Bank of Marin Bancorp
Form 10-Q
August 07, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

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

For the quarterly period ended June 30, 2018

OR

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

For the transition period from __________________ to __________________

Commission File Number 001-33572

Bank of Marin Bancorp
(Exact name of Registrant as specified in its charter)

California	20-8859754
(State or other jurisdiction of incorporation)	(IRS Employer Identification No.)
504 Redwood Blvd., Suite 100, Novato, CA	94947
(Address of principal executive office)	(Zip Code)

Registrant's telephone number, including area code: (415) 763-4520

Indicate by check mark whether the registrant (1) has filed all reports 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 o

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 o

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

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

Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.
o

Indicate by check mark if the registrant is a shell company, as defined in Rule 12b-2 of the Exchange Act.
Yes o No x

As of July 31, 2018, there were 6,993,452 shares of common stock outstanding.

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

ITEM 1. Financial Statements

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CONDITION
June 30, 2018 and December 31, 2017

(in thousands, except share data; unaudited)	June 30, 2018	December 31, 2017
Assets		
Cash and due from banks	$83,855	$203,545
Investment securities		
Held-to-maturity, at amortized cost	170,652	151,032
Available-for-sale, at fair value	388,137	332,467
Total investment securities	558,789	483,499
Loans, net of allowance for loan losses of $15,813 and $15,767 at June 30, 2018 and December 31, 2017, respectively	1,701,798	1,663,246
Bank premises and equipment, net	7,965	8,612
Goodwill	30,140	30,140
Core deposit intangible	6,032	6,492
Interest receivable and other assets	76,463	72,620
Total assets	$2,465,042	$2,468,154
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Non-interest bearing	$1,057,745	$1,014,103
Interest bearing		
Transaction accounts	132,272	169,195
Savings accounts	179,187	178,473
Money market accounts	631,479	626,783
Time accounts	137,040	160,116
Total deposits	2,137,723	2,148,670
Subordinated debentures	5,802	5,739
Interest payable and other liabilities	17,319	16,720
Total liabilities	2,160,844	2,171,129
Stockholders' Equity		
Preferred stock, no par value, Authorized - 5,000,000 shares, none issued	—	—
Common stock, no par value, Authorized - 15,000,000 shares; Issued and outstanding - 6,991,821 and 6,921,542 at June 30, 2018 and December 31, 2017, respectively	146,195	143,967
Retained earnings	166,281	155,544
Accumulated other comprehensive loss, net of taxes	(8,278)	(2,486)
Total stockholders' equity	304,198	297,025
Total liabilities and stockholders' equity	$2,465,042	$2,468,154

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands, except per share amounts; unaudited)	Three months ended		Six months ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Interest income				
Interest and fees on loans	$19,624	$16,423	$38,511	$32,272
Interest on investment securities				
Securities of U.S. government agencies	2,860	1,534	5,335	3,052
Obligations of state and political subdivisions	604	553	1,242	1,121
Corporate debt securities and other	35	36	79	73
Interest on Federal funds sold and due from banks	285	157	688	217
Total interest income	23,408	18,703	45,855	36,735
Interest expense				
Interest on interest-bearing transaction accounts	48	21	100	50
Interest on savings accounts	18	16	36	31
Interest on money market accounts	236	114	452	227
Interest on time accounts	140	139	296	285
Interest on Federal Home Loan Bank ("FHLB") and other borrowings	1	—	1	—
Interest on subordinated debentures	123	109	237	217
Total interest expense	566	399	1,122	810
Net interest income	22,842	18,304	44,733	35,925
Provision for loan losses	—	—	—	—
Net interest income after provision for loan losses	22,842	18,304	44,733	35,925
Non-interest income				
Service charges on deposit accounts	455	447	932	899
Wealth Management and Trust Services	488	504	1,003	1,007
Debit card interchange fees	360	384	756	756
Merchant interchange fees	118	112	198	208
Earnings on bank-owned life insurance	230	210	458	419
Dividends on FHLB stock	192	176	388	408
Gains on investment securities, net	11	10	11	10
Other income	384	253	734	504
Total non-interest income	2,238	2,096	4,480	4,211
Non-interest expense				
Salaries and related benefits	8,316	7,287	17,333	14,762
Occupancy and equipment	1,511	1,380	3,018	2,699
Depreciation and amortization	546	463	1,093	944
Federal Deposit Insurance Corporation insurance	191	162	382	323
Data processing	1,023	963	2,404	1,902
Professional services	810	522	2,109	1,044
Directors' expense	183	224	357	382
Information technology	264	186	533	384
Provision for losses on off-balance sheet commitments	—	(208)	—	(43)
Other expense	1,665	1,652	3,361	3,245
Total non-interest expense	14,509	12,631	30,590	25,642
Income before provision for income taxes	10,571	7,769	18,623	14,494
Provision for income taxes	2,680	2,583	4,343	4,760

Net income	$7,891	$5,186	$14,280	$9,734
Net income per common share:				
Basic	$1.14	$0.85	$2.06	$1.60
Diluted	$1.12	$0.84	$2.03	$1.58
Weighted average shares:				
Basic	6,944	6,110	6,929	6,101
Diluted	7,033	6,174	7,019	6,173
Dividends declared per common share	$0.31	$0.27	$0.60	$0.54
Comprehensive income:				
Net income	$7,891	$5,186	$14,280	$9,734
Other comprehensive (loss) income				
Change in net unrealized gain or loss on available-for-sale securities	(1,131)	1,961	(7,301)	3,635
Reclassification adjustment for gains on available-for-sale securities in net income	(11)	(10)	(11)	(10)
Net unrealized loss on securities transferred from available-for-sale to held-to-maturity	(278)	—	(278)	—
Amortization of net unrealized losses on securities transferred from available-for-sale to held-to-maturity	132	124	268	165
Subtotal	(1,288)	2,075	(7,322)	3,790
Deferred tax (benefit) expense	(384)	892	(2,168)	1,596
Other comprehensive (loss) income, net of tax	(904)	1,183	(5,154)	2,194
Comprehensive income	$6,987	$6,369	$9,126	$11,928

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
for the year ended December 31, 2017 and the six months ended June 30, 2018

(in thousands, except share data; unaudited)	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Loss ("AOCI"), Net of Taxes	Total
Balance at December 31, 2016	6,127,314	$87,392	$146,464	$ (3,293)	$230,563
Net income	—	—	15,976	—	15,976
Other comprehensive income	—	—	—	807	807
Stock options exercised, net of shares surrendered for cashless exercises and tax withholdings	9,266	28	—	—	28
Stock issued under employee stock purchase plan	512	32	—	—	32
Stock issued under employee stock ownership plan ("ESOP")	29,547	1,850	—	—	1,850
Restricted stock granted	16,230	—	—	—	—
Stock-based compensation - stock options	—	529	—	—	529
Stock-based compensation - restricted stock	—	742	—	—	742
Cash dividends paid on common stock	—	—	(6,896)	—	(6,896)
Stock purchased by directors under director stock plan	531	35	—	—	35
Stock issued in payment of director fees	2,878	188	—	—	188
Stock and stock options issued to Bank of Napa shareholders (net of payment for fractional shares of $14 thousand)	735,264	53,171	—	—	53,171
Balance at December 31, 2017	6,921,542	$143,967	$155,544	$ (2,486)	$297,025
Net income			14,280		14,280
Other comprehensive loss				(5,154)	(5,154)
Reclassification of stranded tax effects in AOCI			638	(638)	—
Stock options exercised, net of shares surrendered for cashless exercises and tax withholdings	50,075	534			534
Stock issued under employee stock purchase plan	265	19			19
Stock issued under ESOP	7,900	601			601
Restricted stock granted	18,520				—
Restricted stock surrendered for tax withholdings upon vesting	(658)	(45)			(45)
Restricted stock forfeited / cancelled	(6,028)				—
Stock-based compensation - stock options		442			442
Stock-based compensation - restricted stock		672			672
Cash dividends paid on common stock			(4,181)		(4,181)
Stock purchased by directors under director stock plan	260	18			18
Stock issued in payment of director fees	1,343	91			91
Stock repurchased, net of commissions	(1,398)	(104)			(104)
Balance at June 30, 2018	6,991,821	146,195	166,281	(8,278)	304,198

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the six months ended June 30, 2018 and 2017

(in thousands; unaudited)	June 30, 2018	June 30, 2017
Cash Flows from Operating Activities:		
Net income	$14,280	$9,734
Adjustments to reconcile net income to net cash provided by operating activities:		
Reversal of losses on off-balance sheet commitments	—	(43)
Noncash contribution expense to employee stock ownership plan	601	—
Noncash director compensation expense	146	106
Stock-based compensation expense	1,114	710
Amortization of core deposit intangible	460	236
Amortization of investment security premiums, net of accretion of discounts	1,496	1,496
Accretion of discount on acquired loans	(428)	(498)
Accretion of discount on subordinated debentures	63	80
Net change in deferred loan origination costs/fees	18	60
Gain on sale of investment securities	(11)	(10)
Depreciation and amortization	1,093	944
Gain on sale of repossessed assets	—	(1)
Earnings on bank-owned life insurance policies	(458)	(419)
Net change in operating assets and liabilities:		
Deferred rent and other rent-related expenses	(179)	114
Interest receivable and other assets	(971)	93
Interest payable and other liabilities	1,543	(389)
Total adjustments	4,487	2,479
Net cash provided by operating activities	18,767	12,213
Cash Flows from Investing Activities:		
Purchase of held-to-maturity securities	(1,989)	(4,496)
Purchase of available-for-sale securities	(121,269)	(9,377)
Proceeds from sale of available-for-sale securities	5,006	1,321
Proceeds from paydowns/maturities of held-to-maturity securities	9,615	14,601
Proceeds from paydowns/maturities of available-for-sale securities	24,540	15,385
Loans originated and principal collected, net	(38,835)	(4,563)
Purchase of premises and equipment	(446)	(814)
Proceeds from sale of other real estate owned or repossessed assets	—	170
Cash paid for low-income housing tax credit investment	(373)	(628)
Net cash (used in) provided by investing activities	(123,751)	11,599
Cash Flows from Financing Activities:		
Net (decrease) increase in deposits	(10,947)	67,840
Proceeds from stock options exercised	585	88
Payment of tax withholdings for stock options exercised and vesting of restricted stock	(96)	(60)
Proceeds from stock issued under employee and director stock purchase plans	37	737
Stock repurchased, net of commissions	(104)	—
Cash dividends paid on common stock	(4,181)	(3,315)
Net cash (used in) provided by financing activities	(14,706)	65,290
Net (decrease) increase in cash and cash equivalents	(119,690)	89,102
Cash and cash equivalents at beginning of period	203,545	48,804
Cash and cash equivalents at end of period	$83,855	$137,906

Supplemental disclosure of cash flow information:		
Cash paid in interest	$1,083	$751
Cash paid in income taxes	$2,000	$4,620
Supplemental disclosure of noncash investing and financing activities:		
Change in net unrealized gain or loss on available-for-sale securities	$(7,301)	$3,635
Securities transferred from available-for-sale to held-to-maturity	$27,422	$128,965
Amortization of net unrealized loss on available-for-sale securities transferred to held-to-maturity	$268	$165
Stock issued to ESOP	$601	$—
Stock issued in payment of director fees	$91	$82

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1: Basis of Presentation

The consolidated financial statements include the accounts of Bank of Marin Bancorp (“Bancorp”), a bank holding company, and its wholly-owned bank subsidiary, Bank of Marin (the “Bank”), a California state-chartered commercial bank. References to “we,” “our,” “us” mean Bancorp and the Bank that are consolidated for financial reporting purposes. The accompanying unaudited consolidated interim financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and note disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP") have been condensed or omitted pursuant to those rules and regulations. Although we believe that the disclosures are adequate and the information presented is not misleading, we suggest that these interim financial statements be read in conjunction with the annual financial statements and the notes thereto included in our 2017 Annual Report on Form 10-K. In the opinion of Management, the unaudited consolidated financial statements reflect all adjustments, which are necessary for a fair presentation of the consolidated financial position, the results of operations, changes in comprehensive income, changes in stockholders’ equity, and cash flows for the periods presented. All material intercompany transactions have been eliminated. The results of these interim periods may not be indicative of the results for the full year or for any other period.

The NorCal Community Bancorp Trusts I and II, respectively (the "Trusts") were formed for the sole purpose of issuing trust preferred securities. Bancorp is not considered the primary beneficiary of the Trusts (variable interest entities), therefore the Trusts are not consolidated in our consolidated financial statements, but rather the subordinated debentures are shown as a liability on our consolidated statements of condition (See Note 6, Borrowings). Bancorp accounts for its investment in the securities of the Trusts under the equity method, which is included in interest receivable and other assets in the consolidated statements of condition.

The following table shows: 1) weighted average basic shares, 2) potentially dilutive weighted average common shares related to stock options and unvested restricted stock awards, and 3) weighted average diluted shares. Basic earnings per share (“EPS”) are calculated by dividing net income by the weighted average number of common shares outstanding during each period, excluding unvested restricted stock awards. Diluted EPS are calculated using the weighted average number of potentially dilutive common shares. The number of potentially dilutive common shares included in the quarterly diluted EPS is computed using the average market prices during the three months included in the reporting period under the treasury stock method. The number of potentially dilutive common shares included in year-to-date diluted EPS is a year-to-date weighted average of potentially dilutive common shares included in each quarterly diluted EPS computation. In computing diluted EPS, we exclude anti-dilutive shares such as options whose exercise prices exceed the current common stock price, as they would not reduce EPS under the treasury method. We have two forms of outstanding common stock: common stock and unvested restricted stock awards. Holders of unvested restricted stock awards receive non-forfeitable dividends at the same rate as common shareholders and they both share equally in undistributed earnings. Under the two-class method, the difference in EPS is nominal for these participating securities.

	Three months ended		Six months ended	
(in thousands, except per share data)	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Weighted average basic shares outstanding	6,944	6,110	6,929	6,101
Potentially dilutive common shares related to:				
Stock options	74	52	74	57
Unvested restricted stock awards	15	12	16	15
Weighted average diluted shares outstanding	7,033	6,174	7,019	6,173

Net income	$7,891	$5,186	$14,280	$9,734
Basic EPS	$1.14	$0.85	$2.06	$1.60
Diluted EPS	$1.12	$0.84	$2.03	$1.58
Weighted average anti-dilutive shares not included in the calculation of diluted EPS	30	33	35	23

Note 2: Recently Adopted and Issued Accounting Standards

Accounting Standards Adopted in 2018

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606). The core principle of this ASU (and all subsequent updates) is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. This ASU establishes a five-step model that must be used to recognize revenue that requires the entity to identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the entity satisfies the performance obligation. The ASU does not apply to the majority of our revenue, including revenue associated with financial instruments, such as loans and investment securities, and certain non-interest income, such as earnings on bank-owned life insurance, dividends on Federal Home Loan Bank ("FHLB") stock, gains or losses on sales of investment securities, and deposit overdraft charges. The standard allowed the use of either the full retrospective or modified retrospective transition method. We elected to apply the modified retrospective transition method to incomplete contracts as of the initial date of application on January 1, 2018. The adoption of the new standards did not have a material impact on our financial condition or results of operations as revenue recognition under the new standards did not change significantly from our current practice of recognizing the in-scope non-interest income. In addition, we did not retroactively revise prior period amounts or record a cumulative adjustment to retained earnings upon adoption. We considered the nature, amount, timing, and uncertainty of revenue from contracts with customers and determined that significant revenue streams are sufficiently disaggregated in the consolidated statements of comprehensive income.

Descriptions of our significant revenue-generating transactions that are within the scope of the new revenue recognition standards, which are presented in the consolidated statements of comprehensive income as components of non-interest income, are as follows:

- Wealth Management & Trust ("WM&T") fees - WM&T services include, but are not limited to: customized investment advisory and management; administrative services such as bill pay and tax reporting; trust administration, estate settlement, custody and fiduciary services. Performance obligations for investment advisory and management services are generally satisfied over time. Revenue is recognized monthly according to a tiered fee schedule based on the client's month-end market value of assets under our management. WM&T does not earn revenue based on performance or incentives. Costs associated with WM&T revenue-generating activities, such as payments to sub-advisors, are recorded separately as part of professional service expenses when incurred.

- Deposit account service charges - Service charges on deposit accounts consist of monthly maintenance fees, business account analysis fees, business online banking fees, check order charges, and other deposit account-related fees. Performance obligations for monthly maintenance fees and account analysis fees are satisfied, and the related revenue recognized, when we complete our performance obligation each month. Performance obligations related to transaction-based services (such as check orders) are satisfied, and the related revenue recognized, at a point in time when completed, except for business accounts subject to analysis where the transaction-based fees are part of the monthly account analysis fees.

- Debit card interchange fees - We issue debit cards to our consumer and small business customers that allow them to purchase goods and services from merchants in person, online, or via mobile devices using funds held in their demand deposit accounts held with us. Debit cards issued to our customers are part of global electronic payment networks (such as Visa) who pass a portion of the merchant interchange fees to debit card-issuing member banks like us when our customers make purchases through their networks. Performance obligations for debit card services are satisfied and revenue is recognized daily as the payment networks process transactions. Because we act in an agent capacity, we determined that network costs previously recorded as a component of non-interest expense should be netted with interchange fees recorded in non-interest income. Network costs were immaterial for the six months ended June 30, 2018 and 2017.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in this ASU make improvements to accounting standards related to financial instruments, including the following:

- Requires equity investments, except for those accounted for under the equity method of accounting or those that result in consolidation of the investee, to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.
- Simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When impairment exists, an entity is required to measure the investment at fair value.
- Eliminates the requirement to disclose the method(s) and significant assumptions used to estimate the fair value required under current standards for financial instruments measured at amortized cost on the consolidated balance sheet.
- Requires public companies to use the exit price notion when measuring and disclosing the fair value of financial instruments.
- Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements.
- Clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

We adopted the requirements of this ASU effective January 1, 2018, which did not have a material impact on our financial condition and results of operations. The fair value of our loans held for investment, which is recorded at amortized cost, now incorporates the exit price notion reflecting factors such as a liquidity premium. See Note 3, Fair Value of Assets and Liabilities.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This ASU provides guidance on how to present and classify eight specific cash flow topics in the statement of cash flows. The ASU is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The amendments should be applied using a retrospective transition method to each period presented, if practical. We adopted the requirements of this ASU effective January 1, 2018, which did not impact our financial condition, results of operations, or related financial statement disclosures for the periods presented.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. The amendments are intended to help companies evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses and provide a more robust framework to use in determining when a set of assets and activities is a business. The amendments should be applied prospectively and are effective for annual periods after December 31, 2017, including interim periods within those periods. We adopted the amendments effective January 1, 2018, which did not impact our financial condition, results of operations, or related financial statement disclosures in the first quarter of 2018.

In May 2017, the FASB issued ASU No. 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. This ASU applies to entities that change the terms or conditions of a share-based payment award. The FASB adopted this ASU to provide clarity in what constitutes a modification and to reduce diversity in practice in applying Topic 718. In order for a change to a share-based arrangement to not require Topic 718 modification accounting treatment, all of the following must be met: no change in fair value, no change in vesting conditions and no change in the balance sheet classification of the modified award. The ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those periods. Early adoption is permitted, including adoption in an interim period. The amendments should be applied prospectively to an award modified on or after the adoption date. We adopted the requirements of this ASU effective January 1, 2018, which did not impact our financial condition, results of operation, or related financial statement disclosures.

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. This amendment changes both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. It is intended to more closely align hedge accounting with companies' risk management strategies, simplify the application of hedge accounting and increase transparency as to the scope and results of hedging programs. The ASU is effective for fiscal years beginning after

December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. We early-adopted the amendments of this ASU in the second quarter of 2018, and elected to perform hedge effectiveness assessments using a qualitative approach instead of quantitative regression analysis going forward. The adoption of this ASU had an immaterial impact to our financial results. The amendments also require additional disclosures, which are included in Note 9, Derivative Financial Instruments and Hedging Activities.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. This amendment helps organizations address certain stranded income tax effects in accumulated other comprehensive income (AOCI) resulting from the enactment of the Tax Cuts and Jobs Act of 2017. The ASU requires financial statement preparers to disclose a description of the accounting policy for releasing income tax effects from AOCI, whether or not they elect to reclassify the stranded income tax effects from the Tax Cuts and Jobs Act of 2017, and information about the other income tax effects that are reclassified. The amendments are effective for all organizations for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The amendments in this ASU should be applied in either the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate tax rate in the Tax Cuts and Jobs Act of 2017 is recognized. We early adopted this ASU in the first quarter of 2018. See Note 7, Stockholders' Equity.

Accounting Standards Not Yet Effective

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The amendments in this ASU intend to increase transparency and comparability among organizations by recognizing an asset, which represents the right to use the asset for the lease term, and a lease liability, which is a lessee's obligation to make lease payments measured on a discounted basis. This ASU generally applies to leasing arrangements exceeding a twelve-month term. ASU 2016-02 is effective for annual periods, including interim periods within those annual periods beginning after December 15, 2018 and requires a modified retrospective method of adoption. In July 2018, the FASB issued ASU No. 2018-10, Codification Improvements to Topic 842, Leases, which provides various corrections and clarifications to ASU 2016-02. Early application of the amendments is permitted. We intend to adopt this ASU during the first quarter of 2019, as required. We completed an inventory of our lease agreements and continue to evaluate potential accounting software solutions that will aid in the transition to the new leasing guidance. As of June 30, 2018, our undiscounted operating lease obligations that were off-balance sheet totaled $16.5 million (See Note 8, Commitments and Contingencies). Upon adoption of this ASU, the present values of leases currently classified as operating leases will be recognized as lease assets and liabilities on our consolidated balance sheets. Additional disclosures of key information about our leasing arrangements will also be required. We do not expect that the ASU will have a material impact on our capital ratios or return on average assets when adopted and we are currently evaluating the effect that the ASU will have on other components of our financial condition and results of operations.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. Under the new guidance, entities will be required to present financial assets at the net amount expected to be collected. The measurement of expected credit losses will be based on historical experience, current conditions and reasonable and supportable forecasts that affect the collectability of a credit over its remaining life. In addition, the ASU amends the accounting for expected credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. We have formed an internal Current Expected Credit Loss ("CECL") committee and are working with our third party vendor to determine the appropriate methodologies and resources to utilize in preparation for transition to the new accounting standards. The impact of this ASU on our financial condition and results of operations is not known at this time.

In June 2018, the FASB issued ASU No. 2018-07, Compensation - Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting. This update simplifies the accounting for share-based payment transactions for acquiring goods and services from nonemployees, applying some of the same requirements as employee share-based payment transactions. The ASU will not affect the accounting for share-based payment awards to nonemployee directors, which will continue to be treated as employee share-based transactions under the current standards. ASU 2018-07 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. We do not expect that the ASU will have a material impact on our financial condition or results of operations, as it is not our practice to issue stock-based awards to pay for goods and services from nonemployees, other than nonemployee directors.

Note 3: Fair Value of Assets and Liabilities

Fair Value Hierarchy and Fair Value Measurement

We group our assets and liabilities that are measured at fair value in three levels within the fair value hierarchy, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1: Valuations are based on unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2: Valuations are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuations for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3: Valuations are based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Values are determined using pricing models and discounted cash flow models and may include significant Management judgment and estimation.

Transfers between levels of the fair value hierarchy are recognized through our monthly and/or quarterly valuation process in the reporting period during which the event or circumstances that caused the transfer occurred.

The following table summarizes our assets and liabilities that were required to be recorded at fair value on a recurring basis.

(in thousands) Description of Financial Instruments	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Measurement Categories: Changes in Fair Value Recorded In[1]
June 30, 2018					
Securities available-for-sale:					
Mortgage-backed securities and collateralized mortgage obligations issued by U.S. government agencies	$240,794	$ —	$ 240,794	$ —	OCI
SBA-backed securities	23,954	—	23,954	—	OCI
Debentures of government sponsored agencies	32,139	—	32,139	—	OCI
Privately-issued collateralized mortgage obligations	435	—	435	—	OCI
Obligations of state and political subdivisions	87,788	—	87,788	—	OCI
Corporate bonds	3,027	—	3,027	—	OCI
Derivative financial assets (interest rate contracts)	327	—	327	—	NI
Derivative financial liabilities (interest rate contracts)	276	—	276	—	NI
December 31, 2017					

Securities available-for-sale:					
Mortgage-backed securities and collateralized mortgage obligations issued by U.S. government agencies	$188,061	$ —	$188,061	$ —	OCI
SBA-backed securities	25,982	—	25,817	165	OCI
Debentures of government sponsored agencies	12,938	—	12,938	—	OCI
Privately-issued collateralized mortgage obligations	1,431	—	1,431	—	OCI
Obligations of state and political subdivisions	97,491	—	97,491	—	OCI
Corporate bonds	6,564	—	6,564	—	OCI
Derivative financial assets (interest rate contracts)	74	—	74	—	NI
Derivative financial liabilities (interest rate contracts)	740	—	740	—	NI

[1] Other comprehensive income ("OCI") or net income ("NI").

Securities available-for-sale are recorded at fair value on a recurring basis. When available, quoted market prices (Level 1) are used to determine the fair value of securities available-for-sale. If quoted market prices are not available, we obtain pricing information from a reputable third-party service provider, who may utilize valuation techniques that use current market-based or independently sourced parameters, such as bid/ask prices, dealer-quoted prices, interest rates, benchmark yield curves, prepayment speeds, probability of default, loss severity and credit spreads (Level 2). Level 2 securities include obligations of state and political subdivisions, U.S. agencies or government-sponsored agencies' debt securities, mortgage-backed securities, government agency-issued, privately-issued collateralized mortgage obligations, and corporate bonds. As of June 30, 2018 and December 31, 2017, there were no Level 1 securities. As of December 31, 2017, we had one Level 3 available-for-sale U.S. government agency obligation, which was paid off during the second quarter of 2018.

Securities held-to-maturity may be written down to fair value (determined using the same techniques discussed above for securities available-for-sale) as a result of other-than-temporary impairment, and we did not record any write-downs during the six months ended June 30, 2018 or June 30, 2017.

On a recurring basis, derivative financial instruments are recorded at fair value, which is based on the income approach using observable Level 2 market inputs, reflecting market expectations of future interest rates as of the measurement date. Standard valuation techniques are used to calculate the present value of the future expected cash flows assuming an orderly transaction. Valuation adjustments may be made to reflect both our own credit risk and the counterparties' credit risk in determining the fair value of the derivatives. Level 2 inputs for the valuations are limited to observable market prices for London Interbank Offered Rate ("LIBOR") and Overnight Index Swap ("OIS") rates (for the very short term), quoted prices for LIBOR futures contracts, observable market prices for LIBOR and OIS swap rates, and one-month and three-month LIBOR basis spreads at commonly quoted intervals. Mid-market pricing of the inputs is used as a practical expedient in the fair value measurements. We project spot rates at reset days specified by each swap contract to determine future cash flows, then discount to present value using either LIBOR or OIS curves depending on whether the swap positions are fully collateralized as of the measurement date. When the value of any collateral placed with counterparties is less than the interest rate derivative liability, a credit valuation adjustment ("CVA") is applied to reflect the credit risk we pose to counterparties. We have used the spread between the Standard & Poor's BBB rated U.S. Bank Composite rate and LIBOR for the closest maturity term corresponding to the duration of the swaps to derive the CVA. A similar credit risk adjustment, correlated to the credit standing of the counterparty, is made when collateral posted by the counterparty does not fully cover their liability to the Bank. For further discussion on our methodology in valuing our derivative financial instruments, refer to Note 9, Derivative Financial Instruments and Hedging Activities.

Certain financial assets may be measured at fair value on a non-recurring basis. These assets are subject to fair value adjustments that result from the application of the lower of cost or fair value accounting or write-downs of individual assets, such as impaired loans that are collateral dependent and other real estate owned ("OREO"). As of June 30, 2018 and December 31, 2017, we did not carry any assets measured at fair value on a non-recurring basis.

Disclosures about Fair Value of Financial Instruments

The following table summarizes fair value estimates for financial instruments as of June 30, 2018 and December 31, 2017, excluding financial instruments recorded at fair value on a recurring basis (summarized in the first table in this note). The carrying amounts in the following table are recorded in the consolidated statements of condition under the indicated captions. Further, we have not disclosed the fair value of financial instruments specifically excluded from disclosure requirements such as bank-owned life insurance policies ("BOLI") and non-maturity deposit liabilities. Additionally, we hold shares of FHLB stock and Visa Inc. Class B common stock at cost. These shares are restricted from resale, except among member banks, and their values are discussed in Note 4, Investment Securities.

	June 30, 2018			December 31, 2017		
(in thousands)	Carrying Amounts	Fair Value	Fair Value Hierarchy	Carrying Amounts	Fair Value	Fair Value Hierarchy
Financial assets (recorded at amortized cost)						
Cash and cash equivalents	$83,855	$ 83,855	Level 1	$203,545	$203,545	Level 1
Investment securities held-to-maturity	170,652	166,127	Level 2	151,032	151,032	Level 2
Loans, net	1,701,798	1,666,409	Level 3	1,663,246	1,650,198	Level 3
Interest receivable	7,814	7,814	Level 2	7,501	7,501	Level 2
Financial liabilities (recorded at amortized cost)						
Time deposits	137,040	136,023	Level 2	160,116	159,540	Level 2
Subordinated debentures	5,802	6,988	Level 3	5,739	5,118	Level 3
Interest payable	167	167	Level 2	191	191	Level 2

Commitments - The value of unrecognized financial instruments is estimated based on the fee income associated with the commitments which, in the absence of credit exposure, is considered to approximate their settlement value. The fair value of commitment fees was not material at June 30, 2018 and December 31, 2017.

Note 4: Investment Securities

Our investment securities portfolio consists of obligations of state and political subdivisions, corporate bonds, U.S. government agency securities, including residential and commercial mortgage-backed securities (“MBS”) and collateralized mortgage obligations (“CMOs”) issued or guaranteed by Federal National Mortgage Association ("FNMA"), Federal Home Loan Mortgage Corporation ("FHLMC"), Small Business Administration ("SBA"), or Government National Mortgage Association ("GNMA"), debentures issued by government-sponsored agencies such as FNMA, Federal Farm Credit Bureau, FHLB and FHLMC, and privately issued CMOs, as reflected in the following table.

	June 30, 2018				December 31, 2017			
	Amortized	Fair	Gross Unrealized		Amortized	Fair	Gross Unrealized	
(in thousands)	Cost	Value	Gains	(Losses)	Cost	Value	Gains	(Losses)
Held-to-maturity:								
Securities of U.S. government agencies:								
MBS pass-through securities issued by FHLMC and FNMA	$94,203	$90,824	$—	$(3,379)	$100,376	$100,096	$234	$(514)
SBA-backed securities	8,882	8,743	—	(139)	—	—	—	—
CMOs issued by FNMA	11,881	11,766	—	(115)	—	—	—	—
CMOs issued by FHLMC	34,668	33,591	—	(1,077)	31,010	30,938	2	(74)
CMOs issued by GNMA	3,730	3,713	—	(17)	—	—	—	—
Obligations of state and political subdivisions	17,288	17,490	235	(33)	19,646	19,998	383	(31)
Total held-to-maturity	170,652	166,127	235	(4,760)	151,032	151,032	619	(619)
Available-for-sale:								
Securities of U.S. government agencies:								
MBS pass-through securities issued by FHLMC and FNMA	90,082	87,590	17	(2,509)	65,559	65,262	126	(423)
SBA-backed securities	24,620	23,954	—	(666)	25,979	25,982	58	(55)
CMOs issued by FNMA	21,026	20,571	7	(462)	35,340	35,125	33	(248)
CMOs issued by FHLMC	123,359	120,411	1	(2,949)	70,514	69,889	3	(628)
CMOs issued by GNMA	12,641	12,222	2	(421)	17,953	17,785	26	(194)
Debentures of government- sponsored agencies	32,395	32,139	—	(256)	12,940	12,938	3	(5)
Privately issued CMOs	431	435	4	—	1,432	1,431	1	(2)
Obligations of state and political subdivisions	89,699	87,788	77	(1,988)	98,027	97,491	298	(834)
Corporate bonds	3,015	3,027	24	(12)	6,541	6,564	26	(3)
Total available-for-sale	397,268	388,137	132	(9,263)	334,285	332,467	574	(2,392)
Total investment securities	$567,920	$554,264	$367	$(14,023)	$485,317	$483,499	$1,193	$(3,011)

The amortized cost and fair value of investment debt securities by contractual maturity at June 30, 2018 and December 31, 2017 are shown in the following table. Expected maturities may differ from contractual maturities if the issuers of the securities have the right to call or prepay obligations with or without call or prepayment penalties.

	June 30, 2018				December 31, 2017			
	Held-to-Maturity		Available-for-Sale		Held-to-Maturity		Available-for-Sale	
(in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	$2,859	$2,882	$8,272	$8,263	$2,151	$2,172	$10,268	$10,272
After one but within five years	13,063	13,147	79,662	78,514	15,577	15,791	71,576	71,237
After five years through ten years	63,321	61,350	216,584	210,650	54,641	54,554	129,723	128,954
After ten years	91,409	88,748	92,750	90,710	78,663	78,515	122,718	122,004
Total	$170,652	$166,127	$397,268	$388,137	$151,032	$151,032	$334,285	$332,467

Sales of investment securities and gross gains and losses are shown in the following table.

	Three months ended	Six months ended
(in thousands)		

	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Available-for-sale:				
Sales proceeds	$5,006	$1,321	$5,006	$1,321
Gross realized gains	27	13	27	13
Gross realized losses	(16)	(3)	(16)	(3)

Pledged investment securities are shown in the following table.

(in thousands)	June 30, 2018	December 31, 2017
Pledged to the State of California:		
Secure public deposits in compliance with the Local Agency Security Program	$103,097	$ 107,829
Collateral for trust deposits	749	761
Total investment securities pledged to the State of California	$103,846	$ 108,590
Collateral for Wealth Management and Trust Services checking account	$2,014	$ 2,026

As part of our ongoing review of our investment securities portfolio, we reassessed the classification of certain securities issued by government sponsored agencies. During 2018 and 2017, we transferred $27.4 million and $129.0 million, respectively, of these securities from available-for-sale to held-to-maturity at fair value. We intend and have the ability to hold these securities to maturity. The net unrealized pre-tax loss of $278 thousand and $3.0 million, at the respective transfer dates, remained in accumulated other comprehensive income and are amortized over the remaining lives of the securities. Amortization of the net unrealized pre-tax losses totaled $268 thousand and $165 thousand for the six months ended June 30, 2018 and 2017, respectively.

Other-Than-Temporarily Impaired ("OTTI") Debt Securities

We have evaluated the credit of our investment securities and their issuers and/or insurers. Based on our evaluation, Management has determined that no investment security in our investment portfolio is other-than-temporarily impaired as of June 30, 2018. We do not have the intent and it is more likely than not that we will not have to sell the remaining securities temporarily impaired at June 30, 2018 before recovery of the amortized cost basis.

There were 266 and 198 investment securities in unrealized loss positions at June 30, 2018 and December 31, 2017, respectively. Those securities are summarized and classified according to the duration of the loss period in the following tables:

June 30, 2018	< 12 continuous months		≥ 12 continuous months		Total securities in a loss position	
(in thousands)	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
Held-to-maturity:						
MBS pass-through securities issued by FHLMC and FNMA	$22,100	$ (830)	$68,724	$ (2,549)	$90,824	$ (3,379)
SBA-backed securities	8,742	(139)	—	—	$8,742	$ (139)
CMOs issued by FNMA	11,766	(115)	—	—	11,766	(115)
CMOs issued by FHLMC	19,798	(564)	13,793	(513)	33,591	(1,077)
CMOs issued by GNMA	—	—	3,713	(17)	3,713	(17)
Obligations of state and political subdivisions	3,816	(33)	—	—	3,816	(33)
Total held-to-maturity	66,222	(1,681)	86,230	(3,079)	152,452	(4,760)
Available-for-sale:						
MBS pass-through securities issued by FHLMC and FNMA	68,906	(1,843)	17,713	(666)	86,619	(2,509)
SBA-backed securities	23,954	(666)	—	—	23,954	(666)
CMOs issued by FNMA	15,687	(321)	4,642	(141)	20,329	(462)
CMOs issued by FHLMC	115,370	(2,949)	—	—	115,370	(2,949)
CMOs issued by GNMA	11,297	(419)	603	(2)	11,900	(421)

Debentures of government- sponsored agencies	32,139	(256)	—	—	32,139	(256)
Privately issued CMOs	—	—	—	—	—	—
Obligations of state and political subdivisions	57,217	(835)	18,832	(1,153)	76,049	(1,988)
Corporate bonds	1,522	(12)	—	—	1,522	(12)
Total available-for-sale	326,092	(7,301)	41,790	(1,962)	367,882	(9,263)
Total temporarily impaired securities	$392,314	$(8,982)	$128,020	$(5,041)	$520,334	$(14,023)

December 31, 2017	< 12 continuous months		≥ 12 continuous months		Total securities in a loss position	
(in thousands)	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
Held-to-maturity:						
Obligations of state and political subdivisions	$3,648	$(31)	$—	$—	$3,648	$(31)
MBS pass-through securities issued by FHLMC and FNMA	16,337	(143)	46,845	(371)	63,182	(514)
CMOs issued by FHLMC	11,066	(31)	13,824	(43)	24,890	(74)
Total held-to-maturity	31,051	(205)	60,669	(414)	91,720	(619)
Available-for-sale:						
MBS pass-through securities issued by FHLMC and FNMA	32,189	(121)	15,325	(302)	47,514	(423)
SBA-backed securities	11,028	(53)	165	(2)	11,193	(55)
CMOs issued by FNMA	26,401	(171)	5,440	(77)	31,841	(248)
CMOs issued by FHLMC	69,276	(628)	—	—	69,276	(628)
CMOs issued by GNMA	14,230	(194)	—	—	14,230	(194)
Debentures of government- sponsored agencies	2,984	(5)	—	—	2,984	(5)
Privately issued CMO's	1,310	(2)	—	—	1,310	(2)
Obligations of state and political subdivisions	52,197	(288)	19,548	(546)	71,745	(834)
Corporate bonds	3,060	(3)	—	—	3,060	(3)
Total available-for-sale	212,675	(1,465)	40,478	(927)	253,153	(2,392)
Total temporarily impaired securities	$243,726	$(1,670)	$101,147	$(1,341)	$344,873	$(3,011)

As of June 30, 2018, sixty-four investment securities in our portfolio had been in a continuous loss position for twelve months or more. They consisted of five CMOs issued by FHLMC, three CMOs issued by FNMA, two CMOs issued by GNMA, twenty-two agency MBS securities and thirty-two obligations of U.S. state and political subdivisions securities. We have evaluated the securities and believe that the decline in fair value is primarily driven by factors other than credit. It is probable that we will be able to collect all amounts due according to the contractual terms and no other-than-temporary impairment exists on these securities. The debenture of government-sponsored agency security is supported by the U.S. Federal Government, which protects us from credit losses. Based upon our assessment of the credit fundamentals, we concluded that these securities were not other-than-temporarily impaired at June 30, 2018.

There were two hundred one investment securities in our portfolio that had been in temporary loss positions for less than twelve months as of June 30, 2018, and their temporary loss positions mainly arose from changes in interest rates since purchase. They consisted of eleven SBA-backed securities, eight debentures of a U.S. government-sponsored agency, ninety-eight obligations of U.S. state and political subdivisions, thirty-six MBS securities, forty-six CMOs issued by government-sponsored agencies, and three corporate bonds. Securities of government-sponsored agencies are supported by the U.S. Federal Government, which protects us from credit losses. Other temporarily impaired securities are deemed creditworthy after internal analysis of the issuers' latest financial information and credit enhancement. Additionally, all are rated as investment grade by at least one major rating agency. As a result of this impairment analysis, we concluded that these securities were not other-than-temporarily impaired at June 30, 2018.

Non-Marketable Securities

As a member of the FHLB, we are required to maintain a minimum investment in FHLB capital stock determined by the Board of Directors of the FHLB. The minimum investment requirements can increase in the event we increase our total asset size or borrowings with the FHLB. Shares cannot be purchased or sold except between the FHLB and its members at the $100 per share par value. We held $11.1 million of FHLB stock recorded at cost in other assets in the consolidated statements of condition at both June 30, 2018 and December 31, 2017. The carrying amounts of these investments are reasonable estimates of fair value because the securities are restricted to member banks and they do not have a readily determinable market value. Management does not believe that the FHLB stock is other-than-temporarily-impaired, due to FHLB's current financial condition. On July 26, 2018, FHLB announced a cash dividend to be distributed in mid-August 2018 at an annualized dividend rate of 7.00%. Cash dividends paid on FHLB capital stock are recorded as non-interest income.

As a member bank of Visa U.S.A., we hold 16,939 shares of Visa Inc. Class B common stock with a carrying value of zero, which is equal to our cost basis. These shares are restricted from resale until their conversion into Class A (voting) shares upon the termination of Visa Inc.'s Covered Litigation escrow account. Because of the restriction, these shares are not considered available-for-sale and are not carried at fair value. When converting this Class B common stock to Class A common stock based on the conversion rate of 1.6298 as of June 30, 2018 and 1.6483 as of December 31, 2017, and the closing stock price of Class A shares, the value of our shares of Class B common stock would have been $3.7 million and $3.2 million at June 30, 2018 and December 31, 2017, respectively. The conversion rate is subject to further reduction upon the final settlement of the covered litigation against Visa Inc. and its member banks. As such, the fair value of these Class B shares can differ significantly from their if-converted values. For further information, refer to Note 8, Commitments and Contingencies.

We invest in low-income housing tax credit funds as a limited partner, which totaled $4.9 million and $2.1 million recorded in other assets as of June 30, 2018 and December 31, 2017, respectively. In the first six months of 2018, we recognized $282 thousand of low-income housing tax credits and other tax benefits, net of $237 thousand of amortization expense of low-income housing tax credit investment, as a component of income tax expense. As of June 30, 2018, our unfunded commitments for these low-income housing tax credit funds totaled $3.2 million. We did not recognize any impairment losses on these low-income housing tax credit investments during the six months ended June 30, 2018 or 2017, as the value of the future tax benefits exceeds the carrying value of the investments.

Note 5: Loans and Allowance for Loan Losses

Credit Quality of Loans

The following table shows outstanding loans by class and payment aging as of June 30, 2018 and December 31, 2017.

Loan Aging Analysis by Loan Class

(in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential [1]	Installment and other consumer	Total
June 30, 2018								
30-59 days past due	$ —	$ —	$ —	$ —	$ 77	$ —	$ 11	$ 88
60-89 days past due	—	—	—	—	—	—	—	—
90 days or more past due	—	—	—	—	—	—	—	—
Total past due	—	—	—	—	77	—	11	88
Current	241,994	317,587	839,667	57,015	125,954	108,829	26,477	1,717,523
Total loans [3]	$ 241,994	$ 317,587	$ 839,667	$ 57,015	$ 126,031	$ 108,829	$ 26,488	$ 1,717,611
Non-accrual loans [2]	$ —	$ —	$ —	$ —	$ 385	$ —	$ —	$ 385
December 31, 2017								
30-59 days past due	$ —	$ —	$ —	$ —	$ 99	$ 255	$ 330	$ 684
60-89 days past due	1,340	—	—	—	—	—	—	1,340
90 days or more past due	—	—	—	—	307	—	—	307
Total past due	1,340	—	—	—	406	255	330	2,331
Current	234,495	300,963	822,984	63,828	132,061	95,271	27,080	1,676,682
Total loans [3]	$ 235,835	$ 300,963	$ 822,984	$ 63,828	$ 132,467	$ 95,526	$ 27,410	$ 1,679,013
Non-accrual loans [2]	$ —	$ —	$ —	$ —	$ 406	$ —	$ —	$ 406

[1] Our residential loan portfolio does not include sub-prime loans, nor is it our practice to underwrite loans commonly referred to as "Alt-A mortgages", the characteristics of which are loans lacking full documentation, borrowers having low FICO scores or higher loan-to-value ratios.
[2] One purchased credit impaired ("PCI") loan with an unpaid balance of $6 thousand and no carrying value was not accreting interest at June 30, 2018. Three PCI loans with unpaid balances totaling $131 thousand and no carrying values were not accreting interest at December 31, 2017. Amounts exclude accreting PCI loans totaling $2.1 million at both June 30, 2018 and December 31, 2017 as we have a reasonable expectation about future cash flows to be collected and we continue to recognize accretable yield on these loans in interest income. There were no accruing loans past due more than ninety days at June 30, 2018 or December 31, 2017.
[3] Amounts include net deferred loan origination costs of $800 thousand and $818 thousand at June 30, 2018 and December 31, 2017, respectively. Amounts are also net of unaccreted purchase discounts on non-PCI loans of $956 thousand and $1.2 million at June 30, 2018 and December 31, 2017, respectively.

We generally make commercial loans to established small and mid-sized businesses to provide financing for their growth and working capital needs, equipment purchases and acquisitions. Management examines historical, current, and projected cash flows to determine the ability of the borrower to repay obligations as agreed. Commercial loans are made based primarily on the identified cash flows of the borrower and secondarily on the underlying collateral and guarantor support. The cash flows of borrowers, however, may not occur as expected, and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed, such as accounts receivable and inventory, and typically include personal guarantees. We target stable businesses with guarantors who provide additional sources of repayment and have proven to be resilient in periods of economic stress.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans discussed above. We underwrite these loans to be repaid from cash flow and to be supported by real property collateral. Underwriting standards for commercial real estate loans include, but are not limited to, debt coverage and loan-to-value ratios. Furthermore, the owners of the properties guarantee substantially all of our commercial real estate loans. Conditions in the real estate markets or in the general economy may adversely affect our commercial real estate loans. In the event of a vacancy, we expect guarantors to carry the loans until they find a replacement tenant. The owner's substantial equity investment provides a strong economic incentive to continue to support the commercial real estate projects. As such, we have generally experienced a relatively low level of loss and delinquencies in this portfolio.

We generally make construction loans to developers and builders to finance construction, renovation and occasionally land acquisitions in anticipation of near-term development. These loans are underwritten after evaluation of the borrower's financial strength, reputation, prior track record, and independent appraisals. Significant events can affect the construction industry, including: the inherent volatility of real estate markets and vulnerability to delays due to weather, change orders, inability to obtain construction permits, labor or material shortages, and price changes. Estimates of construction costs and value associated with the completed project may be inaccurate. Repayment of construction loans is largely dependent on the ultimate success of the project.

Consumer loans primarily consist of home equity lines of credit, other residential loans and floating homes, along with a small number of installment loans. Our other residential loans include tenancy-in-common fractional interest loans ("TIC") located almost entirely in San Francisco County. We originate consumer loans utilizing credit score information, debt-to-income ratio and loan-to-value ratio analysis. Diversification among consumer loan types, coupled with relatively small loan amounts that are spread across many individual borrowers, mitigates risk.

We use a risk rating system to evaluate asset quality, and to identify and monitor credit risk in individual loans, and in the loan portfolio. Our definitions of “Special Mention” risk graded loans, or worse, are consistent with those used by the Federal Deposit Insurance Corporation ("FDIC"). Our internally assigned grades are as follows:

Pass and Watch: Loans to borrowers of acceptable or better credit quality. Borrowers in this category demonstrate fundamentally sound financial positions, repayment capacity, credit history, and management expertise. Loans in this category must have an identifiable and stable source of repayment and meet the Bank’s policy regarding debt-service-coverage ratios. These borrowers are capable of sustaining normal economic, market or operational setbacks without significant financial consequences. Negative external industry factors are generally not present. The loan may be secured, unsecured or supported by non-real estate collateral for which the value is more difficult to determine and/or marketability is more uncertain. This category also includes “Watch” loans, where the primary source of repayment has been delayed. “Watch” is intended to be a transitional grade, with either an upgrade or downgrade within a reasonable period.

Special Mention: Potential weaknesses that deserve close attention. If left uncorrected, those potential weaknesses may result in deterioration of the payment prospects for the asset. Special Mention assets do not present sufficient risk to warrant adverse classification.

Substandard: Inadequately protected by either the current sound worth and paying capacity of the obligor or the collateral pledged, if any. A Substandard asset has a well-defined weakness or weaknesses that jeopardize(s) the liquidation of the debt. Substandard assets are characterized by the distinct possibility that we will sustain some loss if such weaknesses or deficiencies are not corrected. Well-defined weaknesses include adverse trends or developments of the borrower's financial condition, managerial weaknesses and/or significant collateral deficiencies.

Doubtful: Critical weaknesses that make collection or liquidation in full improbable. There may be specific pending events that work to strengthen the asset; however, the amount or timing of the loss may not be determinable. Pending events generally occur within one year of the asset being classified as Doubtful. Examples include: merger, acquisition, or liquidation; capital injection; guarantee; perfecting liens on additional collateral; and refinancing. Such loans are placed on non-accrual status and usually are collateral-dependent.

We regularl