COLUMBIA BANKING SYSTEM INC
Form 10-Q
November 08, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011.

¨ 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 0-20288

COLUMBIA BANKING SYSTEM, INC.
(Exact name of issuer as specified in its charter)

Washington (State or other jurisdiction of incorporation or organization)	91-1422237 (I.R.S. Employer Identification Number)
1301 “A” Street Tacoma, Washington (Address of principal executive offices)	98402-2156 (Zip Code)

(253) 305-1900
(Issuer’s telephone number, including area code)
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer ý	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company ¨

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

The number of shares of common stock outstanding at October 31, 2011 was 39,502,313.

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PART I - FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS
CONSOLIDATED CONDENSED STATEMENTS OF INCOME
Columbia Banking System, Inc.
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands except per share)	2011	2010	2011	2010
Interest Income				
Loans	$59,655	$44,882	$151,446	$120,769
Taxable securities	6,037	4,660	16,701	14,113
Tax-exempt securities	2,500	2,252	7,483	6,988
Federal funds sold and deposits in banks	240	281	722	640
Total interest income	68,432	52,075	176,352	142,510
Interest Expense				
Deposits	2,642	4,007	8,569	13,282
Federal Home Loan Bank advances	807	716	2,215	2,131
Long-term obligations	75	266	579	769
Other borrowings	120	121	377	357
Total interest expense	3,644	5,110	11,740	16,539
Net Interest Income	64,788	46,965	164,612	125,971
Provision for loan and lease losses	500	9,000	2,650	37,500
Provision for losses on covered loans	433	453	2,312	453
Net interest income after provision for loan and lease losses	63,855	37,512	159,650	88,018
Noninterest Income				
Service charges and other fees	6,991	6,518	19,746	18,384
Gain on bank acquisitions, net of tax	1,830	—	1,830	9,818
Merchant services fees	1,952	2,051	5,393	5,700
Gain on sale of investment securities, net	—	—	—	58
Bank owned life insurance	523	521	1,556	1,541
Change in FDIC loss sharing asset	(10,855)	(4,536)	(32,048)	(1,137)
Other	1,755	629	3,842	2,529
Total noninterest income	2,196	5,183	319	36,893
Noninterest Expense				
Compensation and employee benefits	21,392	17,574	59,772	52,057
Occupancy	4,815	4,278	13,600	12,554
Merchant processing	976	934	2,764	2,697
Advertising and promotion	1,137	630	3,050	2,253
Data processing and communications	2,195	2,477	6,032	6,923
Legal and professional fees	1,957	1,609	4,868	4,584
Taxes, licenses and fees	1,211	803	2,983	2,055
Regulatory premiums	574	1,952	3,553	4,910
Net cost of operation of other real estate owned	(195)	(1,442)	(423)	(802)
Amortization of intangibles	1,177	1,044	3,116	2,886
FDIC clawback liability	1,146	—	3,294	—
Other	3,550	3,661	11,836	12,045
Total noninterest expense	39,935	33,520	114,445	102,162
Income before income taxes	26,116	9,175	45,524	22,749
Income tax provision	7,244	3,971	12,241	4,573

Net Income	$18,872	$5,204	$33,283	$18,176
Net Income Applicable to Common Shareholders	$18,872	$2,474	$33,283	$13,229
Earnings per common share				
Basic	$0.48	$0.06	$0.84	$0.39
Diluted	$0.48	$0.06	$0.84	$0.38
Dividends paid per common share	$0.06	$0.01	$0.14	$0.03
Weighted average number of common shares outstanding	39,131	38,976	39,092	33,938
Weighted average number of diluted common shares outstanding	39,192	39,137	39,167	34,142

See accompanying notes to unaudited consolidated condensed financial statements.

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CONSOLIDATED CONDENSED BALANCE SHEETS
Columbia Banking System, Inc.
(Unaudited)

(in thousands)			September 30, 2011	December 31, 2010
ASSETS				
Cash and due from banks			$97,432	$55,492
Interest-earning deposits with banks			250,030	458,638
Total cash and cash equivalents			347,462	514,130
Securities available for sale at fair value (amortized cost of $954,415 and $743,928, respectively)			995,854	763,866
Federal Home Loan Bank stock at cost			22,215	17,908
Loans held for sale			2,568	754
Loans, excluding covered loans, net of unearned income of ($23,764) and ($3,490), respectively			2,257,899	1,915,754
Less: allowance for loan and lease losses			50,422	60,993
Loans, excluding covered loans, net			2,207,477	1,854,761
Covered loans, net of allowance for loan losses of ($8,327) and ($6,055), respectively			570,805	517,061
Total loans, net			2,778,282	2,371,822
FDIC loss sharing asset			193,869	205,991
Interest receivable			17,428	11,164
Premises and equipment, net			104,974	93,108
Other real estate owned ($24,835 and $14,443 covered by FDIC loss share, respectively)			49,891	45,434
Goodwill			118,434	109,639
Core deposit intangible, net			21,369	18,696
Other assets			103,486	103,851
Total Assets			$4,755,832	$4,256,363
LIABILITIES AND SHAREHOLDERS' EQUITY				
Deposits:				
Noninterest-bearing			$1,105,169	$895,671
Interest-bearing			2,690,330	2,431,598
Total deposits			3,795,499	3,327,269
Federal Home Loan Bank advances			122,642	119,405
Securities sold under agreements to repurchase			25,000	25,000
Other borrowings			—	642
Long-term subordinated debt			—	25,735
Other liabilities			62,725	51,434
Total liabilities			4,005,866	3,549,485
Commitments and contingent liabilities				
Shareholders' equity:				
	September 30, 2011	December 31, 2010		
Common Stock (no par value)				
Authorized shares	63,033	63,033		
Issued and outstanding	39,502	39,338	578,828	576,905
Retained earnings			145,451	117,692

Accumulated other comprehensive income	25,687	12,281
Total shareholders’ equity	749,966	706,878
Total Liabilities and Shareholders’ Equity	$4,755,832	$4,256,363

See accompanying notes to unaudited consolidated condensed financial statements.

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CONSOLIDATED CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Columbia Banking System, Inc.
(Unaudited)

(in thousands)	Preferred Stock Number of Shares	Preferred Stock Amount	Common Stock Number of Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at January 1, 2010	77	$74,301	28,129	$348,706	$93,316	$ 11,816	$528,139
Comprehensive income:							
Net income					18,176		18,176
Other comprehensive income, net of tax:							
Net unrealized gain from securities, net of reclassification adjustments						11,859	11,859
Net change in cash flow hedging instruments						(943)	(943)
Net pension plan liability adjustment						44	44
Other comprehensive income							10,960
Total comprehensive income							29,136
Redemption of preferred stock and common stock warrant		(76,898)		(3,302)			
Accretion of preferred stock discount	(77)	2,597			(2,597)		—
Issuance of common stock, net of offering costs			11,040	229,129			229,129
Issuance of common stock - stock option and other plans			65	864			864
Issuance of common stock - restricted stock awards, net of cancelled awards			94	1,054			1,054
Tax benefit deficiency associated with share-based compensation				(13)			(13)
Preferred dividends					(2,349)		(2,349)
Cash dividends paid on common stock					(1,068)		(1,068)
Balance at September 30, 2010	—	$—	39,328	$576,438	$105,478	$ 22,776	$704,692
Balance at January 1, 2011	—	$—	39,338	$576,905	$117,692	$ 12,281	$706,878
Comprehensive income:							
Net income					33,283		33,283
Other comprehensive income, net of tax:							

Net unrealized gain from securities, net of reclassification adjustments						13,768	13,768
Net change in cash flow hedging instruments						(143)	(143)
Net pension plan liability adjustment						(219)	(219)
Other comprehensive income							13,406
Total comprehensive income							46,689
Issuance of common stock - stock option and other plans			47	792			792
Issuance of common stock - restricted stock awards, net of cancelled awards			119	1,163			1,163
Repurchase of shares			(2)	(32)			(32)
Cash dividends paid on common stock					(5,524)		(5,524)
Balance at September 30, 2011	—	$—	39,502	$578,828	$145,451	$ 25,687	$749,966

See accompanying notes to unaudited consolidated condensed financial statements.

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CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
Columbia Banking System, Inc.
(Unaudited)

(in thousands)	Nine Months Ended September 30, 2011	2010 (1)
Cash Flows From Operating Activities		
Net Income	$33,283	$18,176
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan and lease losses and losses on covered loans	4,962	37,953
Stock-based compensation expense	1,163	1,054
Depreciation, amortization and accretion	2,612	10,105
Net realized gain on FDIC assisted bank acquisitions	(1,830)	(9,818)
Net realized gain on sale of securities	—	(58)
Net realized gain on sale of other assets	(13)	(16)
Net realized gain on sale of other real estate owned	(7,069)	(3,527)
Gain on termination of cash flow hedging instruments	(222)	(1,463)
Write-down on other real estate owned	5,392	4,586
Deferred income tax benefit	—	(394)
Net change in:		
FDIC loss-sharing asset	29,856	1,022
Loans held for sale	(1,814)	(1,513)
Interest receivable	(3,384)	4,195
Interest payable	(226)	(625)
Other assets	5,886	(251)
Other liabilities	1,608	22,053
Net cash provided by operating activities	70,204	81,479
Cash Flows From Investing Activities		
Loans originated and acquired, net of principal collected	(69,420)	114,618
Purchases of:		
Securities available for sale	(294,678)	(64,054)
Premises and equipment	(10,619)	(3,910)
Proceeds from:		
FDIC reimbursement on loss-sharing asset	51,000	—
Sales of securities available for sale	—	69,328
Principal repayments and maturities of securities available for sale	101,071	66,118
Disposal of premises and equipment	59	71
Sales of covered other real estate owned	14,604	10,652
Sales of other real estate and other personal property owned	10,234	3,943
Capital improvements on other real estate properties	(726)	(1,147)
Decrease in Small Business Administration secured borrowings	(642)	1,599
Net cash acquired in business combinations	247,792	155,910
Net cash provided by investing activities	48,675	353,128
Cash Flows From Financing Activities		
Net decrease in deposits	(215,701)	(323,141)
Proceeds from:		
Issuance of common stock	—	229,129
Exercise of stock options	792	851
Federal Home Loan Bank advances	100	—

Federal Reserve Bank borrowings	100	—
Payment for:		
Repayment of Federal Home Loan Bank advances	(39,447)	—
Repayment of Federal Reserve Bank borrowings	(100)	(36,237)
Preferred stock dividends	—	(2,840)
Common stock dividends	(5,524)	(1,068)
Repurchase of preferred stock and common stock warrant	—	(80,200)
Repurchase of common stock	(32)	—
Net decrease in other borrowings	(25,735)	(86)
Net cash used in financing activities	(285,547)	(213,592)
(Decrease) Increase in cash and cash equivalents	(166,668)	221,015
Cash and cash equivalents at beginning of period	514,130	305,074
Cash and cash equivalents at end of period	$347,462	$526,089
Supplemental Information:		
Cash paid during the year for:		
Cash paid for interest	$11,967	$17,164
Cash paid for income tax	$12,870	$3,015
Non-cash investing activities		
Assets acquired in FDIC assisted acquisitions (excluding cash and cash equivalents)	$485,870	$1,075,166
Liabilities assumed in FDIC assisted acquisitions	$731,832	$1,210,882
Loans transferred to other real estate owned	$16,505	$27,266

(1) Reclassified to conform to the current period’s presentation.

See accompanying notes to unaudited consolidated condensed financial statements.

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NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
Columbia Banking System, Inc.

1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

The interim unaudited consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for condensed interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain financial information and footnotes have been omitted or condensed. The consolidated condensed financial statements include the accounts of the Company, and its wholly owned banking subsidiary Columbia Bank (the “Bank”). All intercompany transactions and accounts have been eliminated in consolidation. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair statement of the results for the interim periods presented have been included. The results of operations for the nine months ended September 30, 2011 are not necessarily indicative of results to be anticipated for the year ending December 31, 2011. The accompanying interim unaudited consolidated condensed financial statements should be read in conjunction with the financial statements and related notes contained in the Company’s 2010 Annual Report on Form 10-K.

Significant Accounting Policies

The significant accounting policies used in preparation of our consolidated financial statements are disclosed in our 2010 Annual Report on Form 10-K. Other than as discussed below, there have not been any changes in our significant accounting policies compared to those contained in our 2010 10-K disclosure for the year ended December 31, 2010.

Discounted Loans

Discounted loans are the loans acquired through acquisitions or direct purchase for which we believe a credit loss is not probable at the time of acquisition. Discounted loans are included on the consolidated condensed balance sheet in the “Loans, excluding covered loans” line item. Generally these loans as a group do not exhibit pervasive indications of declines in credit quality from the time of initial origination. Discounted loans are recorded at fair value at the time of acquisition. The estimate of fair value includes a discount related to credit risk and a premium or discount related to interest rates that is recorded for each loan separately. Interest income is recognized through the accrual of interest at the loans' stated rates, plus accretion or amortization of the discount or premium recorded at acquisition. Credit losses for discounted loans are recorded through the provision for loan losses using a similar methodology as originated loans. However, the amount of expected incurred loss of unpaid principal must be compared to the net carrying value which includes the remaining discount or premium. Currently none of our discounted loans are covered by indemnification agreements with the FDIC.

2. Accounting Pronouncements Recently Issued

In April 2011, the FASB issued Accounting Standards Update ("ASU") 2011-03, Reconsideration of Effective Control for Repurchase Agreements (Topic 860). ASU 2011-03 attempts to improve the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before maturity. The effective date of ASU 2011-03 will be the first interim or annual period beginning after December 15, 2011 and should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The Company is evaluating the impact this ASU will have on its financial condition and results of operations.

In April 2011, the Financial Accounting Standards Board issued ASU 2011-02, A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring (Topic 310). ASU 2011-02 clarifies the criteria for a restructuring to be classified as a Troubled Debt Restructuring ("TDR"). The Company adopted this ASU during the current period as well as the related disclosure requirements which were included in ASU 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses (Topic 310). Adoption of this ASU had no impact on the Company's financial condition or results of operations. See Note 6 for expanded disclosure requirements related to TDR.

In May 2011, the FASB issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. Generally Accepted Accounting Principles ("GAAP") and International Financial Reporting Standards ("IFRS") (Topic 820). ASU 2011-04 developed common requirements between GAAP and IFRS for measuring fair value and for disclosing information about fair value measurements. The effective date of ASU 2011-04 will be during interim or annual period beginning after December 15, 2011 and should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The Company is evaluating the impact this ASU will have on its financial condition and results of operations.

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In June 2011, the FASB issued ASU 2011-05, Presentation of Comprehensive Income (Topic 220). ASU 2011-05 attempts to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. The effective date of ASU 2011-05 will be the first interim or fiscal period beginning after December 15, 2011 and should be applied retrospectively. Early adoption is permitted. The Company will apply the disclosure requirements of ASU 2011-05 for its first interim period beginning after December 15, 2011.

In September 2011, the FASB issued ASU 2011-08, Testing Goodwill for Impairment (Topic 350). ASU 2011-08 permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. ASU 2011-08 is effective for interim and annual periods beginning after December 15, 2011. Early adoption is permitted. This ASU, which the Company adopted during the third quarter of 2011, did not have any impact on the Company's consolidated financial statements.

3. Earnings per Common Share

Basic Earnings per Share (“EPS”) is computed by dividing income applicable to common shareholders by the weighted average number of common shares outstanding for the period. Common shares outstanding include common stock and vested restricted stock awards where recipients have satisfied the vesting terms. Diluted EPS reflects the assumed conversion of all dilutive securities, applying the treasury stock method. The Company calculates earnings per share using the two-class method as described in the Earnings per Share topic of the FASB Accounting Standards Codification (“ASC”). The following table sets forth the computation of basic and diluted earnings per share for the three and nine months ended September 30, 2011 and 2010:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands except per share)	2011	2010	2011	2010
Basic EPS:				
Net income	$18,872	$5,204	$33,283	$18,176
Less: Preferred dividends and accretion of issuance discount for preferred stock	—	(2,730)	—	(4,947)
Net income applicable to common shareholders	$18,872	$2,474	$33,283	$13,229
Less: Earnings allocated to participating securities	(177)	(22)	(311)	(127)
Earnings allocated to common shareholders	$18,695	$2,452	$32,972	$13,102
Weighted average common shares outstanding	39,131	38,976	39,092	33,938
Basic earnings per common share	$0.48	$0.06	$0.84	$0.39
Diluted EPS:				
Earnings allocated to common shareholders	$18,695	$2,452	$32,972	$13,102
Weighted average common shares outstanding	39,131	38,976	39,092	33,938
Dilutive effect of equity awards and warrants	61	161	75	204
Weighted average diluted common shares outstanding	39,192	39,137	39,167	34,142
Diluted earnings per common share	$0.48	$0.06	$0.84	$0.38
Potentially dilutive share options that were not included in the computation of diluted EPS because to do so would be anti-dilutive.	75	62	62	54

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4. Business Combinations

Summit Bank

On May 20, 2011 the Bank acquired certain assets and assumed certain liabilities of Summit Bank from the Federal Deposit Insurance Corporation (“FDIC”) in an FDIC-assisted transaction. As part of the Purchase and Assumption Agreement, the Bank and the FDIC entered into loss-sharing agreements (each, a “loss-sharing agreement” and collectively, the “loss-sharing agreements”), whereby the FDIC will cover a substantial portion of any future losses on loans (and related unfunded commitments), OREO and certain accrued interest on loans for up to 90 days. We refer to the acquired loans and OREO subject to the loss-sharing agreements collectively as “covered assets.” Under the terms of the loss-sharing agreements, the FDIC will absorb 80% of losses and share in 80% of loss recoveries. The loss-sharing provisions of the agreements for commercial and single family residential mortgage loans are in effect for five years and ten years, respectively, from the May 20, 2011 acquisition date and the loss recovery provisions for such loans are in effect for eight years and ten years, respectively, from the acquisition date.

Summit Bank was a full service community bank headquartered in Burlington, Washington that operated three branch locations in Skagit County. We entered into this transaction to assist us with filling in our geographic footprint between Seattle and Bellingham, Washington and to support our recently expanded Bellingham banking team. We believe participating with the FDIC in this assisted transaction was, from an economical standpoint, advantageous to expansion through de novo branching.

The assets acquired and liabilities assumed have been accounted for under the acquisition method of accounting (formerly the purchase method). The assets and liabilities, both tangible and intangible, were provisionally recorded at their estimated fair values as of the May 20, 2011 acquisition date. The initial accounting for acquired loans and the related indemnification asset for the Summit Bank acquisition was incomplete as of June 30, 2011. The amounts recognized at June 30, 2011 were determined provisionally as the fair value analysis of those assets utilizing an income approach was not complete as of June 30, 2011. These amounts have been retrospectively adjusted to reflect the completion of the fair value analysis utilizing an income approach during the current period. The adjustment recorded in the current period was an increase in the FDIC indemnification asset of $3.0 million, a decrease in acquired loans of $1.7 million, a decrease in goodwill of $851 thousand, and a decrease in other real estate owned covered by loss sharing of $509 thousand. The goodwill represents the excess of the estimated fair value of the liabilities assumed over the estimated fair value of the assets acquired and is influenced significantly by the FDIC-assisted transaction process. All of the goodwill and core deposit intangible assets recognized are deductible for income tax purposes.

The operating results of the Company include the operating results produced by the acquired assets and assumed liabilities for the period May 21, 2011 to September 30, 2011. Due primarily to the significant amount of fair value adjustments and the FDIC loss-sharing agreements put in place, historical results of Summit Bank are not meaningful to the Company’s results and thus no proforma information is presented.

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The table below displays the amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed:

	May 20, 2011 (in thousands)
Assets	
Cash and due from banks	$1,837
Interest-earning deposits with banks and federal funds sold	14,198
Investment securities	871
Federal Home Loan Bank stock	406
Acquired loans	69,783
Accrued interest receivable	429
Premises and equipment	42
FDIC receivable	6,984
Other real estate owned covered by loss sharing	2,162
Goodwill	2,919
Core deposit intangible	509
FDIC indemnification asset	30,203
Other assets	786
Total assets acquired	$131,129
Liabilities	
Deposits	$123,279
Federal Home Loan Bank advances	7,772
Accrued interest payable	71
Other liabilities	7
Total liabilities assumed	$131,129

First Heritage Bank

On May 27, 2011 the Bank acquired certain assets and assumed certain liabilities of First Heritage Bank from the FDIC in an FDIC-assisted transaction. As part of the Purchase and Assumption Agreement, the Bank and the FDIC entered into loss-sharing agreements (each, a “loss-sharing agreement” and collectively, the “loss-sharing agreements”), whereby the FDIC will cover a substantial portion of any future losses on loans (and related unfunded commitments), OREO and certain accrued interest on loans for up to 90 days. We refer to the acquired loans and OREO subject to the loss-sharing agreements collectively as “covered assets.” Under the terms of the loss-sharing agreements, the FDIC will absorb 80% of losses and share in 80% of loss recoveries. The loss-sharing provisions of the agreements for commercial and single family residential mortgage loans are in effect for five years and ten years, respectively, from the May 27, 2011 acquisition date and the loss recovery provisions for such loans are in effect for eight years and ten years, respectively, from the acquisition date.

First Heritage Bank was a full service community bank headquartered in Snohomish, Washington that operated five branch locations in King and Snohomish Counties. We entered into this transaction to assist us with filling in our geographic footprint between Seattle and Bellingham, Washington and to support our recently expanded Bellingham banking team. We believe participating with the FDIC in this assisted transaction was, from an economical standpoint, advantageous to expansion through de novo branching.

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The assets acquired and liabilities assumed have been accounted for under the acquisition method of accounting (formerly the purchase method). The assets and liabilities, both tangible and intangible, were provisionally recorded at their estimated fair values as of the May 27, 2011 acquisition date. The initial accounting for acquired loans and the related indemnification asset for the First Heritage Bank acquisition was incomplete as of June 30, 2011. The amounts recognized at June 30, 2011 were determined provisionally as the fair value analysis of those assets utilizing an income approach was not complete as of June 30, 2011. These amounts have been retrospectively adjusted to reflect the completion of the fair value analysis utilizing an income approach during the current period. The adjustment recorded in the current period was an increase in the FDIC indemnification asset of $427 thousand, a decrease in acquired loans of $369 thousand and a decrease in goodwill of $58 thousand. The goodwill represents the excess of the estimated fair value of the liabilities assumed over the estimated fair value of the assets acquired and is influenced significantly by the FDIC-assisted transaction process. All of the goodwill and core deposit intangible assets recognized are deductible for income tax purposes.

The operating results of the Company include the operating results produced by the acquired assets and assumed liabilities for the period May 28, 2011 to September 30, 2011. Due primarily to the significant amount of fair value adjustments and the FDIC loss-sharing agreements put in place, historical results of First Heritage Bank are not meaningful to the Company’s results and thus no proforma information is presented.

The table below displays the amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed:

	May 27, 2011 (in thousands)
Assets	
Cash and due from banks	$4,688
Interest-earning deposits with banks	6,689
Investment securities	5,303
Federal Home Loan Bank stock	477
Acquired loans	81,488
Accrued interest receivable	476
Premises and equipment	5,339
FDIC receivable	4,751
Other real estate owned covered by loss sharing	8,225
Goodwill	5,876
Core deposit intangible	1,337
FDIC indemnification asset	38,531
Other assets	1,804
Total assets acquired	$164,984
Liabilities	
Deposits	$159,525
Federal Home Loan Bank advances	5,003
Accrued interest payable	421
Other liabilities	35
Total liabilities assumed	$164,984

Bank of Whitman

On August 5, 2011 the Bank acquired certain assets and assumed certain liabilities of the Bank of Whitman from the FDIC in an FDIC-assisted transaction. The Bank and the FDIC entered into a modified whole bank purchase and assumption agreement without loss share.

The Bank of Whitman was a full service community bank headquartered in Colfax, Washington. We entered into this transaction to acquire nine branches total in Adams, Asotin, Grant, Spokane, Walla Walla, and Whitman counties to

assist us with filling in our geographic footprint in eastern Washington. We believe participating with the FDIC in this assisted transaction was, from an economical standpoint, advantageous to expansion through de novo branching.

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The assets acquired and liabilities assumed have been accounted for under the acquisition method of accounting (formerly the purchase method). The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the August 5, 2011 acquisition date. The application of the acquisition method of accounting resulted in the recognition of a bargain purchase gain, net of tax, of $1.8 million, which is included in the Gain on bank acquisition line item in the Consolidated Condensed Statements of Income, and a core deposit intangible of $3.9 million. The bargain purchase gain represents the excess of the estimated fair value of the assets acquired over the estimated fair value of the liabilities assumed and is influenced significantly by the FDIC-assisted transaction process. The core deposit intangible asset recognized is deductible for income tax purposes.

The operating results of the Company include the operating results produced by the acquired assets and assumed liabilities for the period August 6, 2011 to September 30, 2011. Due to the exclusion of the majority of the non-performing loans and 11 branch locations, as well as the significant amount of fair value adjustments, historical results of the Bank of Whitman are not meaningful to the Company's results and thus no proforma information is presented.

The table below displays the amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed:

	August 5, 2011 (in thousands)
Assets	
Cash and due from banks	$52,072
Investment securities	16,298
Federal Reserve Bank and Federal Home Loan Bank stock	3,977
Acquired loans	200,041
Accrued interest receivable	1,975
Premises and equipment	86
FDIC receivable	156,710
Core deposit intangible	3,943
Other assets	2,447
Total assets acquired	$437,549
Liabilities	
Deposits	401,127
Federal Home Loan Bank advances	32,949
Accrued interest payable	213
Deferred tax liability	1,034
Other liabilities	396
Total liabilities assumed	$435,719
Net assets acquired (after tax gain)	$1,830

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5. Securities

The following table summarizes the amortized cost, gross unrealized gains and losses and the resulting fair value of securities available for sale:

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2011:				
U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations	$623,934	$21,698	$(906)	$644,726
State and municipal securities	256,343	20,189	(115)	276,417
U.S. government and government-sponsored enterprise securities	70,857	523	—	71,380
Other securities	3,281	77	(27)	3,331
Total	$954,415	$42,487	$(1,048)	$995,854
December 31, 2010:				
U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations	$491,530	$16,139	$(1,027)	$506,642
State and municipal securities	249,117	7,247	(2,383)	253,981
Other securities	3,281	—	(38)	3,243
Total	$743,928	$23,386	$(3,448)	$763,866

The scheduled contractual maturities of investment securities available for sale at September 30, 2011 are presented as follows:

	September 30, 2011	
	Amortized Cost	Fair Value
	(in thousands)	
Due within one year	$43,868	$44,136
Due after one year through five years	91,742	94,242
Due after five years through ten years	168,119	176,815
Due after ten years	647,405	677,330
Total investment securities available-for-sale	$951,134	$992,523

The following table summarizes, as of September 30, 2011, the carrying value of securities pledged as collateral to secure public deposits, borrowings and other purposes as permitted or required by law:

(in thousands)	Carrying Amount
To Washington and Oregon State to secure public deposits	$237,671
To Federal Home Loan Bank to secure advances	95,139
To Federal Reserve Bank to secure borrowings	55,947
Other securities pledged	50,080
Total securities pledged as collateral	$438,837

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The following tables show the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2011 and December 31, 2010:

September 30, 2011

(in thousands)	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations	$119,998	$(905)	$275	$(1)	$120,273	(906)
State and municipal securities	11,558	(97)	1,204	(18)	12,762	(115)
U.S. government and government-sponsored enterprise securities	100	—	—	—	100	—
Other securities	—	—	973	(27)	973	(27)
Total	$131,656	$(1,002)	$2,452	$(46)	$134,108	$(1,048)

December 31, 2010

(in thousands)	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations	$86,529	$(1,025)	$588	$(2)	$87,117	$(1,027)
State and municipal securities	74,755	(2,099)	2,792	(284)	77,547	(2,383)
Other securities	2,275	(6)	968	(32)	3,243	(38)
Total	$163,559	$(3,130)	$4,348	$(318)	$167,907	$(3,448)

The unrealized losses on the above securities are primarily attributable to increases in market interest rates subsequent to their purchase by the Company. Management does not intend to sell any impaired securities nor does available evidence suggest it is more likely than not that management will be required to sell any impaired securities. The Company's securities portfolio does not include any private label mortgage backed securities or investments in trust preferred securities. Management believes the nature of securities in the Company's investment portfolio present a very high probability of collecting all contractual amounts due, as the majority of the securities held are backed by government agencies or government-sponsored enterprises. However, this recovery in value may not occur for some time, perhaps greater than the one-year time horizon or perhaps even at maturity.

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6. Noncovered Loans

Noncovered loans include loans originated through our branch network and loan departments as well as acquired loans, including discounted loans, that are not subject to FDIC loss share, including the loans acquired in the Bank of Whitman transaction described in Note 4.

The following is an analysis of the noncovered loan portfolio by major types of loans (net of unearned income):

(in thousands)	September 30, 2011	December 31, 2010
Noncovered loans:		
Commercial Business	$983,820	$795,369
Real Estate:		
One-to-four family residential	64,535	49,383
Commercial and multifamily residential	977,173	794,329
Total Real Estate	1,041,708	843,712
Real Estate Construction:		
One-to-four family residential	52,287	67,961
Commercial and multifamily residential	27,181	30,185
Total Real Estate Construction	79,468	98,146
Consumer	176,667	182,017
Less: Net unearned income	(23,764)	(3,490)
Total noncovered loans, net of unearned income	2,257,899	1,915,754
Less: Allowance for loan and lease losses	(50,422)	(60,993)
Total noncovered loans, net	$2,207,477	$1,854,761
Loans held for sale	$2,568	$754

At September 30, 2011 and December 31, 2010, the Company had no loans to foreign domiciled businesses or foreign countries, or loans related to highly leveraged transactions. Substantially all of the Company's loans and unfunded commitments are geographically concentrated in its service areas within the states of Washington and Oregon.

The Company and its banking subsidiary have granted loans to officers and directors of the Company and related interests. These loans are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collectability. The aggregate dollar amount of these loans was $9.5 million and $12.9 million at September 30, 2011 and December 31, 2010, respectively. During the first nine months of 2011, advances on related party loans were $3.1 million and repayments totaled $6.5 million.

At September 30, 2011 and December 31, 2010, $401.6 million and $426.6 million of commercial and residential real estate loans were pledged as collateral on Federal Home Loan Bank borrowings.

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The following is an analysis of noncovered, nonaccrual loans as of September 30, 2011 and December 31, 2010:

(in thousands)	September 30, 2011		December 31, 2010	
	Recorded Investment Nonaccrual Loans	Unpaid Principal Balance Nonaccrual Loans	Recorded Investment Nonaccrual Loans	Unpaid Principal Balance Nonaccrual Loans
Commercial Business				
Secured	$9,594	$ 18,025	$32,368	$ 44,316
Unsecured	301	1,244	—	327
Real Estate:				
One-to-four family residential	2,157	2,514	2,999	3,353
Commercial & multifamily residential				
Commercial land	3,872	7,355	4,093	6,279
Income property multifamily	7,135	9,740	11,716	12,737
Owner occupied	9,845	10,908	7,407	8,990
Real Estate Construction:				
One-to-four family residential				
Land and acquisition	7,817	15,952	11,608	21,344
Residential construction	3,164	4,691	6,503	11,547
Commercial & multifamily residential				
Income property multifamily	7,622	14,963	7,585	12,916
Owner occupied	—	—	—	—
Consumer	3,545	4,390	5,022	5,192
Total	$55,052	$ 89,782	$89,301	$ 127,001

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The following is an analysis of the recorded investment of the aged loan portfolio as of September 30, 2011 and December 31, 2010:

(in thousands)	Current Loans	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Nonaccrual Loans	Total Loans
September 30, 2011							
Commercial Business							
Secured	$905,270	$847	$579	$—	$1,426	$9,594	$916,290
Unsecured	57,118	1,359	58	—	1,417	301	58,836
Real Estate:							
One-to-four family residential	61,073	239	204	—	443	2,157	63,673
Commercial & multifamily residential							
Commercial land	44,260	—	—	—	—	3,872	48,132
Income property multifamily	519,034	352	10	—	362	7,135	526,531
Owner occupied	378,541	2,488	931	—	3,419	9,845	391,805
Real Estate Construction:							
One-to-four family residential							
Land and acquisition	16,640	1,084	436	—	1,520	7,817	25,977
Residential construction	22,781	—	—	—	—	3,164	25,945
Commercial & multifamily residential							
Income property multifamily	5,168	1,011	—	—	1,011	7,622	13,801
Owner occupied	10,358	—	—	—	—	—	10,358
Consumer	172,094	465	447	—	912	3,545	176,551
Total	$2,192,337	$7,845	$2,665	$—	$10,510	$55,052	$2,257,899

(in thousands)	Current Loans	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Nonaccrual Loans	Total Loans
December 31, 2010							
Commercial Business							
Secured	$720,926	$919	$692	$1	$1,612	$31,919	$754,457
Unsecured	40,455	9	—	—	9	448	40,912
Real Estate:							
One-to-four family residential	46,167	220	—	—	220	2,996	49,383
Commercial & multifamily residential							
Commercial land	18,979	—	1,752	—	1,752	4,091	24,822
Income property multifamily	426,320	1,208	121	—	1,329	10,745	438,394

Owner occupied	318,508	497	3,752	—	4,249	8,356	331,113
Real Estate Construction:							
One-to-four family residential							
Land and acquisition	24,883	214	205	—	419	11,604	36,906
Residential construction	24,655	—	—	—	—	6,400	31,055
Commercial & multifamily residential							
Income property multifamily	10,666	—	—	—	—	7,584	18,250
Owner occupied	11,935	—	—	—	—	—	11,935
Consumer	176,005	397	595	—	992	5,020	182,017
Total	$1,819,499	$3,464	$7,117	$1	$10,582	$89,163	$1,919,244

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The following is an analysis of impaired loans as of September 30, 2011 and December 31, 2010:

(in thousands)	Recorded Investment of Loans Collectively Measured for Contingency Provision	Recorded Investment of Loans Individually Measured for Specific Impairment	Impaired Loans With Recorded Allowance			Impaired Loans Without Recorded Allowance		Average Recorded Investment on Impaired Loans	Interest Recognized on Impaired Loans
			Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance		
September 30, 2011									
Commercial Business									
Secured	$ 908,699	$ 7,591	$273	$273	$ 54	$7,318	$14,810	$ 17,251	$ 16
Unsecured	58,548	288	—	—	—	288	609	148	—
Real Estate:									
One-to-four family residential	61,629	2,044	—	—	—	2,044	2,283	2,498	—
Commercial & multifamily residential									
Commercial land	44,316	3,816	—	—	—	3,816	6,781	4,380	—
Income property multifamily	519,745	6,786	2,588	3,512	297	4,198	5,673	9,444	526
Owner occupied	376,391	15,414	1,528	2,186	408	13,886	16,616	15,427	298
Real Estate Construction:									
One-to-four family residential									
Land and acquisition	17,550	8,427	1,216	1,813	175	7,211	12,210	9,368	176
Residential construction	20,830	5,115	—	—	—	5,115	6,563	4,397	—
Commercial & multifamily residential									
Income property multifamily	6,178	7,623	—	—	—	7,623	14,963	7,064	—
Owner occupied	10,358	—	—	—	—	—	—	—	—
Consumer	174,059	2,492	154	226	32	2,338	2,832	4,276	13
Total	$ 2,198,303	$ 59,596	$5,759	$8,010	$ 966	$53,837	$83,340	$ 74,253	$ 1,029

	Recorded Investment of Loans	Recorded Investment of Loans	Impaired Loans With Recorded Allowance			Impaired Loans Without Recorded			

(in thousands)	Collectively Measured for Contingency Provision	Individually Measured for Specific Impairment	Recorded Investment	Unpaid Principal Balance	Related Allowance	Allowance Recorded Investment	Unpaid Principal Balance
December 31, 2010							
Commercial Business							
Secured	$ 724,665	$ 29,793	$ 2,717	$ 2,758	$ 600	$ 27,081	$ 26,913
Unsecured	40,808	104	75	75	75	29	30
Real Estate:							
One-to-four family residential	46,728	2,655	—	—	—	2,658	2,949
Commercial & multifamily residential							
Commercial land	20,959	3,863	3,062	5,225	—	804	826
Income property multifamily	427,799	10,595	3,094	3,139	59	10,292	12,253
Owner occupied	317,010	14,103	—	—	—	14,152	17,099
Real Estate Construction:							
One-to-four family residential							
Land and acquisition	25,362	11,543	533	549	3	11,013	20,718
Residential construction	24,655	6,400	915	1,723	62	5,585	9,824
Commercial & multifamily residential							
Income property multifamily	10,666	7,584	6,792	10,515	175	792	2,401
Owner occupied	11,935	—	—	—	—	—	—
Consumer	177,484	4,533	—	—	—	4,533	4,691
Total	$ 1,828,071	$ 91,173	$ 17,188	$ 23,984	$ 974	$ 76,939	$ 97,704

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The following is an analysis of loans classified as Troubled Debt Restructurings ("TDR") during the three months ended September 30, 2011:

(in thousands except number of modifications)	Number of TDR Modifications	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial Business			
Secured	1	$ 226	$ 226
Total	1	$ 226	$ 226

The following is an analysis of loans classified as Troubled Debt Restructurings during the nine months ended September 30, 2011:

(in thousands except number of modifications)	Number of TDR Modifications	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial Business			
Secured	3	$ 578	$ 578
Real Estate: Commercial & multifamily residential			
Income Property Multifamily	1	623	623
Real Estate Construction: One-to-four family residential			
Residential Construction	1	36	36
Total	5	$ 1,237	$ 1,237

The Company's loans classified as TDR are loans that have been modified or the borrower has been granted special concessions due to financial difficulties, that if not for the challenges of the borrower, the Company would not otherwise consider. The Company had commitments to lend $2.4 million of additional funds on loans classified as TDR as of September 30, 2011. The TDR modifications or concessions are made to increase the likelihood these borrowers with financial difficulties will be able to satisfy their debt obligations as amended. Credit losses for loans classified as TDR are measured the same as impaired loans. For impaired loans, an allowance is established when the collateral value (or discounted cash flows or observable market price) of the impaired loan is lower than the recorded investment of that loan. The Company did not have any loans modified as TDR within the past twelve months that have defaulted during the nine months ended September 30, 2011.

7. Allowance for Loan and Lease Losses and Unfunded Commitments and Letters of Credit

We maintain an allowance for loan and lease losses (“ALLL”) to absorb losses inherent in the loan portfolio. The size of the ALLL is determined through quarterly assessments of the probable estimated losses in the loan portfolio. Our methodology for making such assessments and determining the adequacy of the ALLL includes the following key elements:

1. General valuation allowance consistent with the Contingencies topic of the FASB ASC.
2. Classified loss reserves on specific relationships. Specific allowances for identified problem loans are determined in accordance with the Receivables topic of the FASB ASC.
3. The unallocated allowance provides for other factors inherent in our loan portfolio that may not have been contemplated in the general and specific components of the allowance. This unallocated amount generally comprises less than 5% of the allowance. The unallocated amount is reviewed quarterly based on trends in credit losses, the results of credit reviews and overall economic trends.

The general valuation allowance is systematically calculated quarterly using quantitative and qualitative information about specific loan classes. The minimum required level an entity develops a methodology to determine its allowance

for loan and lease losses is by general categories of loans, such as commercial business, real estate, and consumer. However, the Company's methodology in determining its allowance for loan and lease losses is prepared in a more detailed manner at the loan class level, utilizing specific categories such as commercial business secured, commercial business unsecured, real estate commercial land, and real estate income property multifamily. The quantitative information uses historical losses from a

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specific loan class and incorporates the loan's risk rating migration from origination to the point of loss.

A loan's risk rating is primarily determined based upon the borrower's ability to fulfill its debt obligation from a cash flow perspective. In the event there is financial deterioration of the borrower, the borrower's other sources of income or repayment are also considered, including recent appraisal values for collateral dependent loans. The qualitative information takes into account general economic and business conditions affecting our market place, seasoning of the loan portfolio, duration of the business cycle, etc. to ensure our methodologies reflect the current economic environment and other factors as using historical loss information exclusively may not give an accurate estimate of inherent losses within the Company's loan portfolio.

When a loan is deemed to be impaired, the Company has to determine if a specific valuation allowance is required for that loan. The specific valuation allowance is a reserve, calculated at the individual loan level, for each loan determined to be both, impaired and containing a value less than its recorded investment. The Company measures the impairment based on the discounted expected future cash flows, observable market price, or the fair value of the collateral less selling costs if the loan is collateral dependent or if foreclosure is probable. The specific reserve for each loan is equal to the difference between the recorded investment in the loan and its determined impairment value.

The ALLL is increased by provisions for loan and lease losses ("provision") charged to expense, and is reduced by loans charged off, net of recoveries. While the Company's management believes the best information available is used to determine the ALLL, changes in market conditions could result in adjustments to the ALLL, affecting net income, if circumstances differ from the assumptions used in determining the ALLL.

We have used the same methodology for ALLL calculations during the three and nine months ended September 30, 2011 and 2010. Adjustments to the percentages of the ALLL allocated to loan categories are made based on trends with respect to delinquencies and problem loans within each class of loans. The Company reviews the ALLL quantitative and qualitative methodology on a quarterly basis and makes adjustments when appropriate. The Company continues to strive towards maintaining a conservative approach to credit quality and will continue to prudently adjust our ALLL as necessary in order to maintain adequate reserves. The Company carefully monitors the loan portfolio and continues to emphasize the importance of credit quality while continuously strengthening loan monitoring systems and controls.

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The following table shows a detailed analysis of the allowance for loan and lease losses for noncovered loans as of the three and nine months ended September 30, 2011:

(in thousands)	Beginning Balance	Charge-offs	Recoveries	Provision	Ending Balance	Specific Reserve	General Allocation
Three months ended September 30, 2011							
Commercial Business							
Secured	$22,320	$ (1,904)	$420	$2,462	$23,298	$54	$23,244
Unsecured	573	(42)	40	167	738	—	738
Real Estate:							
One-to-four family residential	847	(53)	78	70	942	—	942
Commercial & multifamily residential							
Commercial land	894	(4)	—	(130)	760	—	760
Income property multifamily	14,709	(339)	10	(5,407)	8,973	297	8,676
Owner occupied	6,479	(100)	—	311	6,690	408	6,282
Real Estate Construction:							
One-to-four family residential							
Land and acquisition	2,852	(169)	63	269	3,015	175	2,840
Residential construction	1,704	(14)	56	(222)	1,524	—	1,524
Commercial & multifamily residential							
Income property multifamily	43	(145)	—	157	55	—	55
Owner occupied	34	—	—	(7)	27	—	27
Consumer	2,748	(2,102)	70	2,985	3,701	32	3,669
Unallocated	854	—	—	(155)	699	—	699
Total	$54,057	$ (4,872)	$737	$500	$50,422	$966	$49,456

(in thousands)	Beginning Balance	Charge-offs	Recoveries	Provision	Ending Balance	Specific Reserve	General Allocation
Nine months ended September 30, 2011							
Commercial Business							
Secured	$21,811	$ (6,025)	$749	$6,763	$23,298	$54	$23,244
Unsecured	738	(126)	408	(282)	738	—	738
Real Estate:							
One-to-four family residential	1,100	(717)	78	481	942	—	942
Commercial & multifamily residential							
Commercial land	634	(660)	—	786	760	—	760
Income property multifamily	15,210	(979)	65	(5,323)	8,973	297	8,676
Owner occupied	9,692	(723)	31	(2,310)	6,690	408	6,282
Real Estate Construction:							
One-to-four family residential							
Land and acquisition	3,769	(1,347)	1,831	(1,238)	3,015	175	2,840
Residential construction	2,292	(1,068)	92	208	1,524	—	1,524
Commercial & multifamily residential							
Income property multifamily	274	(1,710)	—	1,491	55	—	55
Owner occupied	70	—	—	(43)	27	—	27

Consumer	2,120	(3,298)	178	4,701	3,701	32	3,669
Unallocated	3,283	—	—	(2,584)	699	—	699
Total	$60,993	$ (16,653)	$3,432	$2,650	$50,422	$966	$49,456

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The three and nine months changes as of September 30, 2011 and 2010 are summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2011	2010	2011	2010
Beginning balance	$54,057	$59,748	$60,993	$53,478
Provision charged to expense	500	9,000	2,650	37,500
Loans charged off	(4,872)	(7,540)	(16,653)	(31,466)
Recoveries	737	1,126	3,432	2,822
Ending balance	$50,422	$62,334	$50,422	$62,334

Changes in the allowance for unfunded commitments and letters of credit are summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2011	2010	2011	2010
Beginning balance	$1,460	$815	$1,165	$775
Net changes in the allowance for unfunded commitments and letters of credit	—	350	295	390
Ending balance	$1,460	$1,165	$1,460	$1,165

Risk Elements

The extension of credit in the form of loans to individuals and businesses is one of our principal commerce activities. Our policies and applicable laws and regulations require risk analysis as well as ongoing portfolio and credit management. We manage our credit risk through lending limit constraints, credit review, approval policies and extensive, ongoing internal monitoring. We also manage credit risk through diversification of the loan portfolio by type of loan, type of industry, type of borrower and by limiting the aggregation of debt to a single borrower.

The monitoring process for the loan portfolio includes periodic reviews of individual loans with risk ratings assigned to each loan. Based on the analysis, loans are given a risk rating of 1-10 based on the following criteria:

- ratings of 1-3 indicate minimal to low credit risk,
- ratings of 4-5 indicate an average credit risk with adequate repayment capacity when prolonged periods of adversity do not exist,
- rating of 6 indicate higher than average risk requiring greater than routine attention by bank personnel due to conditions affecting the borrower, the borrower's industry or economic environment,
- rating of 7 indicate potential weaknesses that, if left uncorrected, may result in deterioration of the repayment prospects for the asset or in the Company's credit position at some future date,
- rating of 8 indicates a loss is possible if loan weaknesses are not corrected,
- rating of 9 indicates loss is highly probable; however, the amount of loss has not yet been determined,
- and a rating of 10 indicates the loan is uncollectable, and when identified is charged-off.

Loans with a risk rating of 1-6 are considered Pass loans and loans with risk ratings of 7, 8, 9 and 10 are considered Special Mention, Substandard, Doubtful and Loss, respectively. Loans with a risk rating of Substandard or worse are reported as classified loans in our allowance for loan and lease losses analysis. We review these loans to assess the ability of our borrowers to service all interest and principal obligations and, as a result, the risk rating may be adjusted accordingly. Risk ratings are reviewed and updated whenever appropriate, with more periodic reviews as the risk and dollar value of loss on the loan increases. In the event full collection of principal and interest is not reasonably assured, the loan is appropriately downgraded and, if warranted, placed on non-accrual status even though the loan may be current as to principal and interest payments. Additionally, we assess whether an impairment of a loan warrants specific reserves or a write-down of the loan.

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The following is an analysis of the credit quality of our noncovered loan portfolio as of September 30, 2011 and December 31, 2010:

	September 30, 2011:		December 31, 2010:	
(dollars in thousands)	Weighted-Average Risk Rating	Recorded Investment Noncovered Loans	Weighted-Average Risk Rating	Recorded Investment Noncovered Loans
Commercial Business				
Secured	4.95	$916,290	4.96	$757,372
Unsecured	4.25	58,836	4.23	41,175
Real Estate:				
One-to-four family residential	4.91	63,672	4.96	49,436
Commercial & multifamily residential				
Commercial land	5.64	48,132	5.75	24,956
Income property multifamily	4.98	526,531	5.07	406,711
Owner occupied	5.08	391,804	5.12	366,284
Real Estate Construction:				
One-to-four family residential				
Land and acquisition	6.61	25,978	6.79	37,054
Residential construction	6.07	25,945	6.63	31,293
Commercial & multifamily residential				
Income property multifamily	5.39	13,801	6.38	18,296
Owner occupied	4.45	10,358	4.93	11,990
Consumer	4.27	176,552	4.31	182,624
Total recorded investment of noncovered loans		$2,257,899		$1,927,191

8. Covered Assets and FDIC Loss-sharing Asset

Covered Assets

Covered assets consist of loans and OREO acquired in FDIC assisted acquisitions during 2010 and 2011, for which the Bank entered into loss-sharing agreements, whereby the FDIC will cover a substantial portion of any future losses on loans (and related unfunded loan commitments), OREO and certain accrued interest on loans. Under the terms of the loss-sharing agreements, the FDIC will absorb 80% of losses and share in 80% of loss recoveries up to specified amounts and, with respect to loss-sharing agreements for two acquisitions completed in 2010, will absorb 95% of losses and share in 95% of loss recoveries thereafter. The loss-sharing provisions of the agreements for commercial and single-family mortgage loans are in effect for five and ten years, respectively, from the acquisition dates and the loss recovery provisions are in effect for eight and ten years, respectively, from the acquisition dates.

Ten years and forty-five days after the acquisition dates, the Bank shall pay to the FDIC a clawback in the event the losses from the acquisitions fail to reach stated levels. This clawback shall be in the amount of 50% of the excess, if any, of 20% of the stated threshold amounts, less the sum of 25% of the asset premium (discount), 20% or 25% of the cumulative loss-sharing payments (depending on the particular agreement), and the cumulative servicing amount. As of September 30, 2011, the net present value of the Bank's estimated clawback liability is $3.3 million, which is included in other liabilities on the consolidated condensed financial statements.

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The following is an analysis of our covered loans, net of related allowance for losses on covered loans as of September 30, 2011 and December 31, 2010:

(dollars in thousands)	Covered Loans September 30, 2011	Weighted-Average Risk Rating	Allowance for Loan Losses
Commercial Business	$220,727	6.09	$2,018
Real Estate:			
One-to-four family residential	84,724	5.33	1,071
Commercial and multifamily residential	346,406	5.90	4,293
Total Real Estate	431,130		5,364
Real Estate Construction:			
One-to-four family residential	55,928	7.40	205
Commercial and multifamily residential	30,034	7.15	134
Total Real Estate Construction	85,962		339
Consumer	60,306	5.07	606
Subtotal of covered loans	798,125		$8,327
Less:			
Valuation discount resulting from acquisition accounting	218,993		
Allowance for loan losses	8,327		
Covered loans, net of valuation discounts and allowance for loan losses	$570,805		

(dollars in thousands)	Covered Loans December 31, 2010	Weighted-Average Risk Rating	Allowance for Loan Losses
Commercial Business	$165,255	5.74	$2,903
Real Estate:			
One-to-four family residential	68,700	4.77	1,013
Commercial and multifamily residential	341,063	5.70	821
Total Real Estate	409,763		1,834
Real Estate Construction:			
One-to-four family residential	39,754	7.29	98
Commercial and multifamily residential	41,624	6.79	469
Total Real Estate Construction	81,378		567
Consumer	58,337	4.49	751
Subtotal of covered loans	714,733		$6,055
Less:			
Valuation discount resulting from acquisition accounting	191,617		
Allowance for loan losses	6,055		
Covered loans, net of valuation discounts and allowance for loan losses	$517,061		

Certain acquired loans are accounted for under ASC 310-30 and initially measured at fair value based on expected future cash flows over the life of the loans. Acquired loans that have common risk characteristics are aggregated into pools. The Company re-measures contractual and expected cash flows, at the pool-level, on a quarterly basis. Contractual cash flows are calculated based upon the loan pool terms after applying a prepayment factor. Calculation of the applied prepayment factor for contractual cash flows is the same as described below for expected cash flows.

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Inputs to the determination of expected cash flows include cumulative default and prepayment data as well as loss severity and recovery lag information. Cumulative default and prepayment data are calculated via a transition matrix. The transition matrix is a matrix of probability values that specifies the probability of a loan pool transitioning into a particular delinquency state (e.g. 0-30 days past due, 31 to 60 days, etc.) given its delinquency state at the re-measurement date. Loss severity factors are based upon actual charge-off data within the loan pools and recovery lags are based upon experience with the collateral within the loan pools.

Acquired loans are also subject to the Company's internal and external credit review and are risk rated using the same criteria as loans originated by the Company. However, risk ratings are not a clear indicator of losses on acquired loans as a majority of the losses are recoverable from the FDIC under the loss-sharing agreements.

Draws on acquired loans, advanced subsequent to the loan acquisition date, are accounted for under ASC 450-20 and those amounts are also subject to the Company's internal and external credit review. An allowance for loan losses is estimated in a similar manner as the originated loan portfolio, and a provision for loan losses is charged to earnings as necessary.

The excess of cash flows expected to be collected over the initial fair value of acquired loans is referred to as the accretable yield and is accreted into interest income over the estimated life of the acquired loans using the effective yield method. Other adjustments to the accretable yield include changes in the estimated remaining life of the acquired loans, changes in expected cash flows and changes of indices for acquired loans with variable interest rates.

The following table shows the changes in accretable yield for acquired loans for three and nine months ended September 30, 2011:

(in thousands)	Three months ended September 30, 2011	Nine months ended September 30, 2011
Balance at beginning of period	$314,333	$256,572
Additions resulting from acquisitions	—	59,811
Accretion	(23,608)	(60,369)
Disposals	(8,594)	(24,134)
Reclassifications from nonaccretable difference	69	50,320
Balance at end of period	$282,200	$282,200

During the nine months ended September 30, 2011, the Company recorded a provision expense for losses on covered loans of $2.3 million. Of this amount, $3.5 million was impairment expense calculated in accordance with ASC 310-30 and $1.2 million was a negative provision to adjust the allowance for loss calculated under ASC 450-20 for draws on acquired loans. The impact to earnings of the $2.3 million of provision expense for covered loans was partially offset through noninterest income by an increase in the FDIC loss-sharing asset.

The following table shows the initially recorded amounts for loans acquired during 2011, which are accounted for on a pooled basis, at acquisition date, respectively:

(in thousands)	First Heritage Bank May 27, 2011	Summit Bank May 20, 2011
Contractually required payments of interest and principal	$151,611	$127,823
Nonaccretable difference	(34,052)	(34,301)
Cash flows expected to be collected(1)	117,559	93,522
Accretable yield	(36,071)	(23,739)
Carrying value of acquired loans	$81,488	$69,783

(1) Represents undiscounted expected principal and interest cash flows

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The following table sets forth activity in covered OREO at carrying value for the three and nine months ended September 30, 2011:

(in thousands)	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Covered OREO:		
Balance, beginning of period	$23,730	$14,443
Established through acquisitions	—	10,387
Transfers in, net of write-downs ($952 and $1,393, respectively)	2,979	8,071
OREO improvements	—	—
Additional OREO write-downs	(189)	(302)
Proceeds from sale of OREO property	(3,523)	(14,604)
Gain on sale of OREO	1,838	6,840
Total covered OREO, end of period	$24,835	$24,835

The covered OREO is covered by loss-sharing agreements with the FDIC in which the FDIC will assume 80% of additional write-downs and losses on covered OREO sales, or 95%, if applicable, of additional write-downs and losses on covered OREO sales if the minimum loss share thresholds are met.

FDIC Loss-sharing Asset

At September 30, 2011, the FDIC loss-sharing asset is comprised of a $186.5 million FDIC indemnification asset and a $7.4 million FDIC receivable. The indemnification represents the cash flows the Company expects to collect from the FDIC under the loss-sharing agreements and the FDIC receivable represents the reimbursable amounts from the FDIC that have not yet been received.

For covered loans, the Company re-measures contractual and expected cash flows on a quarterly basis. When the quarterly re-measurement process results in a decrease in expected cash flows due to an increase in expected credit losses, impairment is recorded. As a result of this impairment, the indemnification asset is increased to reflect anticipated future cash to be received from the FDIC. Consistent with the loss-sharing agreements between the Company and the FDIC, the amount of the increase to the indemnification asset is measured as 80% of the resulting impairment.

Alternatively, when the quarterly re-measurement results in an increase in expected future cash flows due to a decrease in expected credit losses, the nonaccretable difference decreases and the effective yield of the related loan portfolio is increased. As a result of the improved expected cash flows, the indemnification asset would be reduced first by the amount of any impairment previously recorded and, second, by increased amortization over the remaining life of the related loan pool.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2011	2010	2011	2010
Balance at beginning of period	$209,694	$226,745	$205,991	$—
Adjustments not reflected in income				
Established through acquisitions	—	—	68,734	210,405
Cash received from the FDIC	(6,108)	(11,198)	(51,000)	(11,198)
FDIC reimbursable losses, net	1,138	416	2,192	13,357
Adjustments reflected in income				
(Amortization) accretion	(9,333)	2,401	(24,974)	6,353
Loan loss provision	921	—	2,424	—
Other	(2,443)	(6,937)	(9,498)	(7,490)
Balance at end of period	$193,869	$211,427	$193,869	$211,427

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9. Changes in Noncovered Other Real Estate Owned

The following table sets forth activity in noncovered OREO for the period:

(in thousands)	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Noncovered OREO:		
Balance, beginning of period	$22,739	$30,991
Transfers in, net of write-downs ($0 and $108, respectively)	5,287	8,434
OREO improvements	257	726
Additional OREO write-downs	(644)	(5,090)
Proceeds from sale of OREO property	(2,359)	(10,234)
Gain (loss) on sale of OREO	(224)	229
Total noncovered OREO, end of period	$25,056	$25,056

10. Goodwill and Intangible Assets

In accordance with the Intangibles – Goodwill and Other topic of the FASB ASC, goodwill is not amortized but is reviewed for potential impairment at the reporting unit level. Management analyzes its goodwill for impairment during the third quarter on an annual basis and between annual tests in certain circumstances such as material adverse changes in legal, business, regulatory and economic factors. An impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. During the current quarter, the Company analyzed its goodwill for potential impairment utilizing the guidance in ASU 2011-08, Testing Goodwill for Impairment. The Company determined through an assessment of qualitative factors that it was not more likely than not that the fair value of the Company's single reporting unit was less than its carrying amount, and therefore determined it was unnecessary to perform the two-step impairment test.

The core deposit intangible (“CDI”) is evaluated for impairment if events and circumstances indicate a possible impairment. The CDI is amortized on an accelerated basis over an estimated life of approximately 10 years.

The following table sets forth activity for goodwill and intangible assets for the period:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2011	2010	2011	2010
Total goodwill, beginning of period	$118,434	$109,639	$109,639	$95,519
Established through acquisitions	—	—	8,795	14,120
Total goodwill, end of period	118,434	109,639	118,434	109,639
Gross core deposit intangible balance, beginning of period	28,497	26,651	26,651	8,896
Accumulated amortization, beginning of period	(9,894)	(5,874)	(7,955)	(4,032)
Core deposit intangible, net, beginning of period	18,603	20,777	18,696	4,864
Established through acquisitions	3,943	—	5,789	17,755
CDI current period amortization	(1,177)	(1,044)	(3,116)	(2,886)
Total core deposit intangible, end of period	21,369	19,733	21,369	19,733
Total goodwill and intangible assets, end of period	$139,803	$129,372	$139,803	$129,372

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The following table provides the estimated future amortization expense of core deposit intangibles for the remaining three months ending December 31, 2011 and the succeeding four years:

(in thousands)	Amount
Year ending December 31,	
2011	$1,203
2012	4,445
2013	3,964
2014	3,397
2015	2,645

11. Shareholders’ Equity

Common Stock. On February 3, 2011, the Company declared a quarterly cash dividend of $0.03 per share, payable on March 3, 2011 to shareholders of record as of the close of business on February 17, 2011. On April 27, 2011 the Company declared a quarterly cash dividend of $0.05 per share, payable on May 25, 2011 to shareholders of record at the close of business May 11, 2011. On July 28, 2011 the Company declared a quarterly cash dividend of $0.06 per share, payable on August 24, 2011 to shareholders of record at the close of business August 10, 2011. The payment of cash dividends is subject to Federal regulatory requirements for capital levels and other restrictions. In addition, the cash dividends paid by Columbia Bank to the Company are subject to both Federal and State regulatory requirements. Subsequent to quarter end, on October 27, 2011 the Company declared a quarterly cash dividend of $0.08 per share and a special, one time cash dividend of $0.05 per share, both payable on November 23, 2011 to shareholders of record at the close of business November 9, 2011.

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12. Comprehensive Income

The components of comprehensive income are as follows:

	Three Months Ended September 30,	
(in thousands)	2011	2010
Net income as reported	$18,872	$5,204
Unrealized gain from securities:		
Net unrealized holding gain from available for sale securities arising during the period, net of tax of ($2,808) and ($2,611)	4,988	4,739
Reclassification adjustment of net gain from sale of available for sale securities included in income, net of tax of $0 and $0	—	—
Net unrealized gain from securities, net of reclassification adjustment	4,988	4,739
Cash flow hedging instruments:		
Reclassification adjustment of net gain included in income, net of tax of $0 and $119	—	(216)
Net change in cash flow hedging instruments	—	(216)
Pension plan liability adjustment:		
Net unrealized gain from unfunded defined benefit plan liability arising during the period, net of tax of $0 and $0	—	—
Less: amortization of unrecognized net actuarial loss included in net periodic pension cost, net of tax of ($8) and ($4)	14	7
Pension plan liability adjustment, net	14	7
Total comprehensive income	$23,874	$9,734

	Nine Months Ended September 30,	
(in thousands)	2011	2010
Net income as reported	$33,283	$18,176
Unrealized gain from securities:		
Net unrealized holding gain from available for sale securities arising during the period, net of tax of ($7,733) and ($6,553)	13,768	11,897
Reclassification adjustment of net gain from sale of available for sale securities included in income, net of tax of $0 and $20	—	(38)
Net unrealized gain from securities, net of reclassification adjustment	13,768	11,859
Cash flow hedging instruments:		
Reclassification adjustment of net gain included in income, net of tax of $79 and $520	(143)	(943)
Net change in cash flow hedging instruments	(143)	(943)
Pension plan liability adjustment:		
Net unrealized gain (loss) from unfunded defined benefit plan liability arising during the period, net of tax of $154 and ($12)	(260)	23
Less: amortization of unrecognized net actuarial loss included in net periodic pension cost, net of tax of ($23) and ($11)	41	21
Pension plan liability adjustment, net	(219)	44
Total comprehensive income	$46,689	$29,136

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13. Fair Value Accounting and Measurement

The Fair Value Measurements and Disclosures topic of the FASB ASC defines fair value, establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value. We hold fixed and variable rate interest-bearing securities, investments in marketable equity securities and certain other financial instruments, which are carried at fair value. Fair value is determined based upon quoted prices when available or through the use of alternative approaches, such as matrix or model pricing, when market quotes are not readily accessible or available. The valuation techniques are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our own market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1 – Quoted prices for identical instruments in active markets that are accessible at the measurement date.

Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 – Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable.

Fair values are determined as follows:

Securities at fair value are priced using matrix pricing based on the securities' relationship to other benchmark quoted prices, and under the provisions of the Fair Value Measurements and Disclosures topic of the FASB ASC are considered a Level 2 input method.

Interest rate contract positions are valued in models, which use as their basis, readily observable market parameters and are classified within level 2 of the valuation hierarchy.

The following table sets forth the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis at September 30, 2011 by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

(in thousands)	Fair value at September 30, 2011	Fair Value Measurements at Reporting Date Using Level 1	Level 2	Level 3
Assets				
Securities available for sale				
U.S. government and U.S. agency securities	$ 71,380	$—	$71,380	$—
U.S. government agency and sponsored enterprise mortgage-back securities and collateralized mortgage obligations	644,726	—	644,726	—
State and municipal debt securities	276,417	—	276,417	—
Other securities	3,331	—	3,331	—
Total securities available for sale	$ 995,854	$—	$995,854	$—
Other assets (Interest rate contracts)	$ 16,463	$—	$16,463	$—
Liabilities				
Other liabilities (Interest rate contracts)	$ 16,463	$—	$16,463	$—

Certain assets and liabilities are measured at fair value on a nonrecurring basis after initial recognition such as loans measured for impairment and OREO. The following methods were used to estimate the fair value of each such class of financial instrument:

Impaired loans—A loan is considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due (both interest and principal) according to the contractual terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, a loan's observable market price, or the fair market value of the collateral if the loan is collateral-dependent loan. Generally, the Company utilizes the fair market value of the collateral to

measure impairment.

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Other real estate owned—OREO is real property that the Bank has taken ownership of in partial or full satisfaction of a loan or loans. OREO is recorded at the lower of the carrying amount of the loan or fair value less estimated costs to sell. This amount becomes the property's new basis. Any write-downs based on the property fair value less estimated cost to sell at the date of acquisition are charged to the allowance for loan and lease losses. Management periodically reviews OREO in an effort to ensure the property is carried at the lower of its new basis or fair value, net of estimated costs to sell. Any write-downs subsequent to acquisition are charged to earnings.

The following table presents information about the Company's assets measured at fair value on a nonrecurring basis for which a nonrecurring change in fair value has been recorded during the reporting period. The amounts disclosed below represent the fair values at the time the nonrecurring fair value measurements were made and not necessarily the fair value at the reporting date.

		Fair Value Measurements at Reporting Date Using				
(in thousands)	Fair value at September 30, 2011	Level 1	Level 2	Level 3	Losses During the Three Months Ended September 30, 2011	Losses During the Nine Months Ended September 30, 2011
Impaired loans	$ 3,717	$ —	$ —	$ 3,717	$ 735	$ 4,707
Non-covered OREO	2,876	—	—	2,876	573	3,120
	$ 6,593	$ —	$ —	$ 6,593	$ 1,308	$ 7,827

The losses on impaired loans disclosed above represent the amount of the specific reserve and/or charge-offs during the period applicable to loans held at period end. The amount of the specific reserve is included in the allowance for loan and lease losses. The losses on non-covered OREO disclosed above represent the writedowns taken at foreclosure that were charged to the allowance for loan and lease losses, as well as subsequent writedowns from updated appraisals that were charged to earnings.

14. Fair Value of Financial Instruments

Because broadly traded markets do not exist for most of the Company's financial instruments, the fair value calculations attempt to incorporate the effect of current market conditions at a specific time. These determinations are subjective in nature, involve uncertainties and matters of significant judgment and do not include tax ramifications; therefore, the results cannot be determined with precision, substantiated by comparison to independent markets and may not be realized in an actual sale or immediate settlement of the instruments. There may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results. For all of these reasons, the aggregation of the fair value calculations presented herein do not represent, and should not be construed to represent, the underlying value of the Company.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and due from banks and interest-earning deposits with banks—The fair value of financial instruments that are short-term or reprice frequently and that have little or no risk are considered to have a fair value that approximates carrying value.

Securities available for sale—Securities at fair value are priced using matrix pricing based on the securities' relationship to other benchmark quoted prices.

Federal Home Loan Bank stock—The fair value is based upon the par value of the stock which equates to its carrying value.

Loans—Loans are not recorded at fair value on a recurring basis. Nonrecurring fair value adjustments are periodically recorded on impaired loans that are measured for impairment based on the fair value of collateral. For most performing loans, fair value is estimated using expected duration and lending rates that would have been offered on September 30, 2011 for loans which mirror the attributes of the loans with similar rate structures and average

maturities. Commercial loans and construction loans, which are variable rate and short-term are reflected with fair values equal to carrying value. The fair values resulting from these calculations are reduced by an amount representing the change in estimated fair value attributable to changes in borrowers' credit quality since the loans were originated. For nonperforming loans, fair value is estimated by applying a valuation discount based upon loan sales data from the FDIC.

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FDIC loss-sharing asset —The FDIC loss-sharing asset is considered to have a fair value that approximates carrying value.
Interest rate contracts—Interest rate swap positions are valued in models, which use as their basis, readily observable market parameters.
Deposits—For deposits with no contractual maturity, the fair value is equal to the carrying value. The fair value of fixed maturity deposits is based on discounted cash flows using the difference between the deposit rate and current market rates for deposits of similar remaining maturities.
FHLB and FRB borrowings—The fair value of Federal Home Loan Bank of Seattle (the “FHLB”) advances and Federal Reserve Bank of San Francisco (the “FRB”) borrowings are estimated based on discounting the future cash flows using the market rate currently offered.

Repurchase Agreements—The fair value of securities sold under agreement to repurchase are estimated based on discounting the future cash flows using the market rate currently offered.
Long-term subordinated debt—The fair value of long-term subordinated debt are estimated based on discounting the future cash flows using an estimated market rate.
Other Financial Instruments—The majority of our commitments to extend credit and standby letters of credit carry current market interest rates if converted to loans, as such, carrying value is assumed to equal fair value.
The following table summarizes carrying amounts and estimated fair values of selected financial instruments as well as assumptions used by the Company in estimating fair value:

	September 30, 2011		December 31, 2010	
(in thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets				
Cash and due from banks	$97,432	$97,432	$55,492	$55,492
Interest-earning deposits with banks	250,030	250,030	458,638	458,638
Securities available for sale	995,854	995,854	763,866	763,866
FHLB stock	22,215	22,215	17,908	17,908
Loans held for sale	2,568	2,568	754	754
Loans	2,778,282	3,039,531	2,371,822	2,525,113
FDIC loss-sharing asset	193,869	193,869	205,991	205,991
Interest rate contracts	16,463	16,463	10,167	10,167
Liabilities				
Deposits	$3,795,499	$3,797,901	$3,327,269	$3,330,616
FHLB Advances	122,642	124,358	119,405	122,722
Repurchase agreements	25,000	27,022	25,000	27,251
Other borrowings	—	—	642	642
Long-term subordinated debt	—	—	25,735	20,156
Interest rate contracts	16,463	16,463	10,167	10,167

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15. Derivatives and Hedging Activities

The Company periodically enters into certain commercial loan interest rate swap agreements in order to provide commercial loan customers the ability to convert from variable to fixed interest rates. Under these agreements, the Company enters into a variable-rate loan agreement with a customer in addition to a swap agreement. This swap agreement effectively converts the customer’s variable rate loan into a fixed rate. The Company then enters into a corresponding swap agreement with a third party in order to offset its exposure on the variable and fixed components of the customer agreement. As the interest rate swap agreements with the customers and third parties are not designated as hedges under the Derivatives and Hedging topic of the FASB ASC, the instruments are marked to market in earnings.

The following table presents the fair value of derivative instruments at September 30, 2011 and 2010:

	Asset Derivatives				Liability Derivatives			
As of September 30,	2011		2010		2011		2010	
(in thousands)	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives not designated as hedging instruments								
Interest rate contracts	Other assets	$ 16,463	Other assets	$ 13,623	Other liabilities	$ 16,463	Other liabilities	$ 13,623

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Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion should be read in conjunction with the unaudited consolidated condensed financial statements of Columbia Banking System, Inc. (referred to in this report as "we", "our", and "the Company") and notes thereto presented elsewhere in this report and with the December 31, 2010 audited consolidated financial statements and its accompanying notes included in our Annual Report on Form 10-K. In the following discussion, unless otherwise noted, references to increases or decreases in average balances in items of income and expense for a particular period and balances at a particular date refer to the comparison with corresponding amounts for the period or date one year earlier.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, statements about our plans, objectives, expectations and intentions that are not historical facts, and other statements identified by words such as "expects," "anticipates," "intends," "plans," "believes," "should," "projects," "seeks," "estimates" or words of similar r
These forward-looking statements are based on current beliefs and expectations of management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. In addition to the factors set forth in the sections "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this report, the following factors, among others, could cause actual results to differ materially from the anticipated results:

- local and national economic conditions could be less favorable than expected or could have a more direct and pronounced effect on us than expected and adversely affect our ability to continue internal growth at historical rates and maintain the quality of our earning assets;
- the local housing/real estate market could decline further;
- the risks presented by a continued challenging economy, which could adversely affect credit quality, collateral values, including real estate collateral, investment values, liquidity and loan originations and loan portfolio delinquency rates;
- the effects of the U.S. government's management of the federal budget and debt crises;
- the efficiencies and enhanced financial and operating performance we expect to realize from investments in personnel, acquisitions and infrastructure could not be realized;
- interest rate changes could significantly reduce net interest income and negatively affect funding sources;
- projected business increases following strategic expansion or opening of new branches could be lower than expected;
- the scope and cost of FDIC insurance and other coverages could increase;
- changes in accounting principles, policies, and guidelines applicable to bank holding companies and banking could increase costs or adversely affect our financial results;
- competition among financial institutions could increase significantly;
- the goodwill we have recorded in connection with acquisitions could become impaired, which may have an adverse impact on our earnings and capital;
- we may not be able to effectively manage credit risk, interest rate risk, market risk, operational risk, legal risk, liquidity risk and regulatory and compliance risk; and
- our profitability measures could be adversely affected if we are unable to effectively deploy the capital we raised in 2010.

Please take into account that forward-looking statements speak only as of the date of this report. We do not undertake any obligation to publicly correct or update any forward-looking statement whether as a result of new information, future events or otherwise.

CRITICAL ACCOUNTING POLICIES

Management has identified the accounting policies related to the allowance for loan and lease losses, business combinations, acquired impaired loans, FDIC loss sharing asset and the valuation and recoverability of goodwill as

critical to an understanding of our financial statements. These policies and related estimates are discussed in “Item 7. Management Discussion and Analysis of Financial Condition and Results of Operation” under the headings “Allowance for Loan and Lease Losses”, “Business Combinations”, “Acquired Impaired Loans”, FDIC Loss Sharing Asset” and “Valuation and Recoverability of Goodwill” in our 2010 Annual Report on Form 10-K. There have not been any material changes in our critical accounting policies as compared to those disclosed in our 2010 Annual Report on Form 10-K.

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RESULTS OF OPERATIONS

Our results of operations are dependent to a large degree on our net interest income. We also generate noninterest income through service charges and fees, merchant services fees, and bank owned life insurance. Our operating expenses consist primarily of compensation and employee benefits, occupancy, merchant card processing, data processing and legal and professional fees. Like most financial institutions, our interest income and cost of funds are affected significantly by general economic conditions, particularly changes in market interest rates, and by government policies and actions of regulatory authorities.

Earnings Summary

The Company reported net income applicable to common shareholders for the third quarter of $18.9 million or $0.48 per diluted common share, compared to $2.5 million or $0.06 per diluted common share for the third quarter of 2010. The increase in net income from the prior year period was attributable to an increase in net interest income, as well as a significant reduction in the provision for loan losses, partially offset by a decline in noninterest income and an increase in noninterest expense. Return on average assets and return on average common equity were 1.60% and 10.18%, respectively, for the third quarter of 2011, compared with returns of 0.47% and 1.39%, respectively for the same period of 2010.

The Company reported net income for the first nine months of $33.3 million applicable to common shareholders or $0.84 per diluted common share, compared to $13.2 million or $0.38 per diluted common share for the first nine months of 2010. The increase in net income from the prior year period was attributable to an increase in net interest income, as well as a reduction in the provision for loan losses, partially offset by a decline in noninterest income and an increase in noninterest expense. Return on average assets and return on average common equity were 1.01% and 6.17%, respectively, for the first nine months of 2011, compared with returns of 0.58% and 2.97%, respectively for the same period of 2010.

The Company's net income was significantly impacted by the accounting for loans acquired in FDIC-assisted transactions. We account for loans under three general models which impact the way income and credit losses are recorded in our financial statements: Originated Loans, Discounted Loans, and Pooled Loans. Originated and discounted loans are included in the “Loans, excluding covered loans” caption of the consolidated condensed balance sheets and pooled loans are included in the “Covered Loans” caption of the consolidated condensed balance sheets. Please refer to Note 1 to the unaudited consolidated condensed financial statements located elsewhere in this report as well as the Company's 2010 Form 10-K for additional information related to these three general models.

The following table illustrates the significant financial statement impact associated with Columbia's acquired loan portfolios for the indicated periods:

(dollars in thousands)	Three months ended September 30, 2011	Nine months ended September 30, 2011
Accretion income on pooled loans in excess of stated loan rates	$14,604	$35,858
Accretion income on discounted loans	5,096	5,096
Change in FDIC loss sharing asset	(10,855)	(32,048)
Clawback liability	(1,146)	(3,294)
Pre-tax earnings impact of acquisition accounting	$7,699	$5,612

The incremental accretion income represents the amount of income recorded on the acquired loans above the contractual rate stated in the individual loan notes. The additional income stems from the discount established at the time these loan portfolios were acquired, and increases net interest income and the net interest margin.

Revenue (net interest income plus noninterest income) for the three months ended September 30, 2011 was $67.0 million, 28% more than the same period in 2010. Revenue (net interest income plus noninterest income) for the nine months ended September 30, 2011 was $164.9 million, 1% more than the same period in 2010. The increase was primarily a result of the FDIC-assisted transactions. Included in revenue for the nine months ended September 30, 2011 is a net gain on bank acquisitions of $1.8 million, revenue for the same period in 2010 included a net gain on bank acquisitions of $9.8 million. For a more complete discussion of this topic, please refer to the noninterest income section contained in the ensuing pages.

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Total noninterest expense for the quarter ended September 30, 2011 was $39.9 million, a 19% increase from the third quarter of 2010. The increase was primarily due to the additional operating expenses related to the FDIC-assisted acquisition during the third quarter of 2011, as well as an increase to the clawback liability for the FDIC loss-sharing agreements.
Total noninterest expense for the nine months ended September 30, 2011 was $114.4 million, a 12% increase from the same period in 2010. The increase was primarily due to the additional operating expenses related to the three FDIC-assisted acquisitions during 2011, as well as establishing a clawback liability for the FDIC loss-sharing agreements.

The Company acquired a portion of the banking operations of Colfax, Washington-based Bank of Whitman pursuant to a purchase and assumption agreement with the FDIC on August 5, 2011. The Company acquired tangible assets with a fair value of $433.6 million, including $200.0 million of loans (net of acquisition accounting adjustments) and assumed $401.1 million in deposits. The operating results of the Company include the operating results produced by the acquired assets and assumed liabilities for the period August 6, 2011 to September 30, 2011.

The Company acquired the banking operations of Burlington, Washington-based Summit Bank pursuant to a purchase and assumption agreement with the FDIC on May 20, 2011. The Company acquired tangible assets with a fair value of $127.7 million, including $71.5 million of loans (net of acquisition accounting adjustments) and assumed $123.3 million in deposits. The operating results of the Company include the operating results produced by the acquired assets and assumed liabilities for the period May 21, 2011 to September 30, 2011.

The Company acquired the banking operations of Snohomish, Washington-based First Heritage Bank pursuant to a purchase and assumption agreement with the FDIC on May 27, 2011. The Company acquired tangible assets with a fair value of $157.8 million, including $81.9 million of loans (net of acquisition accounting adjustments) and assumed $159.5 million in deposits. The operating results of the Company include the operating results produced by the acquired assets and assumed liabilities for the period May 28, 2011 to September 30, 2011.

The provision for loan and lease losses for the third quarter of 2011 was $500 thousand for the noncovered loan portfolio and $433 thousand for the covered loan portfolio compared with $9.0 million for the noncovered loan portfolio and $453 thousand for the covered loan portfolio during the third quarter of 2010. Net charge-offs for the current quarter were $4.1 million compared to $6.4 million for the third quarter of 2010. The provision for loan and lease losses for the first nine months of 2011 was $2.7 million for the noncovered loan portfolio and $2.3 million for the covered loan portfolio compared with $37.5 million for the noncovered loan portfolio and $453 thousand for the covered loan portfolio during the first nine months of 2010. Net charge-offs for the first nine months were $13.2 million compared to $28.6 million for the same period in 2010. As discussed in more detail elsewhere in this report, the provision decision is made quarterly, based on a detailed process to determine the adequacy and appropriateness of the Company's allowance for loan losses. Accordingly, the level of provisioning in the third quarter of 2011 does not necessarily signal a trend. As a result of recording a noncovered loan provision of $500 thousand, the Company's total allowance for loan and lease losses was 2.23% of net noncovered loans at September 30, 2011 compared to 3.18% at year-end 2010 and 3.22% at the end of the third quarter 2010. The reduction in the allowance for loan and lease losses to noncovered loans is due primarily to loan growth experienced throughout the third quarter of 2011. The loan growth was driven by the Bank of Whitman acquisition which, as previously mentioned, added approximately $200.0 million of loans (net of acquisition accounting adjustments).

Net Interest Income
Net interest income for the third quarter of 2011 was $64.8 million, an increase of 38% from $47.0 million for the same quarter in 2010. The Company's net interest margin increased to 6.53% in the third quarter of 2011, from 5.24% for the same quarter last year. The increases in net interest income and margin were primarily due to the impact of income accretion on the acquired loan portfolios. The incremental accretion income represents the amount of income

recorded on the acquired loans above the contractual rate stated in the individual loan notes. The additional income stems from the discount established at the time these loan portfolios were acquired, and increases net interest income and the net interest margin. The incremental accretion income had a positive impact of approximately 194 bps on the third quarter's net interest margin. For the same period last year, the incremental accretion income had a positive impact of approximately 77 bps on the net interest margin.

Loans acquired from the Bank of Whitman acquisition had a significant impact to net interest income during the current quarter. Those loans were recorded at fair value at the time of acquisition. The estimate of fair value included a

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discount related to credit risk and a premium or discount related to interest rates that is recorded for each loan separately. Interest income is recognized through the accrual of interest at the loans' stated rates, plus accretion or amortization of the discount or premium recorded at acquisition. The average discount upon acquisition was approximately 12% and will be recognized over the remaining term of these loans. During the current quarter and year-to-date period, accretion of the net discount recorded at acquisition was $5.1 million. Of this amount, $974 thousand was related to matured loans and $850 thousand was accelerated recognition due to loan prepayments.

The following table sets forth the average balances of all major categories of interest-earning assets and interest-bearing liabilities, the total dollar amounts of interest income on interest-earning assets and interest expense on interest-bearing liabilities, the average yield earned on interest-earning assets and average rate paid on interest-bearing liabilities by category and in total net interest income and net interest margin.

	Three Months Ended September 30, 2011				Three Months Ended September 30, 2010			
(in thousands)	Average Balances (1)	Interest Earned / Paid	Average Rate		Average Balances (1)	Interest Earned / Paid (3)	Average Rate	
ASSETS								
Loans, net (1) (2)	$2,777,681	$ 59,794	8.54	%	$2,500,302	$44,989	7.14	%
Taxable securities	744,878	6,037	3.22	%	486,201	4,660	3.80	%
Tax exempt securities (2)	253,897	3,879	6.06	%	229,000	3,491	6.05	%
Interest-earning deposits with banks and federal funds sold	251,573	240	0.38	%	439,429	281	0.25	%
Total interest-earning assets	4,028,029	$ 69,950	6.89	%	3,654,932	$53,421	5.80	%
Other earning assets	53,695				51,684			
Noninterest-earning assets	599,177				654,297			
Total assets	$4,680,901				$4,360,913			
LIABILITIES AND SHAREHOLDERS' EQUITY								
Certificates of deposit	$684,084	$ 1,243	0.72	%	$729,053	$1,958	1.07	%
Savings accounts	265,348	39	0.06	%	202,669	70	0.14	%
Interest-bearing demand	709,911	329	0.18	%	641,070	489	0.30	%
Money market accounts	992,321	1,031	0.41	%	894,971	1,490	0.66	%
Total interest-bearing deposits	2,651,664	2,642	0.40	%	2,467,763	4,007	0.64	%
Federal Home Loan Bank and Federal Reserve Bank borrowings	128,911	807	2.48	%	122,250	716	2.32	%
Long-term obligations	7,821	75	3.80	%	25,708	266	4.11	%
Other borrowings	25,000	120	1.90	%	25,000	121	1.92	%
Total interest-bearing liabilities	2,813,396	$ 3,644	0.51	%	2,640,721	$5,110	0.77	%
Noninterest-bearing deposits	1,027,268				829,820			
Other noninterest-bearing liabilities	105,045				151,217			
Shareholders' equity	735,192				739,155			
Total liabilities & shareholders' equity	$4,680,901				$4,360,913			
Net interest income (2)		$ 66,306				$48,311		
Net interest margin			6.53	%			5.24	%

(1)

Nonaccrual loans have been included in the tables as loans carrying a zero yield. Amortized net deferred loan fees were included in the interest income calculations. The amortization of net deferred loan fees was $258 thousand and $401 thousand for the three months ended September 30, 2011 and 2010, respectively.

(2) Tax-exempt income is calculated on a tax equivalent basis, based on a marginal tax rate of 35%.

(3) Reclassified to conform to the current period's presentation.

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Net interest income for the first nine months of 2011 was $164.6 million, an increase of 31% from $126.0 million for the same period in 2010. The Company's net interest margin increased to 5.96% in the first nine months of 2011, from 4.90% for the same period last year. The increases in net interest income and margin were primarily due to the impact of income accretion on the acquired loan portfolios.
The following table sets forth the average balances of all major categories of interest-earning assets and interest-bearing liabilities, the total dollar amounts of interest income on interest-earning assets and interest expense on interest-bearing liabilities, the average yield earned on interest-earning assets and average rate paid on interest-bearing liabilities by category and in total net interest income and net interest margin.

	Nine Months Ended September 30, 2011				Nine Months Ended September 30, 2010			
(in thousands)	Average Balances (1)	Interest Earned / Paid	Average Rate		Average Balances (1)	Interest Earned / Paid (3)	Average Rate	
ASSETS								
Loans, net (1) (2)	$2,536,492	$ 151,866	8.00	%	$2,497,396	$121,088	6.48	%
Taxable securities	671,146	16,701	3.33	%	491,976	14,113	3.84	%
Tax exempt securities (2)	248,027	11,610	6.26	%	226,047	10,842	6.41	%
Interest-earning deposits with banks and federal funds sold	339,200	722	0.28	%	334,871	640	0.26	%
Total interest-earning assets	3,794,865	$ 180,899	6.37	%	3,550,290	$146,683	5.52	%
Other earning assets	53,209				51,178			
Noninterest-earning assets	577,963				611,398			
Total assets	$4,426,037				$4,212,866			
LIABILITIES AND SHAREHOLDERS' EQUITY								
Certificates of deposit	$636,907	$ 4,031	0.85	%	$799,011	$7,042	1.18	%
Savings accounts	235,203	127	0.07	%	195,916	237	0.16	%
Interest-bearing demand	699,106	1,145	0.22	%	631,401	1,730	0.37	%
Money market accounts	949,920	3,266	0.46	%	824,297	4,273	0.69	%
Total interest-bearing deposits	2,521,136	8,569	0.45	%	2,450,625	13,282	0.72	%
Federal Home Loan Bank and Federal Reserve Bank borrowings	120,698	2,215	2.45	%	124,234	2,131	2.29	%
Long-term obligations	19,657	579	3.94	%	25,692	769	4.00	%
Other borrowings	25,000	377	2.02	%	25,000	357	1.91	%
Total interest-bearing liabilities	2,686,491	$ 11,740	0.58	%	2,625,551	$16,539	0.84	%
Noninterest-bearing deposits	936,091				795,698			
Other noninterest-bearing liabilities	81,817				136,240			
Shareholders' equity	721,638				655,377			
Total liabilities & shareholders' equity	$4,426,037				$4,212,866			
Net interest income (2)		$ 169,159				$130,144		
Net interest margin			5.96	%			4.90	%

(1) Nonaccrual loans have been included in the tables as loans carrying a zero yield. Amortized net deferred loan fees were included in the interest income calculations. The amortization of net deferred loan fees was $784 thousand and $1.7 million for the nine months ended September 30, 2011 and 2010, respectively.

(2) Tax-exempt income is calculated on a tax equivalent basis, based on a marginal tax rate of 35%.
(3) Reclassified to conform to the current period's presentation.

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The following tables set forth the total dollar amount of change in interest income and interest expense. The changes have been segregated for each major category of interest-earning assets and interest-bearing liabilities into amounts attributable to changes in volume, changes in rates and changes in rates multiplied by volume. Changes attributable to the combined effect of volume and interest rates have been allocated proportionately to the changes due to volume and the changes due to interest rates:

(in thousands)	Three Months Ended September 30, 2011 Compared to 2010 Increase (Decrease) Due to		
	Volume	Rate	Total
Interest earning assets			
Loans (1)(2)	$5,345	$9,460	$14,805
Taxable securities	2,183	(806)	1,377
Tax exempt securities (2)	380	8	388
Interest earning deposits with banks and federal funds sold	(148)	107	(41)
Interest income (2)	$7,760	$8,769	$