NORTHRIM BANCORP INC
Form 10-K
March 16, 2007

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

ANNUAL REPORT UNDER SECTION 13 OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2006

Commission File Number 0-33501

Northrim BanCorp, Inc.
(Exact name of registrant as specified in its charter)

Alaska	**92-0175752**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification Number)*

3111 C Street
Anchorage, Alaska 99503
(Address of principal executive offices) (Zip Code)

Registrant s Telephone Number, Including Area Code:
(907) 562-0062

Securities Registered Pursuant to Section 12(b) of the Act:
None

Securities Registered Pursuant to Section 12(g) of the Act:
Common Stock, $1.00 Par Value
(Title of Class)

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 þ

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 þ

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (17 C.F.R. 229.405) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. Yes o No þ

Indicate by check mark if the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer þ Non-Accelerated filer o

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

The aggregate market value of common stock held by non-affiliates of registrant at June 30, 2006, was $133,680,506.

The number of shares of registrant s common stock outstanding at March 1, 2007, was 6,115,822.

Documents incorporated by reference and parts of Form 10-K into which incorporated: The portions of the Proxy Statement for Northrim BanCorp s Annual Shareholders Meeting to be held on May 3, 2007, referenced in Part III of this Form 10-K are incorporated by reference therein.

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Note Regarding Forward-Looking Statements

This report includes forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements describe Northrim s management s expectations about future events and developments such as future operating results, growth in loans and deposits, continued success of Northrim s style of banking, and the strength of the local economy. All statements other than statements of historical fact, including statements regarding industry prospects and future results of operations or financial position, made in this report are forward-looking. We use words such as anticipates, believes, expects, intends and similar expressions in part to help identify forward-looking statements. Forward-looking statements reflect management s current expectations and are inherently uncertain. Our actual results may differ significantly from management s expectations, and those variations may be both material and adverse. Forward-looking statements are subject to various risks and uncertainties that may cause our actual results to differ materially and adversely from our expectations as indicated in the forward-looking statements. These risks and uncertainties include: the general condition of, and changes in, the Alaska economy; factors that impact our net interest margins; and our ability to maintain asset quality. Further, actual results may be affected by our ability to compete on price and other factors with other financial institutions; customer acceptance of new products and services; the regulatory environment in which we operate; and general trends in the local, regional and national banking industry and economy. Many of these risks, as well as other risks that may have a material adverse impact on our operations and business, are identified in our filings with the SEC. However, you should be aware that these factors are not an exhaustive list, and you should not assume

these are the only factors that may cause our actual results to differ from our expectations. In addition, you should note that we do not intend to update any of the forward-looking statements or the uncertainties that may adversely impact those statements.

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Northrim BanCorp, Inc.
About the Company

Overview

Northrim BanCorp, Inc. (the Company) is a publicly traded bank holding company with four wholly-owned subsidiaries, Northrim Bank (the Bank), a state chartered, full-service commercial bank; Northrim Investment Services Company (NISC), which we formed in November 2002 to hold the Company s equity interest in Elliott Cove Capital Management LLC, (Elliott Cove), an investment advisory services company; Northrim Capital Trust 1 (NCT1), an entity that we formed in May of 2003 to facilitate a trust preferred security offering by the Company; and Northrim Statutory Trust 2 (NST2), an entity that we formed in December of 2005 to facilitate a trust preferred security offering by the Company. We also hold a 24% interest in the profits and losses of a residential mortgage holding company, Residential Mortgage Holding Company LLC (RML Holding Company) through Northrim Bank s wholly-owned subsidiary, Northrim Capital Investments Co. (NCIC). The predecessor of RML Holding Company, Residential Mortgage LLC (RML), was formed in 1998 and has offices throughout Alaska. We also operate in the Washington and Oregon market areas through Northrim Funding Services, a division of the Bank that was formed in 2004. In March and December of 2005, NCIC purchased ownership interests totaling 50.1% in Northrim Benefits Group, LLC (NBG), an insurance brokerage company that focuses on the sale and servicing of employee benefit plans. Finally, in the first quarter of 2006, through NISC, we purchased a 24% interest in Pacific Wealth Advisors, LLC (PWA), an investment advisory and wealth management business located in Seattle, Washington.

The Company is regulated by the Board of Governors of the Federal Reserve System, and the Bank is regulated by the Federal Deposit Insurance Corporation (FDIC), and the State of Alaska Department of Community and Economic Development, Division of Banking, Securities and Corporations. We began banking operations in Anchorage in December 1990, and formed the Company in connection with our reorganization into a holding company structure; that reorganization was completed effective December 31, 2001. We make our Securities Exchange Act reports available free of charge on our Internet web site, www.northrim.com. Our reports can also be obtained through the Securities and Exchange Commission s EDGAR database at www.sec.gov.

We opened for business in 1990 shortly after the dramatic consolidation of the Alaska banking industry in the late 1980s that left three large commercial banks with over 93% of commercial bank deposits in greater Anchorage. Through the successful implementation of our Customer First Service philosophy of providing our customers with the highest level of service, we capitalized on the opportunity presented by this consolidation and carved out a market niche among small business and professional customers seeking more responsive and personalized service.

We grew substantially in 1999 when we completed a public stock offering in which we raised $18.5 million and acquired eight branches from Bank of America. The Bank of America branch acquisition was completed in June 1999 and increased our outstanding loans by $114 million, our deposits by $124 million, and provided us fixed assets valued at $2 million, for a purchase price of $5.9 million, in addition to the net book value of the loans and fixed assets. The stock offering allowed us to achieve the Bank of America acquisition while remaining well-capitalized under bank regulatory guidelines.

We have grown to be the third largest commercial bank in Anchorage and Alaska in terms of deposits, with $794.9 million in total deposits and $925.6 million in total assets at December 31, 2006. Through our 10 branches, we are accessible by approximately 65% of the Alaska population.

Anchorage: We have two major financial centers in Anchorage, four smaller branches, and one supermarket branch. We are also exploring future branching opportunities in this market.

Fairbanks: We opened our financial center in Fairbanks, Alaska s second largest city, in mid-1996. This branch has given us a strong foothold in Interior Alaska, and management believes that there is significant potential to increase our share of that market. We plan to begin construction of a second branch in the Fairbanks market in the second quarter of 2007.

Eagle River: We also serve Eagle River, a community outside of Anchorage. In January of 2002, we moved from a supermarket branch into a full-service branch to provide a higher level of service to this growing market.

Wasilla: Wasilla is a rapidly growing market in the Matanuska Valley outside of Anchorage where we completed construction of a new financial center in December of 2002 and moved from our supermarket branch and loan production office into this new facility.

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Elliott Cove Capital Management LLC

As of December 31, 2006, the Company owned a 47% equity interest in Elliott Cove, an investment advisory services company, through its wholly owned subsidiary, NISC. Elliott Cove began active operations in the fourth quarter of 2002 and has had start-up losses since that time as it continues to build its assets under management. In addition to its ownership interest, the Company provides Elliott Cove with a line of credit that has a committed amount of $750,000 and an outstanding balance of $617,000 as of December 31, 2006.

As of December 31, 2006, there are 11 Northrim Bank employees who are licensed as IAR s and actively selling the Elliott Cove product. We plan to continue to use the Elliott Cove products to strengthen our existing customer relationships and bring new customers into the Bank. In addition, as Elliott Cove builds its assets under management, we expect that it will reach a break-even point on a monthly basis on its operations in 2008.

Northrim Funding Services

In the third quarter of 2004, we formed Northrim Funding Services (NFS) as a division of the Bank. NFS is based in Bellevue, Washington and provides short-term working capital to customers in the states of Washington and Oregon by purchasing their accounts receivable. During its second full year of operations in 2006, the employees of NFS expanded the base of their operations. In 2007, we expect NFS to continue to penetrate its market and increase its market share in the purchased receivables business.

High Performance Checking

In the first part of 2005, we launched our High Performance Checking (HPC) product consisting of several consumer checking accounts tailored to the needs of specific segments of our market, including a totally free checking product. We supported the new products with a targeted marketing program and extensive branch sales promotions. Through the concentrated efforts of our branch employees, we increased the number of our deposit accounts and the balances in them.

In the fourth quarter of 2006, we introduced HPC for our business checking accounts. In 2007, we plan to continue to support the HPC consumer and business checking products with the same program of targeted marketing and branch promotions in an effort to continue to expand our core deposits.

Business Strategies

In addition to our acquisition strategy, we are pursuing a strategy of aggressive internal growth. Our success will depend on our ability to manage our credit risks and control our costs while providing competitive products and services. To achieve our objectives, we are pursuing the following business strategies:

> ***Providing Customer First Service:*** We believe that we provide a high level of customer service. Our guiding principle is to serve our market areas by operating with a Customer First Service philosophy, affording our customers the highest priority in all aspects of our operations. To achieve this objective, our management emphasizes the hiring and retention of competent and highly motivated employees at all levels of the organization. Management believes that a well-trained and highly motivated core of employees allows maximum personal contact with customers in order to understand and fulfill customer needs and preferences. This Customer First Service philosophy is combined with our emphasis on personalized, local decision making.

Emphasizing Business and Professional Lending: We endeavor to provide commercial lending products and services, and to emphasize relationship banking with businesses and professional individuals. Management believes that our focus on providing financial services to businesses and professional individuals has and may continue to increase lending and core deposit volumes.

Providing Competitive and Responsive Real Estate Lending: We estimate that we are a major land development and residential construction lender and an active lender in the commercial real estate market. Management believes that our willingness to provide these services in a professional and responsive manner has contributed significantly to our growth. Because of our relatively small size, our experienced senior management can be more involved with serving customers and making credit decisions, allowing us to compete more favorably for lending relationships.

Pursuing Strategic Opportunities for Additional Growth: Management believes that the Bank of America branch acquisition in 1999 significantly strengthened our local market position and enabled us to further capitalize on expansion opportunities resulting from the demand for a locally based banking institution providing a high level of service. Not only did the acquisition increase our size, number of branch offices and lending capacity, but it also expanded our consumer

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lending, further diversifying our loan portfolio. We expect to continue seeking similar opportunities to further our growth while maintaining a high level of credit quality. We plan to affect our growth strategy through a combination of growth at existing branch locations, new branch openings, primarily in Anchorage, Wasilla and Fairbanks, and strategic banking and non-banking acquisitions.

Developing a Sales Culture: In 2003, we conducted extensive sales training throughout the Company and developed a comprehensive approach to sales. Since then, we have continued with this sales training in all of our major customer contact areas. Our goal throughout this process is to increase and broaden the relationships that we have with new and existing customers and to continue to increase our market share within our existing markets.

Services

We provide a wide range of banking services in South Central and Interior Alaska to businesses, professionals, and individuals with high service expectations.

Deposit Services: Our deposit services include noninterest-bearing checking accounts and interest-bearing time deposits, checking accounts, and savings accounts. Our interest-bearing accounts generally earn interest at rates established by management based on competitive market factors and management s desire to increase or decrease certain types or maturities of deposits. We have two deposit products that are indexed to specific U.S. Treasury rates.

Several of our innovative deposit services and products are:

- An indexed money market deposit account;
- A Jump-Up certificate of deposit (CD) that allows additional deposits with the opportunity to increase the rate to the current market rate for a similar term CD;
- An indexed CD that allows additional deposits, quarterly withdrawals without penalty, and tailored maturity dates; and
- Arrangements to courier noncash deposits from our customers to their branch.

Lending Services: We are an active lender with an emphasis on commercial and real estate lending. We also believe we have a significant niche in construction and land development lending in Anchorage, Fairbanks, and the Matanuska Valley (near Anchorage). To a lesser extent, we provide consumer loans. See Lending Activities.

Other Customer Services: In addition to our deposit and lending services, we offer our customers several 24-hour services: Telebanking, faxed account statements, Internet banking for individuals and businesses, and automated teller services. Other special services include personalized checks at account opening, overdraft protection from a savings account, extended banking hours (Monday through Friday, 9 a.m. to 6 p.m. for the lobby, and 8 a.m. to 7 p.m. for the drive-up, and Saturday 10 a.m. to 3 p.m.), commercial drive-up banking with coin service, automatic transfers and payments, wire transfers, direct payroll deposit, electronic tax payments, Automated Clearing House origination and receipt, cash management programs to meet the specialized needs of business customers, and courier agents who pick up noncash deposits from business customers.

Directors and Executive Officers: The following table presents the names and occupations of our directors and executive officers.

Executive Officers/Age	Occupation
*R. Marc Langland, 65	Chairman, President, & CEO of the Company and the Bank, and Director, Alaska Air Group
*Christopher N. Knudson, 53	Executive Vice President and Chief Operating Officer of the Company and the Bank
Joseph M. Schierhorn, 49	Executive Vice President, Chief Financial Officer, and Compliance Manager of the Company and the Bank
Joseph M. Beedle, 55	Executive Vice President of the Company and Chief Lending Officer of the Bank
Victor P. Mollozzi, 57	Senior Vice President, Senior Credit Officer of the Bank

*Indicates individual serving as both director and executive officer.

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Directors/Age	Occupation
Larry S. Cash, 55	President and CEO, RIM Architects (Alaska), Inc.; CEO, RIM Architects (Guam), LLC.
Mark G. Copeland, 64	Owner and sole member of Strategic Analysis, LLC, a management consulting firm
Frank A. Danner, 73	Secretary/Treasurer, IMEX, Ltd. dba Dynamic Properties (real estate firm)
Ronald A. Davis, 74	Former Vice President, Acordia of Alaska Insurance (full service insurance agency)
Anthony Drabek, 59	President and CEO, Natives of Kodiak, Inc. (Alaska Native Corporation), Chairman and President, Koncor Forest Products Co.; Secretary/Director, Atikon Forest Products Co.
Richard L. Lowell, 66	Former Chairman, Ribelin Lowell Alaska USA Insurance Brokers, Inc. (insurance brokerage firm)
Irene Sparks Rowan, 65	Former Chairman and Director, Klukwan, Inc. (Alaska Native Corporation) and its subsidiaries
John C. Swalling, 57	President, Swalling & Associates, P.C. (accounting firm)
David G. Wight, 66	Former President and CEO, Alyeska Pipeline Service Company, and Director, Storm Cat Energy Corporation

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Selected Financial Data

	2006	2005	2004	2003	2002
			Unaudited (In Thousands Except Per Share Data)		
Net interest income	$47,522	$43,908	$41,271	$39,267	$34,670
Provision for loan losses	2,564	1,170	1,601	3,567	3,095
Other operating income	7,658	4,833	3,792	6,089	5,199
Other operating expense	31,368	29,477	26,535	24,728	23,061
Income before income taxes and minority interest	21,248	18,094	16,927	17,061	13,713
Minority interest in subsidiaries	296				
Pre tax income	20,952	18,094	16,927	17,061	13,713
Income taxes	7,978	6,924	6,227	6,516	5,171
Net income	$12,974	$11,170	$10,700	$10,545	$8,542
Earnings per share:					
Basic	$2.12	$1.78	$1.68	$1.68	$1.33
Diluted	2.09	1.72	1.63	1.61	1.29
Cash dividends per share	0.47	0.43	0.38	0.33	0.20
Assets	$925,620	$895,580	$800,726	$738,569	$704,249
Loans	717,056	705,059	678,269	601,119	534,990
Deposits	794,904	779,866	699,061	646,197	626,415
Long-term debt	2,174	2,574	2,974	3,374	3,774
Junior subordinated debentures	18,558	18,558	8,000	8,000	
Shareholders equity	95,418	84,474	83,358	75,285	68,373
Book value	$15.61	$13.86	$13.01	$11.82	$10.66
Tangible book value	$14.48	$12.65	$11.97	$10.73	$9.51
Net interest margin (tax equivalent)	5.89%	5.66%	5.88%	6.04%	5.82%
Efficiency ratio (cash)(1)	55.97%	59.72%	58.07%	53.71%	56.92%
Return on assets	1.46%	1.33%	1.44%	1.50%	1.33%
Return on equity	14.45%	13.17%	13.50%	14.89%	13.32%
Equity/assets	10.31%	9.44%	10.41%	10.19%	9.71%
Dividend payout ratio	21.43%	22.92%	21.57%	19.04%	14.29%
Nonperforming loans/portfolio loans	0.92%	0.86%	0.97%	1.72%	1.09%
Net charge-offs/average loans	0.16%	0.18%	0.16%	0.33%	0.36%

Allowance for loan losses/portfolio loans	1.69%	1.52%	1.59%	1.70%	1.61%
Nonperforming assets/assets	0.79%	0.69%	0.82%	1.40%	0.81%
Number of banking offices	10	10	10	10	10
Number of employees (FTE)	277	272	272	268	246

(1) In managing our business, we review the efficiency ratio exclusive of intangible asset amortization (see definition in table below), which is not defined in accounting principles generally accepted in the United States (GAAP). The efficiency ratio is calculated by dividing noninterest expense, exclusive of intangible asset amortization, by the sum of net interest income and noninterest income. Other companies may define or calculate this data differently. We believe this presentation provides investors with a more accurate picture of our operating efficiency. In this presentation, noninterest expense is adjusted for intangible asset amortization. For additional information see the Noninterest Expense section in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operation of this report.

Reconciliation of Selected Financial Data to GAAP Financial Measures[2]

Years ended December 31,	2006	2005	2004	2003	2002
Net interest income[1]	$47,522	$43,908	$41,271	$39,267	$34,670
Noninterest income	7,658	4,833	3,792	6,089	5,199
Noninterest expense	31,368	29,477	26,535	24,728	23,061
Intangible asset amortization	482	368	368	368	368
Adjusted noninterest expense	$30,886	$29,109	$26,167	$24,360	$22,693
Efficiency ratio	56.85%	60.48%	58.88%	54.52%	57.84%
Efficiency ratio (less intangible asset amortization)	55.97%	59.72%	58.07%	53.71%	56.92%
Tax rate	38%	38%	37%	38%	38%

(1) Amount represents net interest income before provision for loan losses.

(2) These unaudited schedules provide selected financial information concerning the Company that should be read in conjunction with Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations of this report.

Management s Discussion and Analysis of Financial Condition and Results of Operation

Overview

We are a publicly traded bank holding company with four wholly-owned subsidiaries: the Bank, a state chartered, full-service commercial bank; NISC, a company formed to invest in both Elliott Cove, an investment advisory services company, and PWA, an investment advisory and wealth management business located in Seattle, Washington; and NCT1 and NST2, entities formed to facilitate two trust preferred securities offerings. The Bank in turn has a wholly-owned subsidiary, NCIC, which has an interest in RML Holding Company, a residential mortgage holding company and NBG, an insurance brokerage company that provides employee benefits plans to businesses throughout Alaska. We are headquartered in Anchorage and have 10 branch locations, seven in Anchorage, and one each in Fairbanks, Eagle River, and Wasilla. The Bank also operates Northrim Funding Services, a division headquartered in Bellevue, Washington with operations in the Washington and Oregon markets. We offer a wide array of commercial and consumer loan and deposit products, investment products, and electronic banking services over the Internet.

We opened the Bank for business in Anchorage in 1990. The Bank became the wholly-owned subsidiary of the Company effective December 31, 2001, when we completed our bank holding company reorganization. We opened our first branch in Fairbanks in 1996, and our second location in Anchorage in 1997. During the second quarter of 1999, we purchased eight branches located in Anchorage, Eagle River and Wasilla from Bank of America. This acquisition resulted in us acquiring $114 million in loans, $124 million in deposits and $2 million in fixed assets for a purchase price of $5.9 million.

One of our major objectives is to increase our market share in Anchorage, Fairbanks, and the Matanuska Valley, Alaska s three largest urban areas. We estimate that we hold a 21% share of the commercial bank deposit market in Anchorage, a 9% share of the Fairbanks market, and a 10% share of the Matanuska Valley market as of June 30, 2006.

Our growth and operations depend upon the economic conditions of Alaska and the specific markets we serve. The economy of Alaska is dependent upon the natural resources industries, in particular oil production, as well as tourism, government, and U.S. military spending. According to the State of Alaska Department of Revenue, approximately 86% of the Alaska state government is funded through various taxes and royalties on the oil industry. Any significant changes in the Alaska economy and the markets we serve eventually could have a positive or negative impact on the Company.

During the second quarter of 1999, we sold 1,842,900 shares of our common stock in an underwritten common stock offering that generated $18.5 million in net proceeds. We used the proceeds to purchase the Bank of America branches and to provide capital for additional growth.

At December 31, 2006, we had assets of $925.6 million and gross loans of $717.1 million, an increase of 3% and 2%, respectively, over assets of $895.6 million and gross loans of $705.1 million at December 31, 2005. Our net income and diluted earnings per share for 2006 were $13 million and $2.09, respectively, an increase of 16% and 22%, respectively, from $11.2 million and $1.72 at year end 2005. During the same time period, our net interest income increased by $3.6 million, or 8%, to $47.5 million, from $43.9 million for the year ended 2005. Our provision for loan losses in 2006 increased by $1.4 million, or 119% to $2.6 million, from $1.2 million in 2005, as our nonperforming loans increased by $561,000, or 9% for 2006, from $6.1 million in 2005 to $6.6 million for 2006. In contrast, for 2006 our other operating income increased by $2.8 million, or 58%, to $7.7 million from $4.8 million in 2005. The growth in our net interest income combined with the positive effects of the increases in our other operating income was offset in part by an increase in other operating expenses of $1.9 million, or 6%, to $31.4 million in 2006 from $29.5 million for 2005, which resulted in an increase in our net income and earnings per share.

Results of Operations

Net Income

We earned net income of $13 million in 2006, compared to net income of $11.2 million in 2005, and $10.7 million in 2004. During these periods, net income per diluted share was $2.09, $1.72, and $1.63, respectively.

Net Interest Income

Our results of operations are dependent to a large degree on our net interest income. We also generate other income, primarily through service charges and fees, earnings from our mortgage affiliate and purchased receivables products, and other sources. Our operating expenses consist in large part of compensation, employee benefits expense, occupancy, and marketing expense. Interest income and cost of funds are affected significantly by general economic conditions, particularly changes in market interest rates, and by government policies and the actions of regulatory authorities.

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Net interest income is the difference between interest income, from loan and investment securities portfolios, and interest expense, on customer deposits and borrowings. Net interest income in 2006 was $47.5 million compared to $43.9 million in 2005, and $41.3 million in 2004, reflecting an increase in our interest-earning assets and the general level of interest rates. Average interest-earning assets increased $32.3 million, or 4%, in 2006 compared to an increase in average interest-bearing liabilities in 2006 of $36 million, or 6%. Average interest-earning assets increased $74.1 million, or 11%, in 2005 compared to an increase in average interest-bearing liabilities in 2005 of $76.1 million, or 15%.

Changes in net interest income result from changes in volume and spread, which in turn affect our margin. For this purpose, volume refers to the average dollar level of interest-earning assets and interest-bearing liabilities, spread refers to the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, and margin refers to net interest income divided by average interest-earning assets. Changes in net interest income are influenced by the level and relative mix of interest-earning assets and interest-bearing liabilities. During the fiscal years ended December 31, 2006, 2005, and 2004, average interest-earning assets were $810.9 million, $778.6 million, and $704.5 million, respectively. During these same periods, net interest margins were 5.86%, 5.64%, and 5.86%, respectively, which reflect our balance sheet mix and premium pricing on loans compared to other community banks and an emphasis on construction lending, which has a higher fee base. Our average yield on earning-assets was 8.57% in 2006, 7.55% in 2005, and 6.89% in 2004, while the average cost of interest-bearing liabilities was 3.63% in 2006, 2.61% in 2005, and 1.48% in 2004.

Our net interest margin increased in 2006 from 2005 due to the interaction of several factors. First, in 2006, the cost of interest-bearing liabilities increased by 102 basis points while the yield on interest-earning assets also increased by 102 basis points. During this time, the average balance of our interest-bearing demand deposits increased by $13 million to $78.9 million at December 31, 2006 from $65.9 million at December 31, 2005. The average balance of our demand deposits and other noninterest-bearing liabilities also increased by $5.5 million to $193.5 million at December 31, 2006 from $188 million at December 31, 2005. The increase in these lower cost deposits in 2006 helped to contain the rate of growth in the cost of interest-bearing liabilities. Second, the 102 basis point increase in the yield on earning assets in 2006 had a larger effect on net interest income because it was applied to earning assets with an average balance of $810.9 million versus the 102 basis point increase in the cost of interest-bearing liabilities that was applied to an average balance of $605.6 million. Finally, in 2006, earning assets increased by $32.3 million, or 4% compared to growth of $74.1 million, or 11% in 2005. However, during these same time periods, net interest income increased by $3.6 million, or 8% and $2.6 million, or 6%, respectively in 2006 and 2005. The growth rate of net interest income increased in 2006 while the rate of growth in earning assets decreased, which contributed to the increase in the net interest margin.

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The following table sets forth for the periods indicated, information with regard to average balances of assets and liabilities, as well as the total dollar amounts of interest income from interest-earning assets and interest expense on interest-bearing liabilities. Resultant yields or costs, net interest income, and net interest margin are also presented:

Years Ended December 31,	2006			2005			2004		
	Average outstanding balance	Interest earned/ paid[1]	Yield/ rate	Average outstanding balance	Interest earned/ paid[1]	Yield/ rate	Average outstanding balance	Interest earned/ paid[1]	Yield/ rate
	(In Thousands)								
Assets:									
Loans[2]	$712,116	$65,347	9.18%	$698,240	$55,870	8.00%	$628,830	$45,898	7.30%
Securities	71,164	2,757	3.87%	61,125	2,202	3.60%	64,008	2,492	3.89%
Overnight investments	27,665								