WASHINGTON TRUST BANCORP INC
Form 10-Q
November 04, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended SEPTEMBER 30, 2016 or

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from ______ to ______.

Commission file number: 001-32991

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

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

23 BROAD STREET

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

(401) 348-1200
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes o No

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

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

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

The number of shares of common stock of the registrant outstanding as of October 31, 2016 was 17,121,527.

FORM 10-Q
WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
For the Quarter Ended September 30, 2016

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

	September 30, 2016	December 31, 2015
Assets:		
Cash and due from banks	$126,752	$93,222
Short-term investments	2,420	4,409
Mortgage loans held for sale (including $45,162 at September 30, 2016 and $33,969 at December 31, 2015 measured at fair value)	45,162	38,554
Securities:		
Available for sale, at fair value	564,256	375,044
Held to maturity, at amortized cost (fair value $17,492 at September 30, 2016 and $20,516 at December 31, 2015)	16,848	20,023
Total securities	581,104	395,067
Federal Home Loan Bank stock, at cost	37,249	24,316
Loans:		
Commercial	1,757,215	1,654,547
Residential real estate	1,079,887	1,013,555
Consumer	344,253	345,025
Total loans	3,181,355	3,013,127
Less allowance for loan losses	25,649	27,069
Net loans	3,155,706	2,986,058
Premises and equipment, net	29,433	29,593
Investment in bank-owned life insurance	70,557	65,501
Goodwill	64,059	64,059
Identifiable intangible assets, net	10,493	11,460
Other assets	81,099	59,365
Total assets	$4,204,034	$3,771,604
Liabilities:		
Deposits:		
Demand deposits	$566,027	$537,298
NOW accounts	404,827	412,602
Money market accounts	794,905	823,490
Savings accounts	357,966	326,967
Time deposits	913,649	833,898
Total deposits	3,037,374	2,934,255
Federal Home Loan Bank advances	671,615	378,973
Junior subordinated debentures	22,681	22,681
Other liabilities	77,037	60,307
Total liabilities	3,808,707	3,396,216
Commitments and contingencies		
Shareholders' Equity:		
Common stock of $.0625 par value; authorized 60,000,000 shares at September 30, 2016 and 30,000,000 at December 31, 2015; issued and outstanding 17,107,476 shares at September 30, 2016 and 17,019,578 shares at December 31, 2015	1,069	1,064
Paid-in capital	113,290	110,949
Retained earnings	288,613	273,074
Accumulated other comprehensive loss	(7,645)	(9,699)
Total shareholders' equity	395,327	375,388

Total liabilities and shareholders' equity	$4,204,034	$3,771,604

The accompanying notes are an integral part of these unaudited consolidated financial statements.
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Consolidated Statements of Income (unaudited) (Dollars and shares in thousands, except per share amounts)

	Three months		Nine months	
Periods ended September 30,	2016	2015	2016	2015
Interest income:				
Interest and fees on loans	$29,633	$28,626	$88,753	$85,718
Interest on securities: Taxable	3,024	2,178	7,881	6,613
Nontaxable	218	366	825	1,203
Dividends on Federal Home Loan Bank stock	288	309	729	638
Other interest income	93	47	227	101
Total interest and dividend income	33,256	31,526	98,415	94,273
Interest expense:				
Deposits	3,110	3,308	9,059	10,045
Federal Home Loan Bank advances	2,641	1,987	7,106	5,780
Junior subordinated debentures	125	232	356	714
Other interest expense	1	2	4	7
Total interest expense	5,877	5,529	16,525	16,546
Net interest income	27,379	25,997	81,890	77,727
Provision for loan losses	1,800	200	2,750	300
Net interest income after provision for loan losses	25,579	25,797	79,140	77,427
Noninterest income:				
Wealth management revenues	9,623	8,902	28,278	26,249
Mortgage banking revenues	3,734	1,990	8,642	7,319
Service charges on deposit accounts	915	986	2,757	2,894
Card interchange fees	870	849	2,527	2,389
Income from bank-owned life insurance	521	498	2,110	1,480
Loan related derivative income	1,178	327	2,331	1,689
Equity in earnings (losses) of unconsolidated subsidiaries	(88)	(69)	(265)	(224)
Other income	508	430	1,429	1,398
Total noninterest income	17,261	13,913	47,809	43,194
Noninterest expense:				
Salaries and employee benefits	16,908	15,971	50,693	46,971
Net occupancy	1,766	1,721	5,376	5,276
Equipment	1,648	1,424	4,652	4,140
Outsourced services	1,254	1,250	3,911	3,774
Legal, audit and professional fees	691	630	1,982	1,916
FDIC deposit insurance costs	504	467	1,488	1,376
Advertising and promotion	370	356	1,055	1,201
Amortization of intangibles	321	260	966	571
Debt prepayment penalties	—	—	431	—
Acquisition related expenses	—	504	—	937
Change in fair value of contingent consideration	(939)	16	(898)	16
Other expenses	2,127	1,939	6,474	6,190
Total noninterest expense	24,650	24,538	76,130	72,368
Income before income taxes	18,190	15,172	50,819	48,253
Income tax expense	5,863	4,964	16,500	15,532
Net income	$12,327	$10,208	$34,319	$32,721

Weighted average common shares outstanding - basic		17,090	16,939	17,060	16,837
Weighted average common shares outstanding - diluted		17,203	17,102	17,198	17,027
Per share information:	Basic earnings per common share	$0.72	$0.60	$2.01	$1.94
	Diluted earnings per common share	$0.72	$0.60	$1.99	$1.92
	Cash dividends declared per share	$0.37	$0.34	$1.09	$1.02

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

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

	Three Months		Nine Months	
Periods ended September 30,	2016	2015	2016	2015
Net income	$12,327	$10,208	$34,319	$32,721
Other comprehensive income (loss), net of tax:				
Net change in fair value of securities available for sale	(91)	344	1,651	(693)
Cash flow hedges:				
Change in fair value of cash flow hedges	(4)	(1)	(94)	(10)
Net cash flow hedge losses reclassified into earnings	—	82	—	265
Net change in fair value of cash flow hedges	(4)	81	(94)	255
Defined benefit plan obligation adjustment	166	233	497	822
Total other comprehensive income, net of tax	71	658	2,054	384
Total comprehensive income	$12,398	$10,866	$36,373	$33,105

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

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

	Common Shares Outstanding	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
Balance at January 1, 2016	17,020	$1,064	$110,949	$273,074	($9,699)	$375,388
Net income				34,319		34,319
Total other comprehensive income, net of tax					2,054	2,054
Cash dividends declared				(18,780)		(18,780)
Share-based compensation			1,634			1,634
Exercise of stock options, issuance of other compensation-related equity awards and related tax benefit	87	5	707			712
Balance at September 30, 2016	17,107	$1,069	$113,290	$288,613	($7,645)	$395,327

	Common Shares Outstanding	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
Balance at January 1, 2015	16,746	$1,047	$101,204	$252,837	($8,809)	$346,279
Net income				32,721		32,721
Total other comprehensive income, net of tax					384	384
Cash dividends declared				(17,392)		(17,392)
Share-based compensation			1,640			1,640
Common stock issued for acquisition	137	8	5,422			5,430
Exercise of stock options, issuance of other compensation-related equity awards and related tax benefit	102	7	1,458			1,465
Balance at September 30, 2015	16,985	$1,062	$109,724	$268,166	($8,425)	$370,527

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

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

Nine months ended September 30,		2016	2015
Cash flows from operating activities:			
Net income		$34,319	$32,721
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses		2,750	300
Depreciation of premises and equipment		2,737	2,535
Net amortization of premium and discount		1,802	1,149
Amortization of intangibles		966	571
Share-based compensation		1,634	1,640
Income from bank-owned life insurance		(2,110)	(1,480)
Net gains on loan sales and commissions on loans originated for others		(8,682)	(7,296)
Net gain on sale of portfolio loans		(135)	—
Equity in (earnings) losses of unconsolidated subsidiaries		265	224
Proceeds from sales of loans		370,526	365,533
Loans originated for sale		(369,746)	(345,322)
Change in fair value of contingent consideration liability		(898)	16
(Increase) decrease in other assets		(22,719)	2,683
Increase (decrease) in other liabilities		17,635	(5,075)
Net cash provided by operating activities		28,344	48,199
Cash flows from investing activities:			
Purchases of:	Mortgage-backed securities available for sale	(248,221)	(1,525)
	Other investment securities available for sale	(70,495)	(63,229)
Maturities and principal payments of:	Mortgage-backed securities available for sale	41,446	38,312
	Other investment securities available for sale	89,441	58,583
	Mortgage-backed securities held to maturity	3,029	3,893
Purchases of Federal Home Loan Bank stock		(12,933)	—
Net increase in loans		(95,759)	(88,680)
Net proceeds from sale of portfolio loans		510	—
Purchases of loans		(77,180)	(2,877)
Proceeds from the sale of property acquired through foreclosure or repossession		731	637
Purchases of premises and equipment		(2,608)	(3,220)
Purchases of bank-owned life insurance		(5,000)	—
Proceeds from bank-owned life insurance		2,054	—
Cash used in business combination, net of cash acquired		—	(1,671)
Net cash used in investing activities		(374,985)	(59,777)
Cash flows from financing activities:			
Net increase in deposits		103,119	81,462
Proceeds from Federal Home Loan Bank advances		981,250	348,000
Repayment of Federal Home Loan Bank advances		(688,608)	(372,648)
Proceeds from stock option exercises and issuance of other equity awards, net of awards surrendered		282	946
Tax benefit from stock option exercises and other equity awards		430	518
Cash dividends paid		(18,291)	(16,976)
Net cash provided by financing activities		378,182	41,302
Net increase in cash and cash equivalents		31,541	29,724
Cash and cash equivalents at beginning of period		97,631	80,350

Cash and cash equivalents at end of period	$129,172	$110,074

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

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

Nine months ended September 30,	2016	2015
Noncash Investing and Financing Activities:		
Loans charged off	$4,390	$1,401
Loans transferred to property acquired through foreclosure or repossession	1,045	491
In conjunction with the purchase acquisition detailed in Note 3 to the Unaudited Consolidated Financial Statements, assets were acquired and liabilities were assumed as follows:		
Common stock issued for acquisition	—	5,430
Fair value of assets acquired, net of cash acquired	—	14,315
Fair value of liabilities assumed	—	7,214
Supplemental Disclosures:		
Interest payments	$16,093	$16,690
Income tax payments	14,860	14,995

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

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Condensed Notes to Unaudited Consolidated Financial Statements

(1) General Information
Washington Trust Bancorp, Inc. (the "Bancorp") is a publicly-owned registered bank holding company and financial holding company. The Bancorp owns all of the outstanding common stock of The Washington Trust Company, of Westerly (the "Bank"), a Rhode Island chartered commercial bank founded in 1800. Through its subsidiaries, the Bancorp offers a complete product line of financial services including commercial, residential and consumer lending, retail and commercial deposit products, and wealth management services through its offices in Rhode Island, eastern Massachusetts and Connecticut.

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

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

The unaudited consolidated financial statements of the Corporation presented herein have been prepared pursuant to the rules of the Securities and Exchange Commission ("SEC") for quarterly reports on Form 10-Q and do not include all of the information and note disclosures required by GAAP. In the opinion of management, all adjustments (consisting of normal recurring adjustments) and disclosures considered necessary for the fair presentation of the accompanying consolidated financial statements have been included. Interim results are not necessarily reflective of the results of the entire year. The accompanying unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

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

Business Combinations - Topic 805
Accounting Standards Update No. 2015-16, “Simplifying the Accounting for Measurement-Period Adjustments (“ASU 2015-16”), was issued in September 2015 and eliminates the requirement for an acquirer to retrospectively adjust the financial statements for measurement-period adjustments that occur in periods after a business combination is consummated. ASU 2015-16 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016. The adoption of ASU 2015-16 is not expected to have a material impact on the Corporation’s consolidated financial statements.

Financial Instruments - Topic 825
Accounting Standards Update No. 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities” (“ASU 2016-01”), was issued in January 2016 and provides revised guidance related to the accounting for and reporting of financial instruments. Some of the main provisions include: requiring most equity securities to be reported at fair value with unrealized gains and losses reported in the income statement; requiring separate presentation of financial assets and liabilities by measurement category and form (i.e. securities or loans); clarifying that entities must assess valuation allowances on a deferred

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

tax asset related to available for sale debt securities in combination with their other deferred tax assets; and eliminating the requirement to disclose the method and significant assumptions used to estimate fair value for financial instruments measured at amortized cost on the balance sheet. ASU 2016-01 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The Corporation is currently evaluating the impact that ASU 2016-01 will have on its consolidated financial statements.

Leases - Topic 842
Accounting Standards Update No. 2016-02, “Leases” (“ASU 2016-02”), was issued in February 2016 and provides revised guidance related to the accounting and reporting of leases. ASU 2016-02 requires lessees to recognize most leases on the balance sheet. The recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee will depend on its classification as a finance or operating lease. ASU 2016-02 requires a modified retrospective transition, with a number of practical expedients that entities may elect to apply. ASU 2016-02 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted. The Corporation is currently evaluating the impact that ASU 2016-02 will have on its consolidated financial statements.

Stock Compensation - Topic 718
Accounting Standards Update No. 2016-09, “Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”), was issued in March 2016. ASU 2016-09 includes multiple provisions intended to simplify several aspects of the accounting for share-based payment transactions, including income tax consequences and the classification of certain tax-related transactions on the statement of cash flows. ASU 2016-09 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016. Early adoption is permitted in any interim or annual period. Amendments should be applied using the appropriate transition method as detailed by the provisions of ASU 2016-09. The Corporation is currently evaluating the impact that ASU 2016-09 will have on its consolidated financial statements.

Derivatives and Hedging - Topic 815
Accounting Standards Update No. 2016-05, “Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships” (“ASU 2016-05”), was issued in March 2016. ASU 2016-05 clarifies that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument does not, in and of itself, require de-designation of that hedging relationship provided that all other hedge accounting criteria continue to be met. ASU 2016-05 allows for either a prospective approach or modified retrospective approach for adoption. ASU 2016-05 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016. Early adoption is permitted. ASU 2016-05 is not expected to have a material impact on the Corporation’s consolidated financial statements.

Accounting Standards Update No. 2016-06, “Contingent Put and Call Options in Debt Instruments” (“ASU 2016-06”), was issued in March 2016. ASU 2016-06 clarifies the requirements for assessing whether contingent call or put options that can accelerate the payment of principal on debt instruments are clearly and closely related to their debt hosts by providing a four-step decision sequence to assess whether the economic characteristics of the embedded call and put options are clearly and closely related to the economic characteristics of their debt hosts. ASU 2016-06 allows for a modified retrospective approach for adoption. ASU 2016-06 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016. Early adoption is permitted. ASU 2016-06 is not expected to have a material impact on the Corporation’s consolidated financial statements.

Credit Losses - Topic 326

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

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

Statement of Cash Flows - Topic 230

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

(3) Cash and Due from Banks

The Bank maintains certain average reserve balances to meet the requirements of the Board of Governors of the Federal Reserve System ("FRB"). Some or all of these reserve requirements may be satisfied with vault cash. Reserve balances amounted to $11.2 million at September 30, 2016 and $10.5 million at December 31, 2015 and were included in cash and due from banks in the Consolidated Balance Sheets.

As of September 30, 2016 and December 31, 2015, cash and due from banks included interest-bearing deposits in other banks of $77.0 million and $48.2 million, respectively.

(4) Securities

The following tables present the amortized cost, gross unrealized holding gains, gross unrealized holding losses and fair value of securities by major security type and class of security:

(Dollars in thousands)

September 30, 2016	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities Available for Sale:				
Obligations of U.S. government-sponsored enterprises	$75,500	$49	($65)	$75,484
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	434,430	8,564	(307)	442,687
Obligations of states and political subdivisions	18,239	157	—	18,396
Individual name issuer trust preferred debt securities	29,842	—	(4,158)	25,684
Corporate bonds	1,956	49	—	2,005
Total securities available for sale	$559,967	$8,819	($4,530)	$564,256
Held to Maturity:				
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	$16,848	$644	$—	$17,492
Total securities held to maturity	$16,848	$644	$—	$17,492
Total securities	$576,815	$9,463	($4,530)	$581,748

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(Dollars in thousands)					
December 31, 2015	Amortized Cost	Unrealized Gains	Unrealized Losses		Fair Value
Securities Available for Sale:					
Obligations of U.S. government-sponsored enterprises	$77,330	$73	($388	)	$77,015
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	228,908	6,398	(450	)	234,856
Obligations of states and political subdivisions	35,353	727	—		36,080
Individual name issuer trust preferred debt securities	29,815	—	(4,677	)	25,138
Corporate bonds	1,970	5	(20	)	1,955
Total securities available for sale	$373,376	$7,203	($5,535	)	$375,044
Held to Maturity:					
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	$20,023	$493	$—		$20,516
Total securities held to maturity	$20,023	$493	$—		$20,516
Total securities	$393,399	$7,696	($5,535	)	$395,560

As of September 30, 2016 and December 31, 2015, securities with a fair value of $559.0 million and $346.1 million, respectively, were pledged as collateral for Federal Home Loan Bank of Boston (“FHLBB”) borrowings, potential borrowings with the FRB, certain public deposits and for other purposes. See Note 7 for additional disclosure on FHLBB borrowings.

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

(Dollars in thousands)	Available for Sale		Held to Maturity	
September 30, 2016	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$70,876	$72,201	$4,019	$4,172
Due after one year to five years	187,480	190,915	8,835	9,173
Due after five years to ten years	185,358	187,402	3,394	3,524
Due after ten years	116,253	113,738	600	623
Total securities	$559,967	$564,256	$16,848	$17,492

Included in the above table are debt securities with an amortized cost balance of $122.5 million and a fair value of $118.5 million at September 30, 2016 that are callable at the discretion of the issuers. Final maturities of the callable securities range from 5 months to 20 years, with call features ranging from 1 month to 5 years.

Other-Than-Temporary Impairment Assessment

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

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Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

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

(Dollars in thousands)	Less than 12 Months			12 Months or Longer			Total		
September 30, 2016	#	Fair Value	Unrealized Losses	#	Fair Value	Unrealized Losses	#	Fair Value	Unrealized Losses
Obligations of U.S. government-sponsored enterprises	2	$29,935	($65)	—	$—	$—	2	$29,935	($65)
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	8	136,398	(307)	—	—	—	8	136,398	(307)
Individual name issuer trust preferred debt securities	—	—	—	10	25,684	(4,158)	10	25,684	(4,158)
Total temporarily impaired securities	10	$166,333	($372)	10	$25,684	($4,158)	20	$192,017	($4,530)

(Dollars in thousands)	Less than 12 Months			12 Months or Longer			Total		
December 31, 2015	#	Fair Value	Unrealized Losses	#	Fair Value	Unrealized Losses	#	Fair Value	Unrealized Losses
Obligations of U.S. government-sponsored enterprises	4	$34,767	($388)	—	$—	$—	4	$34,767	($388)
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	9	61,764	(450)	—	—	—	9	61,764	(450)
Individual name issuer trust preferred debt securities	—	—	—	10	25,138	(4,677)	10	25,138	(4,677)
Corporate bonds	3	1,235	(20)	—	—	—	3	1,235	(20)
Total temporarily impaired securities	16	$97,766	($858)	10	$25,138	($4,677)	26	$122,904	($5,535)

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

Unrealized losses on temporarily impaired securities as of September 30, 2016 were concentrated in variable rate trust preferred debt securities.

Trust Preferred Debt Securities of Individual Name Issuers

Included in debt securities in an unrealized loss position at September 30, 2016 were 10 trust preferred security holdings issued by 7 individual companies in the banking sector. Management believes the unrealized loss position in these holdings was attributable to the general widening of spreads for this category of debt securities issued by financial services companies since the time these securities were purchased. Based on the information available through the filing date of this report, all individual name issuer trust preferred debt securities held in our portfolio continue to accrue and make payments as expected with no payment deferrals or defaults on the part of the issuers. As of September 30, 2016, individual name issuer trust preferred debt securities with an amortized cost of $10.9 million and unrealized losses of $1.5 million were rated below investment grade by Standard & Poors, Inc. ("S&P"). Management reviewed the collectibility of these securities taking into consideration such factors as the financial condition of the issuers, reported regulatory capital ratios of the issuers, credit ratings, including ratings in effect as of the reporting period date as well as credit rating changes between the reporting period date and the filing date of this report, and other information. We noted no additional downgrades to below investment grade between September 30, 2016 and the filing date of this report. Based on this review, management concluded that it expects to recover the entire amortized cost basis of these securities. Furthermore, Washington Trust does not intend to sell these securities and it is not more-likely-than-not that Washington Trust will be required to sell these securities before recovery of their cost basis, which may be maturity. Therefore, management does not consider these investments to be other-than-temporarily impaired at September 30, 2016.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

U.S. Government Agency and U.S. Government-Sponsored Enterprise Securities, including Mortgage-Backed Securities

The gross unrealized losses on these securities, were primarily attributable to relative changes in interest rates since the time of purchase. The contractual cash flows for these securities are guaranteed by U.S. government agencies and U.S. government-sponsored enterprises. Based on the assessment of these factors, management believes that the unrealized losses on these debt security holdings are a function of changes in investment spreads and interest rate movements and not changes in credit quality. Management expects to recover the entire amortized cost basis of these securities. Furthermore, the Corporation does not intend to sell these securities and it is not more-likely-than-not that Washington Trust will be required to sell these securities before recovery of their cost basis, which may be maturity. Therefore, management does not consider these investments to be other-than-temporarily impaired at September 30, 2016.

(5) Loans

The following is a summary of loans:

(Dollars in thousands)	September 30, 2016			December 31, 2015		
	Amount	%		Amount	%	
Commercial:						
Mortgages (1)	$1,086,175	34	%	$931,953	31	%
Construction & development (2)	98,735	3		122,297	4	
Commercial & industrial (3)	572,305	18		600,297	20	
Total commercial	1,757,215	55		1,654,547	55	
Residential real estate:						
Mortgages	1,052,829	33		984,437	33	
Homeowner construction	27,058	1		29,118	1	
Total residential real estate	1,079,887	34		1,013,555	34	
Consumer:						
Home equity lines	265,238	8		255,565	8	
Home equity loans	38,264	1		46,649	2	
Other (4)	40,751	2		42,811	1	
Total consumer	344,253	11		345,025	11	
Total loans (5)	$3,181,355	100	%	$3,013,127	100	%

(1) Loans primarily secured by income producing property.

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

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

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

(5) Includes net unamortized loan origination costs of $2.8 million and $2.6 million, respectively, at September 30, 2016 and December 31, 2015 and net unamortized premiums on purchased loans of $641 thousand and $84 thousand, respectively, at September 30, 2016 and December 31, 2015.

At September 30, 2016 and December 31, 2015, there were $1.5 billion and $1.3 billion, respectively, of loans pledged as collateral to the FHLBB under a blanket pledge agreement and to the FRB for the discount window. See Note 7 for additional disclosure regarding borrowings.

Nonaccrual Loans

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

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

as to principal and interest for approximately 6 months, the borrower has demonstrated an ability to comply with repayment terms, and when, in management's opinion, the loans are considered to be fully collectible.

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

(Dollars in thousands)	Sep 30, 2016	Dec 31, 2015
Commercial:		
Mortgages	$10,357	$5,711
Construction & development	—	—
Commercial & industrial	1,744	3,018
Residential real estate:		
Mortgages	10,140	10,666
Homeowner construction	—	—
Consumer:		
Home equity lines	271	528
Home equity loans	1,322	1,124
Other	116	—
Total nonaccrual loans	$23,950	$21,047
Accruing loans 90 days or more past due	$—	$—

As of September 30, 2016 and December 31, 2015, loans secured by one- to four-family residential property amounting to $5.0 million and $2.6 million, respectively, were in process of foreclosure.

Nonaccrual loans of $5.2 million and $7.4 million, respectively, were current as to the payment of principal and interest at September 30, 2016 and December 31, 2015.

There were no significant commitments to lend additional funds to borrowers whose loans were on nonaccrual status at September 30, 2016.

Past Due Loans

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

(Dollars in thousands)	Days Past Due					
September 30, 2016	30-59	60-89	Over 90	Total Past Due	Current	Total Loans
Commercial:						
Mortgages	$—	$2,497	$7,855	$10,352	$1,075,823	$1,086,175
Construction & development	—	—	—	—	98,735	98,735
Commercial & industrial	—	—	1,047	1,047	571,258	572,305
Residential real estate:						
Mortgages	2,737	860	4,694	8,291	1,044,538	1,052,829
Homeowner construction	—	—	—	—	27,058	27,058
Consumer:						
Home equity lines	110	—	—	110	265,128	265,238
Home equity loans	412	166	731	1,309	36,955	38,264
Other	35	2	109	146	40,605	40,751

Total loans	$3,294	$3,525	$14,436	$21,255	$3,160,100	$3,181,355

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(Dollars in thousands)	Days Past Due					
December 31, 2015	30-59	60-89	Over 90	Total Past Due	Current	Total Loans
Commercial:						
Mortgages	$51	$—	$4,504	$4,555	$927,398	$931,953
Construction & development	—	—	—	—	122,297	122,297
Commercial & industrial	405	9	48	462	599,835	600,297
Residential real estate:						
Mortgages	3,028	2,964	3,294	9,286	975,151	984,437
Homeowner construction	—	—	—	—	29,118	29,118
Consumer:						
Home equity lines	883	373	518	1,774	253,791	255,565
Home equity loans	748	490	222	1,460	45,189	46,649
Other	22	—	—	22	42,789	42,811
Total loans	$5,137	$3,836	$8,586	$17,559	$2,995,568	$3,013,127

Included in past due loans as of September 30, 2016 and December 31, 2015, were nonaccrual loans of $18.8 million and $13.6 million, respectively.

All loans 90 days or more past due at September 30, 2016 and December 31, 2015 were classified as nonaccrual.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

Impaired Loans

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

The following is a summary of impaired loans:

(Dollars in thousands)	Recorded Investment (1)		Unpaid Principal		Related Allowance	
	Sep 30, 2016	Dec 31, 2015	Sep 30, 2016	Dec 31, 2015	Sep 30, 2016	Dec 31, 2015
No Related Allowance Recorded:						
Commercial:						
Mortgages	$3,980	$4,292	$4,903	$5,101	$—	$—
Construction & development	—	—	—	—	—	—
Commercial & industrial	1,945	1,849	2,056	1,869	—	—
Residential real estate:						
Mortgages	13,029	8,441	13,200	8,826	—	—
Homeowner construction	—	—	—	—	—	—
Consumer:						
Home equity lines	271	6	271	64	—	—
Home equity loans	1,323	530	1,344	539	—	—
Other	112	—	112	—	—	—
Subtotal	20,660	15,118	21,886	16,399	—	—
With Related Allowance Recorded:						
Commercial:						
Mortgages	$7,567	$10,873	$9,427	$10,855	$972	$1,633
Construction & development	—	—	—	—	—	—
Commercial & industrial	460	2,024	511	2,248	15	771
Residential real estate:						
Mortgages	1,047	2,895	1,073	2,941	201	156
Homeowner construction	—	—	—	—	—	—
Consumer:						
Home equity lines	—	522	—	522	—	2
Home equity loans	79	679	79	783	1	21
Other	34	145	33	144	5	—
Subtotal	9,187	17,138	11,123	17,493	1,194	2,583
Total impaired loans	$29,847	$32,256	$33,009	$33,892	$1,194	$2,583
Total:						
Commercial	$13,952	$19,038	$16,897	$20,073	$987	$2,404
Residential real estate	14,076	11,336	14,273	11,767	201	156
Consumer	1,819	1,882	1,839	2,052	6	23
Total impaired loans	$29,847	$32,256	$33,009	$33,892	$1,194	$2,583

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

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Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

The following tables present the average recorded investment balance of impaired loans and interest income recognized on impaired loans segregated by loan class. Prior to the third quarter of 2015, the Corporation had defined impaired loans to include nonaccrual commercial loans, troubled debt restructured loans and certain other loans that were individually evaluated for impairment. In the third quarter of 2015, the Corporation redefined impaired loans to include nonaccrual loans and troubled debt restructured loans. The redefinition of impaired loans resulted in well-secured nonaccrual residential real estate mortgage loans and consumer loans being classified as impaired loans in the third quarter of 2015. See further discussion on the redefinition of impaired loans in Washington Trust's Form 10-K for the fiscal year ended December 31, 2015.

(Dollars in thousands)	Average Recorded Investment		Interest Income Recognized	
Three months ended September 30,	2016	2015	2016	2015
Commercial:				
Mortgages	$13,159	$14,583	$40	$82
Construction & development	—	—	—	—
Commercial & industrial	2,342	3,376	21	29
Residential real estate:				
Mortgages	13,962	4,484	86	27
Homeowner construction	—	—	—	—
Consumer:				
Home equity lines	297	157	2	1
Home equity loans	1,328	515	9	3
Other	145	354	3	2
Totals	$31,233	$23,469	$161	$144

(Dollars in thousands)	Average Recorded Investment		Interest Income Recognized	
Nine months ended September 30,	2016	2015	2016	2015
Commercial:				
Mortgages	$13,856	$14,692	$220	$237
Construction & development	—	—	—	—
Commercial & industrial	3,141	3,164	42	89
Residential real estate:				
Mortgages	11,985	3,735	253	67
Homeowner construction	—	—	—	—
Consumer:				
Home equity lines	427	227	10	1
Home equity loans	1,240	224	33	4
Other	147	231	7	7
Totals	$30,796	$22,273	$565	$405

Troubled Debt Restructurings

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

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

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

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

Troubled debt restructurings are classified as impaired loans. The Corporation identifies loss allocations for impaired loans on an individual loan basis. The recorded investment in troubled debt restructurings was $18.5 million at both September 30, 2016 and December 31, 2015. These amounts included insignificant balances of accrued interest. The allowance for loan losses included specific reserves for these troubled debt restructurings of $1.1 million and $1.8 million, respectively, at September 30, 2016 and December 31, 2015.

As of September 30, 2016, there were no significant commitments to lend additional funds to borrowers whose loans had been restructured.

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

(Dollars in thousands)			Outstanding Recorded Investment (1)			
	# of Loans		Pre-Modifications		Post-Modifications	
Three months ended September 30,	2016	2015	2016	2015	2016	2015
Commercial:						
Mortgages	—	1	$—	$1,190	$—	$1,190
Construction & development	—	—	—	—	—	—
Commercial & industrial	5	—	914	—	914	—
Residential real estate:						
Mortgages	—	2	—	526	—	526
Homeowner construction	—	—	—	—	—	—
Consumer:						
Home equity lines	—	—	—	—	—	—
Home equity loans	—	—	—	—	—	—
Other	—	—	—	—	—	—
Totals	5	3	$914	$1,716	$914	$1,716

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

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(Dollars in thousands)			Outstanding Recorded Investment (1)			
	# of Loans		Pre-Modifications		Post-Modifications	
Nine months ended September 30,	2016	2015	2016	2015	2016	2015
Commercial:						
Mortgages	—	1	$—	$1,190	$—	$1,190
Construction & development	—	—	—	—	—	—
Commercial & industrial	6	3	1,047	584	1,047	584
Residential real estate:						
Mortgages	1	3	3,550	619	3,550	619
Homeowner construction	—	—	—	—	—	—
Consumer:						
Home equity lines	—	—	—	—	—	—
Home equity loans	—	1	—	70	—	70
Other	—	1	—	35	—	35
Totals	7	9	$4,597	$2,498	$4,597	$2,498

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

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

(Dollars in thousands)				
	Three months		Nine months	
Periods ended September 30,	2016	2015	2016	2015
Below-market interest rate concession	$—	$—	$—	$—
Payment deferral	—	526	—	1,145
Maturity / amortization concession	324	—	457	163
Interest only payments	—	—	3,550	—
Combination (1)	590	1,190	590	1,190
Total	$914	$1,716	$4,597	$2,498

(1) Loans included in this classification were modified with a combination of any two of the concessions listed in this table.

In the three and nine months ended September 30, 2016 and 2015, there were an insignificant amount of loans modified in a troubled debt restructuring within the previous twelve months for which there were payment defaults.

Credit Quality Indicators

Commercial

The Corporation utilizes an internal rating system to assign a risk to each of its commercial loans. Loans are rated on a scale of 1 to 10. This scale can be assigned to three broad categories including “pass” for ratings 1 through 6, “special mention” for 7-rated loans, and “classified” for loans rated 8, 9 or 10. The loan rating system takes into consideration parameters including the borrower’s financial condition, the borrower’s performance with respect to loan terms, the adequacy of collateral, the adequacy of guarantees and other credit quality characteristics. The weighted average risk rating of the Corporation’s commercial loan portfolio was 4.70 at September 30, 2016 and 4.68 at December 31, 2015. For non-impaired loans, the Corporation takes the risk rating into consideration along with other credit attributes in the establishment of an appropriate allowance for loan losses.

A description of the commercial loan categories are as follows:

Pass - Loans with acceptable credit quality, defined as ranging from superior or very strong to a status of lesser stature. Superior

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

or very strong credit quality is characterized by a high degree of cash collateralization or strong balance sheet liquidity. Lesser stature loans have an acceptable level of credit quality but exhibit some weakness in various credit metrics such as collateral adequacy, cash flow, secondary sources of repayment, or performance inconsistency or may be in an industry or of a loan type known to have a higher degree of risk.

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

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

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

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

(Dollars in thousands)	Pass		Special Mention		Classified	
	Sep 30, 2016	Dec 31, 2015	Sep 30, 2016	Dec 31, 2015	Sep 30, 2016	Dec 31, 2015
Commercial:						
Mortgages	$1,074,473	$914,774	$1,099	$3,035	$10,603	$14,144
Construction & development	98,735	122,297	—	—	—	—
Commercial & industrial	548,154	577,036	15,465	12,012	8,686	11,249
Total commercial loans	$1,721,362	$1,614,107	$16,564	$15,047	$19,289	$25,393

Residential and Consumer

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

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

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

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

(Dollars in thousands)	Current and Under 90 Days Past Due		Over 90 Days Past Due	
	Sep 30, 2016	Dec 31, 2015	Sep 30, 2016	Dec 31, 2015
Residential real estate:				
Accruing mortgages	$1,042,689	$973,771	$—	$—
Nonaccrual mortgages	5,446	7,372	4,694	3,294
Homeowner construction	27,058	29,118	—	—
Total residential loans	$1,075,193	$1,010,261	$4,694	$3,294
Consumer:				
Home equity lines	$265,238	$255,047	$—	$518
Home equity loans	37,533	46,427	731	222
Other	40,642	42,811	109	—
Total consumer loans	$343,413	$344,285	$840	$740

(6) Allowance for Loan Losses

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

Prior to December 31, 2015, an unallocated allowance was maintained for measurement imprecision associated with impaired and nonaccrual loans. As a result of further enhancement and refinement of the allowance methodology to provide a more precise quantification of probable losses in the loan portfolio, management concluded that the potential risks anticipated by the unallocated allowance have been incorporated into the allocated component of the methodology, eliminating the need for the unallocated allowance in the fourth quarter of 2015.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

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

(Dollars in thousands)	Commercial						
	Mortgages	Construction	C&I (1)	Total Commercial	Residential	Consumer	Total
Beginning Balance	$10,413	$904	$6,520	$17,837	$5,469	$2,520	$25,826
Charge-offs	(1,940)	—	(3)	(1,943)	(52)	(60)	(2,055)
Recoveries	4	—	46	50	5	23	78
Provision	1,981	78	(59)	2,000	(21)	(179)	1,800
Ending Balance	$10,458	$982	$6,504	$17,944	$5,401	$2,304	$25,649

(1) Commercial & industrial loans.

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

(Dollars in thousands)	Commercial						
	Mortgages	Construction	C&I (1)	Total Commercial	Residential	Consumer	Total
Beginning Balance	$9,140	$1,758	$8,202	$19,100	$5,460	$2,509	$27,069
Charge-offs	(3,271)	—	(757)	(4,028)	(192)	(170)	(4,390)
Recoveries	21	—	134	155	9	56	220
Provision	4,568	(776)	(1,075)	2,717	124	(91)	2,750
Ending Balance	$10,458	$982	$6,504	$17,944	$5,401	$2,304	$25,649

(1) Commercial & industrial loans.

The following table presents the activity in the allowance for loan losses for the three months ended September 30, 2015:

(Dollars in thousands)	Commercial							
	Mortgages	Construction	C&I (1)	Total Commercial	Residential	Consumer	Un-allocated	Total
Beginning Balance	$8,529	$1,684	$7,010	$17,223	$5,405	$2,683	$2,276	$27,587
Charge-offs	—	—	(378)	(378)	(34)	(313)	—	(725)
Recoveries	4	—	30	34	22	43	—	99
Provision	(38)	5	691	658	150	(164)	(444)	200
Ending Balance	$8,495	$1,689	$7,353	$17,537	$5,543	$2,249	$1,832	$27,161

(1) Commercial & industrial loans.

The following table presents the activity in the allowance for loan losses for the nine months ended September 30, 2015:

(Dollars in thousands)	Commercial							
	Mortgages	Construction	C&I (1)	Total Commercial	Residential	Consumer	Un-allocated	Total
Beginning Balance	$8,202	$1,300	$7,987	$17,489	$5,430	$2,713	$2,391	$28,023
Charge-offs	(400)	—	(429)	(829)	(88)	(484)	—	(1,401)

Recoveries	88	—	62	150	26	63	—	239
Provision	605	389	(267)	727	175	(43)	(559)	300
Ending Balance	$8,495	$1,689	$7,353	$17,537	$5,543	$2,249	$1,832	$27,161

(1) Commercial & industrial loans.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

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

(Dollars in thousands)	September 30, 2016		December 31, 2015	
	Loans	Related Allowance	Loans	Related Allowance
Loans Individually Evaluated for Impairment:				
Commercial:				
Mortgages	$11,546	$972	$15,141	$1,633
Construction & development	—	—	—	—
Commercial & industrial	2,403	15	3,871	771
Residential real estate	14,067	201	11,333	156
Consumer	1,818	6	1,881	23
Subtotal	29,834	1,194	32,226	2,583
Loans Collectively Evaluated for Impairment:				
Commercial:				
Mortgages	$1,074,629	$9,486	$916,812	$7,507
Construction & development	98,735	982	122,297	1,758
Commercial & industrial	569,902	6,489	596,426	7,431
Residential real estate	1,065,820	5,200	1,002,222	5,304
Consumer	342,435	2,298	343,144	2,486
Subtotal	3,151,521	24,455	2,980,901	24,486
Total	$3,181,355	$25,649	$3,013,127	$27,069

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(7) Borrowings
Federal Home Loan Bank Advances
Advances payable to the FHLBB amounted to $671.6 million and $379.0 million, respectively, at September 30, 2016 and December 31, 2015.

The following table presents maturities and weighted average interest rates on FHLBB advances outstanding as of September 30, 2016:

(Dollars in thousands)	Total Outstanding	Weighted Average Rate	
October 1, 2016 to December 31, 2016	$217,685	0.72	%
2017	100,075	1.16	
2018	78,134	1.35	
2019	120,758	1.67	
2020	38,983	2.21	
2021 and thereafter	115,980	3.30	
Balance at September 30, 2016	$671,615	1.56	%

As of September 30, 2016 and December 31, 2015, the Bank had access to a $40.0 million unused line of credit with the FHLBB and also had remaining available borrowing capacity of $611.4 million and $644.8 million, respectively. The Bank pledges certain qualified investment securities and loans as collateral to the FHLBB.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(8) Shareholders' Equity
Regulatory Capital Requirements
Capital levels at both September 30, 2016 and December 31, 2015 exceeded the regulatory minimum levels to be considered well-capitalized.

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

(Dollars in thousands)	Actual		For Capital Adequacy Purposes		To Be "Well Capitalized" Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2016						
Total Capital (to Risk-Weighted Assets):						
Corporation	$382,766	12.31 %	$248,761	8.00 %	N/A	N/A
Bank	382,421	12.30	248,747	8.00	$310,934	10.00 %
Tier 1 Capital (to Risk-Weighted Assets):						
Corporation	356,938	11.48	186,570	6.00	N/A	N/A
Bank	356,593	11.47	186,561	6.00	248,747	8.00
Common Equity Tier 1 Capital (to Risk-Weighted Assets):						
Corporation	334,939	10.77	139,928	4.50	N/A	N/A
Bank	356,593	11.47	139,920	4.50	202,107	6.50
Tier 1 Capital (to Average Assets): (1)						
Corporation	356,938	8.95	159,610	4.00	N/A	N/A
Bank	356,593	8.94	159,543	4.00	199,429	5.00
December 31, 2015						
Total Capital (to Risk-Weighted Assets):						
Corporation	367,443	12.58	233,739	8.00	N/A	N/A
Bank	366,676	12.55	233,676	8.00	292,095	10.00
Tier 1 Capital (to Risk-Weighted Assets):						
Corporation	340,130	11.64	175,304	6.00	N/A	N/A
Bank	339,363	11.62	175,257	6.00	233,676	8.00
Common Equity Tier 1 Capital (to Risk-Weighted Assets):						
Corporation	318,131	10.89	131,478	4.50	N/A	N/A
Bank	339,363	11.62	131,443	4.50	189,861	6.50
Tier 1 Capital (to Average Assets): (1)						
Corporation	340,130	9.37	145,191	4.00	N/A	N/A
Bank	339,363	9.36	145,103	4.00	181,378	5.00

(1) Leverage ratio.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(9) Derivative Financial Instruments

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

Interest Rate Risk Management Agreements

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

Cash Flow Hedging Instruments

As of September 30, 2016 and December 31, 2015, the Bancorp had two interest rate caps with a notional amount of $22.7 million that were designated as cash flow hedges to hedge the interest rate risk associated with our variable rate junior subordinated debentures. In the fourth quarter of 2015, the Bancorp entered into the interest rate cap contracts and paid a premium totaling $257 thousand to obtain the right to receive the difference between 3-month LIBOR and a 4.5% strike for both of the interest rate caps. The caps mature in 2020. Prior to December 31, 2015, the Bancorp had two interest rate swap contracts designated as cash flow hedges to hedge the interest rate risk associated with the junior subordinated debentures noted above. During 2015, both interest rate swaps contracts matured. The effective portion of the changes in fair value of derivatives designated as cash flow hedges is recorded in other comprehensive income and subsequently reclassified to earnings when gains or losses are realized. The ineffective portion of changes in fair value of the derivatives is recognized directly in earnings as interest expense.

Loan Related Derivative Contracts

Interest Rate Swap Contracts with Customers

The Corporation has entered into interest rate swap contracts to help commercial loan borrowers manage their interest rate risk. The interest rate swap contracts with commercial loan borrowers allow them to convert floating-rate loan payments to fixed-rate loan payments. When we enter into an interest rate swap contract with a commercial loan borrower, we simultaneously enter into a "mirror" swap contract with a third party. The third party exchanges the client's fixed-rate loan payments for floating-rate loan payments. We retain the risk that is associated with the potential failure of counterparties and the risk inherent in originating loans. As of September 30, 2016 and December 31, 2015, Washington Trust had interest rate swap contracts with commercial loan borrowers with notional amounts of $446.3 million and $302.1 million, respectively, and equal amounts of "mirror" swap contracts with third-party financial institutions. These derivatives are not designated as hedges and therefore, changes in fair value are recognized in earnings.

Risk Participation Agreements

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

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

At September 30, 2016 and December 31, 2015, the notional amounts of risk participation-out agreements were $38.5 million and $25.3 million, respectively. The notional amounts of risk participation-in agreements at both September 30, 2016 and December 31, 2015 were $21.5 million.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

Loan Commitments

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

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

(Dollars in thousands)	Asset Derivatives			Liability Derivatives		
		Fair Value			Fair Value	
	Balance Sheet Location	Sep 30, 2016	Dec 31, 2015	Balance Sheet Location	Sep 30, 2016	Dec 31, 2015
Derivatives Designated as Cash Flow Hedging Instruments:						
Interest rate risk management contracts:						
Interest rate caps	Other assets	$38	$187	Other liabilities	$—	$—
Derivatives not Designated as Hedging Instruments:						
Forward loan commitments:						
Interest rate lock commitments	Other assets	3,629	1,220	Other liabilities	22	—
Commitments to sell mortgage loans	Other assets	34	—	Other liabilities	4,891	2,012
Loan related derivative contracts:						
Interest rate swaps with customers	Other assets	21,143	8,027	Other liabilities	—	—
Mirror swaps with counterparties	Other assets	—	—	Other liabilities	21,761	8,266
Risk participation agreements	Other assets	3	56	Other liabilities	126	69
Total		$24,847	$9,490		$26,800	$10,347

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

(Dollars in thousands)	Gain (Loss) Recognized in Other Comprehensive Income (Effective Portion)				Location of Gain (Loss) Recognized in Income (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Gain (Loss) Recognized in Income (Ineffective Portion)			
	Three months		Nine months			Three months		Nine months	
Periods ended September 30,	2016	2015	2016	2015		2016	2015	2016	2015
Derivatives Designated as Cash Flow Hedging Instruments:									
Interest rate risk management contracts:									

Interest rate swap contracts	$—	$81	$—	$255	Interest Expense	$—	$—	$—	$—
Interest rate caps	(4)	—	(94)	—	Interest Expense	—	—	—	—
Total	($4)	$81	($94)	$255		$—	$—	$—	$—

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(Dollars in thousands)		Amount of Gain (Loss) Recognized in Income on Derivatives Three months		Amount of Gain (Loss) Recognized in Income on Derivatives Nine months	
Periods ended September 30,	Statement of Income Location	2016	2015	2016	2015
Derivatives not Designated as Hedging Instruments:					
Forward loan commitments:					
Interest rate lock commitments	Mortgage banking revenues	$641	$864	$2,387	$1,002
Commitments to sell mortgage loans	Mortgage banking revenues	(665)	(1,470)	(2,845)	(999)
Customer related derivative contracts:					
Interest rate swaps with customers	Loan related derivative income	32	6,448	17,064	8,717
Mirror swaps with counterparties	Loan related derivative income	1,250	(6,081)	(14,527)	(6,799)
Risk participation agreements	Loan related derivative income	(104)	(40)	(206)	(229)
Total		$1,154	($279)	$1,873	$1,692

(10) Fair Value Measurements

The Corporation uses fair value measurements to record fair value adjustments on certain assets and liabilities and to determine fair value disclosures. As of September 30, 2016 and December 31, 2015, securities available for sale, certain residential real estate mortgage loans held for sale, derivatives and the contingent consideration liability are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other assets on a nonrecurring basis, such as collateral dependent impaired loans, property acquired through foreclosure or repossession, certain residential real estate mortgage loans held for sale and mortgage servicing rights. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write-downs of individual assets.

Fair value is a market-based measurement, not an entity-specific measurement. Fair value measurements are determined based on the assumptions the market participants would use in pricing the asset or liability. In addition, GAAP specifies a hierarchy of valuation techniques based on whether the types of valuation information ("inputs") are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Corporation's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 – Quoted prices for identical assets or liabilities in active markets.
- Level 2 – Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.
- Level 3 – Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable in the markets and which reflect the Corporation's market assumptions.

Fair Value Option Election

GAAP allows for the irrevocable option to elect fair value accounting for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. The Corporation has elected the fair value option for certain residential real estate mortgage loans held for sale to better match changes in fair value of the loans with changes in the fair value of the derivative loan sale contracts used to economically hedge them.

The aggregate principal amount of the residential real estate mortgage loans held for sale that were recorded at fair value was $43.8 million and $33.2 million, respectively, at September 30, 2016 and December 31, 2015. The aggregate fair value of these loans as of the same dates was $45.2 million and $34.0 million, respectively. As of September 30, 2016 and December 31, 2015, the aggregate fair value of residential real estate mortgage loans held for sale exceeded the aggregate principal amount by $1.3 million and $731 thousand, respectively.

There were no residential real estate mortgage loans held for sale 90 days or more past due as of September 30, 2016 and December 31, 2015.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

The following table presents the changes in fair value related to mortgage loans held for sale, interest rate lock commitments and commitments to sell residential real estate mortgage loans, for which the fair value option was elected. Changes in fair values are reported as a component of mortgage banking revenues in the Consolidated Statements of Income.
(Dollars in thousands)

	Three months		Nine months	
Periods ended September 30,	2016	2015	2016	2015
Mortgage loans held for sale	$117	$490	$612	($79)
Interest rate lock commitments	641	864	2,387	1,002
Commitments to sell mortgage loans	(665)	(1,470)	(2,845)	(999)
Total changes in fair value	$93	($116)	$154	($76)

Valuation Techniques

Securities

Securities available for sale are recorded at fair value on a recurring basis. When available, the Corporation uses quoted market prices to determine the fair value of securities; such items are classified as Level 1. There were no Level 1 securities held at September 30, 2016 and December 31, 2015.

Level 2 securities include debt securities with quoted prices, which are traded less frequently than exchange-traded instruments. The fair value of these securities is determined using matrix pricing with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category includes obligations of U.S. government-sponsored enterprises, mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises, obligations of states and political subdivisions, individual name issuer trust preferred debt securities and corporate bonds.

Securities not actively traded whose fair value is determined through the use of cash flows utilizing inputs that are unobservable are classified as Level 3. There were no Level 3 securities held at September 30, 2016 and December 31, 2015.

Mortgage Loans Held for Sale

The fair value of mortgage loans held for sale is estimated based on current market prices for similar loans in the secondary market and therefore are classified as Level 2 assets.

Collateral Dependent Impaired Loans

The fair value of collateral dependent loans that are deemed to be impaired is determined based upon the fair value of the underlying collateral. Such collateral primarily consists of real estate and, to a lesser extent, other business assets. For collateral dependent loans for which repayment is dependent on the sale of the collateral, management adjusts the fair value for estimated costs to sell. For collateral dependent loans for which repayment is dependent on the operation of the collateral, such as accruing troubled debt restructured loans, estimated costs to sell are not incorporated into the measurement. Management may also adjust appraised values to reflect estimated market value declines or apply other discounts to appraised values resulting from its knowledge of the property. Internal valuations are utilized to determine the fair value of other business assets. Collateral dependent impaired loans are categorized as Level 3.

Loan Servicing Rights

Loans sold with the retention of servicing result in the recognition of loan servicing rights. Loan servicing rights are included in other assets in the Consolidated Balance Sheets and are amortized as an offset to mortgage banking revenues over the estimated period of servicing. Loan servicing rights are evaluated quarterly for impairment based on their fair value. Impairment exists if the carrying value exceeds the estimated fair value. Impairment is measured on an aggregated basis by stratifying the loan servicing rights based on homogeneous characteristics such as note rate and loan type. The fair value is estimated using an independent valuation model that estimates the present value of expected cash flows, incorporating assumptions for discount rates and prepayment rates. Any impairment is recognized through a valuation allowance and as a reduction to mortgage banking revenues. Loan servicing rights are categorized as Level 3.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

Property Acquired Through Foreclosure or Repossession
Property acquired through foreclosure or repossession included in other assets in the Consolidated Balance Sheets is adjusted to fair value less costs to sell upon transfer out of loans through a charge to allowance for loan losses. Subsequently, it is carried at the lower of carrying value or fair value less costs to sell. Such subsequent valuation charges are charged through earnings. Fair value is generally based upon appraised values of the collateral. Management may adjust appraised values to reflect estimated market value declines or apply other discounts to appraised values for unobservable factors resulting from its knowledge of the property, and such property is categorized as Level 3.

Derivatives
Interest rate swap and cap contracts are traded in over-the-counter markets where quoted market prices are not readily available. Fair value measurements are determined using independent pricing models that utilize primarily market observable inputs, such as swap rates of different maturities and LIBOR rates. The Corporation also evaluates the credit risk of its counterparties as well as that of the Corporation. Accordingly, Washington Trust considers factors such as the likelihood of default by the Corporation and its counterparties, its net exposures and remaining contractual life, among other factors, in determining if any fair value adjustments related to credit risk are required. Counterparty exposure is evaluated by netting positions that are subject to master netting agreements, as well as considering the amount of collateral securing the position. Although the Corporation has determined that the majority of the inputs used to value its interest rate swap and cap contracts fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with interest rate contracts and risk participation agreements utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by the Corporation and its counterparties. However, as of September 30, 2016 and December 31, 2015, the Corporation has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Corporation has classified its derivative valuations in their entirety as Level 2.

Fair value measurements of forward loan commitments (interest rate lock commitments and commitments to sell residential real estate mortgages) are estimated based on current market prices for similar assets in the secondary market and therefore are classified as Level 2 assets.

Contingent Consideration Liability
A contingent consideration liability was recognized upon the completion of the Halsey Associates, Inc. (“Halsey”) acquisition on August 1, 2015 and represents the estimated present value of future earn-outs to be paid based on the future revenue growth of the acquired business during the 5-year period following the acquisition.

The fair value measurement is based upon unobservable inputs, therefore, the contingent liability is classified within Level 3 of the fair value hierarchy. The unobservable inputs include probability estimates regarding the likelihood of achieving revenue growth targets and the discount rates utilized the discounted cash flow calculations applied to the estimates earn-outs to be paid. The discount rates used ranged from 3% to 4%. The contingent consideration liability is remeasured to fair value at each reporting period taking into consideration changes in those unobservable inputs. Changes in the fair value of the contingent consideration liability are included in noninterest expenses in the Consolidated Statements of Income.

The fair value of the contingency represents the estimated price to transfer the liability between market participants at the measurement date under current market conditions.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

Items Recorded at Fair Value on a Recurring Basis

The following tables present the balances of assets and liabilities reported at fair value on a recurring basis:

(Dollars in thousands) September 30, 2016	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Securities available for sale:				
Obligations of U.S. government-sponsored enterprises	$75,484	$—	$75,484	$—
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	442,687	—	442,687	—
Obligations of states and political subdivisions	18,396	—	18,396	—
Individual name issuer trust preferred debt securities	25,684	—	25,684	—
Corporate bonds	2,005	—	2,005	—
Mortgage loans held for sale	45,162	—	45,162	—
Derivative assets (1)	24,847	—	24,847	—
Total assets at fair value on a recurring basis	$634,265	$—	$634,265	$—
Liabilities:				
Derivative liabilities (2)	$26,800	$—	$26,800	$—
Contingent consideration liability (3)	2,047	—	—	2,047
Total liabilities at fair value on a recurring basis	$28,847	$—	$26,800	$2,047

(1) Derivative assets include interest rate risk management agreements, interest rate swap contracts with customers, risk participation-out agreements and forward loan commitments and are included in other assets in the Consolidated Balance Sheets.

(2) Derivative liabilities include mirror swaps with counterparties, risk participation-in agreements and forward loan commitments and are included in other liabilities in the Consolidated Balance Sheets.

(3) The contingent consideration liability is included in other liabilities in the Consolidated Balance Sheets.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(Dollars in thousands)

December 31, 2015	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Securities available for sale:				
Obligations of U.S. government-sponsored enterprises	$77,015	$—	$77,015	$—
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	234,856	—	234,856	—
Obligations of states and political subdivisions	36,080	—	36,080	—
Individual name issuer trust preferred debt securities	25,138	—	25,138	—
Corporate bonds	1,955	—	1,955	—
Mortgage loans held for sale	33,969	—	33,969	—
Derivative assets (1)	9,490	—	9,490	—
Total assets at fair value on a recurring basis	$418,503	$—	$418,503	$—
Liabilities:				
Derivative liabilities (2)	$10,347	$—	$10,347	$—
Contingent Consideration Liability (3)	2,945	—	—	2,945
Total liabilities at fair value on a recurring basis	$13,292	$—	$10,347	$2,945

(1) Derivative assets include interest rate risk management agreements, interest rate swap contracts with customers, risk participation-out agreements and forward loan commitments and are included in other assets in the Consolidated Balance Sheets.

(2) Derivative liabilities include mirror swaps with counterparties, risk participation-in agreements and forward loan commitments and are included in other liabilities in the Consolidated Balance Sheets.

(3) The contingent consideration liability is included in other liabilities in the Consolidated Balance Sheets.

It is the Corporation's policy to review and reflect transfers between Levels as of the financial statement reporting date. During the nine months ended September 30, 2016 and 2015, there were no transfers in and/or out of Level 1, 2 or 3.

The following table presents the change in the contingent consideration liability, a Level 3 liability measured at fair value on a recurring basis, during the periods indicated:

(Dollars in thousands)

	Three months		Nine months	
Periods ended September 30,	2016	2015	2016	2015
Balance at beginning of period	$2,986	$—	$2,945	$—
Initial recognition	—	2,904	—	2,904
Change in fair value	(939)	16	(898)	16
Payments	—	—	—	—
Balance at end of period	$2,047	$2,920	$2,047	$2,920

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

Items Recorded at Fair Value on a Nonrecurring Basis

The following table presents the carrying value of assets held at September 30, 2016, which were written down to fair value during the nine months ended September 30, 2016:

(Dollars in thousands)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Collateral dependent impaired loans	$5,726	$—	$—	$5,726
Loan servicing rights	3,314	—	—	3,314
Property acquired through foreclosure or repossession	575	—	—	575
Total assets at fair value on a nonrecurring basis	$9,615	$—	$—	$9,615

The allowance for loan losses on collateral dependent impaired loans amounted to $1.0 million at September 30, 2016.

The following table presents the carrying value of assets held at December 31, 2015, which were written down to fair value during the year ended December 31, 2015:

(Dollars in thousands)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Collateral dependent impaired loans	$10,545	$—	$—	$10,545
Property acquired through foreclosure or repossession	270	—	—	270
Total assets at fair value on a nonrecurring basis	$10,815	$—	$—	$10,815

The allowance for loan losses on collateral dependent impaired loans amounted to $2.4 million at December 31, 2015.

The following tables present valuation techniques and unobservable inputs for assets measured at fair value on a nonrecurring basis for which the Corporation has utilized Level 3 inputs to determine fair value:

(Dollars in thousands)

September 30, 2016	Fair Value	Valuation Technique	Unobservable Input	Range of Inputs Utilized (Weighted Average)
Collateral dependent impaired loans	$5,726	Appraisals of collateral	Discount for costs to sell	0% - 20% (10%)

			Appraisal adjustments (1)	0% - 15% (14%)
Loan servicing rights	$3,314	Discounted Cash Flow	Discount rates	10% - 14% (11%)
			Prepayment rates	13% - 24% (16%)
Property acquired through foreclosure or repossession	$575	Appraisals of collateral	Discount for costs to sell	10%
			Appraisal adjustments (1)	6% - 15% (13%)

(1) Management may adjust appraisal values to reflect market value declines or other discounts resulting from its knowledge of the property.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(Dollars in thousands) December 31, 2015	Fair Value	Valuation Technique	Unobservable Input	Range of Inputs Utilized (Weighted Average)
Collateral dependent impaired loans	$10,545	Appraisals of collateral	Discount for costs to sell	0% - 20% (2%)
Property acquired through foreclosure or repossession	$270	Appraisals of collateral	Discount for costs to sell	12%
			Appraisal adjustments (1)	32%

(1) Management may adjust appraisal values to reflect market value declines or other discounts resulting from its knowledge of the property.

Valuation of Other Financial Instruments
The methodologies for estimating the fair value of financial instruments that are measured at fair value on a recurring or nonrecurring basis are discussed above. The methodologies for other financial instruments are discussed below.

Loans
Fair values are estimated for categories of loans with similar financial characteristics. Loans are segregated by type and are then further segmented into fixed-rate and adjustable-rate interest terms to determine their fair value. The fair value of fixed-rate commercial and consumer loans is calculated by discounting scheduled cash flows through the estimated maturity of the loan using interest rates offered at the measurement date that reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on the Corporation’s historical repayment experience. For residential mortgages, fair value is estimated by using market prices for sales of similar loans on the secondary market. The fair value of floating rate commercial and consumer loans approximates carrying value. Fair value for impaired loans is estimated using a discounted cash flow method based upon the loan’s contractual effective interest rate, or at the loan’s observable market price, or if the loan is collateral dependent, at the fair value of the collateral. Loans are classified within Level 3 of the fair value hierarchy.

Time Deposits
The discounted values of cash flows using the rates currently offered for deposits of similar remaining maturities were used to estimate the fair value of time deposits. Time deposits are classified within Level 2 of the fair value hierarchy.

Federal Home Loan Bank Advances
Rates currently available to the Corporation for advances with similar terms and remaining maturities are used to estimate fair value of existing advances. FHLBB advances are categorized as Level 2.

Junior Subordinated Debentures
The fair value of the junior subordinated debentures is estimated using rates currently available to the Corporation for debentures with similar terms and maturities. Junior subordinated debentures are categorized as Level 2.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

The following tables present the carrying amount, estimated fair value and placement in the fair value hierarchy of the Corporation's financial instruments. The tables exclude financial instruments for which the carrying value approximates fair value. Financial assets for which the fair value approximates carrying value include cash and cash equivalents, FHLBB stock, accrued interest receivable and bank-owned life insurance. Financial liabilities for which the fair value approximates carrying value include non-maturity deposits and accrued interest payable.

(Dollars in thousands)

September 30, 2016	Carrying Amount	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:					
Securities held to maturity	$16,848	$17,492	$—	$17,492	$—
Loans, net of allowance for loan losses	3,155,706	3,190,240	—	—	3,190,240
Financial Liabilities:					
Time deposits	$913,649	$916,994	$—	$916,994	$—
FHLBB advances	671,615	685,238	—	685,238	—
Junior subordinated debentures	22,681	16,732	—	16,732	—

(Dollars in thousands)

December 31, 2015	Carrying Amount	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:					
Securities held to maturity	$20,023	$20,516	$—	$20,516	$—
Loans, net of allowance for loan losses	2,986,058	3,004,782	—	—	3,004,782
Financial Liabilities:					
Time deposits	$833,898	$834,574	$—	$834,574	$—
FHLBB advances	378,973	388,275	—	388,275	—
Junior subordinated debentures	22,681	16,468	—	16,468	—

(11) Defined Benefit Pension Plans

The Corporation maintains a tax-qualified defined benefit pension plan for the benefit of certain eligible employees who were hired prior to October 1, 2007. The Corporation also has non-qualified retirement plans to provide supplemental retirement benefits to certain employees, as defined in the plans. The defined benefit pension plans were previously amended to freeze benefit accruals after a 10-year transition period ending in December 2023.

The defined benefit pension plan is funded on a current basis, in compliance with the requirements of ERISA.

Pension benefit costs and benefit obligations incorporate various actuarial and other assumptions, including discount rates, mortality, rates of return on plan assets and compensation increases. Washington Trust evaluates these assumptions annually. Prior to 2016, a single weighted-average discount rate was used to calculate interest and service cost components of net periodic benefit cost. For 2016, Washington Trust utilizes a "spot rate approach" in the calculation of interest and service cost. The spot rate approach applies separate discount rates for each projected benefit payment in the calculation of interest and service cost. This approach provides a more precise measurement of interest and service cost by improving the correlation between projected benefit cash flows and their corresponding spot rates. This change was made in conjunction with the annual evaluation of

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

assumptions and did not affect the measurement of the Corporation's defined benefit obligations at December 31, 2015. It is considered a change in accounting estimate and, accordingly, was accounted for prospectively starting in 2016.

The composition of net periodic benefit cost was as follows:

(Dollars in thousands)	Qualified Pension Plan				Non-Qualified Retirement Plans			
	Three months		Nine months		Three months		Nine months	
Periods ended September 30,	2016	2015	2016	2015	2016	2015	2016	2015
Net Periodic Benefit Cost:								
Service cost	$537	$615	$1,611	$1,844	$30	$20	$91	$59
Interest cost	644	731	1,932	2,195	108	122	324	367
Expected return on plan assets	(1,158)	(1,129)	(3,475)	(3,386)	—	—	—	—
Amortization of prior service (credit) cost	(6)	(6)	(17)	(17)	—	—	—	—
Recognized net actuarial loss	207	313	621	937	62	61	185	183
Net periodic benefit cost	$224	$524	$672	$1,573	$200	$203	$600	$609

The following table presents the measurement date and weighted-average assumptions used to determine net periodic benefit cost:

	Qualified Pension Plan		Non-Qualified Retirement Plans	
Periods ended September 30,	2016	2015	2016	2015
Measurement date	Dec 31, 2015	Dec 31, 2014	Dec 31, 2015	Dec 31, 2014
Discount rate	N/A	4.125%	N/A	3.90%
Equivalent single discount rate for benefit obligations	4.48%	N/A	4.19%	N/A
Equivalent single discount rate for service cost	4.63	N/A	4.59	N/A
Equivalent single discount rate for interest cost	3.88	N/A	3.44	N/A
Expected long-term return on plan assets	6.75	7.25	N/A	N/A
Rate of compensation increase	3.75	3.75	3.75	3.75

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

(12) Share-Based Compensation Arrangements
During the nine months ended September 30, 2016, the Corporation granted equity awards, which included performance share awards and nonvested share units.

The performance share awards were granted to certain executive officers providing the opportunity to earn shares of common stock of the Corporation. The performance share awards were valued at fair market value as of January 20, 2016 (the award date), or $36.11, and will be earned over a 3-year performance period. The number of shares earned will range from zero to 200% of the target number of shares dependent upon the Corporation's core return on equity and core earnings per share growth ranking compared to an industry peer group. The current assumption based on the most recent peer group information available results in shares earned at 140% of the target, or 47,533 shares.

The Corporation granted 8,400 nonvested share units to non-employee directors with 3-year cliff vesting. The nonvested share units were valued at fair market value as of May 10, 2016 (the award date), or $36.10.

(13) Business Segments
Washington Trust segregates financial information in assessing its results among its Commercial Banking and Wealth Management Services operating segments. The amounts in the Corporate unit include activity not related to the segments.

Management uses certain methodologies to allocate income and expenses to the business lines. A funds transfer pricing methodology is used to assign interest income and interest expense to each interest-earning asset and interest-bearing liability on a matched maturity funding basis. Certain indirect expenses are allocated to segments. These include support unit expenses such as technology, operations and other support functions.

Commercial Banking
The Commercial Banking segment includes commercial, residential and consumer lending activities; equity in losses of unconsolidated investments in real estate limited partnerships; mortgage banking activities; deposit generation; cash management activities; and direct banking activities, which include the operation of ATMs, telephone and Internet banking services and customer support and sales.

Wealth Management Services
Wealth Management Services includes investment management; financial planning; personal trust and estate services, including services as trustee, personal representative, custodian and guardian; and settlement of decedents' estates. Institutional trust services are also provided, including fiduciary services.

Corporate
Corporate includes the Treasury Unit, which is responsible for managing the wholesale investment portfolio and wholesale funding needs. It also includes income from bank-owned life insurance, as well as administrative and executive expenses not allocated to the operating segments and the residual impact of methodology allocations such as funds transfer pricing offsets.

Condensed Notes to Unaudited Consolidated Financial Statements – (continued)

The following tables present the statement of operations and total assets for Washington Trust's reportable segments:

(Dollars in thousands)	Commercial Banking		Wealth Management Services		Corporate		Consolidated Total	
Three months ended September 30,	2016	2015	2016	2015	2016	2015	2016	2015
Net interest income (expense)	$22,860	$21,278	($11)	($15)	$4,530	$4,734	$27,379	$25,997
Provision for loan losses	1,800	200	—	—	—	—	1,800	200
Net interest income (expense) after provision for loan losses	21,060	21,078	(11)	(15)	4,530	4,734	25,579	25,797
Noninterest income	7,101	4,498	9,623	8,902	537	513	17,261	13,913
Noninterest expenses:								
Depreciation and amortization expense	709	626	501	404	58	50	1,268	1,080
Other noninterest expenses (1)	14,759	13,805	5,584	6,820	3,039	2,833	23,382	23,458
Total noninterest expenses	15,468	14,431	6,085	7,224	3,097	2,883	24,650	24,538
Income before income taxes	12,693	11,145	3,527	1,663	1,970	2,364	18,190	15,172
Income tax expense	4,392	3,747	1,261	688	210	529	5,863	4,964
Net income	$8,301	$7,398	$2,266	$975	$1,760	$1,835	$12,327	$10,208
Total assets at period end	$3,617,967	$3,074,611	$53,236	$62,461	$532,831	$537,764	$4,204,034	$3,674,836
Expenditures for long-lived assets	424	1,006	280	51	58	61	762	1,118

(1) Other noninterest expenses for the Wealth Management Services segment includes a $939 thousand benefit resulting from the reduction of a contingent consideration liability in the three months ended September 30, 2016 and $504 thousand of acquisition related expenses in the three months ended September 30, 2015.

(Dollars in thousands)	Commercial Banking		Wealth Management Services		Corporate		Consolidated Total	
Nine months ended September 30,	2016	2015	2016	2015	2016	2015	2016	2015
Net interest income (expense)	$67,414	$63,115	($46)	($38)	$14,522	$14,650	$81,890	$77,727
Provision for loan losses	2,750	300	—	—	—	—	2,750	300
Net interest income (expense) after provision for loan losses	64,664	62,815	(46)	(38)	14,522	14,650	79,140	77,427
Noninterest income	17,331	15,164	28,278	26,249	2,200	1,781	47,809	43,194
Noninterest expenses:								
Depreciation and amortization expense	2,093	1,936	1,440	1,009	170	161	3,703	3,106
Other noninterest expenses (1)	43,788	41,259	19,084	19,200	9,555	8,803	72,427	69,262
Total noninterest expenses	45,881	43,195	20,524	20,209	9,725	8,964	76,130	72,368
Income before income taxes	36,114	34,784	7,708	6,002	6,997	7,467	50,819	48,253
Income tax expense	12,336	10,878	2,788	2,682	1,376	1,972	16,500	15,532
Net income								