WASHINGTON TRUST BANCORP INC
Form 10-Q
August 04, 2017
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, 2017 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: 001-32991

WASHINGTON TRUST BANCORP, INC.
(Exact name of registrant as specified in its charter)

RHODE ISLAND	05-0404671
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

23 BROAD STREET	
WESTERLY, RHODE ISLAND	02891
(Address of principal executive offices)	(Zip Code)

(401) 348-1200
(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. x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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). x Yes o No

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

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o	Smaller reporting company o
(Do not check if a smaller reporting company)	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 accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

The number of shares of common stock of the registrant outstanding as of July 31, 2017 was 17,210,750.

FORM 10-Q
WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
For the Quarter Ended June 30, 2017

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PART I. Financial Information
Item 1. Financial Statements
Consolidated Balance Sheets (unaudited) (Dollars in thousands, except par value)

	June 30, 2017	December 31, 2016
Assets:		
Cash and due from banks	$117,608	$106,185
Short-term investments	2,324	1,612
Mortgage loans held for sale, at fair value	32,784	29,434
Securities:		
Available for sale, at fair value	749,486	739,912
Held to maturity, at amortized cost (fair value $14,231 at June 30, 2017 and $15,920 at December 31, 2016)	13,942	15,633
Total securities	763,428	755,545
Federal Home Loan Bank stock, at cost	44,640	43,129
Loans:		
Commercial	1,698,389	1,771,666
Residential real estate	1,168,105	1,122,748
Consumer	333,606	339,957
Total loans	3,200,100	3,234,371
Less allowance for loan losses	26,662	26,004
Net loans	3,173,438	3,208,367
Premises and equipment, net	28,508	29,020
Investment in bank-owned life insurance	72,183	71,105
Goodwill	63,909	64,059
Identifiable intangible assets, net	9,642	10,175
Other assets	67,065	62,484
Total assets	$4,375,529	$4,381,115
Liabilities:		
Deposits:		
Demand deposits	$587,813	$585,960
NOW accounts	448,617	427,707
Money market accounts	666,047	730,075
Savings accounts	364,002	358,397
Time deposits	954,710	961,613
Total deposits	3,021,189	3,063,752
Federal Home Loan Bank advances	869,733	848,930
Junior subordinated debentures	22,681	22,681
Other liabilities	55,884	54,948
Total liabilities	3,969,487	3,990,311
Commitments and contingencies		
Shareholders’ Equity:		
Common stock of $.0625 par value; authorized 60,000,000 shares; issued and outstanding 17,209,699 shares at June 30, 2017 and 17,170,820 shares at December 31, 2016	1,076	1,073
Paid-in capital	116,484	115,123
Retained earnings	306,151	294,365
Accumulated other comprehensive loss	(17,669)	(19,757)
Total shareholders’ equity	406,042	390,804
Total liabilities and shareholders’ equity	$4,375,529	$4,381,115

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

(Dollars and shares in thousands, except per share amounts)

	Three months		Six months	
Periods ended June 30,	2017	2016	2017	2016
Interest income:				
Interest and fees on loans	$31,642	$29,122	$61,994	$59,120
Interest on securities: Taxable	4,844	2,487	9,553	4,857
Nontaxable	72	280	184	607
Dividends on Federal Home Loan Bank stock	439	231	826	441
Other interest income	156	70	260	134
Total interest and dividend income	37,153	32,190	72,817	65,159
Interest expense:				
Deposits	3,591	2,981	7,093	5,949
Federal Home Loan Bank advances	3,509	2,313	6,853	4,465
Junior subordinated debentures	149	119	287	231
Other interest expense	—	1	1	3
Total interest expense	7,249	5,414	14,234	10,648
Net interest income	29,904	26,776	58,583	54,511
Provision for loan losses	700	450	1,100	950
Net interest income after provision for loan losses	29,204	26,326	57,483	53,561
Noninterest income:				
Wealth management revenues	9,942	9,481	19,419	18,655
Mortgage banking revenues	2,919	2,710	5,259	4,908
Service charges on deposit accounts	901	935	1,784	1,842
Card interchange fees	902	860	1,704	1,657
Income from bank-owned life insurance	542	1,090	1,078	1,589
Loan related derivative income	1,144	508	1,292	1,153
Equity in earnings (losses) of unconsolidated subsidiaries	(89)	(89)	(177)	(177)
Other income	545	419	957	921
Total noninterest income	16,806	15,914	31,316	30,548
Noninterest expense:				
Salaries and employee benefits	17,358	17,405	34,153	33,785
Net occupancy	1,767	1,803	3,734	3,610
Equipment	1,313	1,503	2,780	3,004
Outsourced services	1,710	1,294	3,167	2,657
Legal, audit and professional fees	582	662	1,198	1,291
FDIC deposit insurance costs	469	491	950	984
Advertising and promotion	362	420	599	685
Amortization of intangibles	257	322	534	645
Debt prepayment penalties	—	—	—	431
Change in fair value of contingent consideration	—	16	(310)	41
Other expenses	2,488	2,114	4,787	4,347
Total noninterest expense	26,306	26,030	51,592	51,480
Income before income taxes	19,704	16,210	37,207	32,629
Income tax expense	6,505	5,153	12,226	10,637
Net income	$13,199	$11,057	$24,981	$21,992

Weighted average common shares outstanding - basic		17,206	17,067	17,196	17,045
Weighted average common shares outstanding - diluted		17,316	17,194	17,312	17,185
Per share information:	Basic earnings per common share	$0.77	$0.65	$1.45	$1.29
	Diluted earnings per common share	$0.76	$0.64	$1.44	$1.28
	Cash dividends declared per share	$0.38	$0.36	$0.76	$0.72

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

Consolidated Statements of Comprehensive Income (unaudited) (Dollars in thousands)

	Three Months		Six Months	
Periods ended June 30,	2017	2016	2017	2016
Net income	$13,199	$11,057	$24,981	$21,992
Other comprehensive income, net of tax:				
Net change in fair value of securities available for sale	1,828	1,378	2,229	1,742
Net change in fair value of cash flow hedges	(448)	(24)	(350)	(90)
Net change in defined benefit plan obligations	(4)	165	209	331
Total other comprehensive income, net of tax	1,376	1,519	2,088	1,983
Total comprehensive income	$14,575	$12,576	$27,069	$23,975

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

Consolidated Statements of Changes in Shareholders' Equity (unaudited) (Dollars and shares in thousands)

	Common Shares Outstanding	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
Balance at January 1, 2017	17,171	$1,073	$115,123	$294,365	($19,757)	$390,804
Net income	—	—	—	24,981	—	24,981
Total other comprehensive income, net of tax	—	—	—		2,088	2,088
Cash dividends declared	—	—	—	(13,195)	—	(13,195)
Share-based compensation	—	—	1,198	—	—	1,198
Exercise of stock options, issuance of other compensation-related equity awards	39	3	163	—	—	166
Balance at June 30, 2017	17,210	$1,076	$116,484	$306,151	($17,669)	$406,042

	Common Shares Outstanding	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
Balance at January 1, 2016	17,020	$1,064	$110,949	$273,074	($9,699)	$375,388
Net income	—	—	—	21,992	—	21,992
Total other comprehensive income, net of tax	—	—	—	—	1,983	1,983
Cash dividends declared	—	—	—	(12,400)	—	(12,400)
Share-based compensation	—	—	1,109	—	—	1,109
Exercise of stock options, issuance of other compensation-related equity awards and related tax benefit	61	4	256	—	—	260
Balance at June 30, 2016	17,081	$1,068	$112,314	$282,666	($7,716)	$388,332

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

Consolidated Statement of Cash Flows (unaudited) (Dollars in thousands)

Six months ended June 30,		2017	2016
Cash flows from operating activities:			
Net income		$24,981	$21,992
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses		1,100	950
Depreciation of premises and equipment		1,759	1,790
Net amortization of premium and discount		1,616	977
Amortization of intangibles		534	645
Goodwill impairment		150	—
Share-based compensation		1,198	1,109
Tax benefit from stock option exercises and other equity awards		350	286
Income from bank-owned life insurance		(1,078)	(1,589)
Net gains on loan sales and commissions on loans originated for others		(5,052)	(4,938)
Net gain on sale of portfolio loans		—	(135)
Equity in (earnings) losses of unconsolidated subsidiaries		177	177
Proceeds from sales of loans		215,239	222,098
Loans originated for sale		(213,929)	(217,682)
Change in fair value of contingent consideration liability		(310)	41
Increase in other assets		(6,064)	(21,194)
Increase in other liabilities		1,110	16,409
Net cash provided by operating activities		21,781	20,936
Cash flows from investing activities:			
Purchases of:	Mortgage-backed securities available for sale	(35,213)	(62,497)
	Other investment securities available for sale	(19,963)	(40,495)
Maturities and principal payments of:	Mortgage-backed securities available for sale	38,861	23,696
	Other investment securities available for sale	8,955	54,681
	Mortgage-backed securities held to maturity	1,614	2,008
Purchases of Federal Home Loan Bank stock		(1,511)	(9,987)
Net decrease (increase) in loans		33,596	(53,972)
Net proceeds from sale of portfolio loans		—	510
Purchases of loans		—	(17,079)
Proceeds from the sale of property acquired through foreclosure or repossession		213	254
Purchases of premises and equipment		(1,247)	(1,816)
Proceeds of bank-owned life insurance		—	2,054
Net cash provided by (used in) investing activities		25,305	(102,643)
Cash flows from financing activities:			
Net decrease in deposits		(42,563)	(144,905)
Proceeds from Federal Home Loan Bank advances		657,500	640,000
Repayment of Federal Home Loan Bank advances		(636,697)	(378,963)
Net proceeds from stock option exercises and issuance of other equity awards		(184)	(26)
Cash dividends paid		(13,007)	(12,117)
Net cash (used in) provided by financing activities		(34,951)	103,989
Net increase in cash and cash equivalents		12,135	22,282
Cash and cash equivalents at beginning of period		107,797	97,631
Cash and cash equivalents at end of period		$119,932	$119,913
Noncash Investing and Financing Activities:			

Loans charged off	$721	$2,335
Loans transferred to property acquired through foreclosure or repossession	410	1,045
Supplemental Disclosures:		
Interest payments	$14,111	$10,467
Income tax payments	11,849	9,872

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

Condensed Notes to Unaudited Consolidated Financial Statements

(1) General Information

Washington Trust Bancorp, Inc. (the "Bancorp") is a publicly-owned registered bank holding company that has elected to be a financial holding company. The Bancorp's subsidiaries include The Washington Trust Company, of Westerly (the "Bank"), a Rhode Island chartered commercial bank founded in 1800, and Weston Securities Corporation ("WSC"). Through its subsidiaries, the Bancorp offers a comprehensive product line of banking and financial services, including commercial, residential and consumer lending, retail and commercial deposit products, and wealth management services through its offices in Rhode Island, eastern Massachusetts and Connecticut; its automated teller machines ("ATMs"); telephone banking; mobile banking and its internet website (www.washtrust.com).

The Unaudited Consolidated Financial Statements include the accounts of the Bancorp and its subsidiaries (collectively the "Corporation" or "Washington Trust"). All significant intercompany transactions have been eliminated. Certain previously reported amounts have been reclassified to conform to the current year's presentation.

The accounting and reporting policies of the Corporation conform to accounting principles generally accepted in the United States of America ("GAAP") and to general practices of the banking industry. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates.

The Unaudited Consolidated Financial Statements of the Corporation presented herein have been prepared pursuant to the rules of the Securities and Exchange Commission ("SEC") for quarterly reports on Form 10-Q and do not include all of the information and note disclosures required by GAAP. In the opinion of management, all adjustments (consisting of normal recurring adjustments) and disclosures considered necessary for the fair presentation of the accompanying Unaudited Consolidated Financial Statements have been included. Interim results are not necessarily reflective of the results of the entire year. The accompanying Unaudited Consolidated Financial Statements should be read in conjunction with the Audited Consolidated Financial Statements and notes thereto included in the Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

(2) Recently Issued Accounting Pronouncements

Revenue from Contracts with Customers - Topic 606

Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"), was issued in May 2014 and provides a revenue recognition framework for any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets unless those contracts are within the scope of other accounting standards. As issued, ASU 2014-09 was effective for annual periods beginning after December 15, 2016, including interim periods within that reporting period with early adoption not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. In August 2015, Accounting Standards Update No. 2015-14, "Deferral of the Effective Date" ("ASU 2015-14") was issued and delayed the effective date of ASU 2014-09 to annual and interim periods in fiscal years beginning after December 15, 2017. In 2016, Accounting Standards Update No. 2016-08, "Principal versus Agent Considerations" ("ASU 2016-08"), Accounting Standards Update No. 2016-10, "Identifying Performance Obligations and Licensing" ("ASU 2016-10") and Accounting Standards Update No. 2016-12, "Narrow-Scope Improvements and Practical Expedients" ("ASU 2016-12") were issued. These ASUs do not change the core principle for revenue recognition in Topic 606; instead, the amendments provide more detailed guidance in a few areas and additional implementation guidance and examples, which are expected to reduce the degree of judgment necessary to comply with Topic 606. The effective date and transition requirements for ASU 2016-08, ASU 2016-10 and ASU 2016-12 are the same as those provided by ASU 2015-14. Washington Trust's largest source of revenue is net interest income on financial assets and liabilities, which

is explicitly excluded from the scope of this ASU. Management has assembled a project team to address the changes pursuant to Topic 606. The project team has made an initial scope assessment and commenced contract review for in-scope revenue streams. The Corporation has not yet determined the impact this ASU will have on its consolidated financial statements.

Financial Instruments - Topic 825

Accounting Standards Update No. 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities” (“ASU 2016-01”), was issued in January 2016 and provides revised guidance related to the accounting for and reporting of financial instruments. Some of the main provisions include: requiring most equity securities to be reported at fair value with unrealized gains and losses reported in the income statement; requiring separate presentation of financial assets and liabilities by measurement category and form (i.e. securities or loans); clarifying that entities must assess valuation allowances on a deferred tax asset related to available for sale debt securities in combination with their other deferred tax assets; and eliminating the

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

requirement to disclose the method and significant assumptions used to estimate fair value for financial instruments measured at amortized cost on the balance sheet. ASU 2016-01 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The adoption of ASU 2016-01 is not expected to have a material impact on the Corporation’s consolidated financial statements.

Leases - Topic 842
Accounting Standards Update No. 2016-02, “Leases” (“ASU 2016-02”), was issued in February 2016 and provides revised guidance related to the accounting and reporting of leases. ASU 2016-02 requires lessees to recognize most leases on the balance sheet. The recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee will depend on its classification as a finance or operating lease. ASU 2016-02 requires a modified retrospective transition, with a number of practical expedients that entities may elect to apply. ASU 2016-02 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted. Washington Trust expects to adopt the provisions of ASU 2016-02 effective January 1, 2019. Management has assembled a project team to evaluate the provisions of this ASU, identify additional data requirements necessary and determine an approach for implementation. The Corporation has not yet determined the impact ASU 2016-02 will have on its consolidated financial statements.

Stock Compensation - Topic 718
Accounting Standards Update No. 2016-09, “Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”), was issued in March 2016. ASU 2016-09 includes multiple provisions intended to simplify several aspects of the accounting for share-based payment transactions, including income tax consequences and the classification of certain tax-related transactions on the statement of cash flows. ASU 2016-09 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016. Management adopted the provisions of this ASU on January 1, 2017 using the appropriate transition method as required by ASU 2016-09. For Washington Trust, the most significant provision of this ASU pertained to the accounting of excess tax benefits or tax deficiencies on share based award exercises and vestings. ASU 2016-09 requires that excess tax benefits or tax deficiencies be recognized as income tax benefit or expense in the Consolidated Statements of Income in the period that they occur. Management adopted this specific provision of the ASU on a prospective basis. The ASU also requires that the excess tax benefits or tax deficiencies be reported as an operating activity in the Consolidated Statement of Cash Flows and, in accordance with the ASU, management elected the retrospective transition method in adopting this specific provision. The adoption of ASU 2016-09 did not have a material impact on the consolidated financial statements.

Credit Losses - Topic 326
Accounting Standards Update No. 2016-13, “Financial Instruments - Credit Losses” (“ASU 2016-13”), was issued in June 2016. ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 provides for a modified retrospective transition, resulting in a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is effective, except for debt securities for which an other-than-temporary impairment has previously been recognized. For these debt securities, a prospective transition approach will be adopted in order to maintain the same amortized cost prior to and subsequent to the effective date of ASU 2016-13. This ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2019. Early adoption is permitted, for annual periods and interim periods within those annual periods, beginning after December 15, 2018. Washington Trust is evaluating the effect that this ASU will have on consolidated financial statements and disclosures. Management has assembled a project team that

meets regularly to evaluate the provisions of this ASU, identify additional data requirements necessary and determine an approach for implementation. The Corporation has not yet determined if it will early adopt ASU 2016-13 or the impact it will have on its consolidated financial statements.

Statement of Cash Flows - Topic 230
Accounting Standards Update No. 2016-15, “Classification of Certain Cash Receipts and Cash Payments” (“ASU 2016-15”), was issued in August 2016. ASU 2016-15 provides classification guidance on certain cash receipts and cash payments, including, but not limited to, debt prepayment costs, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of bank-owned life insurance policies and distributions received from equity method investees. The adoption of ASU 2016-15 requires a retrospective transition method applied to each period presented. This ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted. The adoption of ASU 2016-15 is not expected to have a material impact on the Corporation’s consolidated financial statements.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

Accounting Standards Update No. 2016-18, "Restricted Cash" ("ASU 2016-18"), was issued in November 2016. ASU 2016-18 requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash. Restricted cash should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The adoption of ASU 2016-18 requires a retrospective transition method applied to each period presented. This ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted. The adoption of ASU 2016-18 is not expected to have a material impact on the Corporation's consolidated financial statements.

Intangibles - Goodwill and Other - Topic 350
Accounting Standards Update No. 2017-04, "Simplifying the Test for Goodwill Impairment" ("ASU 2017-04"), was issued in January 2017 and eliminates Step 2 of the annual goodwill impairment test. Step 2 is a more detailed analysis, which involves measuring the excess of the fair value of the reporting unit, as determined in Step 1, over the aggregate fair value of the individual assets, liabilities, and identifiable intangibles as if the reporting unit was being acquired in a business combination. Under ASU 2017-04, an impairment charge would be recognized for the amount by which the carrying amount exceeded the reporting unit's fair value under Step 1. ASU 2017-04 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2019 and the provisions should be applied on a prospective basis. Effective April 1, 2017, management early adopted the provisions of this ASU, as permitted. The adoption of ASU 2017-04 did not have a material impact on the Corporation's consolidated financial statements.

Compensation - Retirement Benefits - Topic 715
Accounting Standards Update No. 2017-07, "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost" ("ASU 2017-07"), was issued in March 2017. ASU 2017-07 requires that employers include the service cost component of net periodic benefit cost in the same line item as other employee compensation costs and all other components of net periodic benefit cost in a separate line item(s) in the statement of income. In addition, the line item in which the components of net periodic benefit cost other than the service cost are included shall be identified as such on the statement of income or in the notes to the financial statements. ASU 2017-07 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The adoption of ASU 2017-07 is not expected to have a material impact on the Corporation's consolidated financial statements.

Receivables - Nonrefundable Fees and Other Costs - Subtopic 310-20
Accounting Standards Update No. 2017-08, "Premium Amortization on Purchased Callable Debt Securities" ("ASU 2017-08"), was issued in March 2017. ASU 2017-08 shortens the amortization period for certain callable debt securities purchased at a premium by requiring that the premium be amortized to the earliest call date. Effective January 1, 2017, management early adopted the provisions of this ASU, as permitted. The adoption of ASU 2017-08 did not have a material impact on the Corporation's consolidated financial statements.

Compensation - Stock Compensation - Topic 718
Accounting Standards Update No. 2017-09, "Scope of Modification Accounting" ("ASU 2017-09"), was issued in May 2017 to provide clarity when applying the guidance in Topic 718 to a change to the terms or conditions of a share-based payment award. ASU 2017-09 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017 and the provisions should be applied on a prospective basis. Early adoption is permitted. The adoption of ASU 2017-09 is not expected to have a material impact on the Corporation's consolidated financial statements.

(3) Cash and Due from Banks

The Bank maintains certain average reserve balances to meet the requirements of the Board of Governors of the Federal Reserve System (“FRB”). Some or all of these reserve requirements may be satisfied with vault cash. Reserve balances amounted to $13.5 million at June 30, 2017 and $11.5 million at December 31, 2016 and were included in cash and due from banks in the Unaudited Consolidated Balance Sheets.

As of June 30, 2017 and December 31, 2016, cash and due from banks included interest-bearing deposits in other banks of $52.6 million and $60.3 million, respectively.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(4) Securities
The following tables present the amortized cost, gross unrealized holding gains, gross unrealized holding losses and fair value of securities by major security type and class of security:
(Dollars in thousands)

June 30, 2017	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities Available for Sale:				
Obligations of U.S. government-sponsored enterprises	$131,484	$4	($2,558)	$128,930
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	587,814	4,763	(7,928)	584,649
Obligations of states and political subdivisions	5,468	16	—	5,484
Individual name issuer trust preferred debt securities	27,888	—	(1,498)	26,390
Corporate bonds	4,127	22	(116)	4,033
Total securities available for sale	$756,781	$4,805	($12,100)	$749,486
Held to Maturity:				
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	$13,942	$289	$—	$14,231
Total securities held to maturity	$13,942	$289	$—	$14,231
Total securities	$770,723	$5,094	($12,100)	$763,717

(Dollars in thousands)

December 31, 2016	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities Available for Sale:				
Obligations of U.S. government-sponsored enterprises	$111,483	$7	($3,050)	$108,440
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	592,833	4,923	(9,671)	588,085
Obligations of states and political subdivisions	14,423	62	—	14,485
Individual name issuer trust preferred debt securities	29,851	—	(3,115)	26,736
Corporate bonds	2,155	16	(5)	2,166
Total securities available for sale	$750,745	$5,008	($15,841)	$739,912
Held to Maturity:				
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	$15,633	$287	$—	$15,920
Total securities held to maturity	$15,633	$287	$—	$15,920
Total securities	$766,378	$5,295	($15,841)	$755,832

As of June 30, 2017 and December 31, 2016, securities with a fair value of $670.4 million and $736.2 million, respectively, were pledged as collateral for Federal Home Loan Bank of Boston (“FHLBB”) borrowings, potential borrowings with the FRB, certain public deposits and for other purposes. See Note 8 for additional disclosure on FHLBB borrowings.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

The schedule of maturities of debt securities available for sale and held to maturity is presented below. Mortgage-backed securities are included based on weighted average maturities, adjusted for anticipated prepayments. All other debt securities are included based on contractual maturities. Actual maturities may differ from amounts presented because certain issuers have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	Available for Sale		Held to Maturity	
June 30, 2017	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$64,607	$64,271	$2,422	$2,472
Due after one year to five years	249,039	246,979	6,586	6,723
Due after five years to ten years	251,102	247,891	3,876	3,956
Due after ten years	192,033	190,345	1,058	1,080
Total securities	$756,781	$749,486	$13,942	$14,231

Included in the above table are debt securities with an amortized cost balance of $167.8 million and a fair value of $163.6 million at June 30, 2017 that are callable at the discretion of the issuers. Final maturities of the callable securities range from 11 months to 20 years, with call features ranging from 1 month to 4 years.

Other-Than-Temporary Impairment Assessment

Washington Trust assesses whether the decline in fair value of investment securities is other-than-temporary on a regular basis. Unrealized losses on debt securities may occur from current market conditions, increases in interest rates since the time of purchase, a structural change in an investment, volatility of earnings of a specific issuer, or deterioration in credit quality of the issuer. Management evaluates impairments in value both qualitatively and quantitatively to assess whether they are other-than-temporary.

The following tables summarize temporarily impaired securities, segregated by length of time the securities have been in a continuous unrealized loss position:

(Dollars in thousands)	Less than 12 Months			12 Months or Longer			Total		
June 30, 2017	#	Fair Value	Unrealized Losses	#	Fair Value	Unrealized Losses	#	Fair Value	Unrealized Losses
Obligations of U.S. government-sponsored enterprises	11	$108,930	($2,558)	—	$—	$—	11	$108,930	($2,558)
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	35	379,226	(7,928)	—	—	—	35	379,226	(7,928)
Individual name issuer trust preferred debt securities	—	—	—	9	26,390	(1,498)	9	26,390	(1,498)
Corporate bonds	2	402	(3)	1	1,868	(113)	3	2,270	(116)
Total temporarily impaired securities	48	$488,558	($10,489)	10	$28,258	($1,611)	58	$516,816	($12,100)

(Dollars in thousands)	Less than 12 Months			12 Months or Longer			Total		
December 31, 2016	#	Fair Value	Unrealized Losses	#	Fair Value	Unrealized Losses	#	Fair Value	Unrealized Losses
Obligations of U.S. government-sponsored enterprises	10	$98,433	($3,050)	—	$—	$—	10	$98,433	($3,050)
	35	407,073	(9,671)	—	—	—	35	407,073	(9,671)

Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises									
Individual name issuer trust preferred debt securities	—	—	—	10	26,736	(3,115)	10	26,736	(3,115)
Corporate bonds	2	400	(5)	—	—	—	2	400	(5)
Total temporarily impaired securities	47	$505,906	($12,726)	10	$26,736	($3,115)	57	$532,642	($15,841)

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Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

Further deterioration in credit quality of the underlying issuers of the securities, further deterioration in the condition of the financial services industry, worsening of the current economic environment, or additional declines in real estate values, among other things, may further affect the fair value of these securities and increase the potential that certain unrealized losses be designated as other-than-temporary in future periods, and the Corporation may incur write-downs.

U.S. Government Agency and U.S. Government-Sponsored Enterprise Securities, including Mortgage-Backed Securities
The gross unrealized losses on U.S. government agency and U.S government-sponsored debt securities, including mortgage-backed securities, were primarily attributable to relative changes in interest rates since the time of purchase. The contractual cash flows for these securities are guaranteed by U.S. government agencies and U.S. government-sponsored enterprises. Based on the assessment of these factors, management believes that the unrealized losses on these debt security holdings are a function of changes in investment spreads and interest rate movements and not changes in credit quality. Management expects to recover the entire amortized cost basis of these securities. Furthermore, Washington Trust does not intend to sell these securities and it is not more-likely-than-not that Washington Trust will be required to sell these securities before recovery of their cost basis, which may be maturity. Therefore, management does not consider these investments to be other-than-temporarily impaired at June 30, 2017.

Trust Preferred Debt Securities of Individual Name Issuers
Included in debt securities in an unrealized loss position at June 30, 2017 were 9 trust preferred security holdings issued by 6 individual companies in the banking sector. Management believes the unrealized loss position in these holdings was attributable to the general widening of spreads for this category of debt securities issued by financial services companies since the time these securities were purchased. Based on the information available through the filing date of this report, all individual name issuer trust preferred debt securities held in our portfolio continue to accrue and make payments as expected with no payment deferrals or defaults on the part of the issuers. As of June 30, 2017, individual name issuer trust preferred debt securities with an amortized cost of $10.9 million and unrealized losses of $663 thousand were rated below investment grade by Standard & Poors, Inc. ("S&P"). Management reviewed the collectibility of these securities taking into consideration such factors as the financial condition of the issuers, reported regulatory capital ratios of the issuers, credit ratings, including ratings in effect as of the reporting period date as well as credit rating changes between the reporting period date and the filing date of this report, and other information. We noted no additional downgrades to below investment grade between June 30, 2017 and the filing date of this report. Based on this review, management concluded that it expects to recover the entire amortized cost basis of these securities. Furthermore, Washington Trust does not intend to sell these securities and it is not more-likely-than-not that Washington Trust will be required to sell these securities before recovery of their cost basis, which may be maturity. Therefore, management does not consider these investments to be other-than-temporarily impaired at June 30, 2017.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(5) Loans

The following is a summary of loans:

(Dollars in thousands)	June 30, 2017		December 31, 2016	
	Amount	%	Amount	%
Commercial:				
Mortgages (1)	$1,009,096	32 %	$1,074,186	33 %
Construction & development (2)	112,177	4	121,371	4
Commercial & industrial (3)	577,116	17	576,109	18
Total commercial	1,698,389	53	1,771,666	55
Residential Real Estate:				
Mortgages	1,143,416	36	1,094,824	34
Homeowner construction	24,689	1	27,924	1
Total residential real estate	1,168,105	37	1,122,748	35
Consumer:				
Home equity lines	263,934	8	264,200	8
Home equity loans	35,173	1	37,272	1
Other (4)	34,499	1	38,485	1
Total consumer	333,606	10	339,957	10
Total loans (5)	$3,200,100	100%	$3,234,371	100%

(1) Loans primarily secured by income producing property.

(2) Loans for construction of commercial properties, loans to developers for construction of residential properties and loans for land development.

(3) Loans to businesses and individuals, a substantial portion of which are fully or partially collateralized by real estate.

(4) Loans to individuals secured by general aviation aircraft and other personal installment loans.

(5) Includes net unamortized loan origination costs of $3.7 million and $3.0 million, respectively, at June 30, 2017 and December 31, 2016 and net unamortized premiums on purchased loans of $854 thousand and $783 thousand, respectively, at June 30, 2017 and December 31, 2016.

As of June 30, 2017 and December 31, 2016, there were $1.6 billion and $1.4 billion, respectively, of loans pledged as collateral for FHLBB borrowings and potential borrowings with the FRB. See Note 8 for additional disclosure regarding borrowings.

Nonaccrual Loans

Loans, with the exception of certain well-secured loans that are in the process of collection, are placed on nonaccrual status and interest recognition is suspended when such loans are 90 days or more overdue with respect to principal and/or interest, or sooner if considered appropriate by management. Well-secured loans are permitted to remain on accrual status provided that full collection of principal and interest is assured and the loan is in the process of collection. Loans are also placed on nonaccrual status when, in the opinion of management, full collection of principal and interest is doubtful. Interest previously accrued but not collected on such loans is reversed against current period income. Subsequent interest payments received on nonaccrual loans are applied to the outstanding principal balance of the loan or recognized as interest income depending on management's assessment of the ultimate collectability of the loan. Loans are removed from nonaccrual status when they have been current as to principal and interest generally for a period of six months, the borrower has demonstrated an ability to comply with repayment terms, and when, in management's opinion, the loans are considered to be fully collectible.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

The following is a summary of nonaccrual loans, segregated by class of loans:

(Dollars in thousands)	Jun 30, 2017	Dec 31, 2016
Commercial:		
Mortgages	$6,422	$7,811
Construction & development	—	—
Commercial & industrial	1,232	1,337
Residential Real Estate:		
Mortgages	11,815	11,736
Homeowner construction	—	—
Consumer:		
Home equity lines	118	—
Home equity loans	502	1,058
Other	109	116
Total nonaccrual loans	$20,198	$22,058
Accruing loans 90 days or more past due	$—	$—

As of June 30, 2017 and December 31, 2016, loans secured by one- to four-family residential property amounting to $3.4 million and $5.7 million, respectively, were in process of foreclosure.

Nonaccrual loans of $5.7 million and $3.5 million, respectively, were current as to the payment of principal and interest at June 30, 2017 and December 31, 2016.

There were no significant commitments to lend additional funds to borrowers whose loans were on nonaccrual status at June 30, 2017.

Past Due Loans

Past due status is based on the contractual payment terms of the loan. The following tables present an age analysis of past due loans, segregated by class of loans:

(Dollars in thousands)	Days Past Due					
June 30, 2017	30-59	60-89	Over 90	Total Past Due	Current	Total Loans
Commercial:						
Mortgages	$—	$1	$6,421	$6,422	$1,002,674	$1,009,096
Construction & development	—	—	—	—	112,177	112,177
Commercial & industrial	3,194	321	494	4,009	573,107	577,116
Residential Real Estate:						
Mortgages	3,524	1,371	3,962	8,857	1,134,559	1,143,416
Homeowner construction	—	—	—	—	24,689	24,689
Consumer:						
Home equity lines	335	—	—	335	263,599	263,934
Home equity loans	995	317	159	1,471	33,702	35,173
Other	25	—	1	26	34,473	34,499
Total loans	$8,073	$2,010	$11,037	$21,120	$3,178,980	$3,200,100

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(Dollars in thousands)	Days Past Due					
December 31, 2016	30-59	60-89	Over 90	Total Past Due	Current	Total Loans
Commercial:						
Mortgages	$901	$—	$7,807	$8,708	$1,065,478	$1,074,186
Construction & development	—	—	—	—	121,371	121,371
Commercial & industrial	409	—	745	1,154	574,955	576,109
Residential Real Estate:						
Mortgages	5,381	652	6,193	12,226	1,082,598	1,094,824
Homeowner construction	—	—	—	—	27,924	27,924
Consumer:						
Home equity lines	655	26	—	681	263,519	264,200
Home equity loans	776	76	658	1,510	35,762	37,272
Other	32	1	110	143	38,342	38,485
Total loans	$8,154	$755	$15,513	$24,422	$3,209,949	$3,234,371

Included in past due loans as of June 30, 2017 and December 31, 2016, were nonaccrual loans of $14.5 million and $18.6 million, respectively.

All loans 90 days or more past due at June 30, 2017 and December 31, 2016 were classified as nonaccrual.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

Impaired Loans

Impaired loans are loans for which it is probable that the Corporation will not be able to collect all amounts due according to the contractual terms of the loan agreements and loans restructured in a troubled debt restructuring.

The following is a summary of impaired loans:

(Dollars in thousands)	Recorded Investment (1)		Unpaid Principal		Related Allowance	
	Jun 30, 2017	Dec 31, 2016	Jun 30, 2017	Dec 31, 2016	Jun 30, 2017	Dec 31, 2016
No Related Allowance Recorded:						
Commercial:						
Mortgages	$782	$4,676	$778	$9,019	$—	$—
Construction & development	—	—	—	—	—	—
Commercial & industrial	5,256	6,458	5,427	6,550	—	—
Residential real estate:						
Mortgages	14,669	14,385	14,785	14,569	—	—
Homeowner construction	—	—	—	—	—	—
Consumer:						
Home equity lines	118	—	118	—	—	—
Home equity loans	502	1,137	502	1,177	—	—
Other	—	116	7	116	—	—
Subtotal	21,327	26,772	21,617	31,431	—	—
With Related Allowance Recorded:						
Commercial:						
Mortgages	$7,603	$5,104	$11,091	$6,087	$485	$448
Construction & development	—	—	—	—	—	—
Commercial & industrial	1,706	662	1,765	699	718	3
Residential real estate:						
Mortgages	1,062	1,285	1,087	1,310	135	151
Homeowner construction	—	—	—	—	—	—
Consumer:						
Home equity lines	—	—	—	—	—	—
Home equity loans	—	—	—	—	—	—
Other	135	28	136	29	7	4
Subtotal	10,506	7,079	14,079	8,125	1,345	606
Total impaired loans	$31,833	$33,851	$35,696	$39,556	$1,345	$606
Total:						
Commercial	$15,347	$16,900	$19,061	$22,355	$1,203	$451
Residential real estate	15,731	15,670	15,872	15,879	135	151
Consumer	755	1,281	763	1,322	7	4
Total impaired loans	$31,833	$33,851	$35,696	$39,556	$1,345	$606

(1) The recorded investment in impaired loans consists of unpaid principal balance, net of charge-offs, interest payments received applied to principal and unamortized deferred loan origination fees and costs. For impaired accruing loans (troubled debt restructurings for which management has concluded that the collectibility of the loan is not in doubt), the recorded investment also includes accrued interest.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

The following tables present the average recorded investment balance of impaired loans and interest income recognized on impaired loans segregated by loan class.

(Dollars in thousands)	Average Recorded Investment		Interest Income Recognized	
Three months ended June 30,	2017	2016	2017	2016
Commercial:				
Mortgages	$9,549	$13,677	$26	$87
Construction & development	—	—	—	—
Commercial & industrial	6,864	3,290	76	10
Residential Real Estate:				
Mortgages	15,915	10,903	150	98
Homeowner construction	—	—	—	—
Consumer:				
Home equity lines	95	315	2	6
Home equity loans	602	1,216	8	11
Other	140	151	2	2
Totals	$33,165	$29,552	$264	$214

(Dollars in thousands)	Average Recorded Investment		Interest Income Recognized	
Six months ended June 30,	2017	2016	2017	2016
Commercial:				
Mortgages	$9,664	$14,208	$52	$180
Construction & development	—	—	—	—
Commercial & industrial	6,914	3,545	152	21
Residential Real Estate:				
Mortgages	16,076	10,986	272	167
Homeowner construction	—	—	—	—
Consumer:				
Home equity lines	86	493	4	8
Home equity loans	746	1,195	16	24
Other	142	148	6	4
Totals	$33,628	$30,575	$502	$404

Troubled Debt Restructurings

Loans are considered restructured in a troubled debt restructuring when the Corporation has granted concessions to a borrower due to the borrower’s financial condition that it otherwise would not have considered. These concessions may include modifications of the terms of the debt such as deferral of payments, extension of maturity, reduction of principal balance, reduction of the stated interest rate other than normal market rate adjustments, or a combination of these concessions. Debt may be bifurcated with separate terms for each tranche of the restructured debt. Restructuring a loan in lieu of aggressively enforcing the collection of the loan may benefit the Corporation by increasing the ultimate probability of collection.

Restructured loans are classified as accruing or non-accruing based on management's assessment of the collectibility of the loan. Loans which are already on nonaccrual status at the time of the restructuring generally remain on nonaccrual status for approximately 6 months before management considers such loans for return to accruing status. Accruing restructured loans are placed into nonaccrual status if and when the borrower fails to comply with the restructured terms and management deems it unlikely that the borrower will return to a status of compliance in the near term.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

Troubled debt restructurings are reported as such for at least one year from the date of the restructuring. In years after the restructuring, troubled debt restructured loans are removed from this classification if the restructuring did not involve a below-market rate concession and the loan is not deemed to be impaired based on the terms specified in the restructuring agreement.

Troubled debt restructurings are classified as impaired loans. The Corporation identifies loss allocations for impaired loans on an individual loan basis. The recorded investment in troubled debt restructurings was $19.1 million and $22.3 million, respectively, at June 30, 2017 and December 31, 2016. These amounts included insignificant balances of accrued interest. The allowance for loan losses included specific reserves for these troubled debt restructurings of $641 thousand and $567 thousand, respectively, at June 30, 2017 and December 31, 2016.

As of June 30, 2017, there were no significant commitments to lend additional funds to borrowers whose loans had been restructured.

The following tables present loans modified as a troubled debt restructuring:

(Dollars in thousands)			Outstanding Recorded Investment (1)			
	# of Loans		Pre-Modifications		Post-Modifications	
Three months ended June 30,	2017	2016	2017	2016	2017	2016
Commercial:						
Mortgages	—	—	$—	$—	$—	$—
Construction & development	—	—	—	—	—	—
Commercial & industrial	—	1	—	133	—	133
Residential Real Estate:						
Mortgages	—	1	—	3,550	—	3,550
Homeowner construction	—	—	—	—	—	—
Consumer:						
Home equity lines	—	—	—	—	—	—
Home equity loans	—	—	—	—	—	—
Other	—	—	—	—	—	—
Totals	—	2	$—	$3,683	$—	$3,683

(1) The recorded investment in troubled debt restructurings consists of unpaid principal balance, net of charge-offs and unamortized deferred loan origination fees and costs, at the time of the restructuring. For accruing troubled debt restructured loans, the recorded investment also includes accrued interest.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(Dollars in thousands)			Outstanding Recorded Investment (1)			
	# of Loans		Pre-Modifications		Post-Modifications	
Six months ended June 30,	2017	2016	2017	2016	2017	2016
Commercial:						
Mortgages	—	—	$—	$—	$—	$—
Construction & development	—	—	—	—	—	—
Commercial & industrial	—	1	—	133	—	133
Residential Real Estate:						
Mortgages	—	1	—	3,550	—	3,550
Homeowner construction	—	—	—	—	—	—
Consumer:						
Home equity lines	—	—	—	—	—	—
Home equity loans	—	—	—	—	—	—
Other	—	—	—	—	—	—
Totals	—	2	$—	$3,683	$—	$3,683

(1) The recorded investment in troubled debt restructurings consists of unpaid principal balance, net of charge-offs and unamortized deferred loan origination fees and costs, at the time of the restructuring. For accruing troubled debt restructured loans, the recorded investment also includes accrued interest.

The following table provides information on how loans were modified as a troubled debt restructuring:

(Dollars in thousands)	Three months		Six months	
Periods ended June 30,	2017	2016	2017	2016
Below-market interest rate concession	$—	$—	$—	$—
Payment deferral	—	—	—	—
Maturity / amortization concession	—	133	—	133
Interest only payments	—	3,550	—	3,550
Total	$—	$3,683	$—	$3,683

In the three and six months ended June 30, 2017, payment defaults on troubled debt restructured loans modified within the previous 12 months occurred on 3 loans totaling $1.1 million and 4 loans totaling $1.9 million, respectively, compared to 4 loans totaling $577 thousand, in both the three and six months ended June 30, 2016.

Credit Quality Indicators

Commercial

The Corporation utilizes an internal rating system to assign a risk to each of its commercial loans. Loans are rated on a scale of 1 to 10. This scale can be assigned to three broad categories including “pass” for ratings 1 through 6, “special mention” for 7-rated loans, and “classified” for loans rated 8, 9 or 10. The loan rating system takes into consideration parameters including the borrower’s financial condition, the borrower’s performance with respect to loan terms, the adequacy of collateral, the adequacy of guarantees and other credit quality characteristics. The weighted average risk rating of the Corporation’s commercial loan portfolio was 4.71 at June 30, 2017 and 4.68 at December 31, 2016. For non-impaired loans, the Corporation takes the risk rating into consideration along with other credit attributes in the

establishment of an appropriate allowance for loan losses.

A description of the commercial loan categories is as follows:

Pass - Loans with acceptable credit quality, defined as ranging from superior or very strong to a status of lesser stature. Superior or very strong credit quality is characterized by a high degree of cash collateralization or strong balance sheet liquidity. Lesser stature loans have an acceptable level of credit quality but exhibit some weakness in various credit metrics such as collateral

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

adequacy, cash flow, secondary sources of repayment, or performance inconsistency or may be in an industry or of a loan type known to have a higher degree of risk.

Special Mention - Loans with potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Bank's position as creditor at some future date. Special Mention assets are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification. Examples of these conditions include but are not limited to outdated or poor quality financial data, strains on liquidity and leverage, losses or negative trends in operating results, marginal cash flow, weaknesses in occupancy rates or trends in the case of commercial real estate and frequent delinquencies.

Classified - Loans identified as "substandard", "doubtful" or "loss" based on criteria consistent with guidelines provided by banking regulators. A "substandard" loan has defined weaknesses which make payment default or principal exposure likely, but not yet certain. 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. The loans are closely watched and are either already on nonaccrual status or may be placed on nonaccrual status when management determines there is uncertainty of collectibility. A "doubtful" loan is placed on non-accrual status and has a high probability of loss, but the extent of the loss is difficult to quantify due to dependency upon collateral having a value that is difficult to determine or upon some near-term event which lacks certainty. A loan in the "loss" category is considered generally uncollectible or the timing or amount of payments cannot be determined. "Loss" is not intended to imply that the loan has no recovery value but rather it is not practical or desirable to continue to carry the asset.

The Corporation's procedures call for loan ratings and classifications to be revised whenever information becomes available that indicates a change is warranted. The criticized loan portfolio, which generally consists of commercial loans that are risk-rated special mention or worse, and other selected loans are reviewed by management on a quarterly basis, focusing on the current status and strategies to improve the credit. An annual loan review program is conducted by a third party to provide an independent evaluation of the creditworthiness of the commercial loan portfolio, the quality of the underwriting and credit risk management practices and the appropriateness of the risk rating classifications. This review is supplemented with selected targeted internal reviews of the commercial loan portfolio.

The following table presents the commercial loan portfolio, segregated by category of credit quality indicator:

(Dollars in thousands)	Pass		Special Mention		Classified	
	Jun 30, 2017	Dec 31, 2016	Jun 30, 2017	Dec 31, 2016	Jun 30, 2017	Dec 31, 2016
Commercial:						
Mortgages	$1,002,508	$1,065,358	$—	$776	$6,588	$8,052
Construction & development	112,177	121,371	—	—	—	—
Commercial & industrial	556,566	559,416	12,911	8,938	7,639	7,755
Total commercial loans	$1,671,251	$1,746,145	$12,911	$9,714	$14,227	$15,807

Residential and Consumer

The residential and consumer portfolios are monitored on an ongoing basis by the Corporation using delinquency information and loan type as credit quality indicators. These credit quality indicators are assessed on an aggregate basis in these relatively homogeneous portfolios. For non-impaired loans, the Corporation assigns loss allocation factors to each respective loan type.

Various other techniques are utilized to monitor indicators of credit deterioration in the portfolios of residential real estate mortgages and home equity lines and loans. Among these techniques is the periodic tracking of loans with an updated FICO score and an estimated loan to value ("LTV") ratio. LTV ratio is determined via statistical modeling analyses. The indicated LTV levels are estimated based on such factors as the location, the original LTV ratio, and the date of origination of the loan and do not reflect actual appraisal amounts. The results of these analyses and other loan review procedures are taken into consideration in the determination of loss allocation factors for residential mortgage and home equity consumer credits.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

The following table presents the residential and consumer loan portfolios, segregated by category of credit quality indicator:

(Dollars in thousands)	Current and Under 90 Days Past Due		Over 90 Days Past Due	
	Jun 30, 2017	Dec 31, 2016	Jun 30, 2017	Dec 31, 2016
Residential Real Estate:				
Accruing mortgages	$1,131,601	$1,083,088	$—	$—
Nonaccrual mortgages	7,853	5,543	3,962	6,193
Homeowner construction	24,689	27,924	—	—
Total residential loans	$1,164,143	$1,116,555	$3,962	$6,193
Consumer:				
Home equity lines	$263,934	$264,200	$—	$—
Home equity loans	35,014	36,614	159	658
Other	34,498	38,375	1	110
Total consumer loans	$333,446	$339,189	$160	$768

(6) Allowance for Loan Losses

The allowance for loan losses is management's best estimate of inherent risk of loss in the loan portfolio as of the balance sheet date. The Corporation uses a methodology to systematically measure the amount of estimated loan loss exposure inherent in the loan portfolio for purposes of establishing a sufficient allowance for loan losses. The methodology includes: (1) the identification of loss allocations for individual loans deemed to be impaired and (2) the application of loss allocation factors for non-impaired loans based on historical loss experience and estimated loss emergence period, with adjustments for various exposures that management believes are not adequately represented by historical loss experience.

The following table presents the activity in the allowance for loan losses for the three months ended June 30, 2017:

(Dollars in thousands)	Commercial						
	Mortgages	Construction	C&I (1)	Total Commercial	Residential	Consumer	Total
Beginning Balance	$10,861	$1,505	$6,297	$18,663	$5,359	$2,424	$26,446
Charge-offs	(400)	—	(162)	(562)	(32)	(48)	(642)
Recoveries	82	—	47	129	24	5	158
Provision	192	(305)	885	772	18	(90)	700
Ending Balance	$10,735	$1,200	$7,067	$19,002	$5,369	$2,291	$26,662

(1) Commercial & industrial loans.

The following table presents the activity in the allowance for loan losses for the six months ended June 30, 2017:

(Dollars in thousands)	Commercial						
	Mortgages	Construction	C&I (1)	Total Commercial	Residential	Consumer	Total
Beginning Balance	$9,971	$1,195	$6,992	$18,158	$5,252	$2,594	$26,004
Charge-offs	(400)	—	(164)	(564)	(32)	(125)	(721)
Recoveries	82	—	154	236	28	15	279
Provision	1,082	5	85	1,172	121	(193)	1,100
Ending Balance	$10,735	$1,200	$7,067	$19,002	$5,369	$2,291	$26,662

(1) Commercial & industrial loans.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

The following table presents the activity in the allowance for loan losses for the three months ended June 30, 2016:

(Dollars in thousands)	Commercial						
	Mortgages	Construction	C&I (1)	Total Commercial	Residential	Consumer	Total
Beginning Balance	$8,586	$1,643	$8,261	$18,490	$5,363	$2,284	$26,137
Charge-offs	(78)	—	(746)	(824)	(4)	(32)	(860)
Recoveries	13	—	62	75	2	22	99
Provision	1,892	(739)	(1,057)	96	108	246	450
Ending Balance	$10,413	$904	$6,520	$17,837	$5,469	$2,520	$25,826

(1) Commercial & industrial loans.

The following table presents the activity in the allowance for loan losses for the six months ended June 30, 2016:

(Dollars in thousands)	Commercial						
	Mortgages	Construction	C&I (1)	Total Commercial	Residential	Consumer	Total
Beginning Balance	$9,140	$1,758	$8,202	$19,100	$5,460	$2,509	$27,069
Charge-offs	(1,331)	—	(754)	(2,085)	(140)	(110)	(2,335)
Recoveries	17	—	88	105	4	33	142
Provision	2,587	(854)	(1,016)	717	145	88	950
Ending Balance	$10,413	$904	$6,520	$17,837	$5,469	$2,520	$25,826

(1) Commercial & industrial loans.

The following table presents the Corporation's loan portfolio and associated allowance for loan loss by portfolio segment and by impairment methodology:

(Dollars in thousands)	June 30, 2017		December 31, 2016	
	Loans	Related Allowance	Loans	Related Allowance
Loans Individually Evaluated for Impairment:				
Commercial:				
Mortgages	$8,380	$485	$9,776	$448
Construction & development	—	—	—	—
Commercial & industrial	6,939	718	7,098	3
Residential real estate	15,721	135	15,661	151
Consumer	755	7	1,280	4
Subtotal	31,795	1,345	33,815	606
Loans Collectively Evaluated for Impairment:				
Commercial:				
Mortgages	$1,000,716	$10,250	$1,064,410	$9,523
Construction & development	112,177	1,200	121,371	1,195
Commercial & industrial	570,177	6,349	569,011	6,989
Residential real estate	1,152,384	5,234	1,107,087	5,101
Consumer	332,851	2,284	338,677	2,590
Subtotal	3,168,305	25,317	3,200,556	25,398
Total	$3,200,100	$26,662	$3,234,371	$26,004

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Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(7) Goodwill

The following table presents the carrying value of goodwill at the reporting unit (or business segment) level:

(Dollars in thousands)	Commercial Banking	Wealth Management Services	Total
Balance at December 31, 2016	$22,591	$41,468	$64,059
Impairment	—	(150)	(150)
Balance at June 30, 2017	$22,591	$41,318	$63,909

The balance of goodwill in the Commercial Banking segment arose from the acquisition of First Financial Corp. in 2002. The balance of goodwill in the Wealth Management Services segment arose from the 2005 acquisition of Weston Financial Group, Inc. (“Weston Financial”) and its broker-dealer and insurance agency subsidiaries, as well as the 2015 acquisition of Halsey Associates, Inc. (“Halsey”).

As the result of a decision that will reduce the business activities of WSC, Weston Financial’s broker-dealer subsidiary that conducts mutual fund and variable annuity transactions, primarily for Weston Financial clients, the carrying value of WSC’s goodwill was assessed for impairment during the second quarter of 2017. As a result of management’s assessment, an impairment charge of $150 thousand was recognized in the second quarter of 2017 and classified in other expenses in the Unaudited Consolidated Statements of Income.

(8) Borrowings

Federal Home Loan Bank Advances

Advances payable to the FHLBB amounted to $869.7 million and $848.9 million, respectively, at June 30, 2017 and December 31, 2016.

The following table presents maturities and weighted average interest rates on FHLBB advances outstanding as of June 30, 2017:

(Dollars in thousands)	Total Outstanding	Weighted Average Rate
July 1, 2017 to December 31, 2017	$430,877	1.26 %
2018	108,134	1.29
2019	137,258	1.62
2020	72,033	1.90
2021	51,222	2.43
2022 and thereafter	70,209	3.34
Balance at June 30, 2017	$869,733	1.67 %

As of June 30, 2017 and December 31, 2016, the Bank had access to a $40.0 million unused line of credit with the FHLBB and also had remaining available borrowing capacity of $657.9 million and $594.5 million, respectively. The Bank pledges certain qualified investment securities and loans as collateral to the FHLBB.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(9) Shareholders’ Equity

Regulatory Capital Requirements

Capital levels at both June 30, 2017 and December 31, 2016 exceeded the regulatory minimum levels to be considered “well-capitalized.”

The following table presents the Corporation’s and the Bank’s actual capital amounts and ratios, as well as the corresponding minimum and well capitalized regulatory amounts and ratios that were in effect during the respective periods:

(Dollars in thousands)	Actual		For Capital Adequacy Purposes		To Be “Well Capitalized” Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
June 30, 2017						
Total Capital (to Risk-Weighted Assets):						
Corporation	$403,885	12.78 %	$252,908	8.00 %	N/A	N/A
Bank	402,804	12.74	252,869	8.00	$316,087	10.00 %
Tier 1 Capital (to Risk-Weighted Assets):						
Corporation	376,940	11.92	189,681	6.00	N/A	N/A
Bank	375,859	11.89	189,652	6.00	252,869	8.00
Common Equity Tier 1 Capital (to Risk-Weighted Assets):						
Corporation	354,942	11.23	142,261	4.50	N/A	N/A
Bank	375,859	11.89	142,239	4.50	205,456	6.50
Tier 1 Capital (to Average Assets): (1)						
Corporation	376,940	8.78	171,686	4.00	N/A	N/A
Bank	375,859	8.76	171,633	4.00	214,542	5.00
December 31, 2016						
Total Capital (to Risk-Weighted Assets):						
Corporation	390,867	12.26	255,093	8.00	N/A	N/A
Bank	389,840	12.23	255,050	8.00	318,813	10.00
Tier 1 Capital (to Risk-Weighted Assets):						
Corporation	364,655	11.44	191,320	6.00	N/A	N/A
Bank	363,628	11.41	191,288	6.00	255,050	8.00
Common Equity Tier 1 Capital (to Risk-Weighted Assets):						
Corporation	342,656	10.75	143,490	4.50	N/A	N/A
Bank	363,628	11.41	143,466	4.50	207,228	6.50
Tier 1 Capital (to Average Assets): (1)						
Corporation	364,655	8.67	168,271	4.00	N/A	N/A
Bank	363,628	8.65	168,207	4.00	210,259	5.00

(1) Leverage ratio.

In addition to the minimum regulatory capital required for capital adequacy purposes included in the table above, the Corporation is required to maintain a minimum Capital Conservation Buffer, in the form of common equity, in order to avoid restrictions on capital distributions and discretionary bonuses. The required amount of the Capital Conservation Buffer was 1.25% on January 1, 2017 and will increase by 0.625% each year until it reaches 2.5% on January 1, 2019.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(10) Derivative Financial Instruments
The Corporation's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Corporation's known or expected cash receipts and its known or expected cash payments principally to manage the Corporation's interest rate risk. Additionally, the Corporation enters into interest rate derivatives to accommodate the business requirements of its customers. All derivatives are recognized as either assets or liabilities on the balance sheet and are measured at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and resulting designation.

Interest Rate Risk Management Agreements
Interest rate risk management agreements, such as swaps, caps and floors, are used from time to time as part of the Corporation's interest rate risk management strategy. Interest rate swaps are agreements in which the Corporation and another party agree to exchange interest payments (e.g., fixed-rate for variable-rate payments) computed on a notional principal amount. Interest rate caps and floors represent options purchased by the Corporation to manage the interest rate paid throughout the term of the option contract. The credit risk associated with these transactions is the risk of default by the counterparty. To minimize this risk, the Corporation enters into interest rate agreements only with highly rated counterparties that management believes to be creditworthy. The notional amounts of these agreements do not represent amounts exchanged by the parties and, thus, are not a measure of the potential loss exposure.

Cash Flow Hedging Instruments
As of June 30, 2017 and December 31, 2016, the Bancorp had 2 interest rate caps with a total notional amount of $22.7 million that were designated as cash flow hedges to hedge the interest rate risk associated with our variable rate junior subordinated debentures. For both interest rate caps, the Bancorp obtains the right to receive the difference between 3-month LIBOR and a 4.5% strike. The caps mature in 2020.

As of June 30, 2017 and December 31, 2016, the Bank had 2 interest rate swap contracts with a total notional amount of $60.0 million that were designated as cash flow hedges to hedge the interest rate risk associated with short-term variable rate FHLB advances. The interest rate swaps mature in 2021 and 2023.

During the second quarter of 2017, the Bank executed 3 interest rate floor contracts with a total notional amount of $300.0 million that were designated as cash flow hedges to hedge the interest rate risk associated with a pool of variable rate commercial loans. The Bank paid a premium totaling $697 thousand to obtain the right to receive the difference between 1-month LIBOR and a 1.0% strike for each of the interest rate floors. The floors mature in 2020.

The effective portion of the changes in fair value of derivatives designated as cash flow hedges is recorded in other comprehensive income and subsequently reclassified to earnings when gains or losses are realized. The ineffective portion of changes in fair value of the derivatives is recognized directly in earnings. For the three and six months ended June 30, 2017 and 2016, there was no ineffectiveness recorded in earnings.

Loan Related Derivative Contracts
Interest Rate Swap Contracts with Customers
The Corporation has entered into interest rate swap contracts to help commercial loan borrowers manage their interest rate risk. The interest rate swap contracts with commercial loan borrowers allow them to convert floating-rate loan payments to fixed-rate loan payments. When we enter into an interest rate swap contract with a commercial loan borrower, we simultaneously enter into a "mirror" swap contract with a third party. The third party exchanges the client's fixed-rate loan payments for floating-rate loan payments. We retain the risk that is associated with the potential failure of counterparties and the risk inherent in originating loans. As of June 30, 2017 and December 31, 2016, Washington Trust had interest rate swap contracts with commercial loan borrowers with notional amounts of

$480.4 million and $428.7 million, respectively, and equal amounts of “mirror” swap contracts with third-party financial institutions. These derivatives are not designated as hedges and therefore, changes in fair value are recognized in earnings.

Risk Participation Agreements

The Corporation has entered into risk participation agreements with other banks participating in commercial loan arrangements. Participating banks guarantee the performance on borrower-related interest rate swap contracts. These derivatives are not designated as hedges and therefore, changes in fair value are recognized in earnings.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

Under a risk participation-out agreement, a derivative asset, the Corporation participates out a portion of the credit risk associated with the interest rate swap position executed with the commercial borrower for a fee paid to the participating bank. Under a risk participation-in agreement, a derivative liability, the Corporation assumes, or participates in, a portion of the credit risk associated with the interest rate swap position with the commercial borrower for a fee received from the other bank.

At June 30, 2017 and December 31, 2016, the notional amounts of risk participation-out agreements were $53.0 million and $38.3 million, respectively. The notional amounts of risk participation-in agreements were $28.4 million and $28.5 million, respectively, at June 30, 2017 and December 31, 2016.

Loan Commitments

Interest rate lock commitments are extended to borrowers and relate to the origination of residential real estate mortgage loans held for sale. To mitigate the interest rate risk inherent in these rate locks, as well as closed residential real estate mortgage loans held for sale, forward commitments are established to sell individual residential real estate mortgage loans. Both interest rate lock commitments and commitments to sell residential real estate mortgage loans are derivative financial instruments, but do not meet criteria for hedge accounting and, as such the changes in fair value of these commitments are reflected in earnings. The Corporation has elected to carry certain closed residential real estate mortgage loans held for sale at fair value, as changes in fair value in these loans held for sale generally offset changes in interest rate lock and forward sale commitments.

The following table presents the fair values of derivative instruments in the Corporation's Unaudited Consolidated Balance Sheets:

(Dollars in thousands)	Asset Derivatives			Liability Derivatives		
		Fair Value			Fair Value	
	Balance Sheet Location	Jun 30, 2017	Dec 31, 2016	Balance Sheet Location	Jun 30, 2017	Dec 31, 2016
Derivatives Designated as Cash Flow Hedging Instruments:						
Interest rate risk management contracts:						
Interest rate swaps	Other assets	$—	$—	Other liabilities	$537	$378
Interest rate caps	Other assets	44	134	Other liabilities	—	—
Interest rate floors	Other assets	389	—	Other liabilities	—	—
Derivatives not Designated as Hedging Instruments:						
Forward loan commitments:						
Interest rate lock commitments	Other assets	1,679	1,133	Other liabilities	27	88
Commitments to sell mortgage loans	Other assets	27	279	Other liabilities	2,477	1,349
Loan related derivative contracts:						
Interest rate swaps with customers	Other assets	2,318	2,036	Other liabilities	—	—
Mirror swaps with counterparties	Other assets	—	—	Other liabilities	2,446	2,228
Risk participation agreements	Other assets	—	—	Other liabilities	—	—
Total		$4,457	$3,582		$5,487	$4,043

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

The following tables present the effect of derivative instruments in the Corporation's Unaudited Consolidated Statements of Income and Changes in Shareholders' Equity:

(Dollars in thousands)	Amount of Gain (Loss) Recognized in Other Comprehensive Income (Effective Portion)			
	Three months		Six months	
Periods ended June 30,	2017	2016	2017	2016
Derivatives Designated as Cash Flow Hedging Instruments:				
Interest rate risk management contracts:				
Interest rate swaps	($232)	$—	($100)	$—
Interest rate caps	(22)	(24)	(56)	(90)
Interest rate floors	(194)	—	(194)	—
Total	($448)	($24)	($350)	($90)

(Dollars in thousands)		Amount of Gain (Loss) Recognized in Income on Derivatives		Amount of Gain (Loss) Recognized in Income on Derivatives	
		Three months		Six months	
Periods ended June 30,	Statement of Income Location	2017	2016	2017	2016
Derivatives not Designated as Hedging Instruments:					
Forward loan commitments:					
Interest rate lock commitments	Mortgage banking revenues	($11)	$501	$607	$1,746
Commitments to sell mortgage loans	Mortgage banking revenues	(350)	(1,174)	(1,380)	(2,180)
Customer related derivative contracts:					
Interest rate swaps with customers	Loan related derivative income	3,921	7,130	3,666	17,032
Mirror swaps with counterparties	Loan related derivative income	(2,551)	(6,526)	(2,073)	(15,777)
Risk participation agreements	Loan related derivative income	(226)	(96)	(301)	(102)
Total		$783	($165)	$519	$719

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(11) Balance Sheet Offsetting

For interest rate risk management contracts and loan-related derivative contracts, the Corporation records derivative assets and derivative liabilities on a net basis. The interest rate risk management contracts and loan-related derivative contracts with counterparties are subject to master netting agreements. The following tables present the Corporation's derivative asset and derivative liability positions and the effect of netting arrangements on the Unaudited Consolidated Balance Sheets:

(Dollars in thousands) June 30, 2017	Gross Derivative Positions	Offsetting Derivative Positions	Net Amounts Presented in Balance Sheet	Cash Collateral Pledged	Net Amount
Derivative Assets:					