Bank of Marin Bancorp
Form 10-K
March 11, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2015

OR

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

For the transition period from __________________ to __________________

Commission File Number 001-33572

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

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

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

Securities registered pursuant to Section 12 (b) of the Act:

None

Securities registered pursuant to section 12(g) of the Act:

| | |
|---|---|
| Common Stock, No Par Value,<br>and attached Share Purchase Rights<br>(Title of each class) | NASDAQ Capital Market<br>(Name of each exchange on which registered) |

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

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

Note - checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under these sections.

---

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this form 10-K or any amendment to this Form 10-K.
x

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

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

As of June 30, 2015, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the voting common equity held by non-affiliates, based upon the closing price per share of the registrant's common stock as reported by the NASDAQ, was approximately $293 million. For the purpose of this response, directors and certain officers of the Registrant are considered the affiliates at that date.

As of February 29, 2016, there were 6,078,363 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the Annual Meeting of Shareholders to be held on May 17, 2016 are incorporated by reference into Part III.

TABLE OF CONTENTS


| | | |
|---|---|---|
| PART I | | Page-4 |
| Forward-Looking Statements | | Page-4 |
| ITEM 1. | BUSINESS | Page-4 |
| ITEM 1A. | RISK FACTORS | Page-11 |
| ITEM 1B. | UNRESOLVED STAFF COMMENTS | Page-20 |
| ITEM 2. | PROPERTIES | Page-20 |
| ITEM 3. | LEGAL PROCEEDINGS | Page-20 |
| ITEM 4. | MINE SAFETY DISCLOSURES | Page-20 |
| PART II | | Page-21 |
| ITEM 5. | MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES | Page-21 |
| ITEM 6. | SELECTED FINANCIAL DATA | Page-23 |
| ITEM 7. | MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS | Page-24 |
| | Forward-Looking Statements | Page-24 |
| | Executive Summary | Page-24 |
| | Critical Accounting Policies | Page-26 |
| | Net Interest Income | Page-26 |
| | Provision for Loan Losses | Page-29 |
| | Non-Interest Income | Page-30 |
| | Non-Interest Expense | Page-31 |
| | Provision for Income Taxes | Page-32 |
| | FINANCIAL CONDITION | Page-33 |
| | Investment Securities | Page-33 |
| | Loans | Page-35 |
| | Allowance for Loan Losses | Page-37 |
| | Other Assets | Page-41 |
| | Deposits | Page-42 |
| | Borrowings | Page-43 |
| | Deferred Compensation Obligations | Page-43 |
| | Off Balance Sheet Arrangements and Commitments | Page-44 |
| | Capital Adequacy | Page-44 |
| | Liquidity | Page-44 |
| | Selected Quarterly Financial Data | Page-46 |
| ITEM 7A. | QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK | Page-46 |
| ITEM 8. | FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA | Page-48 |

| | | |
|---|---|---|
| | NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Page-54 |
| | Note 1: Summary of Significant Accounting Policies | Page-54 |
| | Note 2: Acquisition | Page-64 |
| | Note 3: Investment Securities | Page-65 |
| | Note 4: Loans and Allowance for Loan Losses | Page-70 |
| | Note 5: Bank Premises and Equipment | Page-78 |
| | Note 6: Bank Owned Life Insurance | Page-79 |
| | Note 7: Deposits | Page-79 |
| | Note 8: Borrowings | Page-80 |
| | Note 9: Stockholders' Equity and Stock Plans | Page-82 |
| | Note 10: Fair Value of Assets and Liabilities | Page-87 |
| | Note 11: Benefit Plans | Page-90 |
| | Note 12: Income Taxes | Page-91 |
| | Note 13: Commitments and Contingencies | Page-93 |
| | Note 14: Concentrations of Credit Risk | Page-94 |
| | Note 15: Derivative Financial Instruments and Hedging Activities | Page-94 |
| | Note 16: Regulatory Matters | Page-97 |
| | Note 17: Financial Instruments with Off-Balance Sheet Risk | Page-98 |
| | Note 18: Condensed Bank of Marin Bancorp Parent Only Financial Statements | Page-100 |
| ITEM 9. | CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE | Page-102 |
| ITEM 9A. | CONTROLS AND PROCEDURES | Page-102 |
| ITEM 9B. | OTHER INFORMATION | Page-103 |
| PART III | | Page-103 |
| ITEM 10. | DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE | Page-103 |
| ITEM 11. | EXECUTIVE COMPENSATION | Page-103 |
| ITEM 12. | SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS | Page-103 |
| ITEM 13. | CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE | Page-103 |
| ITEM 14. | PRINCIPAL ACCOUNTANT FEES AND SERVICES | Page-103 |
| PART IV | | Page-104 |
| ITEM 15. | EXHIBITS AND FINANCIAL STATEMENT SCHEDULES | Page-104 |
| SIGNATURES | | Page-106 |
| EXHIBIT INDEX | | Page-108 |

# PART I

## Forward-Looking Statements

This discussion of financial results includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, (the "1933 Act") and Section 21E of the Securities Exchange Act of 1934, as amended, (the "1934 Act"). Those sections of the 1933 Act and 1934 Act provide a "safe harbor" for forward-looking statements to encourage companies to provide prospective information about their financial performance so long as they provide meaningful, cautionary statements identifying important factors that could cause actual results to differ significantly from projected results.

Our forward-looking statements include descriptions of plans or objectives of Management for future operations, products or services, and forecasts of revenues, earnings or other measures of economic performance. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include the words "believe," "expect," "intend," "estimate" or words of similar meaning, or future or conditional verbs preceded by "will," "would," "should," "could" or "may."

Forward-looking statements are based on Management's current expectations regarding economic, legislative, and regulatory issues that may affect our earnings in future periods. A number of factors—many of which are beyond Management’s control—could cause future results to vary materially from current Management expectations. Such factors include, but are not limited to, general economic conditions and the economic uncertainty in the United States and abroad, including changes in interest rates, deposit flows, real estate values, and expected future cash flows on loans and securities; integration of acquisitions and competition; changes in accounting principles, policies or guidelines; changes in legislation or regulation; adverse weather conditions, including the drought in California; and other economic, competitive, governmental, regulatory and technological factors affecting our operations, pricing, products and services.

Important factors that could cause results or performance to materially differ from those expressed in our prior forward-looking statements are detailed in Item 1A. Risk Factors of this report. Forward-looking statements speak only as of the date they are made. We do not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made or to reflect the occurrence of unanticipated events.

## ITEM 1 BUSINESS

Bank of Marin (the “Bank”) was incorporated in August 1989, received its charter from the California Superintendent of Banks (now the California Department of Business Oversight or "DBO") and commenced operations in January 1990. The Bank is an insured bank under the Federal Deposit Insurance Corporation (“FDIC”). On July 1, 2007 (the “Effective Date”), a bank holding company reorganization was completed whereby Bank of Marin Bancorp (“Bancorp”) became the parent holding company for the Bank, the sole and wholly-owned subsidiary of Bancorp. On the Effective Date, each outstanding share of Bank of Marin common stock was converted into one share of Bank of Marin Bancorp common stock. Bancorp is listed at NASDAQ under the ticker symbol BMRC, which was formerly used by the Bank. Prior to the Effective Date, the Bank filed reports and proxy statements with the FDIC pursuant to Section 12 of the 1934 Act. Upon formation of the holding company, Bancorp became subject to regulation under the Bank Holding Company Act of 1956, as amended, which subjects Bancorp to Federal Reserve Board reporting and examination requirements, and Bancorp now files 1934 Act reports with the Securities and Exchange Commission.

References in this report to "Bancorp" mean Bank of Marin Bancorp, parent holding company for the Bank. References to "we," "our," "us" mean the holding company and the Bank that are consolidated for financial reporting purposes.

Virtually all of our business is conducted through Bancorp's subsidiary, Bank of Marin, which is headquartered in Novato, California. In addition to our headquarters office, we operate through twenty offices in Marin, Sonoma, San Francisco, Napa and Alameda counties, with a strong emphasis on supporting the local communities. Our customer base is made up of business and personal banking relationships from the communities near the branch office locations. Our business banking focus is on small to medium-sized businesses, professionals and not-for-profit organizations.

We offer a broad range of commercial and retail deposit and lending programs designed to meet the needs of our target markets. Our lending categories include commercial real estate loans, commercial and industrial loans,

construction financing, consumer loans, and home equity lines of credit. Merchant card services are available for our business customers. Through third party vendors, we offer a proprietary Visa® credit card product combined with a rewards program to our customers, a Business Visa® program, a leasing program for commercial equipment financing, and cash management sweep services.

We offer a variety of personal and business checking and savings accounts, and a number of time deposit alternatives, including time certificates of deposit, Individual Retirement Accounts (“IRAs”), Health Savings Accounts, Certificate of Deposit Account Registry Service® ("CDARS") and Insured Cash Sweep® ("ICS") accounts. CDARS and ICS are part of a network through which we offer full FDIC insurance coverage in excess of the regulatory maximum by placing deposits in multiple banks participating in the network. We also offer mobile banking, remote deposit capture, Automated Clearing House services (“ACH”), fraud prevention services including Positive Pay for Checks, ACH, Apple Pay®, peer-to-peer funds transfer, and image lockbox services. A valet deposit pick-up service is available to our professional and business clients.

Automated teller machines (“ATM's”) are available at each retail branch location. Our ATM network is linked to the PLUS, CIRRUS and NYCE networks, as well as to a network of nation-wide surcharge-free ATM's called MoneyPass. We also offer our depositors 24-hour access to their accounts by telephone and through our internet banking products available to personal and business account holders.

We offer Wealth Management and Trust Services (“WMTS”) which include customized investment portfolio management, trust administration, estate settlement, custody services, and advice on charitable giving. We also offer 401(k) plan services to small and medium-sized businesses through a third party vendor.

We make international banking services available to our customers indirectly through other financial institutions with whom we have correspondent banking relationships.

We hold no patents, licenses (other than licenses required by the appropriate banking regulatory agencies), franchises or concessions. The Bank has registered the service marks "The Spirit of Marin", the words “Bank of Marin”, the Bank of Marin logo, and the Bank of Marin tagline “Committed to your business and our community” with the United States Patent & Trademark Office. In addition, Bancorp has registered the service marks for the words “Bank of Marin Bancorp” and for the Bank of Marin Bancorp logo with the United States Patent & Trademark Office.

All service marks registered by Bancorp or the Bank are registered on the United States Patent & Trademark Office Principal Register, with the exception of the words "Bank of Marin Bancorp" which is registered on the United States Patent & Trademark Office Supplemental Register.

Market Area

Our primary market area consists of Marin, San Francisco, Napa, Sonoma and Alameda counties. Our customer base is primarily made up of business, not-for-profit and personal banking relationships within these market areas.

We attract deposit relationships from individuals, merchants, small to medium-sized businesses, not-for-profit organizations and professionals who live and/or work in the communities comprising our market areas. As of December 31, 2015, approximately 67% of our deposits are in Marin County and southern Sonoma County, and approximately 56% of our deposits are from businesses and 44% from individuals.

Competition

The banking business in California generally, and in our market area specifically, is highly competitive with respect to attracting both loan and deposit relationships. The increasingly competitive environment is affected by changes in regulation, interest rates, technology and product delivery systems, and consolidation among financial service providers. The banking industry is seeing strong competition for quality loans, with larger banks expanding their activities to attract businesses that are traditionally community bank customers. In all of our five counties, we have significant competition from nationwide banks with much larger branch networks and greater financial resources, as well as credit unions and other independent banks.

In Marin County we have the third largest market share of total deposits at 10.1%, according to the Deposit & Market Share Report from the California Banksite Corporation based upon the FDIC deposit market share data as of June 30, 2015. A significant driver of our franchise value is the growth and stability of our checking deposits, a low-cost funding source for our loan portfolio. We are building our presence in the Sonoma, Napa, Alameda and San Francisco markets.

Other competitors for depositors' funds are money market mutual funds and non-bank financial institutions such as brokerage firms and insurance companies. Among the competitive advantages held by some of these large, non-bank financial institutions is their ability to finance extensive advertising and funding campaigns.

Nationwide banks have the competitive advantages of national advertising campaigns and technology infrastructure to achieve economies of scale. Large commercial banks also have substantially greater lending limits and the ability to offer certain services which are not offered directly by us.

In order to compete with the numerous, and often larger, financial institutions in our primary market area, we use, to the fullest extent possible the flexibility and rapid response capabilities that derive from our independent status, local leadership and local decision making. Our competitive advantages also include an emphasis on personalized service, extensive community involvement, philanthropic giving, local promotional activities and strong relationships with our customers. The commitment and dedication of our directors, officers and staff have also contributed greatly to our success in competing for business.

Employees

At December 31, 2015, we employed 259 full-time equivalent (“FTE”) staff. The actual number of employees, including part-time employees, at year-end 2015 included five executive officers, 105 other corporate officers and 164 staff. None of our employees are presently represented by a union or covered by a collective bargaining agreement. We believe that our employee relations are good. We have been recognized as one of the “Best Places to Work” by the North Bay Business Journal and as a "Top Corporate Philanthropist” by the San Francisco Business Times for many years.

SUPERVISION AND REGULATION

Bank holding companies and banks are extensively regulated under both federal and state law. The following discussion summarizes certain significant laws, rules and regulations affecting Bancorp and the Bank.

Bank Holding Company Regulation

Upon formation of the bank holding company on July 1, 2007, we became subject to regulation under the Bank Holding Company Act of 1956, as amended (“BHCA”) which subjects Bancorp to Federal Reserve Board ("FRB") reporting and examination requirements. Under the FRB's regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks. Under this requirement, we are expected to commit resources to support the Bank, including at times when we may not be in a financial position to provide such resources, and it may not be in our, or our shareholders’ or creditors’, best interests to do so. In addition, any capital loans we make to the Bank are subordinate in right of payment to depositors and to certain other indebtedness of the Bank. The BHCA regulates the activities of holding companies including acquisitions, mergers and consolidations and, together with the Gramm-Leach Bliley Act of 1999, the scope of allowable banking activities. Bancorp is also a bank holding company within the meaning of the California Financial Code. As such, Bancorp and its subsidiaries are subject to examination by, and may be required to file reports with, the DBO.

Bank Regulation

Banking regulations are primarily intended to protect consumers, depositors' funds, federal deposit insurance funds and the banking system as a whole. These regulations affect our lending practices, consumer protections, capital structure, investment practices and dividend policy.

As a state chartered bank, we are subject to regulation, supervision and examination by the DBO. We are also subject to regulation, supervision and periodic examination by the FDIC. If, as a result of an examination of the Bank, the

FDIC or the DBO should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of our operations are unsatisfactory, or that we have violated any law or regulation, various remedies are available to those regulators including issuing a “cease and desist” order, monetary penalties, restitution, restricting our growth or removing officers and directors.

The Bank addresses the many state and federal regulations it is subject to through a comprehensive compliance program that addresses the various risks associated with these issues.

Dividends

The payment of cash dividends by the Bank to Bancorp is subject to restrictions set forth in the California Financial Code (the “Code”) in addition to regulations and policy statements of the FRB. Prior to any distribution from the Bank to Bancorp, a calculation is made to ensure compliance with the provisions of the Code and to ensure that the Bank remains within capital guidelines set forth by the DBO and the FDIC. Management anticipates that there will be sufficient earnings at the Bank level to provide dividends to Bancorp to meet its cash requirements for 2016. See also Note 9 to the Consolidated Financial Statements, under the heading “Dividends” in Item 8 of this report.

FDIC Insurance Assessments

Our deposits are insured by the FDIC to the maximum amount permitted by law, which is currently $250,000 per depositor, based on the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).

Our FDIC insurance assessment base is quarterly average consolidated total assets minus average tangible equity, defined as Common Equity Tier 1 Capital. Assessment rates are between 2.5 and 9 basis points annually on the assessment base for banks in the lowest risk category and 30 to 45 basis points for banks in the highest risk category. In deriving the risk categories, the FDIC uses a bank's capital level, supervisory ratios and other financial measures to determine a bank's ability to withstand financial stress.

Community Reinvestment Act

The Community Reinvestment Act (“CRA”) was enacted in 1977 to encourage financial institutions to meet the credit needs of the communities where they are chartered. All banks and thrifts have a continuing and affirmative obligation, consistent with safe and sound operations, to help meet the credit needs of their entire communities, including low and moderate income neighborhoods. Regulatory agencies rate each bank's performance in assessing and meeting these credit needs. The Bank is committed to serving the credit needs of the communities in which we do business, and it is our policy to respond to all creditworthy segments of our market. As part of its CRA commitment, the Bank maintains strong philanthropic ties to the community. We invest in affordable housing funds that help economically disadvantaged individuals and residents of low- and moderate-income census tracts, in each case consistent with our long-established prudent underwriting practices. We also donate to and volunteer with organizations in our communities that serve small businesses or low-and moderate-income communities or individuals that offer educational and health programs to economically disadvantaged students and families, community development service and affordable housing programs. We provide CRA reportable small business, small farm and community development loans within our assessment areas. The CRA requires a depository institution's primary federal regulator, in connection with its examination of the institution, to assess the institution's record in meeting CRA requirements. The regulatory agency's assessment of the institution's record is made available to the public. The record is taken into consideration when the institution establishes a new branch that accepts deposits, relocates an office, applies to merge or consolidate, or expands into other activities. The FDIC's last CRA performance examination, completed in May 2015, was performed under the large bank requirements and was assigned a rating of “Satisfactory”.

Anti Money-Laundering Regulations

A series of banking laws and regulations beginning with the Bank Secrecy Act in 1970 requires banks to prevent, detect, and report illicit or illegal financial activities to the federal government to prevent money laundering, international drug trafficking, and terrorism. Under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, financial institutions are subject to prohibitions against specified financial transactions and account relationships, requirements regarding the Customer Identification Program, as well as

enhanced due diligence and “know your customer” standards in their dealings with high risk customers, foreign financial institutions, and foreign individuals and entities.

Privacy and Data Security

The Gramm-Leach Bliley Act (“GLBA”) of 1999 imposes requirements on financial institutions with respect to consumer privacy. The GLBA generally prohibits disclosure of consumer information to non-affiliated third parties unless the consumer has been given the opportunity to object and has not objected to such disclosure. Financial institutions are further required to disclose their privacy policies to consumers annually. The GLBA also directs federal regulators, including the FDIC, to prescribe standards for the security of consumer information. We are subject to such standards, as well as standards for notifying consumers in the event of a security breach. We must disclose our privacy policy to consumers and permit consumers to “opt out” of having non-public customer information disclosed to third parties. We are required to have an information security program to safeguard the confidentiality and security of customer information and to ensure proper disposal of information that is no longer needed. Customers must be notified when unauthorized disclosure involves sensitive customer information that may be misused.

Consumer Protection Regulations

Our lending activities are subject to a variety of statutes and regulations designed to protect consumers, including the CRA, Home Mortgage Disclosure Act, Fair Credit Reporting Act, Fair Lending, Equal Credit Opportunity Act, the Fair Housing Act, Truth-in-Lending Act ("TILA"), and the Real Estate Settlement Procedures Act ("RESPA"). Our deposit operations are also subject to laws and regulations that protect consumer rights including Expedited Funds Availability, Truth in Savings, and Electronic Funds Transfers. Other regulatory requirements include: the Unfair, Deceptive or Abusive Acts and Practices ("UDAAP"), Dodd-Frank Act, Right To Financial Privacy and Privacy of Consumer Financial Information. Additional rules govern check writing ability on certain interest earning accounts and prescribe procedures for complying with administrative subpoenas of financial records.

Restriction on Transactions between Bank's Affiliates

Transactions between Bancorp and the Bank are quantitatively and qualitatively restricted under Sections 23A and 23B of the Federal Reserve Act and Federal Reserve Regulation W. Section 23A places restrictions on the Bank's “covered transactions” with Bancorp, including loans and other extensions of credit, investments in the securities of, and purchases of assets from Bancorp. Section 23B requires that certain transactions, including all covered transactions, be on market terms and conditions. Federal Reserve Regulation W combines statutory restrictions on transactions between the Bank and Bancorp with FRB interpretations in an effort to simplify compliance with Sections 23A and 23B.

Capital Requirements

The FRB and the FDIC have adopted risk-based capital guidelines for bank holding companies and banks. Bancorp's ratios exceed the required minimum ratios for capital adequacy purposes and the Bank meets the definition for "well capitalized." Undercapitalized depository institutions may be subject to significant restrictions. Payment of dividends could be restricted or prohibited, with some exceptions, if the Bank were categorized as "critically undercapitalized" under applicable FDIC regulations.

In July 2013, the Federal banking regulators approved a final rule to implement the revised capital adequacy standards of the Basel Committee on Banking Supervision, commonly called Basel III, and to address relevant provisions of the Dodd-Frank Act. The final rule strengthens the definition of regulatory capital, increases risk-based capital requirements, makes selected changes to the calculation of risk-weighted assets, and adjusts the prompt corrective

action thresholds. We became subject to the new rule on January 1, 2015 and certain provisions of the new rule will be phased in over the period of 2015 through 2019. We have modeled our ratios under the finalized Basel III rules and we do not expect that we will be required to raise additional capital when the new rules fully phase in. For further information on our risk-based capital positions and the effect of the new Basel III rules, see Note 16 to the Consolidated Financial Statements in Item 8 of this Form 10-K.

The Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, President Obama signed into law the Dodd-Frank Act, a landmark financial reform bill comprised of voluminous new rules and restrictions on bank operations as regulations have been promulgated. It includes key provisions aimed at preventing a repeat of the 2008 financial crisis and a new process for winding down failing, systemically important institutions in a manner as close to a controlled bankruptcy as possible. The Dodd-Frank Act includes other key provisions as follows:

(1) Establishes a new Financial Stability Oversight Council to monitor systemic financial risks. The FRB is given extensive new authorities to impose strict controls on large bank holding companies with total consolidated assets equal to or in excess of $50 billion and systemically significant non-bank financial companies to limit the risk they might pose to the economy and other large interconnected companies. The FRB can also take direct control of troubled financial companies that are considered systemically significant.

The Dodd-Frank Act restricts the amount of trust preferred securities (“TruPS”) that may be considered as Tier 1 Capital. For bank holding companies below $15 billion in total assets, TruPS issued before May 19, 2010 are grandfathered, so their status as Tier 1 capital does not change.

(2) Creates a new process to liquidate failed financial firms in an orderly manner, including giving the FDIC broader authority to operate or liquidate a failing financial company.

(3) Establishes a new independent Federal regulatory body for consumer protection within the Federal Reserve System known as the Consumer Financial Protection Bureau ("CFPB"), which assumes responsibility for most consumer protection laws (except the Community Reinvestment Act). It is also in charge of setting appropriate consumer banking fees and caps. The Office of Comptroller of the Currency continues to have authority to preempt state banking and consumer protection laws if these laws "prevent or significantly" interfere with the business of banking.

(4) Places certain limitations on investment and other activities by depository institutions, holding companies and their affiliates, including comprehensive regulation of all over-the-counter derivatives.

(5) Authorizes the FRB to regulate debit card and certain general-use prepaid card transaction interchange fees paid to issuing banks with assets in excess of $10 billion to ensure that fees are “reasonable and proportional” to the cost of processing individual transactions and to prohibit networks and issuers from requiring transactions be processed on a single payment network.

(6) Effects changes in the FDIC assessment as discussed above.

Notice and Approval Requirements Related to Control

Banking laws impose notice, approval and ongoing regulatory requirements on any shareholder or other party that seeks to acquire direct or indirect "control" of an FDIC-insured depository institution. These laws include the BHCA and the Change in Bank Control Act. Among other things, these laws require regulatory filings by a shareholder or other party that seeks to acquire direct or indirect "control" of an FDIC-insured depository institution or bank holding company. The determination whether an investor "controls" a depository institution is based on all of the facts and circumstances surrounding the investment. As a general matter, a party is deemed to control a depository institution or other company if the party owns or controls 25% or more of any class of voting stock. Subject to rebuttal, a party may be presumed to control a depository institution or other company if the investor owns or controls 10% or more of any class of voting stock. Ownership by family members, affiliated parties, or parties acting in concert, is typically aggregated for these purposes. If a party's ownership of the Company were to exceed certain thresholds, the investor could be deemed to "control" the Company for regulatory purposes. This could subject the investor to regulatory

filings or other regulatory consequences.

In addition, except under limited circumstances, bank holding companies are prohibited from acquiring, without prior approval:

- control of any other bank or bank holding company or all or substantially all the assets thereof; or
- more than 5% of the voting shares of a bank or bank holding company which is not already a subsidiary.

Incentive Compensation

The Dodd-Frank Act requires the federal bank regulators and the Securities and Exchange Commission ("SEC") to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at specified regulated entities, including us and our bank, having at least $1 billion in total assets that encourage inappropriate risks by providing an executive officer, employee, director or principal stockholder with excessive compensation, fees, or benefits or that could lead to material financial loss to the entity. In addition, these regulators must establish regulations or guidelines requiring enhanced disclosure to regulators of incentive-based compensation arrangements. The agencies proposed such regulations in April 2011, but the regulations have not been finalized. If the regulations are adopted in the form initially proposed, they will impose limitations on the manner in which we may structure compensation for our executives.

The FRB will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as us, that are not “large, complex banking organizations.” These reviews will be tailored to each organization based on the scope and complexity of the organization’s activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization’s supervisory ratings, which can affect the organization’s ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk management control or governance processes, pose a risk to the organization’s safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

Available Information

On our Internet web site, www.bankofmarin.com, we post the following filings as soon as reasonably practical after they are filed with or furnished to the Securities and Exchange Commission: Annual Report to Shareholders, Form 10-K, Proxy Statement for the Annual Meeting of Shareholders, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities and Exchange Act of 1934. The text of the Code of Ethical Conduct for Bancorp and the Bank is also included on the website. All such materials on our website are available free of charge. This website address is for information only and is not intended to be an active link, or to incorporate any website information into this document. In addition, copies of our filings are available by requesting them in writing or by phone from:

Corporate Secretary
Bank of Marin Bancorp
504 Redwood Boulevard, Suite 100
Novato, CA 94947
415-763-4523

ITEM 1A RISK FACTORS

We assume and manage a certain degree of risk in order to conduct our business. The material risks and uncertainties that Management believes may affect our business are listed below. The list is not exhaustive; additional risks and uncertainties that Management is not aware of, or focused on, or currently deems immaterial may also impair business operations. If any of the following risks, or risks that have not been identified, actually occur, our financial condition, results of operations, and stock trading price could be materially and adversely affected. We manage these risks by promoting sound corporate governance practices, which includes but is not limited to, establishing policies and internal controls, and implementing internal review processes. Before making an investment decision, investors should carefully consider the risks, together with all of the other information included or incorporated by reference in this Annual Report on Form 10-K and our other filings with the SEC. This report is qualified in its entirety by these risk factors.

Earnings are Significantly Influenced by General Business and Economic Conditions

We are subject to changes in general economic conditions that remain uncertain. The economic environment is affected by political uncertainty, changes in fiscal and monetary policy, and uncertainty in the economies of Europe and emerging markets, such as China, which could adversely and materially affect our business. Economic conditions have led to prolonged low interest rates, particularly medium and longer-term rates, which may have a long-term impact on the composition of our earning assets and our net interest margin. Among other things, a period of prolonged lower rates has caused prepayments to increase as our customers sought to refinance existing loans, which resulted in a decrease in the weighted average yield of our earning assets and variability in our net interest income. Furthermore, financial institutions continue to be affected by a stricter regulatory environment. While unemployment rates in our core market areas have continued to improve and are below the average California state rate, there can be no assurance that the recent economic improvement is sustainable or that the creditworthiness of our borrowers will not deteriorate.[1]

Weakness in real estate values and home sale volumes, financial stress on borrowers, including job losses, and customers' inability to pay debt could adversely affect our financial condition and results of operations in the following ways:

- Demand for our products and services may decline;
- Low cost or non-interest bearing deposits may decrease;
- Collateral for our loans, especially real estate, may decline in value;
- Loan delinquencies, problem assets and foreclosures may increase;
- Investment securities may become impaired.

Interest Rate Risk is Inherent in Our Business

Our earnings and cash flows are largely dependent upon our net interest income. Net interest income is the difference between interest income earned on interest-earning assets, such as loans and securities, and interest expense paid on interest-bearing liabilities, such as deposits and borrowed funds. Interest rates are sensitive to many factors outside of our control, including general economic conditions and the policies of various governmental and regulatory agencies and, in particular, the FRB, which regulates the supply of money and credit in the United States. Changes in monetary policy, including changes in interest rates, can influence not only the interest we receive on loans and securities and interest we pay on deposits and borrowings, but can also affect (i) our ability to originate loans and obtain deposits, (ii) the fair value of our financial assets and liabilities, and (iii) the average duration of our securities and loan portfolios. Our portfolio of securities will generally decline in value if market interest rates increase, and increase in value if market interest rates decline. Our mortgage-backed securities are also subject to prepayment risk when interest rates fall, and subject to borrowers' credit risk when rates rise.

In December 2015, the Federal Open Market Committee of the FRB ("FOMC") increased the federal funds target rate by 25 basis points (basis points are equal to one hundredth of a percentage point) for the first time in seven years, from a historically low range of 0% to 0.25% to 0.25% to 0.50% currently. However, growing uncertainty about the durability of the U.S. economy's expansion and the Bank of Japan and European Central Bank's recent actions to cut interest rates into negative territory has complicated FOMC's future interest rate planning policy. There was no interest rate action in FOMC's first meeting of 2016 and it is widely expected

---

[1] Unemployment rates were based on the latest available labor market information from the California Employment Development Department. December 2015 results show that the unemployment rate in Marin County was the lowest in California at 3.2%. The unemployment rates in San Francisco, Sonoma, Napa and Alameda County were 3.3%, 4.2%, 5.1% and 4.3%, respectively, compared to the state of California of 5.8%.

that the FOMC will not raise interest rates until they are confident that GDP growth returns to at least 2% from the 0.7% in the fourth quarter of 2015. The FRB's sizable holdings of longer-term securities have placed and will continue to place downward pressure on longer-term interest rates, and hence our net interest margin. Our net interest income is hampered by a flat or falling rate environment, and the prolonged low level of interest rates has resulted in significant net interest margin compression over the last several years. Our 2016 net interest margin may continue to compress due to repricing on loans and securities, if the prevailing market interest rates do not increase.

See the sections captioned “Net Interest Income” in Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 and Quantitative and Qualitative Disclosures about Market Risk in Item 7A of this report for further discussion related to management of interest rate risk.

If interest rates rise, we anticipate that net interest income will increase. However, it may take several upward market rate movements for certain variable rate loans to move above their floor rates and deposit behavior may deviate from our expectations. Further, a rise in index rates leads to lower debt service coverage of variable rate loans if the borrower's operating cash flow does not also rise. This creates a paradox of an improving economy (leading to higher interest rates) with increased credit risk as short-term rates move up faster than the cash flow or income of the borrowers. Higher interest rates may also depress loan demand, making it more difficult for us to grow loans.

Banks and Bank Holding Companies are Subject to Extensive Government Regulation and Supervision

Bancorp and the Bank are subject to extensive federal and state governmental supervision, regulation and control. Holding company regulations affect the range of activities in which Bancorp is engaged. Banking regulations affect the Bank's lending practices, capital structure, investment practices and dividend policy, and compliance costs among other things. Future legislative changes or interpretations may also alter the structure and competitive relationship among financial institutions. Legislation is regularly introduced in the U.S. Congress and the California Legislature which could affect our operating environment in substantive ways. The nature and extent of future legislative and regulatory changes affecting us are unpredictable at this time.

The historic disruptions in the financial marketplace during the recent recession have prompted the Obama administration to reform financial market regulation. This reform includes additional regulations over consumer financial products, bond rating agencies and the creation of a regime for regulating systemic risk across all types of financial service firms. Further restrictions on financial service companies may adversely affect our results of operations and financial condition, as well as increase our compliance risk.

Compliance risk is the current and prospective risk to earnings or capital arising from violations of, or non-conformance with, laws, rules, regulations, prescribed practices, internal policies and procedures, or ethical standards set forth by regulators. Compliance risk also arises in situations where the laws or rules governing certain bank products or activities of our clients may be ambiguous or untested. This risk exposes Bancorp and the Bank to potential fines, civil money penalties, payment of damages and the voiding of contracts. Compliance risk can lead to diminished reputation, reduced franchise value, limited business opportunities, reduced expansion potential and an inability to enforce contracts.

For further information on supervision and regulation, see the section captioned “Supervision and Regulation” in Item 1 above.

As discussed in Item 1, Section captioned “Supervision and Regulation” above, in 2010, President Obama signed into law a landmark financial reform bill - the Dodd-Frank Act. The rules under the Dodd-Frank Act change banking statutes and the operating environment of Bancorp and the Bank in substantial and unpredictable ways, and could

continue to increase the cost of doing business, decrease our revenues, limit or expand permissible activities or affect the competitive balance depending upon whether or how regulations are implemented. We may continue to invest significant Management attention and resources to make any necessary changes related to the Dodd-Frank Act and any regulations promulgated thereunder.

The broader outcome of the enacted legislation and related measures undertaken to alleviate the aftermaths of the credit crisis is uncertain. The capital and credit markets experienced volatility and disruption at unprecedented levels in the last credit crisis. In some cases, the markets have produced downward pressure on credit availability for certain

issuers without regard to those issuers' underlying financial strength. If similar disruptions and volatility return, there can be no assurance that we will not experience an adverse effect on our ability to access credit or capital.

Intense Competition with Other Financial Institutions to Attract and Retain Banking Customers

We are facing significant competition for customers from other banks and financial institutions located in the markets that we serve. We compete with commercial banks, saving banks, credit unions, non-bank financial services companies and other financial institutions operating within or near our service areas. Some of our non-bank competitors and peer-to-peer lenders may not be subject to the same extensive regulations as we are, giving them greater flexibility in competing for business. We anticipate intense competition will continue for the coming year due to the consolidation of many financial institutions and more changes in legislature, regulation and technology. National and regional banks much larger than our size have entered into our market through acquisitions and they may be able to benefit from economies of scale through their wider branch networks, more prominent national advertising campaigns, lower cost of borrowing, capital market access and sophisticated technology infrastructures. Further, intense competition for creditworthy borrowers could lead to loan rate concession pressure or affect our ability to generate profitable loans.

Going forward, we may see continued competition in the industry as competitors seek to expand market share in more profitable and less risky customer segments. Further, if equity markets rebound, our deposit customers may perceive alternative investment opportunities as providing superior expected returns. Recent recovery in the real estate market also supports the sale of real estate that collateralizes our loans, leading to payoff activity. Technology and other changes have made it more convenient for bank customers to transfer funds into alternative investments or other deposit accounts such as online virtual banks and non-bank service providers. Efforts and initiatives we may undertake to retain and increase deposits, including deposit pricing, can increase our costs. When our customers move money into higher yielding deposits or alternative investments, we may lose a relatively inexpensive source of funds, thus increasing our funding costs through more expensive wholesale borrowings.

Negative Conditions Affecting Real Estate May Harm Our Business

Concentration of our lending activities in the California real estate sector could negatively affect our results of operations if adverse changes in our lending area occur or intensify. Although we do not offer traditional first mortgages, nor have sub-prime or Alt-A residential loans or significant amounts of securities backed by such loans in the portfolio, we are not immune to volatility in those markets. Approximately 85% of our loans were secured by real estate at December 31, 2015, of which 66% were secured by commercial real estate and the remaining 19% by residential real estate. Real estate valuations are influenced by demand, and demand is driven by factors such as employment rates and interest rates.

Loans secured by commercial real estate include those secured by office buildings, owner-user office/warehouses, mixed-use residential/commercial properties and retail properties. In general, 2015 office, industrial and retail vacancy rates remained largely unchanged in Marin County, fell in Sonoma County and increased slightly in Napa County based on the latest available real estate information from Keegan & Coppin Company, Inc. There can be no assurance that the companies or properties securing our loans will generate sufficient cash flows to allow borrowers to make full and timely loan payments to us. In the event of default, the collateral value may not cover the outstanding amount due to us, especially during real estate market downturns.

Rising commercial real estate lending concentrations may expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in the investor commercial real estate market. Institutions that are potentially exposed to significant commercial real estate concentration risk may be subject to increased regulatory scrutiny. Institutions that have experienced rapid growth in commercial real estate lending such as us, have notable exposure to

a specific type of commercial real estate lending, or are approaching or exceed certain supervisory criteria that measure an institution's commercial real estate portfolio against its capital levels, may be subject to such increased regulatory scrutiny. We maintain heightened review and analyses of our concentrations and have regular conversations with regulators to avoid unexpected regulatory risk.

Severe Weather, Natural Disasters or Other Climate Change Related Matters Could Significantly Affect Our Business

Our primary market is located in an earthquake-prone zone in northern California, which is also subject to other weather or disasters, such as severe rainstorms, wildfire, drought or flood. These events could interrupt our business operations

unexpectedly. Climate-related physical changes and hazards could also pose credit risks for us. For example, our borrowers may have collateral properties or operations located in coastal areas at risk to a rise in sea level or affected by the severe drought in California. The properties pledged as collateral on our loan portfolio could also be damaged by tsunamis, floods, earthquakes or wildfires and thereby the recoverability of loans could be impaired. A number of factors can affect credit losses, including the extent of damage to the collateral, the extent of damage not covered by insurance, the extent to which unemployment and other economic conditions caused by the natural disaster adversely affect the ability of borrowers to repay their loans, and the cost of collection and foreclosure to us. Lastly, there could be increased insurance premiums and deductibles, or a decrease in the availability of coverage, due to severe weather-related losses. The ultimate outcome on our business of a natural disaster, whether or not caused by climate change, is difficult to predict.

We are Subject to Significant Credit Risk and Loan Losses May Exceed Our Allowance for Loan Losses in the Future

We maintain an allowance for loan losses, which is a reserve established through provisions for loan losses charged to expense, that represents Management's best estimate of probable losses that may be incurred within the existing portfolio of loans (the "incurred loss model"). The level of the allowance reflects Management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality and present economic, political and regulatory conditions. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Further, we generally rely on appraisals of the collateral or comparable sales data to determine the level of specific reserve and/or the charge-off amount on certain collateral dependent loans. Inaccurate assumptions in the appraisals or an inappropriate choice of the valuation techniques may lead to an inadequate level of specific reserve or charge-offs.

Changes in economic conditions affecting borrowers, new information regarding existing loans and their collateral, identification of additional problem loans, and other factors may require an increase in our allowance for loan losses. In addition, bank regulatory agencies periodically review our allowance for loan losses and may require an increase in the provision for loan losses or the recognition of further loan charge-offs. If charge-offs in future periods exceed the allowance for loan losses or cash flows from acquired loans do not perform as expected, we will need to record additional provision for loan losses.

In December 2012, the Financial Accounting Standards Board (“FASB”) issued a proposed Accounting Standards Update, Financial Instruments: Credit Losses, which establishes a new impairment framework also known as the "current expected credit loss model." In contrast to the incurred loss model currently used by financial entities like Bancorp, the current expected credit loss model requires an allowance be recognized based on the expected credit losses (i.e. all contractual cash flows that the entity does not expect to collect from financial assets or commitments to extend credit). It requires the consideration of more forward-looking information than is permitted under current U.S. generally accepted accounting principles. In addition to relevant information about past events and current conditions, such as borrowers’ current creditworthiness, quantitative and qualitative factors specific to borrowers, and the economic environment in which the entity operates, the new model requires consideration of reasonable and supportable forecasts that affect the expected collectability of the financial assets’ remaining contractual cash flows, and evaluation of the forecasted direction of the economic cycle, as well as time value of money. This proposed impairment framework is expected to have wide reaching implications to financial institutions. The allowance for loan losses may increase due to a larger volume of financial assets that fall within the scope of the proposed model, which may adversely affect earnings and lead to higher capital requirements. The FASB continued to deliberate the proposed update at its December 31, 2015 meeting, and the full effect of the implementation of this new model is unknown until the proposed guidance is finalized.

Non-performing Assets Take Significant Time to Resolve and Adversely Affect Results of Operations and Financial Condition.

While we have significantly reduced non-performing assets, such assets may adversely affect our net income in the future. We might incur losses relating to non-performing assets if their collateral values deteriorate. Historically, we have not recorded interest income on non-accrual loans, which adversely affects our interest income and increases our loan administration costs. When we take collateral in foreclosures and similar proceedings, we are required to mark the related loan to the fair value of the collateral, which may result in a loss. While we have managed our problem

assets through workouts, restructurings and other proactive credit management, decreases in the value of the assets, underlying collateral, or borrowers' performance or financial conditions, whether or not due to economic and market conditions beyond our control, could adversely affect our business, results of operations and financial condition. In addition, the resolution of non-performing assets can distract Management from other responsibilities. There can be no assurance that we will not experience further increases in non-performing assets in the future.

Securities May Lose Value due to Credit Quality of the Issuers

We invest in debentures issued by government-sponsored enterprises ("GSE"), such as Federal Home Loan Bank ("FHLB"), Federal National Mortgage Association (“FNMA”), Federal Home Loan Mortgage Corporation ("FHLMC"), and Federal Farm Credit Bank. While we consider them to have low credit risk as they carry the implicit backing of the U.S. Government, they are not direct obligations of the U.S. Government. GSE debt is sponsored but not guaranteed by the federal government, whereas government agencies such as Government National Mortgage Association ("GNMA") are divisions of the government whose securities are backed by the full faith and credit of the United States.
We also hold mortgage-backed securities (“MBS”) securities issued by FNMA and FHLMC. Since 2008, both FNMA and FHLMC have been under a U.S. Government conservatorship. As a result, the mortgage-backed securities (“MBS”) issued by FNMA and FHLMC have benefited from this government support. However, there are political pressures to phase out the governmental support via privatization or to wind down FNMA and FHLMC and uncertainty as to the termination of conservatorship of FNMA and FHLMC remains.

The fair value of our securities issued or guaranteed by these entities may decline when the U.S. Government starts selling FNMA and FHLMC MBS, when the government support is phased-out or completely withdrawn, or if either FNMA or FHLMC comes under further financial stress or suffers creditworthiness deterioration.

We also invest in obligations of state and political subdivisions, some of which may not have fully recovered from past years' of loss of property tax from falling home values and declines in sales tax revenues. While we generally seek to minimize our exposure by diversifying the geographic location of our portfolio and investing in investment grade securities, there is no guarantee that the issuers will remain financially sound or continue their payments on these debentures.

Unexpected Early Termination of Interest Rate Swap Agreements May Affect Earnings

We have entered into interest-rate swap agreements, primarily as an asset/liability risk management tool, in order to mitigate the changes in the fair value of specified long-term fixed-rate loans and firm commitments to enter into long-term fixed-rate loans caused by changes in interest rates. These hedges allow us to offer long-term, fixed-rate loans to customers without assuming the interest rate risk of a long-term asset by swapping our fixed-rate interest stream for a floating-rate interest stream. In the event of default by the borrowers on our hedged loans, we may have to terminate these designated interest-rate swap agreements early, resulting in prepayment penalties charged by our counterparties and negatively affect our earnings.

Growth Strategy or Potential Future Acquisitions May Produce Unfavorable Outcomes

We seek to expand our franchise safely and consistently. A successful growth strategy requires us to manage multiple aspects of the business simultaneously, such as following adequate loan underwriting standards, balancing loan and deposit growth without increasing interest rate risk or compressing our net interest margin, maintaining sufficient capital, and recruiting, training and retaining qualified professionals.

Our growth strategic plan also includes merger and acquisition possibilities that either enhance our market presence or have potential for improved profitability through financial management, economies of scale or expanded services. We may incur significant acquisition related expenses either during the due diligence phase of acquisition targets or during integration of the acquirees. These expenses may negatively impact our earnings prior to realizing the benefits of acquisitions. We may also be exposed to difficulties in combining the operations of acquired institutions into our own operations, which may prevent us from achieving the expected benefits from our acquisition activities. Our earnings, financial condition and prospects after a merger will depend in part on our ability to integrate the operations and management of the acquired institution while continuing to implement other aspects of our business plan. Inherent uncertainties exist in integrating the operations of an acquired institution and there is no assurance that we will be able to do so successfully. Among the issues that we could face are:



---

- unexpected problems with operations, personnel, technology or credit;
- loss of customers and employees of the acquiree;
- difficulty in working with the acquiree's employees and customers;
- the assimilation of the acquiree's operations, culture and personnel;
- instituting and maintaining uniform standards, controls, procedures and policies; and
- litigation risk not discovered during the due diligence period.

Undiscovered factors as a result of an acquisition could bring liabilities against us, our management and the management of the institutions we acquire. These factors could contribute to our not achieving the expected benefits from our acquisitions within desired time frames, if at all. Further, although we generally anticipate cost savings from acquisitions, we may not be able to fully realize those savings. Any cost savings that are realized may be offset by losses in revenues or other charges to earnings.

We May Not Be Able to Attract and Retain Key Employees

Our success depends, in large part, on our ability to attract and retain key people. Competition for the best people in most activities engaged by us has been intense, especially in light of the recent improvement in the job market, and we may not be able to hire skilled people or retain them. We do not have non-compete agreements with any of our senior officers. The unexpected loss of key personnel could have an unfavorable affect on our business because of the skills, knowledge of our market, years of industry experience and difficulty of promptly finding qualified replacement personnel.

Accounting Estimates and Risk Management Processes Rely on Analytical and Forecasting Models

The processes we use to estimate probable loan losses and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on our financial condition and results of operations, depends upon the use of analytical and forecasting models. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. If the models we use for interest rate risk and asset-liability management are inadequate, we may incur increased or unexpected losses upon changes in market interest rates or other market measures. If the models we use for determining our probable loan losses are inadequate, the allowance for loan losses may not be sufficient to support future charge-offs. If the models we use to measure the fair value of financial instruments are inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what we could realize upon sale or settlement of such financial instruments. Any such failure in our analytical or forecasting models could have a material adverse effect on our business, financial condition and results of operations.

The Value of Goodwill and Other Intangible Assets May Decline in the Future

As of December 31, 2015, we had goodwill totaling $6.4 million and a core deposit intangible asset totaling $3.1 million from the NorCal acquisition (the "NorCal Acquisition"). A significant decline in expected future cash flows, a significant adverse change in the business climate, slower growth rates or a significant and sustained decline in the price of our common stock could necessitate taking charges in the future related to the impairment of goodwill or other intangible assets. If we were to conclude that a future write-down of goodwill or other intangible assets is necessary, we would record the appropriate charge, which could have a material adverse effect on our business, financial condition and results of operations.

We May Take Filing Positions or Follow Tax Strategies That May Be Subject to Challenge

We provide for current and deferred taxes in our consolidated financial statements based on our results of operations, business activities and business combinations, legal structure and federal and state legislation and regulations. We may take filing positions or follow tax strategies that are subject to interpretation of tax statutes. Our net income may be reduced if a federal, state or local authority were to assess charges for taxes that have not been provided for in our consolidated financial statements. Taxing authorities could change applicable tax laws, challenge filing positions or assess new taxes and interest charges. If taxing authorities take any of these actions, our business, results of operations or financial condition could be adversely and significantly affected.



---

Financial Institutions Rely on Technology and Continually Encounter Technological Change

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology will enable efficiency and meet customers' changing needs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Failure to keep pace with technological change affecting the financial services industry could have a material adverse impact on the long-term success of our business and, in turn, our financial condition and results of operations.

Risks Associated with Cyber Security Could Negatively Affect Our Earnings and Reputation

Our business requires the secure e-management of sensitive client and bank information. We work diligently through implementing security measures that make our communications and information systems safe to conduct business. Cyber threats such as social engineering, ransomware, and phishing emails are more prevalent now than ever before. These incidents include intentional and unintentional events that may present threats to digital systems that are designed to disrupt operations, corrupt data, release sensitive information or cause denial-of-service attacks. A cyber security breach of systems operated by the Bank, merchants, vendors, customers, or externally publicized breaches of other financial institutions may significantly harm our reputation, result in a loss of customer business, subject us to regulatory scrutiny, or expose us to civil litigation and financial liability. While we have systems and procedures designed to prevent security breaches, we cannot be certain that advances in criminal capabilities, physical system or network break-ins or inappropriate access will not compromise or breach the technology protecting our networks or proprietary client information.

We Rely on Third-Party Vendors for Important Aspects of Our Operation

We depend on the accuracy and completeness of information and systems provided by certain key vendors, including but not limited to data processing, payroll processing, technology support, investment safekeeping and accounting. In particular, we outsource core processing to Fidelity Information Services ("FIS"), a leading financial services solution provider, which allows us access to competitive technology offerings without having to directly invest in their development. Our ability to operate, as well as our financial condition and results of operations, could be negatively affected in the event of an interruption of an information system, an undetected error, a cyber breach, or in the event of a natural disaster whereby certain vendors are unable to maintain business continuity.

Failure of Correspondent Banks and Counterparties May Affect Liquidity

In the economic downturn, the financial services industry in general was materially and adversely affected by the credit crisis. We have witnessed failures and consolidations of banks in the industry in recent years. We rely on our correspondent banks for lines of credit, which can be revoked unexpectedly. We also have two correspondent banks as counterparties in our derivative transactions (see Note 15 to the Consolidated Financial Statements in item 8 in this Form 10-K). While we regularly monitor the financial health of our correspondent banks and we have diverse sources of liquidity, should any one of our correspondent banks become financially impaired, our available credit may decline and/or they may be unable to honor their commitments.

Deterioration of Credit Quality or Insolvency of Insurance Companies May Impede Our Ability to Recover Losses

The financial crisis led certain major insurance companies to be downgraded by rating agencies. We have property, casualty and financial institution risk coverage underwritten by several insurance companies, who may not avoid

insolvency risk inherent in the insurance industry. In addition, some of our investments in obligations of state and political subdivisions are insured by insurance companies. While we closely monitor the credit ratings of our insurers and the insurers of our municipal securities and we are poised to make quick changes if needed, we cannot predict an unexpected inability to honor commitments. We also invest in bank-owned life insurance policies on certain members of Management, which may lose value in the event of a carrier's insolvency. In the event that a bank-owned life insurance policy carrier's credit ratings fall below investment grade, we may exchange policies to other carriers at a cost charged by the original carrier, or we may terminate the policies which may result in adverse tax consequences.



---

Our loan portfolio is secured primarily by properties located in earthquake or fire-prone zones. In the event of a disaster that causes pervasive damage to the region in which we operate, not only the Bank, but also the loan collateral may suffer losses not recoverable by insurance.

Bancorp Relies on Dividends from the Bank to Pay Cash Dividends to Shareholders

Bancorp is a separate legal entity from its subsidiary, the Bank. Bancorp receives substantially all of its revenue from the Bank in the form of dividends, which is Bancorp's principal source of funds to pay cash dividends to Bancorp's common shareholders, service subordinated debt, and cover operational expenses of the holding company. Various federal and state laws and regulations limit the amount of dividends that the Bank may pay to Bancorp. In the event that the Bank is unable to pay dividends to Bancorp, Bancorp may not be able to pay dividends to its shareholders or pay interest on the subordinated debentures. As a result, it could have an adverse effect on Bancorp's stock price and investment value.

Under federal law, capital distributions from the Bank would become prohibited, with limited exceptions, if the Bank were categorized as "undercapitalized" under applicable FRB or FDIC regulations. In addition, as a California bank, Bank of Marin is subject to state law restrictions on the payment of dividends. For further information on the distribution limit from the Bank to Bancorp, see the section captioned “Bank Regulation” in Item 1 above and “Dividends” in Note 9 to the Consolidated Financial Statements in Item 8 of this report.

The Trading Volume of Bancorp's Common Stock is Less than That of Other, Larger Financial Services Companies

Our common stock is listed on the NASDAQ Capital Market exchange. Our trading volume is less than that of nationwide or larger regional financial institutions. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence of willing buyers and sellers of common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the low trading volume of our common stock, significant trades of our stock in a given time, or the expectations of these trades, could cause volatility in the stock price.

We may need to Raise Additional Capital in the Future, and if we Fail to Maintain Sufficient Capital, Whether due to Losses, an Inability to Raise Additional Capital or Otherwise, our Financial Condition, Liquidity and Results of Operations, as well as our Ability to Maintain Regulatory Compliance, Could be Adversely Affected

We face significant capital and other regulatory requirements as a financial institution. We may need to raise additional capital in the future to provide us with sufficient capital resources and liquidity to meet our commitments and business needs, which could include the possibility of financing acquisitions. In addition, Bancorp, on a consolidated basis, and the Bank, on a stand-alone basis, must meet certain regulatory capital requirements and maintain sufficient liquidity. Importantly, as discussed below, regulatory capital requirements could increase from current levels, which could require us to raise additional capital or contract our operations. Our ability to raise additional capital depends on conditions in the capital markets, economic conditions and a number of other factors, including investor perceptions regarding the banking industry, market conditions and governmental activities, and on our financial condition and performance. Accordingly, we cannot assure that we will be able to raise additional capital if needed or on terms acceptable to us. If we fail to maintain capital to meet regulatory requirements, our liquidity, business, financial condition and results of operations could be materially and adversely affected.

We may be Subject to more Stringent Capital Requirements in the Future

We are subject to regulatory requirements specifying minimum amounts and types of capital that we must maintain. From time to time, the regulators change these regulatory capital adequacy guidelines. If we fail to meet these minimum capital guidelines and other regulatory requirements, Bancorp or the Bank may be restricted in the types of activities we may conduct and we may be prohibited from taking certain capital actions, such as paying dividends and repurchasing or redeeming capital securities.

In particular, the capital requirements applicable to us under the recently adopted capital rules implementing the Basel III capital framework in the United States began to be phased-in on January 1, 2015. As these new rules take effect,

we will be required to satisfy additional, more stringent, capital adequacy standards than we have in the past. In addition, if we become subject to annual stress testing requirements, our stress test results may have the effect of requiring us to comply with even greater capital requirements. While we currently meet the requirements of the new Basel III-based capital rules on a fully implemented basis, we may eventually fail to do so. In addition, these requirements could have a negative affect on our ability to lend, grow deposit balances, make acquisitions or make capital distributions in the form of dividends or share repurchases. Higher capital levels could also lower our return on equity.

We may be Subject to Environmental Liabilities in Connection with the Foreclosure on Real Estate Assets Securing our Loan Portfolio

Hazardous or toxic substances or other environmental hazards may be located on the properties that secure our loans. If we acquire such properties as a result of foreclosure or otherwise, we could become subject to various environmental liabilities. For example, we could be held liable for the cost of cleaning up or otherwise addressing contamination at or from these properties. We could also be held liable to a governmental entity or third-party for property damage, personal injury or other claims relating to any environmental contamination at or from these properties. In addition, we own and operate certain properties that may be subject to similar environmental liability risks. Although we have policies and procedures that are designed to mitigate against certain environmental risks, we may not detect all environmental hazards associated with these properties. If we ever became subject to significant environmental liabilities, our business, financial condition and results of operations could be adversely affected.

The Small to Medium-sized Businesses that we Lend to may have Fewer Resources to Weather Adverse Business Developments, which may Impair a Borrower's Ability to Repay a Loan, and such Impairment could Adversely Affect our Results of Operations and Financial Condition

We focus our business development and marketing strategy primarily on small to medium-sized businesses. Small to medium-sized businesses frequently have smaller market shares than their competition, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete and may experience substantial volatility in operating results, any of which may impair a borrower's ability to repay a loan. In addition, the success of a small and medium-sized business often depends on the management talents and efforts of one or two people or a small group of people, and the death, disability or resignation of one or more of these people could adversely affect the business and its ability to repay its loan. If general economic conditions negatively affect the California markets in which we operate and small to medium-sized businesses are adversely affected or our borrowers are otherwise affected by adverse business developments, our business, financial condition and results of operations may be negatively affected.

A Lack of Liquidity could Adversely Affect our Operations and Jeopardize our Business, Financial Condition and Results of Operations

Liquidity is essential to our business. We rely on our ability to generate deposits and effectively manage the repayment and maturity schedules of our loans and investment securities, respectively, to ensure that we have adequate liquidity to fund our operations. An inability to raise funds through deposits, borrowings, the sale of investment securities, Federal Home Loan Bank advances, the sale of loans and other sources could have a substantial negative effect on our liquidity. Our most important source of funds consists of deposits. Deposit balances can decrease when customers perceive alternative investments as providing a better risk/return tradeoff. If customers move money out of bank deposits and into other investments, we would lose a relatively low-cost source of funds, increasing our funding costs and reducing our net interest income and net income.

Other primary sources of funds consist of cash flows from operations, investment maturities and sales of investment securities and proceeds from the issuance and sale of any equity and debt securities to investors. Additional liquidity is provided by the ability to borrow from the Federal Reserve Bank of San Francisco and the Federal Home Loan Bank and our ability to raise brokered deposits. We also may borrow funds from third-party lenders, such as other financial institutions. Our access to funding sources in amounts adequate to finance or capitalize our activities, or on terms that are acceptable to us, could be impaired by factors that affect us directly or the bank or non-bank financial services industries or the economy in general, such as disruptions in the financial markets or negative views and expectations about the prospects for the bank or non-bank financial services industries.

Based on past experience, we believe that our deposit accounts are relatively stable sources of funds. If we increase interest rates paid to retain deposits, our earnings may be adversely affected, which could have an adverse effect on our business, financial condition and results of operations.

Any decline in available funding could adversely affect our ability to originate loans, invest in securities, meet our expenses, pay dividends to our shareholders or to fulfill obligations such as repaying our borrowings or meeting deposit withdrawal demands, any of which could have a material adverse impact on our liquidity, business, financial condition and results of operations.

## ITEM 1B UNRESOLVED STAFF COMMENTS

None

## ITEM 2 PROPERTIES

We lease our corporate headquarters building in Novato, California, which houses substantial loan production, operations and administration. We also lease other branch or office facilities within our primary market areas in the cities of Corte Madera, San Rafael, Novato, Sausalito, Mill Valley, Tiburon, Greenbrae, Petaluma, Santa Rosa, Sonoma, Napa, San Francisco, Alameda and Oakland. We consider our properties to be suitable and adequate for our needs. For additional information on properties, see Notes 5 and 13 to the Consolidated Financial Statements included in Item 8 of this report.

## ITEM 3 LEGAL PROCEEDINGS

We may be party to legal actions which arise from time to time as part of the normal course of our business. We believe, after consultation with legal counsel, that we have meritorious defenses in these actions, and that litigation contingent liability, if any, will not have a material adverse effect on our financial position, results of operations, or cash flows.

We are responsible for our proportionate share of certain litigation indemnifications provided to Visa U.S.A. by its member banks in connection with lawsuits related to anti-trust charges and interchange fees. For further details, see Note 13 to the Consolidated Financial Statements in Item 8 of this report.

## ITEM 4 MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5 MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Bancorp common stock trades on the NASDAQ Capital Market under the symbol BMRC. At February 29, 2016, 6,078,363 shares of Bancorp's common stock, no par value, were outstanding and held by approximately 2,327 holders of record and beneficial owners. The following table sets forth, for the periods indicated, the range of high and low intra-day sales prices of Bancorp's common stock.

| Calendar | 2015 | | 2014 | |
|---|---|---|---|---|
| Quarter | High | Low | High | Low |
| 1st Quarter | $52.96 | $48.63 | $46.09 | $41.59 |
| 2nd Quarter | $53.00 | $45.81 | $47.97 | $42.49 |
| 3rd Quarter | $52.89 | $46.81 | $49.32 | $44.01 |
| 4th Quarter | $56.77 | $47.75 | $53.63 | $45.35 |

The table below shows cash dividends paid to common shareholders on a quarterly basis in the last two fiscal years.

| Calendar | 2015 | | 2014 | |
|---|---|---|---|---|
| Quarter | Per Share | Dollars | Per Share | Dollars |
| 1st Quarter | $0.22 | $1,307 | $0.19 | $1,120,000 |
| 2nd Quarter | $0.22 | $1,313 | $0.19 | $1,123,000 |
| 3rd Quarter | $0.22 | $1,316 | $0.20 | $1,185,000 |
| 4th Quarter | $0.24 | $1,454 | $0.22 | $1,305,000 |

On January 22, 2016 the Company declared a quarterly cash dividend of 25 cents per share payable February 12, 2016 to shareholders of record at the close of business on February 5, 2016. The increase of one cent per share in quarterly cash dividends follows an increase of two cent per share during the fourth quarter of 2015. For additional information regarding our ability to pay dividends, see discussion in Note 9 to the Consolidated Financial Statement, under the heading “Dividends,” in Item 8 of this report.

There were no purchases made by or on behalf of Bancorp or any “affiliated purchaser” (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of the Bancorp's common stock during the fourth quarter of 2015.

On July 2, 2007, Bancorp executed a shareholder rights agreement (“Rights Agreement”) designed to discourage takeovers that involve abusive tactics or do not provide fair value to shareholders. Refer to Exhibit 4.1 to Registration Statement on Form 8-A12B filed with the Securities and Exchange Commission on July 2, 2007. For further information, see Note 9 to the Consolidated Financial Statements, under the heading “Shareholder Rights Plan” in Item 8 of this report.

Securities Authorized for Issuance under Equity Compensation Plans

The following table summarizes information as of December 31, 2015, with respect to equity compensation plans. All plans have been approved by the shareholders.

| | (A) Shares to be issued upon exercise of outstanding options | (B) Weighted average exercise price of | (C) Shares available for future issuance (excluding shares in |
|---|---|---|---|

| | | outstanding options | column A) |
|---|---|---|---|
| Equity compensation plans approved by shareholders | 185,269 [1] | $38.35 | 324,262 [2] |

[1] Represents shares of common stock issuable upon exercise of outstanding options under the Bank of Marin 1999 Stock Option Plan and the Bank of Marin Bancorp 2007 Equity Plan.

[2] Represents shares of common stock available for future grants under the 2007 Equity Plan and the 2010 Director Stock Plan.

Five-Year Stock Price Performance Graph

The following graph, compiled by SNL Financial LC of Charlottesville, Virginia, shows a comparison of cumulative total shareholder return on our common stock during the five fiscal years ended December 31, 2015 compared to the Russell 2000 Stock index and the SNL Bank $1B - $5B Index. The comparison assumes $100 was invested on December 31, 2010 in our common stock and all of the dividends were reinvested. The graph represents past performance and should not be considered to be an indication of future performance. In addition, total return performance results vary depending on the length of the performance period.

The Company's Annual Report on Form 10-K for the year ended December 31, 2014 included the total return performance of stock prices of a group of twenty public California peer bank issuers with assets ranging from $1 billion to $5 billion compiled by an investment banking company. Management believes that a better comparison is provided by the SNL Bank $1B to $5B index, which is a published industry index that includes a larger pool of peer banks comparable to us. The following graph excludes the California peer issuers as the banks that could be included in the group are limited and have been affected by mergers and changes in asset size.

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|
| Bank of Marin Bancorp (BMRC) | 100 | 109 | 111 | 131 | 161 | 167 |
| Russell 2000 Index | 100 | 96 | 111 | 155 | 162 | 155 |
| SNL Bank $1B - $5B Index | 100 | 91 | 112 | 164 | 171 | 191 |

Source: SNL Financial LC of Charlottesville, Virginia

ITEM 6 SELECTED FINANCIAL DATA

The following data has been derived from the audited consolidated financial statements of Bank of Marin Bancorp. For additional information, refer to Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, and Item 8, Financial Statements and Supplementary Data.

| | At December 31, | | | | |
|---|---|---|---|---|---|
| (dollars in thousands) | 2015 | 2014 | 2013 | 2012 | 2011 |
| Selected financial condition data: | | | | | |
| Total assets | $2,031,134 | $1,787,130 | $1,805,194 | $1,434,749 | $1,393,263 |
| Loans, net | 1,436,299 | 1,348,252 | 1,255,098 | 1,060,291 | 1,016,515 |
| Deposits | 1,728,226 | 1,551,619 | 1,587,102 | 1,253,289 | 1,202,972 |
| Borrowings | 72,395 | 20,185 | 19,969 | 15,000 | 40,000 |
| Stockholders' equity | 214,473 | 200,026 | 180,887 | 151,792 | 135,551 |

| | For the Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| (dollars in thousands, except per share data) | 2015 | 2014 | 2013 | 2012 | 2011 |
| Selected operating data: | | | | | |
| Net interest income | 67,187 | 70,441 | 58,775 | 63,190 | 63,819 |
| Provision for loan losses | 500 | 750 | 540 | 2,900 | 7,050 |
| Non-interest income | 9,193 | 9,041 | 8,066 | 7,112 | 6,269 |
| Non-interest expense [1] | 46,949 | 47,263 | 44,092 | 38,694 | 38,283 |
| Net income [1] | $18,441 | $19,771 | $14,270 | $17,817 | $15,564 |
| Net income per common share: | | | | | |
| Basic | $3.09 | $3.35 | $2.62 | $3.34 | $2.94 |
| Diluted | $3.04 | $3.29 | $2.57 | $3.28 | $2.89 |

| | At or for the Years ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2012 | 2011 |
| Performance and other financial ratios: | | | | | |
| Return on average assets | 0.98 % | 1.08 % | 0.96 % | 1.24 % | 1.16 % |
| Return on average equity | 8.84 % | 10.31 % | 8.86 % | 12.36 % | 12.01 % |
| Tax-equivalent net interest margin | 3.83 % | 4.13 % | 4.20 % | 4.74 % | 5.13 % |
| Efficiency ratio | 61.47 % | 59.46 % | 65.97 % | 55.04 % | 54.62 % |
| Loan-to-deposit ratio | 83.97 % | 87.87 % | 79.98 % | 85.69 % | 85.72 % |
| Cash dividend payout ratio on common stock [2] | 29.10 % | 23.90 % | 27.90 % | 21.00 % | 22.10 % |
| Cash dividends per common share | $0.90 | $0.80 | $0.73 | $0.70 | $0.65 |
| Asset quality ratios: | | | | | |
| Allowance for loan losses to total loans | 1.03 % | 1.11 % | 1.12 % | 1.27 % | 1.42 % |
| Allowance for loan losses to non-performing loans [3] | 6.88x | 1.61x | 1.22x | 0.77x | 1.22x |
| Non-performing loans to total loans [3] | 0.15 % | 0.69 % | 0.92 % | 1.64 % | 1.16 % |
| Capital ratios: | | | | | |
| Equity to total assets ratio | 10.60 % | 11.20 % | 10.00 % | 10.60 % | 9.70 % |
| Total capital (to risk-weighted assets) | 13.37 % | 13.94 % | 13.21 % | 13.71 % | 13.13 % |
| Tier 1 capital (to risk-weighted assets) | 12.44 % | 12.87 % | 12.18 % | 12.52 % | 11.45 % |
| Tier 1 capital (to average assets) | 10.67 % | 10.62 % | 10.78 % | 10.30 % | 9.53 % |
| Common equity Tier 1 capital (to risk weighted assets) | 12.16 % | N/A | N/A | N/A | N/A |
| Other data: | | | | | |
| Number of full service offices | 20 | 21 | 21 | 17 | 17 |
| Full time equivalent employees | 259 | 260 | 281 | 238 | 232 |

[1] 2014 included $746 thousand in one-time acquisition expenses related to the NorCal Acquisition. 2013 included $3.7 million in one-time expenses related to the NorCal Acquisition and 2011 included $1.0 million in one-time expenses related to the Charter Oak Bank acquisition.
[2] Calculated as dividends on common share divided by basic net income per common share.
[3] Non-performing loans include loans on non-accrual status and loans past due 90 days or more and still accruing interest.

ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of financial condition as of December 31, 2015 and 2014 and results of operations for each of the years in the three-year period ended December 31, 2015 should be read in conjunction with our consolidated financial statements and related notes thereto, included in Part II Item 8 of this report. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances.

Forward-Looking Statements

The disclosures set forth in this item are qualified by important factors detailed in Part I captioned Forward-Looking Statements and Item 1A captioned Risk Factors of this report and other cautionary statements set forth elsewhere in the report.

Executive Summary

Earnings in 2015 totaled $18.4 million compared to earnings of $19.8 million in 2014. Diluted earnings of $3.04 per share for the year ended December 31, 2015 compared to $3.29 per share in the same period of 2014. Return on assets ("ROA") was 0.98% in 2015 compared to 1.08% in 2014. Return on equity ("ROE") was 8.84% in 2015 compared to 10.31% in 2014.

The following are highlights of our operating and financial performance for the year ended December 31, 2015:

- The Bank generated record loan originations of $252 million in 2015, offset by payoffs for a net increase of $88 million from last year.
- Credit quality remains strong with non-accrual loans trending downward, representing 0.15% of total loans at year end.
- Total deposits grew 11.4% year-over-year to $1.73 billion from $1.55 billion.
- Our loan to deposit ratio has increased to 84%.
- All of our capital ratios are well above current regulatory requirements for a "well-capitalized" institution. Total risk-based capital ratio for Bancorp was 13.4% at December 31, 2015.
- Reflecting the strength of the Bank and its future prospects, the Board of Directors declared the 43rd consecutive quarterly cash dividend in January 2016. The dividend increased $0.01 from the prior quarter and $0.03, or 14% from one year ago to $0.25 per share.

Net interest income totaled $67.2 million and $70.4 million in 2015 and 2014, respectively. The tax-equivalent net interest margin was 3.83% in 2015 compared to 4.13% in 2014. The decrease in net interest margin relates to the continued effect of the low interest rate environment on our loan and investment portfolio turnover and a decline in accretion income related to acquired loans purchased at a discount.

Non-interest income totaled $9.2 million in 2015 compared to $9.0 million in the same period of 2014, an increase of $152 thousand, or 1.7%. The increase in 2015 compared to 2014 primarily relates to higher dividend income from the

Federal Home Loan Bank of San Francisco, partially offset by lower merchant interchange fees due to decreased transaction volume.

Non-interest expense totaled $46.9 million and $47.3 million in 2015 and 2014, respectively, a decrease of $314 thousand, or 0.7%. The decrease in non-interest expense from the prior year is primarily due to the reversal of provision for losses on off-balance sheet commitments and a decrease in data processing expense as the first quarter of 2014 included $442 thousand in one-time NorCal Acquisition-related expenses. Decreases were partially offset by higher salaries and benefits and higher occupancy expense relating to non-recurring accounting adjustments in 2015. Our e

fficiency ratio (the ratio of non-interest expense divided by the sum of net interest income and non-interest income) was 61.47%, 59.46% and 65.97% in 2015, 2014 and 2013, respectively. Our expense discipline allowed for a healthy efficiency ratio, notwithstanding the challenging interest rate, competitive and regulatory environments.

Gross loans increased to $1,451.2 million at December 31, 2015 compared to $1,363.4 million at December 31, 2014, which was driven substantially by new loan volume in investor commercial real estate and commercial and industrial (and related owner occupied commercial real estate). Loan growth in 2015 totaled $87.8 million, or 6.5% over 2014, and was the result of strong new loan volume partially offset by high payoffs.

Credit quality is very strong and continues to improve. Non-accrual loans continued to trend downward, and decreased to $2.2 million at December 31, 2015 from $9.4 million at December 31, 2014, and as a percentage of total loans declined to 0.15% from 0.69% a year ago. The decrease in non-accrual loans from the prior year primarily relates to a previously non-performing loan that was returned to accrual status, the payoff of a commercial real estate loan, and a land development loan that was sold. Net charge-offs for the year ended December 31, 2015 totaled $600 thousand compared to net recoveries of $124 thousand in the prior year. The charge-offs during 2015 primarily related to the land development loan sale.

The provision for loan losses totaled $500 thousand in 2015, compared to $750 thousand in the prior year. The ratio of loan loss reserve to loans decreased from 1.11% at December 31, 2014 to 1.03% at December 31, 2015. The decrease compared to the prior year is primarily related to the improvement in credit quality.

Deposits totaled $1,728.2 million at December 31, 2015 compared to $1,551.6 million at December 31, 2014. Total deposits increased $176.6 million, or 11.4%, compared to December 31, 2014. Non-interest bearing deposits totaled $770.1 million at December 31, 2015, an increase of $99.2 million, or 14.8%, when compared to December 31, 2014. Non-interest bearing deposits represented 44.6% of total deposits as of December 31, 2015 compared to 43.2% at December 31, 2014. The increase in deposits resulted from existing relationships and the development of a number of new relationships.

The total risk-based capital ratio for Bancorp was 13.4% at December 31, 2015 compared to 13.9% at December 31, 2014. The decrease primarily resulted from an increase in risk-weighted assets due to higher loan and investment balances. All risk-based capital ratios continue to be well above (i) regulatory requirements and the new Basel III requirements that took effect on January 1, 2015 (Basel Committee on Bank Supervision guidelines for determining regulatory capital) and (ii) the new Basel III requirements on a fully phased-in basis.

In summary, 2015 was a good year reflecting our consistent approach to the way we do business. Our discipline brought us through the recession in solid financial condition and should ensure our continued success and profitable growth.

The following factors may impact the Company’s performance in 2016:

- New lending and deposit relationships in 2015 should benefit us for a full year in 2016.

- We have ample liquidity and capital to support continued growth in coming years.

- Acquisitions remain a component of our strategic plan. The Bay Area is the most attractive area in the country and we intend to expand our footprint through organic growth and strategic acquisitions.

- Expense control continues to be a critical component of our success. We are convinced that great efficiencies can be achieved as we grow as an organization serving the Bay Area.

- Our net interest margin in 2016 may continue to compress if the current market interest rates do not increase.

## Critical Accounting Policies and Estimates

Critical accounting policies are those that are both very important to the portrayal of our financial condition and results of operations and require Management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and imprecise.

Management has determined the following four accounting policies to be critical:

Allowance for Loan Losses: For information regarding our ALLL methodology, the related provision for loan losses, risks related to asset quality and lending activity, see Item 1A - Risk Factors, Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations, and Note 1 - Summary of Significant Accounting Policies and Note 4 - Loans and Allowance for Loan Losses in Item 8 - Financial Statements and Supplementary Data of this Form 10-K.

Other-than-temporary Impairment of Investment Securities: For information regarding our investment securities, investment activity, and related risks, see Item 1A - Risk Factors, Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations, and Note 1 - Summary of Significant Accounting Policies and Note 3 - Investment Securities in Item 8 - Financial Statements and Supplementary Data of this Form 10-K.

Accounting for Income Taxes: For information on our tax assets and liabilities, and related provision for income taxes, see Note 1 - Summary of Significant Accounting Policies and Note 12 - Income Taxes in Item 8 - Financial Statements and Supplementary Data of this Form 10-K.

Fair Value Measurements: For information on our use of fair value measurements and our related valuation methodologies, see Note 1 - Summary of Significant Accounting Policies and Note 10 - Fair Value of Assets and Liabilities in Item 8 - Financial Statements and Supplementary Data of this Form 10-K.

## RESULTS OF OPERATIONS

### Net Interest Income

Net interest income is the difference between the interest earned on loans, investments and other interest-earning assets and the interest expense incurred on deposits and other interest-bearing liabilities. Net interest income is affected by changes in general market interest rates and by changes in the amounts and composition of interest-earning assets and interest-bearing liabilities. Interest rate changes can create fluctuations in the net interest margin due to an imbalance in the timing of repricing or maturity of assets or liabilities. We manage interest rate risk exposure with the goal of minimizing the effect of interest rate volatility on net interest margin.

Net interest margin is expressed as net interest income divided by average interest-earning assets. Net interest rate spread is the difference between the average rate earned on total interest-earning assets and the average rate incurred on total interest-bearing liabilities. Both of these measures are reported on a taxable-equivalent basis. Net interest margin is the higher of the two because it reflects interest income earned on assets funded with non-interest-bearing sources of funds, which include demand deposits and stockholders’ equity.

The following table, Average Statements of Condition and Analysis of Net Interest Income, compares interest income and average interest-earning assets with interest expense and average interest-bearing liabilities for the periods presented. The table also indicates net interest income, net interest margin and net interest rate spread for each period presented.

Table 1 Average Statements of Condition and Analysis of Net Interest Income

| (dollars in thousands; unaudited) | Year ended December 31, 2015 | | | Year ended December 31, 2014 | | | Year ended December 31, 2013 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Average Balance | Interest Income/ Expense | Yield/ Rate | Average Balance | Interest Income/ Expense | Yield/ Rate | Average Balance | Interest Income/ Expense | Yield/ Rate |
| Assets | | | | | | | | | |
| Interest-bearing due from banks [1] | $52,004 | $135 | 0.26 % | $63,150 | $161 | 0.25 % | $47,401 | $120 | 0.25 % |
| Investment securities [2, 3] | 370,730 | 8,255 | 2.23 % | 341,787 | 8,385 | 2.45 % | 272,767 | 6,648 | 2.44 % |
| Loans [1, 3, 4] | 1,354,564 | 62,953 | 4.58 % | 1,317,794 | 65,856 | 4.93 % | 1,092,885 | 55,157 | 4.98 % |
| Total interest-earning assets [1] | 1,777,298 | 71,343 | 3.96 % | 1,722,731 | 74,402 | 4.26 % | 1,413,053 | 61,925 | 4.32 % |
| Cash and non-interest-bearing due from banks | 44,543 | | | 44,452 | | | 32,903 | | |
| Bank premises and equipment, net | 9,705 | | | 9,290 | | | 9,214 | | |
| Interest receivable and other assets, net | 58,201 | | | 56,592 | | | 38,993 | | |
| Total assets | $1,889,747 | | | $1,833,065 | | | $1,494,163 | | |
| Liabilities and Stockholders' Equity | | | | | | | | | |
| Interest-bearing transaction accounts | $95,662 | $115 | 0.12 % | $101,133 | $99 | 0.10 % | $97,336 | $52 | 0.05 % |
| Savings accounts | 134,997 | 50 | 0.04 % | 125,169 | 46 | 0.04 % | 100,185 | 35 | 0.03 % |
| Money market accounts | 505,280 | 495 | 0.10 % | 507,055 | 550 | 0.11 % | 437,441 | 419 | 0.10 % |
| CDARS and other time accounts | 156,316 | 853 | 0.55 % | 155,229 | 917 | 0.59 % | 145,750 | 922 | 0.63 % |
| Overnight borrowings [1] | 784 | 3 | 0.38 % | 4 | — | — % | 4,054 | 7 | 0.17 % |
| FHLB fixed-rate advances | 15,000 | 315 | 2.07 % | 15,000 | 315 | 2.07 % | 15,000 | 315 | 2.07 % |
| Subordinated debentures | 5,288 | 420 | 7.94 % | 5,070 | 422 | 8.36 % | 407 | 35 | 8.57 % [5] |
| Total interest-bearing liabilities | 913,327 | 2,251 | 0.25 % | 908,660 | 2,349 | 0.26 % | 800,173 | 1,785 | 0.22 % |
| Demand accounts | 753,038 | | | 717,738 | | | 518,986 | | |
| Interest payable and other liabilities | 14,856 | | | 14,934 | | | 13,970 | | |
| Stockholders' equity | 208,526 | | | 191,733 | | | 161,034 | | |
| Total liabilities & stockholders' equity | $1,889,747 | | | $1,833,065 | | | $1,494,163 | | |
| Tax-equivalent net interest income/margin [1] | | $69,092 | 3.83 % | | $72,053 | 4.13 % | | $60,140 | 4.20 % |
| Reported net interest income/margin [1] | | $67,187 | 3.73 % | | $70,441 | 4.03 % | | $58,775 | 4.10 % |
| Tax-equivalent net interest rate spread | | | 3.71 % | | | 4.00 % | | | 4.10 % |

[1] Interest income/expense is divided by actual number of days in the period times 360 days to correspond to stated interest rate terms, where applicable.
[2] Yields on available-for-sale securities are calculated based on amortized cost balances rather than fair value, as changes in fair value are reflected as a component of stockholders' equity. Investment security interest is earned on 30/360 basis monthly.
[3] Yields and interest income on tax-exempt securities and loans are presented on a taxable-equivalent basis using the Federal statutory rate of 35%.
[4] Average balances on loans outstanding include non-accrual loans. The amortized portion of net loan origination fees is included in interest income on loans, representing an adjustment to the yield.

2015 compared with 2014:

The tax-equivalent net interest margin was 3.83% in 2015, compared to 4.13% in 2014. The decrease of thirty basis points was primarily due to a lower yield on interest-earning assets, mainly relating to a decrease in accretion and gains on payoffs of acquired loans, new loans and investment securities yielding lower rates and downward repricing on renewed loans. The net interest spread decreased twenty nine basis points over the same period for the same reasons.

The yield on average interest-earning assets decreased thirty basis points in 2015 compared to 2014 for the reasons listed above. The loan portfolio as a percentage of average interest-earning assets, decreased to 76.2% in 2015, from 76.5% in 2014. The investment securities were 20.9% and 19.8% of average interest-earning assets in 2015 and 2014, respectively. Total average interest-earning assets increased $54.6 million, or 3.2%, in 2015 compared to 2014.

Market interest rates are, in part, based on the target federal funds interest rate (the interest rate banks charge each other for short-term borrowings) regulated by the FOMC. In December 2015, the FOMC raised the target federal funds rate by 25 basis points to a range of 0.25% to 0.50%. This increase from the historic low of 0.00% to 0.25% had not changed for the past seven years. The prolonged low interest rate environment has negatively affected our net interest margin and yields on our earning assets and resulted in significant net interest margin compression over the last several years. Our net interest margin in 2016 may continue to compress if the current market interest rates do not increase.

Early payoffs or prepayments of our acquired loans with significant unamortized purchase discount/premium could result in volatility in our net interest margin. Accretions and gains on payoffs of purchased loans recorded to interest income and the affect on our net interest margin during the past three years were as follows:

| | Years ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | 2013 | |
| (dollars in thousands; unaudited) | Dollar Amount | Basis point affect on net interest margin | Dollar Amount | Basis point affect on net interest margin | Dollar Amount | Basis point affect on net interest margin |
| Accretion on PCI loans | $495 | 3 bps | $614 | 4 bps | $725 | 5 bps |
| Accretion on non-PCI loans | $1,389 | 8 bps | $3,292 | 19 bps | $1,163 | 8 bps |
| Gains on payoffs of PCI loans | $44 | 0 bps | $622 | 4 bps | $469 | 3 bps |

2014 Compared with 2013:

The tax-equivalent net interest margin was 4.13% in 2014, compared to 4.20% in 2013. The decrease of seven basis points was primarily due to a lower yield on interest-earning assets, mainly relating to new loans yielding lower rates and downward repricing on renewed loans offset by an increase in accretion and gains on payoffs of acquired loans. In addition to the decrease on lower yielding interest-earning assets, the cost of interest-bearing liabilities increased by four basis points in 2014 due to subordinated debt acquired, compared to 2013. The net interest spread decreased ten basis points over the same period for the same reasons.

The average yield on interest-earning assets decreased six basis points in 2014 compared to 2013 due to the reasons listed above. The loan portfolio as a percentage of average interest-earning assets, decreased to 76.5% in 2014, from 77.3% in 2013. The investment securities were 19.8% and 19.3% of average interest-earning assets in 2014 and 2013, respectively. Total average interest-earning assets increased $309.7 million, or 21.9%, in 2014 compared to 2013.

Table 2 Analysis of Changes in Net Interest Income

The following table presents the effects of changes in average balances (volume) or changes in average rates on net interest income for the years indicated. Volume variances are equal to the increase or decrease in average balances multiplied by prior period rates. Rate variances are equal to the increase or decrease in rates multiplied by prior period average balances. Mix variances are attributable to the change in yields or rates multiplied by the change in average balances.

| | 2015 compared to 2014 | | | | 2014 compared to 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| (in thousands, unaudited) | Volume | Yield/Rate | Mix | Total | Volume | Yield/Rate | Mix | Total |
| Interest-bearing due from banks | $(28) | $ 3 | $(1) | $(26) | $40 | $ 1 | $— | $41 |
| Investment securities [1] | 710 | (774) | (66) | $(130) | 1,682 | 44 | 11 | $1,737 |
| Loans [1] | 1,838 | (4,612) | (129) | $(2,903) | 11,351 | (541) | (111) | $10,699 |
| Total interest-earning assets | 2,520 | (5,383) | (196) | (3,059) | 13,073 | (496) | (100) | 12,477 |
| | | | | | | | | |
| Interest-bearing transaction accounts | (5) | 23 | (1) | 17 | 2 | 43 | 2 | 47 |
| Savings accounts | 4 | — | — | 4 | 9 | 2 | — | 11 |
| Money market accounts | (2) | (53) | — | (55) | 67 | 55 | 9 | 131 |
| CDARS & other time deposits | 6 | (70) | — | (64) | 60 | (61) | (4) | (5) |
| FHLB borrowings and overnight borrowings | — | — | 3 | 3 | (68) | 78 | (17) | (7) |
| Subordinated debentures | 18 | (20) | (1) | (3) | 401 | (1) | (13) | 387 |
| Total interest-bearing liabilities | 21 | (120) | 1 | (98) | 471 | 116 | (23) | 564 |
| | $2,499 | $ (5,263) | $(197) | $(2,961) | $12,602 | $ (612) | $(77) | $11,913 |

[1] Yields and interest income on tax-exempt securities and loans are presented on a taxable-equivalent basis using the Federal statutory rate of 35%.

Provision for Loan Losses

Management assesses the adequacy of the allowance for loan losses on a quarterly basis based on several factors including growth of the loan portfolio, analysis of probable losses in the portfolio, recent loss experience and the current economic climate. Actual losses on loans are charged against the allowance, and the allowance is increased by loss recoveries and provisions for loan losses charged to expense. For further discussion, see the section captioned "Critical Accounting Policies."

Our provision for loan losses totaled $500 thousand in 2015, compared to $750 thousand in 2014 and $540 thousand in 2013. The decrease compared to 2014 primarily relates to a lower level of impaired loans from the successful resolution of problem loans, as well as a decrease in classified loans. The allowance for loan losses of $15.0 million totaled 1.03% of loans at December 31, 2015, compared to 1.11% at December 31, 2014. Net charge-offs in 2015 totaled $600 thousand and were primarily related to one land development loan that was sold, compared to net recoveries of $125 thousand in the prior year. See the section captioned "Allowance for Loan Losses" below for further analysis of the provision for loan losses.

Non-interest Income

The table below details the components of non-interest income.
Table 3 Components of Non-Interest Income

| (dollars in thousands; unaudited) | Years ended December 31, 2015 | 2014 | 2013 | 2015 compared to 2014 Amount Increase (Decrease) | Percent Increase (Decrease) | 2014 compared to 2013 Amount Increase (Decrease) | Percent Increase (Decrease) |
|---|---|---|---|---|---|---|---|
| Service charges on deposit accounts | $1,979 | $2,167 | $2,062 | $(188) | (8.7)% | $105 | 5.1% |
| Wealth Management and Trust Services | 2,391 | 2,309 | 2,162 | 82 | 3.6% | 147 | 6.8% |
| Debit card interchange fees | 1,445 | 1,378 | 1,104 | 67 | 4.9% | 274 | 24.8% |
| Merchant interchange fees | 545 | 803 | 822 | (258) | (32.1)% | (19) | (2.3)% |
| Earnings on bank-owned life insurance | 814 | 841 | 954 | (27) | (3.2)% | (113) | (11.8)% |
| Dividends on FHLB stock | 1,003 | 563 | 259 | 440 | 78.2% | 304 | 117.4% |
| Gains (losses) on investment securities, net | 79 | 80 | (1) | (1) | (1.3)% | 81 | NM |
| Other income | 937 | 900 | 704 | 37 | 4.1% | 196 | 27.8% |
| Total non-interest income | $9,193 | $9,041 | $8,066 | $152 | 1.7% | $975 | 12.1% |

NM - not meaningful

2015 Compared with 2014:

Non-interest income totaled $9.2 million and $9.0 million at December 31, 2015 and December 31, 2014, respectively. The increase compared to the prior year primarily relates to the increase in dividends on Federal Home Loan Bank ("FHLB") stock, due to a $305 thousand special dividend from the FHLB and higher annualized dividend rates in 2015. The increase was partially offset by lower merchant interchange fees due to decreased transaction volume and lower service charges on deposit accounts compared to 2014.

2014 Compared with 2013:

Service charges on deposit accounts increased in 2014 when compared to 2013 primarily due to increased volume related to the NorCal Acquisition.

The increase in Wealth Management and Trust Services ("WMTS") income in 2014 compared to 2013 is due to the acquisition of new assets and market value appreciation of existing assets under management. Assets under management totaled approximately $352.2 million at December 31, 2014 and $335.9 million at December 31, 2013.

Debit card interchange fees increased in 2014 when compared to the prior year primarily due to an increase in the volume of debit card usage. Bank-owned life insurance (“BOLI”) income decreased in 2014 compared to 2013 due to a $228 thousand benefit realized on the death of an insured employee in the first quarter of 2013, partially offset by earnings from additional policies.

Other income increased when compared to the prior year primarily due to higher dividend income from the FHLB and higher commission income from mortgage brokerage activity. We discontinued the small mortgage brokerage acquired from Bank of Alameda effective June 30, 2014 and the financial impact has not been material.

Non-interest Expense

The table below details the components of non-interest expense.
Table 4 Components of Non-Interest Expense

| (dollars in thousands; unaudited) | Years ended December 31, 2015 | 2014 | 2013 | 2015 compared to 2014 Amount Increase (Decrease) | 2015 compared to 2014 Percent Increase (Decrease) | 2014 compared to 2013 Amount Increase (Decrease) | 2014 compared to 2013 Percent Increase (Decrease) |
|---|---|---|---|---|---|---|---|
| Salaries and related benefits | $25,764 | $25,005 | $21,974 | $759 | 3.0 % | $3,031 | 13.8 % |
| Occupancy and equipment | 5,498 | 5,470 | 4,347 | 28 | 0.5 % | 1,123 | 25.8 % |
| Depreciation and amortization | 1,968 | 1,585 | 1,395 | 383 | 24.2 % | 190 | 13.6 % |
| FDIC insurance | 997 | 1,032 | 921 | (35) | (3.4)% | 111 | 12.1 % |
| Data processing | 3,318 | 3,665 | 5,334 | (347) | (9.5)% | (1,669) | (31.3)% |
| Professional services | 2,121 | 2,230 | 2,985 | (109) | (4.9)% | (755) | (25.3)% |
| (Reversal of) provision for losses on off-balance sheet commitments | (263) | 334 | 112 | (597) | (178.7)% | 222 | 198.2 % |
| Other non-interest expense: | | | | | | | |
| Advertising | 334 | 400 | 490 | (66) | (16.5)% | (90) | (18.4)% |
| Amortization of core deposit intangible | 619 | 771 | 69 | (152) | (19.7)% | 702 | NM |
| Other expense | 6,593 | 6,771 | 6,465 | (178) | (2.6)% | 306 | 4.7 % |
| Total other non-interest expense | 7,546 | 7,942 | 7,024 | (396) | (5.0)% | 918 | 13.1 % |
| Total non-interest expense | $46,949 | $47,263 | $44,092 | $(314) | (0.7)% | $3,171 | 7.2 % |

NM - not meaningful

2015 Compared with 2014:

The increase in salaries and related benefits was mainly due to higher employee benefits and lower deferred loan origination costs. These expenses were partially off-set by lower salaries, commissions and associated payroll taxes in 2015 mainly related to the absence of acquisition-related personnel costs. The number of average FTE employees totaled 260 in 2015 and 266 in 2014.

The increase in depreciation and amortization is primarily due to non-recurring accounting adjustments in 2015.

The decrease in data processing expenses in 2015 mainly reflects one-time NorCal Acquisition-related expenses totaling $442 thousand in the first quarter of 2014 related to the system conversion.

The reversal of provision for losses on off-balance sheet commitments was primarily due to a refinement in methodology used in the calculation of the loss reserve on these commitments by incorporating rolling four-quarter and average commitment usage, as well as eliminating outlier data for small commitment categories. Going forward we expect the result of the refined methodology to reduce the fluctuation in the provision for losses on off-balance sheet commitments.

2014 Compared with 2013:

The increase in salaries and benefit expenses was mainly due to higher salaries and commissions and associated payroll taxes, due to an increase in personnel from the NorCal Acquisition and the addition of commercial lenders, as

well as higher costs incurred in 2014 with the temporary NorCal Acquisition integration staff. These expenses were partially offset by higher capitalized and deferred loan origination costs. The number of average FTE employees totaled 266 in 2014 and 242 in 2013.

The increase in occupancy and equipment primarily reflects higher rent and common area maintenance expenses and other occupancy expenses related to new facilities from the NorCal Acquisition.

The decrease in data processing expenses in 2014 primarily reflects one-time acquisition-related expenses totaling $2.8 million in the fourth quarter of 2013, mainly relating to NorCal's core processing system contract termination and deconversion fees, partially offset by $746 thousand of NorCal deconversion expense recognized in the first quarter of 2014 and increased data processing transaction volumes due to the NorCal Acquisition.

Professional service expenses in 2014 decreased when compared to 2013. This is primarily due to $660 thousand of 2013 professional and legal fees related to the NorCal Acquisition and cost savings on various professional services in 2014.

The increase in the provision for off-balance sheet commitments in 2014 was primarily due to a change in allowance for loan loss methodology, which is applied to these commitments as well as the allowance for loan losses. $771 thousand amortization of core deposit intangibles from the NorCal Acquisition were recorded in other expense in 2014 compared to $69 thousand in 2013. FDIC insurance and other expenses include higher on-going expenses as a result of larger size and increased transaction volume.

Provision for Income Taxes

The provision for income taxes totaled $10.5 million at an effective tax rate of 36.3% in 2015, compared to $11.7 million at an effective tax rate of 37.2% in 2014 and $7.9 million at an effective tax rate of 35.7% in 2013. The decrease in both the provision for income taxes and the effective tax rate from the prior year is primarily due to a lower amount of pre-tax income and higher amounts of tax-exempt earnings on investment securities and loans. These provisions reflect accruals for taxes at the applicable rates for federal income tax and California franchise tax based upon reported pre-tax income, and adjusted for the effects of all permanent differences between income for tax and financial reporting purposes (such as earnings on qualified municipal securities, BOLI and certain tax-exempt loans). Therefore, there are fluctuations in the effective rate from period to period based on the relationship of net permanent differences to income before tax.

Additionally, effective tax rates reflect the adoption of the amended FASB Accounting Standards Codification ("ASC") Topic 323-740 Investments—Equity Method and Joint Ventures—Income Taxes. Beginning in 2014, we adopted this ASU to apply the proportional amortization methodology in accounting for low income tax credit investments. In accordance with ASC 323-740, the tax credit investment amortization expense is now presented as a component of provision for income taxes. Previously, the amortization expense was included as non-interest expense. This change resulted in lower non-interest expense, increased income tax expense and an increased effective tax rate, but did not alter the amount of income taxes actually paid by the Bank. For further discussion, see Note 1, Note 3 and Note 12 to Item 8. Financial Statements and Supplementary Data.

We file a consolidated return in the U.S. Federal tax jurisdiction and a combined return in the State of California tax jurisdiction. There were no ongoing federal or state income tax examinations at the issuance of this report. In June 2015, the State of California completed its examination of the 2011 and 2012 corporate income tax returns, resulting in a minor adjustment. At December 31, 2015 and 2014, neither the Bank nor Bancorp had accruals for interest and penalties related to unrecognized tax benefits.

FINANCIAL CONDITION

Investment Securities

We maintain an investment securities portfolio to provide liquidity and to generate earnings on funds that have not been loaned to customers. Management determines the maturities and types of securities to be purchased based on liquidity and the desire to attain a reasonable investment yield balanced with risk exposure. Table 5 shows the composition of the debt securities portfolio by expected maturity at December 31, 2015 and 2014. Expected maturities differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties. We estimate and update expected maturity dates regularly based on current and historical prepayment speeds. The weighted average maturity of the portfolio at December 31, 2015 was approximately four years.

Table 5 Investment Securities

| December 31, 2015 | Within 1 Year | | 1-5 Years | | 5-10 Years | | After 10 Years | | Total | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| (dollars in thousands; unaudited) | Amortized Cost[1] | Average Yield[2] | Amortized Cost[1] | Average Yield[2] | Amortized Cost[1] | Average Yield[2] | Amortized Cost[1] | Average Yield[2] | Amortized Cost[1] | Fair Value | Averag Yield[2] |
| Held-to-maturity: | | | | | | | | | | | |
| State and municipal | $7,795 | 2.82 % | $28,966 | 4.42 % | $6,158 | 6.40 % | — | — % | $42,919 | $44,146 | 4.41 |
| Corporate bonds | 11,534 | 2.16 | 3,538 | 1.07 | — | — | — | — | 15,072 | 15,098 | 1.90 |
| MBS/CMOs issued by U.S. government agencies | — | — | 2,240 | 4.65 | 9,406 | 1.80 | — | — | 11,646 | 11,810 | 2.35 |
| Total held-to-maturity | 19,329 | 2.43 | 34,744 | 4.09 | 15,564 | 3.62 | — | — | 69,637 | 71,054 | 3.52 |
| Available-for-sale: | | | | | | | | | | | |
| MBS/CMOs issued by U.S. government agencies | 4,262 | 2.93 | 157,982 | 2.04 | 27,459 | 2.41 | — | — | 189,703 | 190,093 | 2.11 |
| State and municipal | 4,673 | 2.24 | 32,406 | 2.25 | 17,755 | 3.58 | 2,276 | 4.84 | 57,110 | 57,673 | 2.77 |
| Debentures of government sponsored agencies | 19,107 | 1.00 | 142,583 | 1.36 | — | — | — | — | 161,690 | 160,892 | 1.32 |
| Privately issued CMOs | — | — | 980 | 1.30 | 2,980 | 2.20 | — | — | 3,960 | 4,150 | 1.98 |
| Corporate bonds | — | — | 3,954 | 1.40 | 993 | 1.43 | — | — | 4,947 | 4,979 | 1.41 |
| Total available-for-sale | 28,042 | 1.50 | 337,905 | 1.76 | 49,187 | 2.80 | 2,276 | 4.84 | 417,410 | 417,787 | 1.88 |
| Total | $47,371 | 1.88 % | $372,649 | 1.98 % | $64,751 | 3.00 % | $2,276 | 4.84 % | $487,047 | $488,841 | 2.12 |

| | Within 1 Year | | 1-5 Years | | 5-10 Years | | After 10 Years | | Total | | |
|---|---|---|---|---|---|---|---|---|---|---|---|

| December 31, 2014 (dollars in thousands; unaudited) | Amortized Cost[1] | Average Yield[2] | Amortized Cost[1] | Average Yield[2] | Amortized Cost[1] | Average Yield[2] | Amortized Cost[1] | Average Yield[2] | Amortized Cost[1] | Fair Value | Averag Yield[2] |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Held-to-maturity: | | | | | | | | | | | |
| State and municipal | $18,536 | 2.37 % | $36,287 | 3.80 % | $8,602 | 6.18 % | — | — % | $63,425 | $65,121 | 3.70 |
| Corporate bonds | 25,060 | 1.55 | 15,197 | 1.89 | — | — | — | — | 40,257 | 40,448 | 1.68 |
| MBS/CMOs issued by U.S. government agencies | 6,222 | 4.32 | 6,533 | 2.26 | — | — | — | — | 12,755 | 13,074 | 3.23 |
| Total held-to-maturity | 49,818 | 2.20 | 58,017 | 3.13 | 8,602 | 6.18 | — | — | 116,437 | 118,643 | 2.94 |
| Available-for-sale: | | | | | | | | | | | |
| MBS/CMOs issued by U.S. government agencies | — | — | 105,761 | 2.31 | 48,227 | 2.25 | 2,557 | 2.13 | 156,545 | 158,119 | 2.29 |
| State and municipal | 2,378 | 2.01 | 11,264 | 2.40 | 725 | 3.18 | 1,366 | 5.08 | 15,733 | 15,880 | 2.62 |
| Debentures of government sponsored agencies | — | — | 14,694 | 1.66 | — | — | — | — | 14,694 | 14,557 | 1.66 |
| Privately issued CMOs | 6,818 | 3.58 | — | — | — | — | 319 | 2.38 | 7,137 | 7,294 | 3.53 |
| Corporate bonds | 3,000 | 0.91 | — | — | 1,936 | 1.97 | — | — | 4,936 | 4,998 | 1.33 |
| Total available-for-sale | 12,196 | 2.62 | 131,719 | 2.25 | 50,888 | 2.25 | 4,242 | 3.10 | 199,045 | 200,848 | 2.29 |
| Total | $62,014 | 2.28 % | $189,736 | 2.51 % | $59,490 | 2.82 % | $4,242 | 3.10 % | $315,482 | $319,491 | 2.53 |

[1] Book value reflects cost, adjusted for accumulated amortization and accretion.

[2] Weighted average yields on tax-exempt basis and weighted average calculation is based on amortized cost of securities.

The amortized cost of our investment securities portfolio increased $171.6 million or 54.4% during 2015 in order to deploy temporary excess liquidity from deposit growth earlier in 2015. $289.5 million in securities were purchased in

2015 and were designated as available-for-sale to provide the flexibility for liquidity management. These purchases were partially offset by $112.0 million of paydowns and maturities, and $3.1 million of sales during 2015.

During 2015, we purchased $172.0 million in agency debentures issued by FNMA, Federal Farm Credit Bureau, FHLB and FHLMC, $65.5 in million mortgage pass-through securities, $44.5 million in municipal securities, and $7.5 million in collateralized mortgage obligations ("CMOs"). We consider agency debentures, mortgage-backed securities, and CMOs issued by U.S. government sponsored entities to have low credit risk as they carry the implicit backing of the U.S. Government. We also invest in municipalities with sound credit fundamentals. The debentures and MBS issued by the U.S. government sponsored agencies, state and municipal securities and corporate bonds, made up 74.5%, 20.5% and 4.1% of the portfolio at December 31, 2015, compared to 58.4%, 25.0% and 14.3%, respectively at December 31, 2014. See the discussion in the section captioned “Securities May Lose Value due to Credit Quality of the Issuers” in Item 1A Risk Factors above.

Any investment securities in our portfolio that may be backed by sub-prime or Alt-A mortgages, which account for approximately 0.2% of our total securities portfolio, relate to privately issued CMOs. See Note 3 to the Consolidated Financial Statements in Item 8, for more information on investment securities.

At December 31, 2015, distribution of our investment in obligations of state and political subdivisions was as follows:

| | December 31, 2015 | | | | December 31, 2014 | | | |
|---|---|---|---|---|---|---|---|---|
| (dollars in thousands; unaudited) | Amortized Cost | Fair Value | % of state and municipal securities | | Amortized Cost | Fair Value | % of state and municipal securities | |
| Within California: | | | | | | | | |
| General obligation bonds | $18,642 | $18,830 | 18.6 | % | $18,556 | $18,734 | 23.7 | % |
| Revenue bonds | 15,453 | 15,767 | 15.5 | | 21,344 | 21,684 | 26.9 | |
| Tax allocation bonds | 5,411 | 5,603 | 5.4 | | 6,280 | 6,446 | 7.6 | |
| Total within California | 39,506 | 40,200 | 39.5 | | 46,180 | 46,864 | 58.2 | |
| Outside California: | | | | | | | | |
| General obligation bonds | 51,920 | 52,990 | 51.9 | | 22,549 | 23,680 | 28.8 | |
| Revenue bonds | 8,603 | 8,629 | 8.6 | | 10,429 | 10,457 | 13.0 | |
| Total outside California | 60,523 | 61,619 | 60.5 | | 32,978 | 34,137 | 41.8 | |
| Total obligations of state and political subdivisions | $100,029 | $101,819 | 100.0 | % | $79,158 | $81,001 | 100.0 | % |

The portion of the portfolio outside the state of California is distributed among 18 states. The largest concentrations outside California are in Minnesota (8.5%), Washington (8.3%), and Texas (6.4%). Revenue bonds, both within and outside California, primarily consisted of bonds relating to essential services (such as roads and utilities) and school district bonds.

Investments in states, municipalities and political subdivisions are subject to an initial pre-purchase credit assessment and ongoing monitoring. Key considerations include:

- The soundness of a municipality’s budgetary position and stability of its tax revenues
- Debt profile and level of unfunded liabilities, diversity of revenue sources, taxing authority of the issuer
- Local demographics/economics including unemployment data, largest local employers, income indices and home values
- For revenue bonds, the source and strength of revenue for municipal authorities including obligor’s financial condition and reserve levels, annual debt service and debt coverage ratio, and credit enhancement (such as insurer’s strength)

- Credit ratings by major credit rating agencies

Loans

Table 6 Loans Outstanding by Type at December 31

| (dollars in thousands; unaudited) | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| Commercial loans | $219,452 | $210,223 | $183,291 | $176,431 | $175,790 |
| Real estate | | | | | |
| Commercial owner-occupied | 242,309 | 230,605 | 241,113 | 196,406 | 174,705 |
| Commercial investor | 715,879 | 673,499 | 625,019 | 509,006 | 446,425 |
| Construction | 65,495 | 48,413 | 31,577 | 30,665 | 51,957 |
| Home equity | 112,300 | 110,788 | 98,469 | 93,237 | 98,043 |
| Other residential [1] | 73,154 | 73,035 | 72,634 | 49,432 | 61,502 |
| Installment and other consumer loans | 22,639 | 16,788 | 17,219 | 18,775 | 22,732 |
| Total loans | 1,451,228 | 1,363,351 | 1,269,322 | 1,073,952 | 1,031,154 |
| Allowance for loan losses | (14,999) | (15,099) | (14,224) | (13,661) | (14,639) |
| Total net loans | $1,436,229 | $1,348,252 | $1,255,098 | $1,060,291 | $1,016,515 |

[1] Our residential loan portfolio includes no sub-prime loans, nor is it our normal practice to underwrite loans commonly referred to as "Alt-A mortgages", the characteristics of which are loans lacking full documentation, borrowers having low FICO scores or collateral compositions reflecting high loan-to-value ratios. Substantially all of our residential loans are indexed to Treasury Constant Maturity Rates and have provisions to reset five years after their origination dates.

2015 was highlighted by record new loan volume of approximately $252 million for the year, compared to approximately $192 million in 2014, as we continued to strengthen our markets throughout our footprint.

Commercial loans increased $9.2 million in 2015 and $26.9 million in 2014. We successfully expanded our lending in strategic market segments such as wine-related industries in 2015.

Commercial real estate loans increased $54.1 million in 2015 and $38.0 million in 2014. Of the commercial real estate loans at December 31, 2015, 75% were non-owner occupied and 25% were owner occupied. This compares to 74% non-owner occupied and 26% owner occupied at December 31, 2014. Our commercial real estate loan portfolio is weighted towards term loans for which the primary source of repayment is cash flow from net operating income of the real estate property. Originated loans are subject to our conservative credit underwriting standards and both the acquired and originated loans are actively managed.

The following table summarizes our commercial real estate loan portfolio by the geographic location in which the property is located as of December 31, 2015 and 2014:

Table 7 Commercial Real Estate Loans Outstanding by Geographic Location

| | December 31, 2015 | | December 31, 2014 | |
|---|---|---|---|---|
| (dollars in thousands; unaudited) | Amount | % of Commercial real estate loans | Amount | % of Commercial real estate loans |
| Marin | $317,035 | 33.1 % | $295,423 | 32.7 % |
| Alameda | 135,835 | 14.2 | 143,194 | 15.9 |
| Sonoma | 132,592 | 13.8 | 139,627 | 15.4 |
| San Francisco | 130,164 | 13.6 | 110,345 | 12.2 |
| Napa | 76,409 | 8.0 | 66,757 | 7.4 |
| Contra Costa | 40,084 | 4.2 | 24,281 | 2.7 |

| | | | | | | |
|---|---|---|---|---|---|---|
| San Mateo | 21,756 | 2.3 | | 12,012 | 1.3 | |
| Sacramento | 17,592 | 1.8 | | 21,003 | 2.3 | |
| Other | 86,721 | 9.0 | | 91,462 | 10.1 | |
| Total | $958,188 | 100.0 | % | $904,104 | 100.0 | % |

Construction loans increased $17.1 million in 2015 and $16.8 million in 2014. The increase in 2015 was due to substantial draws on existing single family development construction projects as they approached completion and origination of new construction loans. The improving economy resulted in a number of new financing opportunities for existing customers who had successfully completed construction projects in the past.

The following table shows an analysis of construction loans by type and location as of December 31, 2015 and 2014:

Table 8 Construction Loans Outstanding by Type and Geographic Location

| (dollars in thousands; unaudited) | December 31, 2015 | | | December 31, 2014 | | |
|---|---|---|---|---|---|---|
| Construction loans by type | Amount | % of Construction Loans | | Amount | % of Construction Loans | |
| 1-4 Single family residential | $39,444 | 60.2 | % | $19,991 | 41.2 | % |
| Commercial real estate | 17,962 | 27.4 | | 12,033 | 24.9 | |
| Apartments and multifamily | 3,127 | 4.8 | | 7,970 | 16.5 | |
| Land - improved | 3,224 | 4.9 | | 6,589 | 13.6 | |
| Land - unimproved | 1,738 | 2.7 | | 1,830 | 3.8 | |
| Total | $65,495 | 100.0 | % | $48,413 | 100.0 | % |

| (dollars in thousands; unaudited) | December 31, 2015 | | | December 31, 2014 | | |
|---|---|---|---|---|---|---|
| Construction loans by geographic location | Amount | % of Construction Loans | | Amount | % of Construction Loans | |
| San Francisco | $26,120 | 39.9 | % | $21,769 | 45.0 | % |
| Marin | 15,921 | 24.3 | | 13,649 | 28.2 | |
| San Mateo | 9,327 | 14.2 | | 3,287 | 6.8 | |
| Napa | 7,749 | 11.8 | | 2,100 | 4.3 | |
| Riverside | 3,224 | 4.9 | | 3,355 | 6.9 | |
| Sonoma | 1,725 | 2.6 | | 3,811 | 7.8 | |
| Other | 1,429 | 2.3 | | 442 | 1.0 | |
| Total | $65,495 | 100.0 | % | $48,413 | 100.0 | % |

Approximately 85% and 87% of our outstanding loans were secured by real estate at December 31, 2015 and 2014, respectively. Also see Item 1A, Risk Factors, regarding our loan concentration risk.

At December 31, 2015 and 2014, approximately 1.5% and 1.0%, respectively, of our loans contained an interest-only feature as part of the loan terms. All of these loans were current with their payments as of December 31, 2015. Except for two loans to one borrowing relationship totaling $7.0 million, all were considered to have low credit risk (graded "Pass").

As of December 31, 2015 and 2014, approximately $43.4 million and $31.3 million, respectively, of our loans had interest reserves, all of which were construction loans. When we determine a loan is impaired before the interest reserve has been depleted, the interest funded by the interest reserve is applied against loan principal. As of December 31, 2015 and 2014, no construction loans having interest reserve balances were determined to be impaired.

The following table presents the maturity distribution of our commercial and construction loans as of December 31, 2015 based on their contractual maturity dates and does not include scheduled payments or potential prepayments.

Table 9A Commercial and Construction Loan Maturity Distribution

| (in thousands; unaudited) | Due within 1 year | Due after 1 but within 5 years | Due after 5 years | Total |
|---|---|---|---|---|
| Maturity distribution: | | | | |
| Commercial | $85,192 | $57,922 | $76,338 | $219,452 |
| Construction | 53,652 | 67 | 11,776 | 65,495 |
| Total | $138,844 | $57,989 | $88,114 | $284,947 |

The following table shows the mix of variable-rate loans to fixed-rate loans for commercial and construction loans. The large majority of the variable-rate loans are tied to independent indices (such as the Wall Street Journal prime rate or a Treasury Constant Maturity Rate). Most loans with original terms of more than five years have provisions for the fixed rates to reset, or convert to variable rates, after one, three or five years. These loans are included in variable rate balances.

Table 9B Commercial and Construction Loan Interest Rate Sensitivity

| (in thousands; unaudited) | Fixed | Variable | Total |
|---|---|---|---|
| Commercial | $88,331 | $131,121 | $219,452 |
| Construction | 1,608 | 63,887 | 65,495 |
| Total | $89,939 | $195,008 | $284,947 |

## Allowance for Loan Losses

Credit risk is inherent in the business of lending. As a result, we maintain an allowance for loan losses to absorb possible losses in our loan portfolio through a provision for loan losses charged against earnings. All specifically identifiable and quantifiable losses are charged off against the allowance. The balance of our allowance for loan losses is Management's best estimate of the remaining probable losses in the portfolio. The ultimate adequacy of the allowance is dependent upon a variety of factors beyond our control, including the real estate market, changes in interest rates and economic and political environments. Based on the current conditions of the loan portfolio, Management believes that the $15.0 million allowance for loan losses at December 31, 2015 is adequate to absorb losses in our loan portfolio. No assurance can be given, however, that adverse economic conditions or other circumstances will not result in increased losses in the portfolio.

### The Components of the Allowance for Loan Losses

As stated previously in “Critical Accounting Policies,” and Note 1 to the Consolidated Financial Statements in this report, the overall allowance consists of 1) specific allowances for individually identified impaired loans ("ASC 310-10") and 2) general allowances for pools of loans ("ASC 450-20"), which incorporate changing qualitative and environmental factors (e.g., portfolio growth and trends, credit concentrations, economic and regulatory factors, etc.).

The first component, specific allowances, results from the analysis of identified problem credits and the evaluation of sources of repayment including collateral, as applicable. Through Management's ongoing loan grading and credit monitoring process, individual loans are identified that have conditions indicating the borrower may be unable to pay all amounts due in accordance with the contractual terms. These loans are evaluated for impairment individually by Management. Management considers an originated loan to be impaired when it is probable we will be unable to

collect all amounts due according to the contractual terms of the loan agreement. For PCI loans, specific allowances are established to account for credit deterioration subsequent to acquisition if we have probable decreases in cash flows expected to be collected. For loans determined to be impaired, the extent of the impairment is measured 1) based on the present value of expected future cash flows discounted at the loan's effective interest rate at origination for originated loans (or discounted at the effective yield for PCI loans), 2) based on the loan's observable market price; or 3) based on the fair value of the collateral if the loan is collateral dependent or if foreclosure is imminent. Generally with problem

credits that are collateral dependent, we obtain appraisals of the collateral at least annually. We may obtain appraisals more frequently if we believe the collateral value is subject to market volatility, if a specific event has occurred to the collateral, or if we believe foreclosure is imminent. Impaired loan balances decreased to $21.2 at December 31, 2015 from $25.2 million at December 31, 2014. The decrease primarily relates to payoffs, sale, and paydowns of several large impaired loans, as well as five loans that were no longer considered modified as a troubled debt restructuring (“TDR”). The specific allowance increased slightly to $1.2 million at December 31, 2015 from $1.1 million at December 31, 2014.

The second component is an estimate of the probable inherent losses in each loan pool with similar risk characteristics. Loans are evaluated on a pool basis by loan segment which is further delineated by Federal regulatory reporting codes ("CALL codes"). Each segment is assigned an expected loss factor which is derived from a rolling twenty-quarter look-back at our historical losses for that particular segment, as well as other qualitative factors. This analysis encompasses the entire loan portfolio and excludes acquired loans where the purchase discount has not been fully accreted. At December 31, 2015 and 2014, the allowance allocated for the second component by categories of credits totaled $13.8 million and $14.0 million, respectively. The allocated allowance related to historical charge-off experience, totaled $2.3 million and $2.8 million at December 31, 2015 and 2014, respectively. In addition, the allocated allowance related to objective qualitative factors such as: changes in the volume and nature of the loan portfolio, changes in credit quality metrics (past due loans, non-accrual loans, net charge-offs, adversely-graded loans), and the existence of credit concentrations totaled $4.9 million and $4.4 million at December 31, 2015 and 2014, respectively. The remaining amounts were allocated based on subjective factors including changes in the overall economic environment, legal and regulatory conditions, lending management and other relevant staff, uncertainties related to acquisitions, as well as the quality of our loan review process.

Table 10 shows the allocation of the allowance by loan type as well as the percentage of total loans in each of the same loan types.

Table 10 Allocation of Allowance for Loan Losses

| (dollars in thousands; unaudited) | December 31, 2015 | | December 31, 2014 | | December 31, 2013 | | December 31, 2012 | | December 31, 2011 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Allowance balance allocation | Loans as percent of total loans | Allowance balance allocation | Loans as percent of total loans | Allowance balance allocation | Loans as percent of total loans | Allowance balance allocation | Loans as percent of total loans | Allowance balance allocation | Loans as percent of total loans |
| Commercial loans | $3,023 | 15.1 % | $2,837 | 15.4 % | $3,056 | 14.4 % | $4,100 | 16.4 % | $4,334 | 17.1 % |
| Real Estate: | | | | | | | | | | |
| Commercial, owner-occupied | 2,249 | 16.7 | 1,924 | 16.9 | 2,012 | 19.0 | 1,313 | 18.3 | 1,305 | 16.9 |
| Commercial, investor | 6,178 | 49.4 | 6,672 | 49.4 | 6,196 | 49.2 | 4,372 | 47.4 | 3,710 | 43.3 |
| Construction | 724 | 4.5 | 839 | 3.6 | 633 | 2.5 | 611 | 2.9 | 1,505 | 5.0 |
| Home Equity | 910 | 7.7 | 859 | 8.1 | 875 | 7.8 | 1,264 | 8.7 | 1,444 | 9.5 |
| Other residential | 394 | 5.0 | 433 | 5.4 | 317 | 5.7 | 551 | 4.6 | 940 | 6.0 |
| Installment and other consumer | 425 | 1.6 | 566 | 1.2 | 629 | 1.4 | 1,231 | 1.7 | 1,182 | 2.2 |
| Unallocated allowance | 1,096 | N/A | 969 | N/A | 506 | N/A | 219 | N/A | 219 | N/A |

| | | | | | |
|---|---|---|---|---|---|
| Total allowance for loan losses | $14,999 | $15,099 | $14,224 | $13,661 | $14,639 |
| Total percent | 100.0 % | 100.0 % | 100.0 % | 100.0 % | 100.0 % |

Table 11 shows the activity in the allowance for loan losses for each of the years in the five-year period ended December 31, 2015. Net charge-offs totaled $600 thousand in 2015, compared to net recoveries of $125 thousand in 2014. Charge-offs in 2015 were primarily comprised of an $839 charge-off related to a land development loan that was sold. The percentage of net charge-offs (recoveries) to average loans was 0.04% in 2015, compared to (0.01)% in 2014 and 0.00% in 2013, reflecting the factors discussed above.

Table 11 Allowance for Loan Losses at December 31,

| (dollars in thousands; unaudited) | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| Beginning balance | $15,099 | $14,224 | $13,661 | $14,639 | $12,392 |
| Provision for loan losses | 500 | 750 | 540 | 2,900 | 7,050 |
| Loans charged-off: | | | | | |
| Commercial | (5) | (66) | (672) | (892) | (3,306) |
| Real Estate: | | | | | |
| Commercial | — | — | (156) | (2,595) | (113) |
| Construction | (839) | (204) | (62) | (373) | (473) |
| Home equity | — | — | (176) | (382) | (554) |
| Other residential | — | — | — | (196) | — |
| Installment and other consumer | (20) | (7) | (88) | (122) | (456) |
| Total | (864) | (277) | (1,154) | (4,560) | (4,902) |
| Loans recovered: | | | | | |
| Commercial | 236 | 168 | 1,021 | 541 | 57 |
| Real Estate: | | | | | |
| Commercial | 23 | 50 | 124 | 5 | 4 |
| Construction | — | 96 | 1 | 122 | 9 |
| Home equity | 3 | 3 | 10 | 12 | 13 |
| Other residential | — | — | — | — | — |
| Installment and other consumer | 2 | 85 | 21 | 2 | 16 |
| Total | 264 | 402 | 1,177 | 682 | 99 |
| Net loans (charged-off) recovered | (600) | 125 | 23 | (3,878) | (4,803) |
| Ending balance | $14,999 | $15,099 | $14,224 | $13,661 | $14,639 |
| Total loans outstanding at end of year, before deducting allowance for loan losses | $1,451,228 | $1,363,351 | $1,269,322 | $1,073,952 | $1,031,154 |
| Average total loans outstanding during year | $1,354,564 | $1,317,794 | $1,092,885 | $1,023,165 | $984,211 |
| Ratio of allowance for loan losses to total loans at end of year | 1.03% | 1.11% | 1.12% | 1.27% | 1.42% |
| Net charge-offs (recoveries) to average loans | 0.04% | (0.01)% | —% | 0.38% | 0.49% |
| Ratio of allowance for loan losses to net (recoveries) charge-offs | 2,499.8% | (12,079.2)% | (61,843.5)% | 352.3% | 304.8% |

Non-performing assets for each of the past five years are presented below. The decrease in non-performing loans from 2014 to 2015 primarily relates to a previously non-performing loan that was returned to accrual status, the payoff of a commercial real estate loan, and a land development loan that was sold. The decrease in non-accrual loans from 2013 to 2014 primarily relates to the successful resolution of several problem loans that led to pay offs, pay downs or resumption of payments on these loans. The decrease in non-performing loans from 2012 to 2013 primarily reflects one commercial real estate loan that paid off in 2013 and pay downs on various commercial real estate and commercial loans, partially offset by one delinquent land development loan that went on to non-accrual status in 2013. The ratio of allowance for loan losses to non-accrual loans increased to 688.3% at December 31, 2015 from 161.5% at December 31, 2014.

| Table 12 Non-performing Assets at December 31,<br>(dollars in thousands; unaudited) | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| Non-accrual loans: | | | | | |
| Commercial | $21 | $— | $1,187 | $4,893 | $2,955 |
| Real Estate: | | | | | |
| Commercial, owner-occupied | — | 1,403 | 1,403 | 1,403 | 2,033 |
| Commercial, investor | 1,903 | 2,429 | 2,807 | 6,843 | 741 |
| Construction | 1 | 5,134 | 5,218 | 2,239 | 3,014 |
| Home equity | 171 | 280 | 234 | 545 | 766 |
| Other residential | — | — | 660 | 1,196 | 1,942 |
| Installment and other consumer | 83 | 104 | 169 | 533 | 519 |
| Total non-accrual loans | 2,179 | 9,350 | 11,678 | 17,652 | 11,970 |
| Other real estate owned | 421 | 461 | 461 | — | — |
| Repossessed personal properties | — | — | — | 35 | 25 |
| Total non-performing assets | $2,600 | $9,811 | $12,139 | $17,687 | $11,995 |
| | | | | | |
| Accruing restructured loans: | | | | | |
| Commercial | $4,562 | $3,584 | $4,514 | $4,577 | $2,741 |
| Real Estate: | | | | | |
| Commercial, owner-occupied | 6,993 | 7,056 | 534 | — | — |
| Commercial, investor | 513 | 524 | 2,930 | — | — |
| Construction | 3,237 | 550 | 1,516 | 1,929 | 290 |
| Home equity | 388 | 414 | 272 | 648 | 279 |
| Other residential | 2,011 | 2,045 | 1,403 | 2,116 | 1,464 |
| Installment and other consumer | 1,168 | 1,689 | 1,693 | 1,515 | 1,552 |
| Total accruing restructured loans | 18,872 | 15,862 | 12,862 | 10,785 | 6,326 |
| | | | | | |
| Accreting impaired PCI loans: | | | | | |
| Commercial real estate [1] | — | — | 1,155 | 1,866 | 1,710 |
| Commercial [1] | 137 | — | — | — | 139 |
| Construction[1] | — | 11 | — | — | — |
| Total accreting impaired PCI loans | 137 | 11 | 1,155 | 1,866 | 1,849 |
| | | | | | |
| Total impaired loans | $21,188 | $25,223 | $25,695 | $30,303 | $20,145 |
| | | | | | |
| Allowance for loan losses to non-accrual loans at period end | 688.3% | 161.5% | 121.8% | 77.4% | 122.3% |
| | | | | | |
| Non-accrual loans to total loans | 0.15% | 0.69% | 0.92% | 1.64% | 1.16% |

[1] The expected cash flows on these PCI loans declined post-acquisition, yet continue to accrete interest based on the revised expected cash flows.

Troubled debt restructured loans, whose contractual terms have been restructured in a manner which grants a concession to a borrower experiencing financial difficulties, totaled $19.1 million and $22.7 million as of December 31, 2015 and 2014, respectively. The decrease primarily relates to five loans that were removed from TDR designation, one sold TDR loan and payoffs and paydowns of several other TDR loans. For more information, refer to Note 4 under “Troubled Debt Restructuring”.

Other Assets

BOLI totaled $29.5 million at December 31, 2015, compared to $28.6 million at December 31, 2014, and is recorded in other assets. Other assets also included net deferred tax assets of $12.7 million and $12.6 million at December 31, 2015 and 2014, respectively. These deferred tax assets consist primarily of tax benefits expected to be realized in future periods related to net operating loss carryforwards, temporary differences of allowance for loan losses, fair value adjustments on acquired loans, deferred compensation, and accrued but unpaid expenses. The increase in deferred tax assets in 2015 primarily relates to the change in the net unrealized gain/loss on securities available-for-sale, increase in interest received on nonaccrual loans, offset by the utilization of net operating loss carryforwards from the NorCal Acquisition and reduction in deferred assets associated with accretion on purchase discounts on acquired loans. Management believes these deferred tax assets to be realizable due to our consistent record of earnings and the expectation that earnings will continue at a level adequate to realize such benefits. Therefore, no valuation allowance has been established as of December 31, 2015 or 2014.

In addition, we held $8.4 million and $8.2 million of FHLB stock recorded at cost in other assets at December 31, 2015 and 2014, respectively. The FHLB paid $1.0 million and $563 thousand in cash dividends in 2015 and 2014, respectively. On February 18, 2016, the FHLB declared a cash dividend for the fourth quarter of 2015 at an annualized dividend rate of 7.99%. Other assets as of December 31, 2015 also included goodwill of $6.4 million and a core deposit intangible asset, net of amortization, totaling $3.1 million from the NorCal Acquisition.

Deposits

Deposits, which are used to fund our interest earning assets, increased $176.6 million, or 11.4%, in 2015. The increase in deposits in 2015 compared to 2014 is primarily due to the expansion of business by many of our commercial depositors as well as the acquisition of key clients. Non-interest bearing deposits totaled $770.1 million at December 31, 2015, an increase of $99.2 million when compared to December 31, 2014. Non-interest bearing deposits totaled 44.6% of total deposits as of December 31, 2015, compared to 43.2% at December 31, 2014. No individual customer accounted for more than 5% of deposits.

The increase in CDARS balances resulted from redirecting certain accounts back onto our balance sheet as part of our contingency funding testing and management.

Table 13 shows the relative composition of our average deposits for the years 2015, 2014 and 2013.

Table 13 Distribution of Average Deposits

| | Years ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2015 | | | 2014 | | | 2013 | | |
| (dollars in thousands; unaudited) | Amount | Percent | | Amount | Percent | | Amount | Percent | |
| Non-interest bearing | $753,038 | 45.8 | % | $717,738 | 44.7 | % | $518,986 | 39.9 | % |
| Interest bearing transaction | 95,662 | 5.8 | | 101,133 | 6.3 | | 97,336 | 7.5 | |
| Savings | 134,997 | 8.2 | | 125,169 | 7.8 | | 100,185 | 7.7 | |
| Money market [1] | 505,280 | 30.7 | | 507,055 | 31.6 | | 437,441 | 33.7 | |
| CDARS | 10,747 | 0.7 | | — | — | | 5,416 | 0.4 | |
| Other Time deposits: | | | | | | | | | |
| Less than $100,000 | 39,666 | 2.4 | | 43,982 | 2.9 | | 38,089 | 2.9 | |
| $100,000 or more | 105,903 | 6.4 | | 111,247 | 6.7 | | 102,245 | 7.9 | |
| Total other time deposits | 145,569 | 8.8 | | 155,229 | 9.6 | | 140,334 | 10.8 | |
| Total Average Deposits | $1,645,293 | 100.0 | % | $1,606,324 | 100.0 | % | $1,299,698 | 100.0 | % |

[1] Included in money market balances are Insured Cash Sweep® ("ICS") balances defined in Note 7: Deposits in Item 8 - Financial Statements
and Supplementary Data.

Note- For average rates paid on deposits, refer to Table 1 in Item 7- Management's Discussion and Analysis of Financial Condition and Results
of Operations.

.

Table 14 below shows the maturity groupings for time deposits of $100,000 or more at December 31, 2015, 2014 and 2013.

Table 14 Maturities of Time Deposits of $100,000 or more at December 31

| | December 31, | | |
|---|---|---|---|
| (in thousands; unaudited) | 2015 | 2014 | 2013 |
| Three months or less | $29,694 | $19,634 | $22,485 |
| Over three months through six months | 18,525 | 16,668 | 19,022 |
| Over six months through twelve months | 35,735 | 20,207 | 22,578 |
| Over twelve months | 37,969 | 49,076 | 47,584 |