HERITAGE FINANCIAL CORP /WA/
Form 10-Q
August 05, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number 0-29480

HERITAGE FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

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

(360) 943-1500
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer x
Non-accelerated filer ¨ Smaller reporting company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the last practicable date:
As of August 1, 2016 there were 29,971,286 shares of the registrant's common stock, no par value per share, outstanding.

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FORWARD LOOKING STATEMENTS:

“Safe Harbor” statement under the Private Securities Litigation Reform Act of 1995: This Quarterly Report on Form 10-Q ("Form 10-Q") contains forward-looking statements that are subject to risks and uncertainties, including, but not limited to: our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we have acquired, including those from the Cowlitz Bank, Pierce Commercial Bank, Northwest Commercial Bank, Valley Community Bancshares, Inc. and the Washington Banking Company transactions described in this Form 10-Q, or may in the future acquire, into our operations and our ability to realize related revenue synergies and cost savings within expected time frames or at all, and any goodwill charges related thereto and costs or difficulties relating to integration matters, including but not limited to customer and employee retention, which might be greater than expected; the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and changes in our allowance for loan losses and provision for loan losses that may be effected by deterioration in the housing and commercial real estate markets, which may lead to increased losses and nonperforming assets in our loan portfolio, and may result in our allowance for loan losses no longer being adequate to cover actual losses, and require us to increase our allowance for loan losses; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates, and the relative differences between short and long term interest rates, deposit interest rates, our net interest margin and funding sources; risks related to acquiring assets in or entering markets in which we have not previously operated and may not be familiar; fluctuations in the demand for loans, the number of unsold homes and other properties and fluctuations in real estate values in our market areas; results of examinations of us by the Board of Governors of the Federal Reserve System and of our bank subsidiary by the Federal Deposit Insurance Corporation ("FDIC"), the Washington State Department of Financial Institutions, Division of Banks or other regulatory authorities, including the possibility that any such regulatory authority may, among other things, initiate an enforcement action against the Company or our bank subsidiary which could require us to increase our allowance for loan losses, write-down assets, change our regulatory capital position, affect our ability to borrow funds or maintain or increase deposits, or impose additional requirements on us, any of which could affect our ability to continue our growth through mergers, acquisitions or similar transactions and adversely affect our liquidity and earnings; legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, or the interpretation of regulatory capital or other rules including as a result of Basel III; our ability to control operating costs and expenses; the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the implementing regulations; further increases in premiums for deposit insurance; the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation; difficulties in reducing risk associated with the loans on our Condensed Consolidated Statements of Financial Condition; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our workforce and potential associated charges; failure or security breach of computer systems on which we depend; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; our ability to implement our expansion strategy of pursuing acquisitions and de novo branching; increased competitive pressures among financial service companies; changes in consumer spending, borrowing and savings habits; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; and other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services and other risks detailed from time to time in our filings with the Securities and Exchange Commission including our Annual Report on Form 10-K for the year ended December 31, 2015.

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

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

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HERITAGE FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Unaudited)

	June 30, 2016	December 31, 2015
	(Dollars in thousands)	
ASSETS		
Cash on hand and in banks	$69,216	$63,816
Interest earning deposits	29,729	62,824
Cash and cash equivalents	98,945	126,640
Other interest earning deposits	5,461	6,719
Investment securities available for sale, at fair value	815,920	811,869
Loans held for sale	7,130	7,682
Loans receivable, net	2,524,601	2,402,042
Allowance for loan losses	(28,426)	(29,746)
Total loans receivable, net	2,496,175	2,372,296
Other real estate owned	1,560	2,019
Premises and equipment, net	60,759	61,891
Federal Home Loan Bank stock, at cost	5,700	4,148
Bank owned life insurance	61,571	60,876
Accrued interest receivable	10,535	10,469
Prepaid expenses and other assets	66,000	58,365
Other intangible assets, net	8,091	8,789
Goodwill	119,029	119,029
Total assets	$3,756,876	$3,650,792
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits	$3,158,906	$3,108,287
Federal Home Loan Bank advances	33,000	—
Junior subordinated debentures	19,571	19,424
Securities sold under agreement to repurchase	16,715	23,214
Accrued expenses and other liabilities	38,626	29,897
Total liabilities	3,266,818	3,180,822
Stockholders’ equity:		
Preferred stock, no par value, 2,500,000 shares authorized; no shares issued and outstanding at June 30, 2016 and December 31, 2015	—	—
Common stock, no par value, 50,000,000 shares authorized; 29,992,236 and 29,975,439 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	358,663	359,451
Retained earnings	119,052	107,960
Accumulated other comprehensive income, net	12,343	2,559
Total stockholders’ equity	490,058	469,970
Total liabilities and stockholders’ equity	$3,756,876	$3,650,792

See accompanying Notes to Condensed Consolidated Financial Statements.

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HERITAGE FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in thousands, except per share amounts)			
INTEREST INCOME				
Interest and fees on loans	$30,503	$30,554	$60,680	$61,035
Taxable interest on investment securities	2,838	2,328	5,634	5,012
Nontaxable interest on investment securities	1,193	1,048	2,364	2,081
Interest and dividends on other interest earning assets	58	60	149	111
Total interest income	34,592	33,990	68,827	68,239
INTEREST EXPENSE				
Deposits	1,242	1,309	2,496	2,626
Junior subordinated debentures	216	193	426	432
Other borrowings	49	18	60	37
Total interest expense	1,507	1,520	2,982	3,095
Net interest income	33,085	32,470	65,845	65,144
Provision for loan losses	1,120	1,189	2,259	2,397
Net interest income after provision for loan losses	31,965	31,281	63,586	62,747
NONINTEREST INCOME				
Service charges and other fees	3,476	3,687	6,832	6,982
Gain on sale of investment securities, net	201	425	761	969
Gain on sale of loans, net	1,242	1,282	1,971	2,417
Gain on sale of Merchant Visa portfolio	—	—	—	1,650
Other income	1,657	1,487	4,002	3,208
Total noninterest income	6,576	6,881	13,566	15,226
NONINTEREST EXPENSE				
Compensation and employee benefits	14,898	13,842	30,019	28,067
Occupancy and equipment	4,111	3,850	7,947	7,541
Data processing	1,829	1,925	3,621	3,552
Marketing	781	1,063	1,509	1,696
Professional services	833	904	1,678	1,708
State and local taxes	604	569	1,211	1,189
Federal deposit insurance premium	528	523	1,020	1,038
Other real estate owned, net	61	200	472	859
Amortization of intangible assets	363	527	698	1,054
Other expense	2,469	2,676	4,671	5,413
Total noninterest expense	26,477	26,079	52,846	52,117
Income before income taxes	12,064	12,083	24,306	25,856
Income tax expense	3,169	3,358	6,320	7,352
Net income	$8,895	$8,725	$17,986	$18,504
Basic earnings per common share	$0.30	$0.29	$0.60	$0.61
Diluted earnings per common share	$0.30	$0.29	$0.60	$0.61
Dividends declared per common share	$0.12	$0.11	$0.23	$0.21

See accompanying Notes to Condensed Consolidated Financial Statements.

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HERITAGE FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(In thousands)			
Net income	$8,895	$8,725	$17,986	$18,504
Change in fair value of investment securities available for sale, net of tax of $2,267, $(2,062), $5,553 and $(358), respectively	4,203	(3,809)	10,278	(657)
Reclassification adjustment for net gain from sale of investment securities available for sale included in income, net of tax of $(71), $(192), $(267) and $(382), respectively	(130)	(358)	(494)	(712)
Accretion of other-than-temporary impairment on investment securities, net of tax of $0, $1, $0 and $4, respectively	—	100	—	108
Reclassification of remaining unaccreted other-than-temporary impairment upon sale of investment securities held to maturity included in income, net of tax $0, $44, $0 and $44, respectively	—	81	—	81
Other comprehensive income (loss)	4,073	(3,986)	9,784	(1,180)
Comprehensive income	$12,968	$4,739	$27,770	$17,324

See accompanying Notes to Condensed Consolidated Financial Statements.

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HERITAGE FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)

	Number of common shares	Common stock	Retained earnings	Accumulated other comprehensive income, net	Total stock-holders' equity
	(In thousands, except per share amounts)				
Balance at December 31, 2014	30,260	$364,741	$86,387	$ 3,378	$454,506
Restricted and unrestricted stock awards issued, net of forfeitures	116	—	—	—	—
Exercise of stock options (including excess tax benefits from nonqualified stock options)	43	541	—	—	541
Restricted stock compensation expense	—	716	—	—	716
Net excess tax benefits from vesting of restricted stock	—	90	—	—	90
Common stock repurchased	(464)	(7,723)	—	—	(7,723)
Net income	—	—	18,504	—	18,504
Other comprehensive income, net of tax	—	—	—	(1,180)	(1,180)
Cash dividends declared on common stock ($0.21 per share)	—	—	(6,326)	—	(6,326)
Balance at June 30, 2015	29,955	$358,365	$98,565	$ 2,198	$459,128
Balance at December 31, 2015	29,975	$359,451	$107,960	$ 2,559	$469,970
Restricted and unrestricted stock awards issued, net of forfeitures	115	—	—	—	—
Exercise of stock options (including excess tax benefits from nonqualified stock options)	26	390	—	—	390
Restricted stock compensation expense	—	872	—	—	872
Net excess tax benefits from vesting of restricted stock	—	76	—	—	76
Common stock repurchased	(124)	(2,126)	—	—	(2,126)
Net income	—	—	17,986	—	17,986
Other comprehensive income, net of tax	—	—	—	9,784	9,784
Cash dividends declared on common stock ($0.23 per share)	—	—	(6,894)	—	(6,894)
Balance at June 30, 2016	29,992	$358,663	$119,052	$ 12,343	$490,058

See accompanying Notes to Condensed Consolidated Financial Statements.

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HERITAGE FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30, 2016	2015
	(In thousands)	
Cash flows from operating activities:		
Net income	$17,986	$18,504
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,483	6,670
Changes in net deferred loan costs, net of amortization	(455)	(1,001)
Provision for loan losses	2,259	2,397
Net change in accrued interest receivable, FDIC indemnification asset, prepaid expenses and other assets, accrued expenses and other liabilities	(3,071)	(6,022)
Restricted stock compensation expense	872	716
Net excess tax benefit from exercise of stock options and vesting of restricted stock	(97)	(90)
Amortization of intangible assets	698	1,054
Gain on sale of investment securities, net	(761)	(969)
Origination of loans held for sale	(57,975)	(66,257)
Gain on sale of loans, net	(1,971)	(2,417)
Gain on sale of Merchant Visa portfolio	—	(1,650)
Proceeds from sale of loans	60,498	67,317
Earnings on bank owned life insurance	(695)	(403)
Valuation adjustment on other real estate owned	383	415
(Gain) loss on sale of other real estate owned, net	(42)	97
Loss on sale or write-off of furniture, equipment and leasehold improvements	244	—
Net cash provided by operating activities	24,356	18,361
Cash flows from investing activities:		
Loans originated, net of principal payments	(126,335)	(98,885)
Maturities of other interest earning deposits	1,248	4,986
Maturities, calls and payments of investment securities available for sale	60,803	56,700
Maturities, calls and payments of investment securities held to maturity	—	1,235
Purchase of investment securities available for sale	(128,046)	(81,755)
Purchase of premises and equipment	(1,088)	(979)
Proceeds from sales of other real estate owned	770	1,639
Proceeds from sales of investment securities available for sale	75,837	63,460
Proceeds from sales of investment securities held to maturity	—	972
Proceeds from redemption of FHLB stock	10,460	8,160
Purchases of FHLB stock	(12,012)	(120)
Purchase of bank owned life insurance	—	(25,000)
Investment in low-income housing tax credit partnership	(2,254)	(244)
Net cash used in investing activities	(120,617)	(69,831)

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	Six Months Ended June 30,	
	2016	2015
	(In thousands)	
Cash flows from financing activities:		
Net increase in deposits	50,619	40,156
FHLB advances	294,500	—
Repayments of FHLB advances	(261,500)	—
Common stock cash dividends paid	(6,894)	(6,326)
Net decrease in securities sold under agreement to repurchase	(6,499)	(11,592)
Proceeds from exercise of stock options	369	541
Net excess tax benefit from exercise of stock options and vesting of restricted stock	97	90
Repurchase of common stock	(2,126)	(7,723)
Net cash provided by financing activities	68,566	15,146
Net decrease in cash and cash equivalents	(27,695)	(36,324)
Cash and cash equivalents at beginning of period	126,640	121,636
Cash and cash equivalents at end of period	$98,945	$85,312
Supplemental disclosures of cash flow information:		
Cash paid for interest	$3,008	$2,923
Cash paid for income taxes	6,000	9,805
Supplemental non-cash disclosures of cash flow information:		
Transfers of loans receivable to other real estate owned	$652	$1,813
Investment in low income housing tax credit partnership and related funding commitment	10,224	—
Purchases of investment securities available for sale not settled	1,164	—

See accompanying Notes to Condensed Consolidated Financial Statements.

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HERITAGE FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) Description of Business, Basis of Presentation, Significant Accounting Policies and Recently Issued Accounting Pronouncements

(a) Description of Business

Heritage Financial Corporation ("Heritage" or the “Company”) is a bank holding company that was incorporated in the State of Washington in August 1997. The Company is primarily engaged in the business of planning, directing and coordinating the business activities of its wholly-owned subsidiary, Heritage Bank (the “Bank”). The Bank is a Washington-chartered commercial bank and its deposits are insured by the FDIC under the Deposit Insurance Fund. The Bank is headquartered in Olympia, Washington and conducts business from its 63 branch offices located throughout Washington State and the greater Portland, Oregon area. The Bank’s business consists primarily of commercial lending and deposit relationships with small businesses and their owners in its market areas and attracting deposits from the general public. The Bank also makes real estate construction and land development loans and consumer loans and originates first mortgage loans on residential properties primarily located in its market area.

The Company has expanded its footprint through mergers and acquisitions. The largest of these transactions was the strategic merger with Washington Banking Company (“Washington Banking”) and its wholly owned subsidiary bank, Whidbey Island Bank ("Whidbey"). Effective May 1, 2014, Washington Banking merged with and into Heritage and Whidbey merged with and into Heritage Bank and this transaction is referred to herein as the "Washington Banking Merger". In connection with the Washington Banking Merger, Heritage also acquired as a subsidiary the Washington Banking Master Trust, a Delaware statutory business trust. Pursuant to the merger agreement, Heritage assumed the performance and observance of the covenants to be performed by Washington Banking under an indenture relating to $25.0 million in trust preferred securities issued in 2007 and the due and punctual payment of the principal of and premium and interest on such trust preferred securities. For additional information, see Note (8) Junior Subordinated Debentures.

(b) Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the accounting principles generally accepted in the United States (“GAAP”) for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. It is recommended that these unaudited Condensed Consolidated Financial Statements and accompanying Notes be read with the audited Consolidated Financial Statements and the accompanying Notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 (“2015 Annual Form 10-K”). In management's opinion, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. In preparing the unaudited Condensed Consolidated Financial Statements, management is required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. Management believes that the judgments, estimates and assumptions used in the preparation of the financial statements are appropriate based on the facts and circumstances at the time. Actual results, however, could differ from those estimates.

Certain prior period amounts have been reclassified to conform to the current period’s presentation. Specifically, the Company reclassified $56.6 million of loans receivable previously classified as owner-occupied commercial real estate at December 31, 2015 to non-owner occupied commercial real estate for all comparative tables in Note (3) Loans Receivable. The related allowance for loan losses and provision for loan losses for all historical periods in Note (4) Allowance for Loan Losses were also reclassified. None of these loans were considered impaired at June 30, 2016 or December 31, 2015. The reclassification was due to a review of certain loan products, including hotels, assisted-living housing and self-storage units, for which the Bank determined the risk characteristics were more akin

to non-owner occupied loans. Reclassifications had no effect on prior periods' net income or stockholders’ equity.
(c) Significant Accounting Policies
The significant accounting policies used in preparation of the Company's Condensed Consolidated Financial Statements are disclosed in the 2015 Annual Form 10-K. There have not been any material changes in the Company's significant accounting policies from those contained in the 2015 Annual Form 10-K.

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(d) Recently Issued Accounting Pronouncements

Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU" or "Update") 2014-09, Revenue from Contracts with Customers, was issued in May 2014. Under this Update, FASB created a new Topic 606 which is in response to a joint initiative of FASB and the International Accounting Standards Board to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and international financial reporting standards that would:

- Remove inconsistencies and weaknesses in revenue requirements.
- Provide a more robust framework for addressing revenue issues.
- Improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets.
- Provide more useful information to users of financial statements through improved disclosure requirements.
- Simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer.

The original effective date for this Update was deferred in FASB ASU 2015-14 below. The Company is currently evaluating the impact that the Update will have on its Condensed Consolidated Financial Statements.

FASB ASU 2015-14, Revenue from Contracts with Customers, was issued in August 2015 and defers the effective date of the above-mentioned FASB ASU 2014-09 for certain entities. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in Update 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is now permitted, but only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The Company is a public business entity and will not early adopt the guidance in Update 2014-09 as permitted in this Update. The Company is currently evaluating the impact that Update 2014-09 will have on its Condensed Consolidated Financial Statements upon adoption.

FASB ASU 2015-16, Business Combinations (Topic 805), was issued in September 2015. Topic 805 requires that an acquirer retrospectively adjust provisional amounts recognized in a business combination, during the measurement period. To simplify the accounting for adjustments made to provisional amounts, the Update requires that the acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amount is determined. The acquirer is required to also record, in the same period’s financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. In addition, an entity is required to present separately on the income statement or disclose in the notes to the financial statements the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The Update did not have an impact on the Company's Condensed Consolidated Financial Statements as of June 30, 2016.

FASB ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10), was issued in January 2016, to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. This Update contains several provisions, including but not limited to 1) requiring equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income; 2) simplifying the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; 3) eliminating the requirement to disclose the method(s) and significant assumptions used to estimate fair value ; and 4) requiring separate presentation of financial assets and liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements. The Update is effective for public entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the impact that the Update will have on its Condensed Consolidated Financial Statements.

FASB ASU 2016-02, Leases (Topic 842), was issued in February 2016, to increase transparency and comparability of leases among organizations and to disclose key information about leasing arrangements. The Update sets out the principles for the recognition, measurement, presentation and disclosure of leases for both lessees and lessors. The Update requires lessees to apply a dual approach, classifying leases as either a finance or operating lease. This classification will determine whether the lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term greater than 12 months regardless of their classification. All cash payments will be classified within operating activities in the statement of cash flows. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The Update is effective for public entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the impact that the Update will have on its Condensed Consolidated Financial Statements.

FASB ASU 2016-08, Revenue from Contracts with Customers: Principal versus Agent Considerations, was issued in March 2016 and it clarifies the implementation guidance of the above-mentioned FASB ASU 2014-09 as it relates to principal versus agent considerations. The Update addresses identifying the unit of account and nature of the goods or services as well as applying the control principle and interactions with the control principle. The amendments to the Update do not change the core principle of the guidance. The effective date and transition requirements for this Update are the same as FASB ASU 2014-09. The Company is currently evaluating the impact that the Update will have on its Condensed Consolidated Financial Statements.

FASB ASU 2016-09, Stock Compensation (Topic 718), issued in March 2016, is intended to simplify several aspects of the accounting for share-based payment award transactions. For public business entities, the guidance is effective for annual periods after December 15, 2016 and interim periods within those annual periods. Early adoption is permitted. Certain amendments will be applied using a modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted. Other amendments will be applied retroactively (such as presentation of employee taxes paid on the statement of cash flows) or prospectively (such as recognition of excess tax benefits on the income statement). The Company is currently evaluating the impact that this Update will have on its Condensed Consolidated Financial Statements.

FASB ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, was issued in April 2016 which clarifies the implementation guidance of the above-mentioned FASB ASU 2014-09 as it relates to identifying performance obligations and licensing. The effective date and transition requirements for this Update are the same as FASB ASU 2014-09. The Company is currently evaluating the impact that this Update will have on its Condensed Consolidated Financial Statements.

FASB ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-scope Improvements and Practical Expedients, was issued in May 2016. The amendments in this Update do not change the core principle of the guidance in Topic 606. Rather, the amendments in this Update affect only the narrow aspects of Topic 606. The effective date and transition requirements for this Update are the same as FASB ASU 2014-09. The Company is currently evaluating the impact that this Update will have on its Condensed Consolidated Financial Statements.

FASB ASU 2016-13, Financial Instruments: Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, was issued in June 2016. Commonly referred to as the current expected credit loss model("CECL"), this Update requires financial assets measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset to present the net carrying value at the amount expected to be collected on the financial asset. The measurement of expected credit losses is based on relevant information about past events including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectibility of the reported amount. The amendment affects loans, debt securities, trade receivables, net investments in leases, off-balance-sheet credit exposures, reinsurance receivables, and any other financial asset not excluded from the scope that have the contractual right to receive cash. The Update replaces the incurred loss impairment methodology, which generally only considered past events and current conditions, with a methodology that reflects the expected credit losses and required consideration of a broader range of reasonable and supportable information to estimate all expected credit losses. The Update additionally addresses purchased assets and introduces the purchased financial asset with a more-than-insignificant amount of credit deterioration since origination ("PCD"). The accounting for these PCD assets is similar to the existing accounting guidance of FASB Accounting Standards Codification ("ASC") 310-30 for purchased credit impaired ("PCI") assets, except the subsequent improvements in estimated cash flows will be immediately recognized into income, similar to the immediate recognition of subsequent deteriorations in cash flows. Current guidance only allows for the prospective recognition of these cash flow improvements. Because the terminology has been changed to a "more-than-insignificant" amount of credit deterioration, the presumption is that more assets might qualify for this accounting under the Update than those under current guidance. For public business entities, the Update is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Entities may early adopt beginning in the years after December 15, 2018. An entity will apply the amendments through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. A prospective transition approach is required for debt securities. An entity with that has previously applied the guidance of ASC 310-30 will prospectively apply the guidance in this Update for PCD assets.

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A prospective transition approach should be used for PCD assets where upon adoption, the amortized cost basis should be adjusted to reflect the addition of the allowance for credit losses. The Company is currently evaluating the impact that this Update will have on its Condensed Consolidated Financial Statements.

(2) Investment Securities

The Company's investment policy is designed primarily to provide and maintain liquidity, generate a favorable return on assets without incurring undue interest rate and credit risk, and complement the Bank's lending activities. Securities are classified as either available for sale or held to maturity when acquired. During the year ended December 31, 2015, the Company transferred all of its investment securities previously classified as held to maturity to available for sale. As a result of the transfer and subsequent sales, the Company believes its held to maturity classification process has been compromised and careful evaluation and analysis will be required going forward in determining when circumstances are suitable for management to assert with a sufficient degree of credibility that it has the intent and ability to hold investments to maturity.

(a) Securities by Type and Maturity

The amortized cost, gross unrealized gains, gross unrealized losses and fair values of investment securities available for sale at the dates indicated were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
June 30, 2016				
U.S. Treasury and U.S. Government-sponsored agencies	$10,567	$ 42	$ (2)	$10,607
Municipal securities	227,064	9,723	(51)	236,736
Mortgage backed securities and collateralized mortgage obligations-residential:				
U.S. Government-sponsored agencies	535,529	9,708	(268)	544,969
Collateralized loan obligations	14,508	—	(110)	14,398
Corporate obligations	9,189	10	(61)	9,138
Mutual funds and other equities	45	27	—	72
Total	$796,902	$ 19,510	$ (492)	$815,920
December 31, 2015				
U.S. Treasury and U.S. Government-sponsored agencies	$35,618	$ 145	$ (186)	$35,577
Municipal securities	216,352	4,826	(185)	220,993
Mortgage backed securities and collateralized mortgage obligations-residential:				
U.S. Government-sponsored agencies	531,403	2,092	(2,460)	531,035
Collateralized loan obligations	15,251	—	(154)	15,097
Corporate obligations	9,252	—	(139)	9,113
Mutual funds and other equities	45	9	—	54
Total	$807,921	$ 7,072	$ (3,124)	$811,869

There were no securities classified as trading or held to maturity at June 30, 2016 or December 31, 2015.

The amortized cost and fair value of investment securities available for sale at June 30, 2016, by contractual maturity, are set forth below. Actual maturities may differ from contractual maturities because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties.