adjusted for amortization of premium and accretion of discount on a level-yield basis. The Company has the ability and intent to hold these securities to maturity.

A decline in the market value of any available for sale or held to maturity security below cost that is deemed other than temporary results in a charge to earnings and the establishment of a new cost basis for the security. Unrealized investment securities losses are evaluated at least quarterly on a specific identification basis to determine whether such declines in value should be considered other than temporary and therefore be subject to immediate loss recognition in income. Although these evaluations involve significant judgment, an unrealized loss in the fair value of a debt security is generally deemed to be temporary when the fair value of the security is below the carrying value primarily due to changes in interest rates, there has not been significant deterioration in the financial condition of the issuer, and the Company has the intent and ability to hold the security for a sufficient time to recover the carrying value. Other factors that may be considered in determining whether a decline in the value is other than temporary include ratings by recognized rating agencies; actions of commercial banks or other lenders relative to the continued extension of credit facilities to the issuer of the security; the financial condition, capital strength and near-term prospects of the issuer, and recommendations of investment advisors or market analysts.

Loans, Recognition of Interest Income and Loan Fees: Loans are carried at their principal amount outstanding, net of unamortized fees and direct loan origination costs. Interest income on loans is accrued and recognized on the principal amount outstanding except

for loans in a non-accrual status. Loans are placed on non-accrual when management believes doubt exists as to the collectibility of the interest or principal. Cash payments received on non-accrual loans are directly applied to the principal balance. Generally, a loan may be returned to accrual status when the delinquent principal and interest are brought current in accordance with the terms of the loan agreement and certain ongoing performance criteria have been met.

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

Loan origination fees received in excess of direct origination costs are deferred and accreted to interest income using a method approximating the level-yield method over the life of the loan.

Allowance for Loan Losses: The Company maintains an Allowance for Loan Losses (the Allowance) to reflect inherent losses from its loan portfolio as of the balance sheet date. The Allowance is decreased by loan charge-offs and increased by loan recoveries and provisions for loan losses. On a quarterly basis, the Company calculates the Allowance based on an established methodology which has been consistently applied.

In determining its total Allowance, the Company first estimates a specific allowance for impaired loans. This analysis is based upon a specific analysis for each impaired loan, including appraisals on loans secured by real property, management s assessment of the current market, recent payment history and an evaluation of other sources of repayment.

The Company then estimates an allowance for all loans that are not impaired. This allowance is based on loss factors applied to loans that are quality graded according to an internal risk classification system (classified loans). The Company s internal risk classifications are based in large part upon regulatory definitions for classified loans. The loss factors that the Company applies to each group of loans within the various risk classifications are based on industry standards, historical experience and management s judgment.

Portfolio components also receive specific attention in the Allowance analysis when those components constitute a significant concentration as a percentage of the Company s capital, when current market or economic conditions point to increased scrutiny, or when historical or recent experience suggests that additional attention is warranted in the analysis process.

Once the Allowance is determined using the methodology described above, management assesses the adequacy of the overall Allowance through an analysis of the size and mix of the loan portfolio, historical and recent credit performance of the loan portfolio (including the absolute level and trends in delinquencies and impaired loans), industry metrics and ratio analysis.

Our banking regulators, as an integral part of their examination process, periodically review the Company s Allowance. Our regulators may require the Company to recognize additions to the allowance based on their judgments related to information available to them at the time of their examinations.

While management believes that it uses the best information available to determine the allowance for loan losses, unforeseen market conditions and other events could result in adjustment to the allowance for loan losses, and net

income could be significantly affected, if circumstances differed substantially from the assumptions used in making the final determination.

Purchased Receivables: The Bank purchases accounts receivable at a discount from its customers. The purchased receivables are carried at cost. The discount and fees charged to the customer are earned while the balances of the purchases are outstanding. In the event an impairment or write-down is evident and warranted, the charge is taken against the asset balance and not from the allowance for loan losses.

Premises and Equipment: Premises and equipment, including leasehold improvements, are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization expense for financial reporting purposes is computed using the straight-line method based upon the shorter of the lease term or the estimated useful lives of the assets that vary according to the asset type and include; vehicles at 3 years, furniture and equipment ranging between 3 and 7 years, leasehold improvements ranging between 2 and 15 years, and buildings over 39 years. Maintenance and repairs are charged to current operations, while renewals and betterments are capitalized.

Intangible Assets: As part of an acquisition of branches from Bank of America in 1999, the Company recorded $6.9 million of goodwill and $2.9 million of core deposit intangible (CDI). This CDI is fully amortized as of December 31, 2008. In 2007, the Company recorded $2.1 million of goodwill and $1.3 million of CDI as part of the acquisition of Alaska First Bank & Trust, N.A. (Alaska First) stock. The Company amortizes this CDI over its estimated useful life of ten years using an accelerated method. In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets,*

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management reviews goodwill at least annually for impairment by reviewing a number of key market indicators. Finally, the Company recorded $1.1 million in intangible assets related to customer relationships purchased in the acquisition of an additional 40.1% of NBG in December 2005. The Company amortizes this intangible over its estimated life of ten years.

Other Assets: Other assets include purchased software and prepaid expenses. Purchased software is carried at amortized cost and is amortized using the straight-line method over their estimated useful life or the term of the agreement. Also included in other assets is the net deferred tax asset and the Company s investments in RML Holding Company, Elliott Cove, NBG, and PWA. All of these entities are affiliates of the Company. The Company includes the income and loss from its affiliates in its financial statements on a one month lagged basis.

Also included in other assets are the Company s investments in three low-income housing partnerships. These partnerships are all Delaware limited partnerships and include Centerline Corporate Partners XXII, L.P. (Centerline XXII) Centerline Corporate Partners XXXIII, L.P. (Centerline XXXIII), and U.S.A. Institutional Tax Credit Fund LVII L.P. (USA 57). These entities are variable interest entities (VIEs). A variable interest entity is an entity whose equity investors lack the ability to make decisions about the entity s activity through voting rights and do not have the obligation to absorb the entity s expected losses or receive residual returns if they occur. The Company made commitments to purchase a $3 million interest in each of these partnerships in January 2003, September 2006 and December 2006, respectively.

Other Real Estate Owned: Other real estate owned represents properties acquired through foreclosure or its equivalent. Prior to foreclosure, the carrying value is adjusted to the fair value, less cost to sell, of the real estate to be acquired by an adjustment to the allowance for loan losses. Management s evaluation of fair value is based on appraisals or discounted cash flows of anticipated sales. The amount by which the fair value less cost to sell is greater than the carrying amount of the loan plus amounts previously charged off is recognized in earnings up to the original cost of the asset. Any subsequent reduction in the carrying value is charged against earnings. Operating expenses associated with other real estate owned are charged to earnings in the period they are incurred.

Advertising: Advertising, promotion and marketing costs are expensed as incurred. The Company reported total expenses of $1.6 million for each of the periods ending December 31, 2008, 2007, and 2006.