

COLUMBIA BANKING SYSTEM INC
Form 10-Q
August 06, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013.

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)
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1301 "A" Street Tacoma, Washington (Address of principal executive offices) (253) 305-1900 (Issuer's telephone number, including area code) (Former name, former address and former fiscal year, if changed since last report)	98402-2156 (Zip Code)
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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 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 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	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

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

The number of shares of common stock outstanding at July 31, 2013 was 51,259,911.

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PART I - FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS

Columbia Banking System, Inc.

(Unaudited)

	June 30, 2013	December 31, 2012
(in thousands)		
ASSETS		
Cash and due from banks	\$154,407	\$124,573
Interest-earning deposits with banks	38,302	389,353
Total cash and cash equivalents	192,709	513,926
Securities available for sale at fair value (amortized cost of \$1,519,951 and \$969,359, respectively)	1,507,900	1,001,665
Federal Home Loan Bank stock at cost	33,139	21,819
Loans held for sale	2,150	2,563
Loans, excluding covered loans, net of unearned income of (\$86,062) and (\$7,767), respectively	4,181,018	2,525,710
Less: allowance for loan and lease losses	51,698	52,244
Loans, excluding covered loans, net	4,129,320	2,473,466
Covered loans, net of allowance for loan losses of (\$26,135) and (\$30,056), respectively	338,661	391,337
Total loans, net	4,467,981	2,864,803
FDIC loss-sharing asset	67,374	96,354
Interest receivable	23,118	14,268
Premises and equipment, net	158,776	118,708
Other real estate owned (\$12,854 and \$16,311 covered by FDIC loss-share, respectively)	37,193	26,987
Goodwill	346,373	115,554
Other intangible assets, net	29,170	15,721
Other assets	204,582	113,967
Total assets	\$7,070,465	\$4,906,335
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	\$1,961,244	\$1,321,171
Interest-bearing	3,786,617	2,720,914
Total deposits	5,747,861	4,042,085
Federal Home Loan Bank advances	179,680	6,644
Securities sold under agreements to repurchase	25,000	25,000
Other liabilities	87,250	68,598
Total liabilities	6,039,791	4,142,327
Commitments and contingent liabilities		
Shareholders' equity:		
	June 30, 2013	December 31, 2012
Preferred stock (no par value)		
Authorized shares	2,000	—
Issued and outstanding	9	—
Common stock (no par value)		2,217

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Authorized shares	63,033	63,033		
Issued and outstanding	51,237	39,686	857,615	581,471
Retained earnings			180,052	162,388
Accumulated other comprehensive income (loss)			(9,210)	20,149
Total shareholders' equity			1,030,674	764,008
Total liabilities and shareholders' equity			\$7,070,465	\$4,906,335

See accompanying Notes to unaudited Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF INCOME

Columbia Banking System, Inc.

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands except per share amounts)			
Interest Income				
Loans	\$74,837	\$54,498	\$122,865	\$116,275
Taxable securities	4,890	4,951	9,124	10,196
Tax-exempt securities	2,508	2,495	4,806	5,020
Federal funds sold and deposits in banks	33	170	234	335
Total interest income	82,268	62,114	137,029	131,826
Interest Expense				
Deposits	1,054	1,561	2,143	3,340
Federal Home Loan Bank advances	(699)	) 734	(628)	) 1,484
Prepayment charge on Federal Home Loan Bank advances	1,548	—	1,548	—
Other borrowings	376	118	495	238
Total interest expense	2,279	2,413	3,558	5,062
Net Interest Income	79,989	59,701	133,471	126,764
Provision for loan and lease losses	2,000	3,750	1,000	8,250
Provision (recapture) for losses on covered loans	(1,712)	) 11,688	(732)	) 27,373
Net interest income after provision (recapture) for loan and lease losses	79,701	44,263	133,203	91,141
Noninterest Income				
Service charges and other fees	13,560	7,436	21,154	14,613
Merchant services fees	2,013	2,095	3,864	4,113
Investment securities gains, net	92	—	462	62
Bank owned life insurance	1,008	719	1,706	1,430
Change in FDIC loss-sharing asset	(13,137)	) (168)	) (23,620)	) (1,836)
Other	3,272	1,746	4,900	3,020
Total noninterest income	6,808	11,828	8,466	21,402
Noninterest Expense				
Compensation and employee benefits	35,657	20,966	57,310	42,961
Occupancy	7,543	5,091	12,296	10,424
Merchant processing	852	930	1,709	1,803
Advertising and promotion	1,160	1,119	2,030	2,001
Data processing and communications	3,638	2,551	6,218	4,764
Legal and professional fees	5,504	1,829	7,554	3,438
Taxes, licenses and fees	1,204	1,115	2,591	2,470
Regulatory premiums	1,177	925	2,034	1,785
Net cost (benefit) of operation of other real estate owned	(2,828)	) (377)	) (5,329)	) 533
Amortization of intangibles	1,693	1,119	2,722	2,269
FDIC clawback liability expense (recovery)	199	(208)	) 430	(234)
Other	8,705	4,765	12,988	11,963
Total noninterest expense	64,504	39,825	102,553	84,177
Income before income taxes	22,005	16,266	39,116	28,366
Income tax provision	7,414	4,367	12,349	7,565
Net Income	\$14,591	\$11,899	\$26,767	\$20,801

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Earnings per common share				
Basic	\$0.28	\$0.30	\$0.59	\$0.52
Diluted	\$0.28	\$0.30	\$0.58	\$0.52
Dividends paid per common share	\$0.10	\$0.22	\$0.20	\$0.59
Weighted average number of common shares outstanding	50,788	39,260	45,099	39,228
Weighted average number of diluted common shares outstanding	52,125	39,308	45,758	39,306

See accompanying Notes to unaudited Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

Columbia Banking System, Inc.

(Unaudited)

	Three Months Ended	
	June 30,	
	2013	2012
	(in thousands)	
Net income as reported	\$14,591	\$11,899
Unrealized gain (loss) from securities:		
Net unrealized holding gain (loss) from available for sale securities arising during the period, net of tax of \$14,116 and (\$840)	(25,930)	2,370
Reclassification adjustment of net gain from sale of available for sale securities included in income, net of tax of \$33 and \$0	(59)	—
Net unrealized gain (loss) from securities, net of reclassification adjustment	(25,989)	2,370
Pension plan liability adjustment:		
Amortization of unrecognized net actuarial loss included in net periodic pension cost, net of tax of (\$32) and (\$17)	60	3
Pension plan liability adjustment, net	60	3
Total comprehensive income (loss)	\$(11,338)	\$14,272
	Six Months Ended	
	June 30,	
	2013	2012
	(in thousands)	
Net income as reported	\$26,767	\$20,801
Unrealized gain (loss) from securities:		
Net unrealized holding gain (loss) from available for sale securities arising during the period, net of tax of (\$15,473) and \$87	(28,423)	725
Reclassification adjustment of net gain from sale of available for sale securities included in income, net of tax of \$163 and \$23	(299)	(39)
Net unrealized gain (loss) from securities, net of reclassification adjustment	(28,722)	686
Pension plan liability adjustment:		
Net unrealized loss from unfunded defined benefit plan liability arising during the period, net of tax of \$412 and \$0	(756)	—
Amortization of unrecognized net actuarial loss included in net periodic pension cost, net of tax of (\$65) and (\$24)	119	16
Pension plan liability adjustment, net	(637)	16
Total comprehensive income (loss)	\$(2,592)	\$21,503

See accompanying Notes to unaudited Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Columbia Banking System, Inc.

(Unaudited)

	Preferred Stock		Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Number of Shares	Amount	Number of Shares	Amount			
	(in thousands)						
Balance at January 1, 2012	—	\$—	39,506	\$579,136	\$155,069	\$ 25,133	\$759,338
Net income	—	—	—	—	20,801	—	20,801
Other comprehensive income	—	—	—	—	—	702	702
Issuance of common stock - stock option and other plans	—	—	19	314	—	—	314
Issuance of common stock - restricted stock awards, net of canceled awards	—	—	130	908	—	—	908
Cash dividends paid on common stock	—	—	—	—	(23,351)	—	(23,351)
Balance at June 30, 2012	—	\$—	39,655	\$580,358	\$152,519	\$ 25,835	\$758,712
Balance at January 1, 2013	—	\$—	39,686	\$581,471	\$162,388	\$ 20,149	\$764,008
Net income	—	—	—	—	26,767	—	26,767
Other comprehensive loss	—	—	—	—	—	(29,359)	(29,359)
Issuance of preferred stock, common stock and warrants	9	2,217	11,380	273,964	—	—	276,181
Activity in deferred compensation plan	—	—	—	517	—	—	517
Issuance of common stock - stock option and other plans	—	—	43	774	—	—	774
Issuance of common stock - restricted stock awards, net of canceled awards	—	—	144	1,280	—	—	1,280
Purchase and retirement of common stock	—	—	(16)	(391)	—	—	(391)
Preferred dividends	—	—	—	—	(10)	—	(10)
Cash dividends paid on common stock	—	—	—	—	(9,093)	—	(9,093)
Balance at June 30, 2013	9	\$2,217	51,237	\$857,615	\$180,052	\$ (9,210)	\$1,030,674

See accompanying Notes to unaudited Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

Columbia Banking System, Inc.

(Unaudited)

	Six Months Ended June 30,	
	2013	2012
	(in thousands)	
Cash Flows From Operating Activities		
Net Income	\$26,767	\$20,801
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan and lease losses on noncovered and covered loans	268	35,623
Stock-based compensation expense	1,280	908
Depreciation, amortization and accretion	22,527	30,478
Investment securities gain, net	(462)	(62)
Net realized gain on sale of other assets	(73)	(41)
Net realized gain on sale of other real estate owned	(6,291)	(6,277)
Write-down on other real estate owned	664	5,812
Net change in:		
Loans held for sale	413	60
Interest receivable	(8,850)	(273)
Interest payable	(12)	(275)
Other assets	6,285	(7,424)
Other liabilities	(12,662)	(4,945)
Net cash provided by operating activities	29,854	74,385
Cash Flows From Investing Activities		
Loans originated and acquired, net of principal collected	(194,322)	(63,362)
Purchases of:		
Securities available for sale	(162,018)	(87,346)
Premises and equipment	(8,071)	(11,630)
Proceeds from:		
FDIC reimbursement on loss-sharing asset	6,387	34,313
Sales of securities available for sale	166,881	3,845
Principal repayments and maturities of securities available for sale	167,736	108,517
Sales of other assets	806	9
Sales of covered other real estate owned	13,814	18,381
Sales of other real estate and other personal property owned	6,076	11,899
Capital improvements on other real estate properties	—	(11)
Acquisition of intangible assets	(913)	—
Net cash paid in acquisition	(154,170)	—
Other investing activities	(1,026)	—
Net cash (used in) provided by investing activities	(158,820)	14,615
Cash Flows From Financing Activities		
Net increase (decrease) in deposits	(177,631)	15,288
Proceeds from:		
Federal Home Loan Bank advances	756,100	—
Federal Reserve Bank borrowings	50	—
Exercise of stock options	774	314
Payments for:		
Repayment of Federal Home Loan Bank advances	(711,000)	(5,727)
Repayment of Federal Reserve Bank borrowings	(50)	—

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Common stock dividends	(9,093)	(23,351)
Preferred stock dividends	(10)	—	
Repayment of long-term subordinated debt	(51,000)	—	
Purchase and retirement of common stock	(391)	—	
Net cash used in financing activities	(192,251	)	(13,476)
Increase (Decrease) in cash and cash equivalents	(321,217	)	75,524	
Cash and cash equivalents at beginning of period	513,926		294,289	
Cash and cash equivalents at end of period	\$192,709		\$369,813	
Supplemental Information:				
Cash paid during the year for:				
Cash paid for interest	\$2,155		\$5,337	
Cash paid for income tax	\$9,589		\$—	
Non-cash investing and financing activities				
Assets acquired in business combinations	\$2,523,842		\$—	
Liabilities assumed in business combinations	\$2,093,491		\$—	
Loans transferred to other real estate owned	\$9,307		\$11,789	
Share-based consideration issued for acquisitions	\$276,181		\$—	
See accompanying Notes to unaudited Consolidated Financial Statements.				

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Columbia Banking System, Inc.

1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

The interim unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. The consolidated financial statements include the accounts of the Company, and its wholly owned banking subsidiary Columbia Bank (the "Bank"), and West Coast Trust. 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 six months ended June 30, 2013 are not necessarily indicative of results to be anticipated for the year ending December 31, 2013. The accompanying interim unaudited consolidated financial statements should be read in conjunction with the financial statements and related notes contained in the Company's 2012 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 2012 Annual Report on Form 10-K. There have not been any changes in our significant accounting policies compared to those contained in our 2012 Form 10-K disclosure for the year ended December 31, 2012, except for the adoption of ASU 2012-06 as noted below.

2. Accounting Pronouncements Recently Issued

In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The Update clarifies when it is appropriate for an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. ASU 2013-11 is effective for interim and annual periods beginning after December 15, 2013. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date, however, retrospective application is also permitted. Adoption of the new guidance is not expected to have a significant impact on the Company's consolidated financial statements.

In February 2013, the FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. The Update requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component and to present either on the face of the statement where net income is presented, or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2012. The Company adopted the ASU 2013-02 reporting requirements during the interim reporting period beginning on January 1, 2013 with no impact to the Company's financial condition or results of operations. See Note 12 to the Consolidated Financial Statements of this report for new disclosures related to accumulated other comprehensive income.

In October 2012, the FASB issued ASU 2012-06, Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution. ASU 2012-06 clarifies that when a reporting entity recognizes an indemnification asset as a result of a government-assisted acquisition of a financial institution and there is a subsequent change in the amount of cash flows expected to be collected on the indemnified asset, the reporting entity should subsequently measure the indemnification asset on the same basis as the underlying loans by taking into account the contractual limitations of the Loss-Sharing Agreement ("LSA"). For amortization of changes in value, the reporting entity should use the term of the indemnification agreement if it is shorter than the term of the acquired loans. ASU 2012-06 is effective for interim and annual periods beginning after December 15, 2012. The Company adopted the ASU as of January 1, 2013. As a result of the adoption of the ASU, an additional \$5.7 million of indemnification asset amortization was recorded during the six months

ending June 30, 2013, resulting in a reduction of \$3.7 million in net income and \$0.08 in earnings per share.

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3. Business Combinations

West Coast Bancorp

On April 1, 2013, the Company completed its acquisition of West Coast Bancorp ("West Coast"). The Company acquired 100% of the voting equity interests of West Coast. The primary reason for the acquisition was to expand the Company's geographic footprint consistent with its ongoing growth strategy.

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 April 1, 2013 acquisition date. Initial accounting for deferred taxes, the mortgage repurchase liability and payment system intangible were incomplete as of June 30, 2013. The amounts currently recognized in the financial statements have been determined provisionally as the completion of a fair value analysis for these items is still in progress.

The application of the acquisition method of accounting resulted in the recognition of goodwill of \$230.8 million and a core deposit intangible of \$15.3 million, or 0.89% of core deposits. The goodwill represents the excess purchase price over the estimated fair value of the net assets acquired. The goodwill is not deductible for income tax purposes. The table below summarizes the amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed:

	April 1, 2013 (in thousands)
Purchase price as of April 1, 2013	\$ 540,791
Recognized amounts of identifiable assets acquired and (liabilities assumed), at fair value:	
Cash and cash equivalents	\$ 110,440
Investment securities	730,842
Federal Home Loan Bank stock	11,824
Acquired loans	1,407,798
Premises and equipment	35,884
Other real estate owned	14,708
Core deposit intangible	15,257
Other assets	76,710
Deposits	(1,883,407)
Federal Home Loan Bank advances	(128,885)
Junior subordinated debentures	(51,000)
Other liabilities	(30,199)
Total fair value of identifiable net assets	309,972
Goodwill	\$ 230,819

See Note 9, Goodwill and other intangible assets, for further discussion of the accounting for goodwill and other intangible assets.

The operating results of the Company include the operating results produced by the acquired assets and assumed liabilities for the period April 1, 2013 to June 30, 2013. Disclosure of the amount of West Coast's revenue and net income (excluding integration costs) included in Columbia's consolidated income statement is impracticable due to the integration of the operations and accounting for this acquisition.

The following table presents certain unaudited pro forma information for illustrative purposes only, for the six month periods ended June 30, 2013 and 2012 as if West Coast had been acquired on January 1, 2012. The unaudited estimated pro forma information combines the historical results of West Coast with the Company's consolidated historical results and includes certain adjustments reflecting the estimated impact of certain fair value adjustments for the respective periods. The pro forma information is not indicative of what would have occurred had the acquisition occurred on January 1, 2012. In particular, no adjustments have been made to eliminate the impact of other-than-temporary impairment losses and losses recognized on the

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sale of securities that may not have been necessary had the investments securities been recorded at fair value as of January 1, 2012. The unaudited pro forma information does not consider any changes to the provision for credit losses resulting from recording loan assets at fair value. Additionally, Columbia expects to achieve further operating cost savings and other business synergies, including revenue growth, as a result of the acquisition which are not reflected in the pro forma amounts that follow. As a result, actual amounts will differ from the unaudited pro forma information presented.

	Unaudited Pro Forma Six Months Ended June 30,	
	2013	2012
	(in thousands)	
Total revenues (net interest income plus noninterest income)	\$177,970	\$217,964
Net income	\$43,256	\$36,809
Earnings per share - basic	\$0.85	\$0.71
Earnings per share - diluted	\$0.83	\$0.71

In connection with the West Coast acquisition, Columbia recognized \$10.0 million of acquisition-related expenses for the six month period ended June 30, 2013. The acquisition-related expenses were excluded from the table above.

4. Securities

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
June 30, 2013				
U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations	\$815,604	\$10,798	\$(18,127)	) \$808,275
State and municipal securities	338,554	10,885	(5,618)	) 343,821
U.S. government agency and government-sponsored enterprise securities	339,447	373	(9,526)	) 330,294
U.S. government securities	21,067	—	(708)	) 20,359
Other securities	5,279	18	(146)	) 5,151
Total	\$1,519,951	\$22,074	\$(34,125)	) \$1,507,900
December 31, 2012				
U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations	\$561,076	\$16,719	\$(5,426)	) \$572,369
State and municipal securities	265,070	20,893	(388)	) 285,575
U.S. government agency and government-sponsored enterprise securities	120,085	851	(435)	) 120,501
U.S. government securities	19,804	39	(15)) 19,828
Other securities	3,324	104	(36)) 3,392
Total	\$969,359	\$38,606	\$(6,300)) \$1,001,665

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The scheduled contractual maturities of investment securities available for sale at June 30, 2013 are presented as follows:

	June 30, 2013	
	Amortized Cost	Fair Value
	(in thousands)	
Due within one year	\$17,562	\$17,827
Due after one year through five years	268,332	267,579
Due after five years through ten years	444,103	436,192
Due after ten years	784,675	781,150
Other securities with no stated maturity	5,279	5,152
Total investment securities available-for-sale	\$1,519,951	\$1,507,900

The following table summarizes, as of June 30, 2013, the carrying value of securities pledged as collateral to secure public deposits, borrowings and other purposes as permitted or required by law:

	Carrying Amount (in thousands)
To Washington and Oregon State to secure public deposits	\$329,101
To Federal Reserve Bank to secure borrowings	44,113
Other securities pledged	46,173
Total securities pledged as collateral	\$419,387

The following table shows 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 June 30, 2013 and December 31, 2012:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
June 30, 2013						
U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations	\$487,032	\$(17,773)	\$10,156	\$(354)	\$497,188	\$(18,127)
State and municipal securities	133,440	(5,570)	806	(48)	134,246	(5,618)
U.S. government agency and government-sponsored enterprise securities	292,729	(9,526)	—	—	292,729	(9,526)
U.S. government securities	20,358	(708)	—	—	20,358	(708)
Other securities	2,297	(13)	2,822	(133)	5,119	(146)
Total	\$935,856	\$(33,590)	\$13,784	\$(535)	\$949,640	\$(34,125)
December 31, 2012						
U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations	\$167,739	\$(5,090)	\$12,204	\$(336)	\$179,943	\$(5,426)
State and municipal securities	20,413	(383)	210	(5)	20,623	(388)
U.S. government agency and government-sponsored enterprise securities	56,600	(435)	—	—	56,600	(435)
U.S. government securities	9,914	(15)	—	—	9,914	(15)

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Other securities	—	—	964	(36)	964	(36)	
Total	\$254,666	\$(5,923)	\$13,378	\$(377)	\$268,044	\$(6,300)

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At June 30, 2013, there were 76 U.S. government agency and government-sponsored enterprise mortgage-backed securities & collateralized mortgage obligations securities in an unrealized loss position, of which one was in a continuous loss position for 12 months or more. The decline in fair value is attributable to changes in interest rates relative to where these investments fall within the yield curve and their individual characteristics. Because the Company does not intend to sell these securities nor does the Company consider it more likely than not that it will be required to sell these securities before the recovery of amortized cost basis, which may be upon maturity, the Company does not consider these investments to be other-than-temporarily impaired at June 30, 2013.

At June 30, 2013, there were 152 state and municipal government securities in an unrealized loss position, of which two were in a continuous loss position for 12 months or more. The unrealized losses on state and municipal securities were caused by interest rate changes or widening of market spreads subsequent to the purchase of the individual securities. Management monitors published credit ratings of these securities for adverse changes. As of June 30, 2013, none of the rated obligations of state and local government entities held by the Company had a below investment grade credit rating. Because the credit quality of these securities are investment grade and the Company does not intend to sell these securities nor does the Company consider it more likely than not that it will be required to sell these securities before the recovery of amortized cost basis, which may be upon maturity, the Company does not consider these investments to be other-than-temporarily impaired at June 30, 2013.

At June 30, 2013, there were 30 U.S. government agency and government-sponsored enterprise securities in an unrealized loss position, of which none were in a continuous loss position for 12 months or more. The decline in fair value is attributable to changes in interest rates relative to where these investments fall within the yield curve and their individual characteristics. Because the Company does not currently intend to sell these securities nor does the Company consider it more likely than not that it will be required to sell these securities before the recovery of amortized cost basis, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at June 30, 2013.

At June 30, 2013, there were five U.S. government securities in an unrealized loss position, none of which were in a continuous loss position for 12 months or more. The decline in fair value is attributable to changes in interest rates relative to where these investments fall within the yield curve and their individual characteristics. Because the Company does not currently intend to sell this security nor does the Company consider it more likely than not that it will be required to sell this security before the recovery of amortized cost basis, which may be maturity, the Company does not consider this investment to be other-than-temporarily impaired at June 30, 2013.

At June 30, 2013, there were two other securities in an unrealized loss position, of which one security, a mortgage-backed securities fund, was in a continuous unrealized loss position for 12 months or more. The decline in fair value is attributable to changes in interest rates and the additional risk premium investors are demanding for investment securities with these characteristics. The Company does not consider this investment to be other-than-temporarily impaired at June 30, 2013 as it has the intent and ability to hold the investment for sufficient time to allow for recovery in the market value.

5. Noncovered Loans

Noncovered loans include loans originated through our branch network and loan departments as well as acquired loans that are not subject to FDIC loss-sharing agreements.

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

	June 30, 2013	December 31, 2012
Noncovered loans:	(in thousands)	
Commercial business	\$1,587,572	\$1,155,158
Real estate:		
One-to-four family residential	97,974	43,922
Commercial and multifamily residential	2,038,278	1,061,201
Total real estate	2,136,252	1,105,123
Real estate construction:		
One-to-four family residential	53,173	50,602
Commercial and multifamily residential	110,226	65,101
Total real estate construction	163,399	115,703
Consumer	379,858	157,493
Less: Net unearned income	(86,063)	(7,767)
Total noncovered loans, net of unearned income	4,181,018	2,525,710
Less: Allowance for loan and lease losses	(51,698)	(52,244)
Total noncovered loans, net	\$4,129,320	\$2,473,466
Loans held for sale	\$2,150	\$2,563

At June 30, 2013 and December 31, 2012, the Company had no material foreign activities. 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 has 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 \$14.2 million at June 30, 2013 and December 31, 2012. During the first six months of 2013, advances and repayments on related party loans totaled \$1.3 million.

At June 30, 2013 and December 31, 2012, \$564.1 million and \$443.4 million of commercial and residential real estate loans were pledged as collateral on Federal Home Loan Bank borrowings and additional borrowing capacity. The Company has also pledged \$47.9 million and \$13.8 million of commercial loans to the Federal Reserve Bank for additional borrowing capacity at June 30, 2013 and December 31, 2012, respectively.

The following is an analysis of noncovered, nonaccrual loans as of June 30, 2013 and December 31, 2012:

	June 30, 2013		December 31, 2012	
	Recorded Investment Nonaccrual Loans	Unpaid Principal Balance Nonaccrual Loans	Recorded Investment Nonaccrual Loans	Unpaid Principal Balance Nonaccrual Loans
Noncovered loans:	(in thousands)			
Commercial business				
Secured	\$14,386	\$ 37,620	\$9,037	\$ 17,821
Unsecured	263	6,279	262	262
Real estate:				
One-to-four family residential	3,805	6,740	2,349	2,672
Commercial & multifamily residential				
Commercial land	3,116	6,503	4,076	7,491
Income property	8,546	11,898	8,520	10,815
Owner occupied	5,383	8,380	6,608	7,741
Real estate construction:				
One-to-four family residential				

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Land and acquisition	3,830	8,382	3,084	6,704
Residential construction	923	5,858	1,816	2,431
Consumer	3,358	17,456	1,643	1,940
Total	\$43,610	\$ 109,116	\$37,395	\$ 57,877

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The following is an aging of the recorded investment of the noncovered loan portfolio as of June 30, 2013 and December 31, 2012:

	Current Loans	30 - 59 Days Past Due	60 - 89 Days Past Due	Total Past Due	Nonaccrual Loans	Total Loans
June 30, 2013	(in thousands)					
Noncovered loans:						
Commercial business						
Secured	\$1,472,621	\$10,265	\$2,094	\$12,359	\$14,386	\$1,499,366
Unsecured	75,496	3,198	44	3,242	263	79,001
Real estate:						
One-to-four family residential	89,103	2,115	31	2,146	3,805	95,054
Commercial & multifamily residential						
Commercial land	130,559	—	—	—	3,116	133,675
Income property	1,126,753	2,372	68	2,440	8,546	1,137,739
Owner occupied	724,178	947	133	1,080	5,383	730,641
Real estate construction:						
One-to-four family residential						
Land and acquisition	16,420	—	—	—	3,830	20,250
Residential construction	30,913	320	—	320	923	32,156
Commercial & multifamily residential						
Income property	71,194	—	—	—	—	71,194
Owner occupied	37,134	598	—	598	—	37,732
Consumer	339,145	1,375	332	1,707	3,358	344,210
Total	\$4,113,516	\$21,190	\$2,702	\$23,892	\$43,610	\$4,181,018
December 31, 2012	(in thousands)					
Noncovered loans:						
Commercial business						
Secured	\$1,091,770	\$4,259	\$1,485	\$5,744	\$9,037	\$1,106,551
Unsecured	44,817	252	12	264	262	45,343
Real estate:						
One-to-four family residential	41,508	193	142	335	2,349	44,192
Commercial & multifamily residential						
Commercial land	42,818	311	122	433	4,076	47,327
Income property	603,339	2,726	227	2,953	8,520	614,812
Owner occupied	387,525	1,040	—	1,040	6,608	395,173
Real estate construction:						
One-to-four family residential						
Land and acquisition	15,412	—	—	—	3,084	18,496
Residential construction	29,848	—	—	—	1,816	31,664
Commercial & multifamily residential						
Income property	28,342	—	—	—	—	28,342
Owner occupied	36,211	—	—	—	—	36,211
Consumer	155,207	387	362	749	1,643	157,599

Total	\$2,476,797	\$9,168	\$2,350	\$11,518	\$37,395	\$2,525,710
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The following is an analysis of impaired loans as of June 30, 2013 and December 31, 2012:

	Recorded Investment of Loans Collectively for Contingency Provision (in thousands)	Recorded Investment of Loans Measurably Measured for Specific Impairment	Impaired Loans With Recorded Allowance	Unpaid Principal Balance	Related Allowance	Impaired Loans Without Recorded Allowance	Unpaid Principal Balance
			Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance
June 30, 2013							
Noncovered loans:							
Commercial business							
Secured	\$1,491,377	\$ 7,989	\$665	\$853	\$ 242	\$7,324	\$11,139
Unsecured	78,950	51	51	7,355	51	—	—
Real estate:							
One-to-four family residential	93,522	1,532	337	360	105	1,195	1,336
Commercial & multifamily residential							
Commercial land	131,330	2,345	2,105	5,145	262	240	507
Income property	1,126,047	11,692	1,252	1,257	76	10,440	14,310
Owner occupied	721,104	9,537	604	602	30	8,933	12,037
Real estate construction:							
One-to-four family residential							
Land and acquisition	16,968	3,282	116	115	73	3,166	4,858
Residential construction	32,156	—	—	—	—	—	—
Commercial & multifamily residential							
Income property	71,194	—	—	—	—	—	—
Owner occupied	37,732	—	—	—	—	—	—
Consumer	343,486	724	—	—	—	724	723
Total	\$4,143,866	\$ 37,152	\$5,130	\$15,687	\$ 839	\$32,022	\$44,910
	Recorded Investment of Loans Collectively for Contingency Provision (in thousands)	Recorded Investment of Loans Measurably Measured for Specific Impairment	Impaired Loans With Recorded Allowance	Unpaid Principal Balance	Related Allowance	Impaired Loans Without Recorded Allowance	Unpaid Principal Balance
			Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance
December 31, 2012							
Noncovered loans:							
Commercial business							
Secured	\$1,101,689	\$ 4,862	\$690	\$1,994	\$ 113	\$4,172	\$6,769
Unsecured	45,251	92	92	92	92	—	—
Real estate:							
One-to-four family residential	42,103	2,089	345	364	112	1,744	1,902
Commercial & multifamily residential							
Commercial land	44,672	2,655	—	—	—	2,655	5,727
Income property	606,656	8,156	2,670	2,727	1,040	5,486	7,860

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Owner occupied	383,269	11,904	608	610	38	11,296	14,642
Real estate construction:							
One-to-four family residential							
Land and acquisition	15,677	2,819	—	—	—	2,819	4,813
Residential construction	29,707	1,957	—	—	—	1,957	2,570
Commercial & multifamily residential							
Income property	28,342	—	—	—	—	—	—
Owner occupied	36,211	—	—	—	—	—	—
Consumer	157,472	127	—	—	—	127	127
Total	\$2,491,049	\$ 34,661	\$4,405	\$5,787	\$ 1,395	\$30,256	\$44,410

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The following table provides additional information on impaired loans for the three and six month periods indicated.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2013		2012		2013		2012	
	Average Recorded Investment on Impaired Loans	Interest Recognized Impaired Loans	Average Recorded Investment on Impaired Loans	Interest Recognized Impaired Loans	Average Recorded Investment on Impaired Loans	Interest Recognized Impaired Loans	Average Recorded Investment on Impaired Loans	Interest Recognized Impaired Loans
	(in thousands)							
Noncovered loans:								
Commercial business								
Secured	\$6,481	\$ 4	\$11,331	\$ 37	\$5,941	\$ 8	\$10,516	\$ 88
Unsecured	68	1	138	2	76	1	124	3
Real estate:								
One-to-four family residential	1,538	27	2,053	5	1,722	31	2,195	9
Commercial & multifamily residential								
Commercial land	2,559	—	3,045	—	2,591	—	3,297	—
Income property	10,478	133	9,207	(29)	9,704	161	8,348	9
Owner occupied	10,437	230	13,956	215	10,926	510	14,159	518
Real estate construction:								
One-to-four family residential								
Land and acquisition	2,931	1	4,649	16	2,894	3	5,562	16
Residential construction	72	—	3,121	7	701	—	3,775	16
Commercial & multifamily residential								
Income property	—	—	4,388	—	—	—	5,281	—
Owner occupied	—	—	—	—	—	—	—	—
Consumer	425	2	1,049	10	326	3	1,464	22
Total	\$34,989	\$ 398	\$52,937	\$ 263	\$34,881	\$ 717	\$54,721	\$ 681

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There were no Troubled Debt Restructurings ("TDR") during the six months ended June 30, 2012. The following is an analysis of loans classified as TDR during the three and six months ended June 30, 2013:

	Three months ended June 30, 2013		
	Number of TDR Modifications	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
(dollars in thousands)			
Noncovered loans:			
Commercial business:			
Secured	1	\$ 343	\$ 343
Commercial and multifamily residential:			
Commercial land	1	137	137
Income property	3	943	943
Owner occupied	1	172	172
Total	6	\$ 1,595	\$ 1,595
Six months ended June 30, 2013			
	Number of TDR Modifications	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
(dollars in thousands)			
Noncovered loans:			
Commercial business:			
Secured	1	\$ 343	\$ 343
Commercial and multifamily residential:			
Commercial land	1	137	137
Income property	3	943	943
Owner occupied	1	172	172
Real estate construction:			
One-to-four family residential:			
Land and acquisition	1	117	117
Total	7	\$ 1,712	\$ 1,712

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 \$1.7 million and \$236 thousand of additional funds on loans classified as TDR as of June 30, 2013 and December 31, 2012, respectively. The TDR modifications or concessions are made to increase the likelihood that these borrowers with financial difficulties will be able to satisfy their debt obligations as amended. Credit losses for loans classified as TDR are measured on the same basis as impaired loans. For impaired loans, an allowance is established when the collateral value less selling costs (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 six months ended June 30, 2013.

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6. Allowance for Noncovered 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 Accounting Standards Codification (“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 specific loan class and incorporates the loan’s risk rating migration from origination to the point of loss based upon the consideration of an appropriate look back period.

During the current quarter, no allowance was established for the acquired West Coast loan portfolio under the methodology described above. Management’s judgment was that acquisition accounting adjustments, which included a net loan discount of \$88.8 million, adequately addressed the estimated losses in those acquired loans at June 30, 2013. 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 marketplace, 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 or a recovery of previous provisions. 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 six months ended June 30, 2013 and 2012. 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.

Once it is determined that all or a portion of a loan balance is uncollectable, and the amount can be reasonably estimated, the uncollectable portion of the loan is charged-off.

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The following tables show a detailed analysis of the allowance for loan and lease losses for noncovered loans for the three and six months ended June 30, 2013 and 2012:

	Beginning Balance	Charge-offs	Recoveries	Provision (Recovery)	Ending Balance	Specific Reserve	General Allocation
Three months ended June 30, 2013	(in thousands)						
Noncovered loans:							
Commercial business							
Secured	\$26,871	\$(856)	\$312	\$4,245	\$30,572	\$242	\$30,330
Unsecured	750	(105)	40	136	821	51	770
Real estate:							
One-to-four family residential	657	(28)	141	(98)	672	105	567
Commercial & multifamily residential							
Commercial land	433	(11)	17	252	691	262	429
Income property	9,411	(35)	27	292	9,695	76	9,619
Owner occupied	5,458	(568)	40	(415)	4,515	30	4,485
Real estate construction:							
One-to-four family residential							
Land and acquisition	990	—	35	(256)	769	73	696
Residential construction	538	—	14	(348)	204	—	204
Commercial & multifamily residential							
Income property	382	—	—	(141)	241	—	241
Owner occupied	108	—	—	(28)	80	—	80
Consumer	2,364	(638)	194	535	2,455	—	2,455
Unallocated	3,157	—	—	(2,174)	983	—	983
Total	\$51,119	\$(2,241)	\$820	\$2,000	\$51,698	\$839	\$50,859
	Beginning Balance	Charge-offs	Recoveries	Provision (Recovery)	Ending Balance	Specific Reserve	General Allocation
Six months ended June 30, 2013	(in thousands)						
Noncovered loans:							
Commercial business							
Secured	\$27,270	\$(1,844)	\$392	\$4,754	\$30,572	\$242	\$30,330
Unsecured	753	(431)	73	426	821	51	770
Real estate:							
One-to-four family residential	694	(144)	141	(19)	672	105	567
Commercial & multifamily residential							