UMPQUA HOLDINGS CORP
Form 10-Q
November 07, 2014

United States
Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the quarterly period ended: September 30, 2014
or
[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the transition period from to .

Commission File Number: 001-34624

Umpqua Holdings Corporation

(Exact Name of Registrant as Specified in Its Charter)

OREGON	93-1261319
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

One SW Columbia Street, Suite 1200
Portland, Oregon 97258
(Address of Principal Executive Offices)(Zip Code)

(503) 727-4100
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

[X] Yes [ ] 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).

[X] Yes [ ] No

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

[X] Large accelerated filer [ ] 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 [X] No

Indicate the number of shares outstanding for each of the issuer's classes of common stock, as of the latest practical date:

Common stock, no par value: 217,263,879 shares outstanding as of October 31, 2014

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements (unaudited)

UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(in thousands, except shares)

	September 30, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$266,624	$178,685
Interest bearing deposits and temporary investments (restricted cash of $34,976 and $13,384)	1,177,086	611,738
Total cash and cash equivalents	1,443,710	790,423
Investment securities		
Trading, at fair value	9,727	5,958
Available for sale, at fair value	2,400,061	1,790,978
Held to maturity, at amortized cost	5,356	5,563
Loans held for sale ($265,800 and $104,664 at fair value)	265,800	104,664
Non-covered loans and leases	14,975,811	7,354,403
Allowance for non-covered loan and lease losses	(107,807)	(85,314)
Net non-covered loans and leases	14,868,004	7,269,089
Covered loans, net of allowance of $7,828 and $9,771	275,562	363,992
Restricted equity securities	120,759	30,685
Premises and equipment, net	314,364	177,680
Goodwill	1,785,407	764,305
Other intangible assets, net	59,835	12,378
Residential mortgage servicing rights, at fair value	118,725	47,765
Non-covered other real estate owned	31,753	21,833
Covered other real estate owned	2,703	2,102
FDIC indemnification asset	7,811	23,174
Bank owned life insurance	293,511	96,938
Deferred tax asset, net	250,910	16,627
Other assets	234,061	111,958
Total assets	$22,488,059	$11,636,112
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest bearing	$4,741,897	$2,436,477
Interest bearing	11,985,713	6,681,183
Total deposits	16,727,610	9,117,660
Securities sold under agreements to repurchase	339,367	224,882
Term debt	1,057,140	251,494
Junior subordinated debentures, at fair value	247,528	87,274
Junior subordinated debentures, at amortized cost	101,657	101,899
Other liabilities	262,249	125,477
Total liabilities	18,735,551	9,908,686
COMMITMENTS AND CONTINGENCIES (NOTE 10)		
SHAREHOLDERS' EQUITY		
	3,515,621	1,514,485

Common stock, no par value, shares authorized: 400,000,000 in 2014 and 200,000,000 in 2013; issued and outstanding: 217,261,722 in 2014 and 111,973,203 in 2013		
Retained earnings	230,302	217,917
Accumulated other comprehensive income (loss)	6,585	(4,976)
Total shareholders' equity	3,752,508	1,727,426
Total liabilities and shareholders' equity	$22,488,059	$11,636,112

See notes to condensed consolidated financial statements

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UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(in thousands, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
INTEREST INCOME				
Interest and fees on non-covered loans and leases	$215,197	$93,706	$499,526	$250,685
Interest and fees on covered loans and leases	8,775	11,837	37,424	41,167
Interest and dividends on investment securities:				
Taxable	12,136	7,882	34,155	24,629
Exempt from federal income tax	2,790	2,200	7,599	6,725
Dividends	81	51	259	165
Interest on temporary investments and interest bearing deposits	544	284	1,407	937
Total interest income	239,523	115,960	580,370	324,308
INTEREST EXPENSE				
Interest on deposits	6,773	4,845	16,696	16,587
Interest on securities sold under agreement to repurchase	54	35	298	99
Interest on term debt	3,586	2,338	9,223	6,916
Interest on junior subordinated debentures	3,394	1,933	8,340	5,815
Total interest expense	13,807	9,151	34,557	29,417
Net interest income	225,716	106,809	545,813	294,891
PROVISION FOR NON-COVERED LOAN AND LEASE LOSSES	14,431	3,008	35,230	12,989
RECAPTURE OF PROVISION FOR COVERED LOAN LOSSES	(98)	(1,904)	(230)	(4,744)
Net interest income after provision for loan and lease losses	211,383	105,705	510,813	286,646
NON-INTEREST INCOME				
Service charges on deposit accounts	16,090	8,374	39,228	22,844
Brokerage commissions and fees	4,882	3,854	13,173	11,152
Residential mortgage banking revenue, net	25,996	15,071	60,776	62,928
Gain on investment securities, net	902	3	1,878	18
Loss on junior subordinated debentures carried at fair value	(1,590)	(554)	(3,501)	(1,643)
Change in FDIC indemnification asset	(2,728)	(6,474)	(13,169)	(19,841)
BOLI income	2,161	763	4,864	2,432
Other income	16,211	5,107	26,211	16,766
Total non-interest income	61,924	26,144	129,460	94,656
NON-INTEREST EXPENSE				
Salaries and employee benefits	102,564	53,699	251,340	157,271
Net occupancy and equipment	33,029	16,019	78,276	45,813
Communications	3,932	2,772	11,000	8,802
Marketing	2,739	1,596	4,901	3,753
Services	14,619	6,445	33,010	18,339
FDIC assessments	3,038	1,709	7,476	5,032
Net loss (gain) on non-covered other real estate owned	271	(27)	431	(303)
Net loss (gain) on covered other real estate owned	42	(68)	76	154
Intangible amortization	3,103	1,186	7,105	3,595

Merger related expenses	8,632	4,856	72,146	7,197
Other expenses	10,589	7,417	27,446	19,644
Total non-interest expense	182,558	95,604	493,207	269,297
Income before provision for income taxes	90,749	36,245	147,066	112,005
Provision for income taxes	31,760	12,768	52,092	38,914
Net income	$58,989	$23,477	$94,974	$73,091

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UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Continued)
(UNAUDITED)

(in thousands, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income	$58,989	$23,477	$94,974	$73,091
Dividends and undistributed earnings allocated to participating securities	142	196	338	576
Net earnings available to common shareholders	$58,847	$23,281	$94,636	$72,515
Earnings per common share:				
Basic	$0.27	$0.21	$0.54	$0.65
Diluted	$0.27	$0.21	$0.54	$0.65
Weighted average number of common shares outstanding:				
Basic	217,245	111,912	175,627	111,934
Diluted	218,941	112,195	176,656	112,154

See notes to condensed consolidated financial statements

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UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income	$58,989	$23,477	$94,974	$73,091
Available for sale securities:				
Unrealized gains (losses) arising during the period	(8,862)	5,878	21,052	(35,342)
Reclassification adjustment for net gains realized in earnings (net of tax expense of $361 and $1 for the three months ended September 30, 2014 and 2013, respectively, and net of tax expense of $751 and $7 for the nine months ended September 30, 2014 and 2013, respectively)	(542)	(2)	(1,127)	(11)
Income tax (expense) benefit related to unrealized gains (losses)	3,545	(2,351)	(8,421)	14,137
Net change in unrealized gains (losses)	(5,859)	3,525	11,504	(21,216)
Held to maturity securities:				
Accretion of unrealized losses related to factors other than credit to investment securities held to maturity (net of tax benefit of $0 and $7 for the three months ended September 30, 2014 and 2013, respectively, and net of tax benefit of $37 and $29 for the nine months ended September 30, 2014 and 2013, respectively)	—	11	57	43
Net change in unrealized losses related to factors other than credit	—	11	57	43
Other comprehensive income (loss), net of tax	(5,859)	3,536	11,561	(21,173)
Comprehensive income	$53,130	$27,013	$106,535	$51,918

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UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(UNAUDITED)

(in thousands, except shares)	Common Stock		Retained	Accumulated Other Comprehensive	
	Shares	Amount	Earnings	Income (Loss)	Total
BALANCE AT JANUARY 1, 2013	111,889,959	$1,512,400	$187,293	$24,346	$1,724,039
Net income			98,361		98,361
Other comprehensive loss, net of tax				(29,322)	(29,322)
Comprehensive income					$69,039
Stock-based compensation		5,017			5,017
Stock repurchased and retired	(584,677)	(9,360)			(9,360)
Issuances of common stock under stock plans and related net tax benefit	667,921	6,428			6,428
Cash dividends on common stock ($0.60 per share)			(67,737)		(67,737)
Balance at December 31, 2013	111,973,203	$1,514,485	$217,917	$(4,976)	$1,727,426
BALANCE AT JANUARY 1, 2014	111,973,203	$1,514,485	$217,917	$(4,976)	$1,727,426
Net income			94,974		94,974
Other comprehensive income, net of tax				11,561	11,561
Comprehensive income					$106,535
Stock issued in connection with merger (1)	104,385,087	1,989,030			1,989,030
Stock-based compensation		11,597			11,597
Stock repurchased and retired	(397,132)	(7,062)			(7,062)
Issuances of common stock under stock plans and related net tax benefit	1,300,564	7,571			7,571
Cash dividends on common stock ($0.45 per share)			(82,589)		(82,589)
Balance at September 30, 2014	217,261,722	$3,515,621	$230,302	$6,585	$3,752,508

(1) The amount of common stock issued in connection with the merger is net of $784,000 of issuance costs.

See notes to condensed consolidated financial statements

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UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(in thousands)	Nine Months Ended September 30,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$94,974	$73,091
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of investment premiums, net	15,320	27,984
Gain on sale of investment securities, net	(1,878)	(18)
Loss (gain) on sale of non-covered other real estate owned	267	(751)
Loss (gain) on sale of covered other real estate owned	34	(549)
Valuation adjustment on non-covered other real estate owned	164	448
Valuation adjustment on covered other real estate owned	42	703
Provision for non-covered loan and lease losses	35,230	12,989
Recapture of provision for covered loan losses	(230)	(4,744)
Proceeds from bank owned life insurance	681	1,173
Change in cash surrender value of bank owned life insurance	(4,008)	(3,618)
Change in FDIC indemnification asset	13,169	19,841
Depreciation, amortization and accretion	24,498	13,292
Increase in residential mortgage servicing rights	(16,583)	(15,182)
Change in residential mortgage servicing rights carried at fair value	8,393	757
Change in junior subordinated debentures carried at fair value	4,082	1,637
Stock-based compensation	11,597	3,531
Net decrease (increase) in trading account assets	724	(265)
Gain on sale of loans	(63,729)	(52,899)
Change in loans held for sale carried at fair value	(6,894)	11,099
Origination of loans held for sale	(1,577,920)	(1,368,902)
Proceeds from sales of loans held for sale	1,692,936	1,614,097
Excess tax benefits from the exercise of stock options	(2,046)	(40)
Change in other assets and liabilities:		
Net decrease in other assets	19,949	37,625
Net increase (decrease) in other liabilities	23,203	(11,983)
Net cash provided by operating activities	271,975	359,316
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investment securities available for sale	(346,844)	(51,191)
Purchases of investment securities held to maturity	—	(2,126)
Proceeds from investment securities available for sale	1,116,539	702,910
Proceeds from investment securities held to maturity	566	1,073
Redemption of restricted equity securities	4,190	1,999
Net non-covered loan and lease originations	(867,149)	(352,390)
Net covered loan paydowns	77,358	68,819
Proceeds from sales of non-covered loans	284,274	60,298
Proceeds from insurance settlement on loss of property	—	575
Proceeds from disposals of furniture and equipment	1,923	330
Purchases of premises and equipment	(43,761)	(25,575)
Net (payments to) proceeds from FDIC indemnification asset	(2,359)	4,621
Proceeds from sales of non-covered other real estate owned	10,626	13,940

Proceeds from sales of covered other real estate owned	1,142	9,794
Net cash paid in branch divestiture	(127,557)	—
Cash acquired in merger, net of cash consideration paid	116,867	(149,658)
Net cash provided by investing activities	$225,815	$283,419

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UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(UNAUDITED)

(in thousands)	Nine Months Ended September 30, 2014	2013
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in deposit liabilities	$739,173	$(311,708)
Net (decrease) increase in securities sold under agreements to repurchase	(470,261)	78,235
Repayment of term debt	(47,003)	(211,204)
Repayment of junior subordinated debentures	—	(8,764)
Dividends paid on common stock	(66,557)	(33,837)
Excess tax benefits from stock based compensation	2,046	40
Proceeds from stock options exercised	5,161	2,511
Retirement of common stock	(7,062)	(4,704)
Net cash provided (used by) financing activities	155,497	(489,431)
Net increase in cash and cash equivalents	653,287	153,304
Cash and cash equivalents, beginning of period	790,423	543,787
Cash and cash equivalents, end of period	$1,443,710	$697,091
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$38,955	$32,419
Income taxes	$6,622	$27,711
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Change in unrealized gains (losses) on investment securities available for sale, net of taxes	$11,504	$(21,216)
Change in unrealized losses on investment securities held to maturity related to factors other than credit, net of taxes	$57	$43
Cash dividend declared on common stock and payable after period-end	$32,684	$16,930
Transfer of non-covered loans to non-covered other real estate owned	$12,271	$14,747
Transfer of covered loans to covered other real estate owned	$1,818	$2,554
Transfer of covered loans to non-covered loans	$9,484	$13,366
Transfer from FDIC indemnification asset to due from FDIC and other	$2,194	$3,530
Acquisitions:		
Assets acquired, including goodwill of $1,021,102	$9,876,718	$376,071
Liabilities assumed	$8,765,353	$219,961

See notes to condensed consolidated financial statements

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 – Summary of Significant Accounting Policies

The accounting and financial reporting policies of Umpqua Holdings Corporation conform to accounting principles generally accepted in the United States of America. The accompanying interim condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material inter-company balances and transactions have been eliminated. The condensed consolidated financial statements have not been audited. A more detailed description of our accounting policies is included in the 2013 Annual Report filed on Form 10-K. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes contained in the 2013 Annual Report filed on Form 10-K. All references in this report to "Umpqua," "we," "our," "us," the "Company" or similar references mean Umpqua Holdings Corporation, and include our consolidated subsidiaries where the context so requires. References to "Bank" refer to our subsidiary Umpqua Bank, an Oregon state-chartered commercial bank, and references to "Umpqua Investments" refer to our subsidiary Umpqua Investments, Inc., a registered broker-dealer and investment adviser. The Bank also has a wholly-owned subsidiary, Financial Pacific Leasing Inc., a commercial equipment leasing company.

In preparing these condensed consolidated financial statements, the Company has evaluated events and transactions subsequent to September 30, 2014 for potential recognition or disclosure. In management's opinion, all accounting adjustments necessary to accurately reflect the financial position and results of operations on the accompanying financial statements have been made. These adjustments include normal and recurring accruals considered necessary for a fair and accurate presentation. The results for interim periods are not necessarily indicative of results for the full year or any other interim period. Certain reclassifications of prior period amounts have been made to conform to current classifications.

Note 2 – Business Combinations

Sterling Financial Corporation
As of the close of business on April 18, 2014, the Company completed its merger with Sterling Financial Corporation, a Washington corporation ("Sterling"). The results of Sterling's operations are included in the Company's financial results beginning April 19, 2014 and the combined company's banking operations are operating under the Umpqua Bank name and brand.

The structure of the transaction was as follows:

- Sterling merged with and into the Company (the "Merger" or the "Sterling Merger") with the Company as the surviving corporation in the Merger;
- Immediately following the Merger, Sterling's wholly owned banking subsidiary, Sterling Savings Bank merged with and into the Bank (the "Bank Merger"), with the Bank as the surviving bank in the Bank Merger;
- Holders of shares of common stock of Sterling had the right to receive 1.671 shares of the Company's common stock and $2.18 in cash for each share of Sterling common stock;
- Each outstanding warrant issued by Sterling converted into a warrant exercisable for 1.671 shares of the Company's common stock and $2.18 in cash for each warrant when exercised;
- Each outstanding option to purchase a share of Sterling common stock converted into an option to purchase 1.7896 shares of Company's common stock, subject to vesting conditions; and
- Each outstanding restricted stock unit in respect of Sterling common stock converted into a restricted stock unit in respect of 1.7896 shares the Company common stock, subject to vesting conditions.

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A summary of the consideration paid, the assets acquired and liabilities assumed in the Merger are presented below:
(in thousands)

	Sterling April 18, 2014	
Fair value of consideration to Sterling shareholders:		
Cash paid		$136,200
Liability recorded for warrants' cash payment per share		6,453
Fair value of common shares issued		1,939,497
Fair value of warrants, common stock options, and restricted stock exchanged		50,317
Total consideration		2,132,467
Fair value of assets acquired:		
Cash and cash equivalents	$253,067	
Investment securities	1,378,300	
Loans held for sale	214,911	
Non-covered loans and leases	7,123,168	
Premises and equipment	116,581	
Residential mortgage servicing rights	62,770	
Other intangible assets	54,562	
Non-covered other real estate owned	8,915	
Bank owned life insurance	193,246	
Deferred tax asset	299,627	
Accrued interest receivable	23,553	
Other assets	148,018	
Total assets acquired	9,876,718	
Fair value of liabilities assumed:		
Deposits	7,086,052	
Securities sold under agreements to repurchase	584,746	
Term debt	854,737	
Junior subordinated debentures	156,171	
Other liabilities	83,647	
Total liabilities assumed	$8,765,353	
Net assets acquired		1,111,365
Preliminary goodwill		$1,021,102

Amounts recorded are preliminary estimates of fair value. During the third quarter of 2014, goodwill increased primarily due to revised estimates of fair value for premises and equipment, as well as the deferred tax asset. The primary reason for the Merger was to continue the Company's growth strategy, including expanding our geographic footprint in markets throughout the West Coast. All of the goodwill recorded has been attributed to the Community Banking segment and reporting unit. None of the goodwill will be deductible for income tax purposes.

Subsequent to acquisition, the Company repaid securities sold under agreements to repurchase acquired of $500.0 million, funded through the sale of acquired investment securities in the second quarter of 2014. On June 20, 2014, the Company completed the required divestiture of six stores acquired in the Merger to another financial institution. The divestiture of the six stores included $211.5 million of deposits and $88.3 million of loans. The assets were sold at a discount of $7.0 million, which was recorded by Sterling prior to the Merger.
As of April 18, 2014, the unpaid principal balance on purchased non-impaired loans was $7.0 billion. The fair value of the purchased non-impaired loans was $6.7 billion, resulting in a discount of $230.5 million being recorded on these loans.

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The following table presents the acquired purchased impaired loans as of the acquisition date:

(in thousands)	Purchased impaired
Contractually required principal payments	$604,136
Nonaccretable difference	(95,614)
Cash flows expected to be collected	508,522
Accretable yield	(110,757)
Fair value of purchased non-covered impaired loans	$397,765

The operations of Sterling are included in our operating results beginning on April 19, 2014, and contributed the following net interest income, provision for loan losses, non-interest income and expense, income tax benefit, and net income for the three and nine months ended September 30, 2014.

(in thousands)	Sterling Stand-alone	
	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
Net interest income	$119,569	$220,823
Provision for loan losses	9,688	17,423
Non-interest income	34,192	56,494
Non-interest expense, excluding merger expense	78,239	143,371
Merger related expense	8,632	66,163
Income tax provision	20,495	19,394
Net income	$36,707	$30,966

The following table provides a breakout of Merger related expense for the three and nine months ended September 30, 2014.

(in thousands)	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
Personnel	$1,251	$16,739
Legal and professional	4,873	18,797
Charitable contributions	—	10,000
Investment banking fees	—	9,573
Contract termination	896	9,749
Communication	53	2,064
Other	1,559	5,224
Total Merger related expense	$8,632	$72,146

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The following table presents unaudited pro forma results of operations for the three and nine months ended September 30, 2014 and 2013, as if the Sterling Merger had occurred on January 1, 2013. The pro forma results have been prepared for comparative purposes only and are not necessarily indicative of the results that would have been obtained had the acquisition actually occurred on January 1, 2013. The pro forma results include the impact of certain purchase accounting adjustments including accretion of loan discount, intangible assets amortization and deposit and borrowing premium accretion. These purchase accounting adjustments increased pro forma net income by $5.3 million and $12.5 million for the three months ended September 30, 2014 and 2013, respectively, and $77.3 million and $6.2 million for the nine months ended September 30, 2014 and 2013, respectively.

(in thousands, except per share data)

	Pro Forma				
	Three Months Ended September 30,		Nine Months Ended September 30,		
	2014	2013	2014	2013	
Net interest income	$225,716	$223,203	$684,528	$651,484	(1), (2)
Provision for non-covered loan and lease losses	14,431	3,008	35,230	12,989	
Recapture of provision for covered loan losses	(98)	(1,904)	(230)	(4,744)	
Non-interest income	61,924	53,567	155,722	192,285	(3), (4), (5)
Non-interest expense	173,926	191,159	523,805	611,075	(6), (7)
Income before provision for income taxes	99,381	84,507	281,445	224,449	
Provision for income taxes	35,083	28,625	103,810	73,678	
Net income	64,298	55,882	177,635	150,771	
Dividends and undistributed earnings allocated to participating securities	142	196	338	576	
Net earnings available to common shareholders	$64,156	$55,686	$177,297	$150,195	
Earnings per share:					
Basic	$0.30	$0.26	$0.82	$0.70	
Diluted	$0.29	$0.25	$0.81	$0.69	
Average shares outstanding:					
Basic	217,245	216,031	216,884	216,005	
Diluted	218,941	218,559	218,801	218,470	

(1) Includes $29.4 million of incremental loan discount accretion for the three months ended September 30, 2013, and $31.9 million and $99.2 million for the nine months ended September 30, 2014 and 2013, respectively.
(2) Includes a reduction of interest expense of $5.4 million related to deposit and borrowing premiums amortization for the three months ended September 30, 2013, and $5.9 million and $16.9 million for the nine months ended September 30, 2014 and 2013, respectively.
(3) Includes a reduction of service charges on deposit of $1.4 million as a result of passing the $10 billion asset threshold for the three months ended September 30, 2013, and $1.7 million and $4.3 million for the nine months ended September 30, 2014 and 2013, respectively.
(4) Includes a loss on junior subordinated debentures carried at fair value of $966,000 for the three months ended September 30, 2013, and $1.1 million and $2.9 million for nine months ended September 30, 2014 and 2013, respectively.
(5) The nine months ended September 30, 2014 includes the reversal of the $7.0 million loss on the required divestiture of six Sterling stores in connection with the Merger.
(6) Includes $2.0 million of incremental core deposit intangible amortization for the three months ended September 30, 2013, and $2.1 million and $6.0 million for the nine months ended September 30, 2014 and 2013, respectively.

(7) The three and nine months ended September 30, 2014 were adjusted to exclude $8.6 million and $88.0 million of merger expenses, respectively, the three and nine months ended September 30, 2013 were adjusted to include these charges.

Financial Pacific Holding Corp.
On July 1, 2013, the Bank acquired Financial Pacific Holding Corp. ("FPHC") based in Federal Way, Washington, and its subsidiary, Financial Pacific Leasing, Inc. ("FinPac Leasing"), and its subsidiaries, Financial Pacific Funding, Inc. ("FPF"), Financial Pacific Funding II, Inc. ("FPF II") and Financial Pacific Funding III, Inc. ("FPF III"). As part of the same transaction,

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the Company acquired two related entities, FPC Leasing Corporation ("FPC") and Financial Pacific Reinsurance Co., Ltd. ("FPR"). FPHC, FinPac Leasing, FPF, FPF II, FPF III, FPC and FPR are collectively referred to herein as "FinPac." FinPac provides business-essential commercial equipment leases to various industries throughout the United States and Canada. It originates leases through its brokers, lessors, and direct marketing programs. The results of FinPac's operations are included in the consolidated financial statements as of July 1, 2013.

The aggregate consideration for the FinPac purchase was $158.0 million. Of that amount, $156.1 million was distributed in cash, and $1.9 million was exchanged for restricted shares of the Company's common stock. The restricted shares were issued from the Company's 2013 Incentive Plan pursuant to employment agreements between the Company and certain executives of FinPac, vest over a period of either two or three years, and will be recognized over that time period within the salaries and employee benefits line item on the Consolidated Statements of Income. The structure of the transaction was as follows:

- The Bank acquired all of the outstanding stock of FPHC, a shell holding company, which was the sole shareholder of FinPac Leasing, the primary operating subsidiary of FinPac that engages in equipment leasing and financing activities. FinPac Leasing was also the sole shareholder of FPF, FPF II and FPF III, which are bankruptcy-remote entities that formerly served as lien holder for certain leases. FPF, FPF II and FPF III had no assets and have been dissolved. With the dissolution of FPHC, the Bank holds all of the outstanding stock of FinPac Leasing.
- The Company acquired all of the outstanding stock of FPC, a Canadian leasing subsidiary, and FPR, a corporation organized in the Turks & Caicos Islands that reinsures a portion of the liability risk of each insurance policy that is issued by a third party insurance company on leased equipment when the lessee fails to meet its contractual obligations under the lease or financing agreement to obtain insurance on the leased equipment.

A summary of consideration paid, and the assets acquired and liabilities assumed at their fair values, in the acquisition of FinPac are presented below.
(in thousands)

	FinPac July 1, 2013	
Fair value of consideration:		
Cash		$156,110
Fair value of assets acquired:		
Cash and equivalents	$6,452	
Non-covered loans and leases, net	264,336	
Premises and equipment	491	
Other assets	8,015	
Total assets acquired	279,294	
Fair value of liabilities assumed:		
Term debt	211,204	
Other liabilities	8,757	
Total liabilities assumed	$219,961	
Net assets acquired		59,333
Goodwill		$96,777

The acquisition provides diversification, and a scalable platform that is consistent with expansion initiatives that the Bank has completed over the last three years, including growth in the business banking, agricultural lending and home builder lending groups. The transaction leverages excess capital of the Company and deploys excess liquidity into significantly higher yielding assets, provides growth and diversification, and is anticipated to increase profitability. There is no tax deductible goodwill or other intangibles.

The operations of FinPac are included in our operating results from July 1, 2013, and added revenue of $17.2 million, non-interest expense of $4.2 million, and net income of $4.6 million net of tax, for the three months ended September 30, 2014. For the nine months ended September 30, 2014, FinPac added revenue of $49.5 million, non-interest expense of $12.1 million, and net income of $12.8 million, net of tax. FinPac's results of operations prior to the acquisition are not included in our operating

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results. There are no FinPac merger related expenses for the three and nine months ended September 30, 2014. FinPac merger related expenses were $629,000 and $1.4 million for the three and nine months ended September 30, 2013.

Non-covered leases acquired from FinPac are presented below as of acquisition date:

(in thousands)	FinPac July 1, 2013
Contractually required payments	$350,403
Purchase adjustment for credit	$(20,520)
Balance of non-covered impaired leases, net	$264,336

The following table presents unaudited pro forma results of operations for the three and nine months ended September 30, 2013 as if the acquisition of FinPac had occurred on January 1, 2013. The proforma results have been prepared for comparative purposes only and are not necessarily indicative of the results that would have been obtained had the acquisition actually occurred on January 1, 2013. The pro forma results include the impact of certain purchase accounting adjustments which reduced pro forma earnings available to common shareholders by $1.4 million and $2.7 million for the three and nine months ended September 30, 2013, respectively.

(in thousands, except per share data)	Pro Forma	
	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2013
Net interest income	$105,688	$318,904
Provision for non-covered loan and lease losses	4,532	20,826
Recapture of provision for covered loan losses	(1,904)	(4,744)
Non-interest income	26,144	95,968
Non-interest expense	95,130	275,783
Income before provision for income taxes	34,074	123,007
Provision for income taxes	11,900	43,039
Net income	22,174	79,968
Dividends and undistributed earnings allocated to participating securities	248	686
Net earnings available to common shareholders	$21,926	$79,282
Earnings per share:		
Basic	$0.20	$0.71
Diluted	$0.20	$0.71
Average shares outstanding:		
Basic	111,912	111,934
Diluted	112,195	112,154

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Note 3 – Investment Securities

The following table presents the amortized costs, unrealized gains, unrealized losses and approximate fair values of investment securities at September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
AVAILABLE FOR SALE:				
U.S. Treasury and agencies	$214	$16	$—	$230
Obligations of states and political subdivisions	327,857	13,763	(374)	341,246
Residential mortgage-backed securities and collateralized mortgage obligations	2,059,267	15,657	(18,392)	2,056,532
Investments in mutual funds and other equity securities	2,016	37	—	2,053
	$2,389,354	$29,473	$(18,766)	$2,400,061
HELD TO MATURITY:				
Residential mortgage-backed securities and collateralized mortgage obligations	$5,223	$353	$(17)	$5,559
Other investment securities	133	—	—	133
	$5,356	$353	$(17)	$5,692

(in thousands)	December 31, 2013			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
AVAILABLE FOR SALE:				
U.S. Treasury and agencies	$249	$20	$(1)	$268
Obligations of states and political subdivisions	229,969	7,811	(2,575)	235,205
Residential mortgage-backed securities and collateralized mortgage obligations	1,567,001	15,359	(28,819)	1,553,541
Investments in mutual funds and other equity securities	1,959	5	—	1,964
	$1,799,178	$23,195	$(31,395)	$1,790,978
HELD TO MATURITY:				
Residential mortgage-backed securities and collateralized mortgage obligations	$5,563	$330	$(19)	$5,874
	$5,563	$330	$(19)	$5,874

Investment securities that were in an unrealized loss position as of September 30, 2014 and December 31, 2013 are presented in the following tables, based on the length of time individual securities have been in an unrealized loss position. In the opinion of management, these securities are considered only temporarily impaired due to changes in market interest rates or the widening of market spreads subsequent to the initial purchase of the securities, and not due to concerns regarding the underlying credit of the issuers or the underlying collateral.

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September 30, 2014

(in thousands)	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
AVAILABLE FOR SALE:						
Obligations of states and political subdivisions	$—	$—	$12,184	$374	$12,184	$374
Residential mortgage-backed securities and collateralized mortgage obligations	390,787	2,626	519,115	15,766	909,902	18,392
Total temporarily impaired securities	$390,787	$2,626	$531,299	$16,140	$922,086	$18,766
HELD TO MATURITY:						
Residential mortgage-backed securities and collateralized mortgage obligations	$2,283	$17	$—	$—	$2,283	$17
Total temporarily impaired securities	$2,283	$17	$—	$—	$2,283	$17

Unrealized losses on the impaired held to maturity collateralized mortgage obligations include the unrealized losses related to factors other than credit that are included in other comprehensive income.

December 31, 2013

(in thousands)	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
AVAILABLE FOR SALE:						
U.S. Treasury and agencies	$—	$—	$32	$1	$32	$1
Obligations of states and political subdivisions	48,342	2,575	—	—	48,342	2,575
Residential mortgage-backed securities and collateralized mortgage obligations	475,982	15,951	249,695	12,868	725,677	28,819
Total temporarily impaired securities	$524,324	$18,526	$249,727	$12,869	$774,051	$31,395
HELD TO MATURITY:						
Residential mortgage-backed securities and collateralized mortgage obligations	$156	$19	$—	$—	$156	$19
Total temporarily impaired securities	$156	$19	$—	$—	$156	$19

The unrealized losses on investments in U.S. Treasury and agency securities were caused by interest rate increases subsequent to the purchase of these securities. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than par. Because the Bank does not intend to sell the securities in this class and it is not likely that the Bank will be required to sell these securities before recovery of their amortized cost basis, which may include holding each security until contractual maturity, the unrealized losses on these investments are not considered other-than-temporarily impaired ("OTTI").

The unrealized losses on obligations of political subdivisions were caused by changes in market interest rates or the widening of market spreads subsequent to the initial purchase of these securities. Management monitors published credit ratings of these securities and no adverse ratings changes have occurred since the date of purchase of obligations of political subdivisions which are in an unrealized loss position as of September 30, 2014. Because the decline in fair value is attributable to changes in interest rates or widening market spreads and not credit quality, and because the Bank does not intend to sell the securities in this class and it is not likely that the Bank will be required to sell these securities before recovery of their amortized cost basis, which may include holding each security until maturity, the unrealized losses on these investments are not considered OTTI.

All of the available for sale residential mortgage-backed securities and collateralized mortgage obligations portfolio in an unrealized loss position at September 30, 2014 are issued or guaranteed by governmental agencies. The unrealized losses on residential mortgage-backed securities and collateralized mortgage obligations were caused by changes in market interest rates or the widening of market spreads subsequent to the initial purchase of these securities, and not concerns regarding the underlying credit of the issuers or the underlying collateral. It is expected that these securities will not be settled at a price less than the amortized cost of each investment. Because the decline in fair value is attributable to changes in interest rates or widening market spreads and not credit quality, and because the Bank does not intend to sell the securities in this class and it is

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not likely that the Bank will be required to sell these securities before recovery of their amortized cost basis, which may include holding each security until contractual maturity, these investments are not considered OTTI.

The following table presents the maturities of investment securities at September 30, 2014:

(in thousands)	Available For Sale		Held To Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
AMOUNTS MATURING IN:				
Three months or less	$7,563	$7,593	$—	$—
Over three months through twelve months	52,418	53,214	—	—
After one year through five years	1,746,126	1,761,633	41	42
After five years through ten years	530,060	522,827	18	19
After ten years	51,171	52,741	5,163	5,497
Other investment securities	2,016	2,053	134	134
	$2,389,354	$2,400,061	$5,356	$5,692

The amortized cost and fair value of collateralized mortgage obligations and mortgage-backed securities are presented by expected average life, rather than contractual maturity, in the preceding table. Expected maturities may differ from contractual maturities because borrowers have the right to prepay underlying loans without prepayment penalties. The following table presents the gross realized gains and gross realized losses on the sale of securities available for sale for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months Ended			
	September 30, 2014		September 30, 2013	
	Gains	Losses	Gains	Losses
Obligations of states and political subdivisions	$—	$—	$3	$—
Residential mortgage-backed securities and collateralized mortgage obligations	902	—	—	—
Other debt securities	—	—	—	—
	$902	$—	$3	$—

	Nine Months Ended			
	September 30, 2014		September 30, 2013	
	Gains	Losses	Gains	Losses
Obligations of states and political subdivisions	$3	$1	$10	$1
Residential mortgage-backed securities and collateralized mortgage obligations	1,876	—	—	—
Other debt securities	—	—	9	—
	$1,879	$1	$19	$1

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The following table presents, as of September 30, 2014, investment securities which were pledged to secure borrowings, public deposits, and repurchase agreements as permitted or required by law:

(in thousands)	Amortized Cost	Fair Value
To Federal Home Loan Bank to secure borrowings	$7,526	$7,842
To state and local governments to secure public deposits	1,627,608	1,634,162
Other securities pledged principally to secure repurchase agreements	498,315	497,031
Total pledged securities	$2,133,449	$2,139,035

Note 4 – Non-Covered Loans and Leases

The following table presents the major types of non-covered loans and leases, net as of September 30, 2014 and December 31, 2013, respectively:

(in thousands)	September 30, 2014	December 31, 2013
Commercial real estate		
Non-owner occupied term, net	$3,273,932	$2,328,260
Owner occupied term, net	2,636,951	1,259,583
Multifamily, net	2,536,710	403,537
Construction & development, net	245,457	245,231
Residential development, net	73,781	88,413
Commercial		
Term, net	1,110,028	770,845
LOC & other, net	1,338,821	987,360
Leases and equipment finance, net	492,221	361,591
Residential		
Mortgage, net	2,085,266	597,201
Home equity loans & lines, net	818,765	264,269
Consumer & other, net	363,879	48,113
Total loans and leases, net of deferred fees and costs	$14,975,811	$7,354,403

The non-covered loan balances are net of net deferred loan costs of $20.2 million as of September 30, 2014 and net of net deferred loan fees of $495,000 at December 31, 2013. Net non-covered loans include discounts on acquired loans of $244.2 million and $3.3 million as of September 30, 2014 and December 31, 2013, respectively. As of September 30, 2014, non-covered loans totaling $8.1 billion were pledged to secure borrowings and available lines of credit.

Purchased loans and leases are recorded at their fair value at the acquisition date. Credit discounts are included in the determination of fair value; therefore, an allowance for loan and lease losses is not recorded at the acquisition date. Acquired loans are evaluated upon acquisition and classified as either purchased impaired or purchased non-impaired. Purchased impaired loans reflect credit deterioration since origination such that it is probable at acquisition that the Company will be unable to collect all contractually required payments. The outstanding contractual unpaid principal balance of non-covered purchased impaired loans, excluding purchase accounting adjustments, was $519.8 million and $35.1 million at September 30, 2014 and December 31, 2013, respectively. The carrying balance of non-covered purchased impaired loans was $367.1 million and $21.9 million at September 30, 2014 and December 31, 2013, respectively.

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The following table presents the changes in the accretable yield for purchased impaired loans for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Balance, beginning of period	$105,505	$170	$1,140	$770
Additions	—	—	110,757	—
Accretion to interest income	(9,779)	(54)	(15,856)	(205)
Disposals	(4,111)	(222)	(4,426)	(671)
Reclassifications from nonaccretable difference	2,794	1,334	2,794	1,334
Balance, end of period	$94,409	$1,228	$94,409	$1,228

Note 5 – Allowance for Non-Covered Loan and Lease Loss and Credit Quality

The Bank's methodology for assessing the appropriateness of the Allowance for Loan and Lease Loss ("ALLL") consists of three key elements: 1) the formula allowance; 2) the specific allowance; and 3) the unallocated allowance. By incorporating these factors into a single allowance requirement analysis, we believe all risk-based activities within the loan and lease portfolios are simultaneously considered.

Formula Allowance
When loans and leases are originated, they are assigned a risk rating that is reassessed periodically during the term of the loan or lease through the credit review process. The Bank's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. The 10 risk rating categories are a primary factor in determining an appropriate amount for the formula allowance.

The formula allowance is calculated by applying risk factors to various segments of pools of outstanding loans and leases. Risk factors are assigned to each portfolio segment based on management's evaluation of the losses inherent within each segment. Segments or regions with greater risk of loss will therefore be assigned a higher risk factor.

Base risk – The portfolio is segmented into loan categories, and these categories are assigned a Base risk factor based on an evaluation of the loss inherent within each segment.

Extra risk – Additional risk factors provide for an additional allocation of ALLL based on the loan and lease risk rating system and loan delinquency, and reflect the increased level of inherent losses associated with more adversely classified loans and leases.

Risk factors may be changed periodically based on management's evaluation of the following factors: loss experience; changes in the level of non-performing loans and leases; regulatory exam results; changes in the level of adversely classified loans and leases; improvement or deterioration in local economic conditions; and any other factors deemed relevant.

Specific Allowance
Regular credit reviews of the portfolio identify loans that are considered potentially impaired. Potentially impaired loans are referred to the ALLL Committee which reviews and approves designated loans as impaired. A loan is considered impaired when, based on current information and events, we determine that we will probably not be able to collect all amounts due according to the loan contract, including scheduled interest payments. When we identify a loan as impaired, we measure the impairment using discounted cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral. In these cases, we use the current fair value of the collateral, less selling costs, instead of discounted cash flows. If we determine that the value of the impaired loan is less than the

recorded investment in the loan, we either recognize an impairment reserve as a specific allowance to be provided for in the allowance for loan and lease losses or charge-off the impaired balance on collateral-dependent loans if it is determined that such amount represents a confirmed loss. Loans determined to be impaired with a specific allowance are excluded from the formula allowance so as not to double-count the loss exposure. The non-accrual impaired loans as of period-end have already been partially charged-off to their estimated net realizable value, and are expected to be resolved over the coming quarters with no additional material loss, absent further decline in market prices.

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The combination of the formula allowance component and the specific allowance component represents the allocated allowance for loan and lease losses.

Unallocated Allowance
The Bank may also maintain an unallocated allowance amount to provide for other credit losses inherent in a loan and lease portfolio that may not have been contemplated in the credit loss factors. This unallocated amount generally comprises less than 5% of the allowance, but may be maintained at higher levels during times of deteriorating economic conditions characterized by falling real estate values. The unallocated amount is reviewed quarterly based on trends in credit losses, the results of credit reviews, overall economic trends and other qualitative factors.

Management believes that the ALLL was adequate as of September 30, 2014. There is, however, no assurance that future loan and lease losses will not exceed the levels provided for in the ALLL and could possibly result in additional charges to the provision for loan and lease losses.

The reserve for unfunded commitments ("RUC") is established to absorb inherent losses associated with our commitment to lend funds, such as with a letter or line of credit. The adequacy of the ALLL and RUC are monitored on a regular basis and are based on management's evaluation of numerous factors. These factors include the quality of the current loan portfolio; the trend in the loan portfolio's risk ratings; current economic conditions; loan concentrations; loan growth rates; past-due and non-performing trends; evaluation of specific loss estimates for all significant problem loans; historical charge-off and recovery experience; and other pertinent information.

There have been no significant changes to the Bank's ALLL methodology or policies in the periods presented.

Activity in the Non-Covered Allowance for Loan and Lease Losses

The following table summarizes activity related to the allowance for non-covered loan and lease losses by non-covered loan and lease portfolio segment for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months Ended September 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$51,958	$32,587	$11,403	$2,047	$97,995
Charge-offs	(595)	(4,212)	(714)	(1,222)	(6,743)
Recoveries	293	1,332	37	462	2,124
Provision	701	8,883	1,459	3,388	14,431
Balance, end of period	$52,357	$38,590	$12,185	$4,675	$107,807

	Three Months Ended September 30, 2013				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$55,249	$21,587	$8,250	$750	$85,836
Charge-offs	(3,101)	(1,754)	(1,181)	(281)	(6,317)
Recoveries	880	1,101	41	145	2,167
Provision	565	2,346	(68)	165	3,008
Balance, end of period	$53,593	$23,280	$7,042	$779	$84,694

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(in thousands)	Nine Months Ended September 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$53,433	$24,191	$6,827	$863	$85,314
Charge-offs	(3,119)	(11,979)	(1,296)	(1,728)	(18,122)
Recoveries	1,264	3,292	204	625	5,385
Provision	779	23,086	6,450	4,915	35,230
Balance, end of period	$52,357	$38,590	$12,185	$4,675	$107,807

	Nine Months Ended September 30, 2013				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$54,909	$22,925	$6,925	$632	$85,391
Charge-offs	(6,595)	(9,541)	(2,813)	(697)	(19,646)
Recoveries	2,830	2,554	221	355	5,960
Provision	2,449	7,342	2,709	489	12,989
Balance, end of period	$53,593	$23,280	$7,042	$779	$84,694

The following table presents the allowance and recorded investment in non-covered loans and leases by portfolio segment as of September 30, 2014 and 2013:

(in thousands)	September 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Allowance for non-covered loans and leases:					
Collectively evaluated for impairment	$51,201	$38,577	$12,185	$4,675	$106,638
Individually evaluated for impairment	1,156	13	—	—	1,169
Loans acquired with deteriorated credit quality	—	—	—	—	—
Total	$52,357	$38,590	$12,185	$4,675	$107,807
Non-covered loans and leases:					
Collectively evaluated for impairment	$8,388,428	$2,891,941	$2,858,947	$363,031	$14,502,347
Individually evaluated for impairment	85,804	20,445	—	128	106,377
Loans acquired with deteriorated credit quality	292,599	28,684	45,084	720	367,087
Total	$8,766,831	$2,941,070	$2,904,031	$363,879	$14,975,811

(in thousands)	September 30, 2013				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Allowance for non-covered loans and leases:					
Collectively evaluated for impairment	$52,199	$23,270	$7,042	$779	$83,290
Individually evaluated for impairment	1,394	10	—	—	1,404
Total	$53,593	$23,280	$7,042	$779	$84,694
Non-covered loans and leases:					
Collectively evaluated for impairment	$4,235,408	$2,039,566	$806,402	$43,621	$7,124,997
Individually evaluated for impairment	97,382	12,736	—	—	110,118
Total	$4,332,790	$2,052,302	$806,402	$43,621	$7,235,115

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The non-covered loan and lease balances are net of net deferred loans costs of $20.2 million at September 30, 2014 and net of net deferred fees of $6.2 million at September 30, 2013.

Summary of Reserve for Unfunded Commitments Activity

The following table presents a summary of activity in the RUC and unfunded commitments for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Balance, beginning of period	$4,845	$1,327	$1,436	$1,223
Net change to other expense	(457)	48	(1,014)	152
Acquired reserve	—	—	3,966	—
Balance, end of period	$4,388	$1,375	$4,388	$1,375

(in thousands)	Total
Unfunded loan and lease commitments:	
September 30, 2014	$2,949,211
September 30, 2013	$1,610,735

Non-covered loans and leases sold

In the course of managing the loan and lease portfolio, at certain times, management may decide to sell loans and leases. The following table summarizes loans and leases sold by loan portfolio during the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Commercial real estate				
Non-owner occupied term	$—	$4,927	$14,799	$7,777
Owner occupied term	22,884	—	71,128	—
Multifamily	35,306	—	60,508	—
Construction & development	—	—	566	3,515
Residential development	—	—	800	363
Commercial				
Term	4,199	1,098	30,068	47,635
LOC & other	299	—	5,361	—
Residential				
Mortgage	54,917	1,008	60,951	1,008
Home equity loans & lines	—	—	24,445	—
Consumer & other	—	—	7,344	—
Total	$117,605	$7,033	$275,970	$60,298

Asset Quality and Non-Performing Loans and Leases

We manage asset quality and control credit risk through diversification of the non-covered loan and lease portfolio and the application of policies designed to promote sound underwriting and loan and lease monitoring practices. The

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Quality Group is charged with monitoring asset quality, establishing credit policies and procedures and enforcing the consistent application of these policies and procedures across the Bank. Reviews of non-performing, past due non-covered loans and leases and larger credits, designed to identify potential charges to the allowance for loan and lease losses, and to determine the adequacy of the allowance, are conducted on an ongoing basis. These reviews consider such factors as the financial strength of borrowers, the value of the applicable collateral, loan and lease loss experience, estimated loan and lease losses, growth in the loan and lease portfolio, prevailing economic conditions and other factors.

Non-Covered Non-Accrual Loans and Leases and Loans and Leases Past Due

The following table summarizes our non-covered non-accrual loans and leases and loans and leases past due, by loan and lease class, as of September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014						
	Greater than 30 to 59 Days Past Due	60 to 89 Days Past Due	90 Days and Greater and Accruing	Total Past Due	Non-Accrual	Current & Other (1)	Total non-cover Loans and Leases
Commercial real estate							
Non-owner occupied term, net	$2,290	$6,180	$225	$8,695	$ 15,675	$3,249,562	$3,273,932
Owner occupied term, net	1,874	5,706	—	7,580	3,555	2,625,816	2,636,951
Multifamily, net	422	—	—	422	1,311	2,534,977	2,536,710
Construction & development, net	—	1,204	—	1,204	—	244,253	245,457
Residential development, net	468	—	—	468	—	73,313	73,781
Commercial							
Term, net	961	944	17	1,922	17,051	1,091,055	1,110,028
LOC & other, net	950	2,672	225	3,847	1,879	1,333,095	1,338,821
Leases and equipment finance, net	1,571	3,438	447	5,456	2,795	483,970	492,221
Residential							
Mortgage, net	10	1,254	5,421	6,685	3	2,078,578	2,085,266
Home equity loans & lines, net	772	750	959	2,481	—	816,284	818,765
Consumer & other, net	2,117	442	122	2,681	128	361,070	363,879
Total, net of deferred fees and costs	$11,435	$22,590	$7,416	$41,441	$ 42,397	$14,891,973	$14,975,811

(1) Other includes purchased credit impaired non-covered loans of $367.1 million.

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(in thousands)	December 31, 2013						
	Greater than 30 to 59 Days Past Due	60 to 89 Days Past Due	90 Days and Greater and Accruing	Total Past Due	Non-Accrual	Current & Other (1)	Total non-cover Loans and Leases
Commercial real estate							
Non-owner occupied term, net	$3,618	$352	$—	$3,970	$ 9,193	$2,315,097	$2,328,260
Owner occupied term, net	1,320	340	610	2,270	6,204	1,251,109	1,259,583
Multifamily, net	—	—	—	—	935	402,602	403,537
Construction & development, net	—	—	—	—	—	245,231	245,231
Residential development, net	—	—	—	—	2,801	85,612	88,413
Commercial							
Term, net	901	1,436	—	2,337	8,723	759,785	770,845
LOC & other, net	619	224	—	843	1,222	985,295	987,360
Leases and equipment finance, net	2,202	1,706	517	4,425	2,813	354,353	361,591
Residential							
Mortgage, net	1,050	342	2,070	3,462	—	593,739	597,201
Home equity loans & lines, net	473	563	160	1,196	—	263,073	264,269
Consumer & other, net	69	75	73	217	—	47,896	48,113
Total, net of deferred fees and costs	$10,252	$5,038	$3,430	$18,720	$ 31,891	$7,303,792	$7,354,403

(1) Other includes purchased credit impaired non-covered loans of $21.9 million

Non-Covered Impaired Loans

Loans with no related allowance reported generally represent non-accrual loans. The Bank recognizes the charge-off on impaired loans in the period it arises for collateral-dependent loans. Therefore, the non-accrual loans as of September 30, 2014 have already been written down to their estimated net realizable value and are expected to be resolved with no additional material loss, absent further decline in market prices. The valuation allowance on impaired loans primarily represents the impairment reserves on performing restructured loans, and is measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan's carrying value.

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The following table summarizes our non-covered impaired loans by loan class as of September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014			
	Unpaid Principal Balance	Recorded Investment Without Allowance	With Allowance	Related Allowance
Commercial real estate				
Non-owner occupied term, net	$62,131	$33,035	$25,334	$613
Owner occupied term, net	11,661	3,555	7,677	378
Multifamily, net	5,185	1,311	3,519	68
Construction & development, net	1,091	—	1,091	7
Residential development, net	10,285	2,675	7,607	90
Commercial				
Term, net	34,251	17,052	269	9
LOC & other, net	9,248	1,879	1,245	4
Leases, net	—	—	—	—
Residential				
Mortgage, net	—	—	—	—
Home equity loans & lines, net	501	—	—	—
Consumer & other, net	294	128	—	—
Total, net of deferred fees and costs	$134,647	$59,635	$46,742	$1,169

(in thousands)	December 31, 2013			
	Unpaid Principal Balance	Recorded Investment Without Allowance	With Allowance	Related Allowance
Commercial real estate				
Non-owner occupied term, net	$50,602	$18,285	$31,362	$928
Owner occupied term, net	11,876	6,204	5,202	198
Multifamily, net	1,416	935	—	—
Construction & development, net	10,609	8,498	1,091	11
Residential development, net	22,513	5,776	11,927	648
Commercial				
Term, net	22,750	8,723	300	8
LOC & other, net	7,144	1,222	1,258	4
Leases, net	—	—	—	—
Residential				
Mortgage, net	—	—	—	—
Home equity loans & lines, net	—	—	—	—
Consumer & other, net	—	—	—	—
Total, net of deferred fees and costs	$126,910	$49,643	$51,140	$1,797

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The following table summarizes our average recorded investment and interest income recognized on impaired non-covered loans by loan class for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Commercial real estate				
Non-owner occupied term, net	$55,246	$573	$62,246	$389
Owner occupied term, net	11,686	79	8,222	49
Multifamily, net	4,830	113	1,082	—
Construction & development, net	5,288	11	13,607	122
Residential development, net	12,190	124	19,442	165
Commercial				
Term, net	18,381	4	11,622	4
LOC & other, net	3,478	13	2,268	13
Residential				
Mortgage, net	—	—	238	—
Home equity loans & lines, net	—	—	—	—
Consumer & other, net	64	—	—	—
Total, net of deferred fees and costs	$111,163	$917	$118,727	$742

(in thousands)	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Commercial real estate				
Non-owner occupied term, net	$53,460	$1,532	$67,281	$1,155
Owner occupied term, net	11,989	231	6,475	146
Multifamily, net	2,737	113	723	—
Construction & development, net	7,423	33	15,001	363
Residential development, net	14,128	373	23,513	474
Commercial				
Term, net	14,512	12	12,688	13
LOC & other, net	2,928	38	4,389	39
Residential				
Mortgage, net	—	—	191	—
Home equity loans & lines, net	—	—	120	—
Consumer & other, net	32	—	1	—
Total, net of deferred fees and costs	$107,209	$2,332	$130,382	$2,190

The impaired loans for which these interest income amounts were recognized primarily relate to accruing restructured loans.

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Non-Covered Credit Quality Indicators

As previously noted, the Bank's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. The Bank differentiates its lending portfolios into homogeneous loans and leases and non-homogeneous loans and leases. The 10 risk rating categories can be generally described by the following groupings for non-homogeneous loans and leases:

Minimal Risk—A minimal risk loan or lease, risk rated 1, is to a borrower of the highest quality. The borrower has an unquestioned ability to produce consistent profits and service all obligations and can absorb severe market disturbances with little or no difficulty.

Low Risk—A low risk loan or lease, risk rated 2, is similar in characteristics to a minimal risk loan. Margins may be smaller or protective elements may be subject to greater fluctuation. The borrower will have a strong demonstrated ability to produce profits, provide ample debt service coverage and to absorb market disturbances.

Modest Risk—A modest risk loan or lease, risk rated 3, is a desirable loan or lease with excellent sources of repayment and no currently identifiable risk associated with collection. The borrower exhibits a very strong capacity to repay the credit in accordance with the repayment agreement. The borrower may be susceptible to economic cycles, but will have reserves to weather these cycles.

Average Risk—An average risk loan or lease, risk rated 4, is an attractive loan or lease with sound sources of repayment and no material collection or repayment weakness evident. The borrower has an acceptable capacity to pay in accordance with the agreement. The borrower is susceptible to economic cycles and more efficient competition, but should have modest reserves sufficient to survive all but the most severe downturns or major setbacks.

Acceptable Risk—An acceptable risk loan or lease, risk rated 5, is a loan or lease with lower than average, but still acceptable credit risk. These borrowers may have higher leverage, less certain but viable repayment sources, have limited financial reserves and may possess weaknesses that can be adequately mitigated through collateral, structural or credit enhancement. The borrower is susceptible to economic cycles and is less resilient to negative market forces or financial events. Reserves may be insufficient to survive a modest downturn.

Watch—A watch loan or lease, risk rated 6, is still pass-rated, but represents the lowest level of acceptable risk due to an emerging risk element or declining performance trend. Watch ratings are expected to be temporary, with issues resolved or manifested to the extent that a higher or lower rating would be appropriate. The borrower should have a plausible plan, with reasonable certainty of success, to correct the problems in a short period of time.

Special Mention—A special mention loan or lease, risk rated 7, has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or the institution's credit position at some future date. They contain unfavorable characteristics and are generally undesirable. Loans and leases in this category are currently protected but are potentially weak and constitute an undue and unwarranted credit risk, but not to the point of a substandard classification. A special mention loan or lease has potential weaknesses, which if not checked or corrected, weaken the asset or inadequately protect the Bank's position at some future date.

Substandard—A substandard asset, risk rated 8, is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified substandard. Loans and leases are classified as

substandard when they have unsatisfactory characteristics causing unacceptable levels of risk. A substandard loan or lease normally has one or more well-defined weaknesses that could jeopardize repayment of the debt. The likely need to liquidate assets to correct the problem, rather than repayment from successful operations is the key distinction between special mention and substandard.

Doubtful—Loans or leases classified as doubtful, risk rated 9, have all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work towards strengthening of the asset, classification as a loss (and immediate charge-off) is deferred until more exact status may be determined. Pending factors include proposed merger, acquisition, liquidation procedures, capital injection, and perfection of liens on additional collateral and refinancing plans. In certain circumstances, a doubtful rating will be temporary, while the Bank is awaiting an updated collateral valuation. In these

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cases, once the collateral is valued and appropriate margin applied, the remaining un-collateralized portion will be charged-off. The remaining balance, properly margined, may then be upgraded to substandard, however must remain on non-accrual.

Loss—Loans or leases classified as loss, risk rated 10, are considered un-collectible and of such little value that the continuance as an active Bank asset is not warranted. This rating does not mean that the loan or lease has no recovery or salvage value, but rather that the loan or lease should be charged-off now, even though partial or full recovery may be possible in the future.

Impaired—Loans are classified as impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal and interest when due, in accordance with the terms of the original loan agreement, without unreasonable delay. This generally includes all loans classified as non-accrual and troubled debt restructurings. Impaired loans are risk rated for internal and regulatory rating purposes, but presented separately for clarification.

Homogeneous loans and leases are not risk rated until they are greater than 30 days past due, and risk rating is based primarily on the past due status of the loan or lease. The risk rating categories can be generally described by the following groupings for commercial and commercial real estate homogeneous loans and leases:

Special Mention—A homogeneous special mention loan or lease, risk rated 7, is 30-59 days past due from the required payment date at month-end.

Substandard—A homogeneous substandard loan or lease, risk rated 8, is 60-89 days past due from the required payment date at month-end.

Doubtful—A homogeneous doubtful loan or lease, risk rated 9, is 90-179 days past due from the required payment date at month-end.

Loss—A homogeneous loss loan or lease, risk rated 10, is 180 days and more past due from the required payment date. These loans are generally charged-off in the month in which the 180 day time period elapses.

The risk rating categories can be generally described by the following groupings for residential and consumer and other homogeneous loans:

Special Mention—A homogeneous retail special mention loan, risk rated 7, is 30-89 days past due from the required payment date at month-end.

Substandard—A homogeneous retail substandard loan, risk rated 8, is an open-end loan 90-180 days past due from the required payment date at month-end or a closed-end loan 90-120 days past due from the required payment date at month-end.

Loss—A homogeneous retail loss loan, risk rated 10, is a closed-end loan that becomes past due 120 cumulative days or an open-end retail loan that becomes past due 180 cumulative days from the contractual due date. These loans are generally charged-off in the month in which the 120 or 180 day period elapses.

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The following table summarizes our internal risk rating by loan and lease class for the non-covered loan and lease portfolio as of September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014						
	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Impaired (1)	Total
Commercial real estate							
Non-owner occupied term, net	$3,004,702	$107,055	$103,479	$327	$—	$58,369	$3,273,932
Owner occupied term, net	2,469,495	68,393	86,640	571	620	11,232	2,636,951
Multifamily, net	2,515,322	10,213	6,345	—	—	4,830	2,536,710
Construction & development, net	236,693	4,367	3,306	—	—	1,091	245,457
Residential development, net	61,061	776	1,662	—	—	10,282	73,781
Commercial							
Term, net	1,063,690	14,065	14,690	251	11	17,321	1,110,028
LOC & other, net	1,272,032	40,874	22,476	225	90	3,124	1,338,821
Leases and equipment finance, net	484,056	3,687	1,351	2,551	576	—	492,221
Residential							
Mortgage, net	2,061,460	4,811	7,545	—	11,450	—	2,085,266
Home equity loans & lines, net	810,760	4,468	1,591	—	1,946	—	818,765
Consumer & other, net	360,396	2,769	360	—	226	128	363,879
Total, net of deferred fees and costs	$14,339,667	$261,478	$249,445	$3,925	$14,919	$106,377	$14,975,811

(1) Impaired loans includes 6.3% classified as watch, 2.8% classified as special mentioned, 89.7% classified as substandard, and 1.2% classified as doubtful.

(in thousands)	December 31, 2013						
	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Impaired (1)	Total
Commercial real estate							
Non-owner occupied term, net	$2,073,366	$108,263	$96,984	$—	$—	$49,647	$2,328,260
Owner occupied term, net	1,182,865	27,615	37,524	173	—	11,406	1,259,583
Multifamily, net	385,335	5,574	11,693	—	—	935	403,537
Construction & development, net	230,262	2,054	3,326	—	—	9,589	245,231
Residential development, net	67,019	1,836	1,855	—	—	17,703	88,413
Commercial							
Term, net	718,778	23,393	19,651	—	—	9,023	770,845
LOC & other, net	951,109	24,197	9,574	—	—	2,480	987,360
Leases and equipment finance, net	351,971	4,585	1,706	2,996	333	—	361,591
Residential							
Mortgage, net	593,723	1,405	743	—	1,330	—	597,201
Home equity loans & lines, net	263,070	1,038	25	—	136	—	264,269
Consumer & other, net	47,895	144	33	—	41	—	48,113
	$6,865,393	$200,104	$183,114	$3,169	$1,840	$100,783	$7,354,403

Total, net of deferred fees and costs

(1) Impaired loans includes 6.4% classified as watch, 3.7% classified as special mentioned, and 89.9% classified as substandard.

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Troubled Debt Restructurings

At September 30, 2014 and December 31, 2013, impaired loans of $63.5 million and $68.8 million, respectively, were classified as accruing restructured loans. The restructurings were granted in response to borrower financial difficulty, and generally provide for a temporary modification of loan repayment terms. The restructured loans on accrual status represent the only impaired loans accruing interest. In order for a restructured loan to be considered for accrual status, the loan's collateral coverage generally will be greater than or equal to 100% of the loan balance, the loan is current on payments, and the borrower must either prefund an interest reserve or demonstrate the ability to make payments from a verified source of cash flow. Impaired restructured loans carry a specific allowance and the allowance on impaired restructured loans is calculated consistently across the portfolios.

There were no available commitments for troubled debt restructurings outstanding as of September 30, 2014 and December 31, 2013.

The following tables present troubled debt restructurings by accrual versus non-accrual status and by loan segment as of September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014		
	Accrual Status	Non-Accrual Status	Total Modifications
Commercial real estate, net	$61,657	$4,808	$66,465
Commercial, net	1,245	2,510	3,755
Residential, net	605	—	605
Total, net of deferred fees and costs	$63,507	$7,318	$70,825

(in thousands)	December 31, 2013		
	Accrual Status	Non-Accrual Status	Total Modifications
Commercial real estate, net	$67,060	$2,196	$69,256
Commercial, net	1,258	2,603	3,861
Residential, net	473	—	473
Total, net of deferred fees and costs	$68,791	$4,799	$73,590

The Bank's policy is that loans placed on non-accrual will typically remain on non-accrual status until all principal and interest payments are brought current and the prospect for future payment in accordance with the loan agreement appears relatively certain. The Bank's policy generally refers to six months of payment performance as sufficient to warrant a return to accrual status.

The types of modifications offered can generally be described in the following categories:

Rate Modification—A modification in which the interest rate is modified.

Term Modification —A modification in which the maturity date, timing of payments, or frequency of payments is changed.

Interest Only Modification—A modification in which the loan is converted to interest only payments for a period of time.

Payment Modification—A modification in which the payment amount is changed, other than an interest only modification described above.

Combination Modification—Any other type of modification, including the use of multiple types of modifications.

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The following table presents newly non-covered restructured loans that occurred during the three and nine months ended September 30, 2014 and three and nine months ended September 30, 2013:

(in thousands)	Three Months Ended September 30, 2014					
	Rate Modifications	Term Modifications	Interest Only Modifications	Payment Modifications	Combination Modifications	Total Modifications
Commercial real estate, net	$—	$1,088	$—	$—	$—	$1,088
Commercial, net	—	—	—	—	—	—
Residential, net	—	—	—	—	—	—
Consumer & other, net	—	—	—	—	—	—
Total, net of deferred fees and costs	$—	$1,088	$—	$—	$—	$1,088

	Three Months Ended September 30, 2013					
	Rate Modifications	Term Modifications	Interest Only Modifications	Payment Modifications	Combination Modifications	Total Modifications
Commercial real estate, net	$—	$—	$—	$—	$—	$—
Commercial, net	—	—	—	—	3,588	3,588
Residential, net	—	—	—	—	—	—
Consumer & other, net	—	—	—	—	—	—
Total, net of deferred fees and costs	$—	$—	$—	$—	$3,588	$3,588

	Nine Months Ended September 30, 2014					
	Rate Modifications	Term Modifications	Interest Only Modifications	Payment Modifications	Combination Modifications	Total Modifications
Commercial real estate, net	$—	$2,332	$—	$—	$3,519	$5,851
Commercial, net	—	—	—	—	—	—
Residential, net	—	—	—	—	138	138
Consumer & other, net	—	—	—	—	—	—
Total	$—	$2,332	$—	$—	$3,657	$5,989

(in thousands)	Nine Months Ended September 30, 2013					
	Rate Modifications	Term Modifications	Interest Only Modifications	Payment Modifications	Combination Modifications	Total Modifications
Commercial real estate, net	$—	$—	$4,291	$—	$—	$4,291
Commercial, net	—	—	—	—	4,040	4,040
Residential, net	—	—	—	—	478	478
Consumer & other, net	—	—	—	—	—	—
	$—	$—	$4,291	$—	$4,518	$8,809

Total, net of deferred fees
and costs

For the periods presented in the tables above, the outstanding recorded investment was the same pre and post modification.

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There were no financing receivables modified as troubled debt restructurings within the previous 12 months for which there was a payment default during the three and nine months ended September 30, 2014 and 2013.

Note 6 – Covered Assets and Indemnification Asset

Covered Loans, Net
Loans acquired in a Federal Deposit Insurance Corporation ("FDIC")-assisted acquisition that are subject to a loss-share agreement are referred to as covered loans and reported separately in our statements of financial condition. Covered loans are reported exclusive of the cash flow reimbursements expected from the FDIC.

The following table presents the major types of covered loans as of September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014	December 31, 2013
Commercial real estate		
Non-owner occupied term, net	$149,521	$206,902
Owner occupied term, net	45,919	49,817
Multifamily, net	29,001	37,671
Construction & development, net	2,359	3,455
Residential development, net	3,068	7,286
Commercial		
Term, net	9,630	15,719
LOC & other, net	5,920	6,698
Residential		
Mortgage, net	17,067	22,316
Home equity loans & lines, net	17,289	19,637
Consumer & other, net	3,616	4,262
Total, net of deferred fees and costs	$283,390	$373,763
Allowance for covered loans	(7,828)	(9,771)
Total	$275,562	$363,992

The outstanding contractual unpaid principal balance, excluding purchase accounting adjustments, at September 30, 2014 was $336.9 million as compared to $462.4 million at December 31, 2013.

In estimating the fair value of the covered loans at the acquisition date, we (a) calculated the contractual amount and timing of undiscounted principal and interest payments and (b) estimated the amount and timing of undiscounted expected principal and interest payments. The difference between these two amounts represents the nonaccretable difference.

On the acquisition date, the amount by which the undiscounted expected cash flows exceed the estimated fair value of the acquired loans is the "accretable yield." The accretable yield is then measured at each financial reporting date and represents the difference between the remaining undiscounted expected cash flows and the current carrying value of the loans.

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The following table presents the changes in the accretable yield for the three and nine months ended September 30, 2014 and 2013 for the covered loan portfolio:

(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Balance, beginning of period	$95,022	$154,803	$126,484	$183,388
Accretion to interest income	(8,478)	(11,457)	(36,461)	(40,041)
Disposals	(2,723)	(3,726)	(19,977)	(11,179)
Reclassifications from nonaccretable difference	6,201	2,696	19,976	10,148
Balance, end of period	$90,022	$142,316	$90,022	$142,316

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Allowance for Covered Loan Losses

The following table summarizes activity related to the allowance for covered loan losses by covered loan portfolio segment for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months Ended September 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$4,962	$2,839	$550	$149	$8,500
Charge-offs	(509)	(212)	(13)	(47)	(781)
Recoveries	100	80	12	15	207
(Recapture) provision	(271)	(66)	238	1	(98)
Balance, end of period	$4,282	$2,641	$787	$118	$7,828

	Three Months Ended September 30, 2013				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$8,871	$4,512	$808	$176	$14,367
Charge-offs	(553)	(406)	(48)	(88)	(1,095)
Recoveries	182	156	59	153	550
(Recapture) provision	(1,466)	(367)	(16)	(55)	(1,904)
Balance, end of period	$7,034	$3,895	$803	$186	$11,918

(in thousands)	Nine Months Ended September 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$6,105	$2,837	$660	$169	$9,771
Charge-offs	(1,555)	(1,126)	(177)	(110)	(2,968)
Recoveries	729	326	147	53	1,255
(Recapture) provision	(997)	604	157	6	(230)
Balance, end of period	$4,282	$2,641	$787	$118	$7,828

	Nine Months Ended September 30, 2013				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$12,129	$4,980	$804	$362	$18,275
Charge-offs	(1,321)	(1,219)	(156)	(420)	(3,116)
Recoveries	669	428	185	221	1,503
(Recapture) provision	(4,443)	(294)	(30)	23	(4,744)
Balance, end of period	$7,034	$3,895	$803	$186	$11,918

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The following table presents the allowance and recorded investment in covered loans by portfolio segment as of September 30, 2014 and 2013:

(in thousands)	September 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Allowance for covered loans:					
Loans acquired with deteriorated credit quality (1)	$4,200	$2,537	$733	$71	$7,541
Collectively evaluated for impairment (2)	82	104	54	47	287
Total	$4,282	$2,641	$787	$118	$7,828
Covered loans:					
Loans acquired with deteriorated credit quality (1)	$229,469	$8,924	$29,227	$1,312	$268,932
Collectively evaluated for impairment (2)	399	6,626	5,129	2,304	14,458
Total	$229,868	$15,550	$34,356	$3,616	$283,390

(in thousands)	September 30, 2013				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Allowance for covered loans:					
Loans acquired with deteriorated credit quality (1)	$6,648	$3,691	$752	$135	$11,226
Collectively evaluated for impairment (2)	386	204	51	51	692
Total	$7,034	$3,895	$803	$186	$11,918
Covered loans:					
Loans acquired with deteriorated credit quality (1)	$329,044	$17,799	$38,887	$2,000	$387,730
Collectively evaluated for impairment (2)	2,852	10,542	5,114	2,763	21,271
Total	$331,896	$28,341	$44,001	$4,763	$409,001

(1) The valuation allowance is netted against the carrying value of the covered loan balance.
(2) The allowance on covered loan losses includes an allowance on covered loan advances on acquired loans subsequent to acquisition.

The valuation allowance on covered loans was reduced by recaptured provision of $311,000 and $1.6 million for the three and nine months ended September 30, 2014, respectively, and $2.4 million and $7.9 million for the three and nine months ended September 30, 2013, respectively.

Covered Credit Quality Indicators

Covered loans are risk rated in a manner consistent with non-covered loans. As previously noted, the Bank's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. The 10 risk rating groupings are described fully in Note 5. The following table includes loans acquired with deteriorated credit quality and advances made subsequent to acquisition on covered loans.

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The following table summarizes our internal risk rating grouping by covered loans, net as of September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014					
	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Total
Commercial real estate						
Non-owner occupied term, net	$93,662	$18,128	$35,905	$—	$—	$147,695
Owner occupied term, net	28,917	4,874	11,028	—	—	44,819
Multifamily, net	18,061	1,664	8,820	—	—	28,545
Construction & development, net	1,160	—	830	—	—	1,990
Residential development, net	—	221	2,313	—	—	2,534
Commercial						
Term, net	3,361	536	3,199	—	—	7,096
LOC & other, net	5,813	—	—	—	—	5,813
Residential						
Mortgage, net	17,005	—	—	—	—	17,005
Home equity loans & lines, net	16,486	—	79	—	—	16,565
Consumer & other, net	3,500	—	—	—	—	3,500
Total, net of deferred fees and costs and allowance for loan losses	$187,965	$25,423	$62,174	$—	$—	$275,562

(in thousands)	December 31, 2013					
	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Total
Commercial real estate						
Non-owner occupied term, net	$133,452	$26,321	$44,279	$—	$—	$204,052
Owner occupied term, net	30,119	3,370	14,971	213	—	48,673
Multifamily, net	24,213	2,563	10,409	—	—	37,185
Construction & development, net	1,117	—	1,686	—	—	2,803
Residential development, net	492	224	5,541	54	—	6,311
Commercial						
Term, net	3,753	3,141	6,128	258	—	13,280
LOC & other, net	4,630	991	681	—	—	6,302
Residential						
Mortgage, net	22,175	—	—	—	—	22,175
Home equity loans & lines, net	19,043	—	76	—	—	19,119
Consumer & other, net	4,092	—	—	—	—	4,092
Total, net of deferred fees and costs and allowance for loan losses	$243,086	$36,610	$83,771	$525	$—	$363,992

FDIC Indemnification Asset

The Company has elected to account for amounts receivable under the loss-share agreements as an indemnification asset. The FDIC indemnification asset is initially recorded at fair value, based on the discounted value of expected future cash flows under the loss-share agreement. The difference between the present value and the undiscounted cash flows the Company expects to collect from the FDIC will be accreted into non-interest income over the life of the

FDIC indemnification asset.

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Subsequent to initial recognition, the FDIC indemnification asset is reviewed quarterly and adjusted for any changes in expected cash flows based on recent performance and expectations for future performance of the covered assets. These adjustments are measured on the same basis as the related covered loans and covered OREO. Any increases in cash flow of the covered assets over those expected will reduce the FDIC indemnification asset and any decreases in cash flow of the covered assets under those expected will increase the FDIC indemnification asset. Increases and decreases to the FDIC indemnification asset are recorded as adjustments to non-interest income. The resulting carrying value of the indemnification asset represents the amounts recoverable from the FDIC for future expected losses, and the amounts due from the FDIC for claims related to covered losses the Company has incurred less amounts due back to the FDIC relating to shared recoveries.

The following table summarizes the activity related to the FDIC indemnification asset for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Balance, beginning of period	$11,293	$36,263	$23,174	$52,798
Change in FDIC indemnification asset	(2,728)	(6,474)	(13,169)	(19,841)
Transfers to due from FDIC and other	(754)	(362)	(2,194)	(3,530)
Balance, end of period	$7,811	$29,427	$7,811	$29,427

Note 7–Goodwill and Other Intangible Assets

The following tables summarize the changes in the Company's goodwill and other intangible assets for the year ended December 31, 2013, and the nine months ended September 30, 2014. Goodwill and all other intangible assets are related to the Community Banking segment.

(in thousands)	Goodwill		
	Gross	Accumulated Impairment	Total
Balance, December 31, 2012	$781,106	$(112,934)	$668,172
Net additions	96,777	—	96,777
Reductions	(644)	—	(644)
Balance, December 31, 2013	877,239	(112,934)	764,305
Net additions	1,021,102	—	1,021,102
Reductions	—	—	—
Balance, September 30, 2014	$1,898,341	$(112,934)	$1,785,407

Goodwill represents the excess of the total purchase price paid over the fair value of the assets acquired, net of the fair values of liabilities assumed. Additional information on the acquisitions and purchase price allocations is provided in Note 2. The reduction to goodwill in 2013 of $644,000 relates to purchase accounting adjustments.

(in thousands)	Other Intangible Assets		
	Gross	Accumulated Amortization	Net
Balance, December 31, 2012	$58,909	(41,750)	$17,159
Net additions	—	—	—
Amortization	—	(4,781)	(4,781)
Balance, December 31, 2013	58,909	(46,531)	12,378
Net additions	54,562	—	54,562

Amortization	—	(7,105)	(7,105)
Balance, September 30, 2014	$113,471	$(53,636)	$59,835

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Intangible additions in 2014 relate to the Merger and represent the value of the core deposits, which includes all deposits except certificates of deposit. The value of the core deposit intangible assets were determined by an analysis of the cost differential between the core deposits inclusive of estimated servicing costs and alternative funding sources. The core deposit intangible recorded in connection with the Merger will be amortized on an accelerated basis over a period of 10 years.

The Company conducts its annual evaluation of goodwill for impairment as of its year end of December 31. Goodwill and other intangibles are required to be analyzed for impairment if certain triggering events occur. During the nine months ended September 30, 2014, management determined that no trigger events occurred that required an impairment analysis. The table below presents the forecasted amortization expense for intangible assets acquired in all mergers:

(in thousands)

Year	Expected Amortization
Remainder of 2014	$3,102
2015	11,225
2016	8,622
2017	6,756
2018	6,166
Thereafter	23,964
	$59,835

Note 8 – Residential Mortgage Servicing Rights

The following table presents the changes in the Company's residential mortgage servicing rights ("MSR") for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Balance, beginning of period	$114,192	$38,192	$47,765	$27,428
Acquired/purchased MSR	—	—	62,770	—
Additions for new MSR capitalized	8,813	4,072	16,583	15,182
Changes in fair value:				
Due to changes in model inputs or assumptions(1)	(672)	3,406	(2,543)	3,739
Other(2)	(3,608)	(3,817)	(5,850)	(4,496)
Balance, end of period	$118,725	$41,853	$118,725	$41,853

(1) Principally reflects changes in discount rates and prepayment speed assumptions, which are primarily affected by changes in interest rates.
(2) Represents changes due to collection/realization of expected cash flows over time.

Information related to our residential mortgage serviced loan portfolio as of September 30, 2014 and December 31, 2013 is as follows:

(dollars in thousands)	September 30, 2014	December 31, 2013
Balance of residential mortgage loans serviced for others	$11,300,947	$4,362,499
MSR as a percentage of serviced loans	1.05%	1.09%

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The amount of contractually specified servicing fees, late fees and ancillary fees earned, recorded in residential mortgage banking revenue, was $6.2 million and $14.5 million for the three and nine months ended September 30, 2014, as compared to $2.7 million and $7.5 million for the three and nine months ended September 30, 2013.

Key assumptions used in measuring the fair value of MSR as of September 30, 2014 and December 31, 2013 are as follows:

	September 30, 2014	December 31, 2013
Constant prepayment rate	11.52 %	12.74 %
Discount rate	9.16 %	8.69 %
Weighted average life (years)	6.7	6.0

A sensitivity analysis of the current fair value to changes in discount and prepayment speed assumptions as of September 30, 2014 and December 31, 2013 is as follows:

(in thousands)	September 30, 2014	December 31, 2013
Constant prepayment rate		
Effect on fair value of a 10% adverse change	$(4,822)	$(2,255)
Effect on fair value of a 20% adverse change	$(9,275)	$(4,323)
Discount rate		
Effect on fair value of a 100 basis point adverse change	$(4,722)	$(1,832)
Effect on fair value of a 200 basis point adverse change	$(9,120)	$(3,534)

The sensitivity analysis presents the hypothetical effect on fair value of the MSR. The effect of such hypothetical change in assumptions generally cannot be extrapolated because the relationship of the change in an assumption to the change in fair value is not linear. Additionally, in the analysis, the impact of an adverse change in one assumption is calculated independent of any impact on other assumptions. In reality, changes in one assumption may change another assumption.

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Note 9 – Junior Subordinated Debentures

Following is information about the Company's wholly-owned trusts ("Trusts") as of September 30, 2014:

(dollars in thousands) Trust Name	Issue Date	Issued Amount	Carrying Value (1)	Rate (2)	Effective Rate (3)	Maturity Date
AT FAIR VALUE:						
Umpqua Statutory Trust II	October 2002	$20,619	$15,028	Floating rate, LIBOR plus 3.35%, adjusted quarterly	4.92%	October 2032
Umpqua Statutory Trust III	October 2002	30,928	22,736	Floating rate, LIBOR plus 3.45%, adjusted quarterly	5.01%	November 2032
Umpqua Statutory Trust IV	December 2003	10,310	7,104	Floating rate, LIBOR plus 2.85%, adjusted quarterly	4.48%	January 2034
Umpqua Statutory Trust V	December 2003	10,310	7,081	Floating rate, LIBOR plus 2.85%, adjusted quarterly	4.49%	March 2034
Umpqua Master Trust I	August 2007	41,238	23,281	Floating rate, LIBOR plus 1.35%, adjusted quarterly	2.81%	September 2037
Umpqua Master Trust IB	September 2007	20,619	13,684	Floating rate, LIBOR plus 2.75%, adjusted quarterly	4.50%	December 2037
Sterling Capital Trust III	April 2003	14,433	11,075	Floating rate, LIBOR plus 3.25%, adjusted quarterly	4.55%	April 2033
Sterling Capital Trust IV	May 2003	10,310	7,824	Floating rate, LIBOR plus 3.15%, adjusted quarterly	4.46%	May 2033
Sterling Capital Statutory Trust V	May 2003	20,619	15,708	Floating rate, LIBOR plus 3.25%, adjusted quarterly	4.57%	June 2033
Sterling Capital Trust VI	June 2003	10,310	7,802	Floating rate, LIBOR plus 3.20%, adjusted quarterly	4.54%	September 2033
Sterling Capital Trust VII	June 2006	56,702	33,170	Floating rate, LIBOR plus 1.53%, adjusted quarterly	3.00%	June 2036
Sterling Capital Trust VIII	September 2006	51,547	30,511	Floating rate, LIBOR plus 1.63%, adjusted quarterly	3.15%	December 2036
Sterling Capital Trust IX	July 2007	46,392	26,334	Floating rate, LIBOR plus 1.40%, adjusted quarterly	2.88%	October 2037
Lynnwood Financial Statutory Trust I	March 2003	9,279	6,987	Floating rate, LIBOR plus 3.15%, adjusted quarterly	4.50%	March 2033
	June 2005	10,310	6,357		3.30%	June 2035

Lynnwood Financial Statutory Trust II				Floating rate, LIBOR plus 1.80%, adjusted quarterly		
Klamath First Capital Trust I	July 2001	15,464	12,846	Floating rate, LIBOR plus 3.75%, adjusted semiannually	4.91%	July 2031
		$379,390	$247,528			
AT AMORTIZED COST:						
HB Capital Trust I	March 2000	$5,310	$6,175	10.875%	8.44%	March 2030
Humboldt Bancorp Statutory Trust I	February 2001	5,155	5,790	10.200%	8.41%	February 2031
Humboldt Bancorp Statutory Trust II	December 2001	10,310	11,231	Floating rate, LIBOR plus 3.60%, adjusted quarterly	3.04%	December 2031
Humboldt Bancorp Statutory Trust III	September 2003	27,836	30,246	Floating rate, LIBOR plus 2.95%, adjusted quarterly	2.50%	September 2033
CIB Capital Trust	November 2002	10,310	11,099	Floating rate, LIBOR plus 3.45%, adjusted quarterly	3.03%	November 2032
Western Sierra Statutory Trust I	July 2001	6,186	6,186	Floating rate, LIBOR plus 3.58%, adjusted quarterly	3.82%	July 2031
Western Sierra Statutory Trust II	December 2001	10,310	10,310	Floating rate, LIBOR plus 3.60%, adjusted quarterly	3.83%	December 2031
Western Sierra Statutory Trust III	September 2003	10,310	10,310	Floating rate, LIBOR plus 2.90%, adjusted quarterly	3.13%	September 2033
Western Sierra Statutory Trust IV	September 2003	10,310	10,310	Floating rate, LIBOR plus 2.90%, adjusted quarterly	3.13%	September 2033
		96,037	101,657			
	Total	$475,427	$349,185			

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(1) Includes purchase accounting adjustments, net of accumulated amortization, for junior subordinated debentures assumed in connection with previous mergers as well as fair value adjustments related to trusts recorded at fair value.
(2) Contractual interest rate of junior subordinated debentures.
(3) Effective interest rate based upon the carrying value as of September 30, 2014.

The Trusts are reflected as junior subordinated debentures in the Condensed Consolidated Balance Sheets. The common stock issued by the Trusts is recorded in other assets in the Condensed Consolidated Balance Sheets, and totaled $14.3 million at September 30, 2014 and $6.9 million at December 31, 2013. As of September 30, 2014, all of the junior subordinated debentures were redeemable at par, at their applicable quarterly or semiannual interest payment dates.

The Company selected the fair value measurement option for junior subordinated debentures originally issued by the Company (the Umpqua Statutory Trusts) and for junior subordinated debentures acquired from Sterling. Refer to Note 16 for discussion of the rational for election of fair value and the approach used to fair value the selected junior subordinated debentures.

Absent changes to the significant inputs utilized in the discounted cash flow model used to measure the fair value of these instruments, the discounts will reverse over time in a manner similar to the effective interest rate method as if these instruments were accounted for under the amortized cost method. Losses recorded resulting from the change in the fair value of these instruments were $1.6 million and $554,000 for the three months ended September 30, 2014 and 2013 and $3.5 million and $1.6 million for the nine months ended September 30, 2014 and 2013.

Note 10 – Commitments and Contingencies

Lease Commitments — As of September 30, 2014, the Bank leased 289 sites under non-cancelable operating leases. The leases contain various provisions for increases in rental rates, based either on changes in the published Consumer Price Index or a predetermined escalation schedule. Substantially all of the leases provide the Company with the option to extend the lease term one or more times following expiration of the initial term.

Rent expense for the three and nine months ended September 30, 2014 was $9.8 million and $23.6 million, respectively, and for the three and nine months ended September 30, 2013 was $4.9 million and $14.2 million, respectively. Rent expense was partially offset by rent income for the three and nine months ended September 30, 2014 of $170,000 and $441,000, respectively, and for the three and nine months ended September 30, 2013 of $148,000 and $596,000, respectively.

Financial Instruments with Off-Balance-Sheet Risk — The Company's financial statements do not reflect various commitments and contingent liabilities that arise in the normal course of the Bank's business and involve elements of credit, liquidity, and interest rate risk.

The following table presents a summary of the Bank's commitments and contingent liabilities:

(in thousands)	As of September 30, 2014
Commitments to extend credit	$2,899,299
Commitments to extend overdrafts	$944,855
Forward sales commitments	$383,413
Commitments to originate residential mortgage loans held for sale	$226,946

Standby letters of credit	$67,527

The Bank is a party to financial instruments with off-balance-sheet credit risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and financial guarantees. Those instruments involve elements of credit and interest-rate risk similar to the risk involved in on-balance sheet items recognized in the Condensed Consolidated Balance Sheets. The contract or notional amounts of those instruments reflect the extent of the Bank's involvement in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit, and financial guarantees written, is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

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Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any covenant or condition established in the applicable contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. While most standby letters of credit are not utilized, a significant portion of such utilization is on an immediate payment basis. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral varies but may include cash, accounts receivable, inventory, premises and equipment and income-producing commercial properties.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements, including international trade finance, commercial paper, bond financing and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds cash, marketable securities, or real estate as collateral supporting those commitments for which collateral is deemed necessary. The Bank was not required to perform on any financial guarantees during the three and nine months ended September 30, 2014 and September 30, 2013. At September 30, 2014, approximately $48.6 million of standby letters of credit expire within one year, and $18.9 million expire thereafter. Upon issuance, the Bank recognizes a liability equivalent to the amount of fees received from the customer for these standby letter of credit commitments. Fees are recognized ratably over the term of the standby letter of credit. The estimated fair value of guarantees associated with standby letters of credit was $1.6 million as of September 30, 2014.

Residential mortgage loans sold into the secondary market are sold with limited recourse against the Company, meaning that the Company may be obligated to repurchase or otherwise reimburse the investor for incurred losses on any loans that suffer an early payment default, are not underwritten in accordance with investor guidelines or are determined to have pre-closing borrower misrepresentations. As of September 30, 2014, the Company had a residential mortgage loan repurchase reserve liability of $3.5 million.

Legal Proceedings—The Bank owns 483,806 shares of Class B common stock of Visa Inc. which are convertible into Class A common stock at a conversion ratio of 0.4121 per Class A share. As of September 30, 2014, the value of the Class A shares was $213.37 per share. Utilizing the conversion ratio, the value of unredeemed Class A equivalent shares owned by the Bank was $42.5 million as of September 30, 2014, and has not been reflected in the accompanying financial statements. The shares of Visa Inc. Class B common stock are restricted and may not be transferred. Visa member banks are required to fund an escrow account to cover settlements, resolution of pending litigation and related claims. If the funds in the escrow account are insufficient to settle all the covered litigation, Visa Inc. may sell additional Class A shares and use the proceeds to settle litigation, thereby reducing the conversion ratio. If funds remain in the escrow account after all litigation is settled, the Class B conversion ratio will be increased to reflect that surplus.

On July 13, 2012, Visa Inc. announced that it had entered into a memorandum of understanding obligating it to enter into a settlement agreement to resolve the multi-district interchange litigation brought by the class plaintiffs in the matter styled In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation, Case No. 5-MD-1720 (JG) (JO) pending in the U.S. District Court for the Eastern District of New York. The claims originally were brought by a class of U.S. retailers in 2005. The settlement was approved by the court on December 13, 2013, but that decision is currently being appealed. Visa's share of the previously agreed settlement amount was approximately $4.4 billion. The effect of this proposed settlement and pending appeal on the value of the Bank's Class B common stock is unknown at this time.

In the ordinary course of business, various claims and lawsuits are brought by and against the Company and its subsidiaries, including the Bank and Umpqua Investments. In the opinion of management, there is no pending or threatened proceeding in which an adverse decision could result in a material adverse change in the Company's consolidated financial condition or results of operations.

Concentrations of Credit Risk— The Bank grants real estate mortgage, real estate construction, commercial, agricultural and installment loans and leases to customers throughout Oregon, Washington, California, Idaho, and Nevada. In management's judgment, a concentration exists in real estate-related loans, which represented approximately 79% and 74% of the Bank's non-covered loan and lease portfolio at September 30, 2014 and December 31, 2013, respectively. Commercial real estate concentrations are managed to assure wide geographic and business diversity. Although management believes such concentrations have no more than the normal risk of collectability, a substantial decline in the economy in general, material increases in interest rates, changes in tax policies, tightening credit or refinancing markets, or a decline in real estate values in the Bank's primary market areas in particular, could have an adverse impact on the repayment of these loans. Personal and

business incomes, proceeds from the sale of real property, or proceeds from refinancing, represent the primary sources of repayment for a majority of these loans.

The Bank recognizes the credit risks inherent in dealing with other depository institutions. Accordingly, to prevent excessive exposure to any single correspondent, the Bank has established general standards for selecting correspondent banks as well as internal limits for allowable exposure to any single correspondent. In addition, the Bank has an investment policy that sets forth limitations that apply to all investments with respect to credit rating and concentrations with an issuer.

Note 11 – Derivatives

The Bank may use derivatives to hedge the risk of changes in the fair values of interest rate lock commitments, residential mortgage loans held for sale, and residential mortgage servicing rights. None of the Company's derivatives are designated as hedging instruments. Rather, they are accounted for as free-standing derivatives, or economic hedges, with changes in the fair value of the derivatives reported in income. The Company primarily utilizes forward interest rate contracts in its derivative risk management strategy.

The Bank enters into forward delivery contracts to sell residential mortgage loans or mortgage-backed securities to broker/dealers at specific prices and dates in order to hedge the interest rate risk in its portfolio of mortgage loans held for sale and its residential mortgage loan commitments. Credit risk associated with forward contracts is limited to the replacement cost of those forward contracts in a gain position. There were no counterparty default losses on forward contracts in the three and nine months ended September 30, 2014 and 2013. Market risk with respect to forward contracts arises principally from changes in the value of contractual positions due to changes in interest rates. The Bank limits its exposure to market risk by monitoring differences between commitments to customers and forward contracts with broker/dealers. In the event the Company has forward delivery contract commitments in excess of available mortgage loans, the Company completes the transaction by either paying or receiving a fee to or from the broker/dealer equal to the increase or decrease in the market value of the forward contract. At September 30, 2014, the Bank had commitments to originate mortgage loans held for sale totaling $226.9 million and forward sales commitments of $383.4 million.

The Bank's mortgage banking derivative instruments do not have specific credit risk-related contingent features. The forward sales commitments do have contingent features that may require transferring collateral to the broker/dealers upon their request. However, this amount would be limited to the net unsecured loss exposure at such point in time and would not materially affect the Company's liquidity or results of operations.

The Bank executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps are simultaneously hedged by offsetting the interest rate swaps that the Bank executes with a third party, such that the Bank minimizes its net risk exposure. As of September 30, 2014, the Bank had 300 interest rate swaps with an aggregate notional amount of $1.5 billion related to this program.

In connection with the interest rate swap program with commercial customers, the Bank has agreements with its derivative counterparties that contain a provision where if the Bank defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Bank could also be declared in default on its derivative obligations. The Bank also has agreements with its derivative counterparties that contain a provision where if the Bank fails to maintain its status as a well/adequately capitalized institution, then the counterparty could terminate the derivative positions and the Bank would be required to settle its obligations under the agreements. Similarly, the Bank could be required to settle its obligations under certain of its agreements if specific regulatory events occur, such as if the Bank were issued a prompt corrective action directive or a cease and desist order, or if certain regulatory ratios fall below specified levels. If the Bank had breached any of

these provisions at September 30, 2014, it could have been required to settle its obligations under the agreements at the termination value.

As of September 30, 2014, the termination value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was $21.0 million. The Bank has collateral posting requirements for initial or variation margins with its counterparties and has been required to post collateral against its obligations under these agreements of $31.3 million and $13.0 million as of September 30, 2014 and December 31, 2013, respectively.

The Bank incorporates credit valuation adjustments ("CVA") to appropriately reflect nonperformance risk in the fair value measurement of its derivatives. As of September 30, 2014, the net CVA decreased the settlement values of the Bank's net derivative assets by $1.4 million. During the three and nine months ended September 30, 2014, the Bank recognized a gain of $107,000 and a loss of $2.9 million, respectively, and during the three and nine months ended September 30, 2013, the Bank

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recognized a loss of $738,000 and a gain of $1.1 million, respectively related to CVA on nonhedge derivative instruments, which is included in noninterest income. Various factors impact changes in the CVA over time, including changes in the credit spreads of the parties to the contracts, as well as changes in market rates and volatilities, which affect the total expected exposure of the derivative instruments.

The following tables summarize the types of derivatives, separately by assets and liabilities, and the fair values of such derivatives as of September 30, 2014 and December 31, 2013:

(in thousands)	Asset Derivatives		Liability Derivatives	
Derivatives not designated as hedging instrument	September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013
Interest rate lock commitments	$2,180	$706	$—	$—
Interest rate forward sales commitments	246	1,250	1,010	6
Interest rate swaps	18,963	15,965	20,276	14,556
Total	$21,389	$17,921	$21,286	$14,562

The fair values of the derivatives are recorded in other assets and other liabilities. The following table summarizes the types of derivatives and the gains (losses) recorded during the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three months ended September 30,		Nine Months Ended September 30,	
Derivatives not designated as hedging instrument	2014	2013	2014	2013
Interest rate lock commitments	$(5,475)	$2,370	$1,312	$1,530
Interest rate forward sales commitments	1,788	(3,239)	(14,228)	11,508
Interest rate swaps	107	(738)	(2,893)	1,101
Total	$(3,580)	$(1,607)	$(15,809)	$14,139

The gains and losses on the Company's mortgage banking derivatives are included in mortgage banking revenue. The gains and losses on the Company's interest rate swaps are included in other income.

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The following table summarizes the derivatives that have a right of offset as of September 30, 2014 and December 31, 2013:

(in thousands)				Gross Amounts Not Offset in the Statement of Financial Position		
	Gross Amounts of Recognized Assets/Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets/Liabilities presented in the Statement of Financial Position	Financial Instruments	Collateral Posted	Net Amount
September 30, 2014						
Derivative Assets						
Interest rate swaps	$ 18,963	$—	$ 18,963	$2,406	$(15,946)	$5,423
Derivative Liabilities						
Interest rate swaps	$ 20,276	$—	$ 20,276	$2,406	$(22,682)	$—
December 31, 2013						
Derivative Assets						
Interest rate swaps	$ 15,965	$—	$ 15,965	$(4,852)	$(2,207)	$8,906
Derivative Liabilities						
Interest rate swaps	$ 14,556	$—	$ 14,556	$(4,852)	$(9,704)	$—

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Note 12 – Shareholders' Equity and Stock Compensation

On April 18, 2014, the Company completed the Merger with Sterling. The details of the conversion of Sterling common stock, stock options, and restricted stock units are included in Note 2. The conversion resulted in the issuance of 104,385,087 shares of common stock, 994,214 restricted stock units, and 439,921 stock options granted. Additionally, the 2,960,238 outstanding Sterling warrants were converted into warrants exercisable to receive 1.671 shares of Umpqua stock per warrant, with an exercise price of $12.88 as of the merger date. As of September 30, 2014, there were 3,025,886 warrants outstanding, with an exercise price of $12.60. Adjustments to the number and exercise price of these outstanding warrants occurred in the second and third quarter of 2014, due to dividend distributions triggering an anti-dilutive provision.

At a special meeting on February 25, 2014, the Company's shareholders approved an amendment to the Company's articles of incorporation, effective on April 18, 2014, increasing the number of authorized shares of common stock to 400,000,000.

At the annual meeting on April 16, 2013, shareholders approved the Company's 2013 Incentive Plan (the "2013 Plan"), which, among other things, authorizes the issuance of equity awards to directors and employees and reserves 4,000,000 shares of the Company's common stock for issuance under the plan. With the adoption of the 2013 Plan, no additional awards will be issued from the 2003 Stock Incentive Plan or the 2007 Long Term Incentive Plan.

Stock-Based Compensation

The compensation cost related to stock options, restricted stock and restricted stock units (included in salaries and employee benefits) was $3.7 million and $8.8 million for the three and nine months ended September 30, 2014, as compared to $1.3 million and $3.5 million for the three and nine months ended September 30, 2013. The total income tax benefit recognized related to stock-based compensation was $1.4 million and $3.4 million for the three and nine months ended September 30, 2014 as compared to $524,000 and $1.4 million for the three and nine months ended September 30, 2013. During the three months ended September 30, 2014, vesting was accelerated for certain restricted stock units and stock options issued in connection with the Sterling Merger, resulting in $2.8 million of accelerated compensation expense which was recorded in merger related expense.

The following table summarizes information about stock option activity for the nine months ended September 30, 2014:

(in thousands, except per share data)	Nine Months Ended September 30, 2014			
	Options Outstanding	Weighted-Avg Exercise Price	Weighted-Avg Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Balance, beginning of period	981	$16.17		
Granted/Assumed	440	$12.12		
Exercised	(563)	$11.91		
Forfeited/expired	(42)	$19.28		
Balance, end of period	816	$16.77	3.96	$2,228
Options exercisable, end of period	680	$17.69	3.26	$1,638

The total intrinsic value (which is the amount by which the stock price exceeded the exercise price on the date of exercise) of options exercised during the three and nine months ended September 30, 2014 was $241,000 and $3.1 million, respectively, as compared to the three and nine months ended September 30, 2013 of $630,000 and $767,000, respectively.

During the three and nine months ended September 30, 2014, the amount of cash received from the exercise of stock options was $239,000 and $4.5 million, as compared to the three and nine months ended September 30, 2013 of $1.7 million and $2.5 million. Total consideration was $483,000 and $6.7 million for the three and nine months ended September 30, 2014, as compared to the three and nine months ended September 30, 2013 of $1.7 million and $2.5 million.

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The fair value of each option grant is estimated as of the grant date using the Black-Scholes option-pricing model. There were no stock options granted in the nine months ended September 30, 2014 and September 30, 2013. The following weighted average assumptions were used to determine the fair value of stock options grants assumed during the nine months ended September 30, 2014:

	Nine Months Ended September 30, 2014	
Dividend yield	3.25	%
Expected life (years)	6.79	
Expected volatility	31	%
Risk-free rate	0.91	%
Weighted average fair value of options on date of grant	$3.22	

The Company grants restricted stock periodically for the benefit of employees and directors. Restricted shares issued prior to 2011 generally vest on an annual basis over five years. Restricted shares issued since 2011 generally vest over a three year period, subject to time or time plus performance vesting conditions. The following table summarizes information about nonvested restricted share activity for the nine months ended September 30, 2014:

(in thousands, except per share data)	Nine Months Ended September 30, 2014		
	Restricted Shares Outstanding		Weighted Average Grant Date Fair Value
Balance, beginning of period	992		$12.79
Granted/Assumed	839		$17.33
Released	(374	)	$12.13
Forfeited/expired	(66	)	$14.37
Balance, end of period	1,391		$15.63

The total fair value of restricted shares vested and released during the three and nine months ended September 30, 2014 was $615,000 and $7.0 million as compared to the three and nine months ended September 30, 2013 of $108,000 and $1.9 million.

The Company granted restricted stock units as a part of the 2007 Long Term Incentive Plan for the benefit of certain executive officers. In addition, the Company granted restricted stock units in connection with the acquisition of Sterling as replacement awards. Restricted stock unit grants may be subject to performance-based vesting as well as other approved vesting conditions. The total number of restricted stock units granted represents the maximum number of restricted stock units eligible to vest based upon the performance and service conditions set forth in the grant agreements.

(in thousands, except per share data)	Nine Months Ended September 30, 2014		
	Restricted Stock Units Outstanding		Weighted Average Grant Date Fair Value
Balance, beginning of period	95		$10.41
Granted/Assumed	1,024		$18.34
Released	(339	)	$16.90
Forfeited/expired	(49	)	$18.58
Balance, end of period	731		$18.34

As of September 30, 2014, there was $425,000 of total unrecognized compensation cost related to nonvested stock options which is expected to be recognized over a weighted-average period of 1.92 years. As of September 30, 2014, there was $13.2 million of total unrecognized compensation cost related to nonvested restricted stock which is expected to be recognized over a

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weighted-average period of 1.50 years. As of September 30, 2014, there was $9.3 million of total unrecognized compensation cost related to nonvested restricted stock units which is expected to be recognized over a weighted-average period of 2.54 years, assuming expected performance conditions are met.

For the three and nine months ended September 30, 2014, the Company received income tax benefits of $469,000 and $6.2 million, respectively, as compared to the three and nine months ended September 30, 2013 of $294,000 and $1.1 million, respectively, related to the exercise of non-qualified employee stock options, disqualifying dispositions on the exercise of incentive stock options, the vesting of restricted shares and the vesting of restricted stock units. In the nine months ended September 30, 2014, the Company had net excess tax benefit (tax benefit resulting from tax deductions greater than the compensation cost recognized) of $1.2 million, as compared to $20,000 of net tax deficiencies (tax deficiency resulting from tax deductions greater than the compensation cost recognized) for the nine months ended September 30, 2013. Only gross excess tax benefits are classified as financing cash flows.

Note 13 – Income Taxes

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, as well as in the majority of states and in Canada. The Company acquired a $276.8 million net deferred tax asset before purchase accounting adjustments in the Merger, including $238.4 million of federal and state net operating loss ("NOL") and tax credit carry-forwards. The Merger triggered an "ownership change" as defined in Section 382 of the Internal Revenue Service Code ("Section 382"). As a result of being subject to Section 382, the Company will be limited in the amount of federal NOL carry-forwards that can be used annually to offset future taxable income. The Company believes it is more likely than not that it will be able to fully realize the benefit of its federal NOL carry-forwards. The Company also believes that it is more likely than not that the benefit from certain state NOL carry-forwards will not be realized and therefore has provided a valuation allowance of $3.3 million against the deferred tax assets relating to these state NOL carry-forwards.

The Company had gross unrecognized tax benefits of $2.6 million as of September 30, 2014, including $2.0 million assumed in the Merger. If recognized, the unrecognized tax benefit would reduce the 2014 annual effective tax rate by 1.0%. During the three months and nine months ended September 30, 2014, the Company accrued $44,000 and $49,000, respectively, of interest relating to its liability for unrecognized tax benefits. Interest on unrecognized tax benefits is reported by the Company as a component of tax expense. As of September 30, 2014, the accrued interest related to unrecognized tax benefits was $370,000, including $128,000 assumed in the Merger.

Note 14 – Earnings Per Common Share

Nonvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are participating securities and are included in the computation of earnings per share pursuant to the two-class method. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. Certain of the Company's nonvested restricted stock awards qualify as participating securities.

Net earnings is allocated between the common stock and participating securities pursuant to the two-class method. Basic earnings per common share is computed by dividing net earnings available to common shareholders by the weighted average number of common shares outstanding during the period, excluding participating nonvested restricted shares.

Diluted earnings per common share is computed in a similar manner, except that first the denominator is increased to include the number of additional common shares that would have been outstanding if potentially dilutive common shares, excluding the participating securities, were issued using the treasury stock method. For all periods presented,

stock options, certain restricted stock awards and restricted stock units are the only potentially dilutive non-participating instruments issued by the Company. Next, we determine and include in diluted earnings per common share calculation the more dilutive effect of the participating securities using the treasury stock method or the two-class method. Undistributed losses are not allocated to the nonvested share-based payment awards (the participating securities) under the two-class method as the holders are not contractually obligated to share in the losses of the Company.

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The following is a computation of basic and diluted earnings per common share for the three and nine months ended September 30, 2014 and 2013:

(in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
NUMERATORS:				
Net income	$58,989	$23,477	$94,974	$73,091
Less:				
Dividends and undistributed earnings allocated to participating securities (1)	142	196	338	576
Net earnings available to common shareholders	$58,847	$23,281	$94,636	$72,515
DENOMINATORS:				
Weighted average number of common shares outstanding - basic	217,245	111,912	175,627	111,934
Effect of potentially dilutive common shares (2)	1,696	283	1,029	220
Weighted average number of common shares outstanding - diluted	218,941	112,195	176,656	112,154
EARNINGS PER COMMON SHARE:				
Basic	$0.27	$0.21	$0.54	$0.65
Diluted	$0.27	$0.21	$0.54	$0.65

(1) Represents dividends paid and undistributed earnings allocated to nonvested restricted stock awards.
(2) Represents the effect of the assumed exercise of stock options, vesting of non-participating restricted shares, and vesting of restricted stock units and warrants that were converted into warrants exercisable for Umpqua common shares in connection with the Sterling acquisition, based on the treasury stock method.

The following table presents the weighted average outstanding securities that were not included in the computation of diluted earnings per common share because their effect would be anti-dilutive for the three and nine months ended September 30, 2014 and 2013.

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Stock options	5	363	398	738

Note 15 – Segment Information

The Company operates two primary segments: Community Banking and Home Lending. The Community Banking segment's principal business focus is the offering of loan and deposit products to business and retail customers in its primary market areas. As of September 30, 2014, the Community Banking segment operated 408 locations throughout Oregon, Washington, California, Idaho, and Nevada.

The Home Lending segment, which operates as a division of the Bank, originates, sells and services residential mortgage loans.

In the second quarter of 2014, the Company combined its Wealth Management segment into the Community Banking segment as Wealth Management no longer met the definition of an operating segment. The segment results for comparable periods have been modified to reflect the current period presentation.

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Summarized financial information concerning the Company's reportable segments and the reconciliation to the consolidated financial results is shown in the following tables:

(in thousands)	Three Months Ended September 30, 2014		
	Community Banking	Home Lending	Consolidated
Interest income	$219,268	$20,255	$239,523
Interest expense	12,003	1,804	13,807
Net interest income	207,265	18,451	225,716
Provision for non-covered loan and lease losses	14,431	—	14,431
Recapture of provision for covered loan losses	(98)	—	(98)
Non-interest income	30,198	31,726	61,924
Non-interest expense	160,559	21,999	182,558
Income before income taxes	62,571	28,178	90,749
Provision for income taxes	21,898	9,862	31,760
Net income	40,673	18,316	58,989
Dividends and undistributed earnings allocated to participating securities	142	—	142
Net earnings available to common shareholders	$40,531	$18,316	$58,847

(in thousands)	Nine Months Ended September 30, 2014		
	Community Banking	Home Lending	Consolidated
Interest income	$536,922	$43,448	$580,370
Interest expense	30,858	3,699	34,557
Net interest income	506,064	39,749	545,813
Provision for non-covered loan and lease losses	35,230	—	35,230
Recapture of provision for covered loan losses	(230)	—	(230)
Non-interest income	62,663	66,797	129,460
Non-interest expense	445,189	48,018	493,207
Income before income taxes	88,538	58,528	147,066
Provision for income taxes	30,090	22,002	52,092
Net income	58,448	36,526	94,974
Dividends and undistributed earnings allocated to participating securities	338	—	338
Net earnings available to common shareholders	$58,110	$36,526	$94,636

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(in thousands)	Three Months Ended September 30, 2013		
	Community Banking	Home Lending	Consolidated
Interest income	$110,594	$5,366	$115,960
Interest expense	8,537	614	9,151
Net interest income	102,057	4,752	106,809
Provision for non-covered loan and lease losses	3,008	—	3,008
Recapture of provision for covered loan losses	(1,904)	—	(1,904)
Non-interest income	11,040	15,104	26,144
Non-interest expense	85,859	9,745	95,604
Income before income taxes	26,134	10,111	36,245
Provision for income taxes	8,724	4,044	12,768
Net income	17,410	6,067	23,477
Dividends and undistributed earnings allocated to participating securities	196	—	196
Net earnings available to common shareholders	$17,214	$6,067	$23,281

	Nine Months Ended September 30, 2013		
	Community Banking	Home Lending	Consolidated
Interest income	$307,900	$16,408	$324,308
Interest expense	27,471	1,946	29,417
Net interest income	280,429	14,462	294,891
Provision for non-covered loan and lease losses	12,989	—	12,989
Recapture of provision for covered loan losses	(4,744)	—	(4,744)
Non-interest income	31,411	63,245	94,656
Non-interest expense	238,411	30,886	269,297
Income before income taxes	65,184	46,821	112,005
Provision for income taxes	20,186	18,728	38,914
Net income	44,998	28,093	73,091
Dividends and undistributed earnings allocated to participating securities	576	—	576
Net earnings available to common shareholders	$44,422	$28,093	$72,515

(in thousands)	September 30, 2014		
	Community Banking	Home Lending	Consolidated
Total assets	$20,078,945	$2,409,114	$22,488,059
Total loans and leases (covered and non-covered)	$13,211,330	$2,047,871	$15,259,201
Total deposits	$16,660,992	$66,618	$16,727,610

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(in thousands)	December 31, 2013		
	Community Banking	Home Lending	Consolidated
Total assets	$10,949,050	$687,062	$11,636,112
Total loans and leases (covered and non-covered)	$7,186,366	$532,029	$7,718,395
Total deposits	$9,090,959	$26,701	$9,117,660

Note 16 – Fair Value Measurement

The following table presents estimated fair values of the Company's financial instruments as of September 30, 2014 and December 31, 2013, whether or not recognized or recorded at fair value in the Condensed Consolidated Balance Sheets:

(in thousands)		September 30, 2014		December 31, 2013	
	Level	Carrying Value	Fair Value	Carrying Value	Fair Value
FINANCIAL ASSETS:					
Cash and cash equivalents	1	$1,443,710	$1,443,710	$790,423	$790,423
Trading securities	1,2	9,727	9,727	5,958	5,958
Securities available for sale	2	2,400,061	2,400,061	1,790,978	1,790,978
Securities held to maturity	3	5,356	5,692	5,563	5,874
Loans held for sale	2	265,800	265,800	104,664	104,664
Non-covered loans and leases, net	3	14,868,004	14,845,248	7,269,089	7,250,596
Covered loans, net	3	275,562	309,804	363,992	409,555
Restricted equity securities	1	120,759	120,759	30,685	30,685
Residential mortgage servicing rights	3	118,725	118,725	47,765	47,765
Bank owned life insurance assets	1	293,511	293,511	96,938	96,938
FDIC indemnification asset	3	7,811	2,978	23,174	6,001
Derivatives	2,3	21,389	21,389	17,921	17,921
Visa Class B common stock	3	—	40,414	—	41,700
FINANCIAL LIABILITIES:					
Deposits	1,2	$16,727,610	$16,728,741	$9,117,660	$9,125,832
Securities sold under agreements to repurchase	2	339,367	339,367	224,882	224,882
Term debt	2	1,057,140	1,079,457	251,494	270,004
Junior subordinated debentures, at fair value	3	247,528	247,528	87,274	87,274
Junior subordinated debentures, at amortized cost	3	101,657	73,321	101,899	72,009
Derivatives	2	21,286	21,286	14,562	14,562

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Fair Value of Assets and Liabilities Measured on a Recurring Basis

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring basis as of September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014			
Description	Total	Level 1	Level 2	Level 3
FINANCIAL ASSETS:				
Trading securities				
Obligations of states and political subdivisions	$219	$—	$219	$—
Equity securities	4,918	4,918	—	—
Other investments securities(1)	4,590	—	4,590	—
Available for sale securities				
U.S. Treasury and agencies	230	—	230	—
Obligations of states and political subdivisions	341,246	—	341,246	—
Residential mortgage-backed securities and collateralized mortgage obligations	2,056,532	—	2,056,532	—
Investments in mutual funds and other equity securities	2,053	—	2,053	—
Loans held for sale, at fair value	265,800		265,800	
Residential mortgage servicing rights, at fair value	118,725	—	—	118,725
Derivatives				
Interest rate lock commitments	2,180	—	—	2,180
Interest rate forward sales commitments	246	—	246	—
Interest rate swaps	18,963	—	18,963	—
Total assets measured at fair value	$2,815,702	$4,918	$2,689,879	$120,905
FINANCIAL LIABILITIES:				
Junior subordinated debentures, at fair value	$247,528	$—	$—	$247,528
Derivatives				
Interest rate lock commitments	—	—	—	—
Interest rate forward sales commitments	1,010	—	1,010	—
Interest rate swaps	20,276	—	20,276	—
Total liabilities measured at fair value	$268,814	$—	$21,286	$247,528

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(in thousands)	December 31, 2013			
Description	Total	Level 1	Level 2	Level 3
FINANCIAL ASSETS:				
Trading securities				
Obligations of states and political subdivisions	$2,366	$—	$2,366	$—
Equity securities	3,498	3,498	—	—
Other investments securities(1)	94	—	94	—
Available for sale securities				
U.S. Treasury and agencies	268	—	268	—
Obligations of states and political subdivisions	235,205	—	235,205	—
Residential mortgage-backed securities and collateralized mortgage obligations	1,553,541	—	1,553,541	—
Investments in mutual funds and other equity securities	1,964	—	1,964	—
Loans held for sale, at fair value	104,664		104,664	
Residential mortgage servicing rights, at fair value	47,765	—	—	47,765
Derivatives				
Interest rate lock commitments	706	—	—	706
Interest rate forward sales commitments	1,250	—	1,250	—
Interest rate swaps	15,965	—	15,965	—
Total assets measured at fair value	$1,967,286	$3,498	$1,915,317	$48,471
FINANCIAL LIABILITIES:				
Junior subordinated debentures, at fair value	$87,274	$—	$—	$87,274
Derivatives				
Interest rate lock commitments	—	—	—	—
Interest rate forward sales commitments	6	—	6	—
Interest rate swaps	14,556	—	14,556	—
Total liabilities measured at fair value	$101,836	$—	$14,562	$87,274

(1) Principally represents U.S. Treasury and agencies or residential mortgage-backed securities issued or guaranteed by governmental agencies.

The following methods were used to estimate the fair value of each class of financial instrument above:

Cash and Cash Equivalents—For short-term instruments, including cash and due from banks, and interest bearing deposits with banks, the carrying amount is a reasonable estimate of fair value.

Securities— Fair values for investment securities are based on quoted market prices when available or through the use of alternative approaches, such as matrix or model pricing, or broker indicative bids, when market quotes are not readily accessible or available.

Loans Held for Sale— Fair value is determined based on quoted secondary market prices for similar loans, including the implicit fair value of embedded servicing rights.

Non-covered Loans and Leases - Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type, including commercial, real estate and consumer loans. Each loan category is further segregated by fixed and adjustable rate loans. The fair value of loans is calculated by discounting expected cash flows at rates which similar loans are currently being made. These amounts are discounted further by embedded probable losses expected to be realized in the portfolio.

Covered Loans – Covered loans are initially measured at their estimated fair value on their date of acquisition as described in Note 6. Subsequent to acquisition, the fair value of covered loans is measured using the same methodology as that of non-covered loans.

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Restricted Equity Securities – The carrying value of restricted equity securities approximates fair value as the shares can only be redeemed by the issuing institution at par.

Residential Mortgage Servicing Rights - The fair value of mortgage servicing rights is estimated using a discounted cash flow model. Assumptions used include market discount rates, anticipated prepayment speeds, delinquency and foreclosure rates, and ancillary fee income net of servicing costs. This model is periodically validated by an independent external model validation group. The model assumptions and the MSR fair value estimates are also compared to observable trades of similar portfolios as well as to MSR broker valuations and industry surveys, as available. Management believes the significant inputs utilized are indicative of those that would be used by market participants.

Bank Owned Life Insurance Assets – Fair values of insurance policies owned are based on the insurance contract's cash surrender value.

FDIC Indemnification Asset - The FDIC indemnification asset is calculated as the expected future cash flows under the loss-share agreement discounted by a rate reflective of the creditworthiness of the FDIC as would be required from the market.

Visa Inc. Class B Common Stock - The fair value of Visa Class B common stock is estimated by applying a 5% discount to the value of the unredeemed Class A equivalent shares. The discount primarily represents the risk related to the further potential reduction of the conversion ratio between Class B and Class A shares and a liquidity risk premium.

Deposits—The fair value of deposits with no stated maturity, such as non-interest bearing deposits, savings and interest checking accounts, and money market accounts, is equal to the amount payable on demand. The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities.

Securities Sold under Agreements to Repurchase - For short-term instruments, including securities sold under agreements to repurchase and federal funds purchased, the carrying amount is a reasonable estimate of fair value.

Term Debt—The fair value of medium term notes is calculated based on the discounted value of the contractual cash flows using current rates at which such borrowings can currently be obtained.

Junior Subordinated Debentures - The fair value of junior subordinated debentures is estimated using an income approach valuation technique. The significant inputs utilized in the estimation of fair value of these instruments are the credit risk adjusted spread and three month LIBOR. The credit risk adjusted spread represents the nonperformance risk of the liability, contemplating the inherent risk of the obligation. The Company periodically utilizes an external valuation firm to determine or validate the reasonableness of inputs and factors that are used to determine the fair value. The ending carrying (fair) value of the junior subordinated debentures measured at fair value represents the estimated amount that would be paid to transfer these liabilities in an orderly transaction amongst market participants. Due to credit concerns in the capital markets and inactivity in the trust preferred markets that have limited the observability of market spreads, we have classified this as a Level 3 fair value measure.

Derivative Instruments - The fair value of the interest rate lock commitments and forward sales commitments are estimated using quoted or published market prices for similar instruments, adjusted for factors such as pull-through rate assumptions based on historical information, where appropriate. The pull-through rate assumptions are considered Level 3 valuation inputs and are significant to the interest rate lock commitment valuation; as such, the

interest rate lock commitment derivatives are classified as Level 3. The fair value of the interest rate swaps is determined using a discounted cash flow technique incorporating credit valuation adjustments to reflect nonperformance risk in the measurement of fair value. Although the Bank has determined that the majority of the inputs used to value its interest rate swap derivatives fall within Level 2 of the fair value hierarchy, the CVA associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of September 30, 2014, the Bank has assessed the significance of the impact of the CVA on the overall valuation of its interest rate swap positions and has determined that the CVA are not significant to the overall valuation of its interest rate swap derivatives. As a result, the Bank has classified its interest rate swap derivative valuations in Level 2 of the fair value hierarchy.

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Assets and Liabilities Measured at Fair Value Using Significant Unobservable Inputs (Level 3)

The following table provides a description of the valuation technique, unobservable input, and qualitative information about the unobservable inputs for the Company's assets and liabilities classified as Level 3 and measured at fair value on a recurring basis at September 30, 2014:

Financial Instrument	Valuation Technique	Unobservable Input	Weighted Average (Range)
Residential mortgage servicing rights	Discounted cash flow		
		Constant Prepayment Rate	11.52%
		Discount Rate	9.16%
Interest rate lock commitment	Internal Pricing Model		
		Pull-through rate	76.6%
Junior subordinated debentures	Discounted cash flow		
		Credit Spread	6.18%

Generally, any significant increases in the constant prepayment rate and discount rate utilized in the fair value measurement of the residential mortgage servicing rights will result in negative fair value adjustments (and a decrease in the fair value measurement). Conversely, a decrease in the constant prepayment rate and discount rate will result in a positive fair value adjustment (and increase in the fair value measurement).

An increase in the pull-through rate utilized in the fair value measurement of the interest rate lock commitment derivative will result in positive fair value adjustments (and an increase in the fair value measurement.) Conversely, a decrease in the pull-through rate will result in a negative fair value adjustment (and a decrease in the fair value measurement.)

Management believes that the credit risk adjusted spread utilized in the fair value measurement of the junior subordinated debentures carried at fair value is indicative of the nonperformance risk premium a willing market participant would require under current market conditions, that is, the inactive market. Management attributes the change in fair value of the junior subordinated debentures during the period to market changes in the nonperformance expectations and pricing of this type of debt, and not as a result of changes to our entity-specific credit risk. The widening of the credit risk adjusted spread above the Company's contractual spreads has primarily contributed to the positive fair value adjustments. Future contractions in the credit risk adjusted spread relative to the spread currently utilized to measure the Company's junior subordinated debentures at fair value as of September 30, 2014, or the passage of time, will result in negative fair value adjustments. Generally, an increase in the credit risk adjusted spread and/or a decrease in the three month LIBOR swap curve will result in positive fair value adjustments (and decrease the fair value measurement). Conversely, a decrease in the credit risk adjusted spread and/or an increase in the three month LIBOR swap curve will result in negative fair value adjustments (and increase the fair value measurement).

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The following table provides a reconciliation of assets and liabilities measured at fair value using significant unobservable inputs (Level 3) on a recurring basis during the three and nine months ended September 30, 2014 and 2013.

(in thousands)

Three Months Ended September 30,	Beginning Balance	Change included in earnings	Purchases and issuances	Sales and settlements	Ending Balance	Net change in unrealized gains or (losses) relating to items held at end of period
2014						
Residential mortgage servicing rights	$114,192	$(4,280)	$8,813	$—	$118,725	$(3,554)
Interest rate lock commitment, net	4,405	3,250	1,929	(7,404)	2,180	2,180
Junior subordinated debentures, at fair value	246,077	3,745	—	(2,294)	247,528	3,745
2013						
Residential mortgage servicing rights	$38,192	$(411)	$4,072	$—	$41,853	$746
Interest rate lock commitment, net	638	(638)	17,695	(14,687)	3,008	3,008
Junior subordinated debentures, at fair value	86,159	1,533	—	(974)	86,718	1,533

(in thousands)

Nine Months Ended September 30,	Beginning Balance	Change included in earnings	Purchases and issuances	Sales and settlements	Ending Balance	Net change in unrealized gains or (losses) relating to items held at end of period
2014						
Residential mortgage servicing rights	$47,765	$(8,393)	$79,353	$—	$118,725	$(6,424)
Interest rate lock commitment, net	706	(868)	18,106	(15,764)	2,180	2,180
Junior subordinated debentures, at fair value	87,274	8,512	156,840	(5,098)	247,528	8,512
2013						
Residential mortgage servicing rights	$27,428	$(757)	$15,182	$—	$41,853	$(755)
Interest rate lock commitment, net	1,478	(1,478)	52,192	(49,184)	3,008	3,008
Junior subordinated debentures, at fair value	85,081	4,563	—	(2,926)	86,718	4,563

Losses on residential mortgage servicing rights carried at fair value are recorded in residential mortgage banking revenue within non-interest income. Gains (losses) on interest rate lock commitments carried at fair value are recorded

in residential mortgage banking revenue within non-interest income. Gains (losses) on junior subordinated debentures carried at fair value are recorded within its own line item in non-interest income. The contractual interest expense on the junior subordinated debentures is recorded on an accrual basis as interest on junior subordinated debentures within interest expense. Settlements related to the junior subordinated debentures represent the payment of accrued interest that is embedded in the fair value of these liabilities.

Additionally, from time to time, certain assets are measured at fair value on a nonrecurring basis. These adjustments to fair value generally result from the application of lower-of-cost-or-market accounting or write-downs of individual assets due to impairment.

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Fair Value of Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The following table presents information about the Company's assets and liabilities 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 as of the dates reported upon.

(in thousands)	September 30, 2014			
	Total	Level 1	Level 2	Level 3
Non-covered loans and leases	$17,549	$—	$—	$17,549
Non-covered other real estate owned	—	—	—	—
Covered other real estate owned	234	—	—	234
	$17,783	$—	$—	$17,783

(in thousands)	December 31, 2013			
	Total	Level 1	Level 2	Level 3
Non-covered loans and leases	$20,421	$—	$—	$20,421
Non-covered other real estate owned	1,986	—	—	1,986
Covered other real estate owned	2,770	—	—	2,770
	$25,177	$—	$—	$25,177

The following table presents the losses resulting from nonrecurring fair value adjustments for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Non-covered loans and leases	$2,326	$5,663	$7,585	$18,126
Non-covered other real estate owned	49	11	164	448
Covered other real estate owned	41	24	41	704
Total loss from nonrecurring measurements	$2,416	$5,698	$7,790	$19,278

The non-covered loans and leases amount above represents impaired, collateral-dependent loans that have been adjusted to fair value. When we identify a collateral-dependent loan as impaired, we measure the impairment using the current fair value of the collateral, less selling costs. Depending on the characteristics of a loan, the fair value of collateral is generally estimated by obtaining external appraisals. If we determine that the value of the impaired loan is less than the recorded investment in the loan, we recognize this impairment and adjust the carrying value of the loan to fair value through the allowance for loan and lease losses. The loss represents charge-offs or impairments on collateral-dependent loans for fair value adjustments based on the fair value of collateral.

The non-covered and covered other real estate owned amount above represents impaired real estate that has been adjusted to fair value. Non-covered other real estate owned represents real estate which the Bank has taken control of in partial or full satisfaction of loans. At the time of foreclosure, other real estate owned is recorded at the lower of the carrying amount of the loan or fair value less costs to sell, which becomes the property's new basis. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan and lease losses. After foreclosure, management periodically performs valuations such that the real estate is carried at the lower of its new cost basis or fair value, net of estimated costs to sell. Fair value adjustments on other real estate owned are recognized within net loss on real estate owned. The loss represents impairments on non-covered other real estate owned for fair value adjustments based on the fair value of the real estate.

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Fair Value Option

The following table presents the difference between the aggregate fair value and the aggregate unpaid principal balance of loans held for sale accounted for under the fair value option as of September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014			December 31, 2013		
	Fair Value	Aggregate Unpaid Principal Balance	Fair Value Less Aggregate Unpaid Principal Balance	Fair Value	Aggregate Unpaid Principal Balance	Fair Value Less Aggregate Unpaid Principal Balance
Loans held for sale	$265,800	$256,037	$9,763	$104,664	$101,795	$2,869

Residential mortgage loans held for sale accounted for under the fair value option are measured initially at fair value with subsequent changes in fair value recognized in earnings. Gains and losses from such changes in fair value are reported as a component of mortgage banking revenue, net in the Consolidated Statements of Income. For the three and nine months ended September 30, 2014 the Company recorded a net decrease of $5.7 million and a net increase of $6.9 million, respectively. For the three and nine months ended September 30, 2013, the Company recorded a net increase of $5.7 million and a net decrease $11.1 million, respectively, representing the change in fair value reflected in earnings.

There were no nonaccrual residential mortgage loans held for sale or residential mortgage loans held for sale 90 days or more past due and still accruing interest as of September 30, 2014 and December 31, 2013, respectively.

The Company selected the fair value measurement option for existing junior subordinated debentures (the Umpqua Statutory Trusts) and for junior subordinated debentures acquired from Sterling. The remaining junior subordinated debentures were acquired through previous business combinations and were measured at fair value at the time of acquisition and subsequently measured at amortized cost.

Accounting for the selected junior subordinated debentures at fair value enables us to more closely align our financial performance with the economic value of those liabilities. Additionally, we believe it improves our ability to manage the market and interest rate risks associated with the junior subordinated debentures. The junior subordinated debentures measured at fair value and amortized cost are presented as separate line items on the balance sheet. The ending carrying (fair) value of the junior subordinated debentures measured at fair value represents the estimated amount that would be paid to transfer these liabilities in an orderly transaction amongst market participants under current market conditions as of the measurement date.

Due to inactivity in the junior subordinated debenture market and the lack of observable quotes of our, or similar, junior subordinated debenture liabilities or the related trust preferred securities when traded as assets, we utilize an income approach valuation technique to determine the fair value of these liabilities using our estimation of market discount rate assumptions. The Company monitors activity in the trust preferred and related markets, to the extent available, changes related to the current and anticipated future interest rate environment, and considers our entity-specific creditworthiness, to validate the reasonableness of the credit risk adjusted spread and effective yield utilized in our discounted cash flow model. Regarding the activity in and condition of the junior subordinated debt market, we noted no observable changes in the current period as it relates to companies comparable to our size and condition, in either the primary or secondary markets. Relating to the interest rate environment, we considered the change in slope and shape of the forward LIBOR swap curve in the current period, the effects of which did not result in a significant change in the fair value of these liabilities.

Note 17 – Subsequent Event

On November 3, 2014, the Company announced the commencement of a secondary public offering of 31,190,716 shares of the Company's common stock, including 28,300,720 shares by certain funds affiliated with Thomas H. Lee Partners, L.P. and Warburg Pincus LLC (collectively, the "Selling Stockholders"), and 2,889,996 shares related to warrants originally issued to the Selling Stockholders. The warrants were net exercised in full for 2,889,996 shares of the Company's common stock and $6,596,431, purchased from the Selling Stockholders. No shares of common stock were sold and no proceeds of the offering were received by the Company. The offering was completed November 7, 2014 and the Selling Stockholders no longer own any warrants or shares of the Company's common stock.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This Report contains certain forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbor for "forward-looking statements" provided by the Private Securities Litigation Reform Act of 1995. These statements may include statements that expressly or implicitly predict future results, performance or events. Statements other than statements of historical fact are forward-looking statements. You can find many of these statements by looking for words such as "anticipates," "expects," "believes," "estimates" and "intends" and words or phrases of similar meaning. We make forward-looking statements regarding our liquidity and projected sources of funds and use of proceeds; availability of acquisition and growth opportunities; dividends; adequacy of our allowance for loan and lease losses and reserve for unfunded commitments; provision for loan and lease losses; performance of troubled debt restructurings; our commercial real estate portfolio, stress testing results and subsequent charge-offs; our covered loan portfolio and the FDIC indemnification asset; the benefits of the Sterling and FinPac acquisitions; cost of interest bearing deposits and pricing strategy; valuation and the potential redemption of junior subordinated debentures; the impact of Basel III on our capital ratios; tax rates; the impact, and mitigation of, LIBOR changes with respect to junior subordinated debentures; and the impact of accounting pronouncements. Forward-looking statements involve substantial risks and uncertainties, many of which are difficult to predict and are generally beyond our control. There are many factors that could cause actual results to differ materially from those contemplated by these forward-looking statements. Risks and uncertainties include those set forth in our filings with the Securities and Exchange Commission (the "SEC") and the following factors that might cause actual results to differ materially from those presented:

- our ability to attract new deposits and loans and leases;
- demand for financial services in our market areas;
- competitive market pricing factors;
- deterioration in economic conditions that could result in increased loan and lease losses;
- risks associated with concentrations in real estate related loans;
- market interest rate volatility;
- compression of our net interest margin;
- stability of funding sources and continued availability of borrowings;
- changes in legal or regulatory requirements or the results of regulatory examinations that could restrict growth;
- our ability to recruit and retain key management and staff;
- availability of, and competition for acquisition opportunities;
- risks associated with merger and acquisition integration;
- significant decline in the market value of the Company that could result in an impairment of goodwill;
- our ability to raise capital or incur debt on reasonable terms;
- regulatory limits on the Bank's ability to pay dividends to the Company;
- the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") and related rules and regulations on the Company's business operations and competitiveness, including the impact of executive compensation restrictions, which may affect the Company's ability to retain and recruit executives in competition with firms in other industries who do not operate under those restrictions;
- the impact of the Dodd-Frank Act on the Company's interest expense, FDIC deposit insurance assessments, regulatory compliance expenses, and interchange fee revenue, which includes a maximum permissible interchange fee that an issuer may receive for an electronic debit transaction, resulting in a decrease in interchange revenue on an average transaction; and
- the impact of "Basel III" capital rules that could require the Company to adjust the fair value, including the acceleration of losses, of the trust preferred securities.
- benefits from the Merger may not be fully realized or may take longer to realize than expected, including as a result of changes in general economic and market conditions, interest rates, monetary policy, laws and regulations and their

enforcement, and the degree of competition in the geographic and business areas in which we operate;

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- Sterling's business may not be integrated into Umpqua's successfully, or such integration may take longer to accomplish than expected;
- the anticipated growth opportunities and cost savings from the Merger may not be fully realized or may take longer to realize than expected;
- operating costs, customer losses and business disruption following the Merger, including adverse developments in relationships with employees, may be greater than expected; and
- management's time and effort will be diverted to the resolution of Merger-related issues.

There are many factors that could cause actual results to differ materially from those contemplated by these forward-looking statements. Forward-looking statements are made as of the date of this Form 10-Q. We do not intend to update these forward-looking statements. Readers should consider any forward-looking statements in light of this explanation, and we caution readers about relying on forward-looking statements.

General

Umpqua Holdings Corporation (referred to in this report as "we," "our," "Umpqua," and "the Company"), an Oregon corporation, is a financial holding company with two principal operating subsidiaries, Umpqua Bank (the "Bank") and Umpqua Investments, Inc. ("Umpqua Investments").

Headquartered in Roseburg, Oregon, the Bank is considered one of the most innovative community banks in the United States and has implemented a variety of retail marketing strategies to increase revenue and differentiate the Bank from its competition. The Bank combines a high touch customer experience with the sophisticated products and expertise of a commercial bank. The Bank provides a wide range of banking, wealth management, mortgage and other financial services to corporate, institutional and individual customers. The Bank also owns Financial Pacific Leasing, Inc., a commercial equipment leasing company.

Along with its subsidiaries, the Company is subject to the regulations of state and federal agencies and undergoes periodic examinations by these regulatory agencies.

Umpqua Investments is a registered broker-dealer and investment advisor with offices in Portland, Lake Oswego, and Medford, Oregon, and Santa Rosa, California, and also offers products and services through certain Bank stores. The firm is one of the oldest investment companies in the Northwest and is actively engaged in the communities it serves. Umpqua Investments offers a full range of investment products and services including: stocks, fixed income securities (municipal, corporate, and government bonds, certificates of deposit, and money market instruments), mutual funds, annuities, options, retirement planning, money management services and life insurance.

Executive Overview

Significant items for the three and nine months ended September 30, 2014 were as follows:

- Net earnings available to common shareholders per diluted common share were $0.27 and $0.54 for the three and nine months ended September 30, 2014, respectively, as compared to $0.21 and $0.65 for the three and nine months ended September 30, 2013, respectively. Operating income per diluted common share, defined as earnings available to common shareholders before net gains or losses on junior subordinated debentures carried at fair value, net of tax and merger related expenses, net of tax, divided by the same diluted share total used in determining diluted earnings per common share, were $0.30 and $0.81 for the three and nine months ended September 30, 2014, respectively, as compared to operating income per diluted common share of $0.24 and $0.69 for the three and nine months ended September 30, 2013, respectively. Operating income per diluted share is considered a "non-GAAP" financial measure. More information regarding this measurement and reconciliation to the comparable GAAP measurement is provided under the heading Results of Operations - Overview below.

- Net interest margin, on a tax equivalent basis, was 4.75% and 4.74% for the three and nine months ended September 30, 2014, respectively, as compared to 4.22% and 3.91% for the three and nine months ended September 30, 2013, respectively. The increase in net interest margin for the three and nine months ended September 30, 2014 was primarily attributable to the acquisitions of Sterling and FinPac and the related loan discount and deposit premium accretion. Excluding the impact of loan disposal gains from the covered loan portfolio, and interest and fee reversals on non-accrual loans, our adjusted net interest margin was 4.71% and 4.63% for the three and nine months ended September 30, 2014, respectively, as compared to adjusted net interest margin

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of 4.16% and 3.81% for the three and nine months ended September 30, 2013, respectively. Adjusted net interest margin is considered a "non-GAAP" financial measure. More information regarding this measurement and reconciliation to the comparable Generally Accepted Accounting Principles ("GAAP") measurement is provided under the heading Results of Operations - Overview below.

- The provision for non-covered loan and lease losses was $14.4 million and $35.2 million for the three and nine months ended September 30, 2014, respectively, as compared to the $3.0 million and $13.0 million recognized for the three and nine months ended September 30, 2013, respectively. This increase in the provision related primarily to new loan production from former Sterling offices, growth in the FinPac lease portfolio and organic loan growth.

- Residential mortgage banking revenue was $26.0 million and $60.8 million for the three and nine months ended September 30, 2014, respectively, compared to $15.1 million and $62.9 million for the three and nine months ended September 30, 2013, respectively. Closed for sale mortgage volume increased 94.7% in the three months ended September 30, 2014, compared to the prior year same period, due to the Sterling Merger, partially offset by lower refinance activity. The 14.7% increase in closed for sale mortgage volume in the nine months ended September 30, 2014, compared to the prior year same period was due to the Sterling Merger, offset by lower refinance activity.

- Total gross non-covered loans and leases were $15.0 billion as of September 30, 2014, an increase of $7.6 billion, as compared to December 31, 2013. In addition to the loans acquired in the Sterling Merger, organic loan growth (gross of sales) of $771.7 million contributed to the increase.

- Total deposits were $16.7 billion as of September 30, 2014, an increase of $7.6 billion, as compared to December 31, 2013. The increase was primarily attributed to the deposits acquired in the Sterling Merger along with organic deposit growth of $749.1 million.

- Total consolidated assets were $22.5 billion as of September 30, 2014, compared to $11.6 billion at December 31, 2013. The increase was primarily related to the Sterling Merger.

- Non-covered, non-performing assets were $81.6 million, or 0.36% of total assets, as of September 30, 2014, as compared to $57.2 million, or 0.49% of total assets, as of December 31, 2013. Non-covered, non-performing loans were $49.8 million, or 0.33% of total non-covered loans, as of September 30, 2014, as compared to $35.3 million, or 0.48% of total non-covered loans as of December 31, 2013.

- Net charge-offs on non-covered loans were $4.6 million for the three months ended September 30, 2014, or 0.12% of average non-covered loans and leases (annualized), as compared to net charge-offs of $4.2 million, or 0.23% of average non-covered loans and leases (annualized), for the three months ended September 30, 2013. Net charge-offs on non-covered loans were $12.7 million for the nine months ended September 30, 2014, or 0.14% of average non-covered loans and leases (annualized), as compared to net charge-offs of $13.7 million, or 0.26% of average non-covered loans and leases (annualized), for the nine months ended September 30, 2013.

- Total risk based capital was 14.9% as of September 30, 2014, compared to 14.7% as of December 31, 2013.

- Cash dividends declared in the third quarter of 2014 were $0.15 per common share, comparable to the same period of the prior year.

- The Company completed the Merger with Sterling on April 18, 2014. After fair value adjustments, Umpqua Bank acquired assets totaling $9.9 billion, non-covered loans and leases totaling $7.1 billion, and deposits totaling $7.1 billion. The Company recorded $1.0 billion of goodwill in connection with the Merger. Subsequent to the Merger, and prior to the end of the second quarter of 2014, the Company completed the required divestiture of six stores to another

financial institution, which included $88.3 million of loans and $211.5 million of deposits. The operations of Sterling are included in our operating results beginning on April 19, 2014.

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Summary of Critical Accounting Policies

Our significant accounting policies are described in Note 1 to the Consolidated Financial Statements for the year ended December 31, 2013 included in the Form 10-K filed with the SEC on February 14, 2014. Not all of these critical accounting policies require management to make difficult, subjective or complex judgments or estimates. Management believes that the following policies would be considered critical under the SEC's definition.

Allowance for Loan and Lease Losses and Reserve for Unfunded Commitments

The Bank performs regular credit reviews of the loan and lease portfolio to determine the credit quality and adherence to underwriting standards. When loans and leases are originated, they are assigned a risk rating that is reassessed periodically during the term of the loan through the credit review process. The Bank's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. The 10 risk rating categories are a primary factor in determining an appropriate amount for the allowance for loan and lease losses. The Bank has a management Allowance for Loan and Lease Losses ("ALLL") Committee, which is responsible for, among other things, regularly reviewing the ALLL methodology, including loss factors, and ensuring that it is designed and applied in accordance with generally accepted accounting principles. The ALLL Committee reviews and approves loans and leases recommended for impaired status. The ALLL Committee also approves removing loans and leases from impaired status. The Bank's Audit and Compliance Committee provides board oversight of the ALLL process and reviews and approves the ALLL methodology on a quarterly basis.

Each risk rating is assessed an inherent credit loss factor that determines the amount of the allowance for loan and lease losses provided for that group of loans and leases with similar risk rating. Credit loss factors may vary by region based on management's belief that there may ultimately be different credit loss rates experienced in each region.

Regular credit reviews of the portfolio also identify loans that are considered potentially impaired. Potentially impaired loans are referred to the ALLL Committee which reviews and approves designated loans as impaired. A loan is considered impaired when based on current information and events, we determine that we will probably not be able to collect all amounts due according to the loan contract, including scheduled interest payments. When we identify a loan as impaired, we measure the impairment using discounted cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral. In these cases, we use the current fair value of the collateral, less selling costs, instead of discounted cash flows. If we determine that the value of the impaired loan is less than the recorded investment in the loan, we either recognize an impairment reserve as a specific component to be provided for in the allowance for loan and lease losses or charge-off the impaired balance on collateral-dependent loans if it is determined that such amount represents a confirmed loss. The combination of the risk rating-based allowance component and the impairment reserve allowance component lead to an allocated allowance for loan and lease losses.

The Bank may also maintain an unallocated allowance amount to provide for other credit losses inherent in a loan and lease portfolio that may not have been contemplated in the credit loss factors. This unallocated amount generally comprises less than 5% of the allowance, but may be maintained at higher levels during times of economic conditions characterized by falling real estate values. The unallocated amount is reviewed periodically based on trends in credit losses, the results of credit reviews and overall economic trends.

The reserve for unfunded commitments ("RUC") is established to absorb inherent losses associated with our commitment to lend funds, such as with a letter or line of credit. The adequacy of the ALLL and RUC are monitored on a regular basis and are based on management's evaluation of numerous factors. These factors include the quality of the current loan portfolio; the trend in the loan portfolio's risk ratings; current economic conditions; loan concentrations; loan growth rates; past-due and non-performing trends; evaluation of specific loss estimates for all

significant problem loans; historical charge-off and recovery experience; and other pertinent information.

Management believes that the ALLL and RUC was adequate as of September 30, 2014. There is, however, no assurance that future loan losses will not exceed the levels provided for in the ALLL and could possibly result in additional charges to the provision for loan and lease losses. In addition, bank regulatory authorities, as part of their periodic examination of the Bank, may require additional charges to the provision for loan and lease losses in future periods if warranted as a result of their review. Approximately 79% of our loan portfolio is secured by real estate, and a significant decline in real estate market values may require an increase in the ALLL.

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Covered Loans and FDIC Indemnification Asset

Loans acquired in an FDIC-assisted acquisition that are subject to a loss-share agreement are referred to as "covered loans" and reported separately in our statements of financial condition. The acquired loans were aggregated into pools based on individually evaluated common risk characteristics and aggregate expected cash flows were estimated for each pool. A pool is accounted for as a single asset with a single interest rate, cumulative loss rate and cash flow expectation. The cash flows expected to be received over the life of the pool were estimated by management with the assistance of a third party valuation specialist. These cash flows were input into an accounting loan system which calculates the carrying values of the pools and underlying loans, book yields, effective interest income and impairment, if any, based on actual and projected events. Default rates, loss severity, and prepayment speeds assumptions are periodically reassessed and updated within the accounting model to update our expectation of future cash flows. The excess of the cash flows expected to be collected over a pool's carrying value is considered to be the accretable yield and is recognized as interest income over the estimated life of the loan or pool using the effective yield method. The accretable yield may change due to changes in the timing and amounts of expected cash flows.

The Company has elected to account for amounts receivable under the loss-share agreements as an indemnification asset. The FDIC indemnification asset is initially recorded at fair value, based on the discounted value of expected future cash flows under the relevant loss-share agreement. The difference between the carrying value and the undiscounted cash flows the Company expects to collect from the FDIC will be accreted or amortized into non-interest income over the life of the FDIC indemnification asset, which is maintained at the loan pool level.

Residential Mortgage Servicing Rights ("MSR")

The Company determines its classes of servicing assets based on the asset type being serviced along with the methods used to manage the risk inherent in the servicing assets, which includes the market inputs used to value the servicing assets. The Company measures its residential mortgage servicing assets at fair value and reports changes in fair value through earnings. Fair value adjustments encompass market-driven valuation changes and the runoff in value that occurs from the passage of time, which are separately reported. Under the fair value method, the MSR is carried on the balance sheet at fair value and the changes in fair value are reported in earnings under the caption residential mortgage banking revenue in the period in which the change occurs.

Retained MSR are measured at fair values as of the date of sale. We use quoted market prices when available. Subsequent fair value measurements are determined using a discounted cash flow model. In order to determine the fair value of the MSR, the present value of expected future cash flows is estimated. Assumptions used include market discount rates, anticipated prepayment speeds, delinquency and foreclosure rates, and ancillary fee income net of servicing costs. This model is periodically validated by an independent external model validation group. The model assumptions and the MSR fair value estimates are also compared to observable trades of similar portfolios as well as to MSR broker valuations and industry surveys, as available.

The expected life of the loan can vary from management's estimates due to prepayments by borrowers, especially when rates fall. Prepayments in excess of management's estimates would negatively impact the recorded value of the MSR. The value of the MSR is also dependent upon the discount rate used in the model, which is based on management's ongoing review of current market rates. A significant increase in the discount rate would reduce the value of the MSR. Additional information is included in Note 8 of the Notes to Consolidated Financial Statements.

Valuation of Goodwill and Intangible Assets

Goodwill and other intangible assets with indefinite lives are not amortized but instead are periodically tested for impairment. Management performs an impairment analysis for goodwill on an annual basis as of December

31. Additionally, goodwill and other intangible assets are evaluated on an interim basis when events or circumstance indicate impairment potentially exists. The impairment analysis requires management to make subjective judgments. Events and factors that may significantly affect the estimates include, among others, competitive forces, customer behaviors and attrition, changes in revenue growth trends, cost structures, technology, changes in discount rates and specific industry and market conditions. There can be no assurance that changes in circumstances, estimates or assumption may result in impairment of all, or some portion of, goodwill or other intangible assets.

The Company has the option to perform a qualitative assessment before completing the goodwill impairment test two-step process. The first step compares the fair value of a reporting unit to its carrying value. If the reporting unit's fair value is less than its carrying value, the Company would be required to proceed to the second step. In the second step the Company calculates the implied fair value of the reporting unit's goodwill. The implied fair value of goodwill is determined in the same

manner as goodwill recognized in a business combination. If the carrying amount of the goodwill is greater than the implied fair value of that goodwill, an impairment loss would be recognized as a charge to earnings in an amount equal to that excess. The Company performs the qualitative assessment on an annual basis and in between if certain events or circumstances indicate goodwill may be impaired.

Stock-based Compensation

We recognize expense in the income statement for the grant-date fair value of stock options and other equity-based forms of compensation issued to employees over the employees' requisite service period (generally the vesting period). The requisite service period may be subject to performance conditions. The fair value of each grant is estimated as of the grant date using the Black-Scholes option-pricing model or a Monte Carlo simulation pricing model. Management assumptions utilized at the time of grant impact the fair value of the option calculated under the pricing model, and ultimately, the expense that will be recognized over the life of the option. Additional information is included in Note 12 of the Notes to Consolidated Financial Statements.

Fair Value

A hierarchical disclosure framework is used based on the level of pricing observability utilized in measuring financial instruments at fair value. The degree of judgment utilized in measuring the fair value of financial instruments generally correlates to the level of pricing observability. Financial instruments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of pricing observability and a lesser degree of judgment utilized in measuring fair value. Conversely, financial instruments rarely traded or not quoted will generally have little or no pricing observability and a higher degree of judgment utilized in measuring fair value. Pricing observability is impacted by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established and the characteristics specific to the transaction. See Note 16 of the Notes to Consolidated Financial Statements for additional information about the level of pricing transparency associated with financial instruments carried at fair value.

Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board "FASB" issued 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. ASU No. 2013-11 requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except to the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. No new recurring disclosures are required. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2013 and are to be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. The adoption of ASU No. 2013-11 did not have a material impact on the Company's consolidated financial statements.
In January 2014, the FASB issued ASU No. 2014-01, Accounting for Investments in Qualified Affordable Housing Projects. ASU 2014-04 permit an entity to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognize the net investment performance in the income statement as a

component of income tax expense (benefit). The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2014 and should be applied prospectively. The Company is currently reviewing the requirements of ASU No. 2014-01, but does not expect the ASU to have a material impact on the Company's consolidated financial statements.

In January 2014, the FASB issued ASU No. 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon foreclosure. ASU 2014-04 clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2)

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the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2014 and can be applied with a modified retrospective transition method or prospectively. The adoption of ASU No. 2014-04 is not expected to have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which creates Topic 606 and supersedes Topic 605, Revenue Recognition. The core principle of Topic 606 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In general, the new guidance requires companies to use more judgment and make more estimates than under current guidance, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The standard is effective for public entities for interim and annual periods beginning after December 15, 2016; early adoption is not permitted. For financial reporting purposes, the standard allows for either full retrospective adoption, meaning the standard is applied to all of the periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements with the cumulative effect of initially applying the standard recognized at the date of initial application. The Company is currently evaluating the provisions of ASU No. 2014-09 to determine the potential impact the new standard will have on the Company's consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-11, Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures, which changes the accounting for repurchase-to-maturity transactions and repurchase financing arrangements. It also requires additional disclosures about repurchase agreements and other similar transactions. The new guidance aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. Going forward, these transactions would all be accounted for as secured borrowings. The ASU also requires new and expanded disclosures. This ASU is effective for the first interim or annual period beginning after December 15, 2014. The adoption of ASU No. 2014-11 is not expected to have a material impact on the Company's consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. The ASU requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718, Compensation – Stock Compensation, as it relates to awards with performance conditions that affect vesting to account for such awards. The performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. The amendments in this ASU can be applied prospectively or retrospectively and are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015 with early adoption permitted. The Company is currently reviewing the requirements of ASU No. 2014-12, but does not expect the ASU to have a material impact on the Company's consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-14, Receivables -Troubled Debt Restructuring by Creditors. Under certain government-sponsored loan guarantee programs, such as those offered by the Federal Housing Administration (FHA) and the Department of Veterans Affairs (VA), qualifying creditors can extend mortgage loans to borrowers with a guarantee that entitles the creditor to recover all or a portion of the unpaid principal balance from the government if the borrower defaults. The objective of this Update is to reduce diversity in practice by addressing the classification of foreclosed mortgage loans that are fully or partially guaranteed under government programs.

Currently, some creditors reclassify those loans to real estate as with other foreclosed loans that do not have guarantees; others reclassify the loans to other receivables. The amendments affect creditors that hold government-guaranteed mortgage loans, including those guaranteed by the FHA and the VA. This ASU is effective for annual periods and interim periods within those annual periods beginning after December 15, 2014 with early adoption permitted. The Company is currently reviewing the requirements of ASU No. 2014-14.

Results of Operations

Overview

For the three months ended September 30, 2014, net earnings available to common shareholders were $58.8 million, or $0.27 per diluted common share, as compared to net earnings available to common shareholders of $23.3 million, or $0.21 per diluted

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common share for the three months ended September 30, 2013. For the nine months ended September 30, 2014, net earnings available to common shareholders were $94.6 million, or $0.54 per diluted common share, as compared to net earnings available to common shareholders of $72.5 million, or $0.65 per diluted common share for the nine months ended September 30, 2013. The increase in net earnings for the three and nine months ended September 30, 2014 compared to the same period of the prior year was principally attributable to income contribution from the operations acquired from Sterling, partially offset by the expenses associated with the Sterling Merger.

Umpqua recognizes gains or losses on our junior subordinated debentures carried at fair value resulting from the estimated market credit risk adjusted spread and changes in interest rates that do not directly correlate with the Company's operating performance. Also, Umpqua incurs significant expenses related to the completion and integration of mergers and acquisitions. Additionally, we may recognize goodwill impairment losses that have no direct effect on the Company's or the Bank's cash balances, liquidity, or regulatory capital ratios. Lastly, Umpqua may recognize one-time bargain purchase gains on certain FDIC-assisted acquisitions that are not reflective of Umpqua's on-going earnings power. Accordingly, management believes that our operating results are best measured on a comparative basis excluding the impact of gains or losses on junior subordinated debentures measured at fair value, net of tax, merger related expenses, net of tax, and other charges related to business combinations such as goodwill impairment charges or bargain purchase gains, net of tax. We define operating earnings as earnings available to common shareholders before gains or losses on junior subordinated debentures carried at fair value, net of tax, bargain purchase gains on acquisitions, net of tax, merger related expenses, net of tax, and goodwill impairment, and we calculate operating earnings per diluted share by dividing operating earnings by the same diluted share total used in determining diluted earnings per common share.

The following table provides the reconciliation of earnings available to common shareholders (GAAP) to operating earnings (non-GAAP), and earnings per diluted common share (GAAP) to operating earnings per diluted share (non-GAAP) for the three and nine months ended September 30, 2014 and 2013:

Reconciliation of Net Earnings Available to Common Shareholders to Operating Earnings

(in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net earnings available to common shareholders	$58,847	$23,281	$94,636	$72,515
Adjustments:				
Net loss on junior subordinated debentures carried at fair value, net of tax	955	332	2,101	986
Merger related expenses, net of tax	5,274	2,914	46,273	4,318
Operating earnings	$65,076	$26,527	$143,010	$77,819
Per diluted share:				
Net earnings available to common shareholders	$0.27	$0.21	$0.54	$0.65
Adjustments:				
Net loss on junior subordinated debentures carried at fair value, net of tax	0.01	—	0.01	0.01
Merger related expenses, net of tax	0.02	0.03	0.26	0.03
Operating earnings	$0.30	$0.24	$0.81	$0.69

Management believes adjusted net interest income and adjusted net interest margin are useful financial measures because they enable investors to evaluate the underlying growth or compression in these values excluding interest income adjustments related to credit quality. Management uses these measures to evaluate adjusted net interest income operating results exclusive of credit costs, in order to monitor our effectiveness in growing higher interest yielding assets and managing our cost of interest bearing liabilities over time. Adjusted net interest income is

calculated as net interest income, adjusting tax exempt interest income to its taxable equivalent, adding back interest and fee reversals related to new non-accrual loans during the period, and deducting the interest income gains recognized from loan disposition activities within covered loan pools. Adjusted net interest margin is calculated by dividing annualized adjusted net interest income by a period's average interest earning assets. Adjusted net interest income and adjusted net interest margin are considered "non-GAAP" financial measures. Although we believe the presentation of non-GAAP financial measures provides a better indication of our operating performance, readers of this report are urged to review the GAAP results as presented in the Financial Statements (unaudited) in Item 1.

The following table presents a reconciliation of net interest income to adjusted net interest income and net interest margin to adjusted net interest margin for the three and nine months ended September 30, 2014 and 2013:

Reconciliation of Net Interest Income to Adjusted Net Interest Income and Net Interest Margin to Adjusted Net Interest Margin
(in thousands, except per share data)