HERITAGE FINANCIAL CORP /WA/
Form 10-Q
August 03, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2012

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 0-29480

HERITAGE FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

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

(360) 943-1500

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

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

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

As of July 13, 2012 there were 15,144,079 common shares outstanding, with no par value, of the registrant.

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Forward Looking Statements

Safe Harbor statement under the Private Securities Litigation Reform Act of 1995: This Form 10-Q contains forward-looking statements that are subject to risks and uncertainties, including, but not limited to: the credit and concentration risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and changes in our allowance for loan losses and provision for loan losses that may be impacted by deterioration in the housing and commercial real estate markets; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates, and the relative differences between short and long term interest rates, deposit interest rates, our net interest margin and funding sources; risks related to acquiring assets in or entering markets in which we have not previously operated and may not be familiar; fluctuations in the demand for loans, the number of unsold homes and other properties and fluctuations in real estate values in our market areas; results of examinations of us by the Board of Governors of the Federal Reserve System (the Federal Reserve Board) and of our bank subsidiaries by the Federal Deposit Insurance Corporation (the FDIC), the Washington State Department of Financial Institutions, Division of Banks (the Washington DFI) or other regulatory authorities, including the possibility that any such regulatory authority may, among other things, require us to increase our reserve for loan losses, write-down assets, change our regulatory capital position or affect our ability to borrow funds or maintain or increase deposits, which could adversely affect our liquidity and earnings; legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, including the interpretation of regulatory capital or other rules including changes from the Dodd-Frank Wall Street Reform and Consumer Protection Act and regulations that have been or will be promulgated thereunder; our ability to control operating costs and expenses; the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation; difficulties in reducing risk associated with the loans on our balance sheet; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our workforce and potential associated charges; computer systems on which we depend could fail or experience a security breach; our ability to recruit and retain key members of our senior management team and staff; costs and effects of litigation, including settlements and judgments; our ability to implement our expansion strategy; our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we have acquired including the Cowlitz Bank and Pierce Commercial Bank transactions or may in the future acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto; risks relating to acquiring assets or entering markets in which we have not previously operated and may not be familiar; changes in consumer spending, borrowing and savings habits; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services; and other risks detailed from time to time in our filings with the Securities and Exchange Commission.

The Company cautions readers not to place undue reliance on any forward-looking statements. Moreover, you should treat these statements as speaking only as of the date they are made and based only on information then actually known to the Company. The Company does not undertake and specifically disclaims any obligation to revise any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements. These risks could cause our actual results for the remainder of 2012 and beyond to differ materially from those expressed in any forward-looking statements by, or on behalf of, us, and could negatively affect the Company s operating and stock price performance.

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

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ITEM 1. HERITAGE FINANCIAL CORPORATION

HERITAGE FINANCIAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(Dollars in thousands, except for per share amounts)

(Unaudited)

	June 30, 2012	December 31, 2011
Assets		
Cash on hand and in banks	$ 31,245	$ 30,193
Interest earning deposits	52,011	93,566
Cash and cash equivalents	83,256	123,759
Investment securities available for sale	149,778	144,602
Investment securities held to maturity (fair value of $12,059 and $12,881)	11,190	12,093
Loans held for sale	1,174	1,828
Originated loans receivable	853,633	837,924
Less: Allowance for loan losses	(20,843)	(22,317)
Originated loans receivable, net	832,790	815,607
Purchased covered loans receivable, net of allowance for loan losses of ($3,973 and $3,963)	97,357	105,394
Purchased non-covered loans receivable, net of allowance for loan losses of ($4,667 and $4,635)	72,273	83,479
Total loans receivable, net	1,002,420	1,004,480
FDIC indemnification asset	8,212	10,350
Other real estate owned ($563 and $774 covered by FDIC loss share, respectively)	8,634	4,484
Premises and equipment, net	23,166	22,975
Federal Home Loan Bank stock, at cost	5,594	5,594
Accrued interest receivable	4,683	5,117
Prepaid expenses and other assets	14,982	8,190
Deferred income taxes, net	10,739	10,988
Other intangible assets, net	1,299	1,513
Goodwill	13,012	13,012
Total assets	$ 1,338,139	$ 1,368,985
Liabilities and Stockholders Equity		
Deposits	$ 1,113,346	$ 1,136,044
Securities sold under agreement to repurchase	13,656	23,091
Accrued expenses and other liabilities	11,002	7,330
Total liabilities	1,138,004	1,166,465
Stockholders equity:		
Preferred stock, no par value, 2,500,000 shares authorized; no shares issued and outstanding at June 30, 2012 and December 31, 2011		
Common stock, no par value, 50,000,000 shares authorized; 15,143,189 and 15,456,297 shares outstanding at June 30, 2012 and December 31, 2011, respectively	121,955	126,622
Unearned compensation Employee Stock Ownership Plan (ESOP)	(50)	(94)
Retained earnings	76,434	74,256
Accumulated other comprehensive income, net	1,796	1,736

Total stockholders equity	200,135	202,520
Total liabilities and stockholders equity	$ 1,338,139	$ 1,368,985

See Notes to Condensed Consolidated Financial Statements.

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HERITAGE FINANCIAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except for per share amounts)

(Unaudited)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
INTEREST INCOME:				
Interest and fees on loans	$ 16,465	$ 18,829	$ 33,483	$ 35,401
Taxable interest on investment securities	604	768	1,256	1,431
Nontaxable interest on investment securities	267	199	523	378
Interest on interest bearing deposits	53	61	116	141
Total interest income	17,389	19,857	35,378	37,351
INTEREST EXPENSE:				
Deposits	1,163	1,682	2,440	3,557
Other borrowings	16	20	34	42
Total interest expense	1,179	1,702	2,474	3,599
Net interest income	16,210	18,155	32,904	33,752
Provision for loan losses on originated loans	200	1,995	200	4,590
Provision for loan losses on purchased loans	419	1,529	310	3,307
Net interest income after provision for loan losses	15,591	14,631	32,394	25,855
NON-INTEREST INCOME:				
Gains on sales of loans, net	53	35	116	186
Service charges on deposits	1,345	1,278	2,650	2,516
Merchant Visa income, net	182	129	352	259
Change in FDIC indemnification asset	(19)	(1,712)	(195)	(912)
Other income	503	521	1,049	1,111
Total non-interest income	2,064	251	3,972	3,160
NON-INTEREST EXPENSE:				
Impairment loss on investment securities	62	19	98	64
Less: Portion recorded as other comprehensive loss	(38)		(38)	(20)
Impairment loss on investment securities, net	24	19	60	44
Salaries and employee benefits	7,287	7,075	14,485	13,712
Occupancy and equipment	1,832	1,719	3,617	3,565
Data processing	668	636	1,259	1,458
Marketing	369	379	772	694
Professional services	628	413	1,182	1,047
State and local taxes	320	369	630	725
Federal deposit insurance premium	263	432	538	889
Other real estate owned, net	196	48	452	565
Other expense	1,283	1,483	2,473	2,957
Total non-interest expense	12,870	12,573	25,468	25,656

Income before income taxes	4,785	2,309	10,898	3,359
Income tax expense	1,591	624	3,534	909
Net income	$ 3,194	$ 1,685	$ 7,364	$ 2,450
Earnings per share:				
Basic	$ 0.21	$ 0.11	$ 0.48	$ 0.16
Diluted	$ 0.21	$ 0.11	$ 0.48	$ 0.16
Dividends declared per common share:	$ 0.28	$ 0.03	$ 0.34	$ 0.03

See Notes to Condensed Consolidated Financial Statements.

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HERITAGE FINANCIAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands, except for per share amounts)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
Comprehensive Income	**2012**	**2011**	**2012**	**2011**
Net income	$ 3,194	$ 1,685	$ 7,364	$ 2,450
Change in fair value of securities available for sale, net of tax of $194, $178, $17 and $174	360	928	33	922
Reclassification adjustment of net gain from sale of available for sale securities included in income, net of tax of $0, $(7), $0 and $(8)		(13)		(14)
Other-than-temporary impairment on securities held to maturity, net of tax of $(13), $0, $(13) and $(7)	(25)		(25)	(13)
Accretion of other-than-temporary impairment in securities held to maturity, net of tax of $14, $15, $28 and $35	26	28	52	64
Other comprehensive income	$ 361	$ 943	$ 60	$ 959
Comprehensive income	$ 3,555	$ 2,628	$ 7,424	$ 3,409

See Notes to Condensed Consolidated Financial Statements.

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HERITAGE FINANCIAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY FOR THE SIX MONTHS ENDED

JUNE 30, 2012

(Dollars and shares in thousands)

(Unaudited)

	Number of common shares	Common stock	Unearned Compensation-ESOP	Retained earnings	Accumulated other comprehensive income, net	Total stockholders equity
Balance at December 31, 2011	15,456	$ 126,622	$ (94)	$ 74,256	$ 1,736	$ 202,520
Restricted stock awards issued, net of forfeitures	73					
Stock option compensation expense		60				60
Exercise of stock options (including tax benefits from nonqualified stock options)	1	11				11
Share based payment and earned ESOP	5	576	44			620
Tax associated with share based payment and unallocated ESOP		(44)				(44)
Common stock repurchased and retired	(392)	(5,270)				(5,270)
Net income				7,364		7,364
Other comprehensive income, net of tax					60	60
Cash dividends declared on common stock ($0.34 per share)				(5,186)		(5,186)
Balance at June 30, 2012	15,143	$ 121,955	$ (50)	$ 76,434	$ 1,796	$ 200,135

See Notes to Condensed Consolidated Financial Statements.

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HERITAGE FINANCIAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the six months ended June 30, 2012 and 2011

(Dollars in thousands)

(Unaudited)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Cash flows from operating activities:		
Net income	$ 7,364	$ 2,450
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,868	531
Change in net deferred loan fees	36	301
Provision for loan losses	510	7,897
Net change in accrued interest receivable, prepaid expenses and other assets and accrued expenses and other liabilities	(3,621)	(2,141)
Recognition of compensation related to ESOP shares and share based payment	620	485
Stock option compensation expense	60	95
Excess tax benefit realized from stock options exercised, share based payment and dividends on unallocated ESOP shares	44	147
Amortization of intangible assets	214	226
Deferred income taxes	217	332
Loss (gain) on investments		(23)
Impairment loss on investment securities	60	44
Origination of loans held for sale	(7,568)	(6,259)
Gains on sales of loans, net	(116)	(186)
Proceeds from sale of loans	8,338	6,536
Valuation adjustment on other real estate owned	483	595
Losses on sale of other real estate owned, net	2	53
Losses on sale of premises and equipment, net	2	1
Net cash provided by operating activities	8,513	11,084
Cash flows from investing activities:		
Loans originated, net of principal payments	(4,012)	(11,377)
Maturities of investment securities available for sale	25,989	11,843
Maturities of investment securities held to maturity	1,037	976
Purchases of investment securities available for sale	(32,113)	(33,559)
Purchases of investment securities held to maturity		(271)
Purchases of premises and equipment	(1,215)	(1,587)
Proceeds from sales of other real estate owned	891	1,808
Proceeds from sales of investment securities available for sale		412
Net cash used in investing activities	(9,423)	(31,755)
Cash flows from financing activities:		
Net decrease in deposits	(22,698)	(28,556)
Common stock cash dividends paid	(2,157)	(470)
Net decrease in securities sold under agreement to repurchase	(9,435)	(1,755)

Proceeds from exercise of stock options	11	
Excess tax benefits realized from stock options exercised, share based payment and dividends on unallocated ESOP shares	(44)	(147)
Repurchase of common stock	(5,270)	
Net cash used in financing activities	(39,593)	(30,928)
Net decrease in cash and cash equivalents	(40,503)	(51,599)
Cash and cash equivalents at beginning of period	123,759	168,991
Cash and cash equivalents at end of period	$ 83,256	$ 117,392
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ 2,531	$ 3,692
Cash paid for income taxes	7,372	3,089
Loans transferred to other real estate owned	$ 5,526	$ 1,337

See Notes to Condensed Consolidated Financial Statements.

HERITAGE FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Three and Six Months Ended June 30, 2012 and 2011

(Unaudited)

NOTE 1. Description of Business and Basis of Presentation

(a) Description of Business

Heritage Financial Corporation (the Company) is a bank holding company incorporated in the State of Washington in August 1997. The Company is primarily engaged in the business of planning, directing and coordinating the business activities of its wholly owned subsidiaries: Heritage Bank and Central Valley Bank (the Banks). The Banks are Washington-chartered commercial banks and their deposits are insured by the FDIC under the Deposit Insurance Fund (DIF). Heritage Bank conducts business from its main office in Olympia, Washington and its twenty-six branch offices located in western Washington and the greater Portland, Oregon area. Central Valley Bank conducts business from its main office in Toppenish, Washington and its five branch offices located in Yakima and Kittitas counties of Washington State.

The Company s business consists primarily of lending and deposit relationships with small businesses and their owners in its market areas and attracting deposits from the general public. The Company also makes real estate construction and land development loans, one-to-four family residential loans, and consumer loans and originates for sale or investment purposes first mortgage loans on residential properties located in western and central Washington State and the greater Portland, Oregon area.

Effective July 30, 2010, Heritage Bank entered into a definitive agreement with the FDIC, pursuant to which Heritage Bank acquired certain assets and assumed certain liabilities of Cowlitz Bank, a Washington state-chartered bank headquartered in Longview, Washington (the Cowlitz Acquisition). The Cowlitz Acquisition included nine branches of Cowlitz Bank, including its division Bay Bank, which opened as branches of Heritage Bank as of August 2, 2010. It also included the Trust Services Division of Cowlitz Bank. Effective November 5, 2010, Heritage Bank entered into a definitive agreement with the FDIC, pursuant to which Heritage Bank acquired certain assets and assumed certain liabilities of Pierce Commercial Bank, a Washington state-chartered bank headquartered in Tacoma, Washington (the Pierce Commercial Acquisition). The Pierce Commercial Acquisition included one branch, which opened as a branch of Heritage Bank as of November 8, 2010. The Cowlitz Acquisition and the Pierce Commercial Acquisition are collectively referred to as the Cowlitz and Pierce Acquisitions.

(b) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with Generally Accepted Accounting Principles (GAAP), for interim financial information, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. These condensed consolidated financial statements should be read with our December 31, 2011 audited consolidated financial statements and its accompanying notes included in our Annual Report on Form 10-K (Form 10-K). In our opinion, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. In preparing the condensed consolidated financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses. Actual results could differ from those estimates. Estimates related to fair value measurements, the allowance for loan losses, expected cash flows from, and indemnification asset related to, purchased loans, other real estate owned, other-than-temporary impairment of investment securities, goodwill and other intangible assets, stock-based compensation and income taxes are particularly subject to change.

Certain prior period amounts have been reclassified to conform to the current period s presentation. Reclassifications had no effect on prior period net income or stockholders equity.

(c) Significant Accounting Policies

The significant accounting policies used in preparation of our consolidated financial statements are disclosed in our 2011 Annual Form 10-K. There have not been any material changes in our significant accounting policies compared to those contained in our Form 10-K disclosure for the year ended December 31, 2011.

(d) Recently Issued Accounting Pronouncements

Financial Accounting Standards Board (FASB) Accounting Standards Updates (ASU) 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, was issued in May 2011 as a result of the FASB and International Accounting Standards Board s (IASB) goal to develop common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. GAAP and International Financial Reporting

Standards. The provisions of this Update are effective during the interim or annual periods beginning after December 15, 2011, and are to be applied prospectively. The adoption of the Update did not have a material effect on the Company s consolidated financial statements, however the additional disclosures are included in Note 10.

FASB ASU 2011-05, *Presentation of Comprehensive Income*, was issued in June 2011 requiring that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This Update also requires that reclassification adjustments for items that are reclassified from other comprehensive income to net income be presented on the face of the financial statements. The provisions of this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, and are to be applied retrospectively. Early adoption is permitted. The adoption of the Update did not have a material effect on the Company s consolidated financial statements at the date of adoption. The Company has presented condensed consolidated statements of comprehensive income for the three and six months ended June 30, 2012 and 2011 as a separate statement immediately following the condensed consolidated statements of income for the three and six months ended June 30, 2012 and 2011.

FASB ASU 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*, was issued in December 2011 updating and superseding certain pending paragraphs relating to the presentation on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. This Update is effective concurrent with ASU 2011-05, *Presentation of Comprehensive Income,* and will not have a material effect on the Company s consolidated financial statements at the date of adoption.

NOTE 2. Loans Receivable

The Company originates loans under the normal course of business. These loans are identified as originated loans. Disclosures related to the Company s recorded investment in originated loans receivable generally exclude accrued interest receivable and deferred loan origination fees and costs due to their insignificance. The Company has also acquired loans through FDIC-assisted transactions. Loans acquired in a business acquisition are designated as purchased loans. The Company refers to the purchased loans subject to the shared-loss agreements as covered loans, and those loans without a shared-loss agreement are referred to as non-covered loans. Loans purchased with evidence of credit deterioration since origination for which it is probable that all contractually required payments will not be collected are accounted for under FASB Accounting Standards Codification (FASB ASC) 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. These loans are identified as purchased impaired loans. Loans purchased that are not accounted for under FASB ASC 310-30 are accounted for under FASB ASC 310-20, *Receivables Nonrefundable fees and Other Costs*. These loans are identified as purchased other loans.

(a) Loan Origination/Risk Management

The Company originates loans in one of the four segments of the total loan portfolio: commercial business, real estate construction and land development, one-to-four family residential, and consumer. Within these segments are classes of loans to which management monitors and assesses credit risk in the loan portfolios. The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies, and nonperforming and potential problem loans. The Company also conducts external loan reviews and validates the credit risk assessment on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company s policies and procedures.

A discussion of the risk characteristics of each portfolio segments is as follows:

Commercial Business: There are three significant classes of loans in the commercial portfolio segment, including commercial and industrial loans, owner-occupied commercial real estate, and non-owner occupied commercial real estate. The owner and non-owner occupied commercial real estate are both considered commercial real estate loans. As the commercial and industrial loans carry different risk characteristics than the commercial real estate loans, they are discussed separately below.

Commercial and industrial. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may include a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

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Commercial real estate. The Company originates commercial real estate loans within its primary market areas. These loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate involves more risk than other classes in that the lending typically involves higher loan principal amounts, and payments on loans secured by real estate properties are dependent on successful operation and management of the properties. Repayment of these loans may be more adversely affected by conditions in the real estate market or the economy.

One-to-Four Family Residential: The majority of the Company s one-to four-family residential loans are secured by single-family residences located in its primary market areas. The Company s underwriting standards require that single-family portfolio loans generally are owner-occupied and do not exceed 80% of the lower of appraised value at origination or cost of the underlying collateral. Terms typically range from 15 to 30 years. The Company generally sells most single-family loans in the secondary market. Management determines to what extent the Company will retain or sell these loans and other fixed rate mortgages in order to control the Banks interest rate sensitivity position, growth and liquidity.

Real Estate Construction and Land Development: The Company originates construction loans for one-to-four family residential and for five or more residential properties and commercial properties. The one-to-four family residential construction loans generally include construction of custom homes whereby the home buyer is the borrower. The Company also provides financing to builders for the construction of pre-sold homes and, in selected cases, to builders for the construction of speculative residential property. Substantially all construction loans are short-term in nature and priced with a variable rate of interest. Construction lending can involve a higher level of risk than other types of lending because funds are advanced partially based upon the value of the project, which is uncertain prior to the project s completion. Because of the uncertainties inherent in estimating construction costs as well as the market value of a completed project and the effects of governmental regulation of real property, the Company s estimates with regards to the total funds required to complete a project and the related loan-to-value ratio may vary from actual results. As a result, construction loans often involve the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project and the ability of the borrower to sell or lease the property or refinance the indebtedness. If the Company s estimate of the value of a project at completion proves to be overstated, it may have inadequate security for repayment of the loan and may incur a loss if the borrower does not repay the loan. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

Consumer: The Company originates consumer loans and lines of credit that are both secured and unsecured. The underwriting process is developed to ensure a qualifying primary and secondary source of repayment. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include, but are not limited to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time and documentation requirements. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed. The majority of the consumer loans are relatively small amounts spread across many individual borrowers which minimizes the credit risk. Additionally, trend reports are reviewed by management on a regular basis.

Originated loans receivable at June 30, 2012 and December 31, 2011 consisted of the following portfolio segments and classes:

	June 30, 2012	**December 31, 2011**
	(In thousands)	
Commercial business:		
Commercial and industrial	$ 278,194	$ 273,590
Owner-occupied commercial real estate	180,982	166,881
Non-owner occupied commercial real estate	257,263	251,049
Total commercial business	716,439	691,520
One-to-four family residential	37,752	37,960
Real estate construction and land development:		
One-to-four family residential	24,132	22,369
Five or more family residential and commercial properties	46,457	54,954
Total real estate construction and land development	70,589	77,323

Consumer	30,749	32,981
Gross originated loans receivable	855,529	839,784
Net deferred loan fees	(1,896)	(1,860)
Total originated loans receivable	$ 853,633	$ 837,924

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The recorded investment in purchased covered loans receivable at June 30, 2012 and December 31, 2011 consisted of the following portfolio segments and classes:

	June 30, 2012	December 31, 2011
	(In thousands)	
Commercial business:		
Commercial and industrial	$ 36,032	$ 38,607
Owner-occupied commercial real estate	36,286	38,067
Non-owner occupied commercial real estate	13,961	15,753
Total commercial business	86,279	92,427
One-to-four family residential	5,051	5,197
Real estate construction and land development:		
One-to-four family residential	4,271	5,786
Five or more family residential and commercial properties		
Total real estate construction and land development	4,271	5,786
Consumer	5,729	5,947
Total purchased covered loans receivable	101,330	109,357
Allowance for loan losses	(3,973)	(3,963)
Purchased covered loans receivable, net	$ 97,357	$ 105,394

The June 30, 2012 and December 31, 2011 gross recorded investment balance of purchased impaired covered loans accounted for under FASB ASC 310-30 was $70.7 million and $78.7 million, respectively. The gross recorded investment balance of purchased other covered loans was $30.7 million at June 30, 2012 and December 31, 2011. As of June 30, 2012 and December 31, 2011, the recorded investment balance of purchased covered loans which are no longer covered under the FDIC loss-sharing agreements was $4.3 million and $3.8 million, respectively.

Funds advanced on the purchased covered loans subsequent to acquisition, referred to as subsequent advances, are included in the purchased covered loan balances as these subsequent advances are covered under the loss-sharing agreements. These subsequent advances are not accounted for under FASB ASC 310-30. The total balance of subsequent advances on the purchased covered loans was $13.7 million and $13.5 million as of June 30, 2012 and December 31, 2011, respectively.

The recorded investment in purchased non-covered loans receivable at June 30, 2012 and December 31, 2011 consisted of the following portfolio segments and classes:

	June 30, 2012	December 31, 2011
	(In thousands)	
Commercial business:		
Commercial and industrial	$ 29,802	$ 35,607
Owner-occupied commercial real estate	16,984	17,052
Non-owner occupied commercial real estate	12,678	12,833
Total commercial business	59,464	65,492
One-to-four family residential	3,084	2,743
Real estate construction and land development:		
One-to-four family residential	1,030	1,381
Five or more family residential and commercial properties	1,329	1,078
Total real estate construction and land development	2,359	2,459

Consumer	12,033	17,420
Total purchased non-covered loans receivable	76,940	88,114
Allowance for loan losses	(4,667)	(4,635)
Purchased non-covered loans receivable, net	$ 72,273	$ 83,479

The June 30, 2012 and December 31, 2011 gross recorded investment balance of impaired purchased non-covered loans accounted for under FASB ASC 310-30 was $48.0 million and $56.1 million, respectively. The recorded investment balance of other purchased non-covered loans was $29.0 million and $32.0 million at June 30, 2012 and December 31, 2011, respectively.

(b) Concentrations of Credit

Most of the Company s lending activity occurs within the State of Washington, and to a lesser extent the State of Oregon. The primary market areas include Thurston, Pierce, King, Mason, Cowlitz and Clark counties in Washington and Multnomah County in Oregon, as well as other markets. The majority of the Company s loan portfolio consists of commercial and industrial, non-owner occupied commercial real estate, and owner occupied commercial real estate. As of June 30, 2012 and December 31, 2011, there were no concentrations of loans related to any single industry in excess of 10% of total loans.

(c) Credit Quality Indicators

As part of the on-going monitoring of the credit quality of the Company s loan portfolio, management tracks certain credit quality indicators including trends related to (i) the risk grade of the loans, (ii) the level of classified loans, (iii) net charge-offs, (iv) nonperforming loans, and (v) the general economic conditions of the United States of America, and specifically the states of Washington and Oregon. The Company utilizes a risk grading matrix to assign a risk grade to each of its loans. Loans are graded on a scale of 0 to 9, and a W . A description of the general characteristics of the risk grades is as follows:

Grades 0 to 5: These grades are considered pass grade with negligible to above average but acceptable risk. These borrowers generally have strong to acceptable capital levels and consistent earnings and debt service capacity. Loans with the higher grades within the pass category may include borrowers who are experiencing unusual operating difficulties, but have acceptable payment performance to date. Increased monitoring of financials and/or collateral may be appropriate. Overall, loans with this grade show no immediate loss exposure.

Grade W : This grade includes loans on management s watch list and is intended to be utilized on a temporary basis for pass grade borrowers where a potentially significant risk-modifying action is anticipated in the near term.

Grade 6: This grade is for Other Assets Especially Mentioned loans (OAEM) in accordance with regulatory guidelines, and is intended to highlight loans with elevated risks. Loans with this grade show signs of deteriorating profits and capital, and the borrower might not be strong enough to sustain a major setback. The borrower is typically higher than normally leveraged, and outside support might be modest and likely illiquid. The loan is at risk of further decline unless active measures are taken to correct the situation.

Grade 7: This grade includes Substandard loans, in accordance with regulatory guidelines, for which the loan has a high risk. The loan also has well-defined weaknesses which make payment default or principal exposure likely, but not yet certain. The borrower may have shown serious negative trends in financial ratios and performance. Such loans are apt to be dependent upon collateral liquidation, a secondary source of repayment or an event outside of the normal course of business. Loans with this grade can be accrual or nonaccrual status based on the Company s accrual policy.

Grade 8: This grade includes Doubtful loans in accordance with regulatory guidelines, and the Company has determined these loans to have excessive risk. Such loans are placed on nonaccrual status and may be dependent upon collateral having a value that is difficult to determine or upon some near-term event which lacks certainty. Additionally, these loans generally have a specific valuation allowance.

Grade 9: This grade includes Loss loans in accordance with regulatory guidelines. These loans are determined to have the highest risk of loss. Such loans are charged-off or charged-down when payment is acknowledged to be uncertain or when the timing or value of payments cannot be determined. Loss is not intended to imply that the loan or some portion of it will never be paid, nor does it in any way imply that there has been a forgiveness of debt.

Loan grades for all commercial business loans and real estate construction and land development loans are established at the origination of the loan. One-to-four family residential loans and consumer loans (non-commercial loans) are not graded as a 0 to 9 at origination date as these loans are determined to be pass graded loans. These non-commercial loans may subsequently require a 0-9 risk grade if the credit department has evaluated the credit and determined it necessary to classify the loan. Loan grades are reviewed on a quarterly basis, or more frequently if necessary, by the credit department. Typically, an individual loan grade will not be changed from the prior period unless there is a specific indication of credit deterioration or improvement. Credit deterioration is evidenced by delinquency, direct communications with the borrower, or other borrower information that becomes known to management. Credit improvements are evidenced by known facts regarding the borrower or the collateral property.

The loan grades relate to the likelihood of losses in that the higher the grade, the greater the loss potential. Loans with a pass grade are believed to have some inherent losses in the portfolios, but to a lesser extent than the other loan grades. These pass graded loans might have a zero percent loss based on historical experience and current market trends. The OAEM loan grade is transitory in that the Company is waiting on additional information to determine the likelihood and extent of the potential loss. However, the likelihood of loss is greater than Watch grade because there has been measurable credit deterioration. Loans with a Substandard grade are generally loans for which the Company has individually analyzed for potential impairment. For Doubtful and Loss graded loans, the Company is almost certain of the losses, and the unpaid principal balances are generally charged-off.

The following tables present the balance of the originated loans receivable by credit quality indicator as of June 30, 2012 and December 31, 2011.

	June 30, 2012				
	Pass	OAEM	Substandard (In thousands)	Doubtful	Total
Commercial business:					
Commercial and industrial	$ 253,643	$ 2,623	$ 20,378	$ 1,550	$ 278,194
Owner-occupied commercial real estate	176,542	1,775	2,665		180,982
Non-owner occupied commercial real estate	244,885	4,094	7,915	369	257,263
Total commercial business	675,070	8,492	30,958	1,919	716,439
One-to-four family residential	35,977	427	944	404	37,752
Real estate construction and land development:					
One-to-four family residential	13,126	2,694	8,312		24,132
Five or more family residential and commercial properties	41,815		4,642		46,457
Total real estate construction and land development	54,941	2,694	12,954		70,589
Consumer	30,465	100	182	2	30,749
Gross originated loans	$ 796,453	$ 11,713	$ 45,038	$ 2,325	$ 855,529

	December 31, 2011				
	Pass	OAEM	Substandard (In thousands)	Doubtful	Total
Commercial business:					
Commercial and industrial	$ 247,503	$ 2,770	$ 22,887	$ 430	$ 273,590
Owner-occupied commercial real estate	162,536	1,225	3,120		166,881
Non-owner occupied commercial real estate	240,096	2,063	8,890		251,049
Total commercial business	650,135	6,058	34,897	430	691,520
One-to-four family residential	36,997	431	532		37,960
Real estate construction and land development:					
One-to-four family residential	10,725	2,828	8,816		22,369
Five or more family residential and commercial properties	42,541		12,413		54,954
Total real estate construction and land development	53,266	2,828	21,229		77,323
Consumer	32,629		346	6	32,981
Gross originated loans	$ 773,027	$ 9,317	$ 57,004	$ 436	$ 839,784

The tables above include impaired loan balances. Potential problem loans are those loans that are currently accruing interest and are not considered impaired, but which management is monitoring because the financial information of the borrower causes concern as to their ability to meet their loan repayment terms. Potential problem originated loans as of June 30, 2012 and December 31, 2011 were $28.3 million and $29.7 million, respectively. The balance of potential problem originated loans guaranteed by a governmental agency was $3.2 million and $2.8 million as of June 30, 2012 and December 31, 2011, respectively. This guarantee reduces the Company s credit exposure.

The following tables present the recorded balance of the purchased other covered and non-covered loans receivable by credit quality indicator as of June 30, 2012 and December 31, 2011.

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	Pass	OAEM	June 30, 2012 Substandard (In thousands)	Doubtful	Total
Commercial business:					
Commercial and industrial	$ 13,643	$ 87	$ 705	$	$ 14,435
Owner-occupied commercial real estate	26,892	2,442	341		29,675
Non-owner occupied commercial real estate	4,536	491	979		6,006
Total commercial business	45,071	3,020	2,025		50,116
One-to-four family residential	1,396				1,396
Real estate construction and land development:					
One-to-four family residential	48				48
Five or more family residential and commercial properties					
Total real estate construction and land development	48				48
Consumer	7,476		170	417	8,063
Gross purchased other loans	$ 53,991	$ 3,020	$ 2,195	$ 417	$ 59,623

	Pass	OAEM	December 31, 2011 Substandard (In thousands)	Doubtful	Total
Commercial business:					
Commercial and industrial	$ 11,781	$ 125	$ 780	$	$ 12,686
Owner-occupied commercial real estate	29,791		587		30,378
Non-owner occupied commercial real estate	4,427	1,046	441		5,914
Total commercial business	45,999	1,171	1,808		48,978
One-to-four family residential	1,529		42		1,571
Real estate construction and land development:					
One-to-four family residential	50				50
Five or more family residential and commercial properties					
Total real estate construction and land development	50				50
Consumer	11,435		674		12,109
Gross purchased other loans	$ 59,013	$ 1,171	$ 2,524	$	$ 62,708

(d) Nonaccrual loans

Originated nonaccrual loans, segregated by segments and classes of loans, were as follows as of June 30, 2012 and December 31, 2011:

	June 30, 2012(1)	December 31, 2011(1)
	(In thousands)	
Commercial business:		
Commercial and industrial	$ 6,491	$ 6,946
Owner-occupied commercial real estate	647	399
Non-owner occupied commercial real estate	369	921

Total commercial business	7,507	8,266
One-to-four family residential	753	
Real estate construction and land development:		
One-to-four family residential	3,647	5,150
Five or more family residential and commercial properties	4,642	9,797
Total real estate construction and land development	8,289	14,947
Consumer	148	125
Gross originated nonaccrual loans	$ 16,697	$ 23,338

(1) $2.3 million and $1.8 million of nonaccrual originated loans were guaranteed by governmental agencies at June 30, 2012 and December 31, 2011, respectively.

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The recorded investment balance of purchased other nonaccrual loans, segregated by segments and classes of loans, were as follows as of June 30, 2012 and December 31, 2011:

	June 30, 2012	December 31, 2011
	(In thousands)	
Commercial business:		
Commercial and industrial	$ 263	$
Owner-occupied commercial real estate	144	
Non-owner occupied commercial real estate	437	
Total commercial business	844	
Consumer	424	497
Gross purchased other nonaccrual loans	$ 1,268	$ 497

(e) Aged loans

The Company performs aging analysis of past due loans using the categories of 30-89 days past due and 90 or more days past due. This policy is consistent with regulatory reporting requirements. The balances of originated past due loans, segregated by segments and classes of loans, as of June 30, 2012 and December 31, 2011 were as follows:

	June 30, 2012					
	30-89 Days	90 Days or Greater	Total Past Due	Current	Total	90 Days or More and Still Accruing
	(In thousands)					
Commercial business:						
Commercial and industrial	$ 3,290	$ 4,041	$ 7,331	$ 270,863	$ 278,194	$
Owner-occupied commercial real estate	545	719	1,264	179,718	180,982	560
Non-owner occupied commercial real estate	551	369	920	256,343	257,263	
Total commercial business	4,386	5,129	9,515	706,924	716,439	560
One-to-four family residential	305	721	1,026	36,726	37,752	
Real estate construction and land development:						
One-to-four family residential	1,305	3,647	4,952	19,180	24,132	
Five or more family residential and commercial properties	2,594	4,289	6,883	39,574	46,457	
Total real estate construction and land development	3,899	7,936	11,835	58,754	70,589	
Consumer	122	54	176	30,573	30,749	4
Gross originated loans	$ 8,712	$ 13,840	$ 22,552	$ 832,977	$ 855,529	$ 564

	December 31, 2011					
	30-89 Days	90 Days or Greater	Total Past Due	Current	Total	90 Days or More and Still Accruing
	(In thousands)					
Commercial business:						
Commercial and industrial	$ 3,716	$ 4,769	$ 8,485	$ 265,105	$ 273,590	$ 921
Owner-occupied commercial real estate	1,903	398	2,301	164,580	166,881	
Non-owner occupied commercial real estate	369		369	250,680	251,049	
Total commercial business	5,988	5,167	11,155	680,365	691,520	921
One-to-four family residential	1,251	404	1,655	36,305	37,960	404
Real estate construction and land development:						
One-to-four family residential	582	5,150	5,732	16,637	22,369	
Five or more family residential and commercial properties	369	9,428	9,797	45,157	54,954	
Total real estate construction and land development	951	14,578	15,529	61,794	77,323	
Consumer	465	60	525	32,456	32,981	3
Gross originated loans	$ 8,655	$ 20,209	$ 28,864	$ 810,920	$ 839,784	$ 1,328

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The balances of purchased other past due loans, segregated by segments and classes of loans, as of June 30, 2012 and December 31, 2011 are as follows:

	June 30, 2012					
	30-89 Days	90 Days or Greater	Total Past Due	Current	Total	90 Days or More and Still Accruing
	(In thousands)					
Commercial business:						
Commercial and industrial	$	$ 262	$ 262	$ 14,173	$ 14,435	$
Owner-occupied commercial real estate	980	63	1,043	28,632	29,675	62
Non-owner occupied commercial real estate	120	437	557	5,449	6,006	
Total commercial business	1,100	762	1,862	48,254	50,116	62
One-to-four family residential				1,396	1,396	
Real estate construction and land development:						
One-to-four family residential				48	48	
Five or more family residential and commercial properties						
Total real estate construction and land development				48	48	
Consumer	370	417	787	7,276	8,063	
Gross purchased other loans	$ 1,470	$ 1,179	$ 2,649	$ 56,974	$ 59,623	$ 62

	December 31, 2011					
	30-89 Days	90 Days or Greater	Total Past Due	Current	Total	90 Days or More and Still Accruing
	(In thousands)					
Commercial business:						
Commercial and industrial	$ 243	$ 15	$ 258	$ 12,428	$ 12,686	$ 15
Owner-occupied commercial real estate	151		151	30,227	30,378	
Non-owner occupied commercial real estate	441		441	5,473	5,914	
Total commercial business	835	15	850	48,128	48,978	15
One-to-four family residential	42		42	1,529	1,571	
Real estate construction and land development:						
One-to-four family residential				50	50	
Five or more family residential and commercial properties						
Total real estate construction and land development				50	50	
Consumer	757	490	1,247	10,862	12,109	
Gross purchased other loans	$ 1,634	$ 505	$ 2,139	$ 60,569	$ 62,708	$ 15

(f) Impaired loans

Impaired originated loans (including restructured loans) at June 30, 2012 and December 31, 2011 are set forth in the following tables.

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	June 30, 2012				
	Recorded Investment With No Specific Valuation Allowance	Recorded Investment With Specific Valuation Allowance	Total Recorded Investment	Unpaid Contractual Principal Balance	Related Specific Valuation Allowance
			(In thousands)		
Commercial business:					
Commercial and industrial	$ 9,168	$ 3,010	$ 12,178	$ 13,308	$ 1,288
Owner-occupied commercial real estate	476	570	1,046	1,565	245
Non-owner occupied commercial real estate	2,964	4,277	7,241	7,241	727
Total commercial business	12,608	7,857	20,465	22,114	2,260
One-to-four family residential		1,179	1,179	1,881	183
Real estate construction and land development:					
One-to-four family residential	1,098	3,309	4,407	5,580	910
Five or more family residential and commercial properties		4,642	4,642	4,706	1,009
Total real estate construction and land development	1,098	7,951	9,049	10,286	1,919
Consumer	49	100	149	572	100
Gross impaired originated loans	$ 13,755	$ 17,087	$ 30,842	$ 34,853	$ 4,462

	December 31, 2011				
	Recorded Investment With No Specific Valuation Allowance	Recorded Investment With Specific Valuation Allowance	Total Recorded Investment	Unpaid Contractual Principal Balance	Related Specific Valuation Allowance
			(In thousands)		
Commercial business:					
Commercial and industrial	$ 4,532	$ 6,139	$ 10,671	$ 10,586	$ 1,488
Owner-occupied commercial real estate	603	1,368	1,971	2,271	107
Non-owner occupied commercial real estate	3,915	4,314	8,229	9,980	764
Total commercial business	9,050	11,821	20,871	22,837	2,359
One-to-four family residential		835	835	1,046	187
Real estate construction and land development:					
One-to-four family residential	748	4,765	5,513	6,813	1,436
Five or more family residential and commercial properties	963	8,835	9,798	14,219	530
Total real estate construction and land development	1,711	13,600	15,311	21,032	1,966
Consumer	120	6	126	159	6
Gross impaired originated loans	$ 10,881	$ 26,262	$ 37,143	$ 45,074	$ 4,518

The Company had governmental guarantees of $2.8 million and $1.8 million related to the impaired originated loan balances at June 30, 2012 and December 31, 2011, respectively.

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The average recorded investment of impaired originated loans (including restructured loans) for the three and six months ended June 30, 2012 and June 30, 2011 are set forth in the following tables.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands)			
Commercial business:				
Commercial and industrial	$ 12,044	$ 9,361	$ 11,226	$ 9,605
Owner-occupied commercial real estate	1,780	1,052	1,706	426
Non-owner occupied commercial real estate	7,406	1,847	7,736	1,872
Total commercial business	21,230	12,260	20,668	11,903
One-to-four family residential	1,165		1,007	
Real estate construction and land development:				
One-to-four family residential	4,606	6,570	4,960	8,564
Five or more family residential and commercial properties	4,652	10,202	7,220	7,561
Total real estate construction and land development	9,258	16,772	12,180	16,125
Consumer	189	52	137	
Gross impaired originated loans	$ 31,842	$ 29,084	$ 33,992	$ 28,028

Impaired purchased other loans (including restructured loans) at June 30, 2012 and December 31, 2011 are set forth in the following tables.

	June 30, 2012				
	Recorded Investment With No Specific Valuation Allowance	Recorded Investment With Specific Valuation Allowance	Total Recorded Investment	Unpaid Contractual Principal Balance	Related Specific Valuation Allowance
	(In thousands)				
Commercial business:					
Commercial and industrial	$ 18	$	$ 18	$ 18	$
Owner-occupied commercial real estate					
Non-owner occupied commercial real estate		542	542	528	23
Total commercial business	18	542	560	546	23
Consumer		7	7	9	3
Gross impaired purchased other loans	$ 18	$ 549	$ 567	$ 555	$ 26

	December 31, 2011				
	Recorded Investment With No Specific Valuation Allowance	Recorded Investment With Specific Valuation Allowance	Total Recorded Investment	Unpaid Contractual Principal Balance	Related Specific Valuation Allowance
	(In thousands)				

Consumer	$	$	9	$	9	$	9	$	5
Gross impaired purchased other loans	$	$	9	$	9	$	9	$	5

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The average recorded investment of impaired purchased other loans (including restructured loans) for the three and six months ended June 30, 2012 and June 30, 2011 are set forth in the following tables.

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(In thousands)			
Commercial business:				
Commercial and industrial	$ 19	$	$ 9	$
Owner-occupied commercial real estate				
Non-owner occupied commercial real estate	289		289	
Total commercial business	308		298	
Consumer	7		7	
Gross impaired purchased other loans	$ 315	$	$ 305	$

For the three and six months ended June 30, 2012 and June 30, 2011 no interest income was recognized subsequent to a loan s classification as impaired.

(g) Troubled Debt Restructured Loans

A troubled debt restructured loan (TDR) is a restructuring in which the Banks, for economic or legal reasons related to a borrower s financial difficulties, grants a concession to the borrower that it would not otherwise consider. TDRs are considered impaired and are separately measured for impairment under ASC 310-10-35, whether on accrual or nonaccrual status. At June 30, 2012 and December 31, 2011, the balance of originated accruing TDRs was $14.1 million and $13.8 million, respectively. The related allowance for loan losses on the originated accruing TDRs was $1.2 million and $1.4 million as of June 30, 2012 and December 31, 2011, respectively. At June 30, 2012, originated non-accruing TDRs were $10.3 million and had a related allowance for loan losses of $2.1 million. At December 31, 2011, originated non-accruing TDRs of $11.7 million had a related allowance for loan losses of $1.8 million. At June 30, 2012 and December 31, 2011, the balance of purchased other TDRs was $567,000 and $9,000, respectively. The related allowance for loan losses on the purchased other TDRs was $26,000 and $5,000 as of June 30, 2012 and December 31, 2011, respectively.

Originated TDRs that were modified during the three and six months ended June 30, 2012 and June 30, 2011 are set forth in the following tables:

	Three Months Ended June 30, 2012		2011	
	(Dollars in thousands)			
	Number of Contracts	Outstanding Principal Balance (1)	Number of Contracts	Outstanding Principal Balance (1)
Commercial business:				
Commercial and industrial	9	$ 1,248	6	$ 3,180
Owner-occupied commercial real estate		$	1	$ 1,380
Total commercial business	9	1,248	7	4,560
One-to-four family residential			2	841
Real estate construction and land development:				
Five or more family residential and commercial properties			2	4,813
Total real estate construction and land development			2	4,813

Total originated TDRs	9	$	1,248	11	$	10,214

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	Six Months Ended June 30,			
	2012		2011	
	(Dollars in thousands)			
	Number of Contracts (2)	Outstanding Principal Balance (1)(2)	Number of Contracts (2)	Outstanding Principal Balance (1)(2)
Commercial business:				
Commercial and industrial	13	$ 1,864	11	$ 4,110
Owner-occupied commercial real estate	1	198	2	1,585
Non-owner occupied commercial real estate			1	669
Total commercial business	14	2,062	14	6,364
One-to-four family residential			2	841
Real estate construction and land development:				
One-to-four family residential	2	397	2	364
Five or more family residential and commercial properties			2	4,813
Total real estate construction and land development	2	397	4	5,177
Total originated TDRs	16	$ 2,459	20	$ 12,382

(1) Includes subsequent payments after modifications and reflects the balance as of June 30, 2012 and June 30, 2011, respectively. The Banks initial recorded investments in the loans did not change as a result of the modifications as the Banks did not forgive any principal or interest balance as part of the modifications.

(2) Number of contracts and outstanding principal balance represents loans which have balances as of June 30, 2012 and June 30, 2011 as certain loans may have been paid-down or charged-off during the three months ended June 30, 2012 and June 30, 2011.

Purchased other TDRs that were modified during the three and six months ended June 30, 2012 are set forth in the following table:

	Three Months Ended June 30, 2012		Six Months Ended June 30, 2012	
	Number of Contracts	Outstanding Principal Balance (1)	Number of Contracts	Outstanding Principal Balance (1)
	(Dollars in thousands)			
Commercial business:				
Commercial and industrial		$	1	$ 18
Non-owner occupied commercial real estate	1	542	1	542
Total commercial business	1	542	2	560
Total purchased other TDRs	1	$ 542	2	$ 560

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