

COLUMBIA BANKING SYSTEM INC  
Form 10-Q  
August 06, 2014  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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FORM 10-Q

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(Mark One)

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

For the quarterly period ended June 30, 2014.

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 0-20288

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

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|   |  |
|---|--|
| Washington<br>(State or other jurisdiction of<br>incorporation or organization) | 91-1422237<br>(I.R.S. Employer<br>Identification Number) |
|---|--|

|   |                          |
|---|--------------------------|
| 1301 "A" Street<br>Tacoma, Washington<br>(Address of principal executive offices)<br>(253) 305-1900<br>(Issuer's telephone number, including area code)<br>(Former name, former address and former fiscal year, if changed since last report) | 98402-2156<br>(Zip Code) |
|---|--------------------------|

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

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

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

|                         |                                     |                           |                          |
|-------------------------|-------------------------------------|---------------------------|--------------------------|
| Large accelerated filer | <input checked="" type="checkbox"/> | Accelerated filer         | <input type="checkbox"/> |
| Non-accelerated filer   | <input type="checkbox"/>            | Smaller reporting company | <input type="checkbox"/> |

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

The number of shares of common stock outstanding at July 31, 2014 was 52,651,886.



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## PART I - FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

## CONSOLIDATED BALANCE SHEETS

Columbia Banking System, Inc.

(Unaudited)

|   | June 30,<br>2014 | December 31,<br>2013 |
|---|------------------|----------------------|
|   | (in thousands)   |                      |
| <b>ASSETS</b>   |                  |                      |
| Cash and due from banks   | \$193,816        | \$165,030            |
| Interest-earning deposits with banks  | 30,646           | 14,531               |
| Total cash and cash equivalents   | 224,462          | 179,561              |
| Securities available for sale at fair value (amortized cost of \$1,581,989 and \$1,680,491, respectively) | 1,590,017        | 1,664,111            |
| Federal Home Loan Bank stock at cost  | 31,912           | 32,529               |
| Loans held for sale   | 750              | 735                  |
| Loans, excluding covered loans, net of unearned income of (\$57,126) and (\$68,282), respectively         | 4,452,674        | 4,219,451            |
| Less: allowance for loan and lease losses   | 49,494           | 52,280               |
| Loans, excluding covered loans, net   | 4,403,180        | 4,167,171            |
| Covered loans, net of allowance for loan losses of (\$19,801) and (\$20,174), respectively                | 242,100          | 277,671              |
| Total loans, net  | 4,645,280        | 4,444,842            |
| FDIC loss-sharing asset   | 27,981           | 39,846               |
| Interest receivable   | 22,183           | 22,206               |
| Premises and equipment, net   | 156,645          | 154,732              |
| Other real estate owned (\$13,051 and \$12,093 covered by FDIC loss-share, respectively)                  | 28,254           | 35,927               |
| Goodwill  | 343,952          | 343,952              |
| Other intangible assets, net  | 22,792           | 25,852               |
| Other assets  | 203,230          | 217,289              |
| Total assets  | \$7,297,458      | \$7,161,582          |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                  |                      |
| Deposits:   |                  |                      |
| Noninterest-bearing   | \$2,190,161      | \$2,171,703          |
| Interest-bearing  | 3,794,908        | 3,787,772            |
| Total deposits  | 5,985,069        | 5,959,475            |
| Federal Home Loan Bank advances   | 110,587          | 36,606               |
| Securities sold under agreements to repurchase  | 25,000           | 25,000               |
| Other liabilities   | 84,651           | 87,252               |
| Total liabilities   | 6,205,307        | 6,108,333            |
| Commitments and contingent liabilities  |                  |                      |
| Shareholders' equity:   |                  |                      |
|   | June 30,<br>2014 | December 31,<br>2013 |
|   | (in thousands)   |                      |
| Preferred stock (no par value)  | 2,000            | 2,000                |
| Authorized shares   | 9                | 9                    |
| Issued and outstanding  | 2,217            | 2,217                |
| Common stock (no par value)   |                  |                      |

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|   |        |        |             |             |
|---|--------|--------|-------------|-------------|
| Authorized shares                             | 63,033 | 63,033 |             |             |
| Issued and outstanding                        | 52,635 | 51,265 | 861,609     | 860,562     |
| Retained earnings                             |        |        | 224,765     | 202,514     |
| Accumulated other comprehensive income (loss) |        |        | 3,560       | (12,044 )   |
| Total shareholders' equity                    |        |        | 1,092,151   | 1,053,249   |
| Total liabilities and shareholders' equity    |        |        | \$7,297,458 | \$7,161,582 |

See accompanying Notes to unaudited Consolidated Financial Statements.

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## CONSOLIDATED STATEMENTS OF INCOME

Columbia Banking System, Inc.

(Unaudited)

|   | Three Months Ended                      |            | Six Months Ended |            |
|---|---|------------|------------------|------------|
|   | June 30,                                |            | June 30,         |            |
|   | 2014                                    | 2013 (1)   | 2014             | 2013 (1)   |
|   | (in thousands except per share amounts) |            |                  |            |
| Interest Income   |   |            |                  |            |
| Loans   | \$67,004                                | \$74,837   | \$132,545        | \$122,865  |
| Taxable securities  | 6,382                                   | 4,890      | 13,134           | 9,124      |
| Tax-exempt securities   | 2,671                                   | 2,508      | 5,289            | 4,806      |
| Federal funds sold and deposits in banks                                  | 30                                      | 33         | 44               | 234        |
| Total interest income   | 76,087                                  | 82,268     | 151,012          | 137,029    |
| Interest Expense  |   |            |                  |            |
| Deposits  | 729                                     | 1,054      | 1,481            | 2,143      |
| Federal Home Loan Bank advances   | 115                                     | (699)      | ) 229            | (628)      |
| Prepayment charge on Federal Home Loan Bank advances                      | —                                       | 1,548      | —                | 1,548      |
| Other borrowings  | 119                                     | 376        | 238              | 495        |
| Total interest expense  | 963                                     | 2,279      | 1,948            | 3,558      |
| Net Interest Income   | 75,124                                  | 79,989     | 149,064          | 133,471    |
| Provision for loan and lease losses                                       | 600                                     | 2,000      | 100              | 1,000      |
| Provision (recapture) for losses on covered loans, net                    | 1,517                                   | (1,712)    | ) 3,939          | (732)      |
| Net interest income after provision (recapture) for loan and lease losses | 73,007                                  | 79,701     | 145,025          | 133,203    |
| Noninterest Income  |   |            |                  |            |
| Service charges and other fees  | 13,790                                  | 13,560     | 26,726           | 21,154     |
| Merchant services fees  | 2,040                                   | 2,013      | 3,910            | 3,864      |
| Investment securities gains, net  | 296                                     | 92         | 519              | 462        |
| Bank owned life insurance   | 976                                     | 1,008      | 1,941            | 1,706      |
| Change in FDIC loss-sharing asset   | (5,050)                                 | ) (13,137) | ) (9,869)        | ) (23,620) |
| Other   | 2,575                                   | 3,272      | 5,408            | 4,900      |
| Total noninterest income  | 14,627                                  | 6,808      | 28,635           | 8,466      |
| Noninterest Expense   |   |            |                  |            |
| Compensation and employee benefits  | 31,064                                  | 35,657     | 62,402           | 57,310     |
| Occupancy   | 8,587                                   | 7,543      | 16,831           | 12,296     |
| Merchant processing   | 998                                     | 852        | 1,978            | 1,709      |
| Advertising and promotion   | 950                                     | 1,160      | 1,719            | 2,030      |
| Data processing and communications  | 3,680                                   | 3,638      | 7,200            | 6,218      |
| Legal and professional fees   | 2,303                                   | 5,504      | 4,472            | 7,554      |
| Taxes, licenses and fees  | 1,051                                   | 1,204      | 2,231            | 2,591      |
| Regulatory premiums   | 1,073                                   | 1,177      | 2,249            | 2,034      |
| Net cost (benefit) of operation of other real estate owned                | (97)                                    | ) (2,828)  | ) 49             | (5,329)    |
| Amortization of intangibles   | 1,480                                   | 1,693      | 3,060            | 2,722      |
| Other (1)   | 6,675                                   | 8,904      | 12,959           | 13,418     |
| Total noninterest expense   | 57,764                                  | 64,504     | 115,150          | 102,553    |
| Income before income taxes  | 29,870                                  | 22,005     | 58,510           | 39,116     |
| Income tax provision  | 8,643                                   | 7,414      | 17,439           | 12,349     |
| Net Income  | \$21,227                                | \$14,591   | \$41,071         | \$26,767   |
| Earnings per common share   |   |            |                  |            |

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|  |        |        |        |        |
|--|--------|--------|--------|--------|
| Basic  | \$0.40 | \$0.28 | \$0.79 | \$0.59 |
| Diluted  | \$0.40 | \$0.28 | \$0.77 | \$0.58 |
| Dividends paid per common share                              | \$0.24 | \$0.10 | \$0.36 | \$0.20 |
| Weighted average number of common shares outstanding         | 52,088 | 50,788 | 51,600 | 45,099 |
| Weighted average number of diluted common shares outstanding | 52,494 | 52,125 | 52,463 | 45,758 |

(1) Reclassified to conform to the current period's presentation. The reclassification was limited to removing the separate line item for FDIC clawback liability expense within noninterest expense and including the prior period activity in the line item for other noninterest expense.

See accompanying Notes to unaudited Consolidated Financial Statements.

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## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Columbia Banking System, Inc.

(Unaudited)

|   | Three Months Ended<br>June 30, |             |
|---|--------------------------------|-------------|
|   | 2014                           | 2013        |
|   | (in thousands)                 |             |
| Net income as reported  | \$21,227                       | \$14,591    |
| Other comprehensive income (loss), net of tax:  |                                |             |
| Unrealized gain (loss) from securities:   |                                |             |
| Net unrealized holding gain (loss) from available for sale securities arising during the period, net of tax of (\$4,992) and \$14,116 | 8,768                          | (25,930 )   |
| Reclassification adjustment of net gain from sale of available for sale securities included in income, net of tax of \$107 and \$33   | (189 )                         | (59 )       |
| Net unrealized gain (loss) from securities, net of reclassification adjustment  | 8,579                          | (25,989 )   |
| Pension plan liability adjustment:  |                                |             |
| Amortization of unrecognized net actuarial loss included in net periodic pension cost, net of tax of (\$13) and (\$32)                | 24                             | 60          |
| Pension plan liability adjustment, net  | 24                             | 60          |
| Other comprehensive income (loss)   | 8,603                          | (25,929 )   |
| Total comprehensive income (loss)   | \$29,830                       | \$(11,338 ) |
|   | Six Months Ended<br>June 30,   |             |
|   | 2014                           | 2013        |
|   | (in thousands)                 |             |
| Net income as reported  | \$41,071                       | \$26,767    |
| Other comprehensive income (loss), net of tax:  |                                |             |
| Unrealized gain (loss) from securities:   |                                |             |
| Net unrealized holding gain (loss) from available for sale securities arising during the period, net of tax of (\$9,041) and \$15,473 | 15,887                         | (28,423 )   |
| Reclassification adjustment of net gain from sale of available for sale securities included in income, net of tax of \$188 and \$163  | (331 )                         | (299 )      |
| Net unrealized gain (loss) from securities, net of reclassification adjustment  | 15,556                         | (28,722 )   |
| Pension plan liability adjustment:  |                                |             |
| Net unrealized loss from unfunded defined benefit plan liability arising during the period, net of tax of \$0 and \$412               | —                              | (756 )      |
| Amortization of unrecognized net actuarial loss included in net periodic pension cost, net of tax of (\$26) and (\$65)                | 48                             | 119         |
| Pension plan liability adjustment, net  | 48                             | (637 )      |
| Other comprehensive income (loss)   | 15,604                         | (29,359 )   |
| Total comprehensive income (loss)   | \$56,675                       | \$(2,592 )  |
| See accompanying Notes to unaudited Consolidated Financial Statements.  |                                |             |



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## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Columbia Banking System, Inc.

(Unaudited)

|  | Preferred Stock  |         | Common Stock     |           | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|--|------------------|---------|------------------|-----------|-------------------|---|----------------------------|
|  | Number of Shares | Amount  | Number of Shares | Amount    |                   |   |                            |
|  | (in thousands)   |         |                  |           |                   |   |                            |
| Balance at January 1, 2013   | —                | \$—     | 39,686           | \$581,471 | \$162,388         | \$ 20,149                                     | \$764,008                  |
| Net income   | —                | —       | —                | —         | 26,767            | —   | 26,767                     |
| Other comprehensive loss   | —                | —       | —                | —         | —                 | (29,359 )                                     | (29,359 )                  |
| Issuance of preferred stock, common stock and warrants                     | 9                | 2,217   | 11,380           | 273,964   | —                 | —   | 276,181                    |
| Activity in deferred compensation plan                                     | —                | —       | —                | 517       | —                 | —   | 517                        |
| Issuance of common stock - stock option and other plans                    | —                | —       | 43               | 774       | —                 | —   | 774                        |
| Issuance of common stock - restricted stock awards, net of canceled awards | —                | —       | 144              | 1,280     | —                 | —   | 1,280                      |
| Purchase and retirement of common stock                                    | —                | —       | (16 )            | (391 )    | —                 | —   | (391 )                     |
| Preferred dividends  | —                | —       | —                | —         | (10 )             | —   | (10 )                      |
| Cash dividends paid on common stock  | —                | —       | —                | —         | (9,093 )          | —   | (9,093 )                   |
| Balance at June 30, 2013   | 9                | \$2,217 | 51,237           | \$857,615 | \$180,052         | \$ (9,210 )                                   | \$1,030,674                |
| Balance at January 1, 2014   | 9                | \$2,217 | 51,265           | \$860,562 | \$202,514         | \$ (12,044 )                                  | \$1,053,249                |
| Net income   | —                | —       | —                | —         | 41,071            | —   | 41,071                     |
| Other comprehensive income   | —                | —       | —                | —         | —                 | 15,604  | 15,604                     |
| Issuance of common stock - cashless exercise of warrants                   | —                | —       | 1,140            | —         | —                 | —   | —                          |
| Activity in deferred compensation plan                                     | —                | —       | —                | (1 )      | —                 | —   | (1 )                       |
| Issuance of common stock - stock option and other plans                    | —                | —       | 21               | 425       | —                 | —   | 425                        |
| Issuance of common stock - restricted stock awards, net of canceled awards | —                | —       | 233              | 1,224     | —                 | —   | 1,224                      |
| Purchase and retirement of common stock                                    | —                | —       | (24 )            | (601 )    | —                 | —   | (601 )                     |
| Preferred dividends  | —                | —       | —                | —         | (37 )             | —   | (37 )                      |
| Cash dividends paid on common stock  | —                | —       | —                | —         | (18,783 )         | —   | (18,783 )                  |
| Balance at June 30, 2014   | 9                | \$2,217 | 52,635           | \$861,609 | \$224,765         | \$ 3,560                                      | \$1,092,151                |

See accompanying Notes to unaudited Consolidated Financial Statements.



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## CONSOLIDATED STATEMENTS OF CASH FLOWS

Columbia Banking System, Inc.

(Unaudited)

|  | Six Months Ended June 30, |            |
|--|---------------------------|------------|
|  | 2014                      | 2013       |
|  | (in thousands)            |            |
| Cash Flows From Operating Activities   |                           |            |
| Net Income   | \$41,071                  | \$26,767   |
| Adjustments to reconcile net income to net cash provided by operating activities |                           |            |
| Provision for loan and lease losses on noncovered and covered loans              | 4,039                     | 268        |
| Stock-based compensation expense   | 1,224                     | 1,280      |
| Depreciation, amortization and accretion   | 17,057                    | 22,527     |
| Investment securities gain, net  | (519                      | ) (462     |
| Net realized (gain) loss on sale of other assets                                 | 453                       | (73        |
| Net realized gain on sale of other real estate owned                             | (2,972                    | ) (6,291   |
| Write-down on other real estate owned  | 2,554                     | 664        |
| Net change in:   |                           |            |
| Loans held for sale  | (15                       | ) 413      |
| Interest receivable  | 23                        | (8,850     |
| Interest payable   | (20                       | ) (12      |
| Other assets   | 3,062                     | 6,285      |
| Other liabilities  | (2,589                    | ) (12,662  |
| Net cash provided by operating activities  | 63,368                    | 29,854     |
| Cash Flows From Investing Activities   |                           |            |
| Loans originated and acquired, net of principal collected                        | (201,162                  | ) (194,322 |
| Purchases of:  |                           |            |
| Securities available for sale  | (22,804                   | ) (162,018 |
| Premises and equipment   | (8,383                    | ) (8,071   |
| Proceeds from:   |                           |            |
| FDIC reimbursement on loss-sharing asset   | 3,982                     | 6,387      |
| Sales of securities available for sale   | 30,704                    | 166,881    |
| Principal repayments and maturities of securities available for sale             | 83,788                    | 167,736    |
| Sales of other assets  | 1,095                     | 806        |
| Sales of covered other real estate owned   | 5,634                     | 13,814     |
| Sales of other real estate and other personal property owned                     | 10,298                    | 6,076      |
| Payments to FDIC related to loss-sharing asset                                   | (2,217                    | ) —        |
| Acquisition of intangible assets   | —                         | (913       |
| Net cash paid in acquisition   | —                         | (154,170   |
| Other investing activities   | —                         | (1,026     |
| Net cash used in investing activities  | (99,065                   | ) (158,820 |
| Cash Flows From Financing Activities   |                           |            |
| Net increase (decrease) in deposits  | 25,594                    | (177,631   |
| Proceeds from:   |                           |            |
| Federal Home Loan Bank advances  | 1,168,000                 | 756,100    |
| Federal Reserve Bank borrowings  | 50                        | 50         |
| Exercise of stock options  | 425                       | 774        |
| Payments for:  |                           |            |
| Repayment of Federal Home Loan Bank advances                                     | (1,094,000                | ) (711,000 |
| Repayment of Federal Reserve Bank borrowings                                     | (50                       | ) (50      |

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|   |           |   |           |   |
|---|-----------|---|-----------|---|
| Common stock dividends                              | (18,783   | ) | (9,093    | ) |
| Preferred stock dividends                           | (37       | ) | (10       | ) |
| Repayment of long-term subordinated debt            | —         |   | (51,000   | ) |
| Purchase and retirement of common stock             | (601      | ) | (391      | ) |
| Net cash provided by (used in) financing activities | 80,598    |   | (192,251  | ) |
| Increase (Decrease) in cash and cash equivalents    | 44,901    |   | (321,217  | ) |
| Cash and cash equivalents at beginning of period    | 179,561   |   | 513,926   |   |
| Cash and cash equivalents at end of period          | \$224,462 |   | \$192,709 |   |
| Supplemental Information:                           |           |   |           |   |
| Cash paid during the period for:                    |           |   |           |   |
| Cash paid for interest                              | \$1,968   |   | \$2,155   |   |
| Cash paid for income tax                            | \$8,200   |   | \$9,589   |   |
| Non-cash investing and financing activities         |           |   |           |   |
| Loans transferred to other real estate owned        | \$7,841   |   | \$9,307   |   |
| Share-based consideration issued for acquisitions   | \$—       |   | \$276,181 |   |

See accompanying Notes to unaudited Consolidated Financial Statements.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Columbia Banking System, Inc.

1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

The interim unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. The consolidated financial statements include the accounts of Columbia Banking System, Inc. (“we”, “our”, “Columbia” or the “Company”) and its subsidiaries, including its wholly owned banking subsidiary Columbia State Bank (“Columbia Bank” or the “Bank”) and West Coast Trust Company, Inc. (“West Coast Trust”). All intercompany transactions and accounts have been eliminated in consolidation. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair statement of the results for the interim periods presented have been included. The results of operations for the six months ended June 30, 2014 are not necessarily indicative of results to be anticipated for the year ending December 31, 2014. The accompanying interim unaudited consolidated financial statements should be read in conjunction with the financial statements and related notes contained in the Company’s 2013 Annual Report on Form 10-K.

Due to the timing of the acquisition of West Coast Bancorp (“West Coast”), our results of operations for the six month period ended June 30, 2014 include the acquisition for the full six month period, however the prior year period only includes the acquisition for three months of the six month period. See Note 3, Business Combinations, for further information regarding this acquisition.

Significant Accounting Policies

The significant accounting policies used in preparation of our consolidated financial statements are disclosed in our 2013 Annual Report on Form 10-K. There have not been any changes in our significant accounting policies compared to those contained in our 2013 Form 10-K disclosure for the year ended December 31, 2013.

2. Accounting Pronouncements Recently Issued

In June 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“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 Services Period. The amendments in ASU 2014-12 provide guidance for determining compensation cost under specific circumstances when an employee is eligible to vest in an award regardless of whether the employee is rendering service on the date the performance target is achieved. ASU 2014-12 becomes effective for annual and interim periods beginning after December 15, 2015 with early adoption permitted. As of June 30, 2014, the Company did not have any share-based payment awards that include performance targets that could be achieved after the requisite service period. As such, the adoption of ASU No. 2014-12 is not expected to have a material impact on the Company’s consolidated financial statements.

In June 2014, the FASB issued ASU 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures. The amendments in ASU 2014-11 change the accounting for repurchase-to-maturity transactions and linked repurchase financings to secured borrowing accounting, which is consistent with accounting for other repurchase agreements. Additionally, the amendment requires new disclosures on transfers accounted for as sales in transactions that are economically similar to repurchase agreements and requires increased transparency on collateral pledged in secured borrowings. The amendments in this update will be effective for the first interim or annual period beginning after December 31, 2014, with the exception of the collateral disclosures which will be effective for interim periods beginning after March 15, 2015. Early application is not permitted. The Company is currently assessing the impact that this guidance will have on its consolidated financial statements, but does not expect the guidance to have a material impact on the Company’s consolidated financial statements.

In May 2014, the FASB issued ASU 2014-04 No. 2014-09, Revenue from Contracts with Customers. The guidance in this update supersedes the revenue recognition requirements in ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the industry topics of the codification. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2016. The Company is currently assessing the impact that this guidance will have on its consolidated financial statements, but does not expect the guidance to have a

material impact on the Company's consolidated financial statements.

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In April 2014, the the FASB issued ASU No. 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. ASU 2014-08 raises the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. It is effective for annual periods beginning on or after December 15, 2014. Early adoption is permitted but only for disposals that have not been reported in financial statements previously issued. The Company is assessing the impact of the new guidance on its consolidated financial statements.

In January 2014, the FASB issued ASU 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure. The Update clarifies when a creditor would be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that all or a portion of the loan would be derecognized and the real estate property recognized. Under the guidance, a consumer loan collateralized by residential real estate should be reclassified to other real estate owned when (1) the creditor obtains legal title to the residential property or (2) the borrower conveys all interest in the property to the creditor to satisfy the loan by completing a deed in lieu of foreclosure or similar agreement. In addition, an entity is required to disclose the amount of residential real estate meeting the conditions above, and the recorded investment in consumer mortgage loans secured by residential real estate that are in the process of foreclosure. ASU 2014-04 is effective for annual and interim reporting periods within those annual periods, beginning after December 15, 2014. Adoption of the new guidance is not expected to have a significant 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. The Update provides guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit. The amendments in this Update permit the reporting entity to make an accounting policy election to account for its investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, the cost of the investment is amortized each reporting period in proportion to the tax credits received. Under the new guidance, classification of the amortization would change from noninterest expense to income tax expense. ASU 2014-01 is effective for annual and interim reporting periods within those annual periods, beginning after December 15, 2014. The guidance is to be applied retrospectively to all periods presented. The Company is assessing the impact of the new guidance on its consolidated financial statements.

### 3. Business Combinations

On April 1, 2013, the Company completed its acquisition of West Coast. The Company paid \$540.8 million in total consideration to acquire 100% of the voting equity interests of West Coast. The primary reason for the acquisition was to expand the Company's geographic footprint consistent with its ongoing growth strategy. The fair value of the net assets acquired totaled \$312.4 million, including \$1.88 billion of deposits, \$1.41 billion of loans and \$15.3 million of other intangible assets. Goodwill of \$228.4 million was recorded as part of the acquisition. The goodwill is not deductible for income tax purposes.

The operating results of the Company include the operating results produced by the acquired assets and assumed liabilities for the period April 1, 2013 to June 30, 2014. Disclosure of the amount of West Coast's revenue and net income (excluding integration costs) included in Columbia's consolidated income statement is impracticable due to the integration of the operations and accounting for this acquisition.

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The following table presents certain unaudited pro forma information for the six month period ended June 30, 2013, for illustrative purposes only. This unaudited pro forma information was calculated as if West Coast had been acquired as of the beginning of the year prior to the acquisition. The unaudited estimated pro forma information combines the historical results of West Coast with the Company's consolidated historical results and includes certain adjustments reflecting the estimated impact of certain fair value adjustments for the respective periods. The pro forma information is not indicative of what would have occurred had the acquisition occurred as of the beginning of the year prior to the acquisition. In particular, no adjustments have been made to eliminate the impact of other-than-temporary impairment losses and losses recognized on the sale of securities that may not have been necessary had the investment securities been recorded at fair value as of the beginning of the year prior to the acquisition. The unaudited pro forma information does not consider any changes to the provision for credit losses resulting from recording loan assets at fair value. Additionally, Columbia expects to achieve further operating cost savings and other business synergies, including revenue growth, as a result of the acquisition which are not reflected in the pro forma amounts that follow. As a result, actual amounts would have differed from the unaudited pro forma information presented.

|  | Unaudited Pro<br>Forma<br>Six Months<br>Ended June 30,<br>2013<br>(in thousands) |
|--|--|
| Total revenues (net interest income plus noninterest income) | \$177,970  |
| Net income   | \$43,256   |
| Earnings per share - basic                                   | \$0.85   |
| Earnings per share - diluted                                 | \$0.83   |

In connection with the West Coast acquisition, Columbia recognized \$672 thousand and \$9.2 million of acquisition-related expenses for the three month periods ended June 30, 2014 and 2013, respectively, and \$1.6 million and \$10.0 million for the six month periods ended June 30, 2014 and 2013, respectively.

See Note 2, Business Combinations, in Item 8 of our 2013 Form 10-K for additional details related to the West Coast acquisition.



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## 4. Securities

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

|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value    |
|---|-------------------|------------------------------|-------------------------------|---------------|
|   | (in thousands)    |                              |                               |               |
| June 30, 2014   |                   |                              |                               |               |
| U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations | \$862,248         | \$11,858                     | \$(11,488)                    | ) \$862,618   |
| State and municipal securities  | 368,221           | 13,783                       | (1,498)                       | ) 380,506     |
| U.S. government agency and government-sponsored enterprise securities   | 325,341           | 492                          | (4,444)                       | ) 321,389     |
| U.S. government securities  | 20,895            | 1                            | (559)                         | ) 20,337      |
| Other securities  | 5,284             | 22                           | (139)                         | ) 5,167       |
| Total   | \$1,581,989       | \$26,156                     | \$(18,128)                    | ) \$1,590,017 |
| December 31, 2013   |                   |                              |                               |               |
| U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations | \$961,442         | \$10,640                     | \$(23,674)                    | ) \$948,408   |
| State and municipal securities  | 357,013           | 11,450                       | (3,993)                       | ) 364,470     |
| U.S. government agency and government-sponsored enterprise securities   | 335,671           | 434                          | (10,066)                      | ) 326,039     |
| U.S. government securities  | 21,081            | —                            | (967)                         | ) 20,114      |
| Other securities  | 5,284             | 27                           | (231)                         | ) 5,080       |
| Total   | \$1,680,491       | \$22,551                     | \$(38,931)                    | ) \$1,664,111 |

The scheduled contractual maturities of investment securities available for sale at June 30, 2014 are presented as follows:

|  | June 30, 2014  |             |
|--|----------------|-------------|
|  | Amortized Cost | Fair Value  |
|  | (in thousands) |             |
| Due within one year                            | \$21,359       | \$21,470    |
| Due after one year through five years          | 332,516        | 333,068     |
| Due after five years through ten years         | 431,423        | 432,434     |
| Due after ten years                            | 791,407        | 797,878     |
| Other securities with no stated maturity       | 5,284          | 5,167       |
| Total investment securities available-for-sale | \$1,581,989    | \$1,590,017 |

The following table summarizes, as of June 30, 2014, the carrying value of securities pledged as collateral to secure public deposits, borrowings and other purposes as permitted or required by law:

|   | Carrying<br>Amount<br>(in thousands) |
|---|--------------------------------------|
| Washington and Oregon State to secure public deposits | \$291,729                            |
| Federal Reserve Bank to secure borrowings             | 42,582                               |
| Other securities pledged                              | 43,994                               |
| Total securities pledged as collateral                | \$378,305                            |



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The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2014 and December 31, 2013:

|   | Less than 12 Months |                   | 12 Months or More |                   | Total       |                   |
|---|---------------------|-------------------|-------------------|-------------------|-------------|-------------------|
|   | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value  | Unrealized Losses |
|   | (in thousands)      |                   |                   |                   |             |                   |
| June 30, 2014   |                     |                   |                   |                   |             |                   |
| U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations | \$70,725            | \$(160 )          | \$296,832         | \$(11,328 )       | \$367,557   | \$(11,488 )       |
| State and municipal securities  | 26,340              | (101 )            | 61,424            | (1,397 )          | 87,764      | (1,498 )          |
| U.S. government agency and government-sponsored enterprise securities   | 16,231              | (2 )              | 246,776           | (4,442 )          | 263,007     | (4,444 )          |
| U.S. government securities  | —                   | —                 | 19,288            | (559 )            | 19,288      | (559 )            |
| Other securities  | —                   | —                 | 5,131             | (139 )            | 5,131       | (139 )            |
| Total   | \$113,296           | \$(263 )          | \$629,451         | \$(17,865 )       | \$742,747   | \$(18,128 )       |
| December 31, 2013   |                     |                   |                   |                   |             |                   |
| U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations | \$492,921           | \$(10,991 )       | \$121,303         | \$(12,684 )       | \$614,224   | \$(23,675 )       |
| State and municipal securities  | 112,400             | (3,069 )          | 13,815            | (923 )            | 126,215     | (3,992 )          |
| U.S. government agency and government-sponsored enterprise securities   | 260,001             | (8,063 )          | 28,447            | (2,003 )          | 288,448     | (10,066 )         |
| U.S. government securities  | 20,114              | (967 )            | —                 | —                 | 20,114      | (967 )            |
| Other securities  | 2,257               | (58 )             | 2,783             | (173 )            | 5,040       | (231 )            |
| Total   | \$887,693           | \$(23,148 )       | \$166,348         | \$(15,783 )       | \$1,054,041 | \$(38,931 )       |

At June 30, 2014, there were 54 U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations securities in an unrealized loss position, of which 45 were in a continuous loss position for 12 months or more. The decline in fair value is attributable to changes in interest rates relative to where these investments fall within the yield curve and their individual characteristics. Because the Company does not intend to sell these securities nor does the Company consider it more likely than not that it will be required to sell these securities before the recovery of amortized cost basis, which may be upon maturity, the Company does not consider these investments to be other-than-temporarily impaired at June 30, 2014.

At June 30, 2014, there were 88 state and municipal government securities in an unrealized loss position, of which 64 were in a continuous loss position for 12 months or more. The unrealized losses on state and municipal securities were caused by interest rate changes or widening of market spreads subsequent to the purchase of the individual securities. Management monitors published credit ratings of these securities for adverse changes. As of June 30, 2014, none of the rated obligations of state and local government entities held by the Company had a below investment grade credit rating. Because the credit quality of these securities are investment grade and the Company does not intend to sell these securities nor does the Company consider it more likely than not that it will be required to sell these securities before the recovery of amortized cost basis, which may be upon maturity, the Company does not consider these investments to be other-than-temporarily impaired at June 30, 2014.

At June 30, 2014, there were 27 U.S. government agency and government-sponsored enterprise securities in an unrealized loss position, 22 of which were in a continuous loss position for 12 months or more. The decline in fair value is attributable to changes in interest rates relative to where these investments fall within the yield curve and their individual characteristics. Because the Company does not currently intend to sell these securities nor does the Company consider it more likely than not that it will be required to sell these securities before the recovery of amortized cost basis, which may be upon maturity, the Company does not consider these investments to be other-than-temporarily impaired at June 30, 2014.

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At June 30, 2014, there were two U.S. government securities in an unrealized loss position, both of which were in a continuous loss position for 12 months or more. The decline in fair value is attributable to changes in interest rates relative to where these investments fall within the yield curve and their individual characteristics. Because the Company does not currently intend to sell these securities nor does the Company consider it more likely than not that it will be required to sell these securities before the recovery of amortized cost basis, which may be upon maturity, the Company does not consider these investments to be other-than-temporarily impaired at June 30, 2014.

At June 30, 2014, there were two other securities in an unrealized loss position, both of which were in a continuous unrealized loss position for 12 months or more. The decline in fair value is attributable to changes in interest rates and the additional risk premium investors are demanding for investment securities with these characteristics. The Company does not consider these investments to be other-than-temporarily impaired at June 30, 2014 as it has the intent and ability to hold the investments for sufficient time to allow for recovery in the market value.

## 5. Noncovered Loans

Noncovered loans include loans originated through our branch network and loan departments as well as acquired loans that are not subject to Federal Deposit Insurance Corporation ("FDIC") loss-sharing agreements.

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

|  | June 30,<br>2014 | December 31,<br>2013 |
|--|------------------|----------------------|
| Noncovered loans:                              | (in thousands)   |                      |
| Commercial business                            | \$1,735,588      | \$1,561,782          |
| Real estate:                                   |                  |                      |
| One-to-four family residential                 | 102,632          | 108,317              |
| Commercial and multifamily residential         | 2,127,520        | 2,080,075            |
| Total real estate                              | 2,230,152        | 2,188,392            |
| Real estate construction:                      |                  |                      |
| One-to-four family residential                 | 61,481           | 54,155               |
| Commercial and multifamily residential         | 134,140          | 126,390              |
| Total real estate construction                 | 195,621          | 180,545              |
| Consumer                                       | 348,439          | 357,014              |
| Less: Net unearned income                      | (57,126          | ) (68,282            |
| Total noncovered loans, net of unearned income | 4,452,674        | 4,219,451            |
| Less: Allowance for loan and lease losses      | (49,494          | ) (52,280            |
| Total noncovered loans, net                    | \$4,403,180      | \$4,167,171          |
| Loans held for sale                            | \$750            | \$735                |

At June 30, 2014 and December 31, 2013, the Company had no material foreign activities. Substantially all of the Company's loans and unfunded commitments are geographically concentrated in its service areas within the states of Washington and Oregon.

The Company has granted loans to executive officers and directors of the Company and related interests. These loans are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collectability. The aggregate dollar amount of these loans was \$11.6 million at June 30, 2014 and \$14.2 million at December 31, 2013. During the first six months of 2014, advances on related party loans totaled \$1.1 million and repayments totaled \$3.7 million. At June 30, 2014 and December 31, 2013, \$1.07 billion and \$1.08 billion of commercial and residential real estate loans were pledged as collateral on Federal Home Loan Bank borrowings and additional borrowing capacity. The Company has also pledged \$43.9 million and \$45.2 million of commercial loans to the Federal Reserve Bank for additional borrowing capacity at June 30, 2014 and December 31, 2013, respectively.

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The following is an analysis of noncovered, nonaccrual loans as of June 30, 2014 and December 31, 2013:

|                                       | June 30, 2014   |  | December 31, 2013                             |  |
|---------------------------------------|---|--|---|--|
|                                       | Recorded<br>Investment<br>Nonaccrual<br>Loans<br>(in thousands) | Unpaid Principal<br>Balance<br>Nonaccrual<br>Loans | Recorded<br>Investment<br>Nonaccrual<br>Loans | Unpaid Principal<br>Balance<br>Nonaccrual<br>Loans |
| Noncovered loans:                     |   |  |   |  |
| Commercial business:                  |   |  |   |  |
| Secured                               | \$11,190  | \$ 15,739  | \$12,433                                      | \$ 19,186  |
| Unsecured                             | 294   | 326  | 176   | 202  |
| Real estate:                          |   |  |   |  |
| One-to-four family residential        | 3,024   | 5,125  | 2,667   | 4,678  |
| Commercial & multifamily residential: |   |  |   |  |
| Commercial land                       | 658   | 998  | 442   | 783  |
| Income property                       | 5,062   | 7,648  | 4,267   | 5,383  |
| Owner occupied                        | 5,319   | 7,388  | 6,334   | 7,486  |
| Real estate construction:             |   |  |   |  |
| One-to-four family residential:       |   |  |   |  |
| Land and acquisition                  | 581   | 1,761  | 3,246   | 6,601  |
| Residential construction              | 459   | 1,928  | 459   | 1,928  |
| Consumer                              | 4,026   | 5,758  | 3,991   | 6,187  |
| Total                                 | \$30,613  | \$ 46,671  | \$34,015                                      | \$ 52,434  |

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The following is an aging of the recorded investment of the noncovered loan portfolio as of June 30, 2014 and December 31, 2013:

|  | Current<br>Loans | 30 - 59<br>Days<br>Past Due | 60 - 89<br>Days<br>Past Due | Greater<br>than 90<br>Days Past<br>Due | Total<br>Past Due | Nonaccrual<br>Loans | Total Loans |
|--|------------------|-----------------------------|-----------------------------|--|-------------------|---------------------|-------------|
| June 30, 2014                            | (in thousands)   |                             |                             |  |                   |                     |             |
| Noncovered loans:                        |                  |                             |                             |  |                   |                     |             |
| Commercial business:                     |                  |                             |                             |  |                   |                     |             |
| Secured                                  | \$1,640,938      | \$3,046                     | \$2,602                     | \$—                                    | \$5,648           | \$11,190            | \$1,657,776 |
| Unsecured                                | 72,749           | 142                         | 67                          | —                                      | 209               | 294                 | 73,252      |
| Real estate:                             |                  |                             |                             |  |                   |                     |             |
| One-to-four family<br>residential        | 95,653           | 1,415                       | 570                         | —                                      | 1,985             | 3,024               | 100,662     |
| Commercial &<br>multifamily residential: |                  |                             |                             |  |                   |                     |             |
| Commercial land                          | 148,163          | —                           | —                           | —                                      | —                 | 658                 | 148,821     |
| Income property                          | 1,191,882        | 1,336                       | 9                           | —                                      | 1,345             | 5,062               | 1,198,289   |
| Owner occupied                           | 746,217          | 410                         | 2,575                       | —                                      | 2,985             | 5,319               | 754,521     |
| Real estate construction:                |                  |                             |                             |  |                   |                     |             |
| One-to-four family<br>residential:       |                  |                             |                             |  |                   |                     |             |
| Land and acquisition                     | 10,899           | —                           | —                           | —                                      | —                 | 581                 | 11,480      |
| Residential construction                 | 48,699           | 393                         | —                           | —                                      | 393               | 459                 | 49,551      |
| Commercial &<br>multifamily residential: |                  |                             |                             |  |                   |                     |             |
| Income property                          | 87,603           | —                           | —                           | —                                      | —                 | —                   | 87,603      |
| Owner occupied                           | 45,951           | —                           | —                           | —                                      | —                 | —                   | 45,951      |
| Consumer                                 | 319,958          | 717                         | 67                          | —                                      | 784               | 4,026               | 324,768     |
| Total                                    | \$4,408,712      | \$7,459                     | \$5,890                     | \$—                                    | \$13,349          | \$30,613            | \$4,452,674 |
| December 31, 2013                        | (in thousands)   |                             |                             |  |                   |                     |             |
| Noncovered loans:                        |                  |                             |                             |  |                   |                     |             |
| Commercial business:                     |                  |                             |                             |  |                   |                     |             |
| Secured                                  | \$1,457,820      | \$12,713                    | \$681                       | \$—                                    | \$13,394          | \$12,433            | \$1,483,647 |
| Unsecured                                | 72,255           | 156                         | 17                          | —                                      | 173               | 176                 | 72,604      |
| Real estate:                             |                  |                             |                             |  |                   |                     |             |
| One-to-four family<br>residential        | 100,591          | 1,993                       | 641                         | —                                      | 2,634             | 2,667               | 105,892     |
| Commercial &<br>multifamily residential: |                  |                             |                             |  |                   |                     |             |
| Commercial land                          | 142,034          | —                           | 358                         | —                                      | 358               | 442                 | 142,834     |
| Income property                          | 1,138,732        | 144                         | 3,289                       | —                                      | 3,433             | 4,267               | 1,146,432   |
| Owner occupied                           | 749,561          | 4,714                       | —                           | —                                      | 4,714             | 6,334               | 760,609     |

## Real estate construction:

One-to-four family  
residential:

|  |             |          |         |     |          |          |             |
|--|-------------|----------|---------|-----|----------|----------|-------------|
| Land and acquisition                     | 8,225       | 199      | —       | —   | 199      | 3,246    | 11,670      |
| Residential construction                 | 41,533      | —        | —       | —   | —        | 459      | 41,992      |
| Commercial &<br>multifamily residential: |             |          |         |     |          |          |             |
| Income property                          | 86,521      | —        | —       | —   | —        | —        | 86,521      |
| Owner occupied                           | 38,916      | —        | —       | —   | —        | —        | 38,916      |
| Consumer                                 | 322,685     | 835      | 823     | —   | 1,658    | 3,991    | 328,334     |
| Total                                    | \$4,158,873 | \$20,754 | \$5,809 | \$— | \$26,563 | \$34,015 | \$4,219,451 |



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The following is an analysis of impaired loans as of June 30, 2014 and December 31, 2013:

|                                       | Recorded<br>Investment<br>of Loans<br>Collectively<br>for<br>Contingency<br>Provision<br>(in thousands) | Recorded<br>Investment<br>of Loans<br>Measurably<br>for<br>Specific<br>Impairment<br>(in thousands) | Impaired Loans With<br>Recorded Allowance |                                |                      | Impaired Loans<br>Without<br>Recorded Allowance |                                |
|---------------------------------------|---|---|---|--------------------------------|----------------------|---|--------------------------------|
|                                       |   |   | Recorded<br>Investment                    | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Recorded<br>Investment                          | Unpaid<br>Principal<br>Balance |
| <b>June 30, 2014</b>                  |   |   |   |                                |                      |   |                                |
| Noncovered loans:                     |   |   |   |                                |                      |   |                                |
| Commercial business:                  |   |   |   |                                |                      |   |                                |
| Secured                               | \$1,651,286   | \$ 6,490  | \$1,332                                   | \$2,450                        | \$ 128               | \$5,158   | \$5,929                        |
| Unsecured                             | 73,233  | 19  | 19  | 19                             | 19                   | —   | —                              |
| Real estate:                          |   |   |   |                                |                      |   |                                |
| One-to-four family residential        | 98,616  | 2,046   | 432                                       | 472                            | 128                  | 1,614   | 2,794                          |
| Commercial & multifamily residential: |   |   |   |                                |                      |   |                                |
| Commercial land                       | 148,722   | 99  | —   | —                              | —                    | 99  | 398                            |
| Income property                       | 1,190,323   | 7,966   | —   | —                              | —                    | 7,966   | 12,518                         |
| Owner occupied                        | 745,351   | 9,170   | 588                                       | 588                            | 35                   | 8,582   | 13,020                         |
| Real estate construction:             |   |   |   |                                |                      |   |                                |
| One-to-four family residential:       |   |   |   |                                |                      |   |                                |
| Land and acquisition                  | 11,368  | 112   | 112                                       | 111                            | 69                   | —   | —                              |
| Residential construction              | 49,551  | —   | —   | —                              | —                    | —   | —                              |
| Commercial & multifamily residential: |   |   |   |                                |                      |   |                                |
| Income property                       | 87,603  | —   | —   | —                              | —                    | —   | —                              |
| Owner occupied                        | 45,951  | —   | —   | —                              | —                    | —   | —                              |
| Consumer                              | 324,616   | 152   | 20  | 26                             | 1                    | 132   | 199                            |
| <b>Total</b>                          | <b>\$4,426,620</b>  | <b>\$ 26,054</b>  | <b>\$2,503</b>                            | <b>\$3,666</b>                 | <b>\$ 380</b>        | <b>\$23,551</b>                                 | <b>\$34,858</b>                |
|                                       | Recorded<br>Investment<br>of Loans<br>Collectively<br>for<br>Contingency<br>Provision<br>(in thousands) | Recorded<br>Investment<br>of Loans<br>Measurably<br>for<br>Specific<br>Impairment<br>(in thousands) | Impaired Loans With<br>Recorded Allowance |                                |                      | Impaired Loans<br>Without<br>Recorded Allowance |                                |
|                                       |   |   | Recorded<br>Investment                    | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Recorded<br>Investment                          | Unpaid<br>Principal<br>Balance |
| <b>December 31, 2013</b>              |   |   |   |                                |                      |   |                                |
| Noncovered loans:                     |   |   |   |                                |                      |   |                                |
| Commercial business:                  |   |   |   |                                |                      |   |                                |
| Secured                               | \$1,478,560   | \$ 5,087  | \$2,866                                   | \$2,885                        | \$ 343               | \$2,221   | \$2,560                        |
| Unsecured                             | 72,569  | 35  | 35  | 35                             | 35                   | —   | —                              |
| Real estate:                          |   |   |   |                                |                      |   |                                |
| One-to-four family residential        | 104,272   | 1,620   | 442                                       | 479                            | 138                  | 1,178   | 2,119                          |
| Commercial & multifamily residential: |   |   |   |                                |                      |   |                                |
| Commercial land                       | 142,719   | 115   | —   | —                              | —                    | 115   | 398                            |
| Income property                       | 1,140,019   | 6,413   | 918                                       | 933                            | 26                   | 5,495   | 7,885                          |

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|                                       |             |           |         |          |          |          |          |
|---------------------------------------|-------------|-----------|---------|----------|----------|----------|----------|
| Owner occupied                        | 749,601     | 11,008    | 3,802   | 3,817    | 1,073    | 7,206    | 10,464   |
| Real estate construction:             |             |           |         |          |          |          |          |
| One-to-four family residential:       |             |           |         |          |          |          |          |
| Land and acquisition                  | 9,726       | 1,944     | 113     | 113      | 71       | 1,831    | 2,587    |
| Residential construction              | 41,992      | —         | —       | —        | —        | —        | —        |
| Commercial & multifamily residential: |             |           |         |          |          |          |          |
| Income property                       | 86,521      | —         | —       | —        | —        | —        | —        |
| Owner occupied                        | 38,916      | —         | —       | —        | —        | —        | —        |
| Consumer                              | 328,167     | 167       | 23      | 27       | 4        | 144      | 210      |
| Total                                 | \$4,193,062 | \$ 26,389 | \$8,199 | \$ 8,289 | \$ 1,690 | \$18,190 | \$26,223 |

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

|                                       | Three Months Ended June 30,                   |                                    |   |                                    | Six Months Ended June 30,                     |                                    |   |                                    |
|---------------------------------------|---|------------------------------------|---|------------------------------------|---|------------------------------------|---|------------------------------------|
|                                       | 2014  |                                    | 2013  |                                    | 2014  |                                    | 2013  |                                    |
|                                       | Average Recorded Investment on Impaired Loans | Interest Recognized Impaired Loans | Average Recorded Investment on Impaired Loans | Interest Recognized Impaired Loans | Average Recorded Investment on Impaired Loans | Interest Recognized Impaired Loans | Average Recorded Investment on Impaired Loans | Interest Recognized Impaired Loans |
| (in thousands)                        |   |                                    |   |                                    |   |                                    |   |                                    |
| Noncovered loans:                     |   |                                    |   |                                    |   |                                    |   |                                    |
| Commercial business:                  |   |                                    |   |                                    |   |                                    |   |                                    |
| Secured                               | \$6,933                                       | \$ 17                              | \$6,481                                       | \$ 4                               | \$6,318                                       | \$ 33                              | \$5,941                                       | \$ 8                               |
| Unsecured                             | 23  | —                                  | 68  | 1                                  | 27  | 1                                  | 76  | 1                                  |
| Real estate:                          |   |                                    |   |                                    |   |                                    |   |                                    |
| One-to-four family residential        | 2,069   | 11                                 | 1,538   | 27                                 | 1,920   | 23                                 | 1,722   | 31                                 |
| Commercial & multifamily residential: |   |                                    |   |                                    |   |                                    |   |                                    |
| Commercial land                       | 103   | —                                  | 2,559   | —                                  | 107   | —                                  | 2,591   | —                                  |
| Income property                       | 7,213   | 74                                 | 10,478  | 133                                | 6,946   | 136                                | 9,704   | 161                                |
| Owner occupied                        | 9,222   | 235                                | 10,437  | 230                                | 9,817   | 476                                | 10,926  | 510                                |
| Real estate construction:             |   |                                    |   |                                    |   |                                    |   |                                    |
| One-to-four family residential:       |   |                                    |   |                                    |   |                                    |   |                                    |
| Land and acquisition                  | 653   | 1                                  | 2,931   | 1                                  | 1,083   | 3                                  | 2,894   | 3                                  |
| Residential construction              | —   | —                                  | 72  | —                                  | —   | —                                  | 701   | —                                  |
| Consumer                              | 155   | 3                                  | 425   | 2                                  | 159   | 5                                  | 326   | 3                                  |
| Total                                 | \$26,371                                      | \$ 341                             | \$34,989                                      | \$ 398                             | \$26,377                                      | \$ 677                             | \$34,881                                      | \$ 717                             |

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The following is an analysis of loans classified as troubled debt restructurings (“TDR”) during the three and six months ended June 30, 2014 and 2013:

|   | Three months ended June 30, 2014 |  |   | Three months ended June 30, 2013 |  |   |
|---|----------------------------------|--|---|----------------------------------|--|---|
|   | Number of TDR Modifications      | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of TDR Modifications      | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Noncovered loans:<br>(dollars in thousands) |                                  |  |   |                                  |  |   |
| Commercial business:                        |                                  |  |   |                                  |  |   |
| Secured                                     | 2                                | \$ 546   | \$ 546  | 1                                | \$ 343   | \$ 343  |
| Commercial and multifamily residential:     |                                  |  |   |                                  |  |   |
| Commercial land                             | —                                | —  | —   | 1                                | 137  | 137   |
| Income property                             | —                                | —  | —   | 3                                | 943  | 943   |
| Owner occupied                              | —                                | —  | —   | 1                                | 172  | 172   |
| Total                                       | 2                                | \$ 546   | \$ 546  | 6                                | \$ 1,595   | \$ 1,595  |
| Six months ended June 30, 2014              |                                  |  |   |                                  |  |   |
| Six months ended June 30, 2013              |                                  |  |   |                                  |  |   |
|   | Number of TDR Modifications      | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of TDR Modifications      | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Noncovered loans:<br>(dollars in thousands) |                                  |  |   |                                  |  |   |
| Commercial business:                        |                                  |  |   |                                  |  |   |
| Secured                                     | 4                                | \$ 759   | \$ 759  | 1                                | \$ 343   | \$ 343  |
| Real estate:                                |                                  |  |   |                                  |  |   |
| One-to-four family residential              | 2                                | 494  | 494   | —                                | —  | —   |
| Commercial and multifamily residential:     |                                  |  |   |                                  |  |   |
| Commercial land                             | —                                | —  | —   | 1                                | 137  | 137   |
| Income property                             | 1                                | 143  | 126   | 3                                | 943  | 943   |
| Owner occupied                              | —                                | —  | —   | 1                                | 172  | 172   |
| Real estate construction:                   |                                  |  |   |                                  |  |   |
| One-to-four family residential:             |                                  |  |   |                                  |  |   |
| Land and acquisition                        | —                                | —  | —   | 1                                | 117  | 117   |
| Total                                       | 7                                | \$ 1,396   | \$ 1,379  | 7                                | \$ 1,712   | \$ 1,712  |

The Company’s loans classified as TDR are loans that have been modified or the borrower has been granted special concessions due to financial difficulties that, if not for the challenges of the borrower, the Company would not otherwise consider. The TDR modifications or concessions are made to increase the likelihood that these borrowers with financial difficulties will be able to satisfy their debt obligations as amended. The concessions granted in the restructurings completed in the six month periods ending June 30, 2014 and 2013 largely consisted of maturity extensions, interest rate modifications or a combination of both. In limited circumstances, a reduction in the principal balance of the loan could also be made as a concession. Credit losses for loans classified as TDR are measured on the same basis as impaired loans. For impaired loans, an allowance is established when the collateral value less selling costs (or discounted cash flows or observable market price) of the impaired loan is lower than the recorded investment of that loan.

The Company had commitments to lend \$269 thousand of additional funds on loans classified as TDR as of June 30, 2014, but had no commitments to lend additional funds on loans classified as TDR as of December 31, 2013. The

Company did not have any loans modified as TDR that defaulted within twelve months of being modified as TDR during the six month periods ended June 30, 2014 and 2013.

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

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

1. General valuation allowance consistent with the Contingencies topic of the FASB Accounting Standards Codification (“ASC”).
2. Classified loss reserves on specific relationships. Specific allowances for identified problem loans are determined in accordance with the Receivables topic of the FASB ASC.

The unallocated allowance provides for other factors inherent in our loan portfolio that may not have been contemplated in the general and specific components of the allowance. This unallocated amount generally

3. comprises less than 5% of the allowance. The unallocated amount is reviewed quarterly based on trends in credit losses, the results of credit reviews and overall economic trends.

The general valuation allowance is systematically calculated quarterly using quantitative and qualitative information about specific loan classes. The minimum required level with respect to which an entity develops a methodology to determine its allowance for loan and lease losses is by general categories of loans, such as commercial business, real estate, and consumer. However, the Company’s methodology in determining its allowance for loan and lease losses is prepared in a more detailed manner at the loan class level, utilizing specific categories such as commercial business secured, commercial business unsecured, real estate commercial land, and real estate income property multifamily. The quantitative information uses historical losses from a specific loan class and incorporates the loan’s risk rating migration from origination to the point of loss based upon the consideration of an appropriate look back period. A loan’s risk rating is primarily determined based upon the borrower’s ability to fulfill its debt obligation from a cash flow perspective. In the event there is financial deterioration of the borrower, the borrower’s other sources of income or repayment are also considered, including recent appraisal values for collateral dependent loans. The qualitative information takes into account general economic and business conditions affecting our marketplace, seasoning of the loan portfolio, duration of the business cycle, etc. to ensure our methodologies reflect the current economic environment and other factors as using historical loss information exclusively may not give an accurate estimate of inherent losses within the Company’s loan portfolio.

When a loan is deemed to be impaired, the Company has to determine if a specific valuation allowance is required for that loan. The specific valuation allowance is a reserve, calculated at the individual loan level, for each loan determined to be both impaired and containing a value less than its recorded investment. The Company measures the impairment based on the discounted expected future cash flows, observable market price, or the fair value of the collateral less selling costs if the loan is collateral dependent or if foreclosure is probable. The specific reserve for each loan is equal to the difference between the recorded investment in the loan and its determined impairment value. The ALLL is increased by provisions for loan and lease losses (“provision”) charged to expense, and is reduced by loans charged off, net of recoveries or a recovery of previous provisions. While the Company’s management believes the best information available is used to determine the ALLL, changes in market conditions could result in adjustments to the ALLL, affecting net income, if circumstances differ from the assumptions used in determining the ALLL.

We have used the same methodology for ALLL calculations during the six months ended June 30, 2014 and 2013. Adjustments to the percentages of the ALLL allocated to loan categories are made based on trends with respect to delinquencies and problem loans within each class of loans. The Company reviews the ALLL quantitative and qualitative methodology on a quarterly basis and makes adjustments when appropriate. The Company continues to strive towards maintaining a conservative approach to credit quality and will continue to prudently adjust our ALLL as necessary in order to maintain adequate reserves. The Company carefully monitors the loan portfolio and continues to emphasize the importance of credit quality.

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



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The following tables show a detailed analysis of the allowance for loan and lease losses for noncovered loans for the three and six months ended June 30, 2014 and 2013:

|                                       | Beginning<br>Balance | Charge-offs | Recoveries | Provision<br>(Recovery) | Ending<br>Balance | Specific<br>Reserve | General<br>Allocation |
|---------------------------------------|----------------------|-------------|------------|-------------------------|-------------------|---------------------|-----------------------|
| Three months ended June 30,<br>2014   | (in thousands)       |             |            |                         |                   |                     |                       |
| Noncovered loans:                     |                      |             |            |                         |                   |                     |                       |
| Commercial business:                  |                      |             |            |                         |                   |                     |                       |
| Secured                               | \$28,801             | \$(1,642 )  | \$1,435    | \$(3,077 )              | \$25,517          | \$128               | \$25,389              |
| Unsecured                             | 746                  | (75 )       | 277        | (194 )                  | 754               | 19                  | 735                   |
| Real estate:                          |                      |             |            |                         |                   |                     |                       |
| One-to-four family residential        | 1,194                | —           | 12         | (123 )                  | 1,083             | 128                 | 955                   |
| Commercial & multifamily residential: |                      |             |            |                         |                   |                     |                       |
| Commercial land                       | 579                  | (29 )       | 2          | (82 )                   | 470               | —                   | 470                   |
| Income property                       | 10,107               | (1,934 )    | 505        | 1,833                   | 10,511            | —                   | 10,511                |
| Owner occupied                        | 4,560                | —           | 30         | 399                     | 4,989             | 35                  | 4,954                 |
| Real estate construction:             |                      |             |            |                         |                   |                     |                       |
| One-to-four family residential:       |                      |             |            |                         |                   |                     |                       |
| Land and acquisition                  | 580                  | —           | 2          | (179 )                  | 403               | 69                  | 334                   |
| Residential construction              | 696                  | —           | 440        | (459 )                  | 677               | —                   | 677                   |
| Commercial & multifamily residential: |                      |             |            |                         |                   |                     |                       |
| Income property                       | 320                  | —           | —          | 94                      | 414               | —                   | 414                   |
| Owner occupied                        | 154                  | —           | —          | 12                      | 166               | —                   | 166                   |
| Consumer                              | 2,637                | (909 )      | 338        | 577                     | 2,643             | 1                   | 2,642                 |
| Unallocated                           | 68                   | —           | —          | 1,799                   | 1,867             | —                   | 1,867                 |
| Total                                 | \$50,442             | \$(4,589 )  | \$3,041    | \$600                   | \$49,494          | \$380               | \$49,114              |
|                                       | Beginning<br>Balance | Charge-offs | Recoveries | Provision<br>(Recovery) | Ending<br>Balance | Specific<br>Reserve | General<br>Allocation |
| Six months ended June 30, 2014        | (in thousands)       |             |            |                         |                   |                     |                       |
| Noncovered loans:                     |                      |             |            |                         |                   |                     |                       |
| Commercial business:                  |                      |             |            |                         |                   |                     |                       |
| Secured                               | \$31,027             | \$(1,840 )  | \$1,883    | \$(5,553 )              | \$25,517          | \$128               | \$25,389              |
| Unsecured                             | 696                  | (110 )      | 319        | (151 )                  | 754               | 19                  | 735                   |
| Real estate:                          |                      |             |            |                         |                   |                     |                       |
| One-to-four family residential        | 1,252                | (207 )      | 40         | (2 )                    | 1,083             | 128                 | 955                   |
| Commercial & multifamily residential: |                      |             |            |                         |                   |                     |                       |
| Commercial land                       | 489                  | (29 )       | 19         | (9 )                    | 470               | —                   | 470                   |
| Income property                       | 9,234                | (1,934 )    | 518        | 2,693                   | 10,511            | —                   | 10,511                |
| Owner occupied                        | 3,605                | (1,023 )    | 39         | 2,368                   | 4,989             | 35                  | 4,954                 |
| Real estate construction:             |                      |             |            |                         |                   |                     |                       |
| One-to-four family residential:       |                      |             |            |                         |                   |                     |                       |
| Land and acquisition                  | 610                  | —           | 41         | (248 )                  | 403               | 69                  | 334                   |
| Residential construction              | 822                  | —           | 443        | (588 )                  | 677               | —                   | 677                   |
| Commercial & multifamily residential: |                      |             |            |                         |                   |                     |                       |
| Income property                       | 285                  | —           | —          | 129                     | 414               | —                   | 414                   |



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|                |          |          |           |        |          |       |          |
|----------------|----------|----------|-----------|--------|----------|-------|----------|
| Owner occupied | 58       | —        | —         | 108    | 166      | —     | 166      |
| Consumer       | 2,547    | (1,636   | ) 591     | 1,141  | 2,643    | 1     | 2,642    |
| Unallocated    | 1,655    | —        | —         | 212    | 1,867    | —     | 1,867    |
| Total          | \$52,280 | \$(6,779 | ) \$3,893 | \$ 100 | \$49,494 | \$380 | \$49,114 |

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|  | Beginning<br>Balance | Charge-offs | Recoveries | Provision<br>(Recovery) | Ending<br>Balance | Specific<br>Reserve | General<br>Allocation |
|--|----------------------|-------------|------------|-------------------------|-------------------|---------------------|-----------------------|
| Three months ended June 30,<br>2013      | (in thousands)       |             |            |                         |                   |                     |                       |
| Noncovered loans:                        |                      |             |            |                         |                   |                     |                       |
| Commercial business:                     |                      |             |            |                         |                   |                     |                       |
| Secured                                  | \$26,871             | \$(856 )    | \$312      | \$4,245                 | \$30,572          | \$242               | \$30,330              |
| Unsecured                                | 750                  | (105 )      | 40         | 136                     | 821               | 51                  | 770                   |
| Real estate:                             |                      |             |            |                         |                   |                     |                       |
| One-to-four family residential           | 657                  | (28 )       | 141        | (98 )                   | 672               | 105                 | 567                   |
| Commercial & multifamily<br>residential: |                      |             |            |                         |                   |                     |                       |
| Commercial land                          | 433                  | (11 )       | 17         | 252                     | 691               | 262                 | 429                   |
| Income property                          | 9,411                | (35 )       | 27         | 292                     | 9,695             | 76                  | 9,619                 |
| Owner occupied                           | 5,458                | (568 )      | 40         | (415 )                  | 4,515             | 30                  | 4,485                 |
| Real estate construction:                |                      |             |            |                         |                   |                     |                       |
| One-to-four family residential:          |                      |             |            |                         |                   |                     |                       |
| Land and acquisition                     | 990                  | —           | 35         | (256 )                  | 769               | 73                  | 696                   |
| Residential construction                 | 538                  | —           | 14         | (348 )                  | 204               | —                   | 204                   |
| Commercial & multifamily<br>residential: |                      |             |            |                         |                   |                     |                       |
| Income property                          | 382                  | —           | —          | (141 )                  | 241               | —                   | 241                   |
| Owner occupied                           | 108                  | —           | —          | (28 )                   | 80                | —                   | 80                    |
| Consumer                                 | 2,364                | (638 )      | 194        | 535                     | 2,455             | —                   | 2,455                 |
| Unallocated                              | 3,157                | —           | —          | (2,174 )                | 983               | —                   | 983                   |
| Total                                    | \$51,119             | \$(2,241 )  | \$820      | \$2,000                 | \$51,698          | \$839               | \$50,859              |
|  | Beginning<br>Balance | Charge-offs | Recoveries | Provision<br>(Recovery) | Ending<br>Balance | Specific<br>Reserve | General<br>Allocation |
| Six months ended June 30, 2013           | (in thousands)       |             |            |                         |                   |                     |                       |
| Noncovered loans:                        |                      |             |            |                         |                   |                     |                       |
| Commercial business:                     |                      |             |            |                         |                   |                     |                       |
| Secured                                  | \$27,270             | \$(1,844 )  | \$392      | \$4,754                 | \$30,572          | \$242               | \$30,330              |
| Unsecured                                | 753                  | (431 )      | 73         | 426                     | 821               | 51                  | 770                   |
| Real estate:                             |                      |             |            |                         |                   |                     |                       |
| One-to-four family residential           | 694                  | (144 )      | 141        | (19 )                   | 672               | 105                 | 567                   |
| Commercial & multifamily<br>residential: |                      |             |            |                         |                   |                     |                       |
| Commercial land                          | 460                  | (11 )       | 27         | 215                     | 691               | 262                 | 429                   |
| Income property                          | 11,033               | (818 )      | 106        | (626 )                  | 9,695             | 76                  | 9,619                 |
| Owner occupied                           | 6,362                | (568 )      | 44         | (1,323 )                | 4,515             | 30                  | 4,485                 |
| Real estate construction:                |                      |             |            |                         |                   |                     |                       |
| One-to-four family residential:          |                      |             |            |                         |                   |                     |                       |
| Land and acquisition                     | 1,171                | (32 )       | 2,174      | (2,544 )                | 769               | 73                  | 696                   |
| Residential construction                 | 635                  | (101 )      | 14         | (344 )                  | 204               | —                   | 204                   |
| Commercial & multifamily<br>residential: |                      |             |            |                         |                   |                     |                       |
| Income property                          | 316                  | —           | —          | (75 )                   | 241               | —                   | 241                   |
| Owner occupied                           | 102                  | —           | —          | (22 )                   | 80                | —                   | 80                    |
| Consumer                                 | 2,437                | (809 )      | 241        | 586                     | 2,455             | —                   | 2,455                 |

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|             |          |          |   |         |          |          |       |          |
|-------------|----------|----------|---|---------|----------|----------|-------|----------|
| Unallocated | 1,011    | —        | — | (28     | )        | 983      | —     | 983      |
| Total       | \$52,244 | \$(4,758 | ) | \$3,212 | \$ 1,000 | \$51,698 | \$839 | \$50,859 |

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Changes in the allowance for unfunded commitments and letters of credit, a component of other liabilities in the consolidated balance sheet, are summarized as follows:

|   | Three Months Ended |         | Six Months Ended |         |
|---|--------------------|---------|------------------|---------|
|   | June 30,<br>2014   | 2013    | June 30,<br>2014 | 2013    |
|   | (in thousands)     |         |                  |         |
| Balance at beginning of period  | \$2,455            | \$1,915 | \$2,505          | \$1,915 |
| Net changes in the allowance for unfunded commitments and letters of credit | (100               | ) 550   | (150             | ) 550   |
| Balance at end of period  | \$2,355            | \$2,465 | \$2,355          | \$2,465 |

**Risk Elements**

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

Risk ratings are reviewed and updated whenever appropriate, with more periodic reviews as the risk and dollar value of loss on the loan increases. In the event full collection of principal and interest is not reasonably assured, the loan is appropriately downgraded and, if warranted, placed on nonaccrual status even though the loan may be current as to principal and interest payments. Additionally, we assess whether an impairment of a loan warrants specific reserves or a write-down of the loan.

Pass loans are generally considered to have sufficient sources of repayment in order to repay the loan in full in accordance with all terms and conditions. Special mention loans have potential weaknesses that, if left uncorrected, may result in deterioration of the repayment prospects for the asset or in the Company's credit position at some future date. Loans with a risk rating of Substandard or worse are reported as classified loans in our allowance for loan and lease losses analysis. We review these loans to assess the ability of our borrowers to service all interest and principal obligations and, as a result, the risk rating may be adjusted accordingly. Substandard loans reflect loans where a loss is possible if loan weaknesses are not corrected. Doubtful loans have a high probability of loss, however, the amount of loss has not yet been determined. Loss loans are considered uncollectable and when identified, are charged off.

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The following is an analysis of the credit quality of our noncovered loan portfolio as of June 30, 2014 and December 31, 2013:

|   | Pass           | Special<br>Mention | Substandard | Doubtful | Loss | Total       |
|---|----------------|--------------------|-------------|----------|------|-------------|
| June 30, 2014                           | (in thousands) |                    |             |          |      |             |
| Noncovered loans:                       |                |                    |             |          |      |             |
| Commercial business:                    |                |                    |             |          |      |             |
| Secured                                 | \$1,572,391    | \$41,465           | \$43,920    | \$—      | \$—  | \$1,657,776 |
| Unsecured                               | 72,825         | 199                | 228         | —        | —    | 73,252      |
| Real estate:                            |                |                    |             |          |      |             |
| One-to-four family residential          | 95,647         | 55                 | 4,960       | —        | —    | 100,662     |
| Commercial and multifamily residential: |                |                    |             |          |      |             |
| Commercial land                         | 145,901        | —                  | 2,920       | —        | —    | 148,821     |
| Income property                         | 1,173,006      | 4,455              | 20,828      | —        | —    | 1,198,289   |
| Owner occupied                          | 742,585        | 2,996              | 8,940       | —        | —    | 754,521     |
| Real estate construction:               |                |                    |             |          |      |             |
| One-to-four family residential:         |                |                    |             |          |      |             |
| Land and acquisition                    | 9,758          | —                  | 1,722       | —        | —    | 11,480      |
| Residential construction                | 46,335         | —                  | 3,216       | —        | —    | 49,551      |
| Commercial and multifamily residential: |                |                    |             |          |      |             |
| Income property                         | 87,603         | —                  | —           | —        | —    | 87,603      |
| Owner occupied                          | 45,538         | 413                | —           | —        | —    | 45,951      |
| Consumer                                | 319,518        | 5                  | 5,245       | —        | —    | 324,768     |
| Total                                   | \$4,311,107    | \$49,588           | \$91,979    | \$—      | \$—  | 4,452,674   |
| Less:                                   |                |                    |             |          |      |             |
| Allowance for loan and lease losses     |                |                    |             |          |      | 49,494      |
| Noncovered loans, net                   |                |                    |             |          |      | \$4,403,180 |
|   | Pass           | Special<br>Mention | Substandard | Doubtful | Loss | Total       |
| December 31, 2013                       | (in thousands) |                    |             |          |      |             |
| Noncovered loans:                       |                |                    |             |          |      |             |
| Commercial business:                    |                |                    |             |          |      |             |
| Secured                                 | \$1,372,038    | \$43,309           | \$68,300    | \$—      | \$—  | \$1,483,647 |
| Unsecured                               | 72,226         | 199                | 179         | —        | —    | 72,604      |
| Real estate:                            |                |                    |             |          |      |             |
| One-to-four family residential          | 98,626         | 1,567              | 5,699       | —        | —    | 105,892     |
| Commercial and multifamily residential: |                |                    |             |          |      |             |
| Commercial land                         | 137,850        | —                  | 4,984       | —        | —    | 142,834     |
| Income property                         | 1,108,033      | 5,473              | 32,926      | —        | —    | 1,146,432   |
| Owner occupied                          | 748,725        | —                  | 11,884      | —        | —    | 760,609     |
| Real estate construction:               |                |                    |             |          |      |             |
| One-to-four family residential:         |                |                    |             |          |      |             |
| Land and acquisition                    | 7,526          | —                  | 4,144       | —        | —    | 11,670      |
| Residential construction                | 36,270         | 2,352              | 3,370       | —        | —    | 41,992      |
| Commercial and multifamily residential: |                |                    |             |          |      |             |

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|                                     |             |          |            |       |     |             |
|-------------------------------------|-------------|----------|------------|-------|-----|-------------|
| Income property                     | 86,206      | —        | 315        | —     | —   | 86,521      |
| Owner occupied                      | 38,916      | —        | —          | —     | —   | 38,916      |
| Consumer                            | 321,348     | 331      | 6,188      | 467   | —   | 328,334     |
| Total                               | \$4,027,764 | \$53,231 | \$ 137,989 | \$467 | \$— | 4,219,451   |
| Less:                               |             |          |            |       |     |             |
| Allowance for loan and lease losses |             |          |            |       |     | 52,280      |
| Noncovered loans, net               |             |          |            |       |     | \$4,167,171 |

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## 7. Changes in Noncovered Other Real Estate Owned (“OREO”)

The following tables set forth activity in noncovered OREO for the three and six months ended June 30, 2014 and 2013:

|  | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
|--|-----------------------------|----------|---------------------------|----------|
|  | 2014                        | 2013     | 2014                      | 2013     |
|  | (in thousands)              |          |                           |          |
| Noncovered OREO:   |                             |          |                           |          |
| Balance at beginning of period   | \$15,841                    | \$11,916 | \$23,834                  | \$10,676 |
| Established through acquisitions   | —                           | 14,708   | —                         | 14,708   |
| Transfers in, net of write-downs (\$0, \$11, \$0 and \$43, respectively) | 2,090                       | 2,067    | 2,334                     | 4,777    |
| Additional OREO write-downs  | (636 )                      | (477 )   | (1,565 )                  | (570 )   |
| Proceeds from sale of OREO property                                      | (2,196 )                    | (4,057 ) | (10,298 )                 | (5,622 ) |
| Gain on sale of OREO, net  | 104                         | 182      | 898                       | 370      |
| Total noncovered OREO at end of period                                   | \$15,203                    | \$24,339 | \$15,203                  | \$24,339 |

## 8. Covered Assets and FDIC Loss-sharing Asset

## Covered Assets

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

Ten years and forty-five days after the acquisition dates, the Bank must pay to the FDIC a clawback in the event the losses from the acquisitions fail to reach stated levels. The amount of the clawback is determined by a formula specified in each individual loss-sharing agreement. As of June 30, 2014, the net present value of the Bank’s estimated clawback liability is \$4.0 million, which is included in other liabilities on the consolidated balance sheets.

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The following is an analysis of our covered loans, net of related allowance for losses as of June 30, 2014 and December 31, 2013:

|  | June 30, 2014  | December 31,<br>2013 |
|--|----------------|----------------------|
| Covered loans:   | (in thousands) |                      |
| Commercial business                                      | \$60,287       | \$72,870             |
| Real estate:   |                |                      |
| One-to-four family residential                           | 36,711         | 41,642               |
| Commercial and multifamily residential                   | 153,765        | 170,879              |
| Total real estate  | 190,476        | 212,521              |
| Real estate construction:                                |                |                      |
| One-to-four family residential                           | 9,444          | 14,781               |
| Commercial and multifamily residential                   | 3,910          | 6,869                |
| Total real estate construction                           | 13,354         | 21,650               |
| Consumer   | 30,755         | 34,101               |
| Subtotal of covered loans                                | 294,872        | 341,142              |
| Less:  |                |                      |
| Valuation discount resulting from acquisition accounting | 32,971         | 43,297               |
| Allowance for loan losses                                | 19,801         | 20,174               |
| Covered loans, net of allowance for loan losses          | \$242,100      | \$277,671            |

Acquired impaired loans are accounted for under ASC 310-30 and initially measured at fair value based on expected future cash flows over the life of the loans. Acquired loans that have common risk characteristics are aggregated into pools. The Company remeasures contractual and expected cash flows, at the pool-level, on a quarterly basis.

Contractual cash flows are calculated based upon the loan pool terms after applying a prepayment factor. Calculation of the applied prepayment factor for contractual cash flows is the same as described below for expected cash flows. Inputs to the determination of expected cash flows include cumulative default and prepayment data as well as loss severity and recovery lag information. Cumulative default and prepayment data are calculated via a transition matrix. The transition matrix is a matrix of probability values that specifies the probability of a loan pool transitioning into a particular delinquency state (e.g. 0-30 days past due, 31 to 60 days, etc.) given its delinquency state at the remeasurement date. Loss severity factors are based upon either actual charge-off data within the loan pools or industry averages and recovery lags are based upon the collateral within the loan pools.

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

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

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



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The following table shows the changes in accretable yield for acquired loans for the three and six months ended June 30, 2014 and 2013:

|  | Three Months Ended June 30, |           | Six Months Ended June 30, |           |
|--|-----------------------------|-----------|---------------------------|-----------|
|  | 2014                        | 2013      | 2014                      | 2013      |
|  | (in thousands)              |           |                           |           |
| Balance at beginning of period                       | \$101,543                   | \$158,786 | \$103,907                 | \$166,888 |
| Accretion  | (10,055 )                   | (13,520 ) | (20,624 )                 | (27,997 ) |
| Disposals  | —                           | (1,998 )  | (2,826 )                  | 5,151     |
| Reclassifications (to) from nonaccretable difference | 1,023                       | (2,757 )  | 12,054                    | (3,531 )  |
| Balance at end of period                             | \$92,511                    | \$140,511 | \$92,511                  | \$140,511 |

During the three months ended June 30, 2014, the Company recorded a provision for losses on covered loans of \$1.5 million. Of this amount, \$1.7 million was impairment calculated in accordance with ASC 310-30 and \$200 thousand was a provision recapture to adjust the allowance for loss calculated under ASC 450-20 for draws on acquired loans. The impact to earnings of the \$1.5 million of provision for covered loans was partially offset through noninterest income by a \$1.2 million favorable adjustment to the change FDIC loss-sharing asset line item.

The changes in the ALLL for covered loans for the three and six months ended June 30, 2014 and 2013 are summarized as follows:

|                                       | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
|---------------------------------------|-----------------------------|----------|---------------------------|----------|
|                                       | 2014                        | 2013     | 2014                      | 2013     |
|                                       | (in thousands)              |          |                           |          |
| Balance at beginning of period        | \$20,129                    | \$29,489 | \$20,174                  | \$30,056 |
| Loans charged off                     | (3,842 )                    | (2,642 ) | (8,115 )                  | (5,024 ) |
| Recoveries                            | 1,997                       | 1,000    | 3,803                     | 1,835    |
| Provision (recapture) for loan losses | 1,517                       | (1,712 ) | 3,939                     | (732 )   |
| Balance at end of period              | \$19,801                    | \$26,135 | \$19,801                  | \$26,135 |

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The following is an analysis of the credit quality of our covered loan portfolio as of June 30, 2014 and December 31, 2013:

|  | Pass           | Special<br>Mention | Substandard | Doubtful | Loss | Total     |
|--|----------------|--------------------|-------------|----------|------|-----------|
| June 30, 2014  | (in thousands) |                    |             |          |      |           |
| Covered loans:   |                |                    |             |          |      |           |
| Commercial business:                                     |                |                    |             |          |      |           |
| Secured  | \$42,653       | \$1,151            | \$14,206    | \$7      | \$—  | \$58,017  |
| Unsecured  | 2,168          | —                  | 102         | —        | —    | 2,270     |
| Real estate:   |                |                    |             |          |      |           |
| One-to-four family residential                           | 31,618         | —                  | 5,093       | —        | —    | 36,711    |
| Commercial and multifamily residential:                  |                |                    |             |          |      |           |
| Commercial land  | 10,410         | —                  | 7,253       | —        | —    | 17,663    |
| Income property  | 56,858         | 3,220              | 7,695       | —        | —    | 67,773    |
| Owner occupied   | 61,344         | 362                | 6,623       | —        | —    | 68,329    |
| Real estate construction:                                |                |                    |             |          |      |           |
| One-to-four family residential:                          |                |                    |             |          |      |           |
| Land and acquisition                                     | 3,589          | —                  | 1,405       | —        | —    | 4,994     |
| Residential construction                                 | 420            | —                  | 4,030       | —        | —    | 4,450     |
| Commercial and multifamily residential:                  |                |                    |             |          |      |           |
| Income property  | 1,478          | —                  | 1,491       | —        | —    | 2,969     |
| Owner occupied   | 941            | —                  | —           | —        | —    | 941       |
| Consumer   | 27,531         | —                  | 3,224       | —        | —    | 30,755    |
| Total  | \$239,010      | \$4,733            | \$51,122    | \$7      | \$—  | 294,872   |
| Less:  |                |                    |             |          |      |           |
| Valuation discount resulting from acquisition accounting |                |                    |             |          |      | 32,971    |
| Allowance for loan losses                                |                |                    |             |          |      | 19,801    |
| Covered loans, net                                       |                |                    |             |          |      | \$242,100 |
|  | Pass           | Special<br>Mention | Substandard | Doubtful | Loss | Total     |
| December 31, 2013  | (in thousands) |                    |             |          |      |           |
| Covered loans:   |                |                    |             |          |      |           |
| Commercial business:                                     |                |                    |             |          |      |           |
| Secured  | \$48,510       | \$2,849            | \$18,291    | \$—      | \$—  | \$69,650  |
| Unsecured  | 2,732          | 396                | 92          | —        | —    | 3,220     |
| Real estate:   |                |                    |             |          |      |           |
| One-to-four family residential                           | 35,066         | 1,842              | 4,734       | —        | —    | 41,642    |
| Commercial and multifamily residential:                  |                |                    |             |          |      |           |
| Commercial land  | 10,778         | 198                | 7,589       | —        | —    | 18,565    |
| Income property  | 55,985         | 3,950              | 10,657      | —        | —    | 70,592    |
| Owner occupied   | 67,653         | 111                | 13,958      | —        | —    | 81,722    |
| Real estate construction:                                |                |                    |             |          |      |           |
| One-to-four family residential:                          |                |                    |             |          |      |           |
| Land and acquisition                                     | 4,674          | 2,739              | 1,936       | —        | —    | 9,349     |
| Residential construction                                 | 3,008          | —                  | 2,424       | —        | —    | 5,432     |

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Commercial and multifamily  
residential:

|  |           |          |          |      |     |           |
|--|-----------|----------|----------|------|-----|-----------|
| Income property  | 3,806     | —        | 1,709    | —    | —   | 5,515     |
| Owner occupied   | 1,074     | —        | 280      | —    | —   | 1,354     |
| Consumer   | 30,722    | 33       | 3,319    | 27   | —   | 34,101    |
| Total  | \$264,008 | \$12,118 | \$64,989 | \$27 | \$— | 341,142   |
| Less:  |           |          |          |      |     |           |
| Valuation discount resulting from acquisition accounting |           |          |          |      |     | 43,297    |
| Allowance for loan losses                                |           |          |          |      |     | 20,174    |
| Covered loans, net                                       |           |          |          |      |     | \$277,671 |

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The following table sets forth activity in covered OREO at carrying value for the three and six months ended June 30, 2014 and 2013:

|                                     | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
|-------------------------------------|-----------------------------|----------|---------------------------|----------|
|                                     | 2014                        | 2013     | 2014                      | 2013     |
|                                     | (in thousands)              |          |                           |          |
| Covered OREO:                       |                             |          |                           |          |
| Balance at beginning of period      | \$14,712                    | \$13,811 | \$12,093                  | \$16,311 |
| Transfers in                        | —                           | 3,125    | 5,507                     | 4,530    |
| Write-downs                         | (338)                       | (29)     | (989)                     | (94)     |
| Proceeds from sale of OREO property | (2,530)                     | (7,376)  | (5,634)                   | (13,814) |
| Net gain on sale of OREO            | 1,207                       | 3,323    | 2,074                     | 5,921    |
| Total covered OREO at end of period | \$13,051                    | \$12,854 | \$13,051                  | \$12,854 |

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

**FDIC Loss-sharing Asset**

At June 30, 2014, the FDIC loss-sharing asset is comprised of a \$25.0 million FDIC indemnification asset and a \$2.9 million FDIC receivable. The indemnification represents the cash flows the Company expects to collect from the FDIC under the loss-sharing agreements and the FDIC receivable represents the reimbursable amounts from the FDIC that have not yet been received.

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

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

The following table shows a detailed analysis of the FDIC loss-sharing asset for the three and six months ended June 30, 2014 and 2013:

|  | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
|--|-----------------------------|----------|---------------------------|----------|
|  | 2014                        | 2013     | 2014                      | 2013     |
|  | (in thousands)              |          |                           |          |
| Balance at beginning of period             | \$36,837                    | \$83,115 | \$39,846                  | \$96,354 |
| Adjustments not reflected in income:       |                             |          |                           |          |
| Cash payments from the FDIC                | (3,442)                     | (3,268)  | (1,765)                   | (6,387)  |
| FDIC reimbursable losses (recoveries), net | (364)                       | 664      | (231)                     | 1,027    |
| Adjustments reflected in income:           |                             |          |                           |          |
| Amortization, net                          | (5,764)                     | (9,801)  | (12,216)                  | (19,580) |
| Loan impairment (recapture)                | 1,214                       | (1,370)  | 3,151                     | (585)    |
| Sale of other real estate                  | (965)                       | (2,251)  | (1,721)                   | (3,597)  |
| Write-downs of other real estate           | 276                         | 102      | 792                       | 154      |
| Other                                      | 189                         | 183      | 125                       | (12)     |
| Balance at end of period                   | \$27,981                    | \$67,374 | \$27,981                  | \$67,374 |



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## 9. Goodwill and Other Intangible Assets

In accordance with the Intangibles – Goodwill and Other topic of the FASB ASC, goodwill is not amortized but is reviewed for potential impairment at the reporting unit level. Management analyzes its goodwill for impairment on an annual basis on July 31 and between annual tests in certain circumstances such as material adverse changes in legal, business, regulatory and economic factors. An impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value.

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

The following table sets forth activity for goodwill and other intangible assets for the periods indicated:

|  | Three Months Ended June 30, |           | Six Months Ended June 30, |           |
|--|-----------------------------|-----------|---------------------------|-----------|
|  | 2014                        | 2013      | 2014                      | 2013      |
|  | (in thousands)              |           |                           |           |
| Goodwill   |                             |           |                           |           |
| Goodwill at beginning of period                              | \$343,952                   | \$115,554 | \$343,952                 | \$115,554 |
| Established through acquisitions (1)                         | —                           | 228,398   | —                         | 228,398   |
| Total goodwill   | 343,952                     | 343,952   | 343,952                   | 343,952   |
| Other intangible assets, net                                 |                             |           |                           |           |
| Core deposit intangible:                                     |                             |           |                           |           |
| Gross core deposit intangible balance at beginning of period | 47,698                      | 32,441    | 47,698                    | 32,441    |
| Accumulated amortization at beginning of period              | (24,344)                    | (17,748)  | (22,765)                  | (16,720)  |
| Core deposit intangible, net at beginning of period          | 23,354                      | 14,693    | 24,933                    | 15,721    |
| Established through acquisitions (1)                         | —                           | 15,257    | —                         | 15,257    |
| CDI current period amortization                              | (1,481)                     | (1,693)   | (3,060)                   | (2,721)   |
| Total core deposit intangible, net at end of period          | 21,873                      | 28,257    | 21,873                    | 28,257    |
| Intangible assets not subject to amortization                | 919                         | 913       | 919                       | 913       |
| Other intangible assets, net at end of period                | 22,792                      | 29,170    | 22,792                    | 29,170    |
| Total goodwill and other intangible assets at end of period  | \$366,744                   | \$373,122 | \$366,744                 | \$373,122 |

(1) Goodwill established through acquisitions has been retrospectively adjusted for the prior year periods due to adjustments to provisional amounts made related to the West Coast acquisition. See Note 3, Business Combinations, for additional information regarding goodwill and intangible assets recorded related to the acquisition of West Coast on April 1, 2013.

The following table provides the estimated future amortization expense of core deposit intangibles for the remaining six months ending December 31, 2014 and the succeeding four years:

| Year ending December 31, | Amount<br>(in thousands) |
|--------------------------|--------------------------|
| 2014                     | \$2,903                  |
| 2015                     | 4,934                    |
| 2016                     | 4,195                    |
| 2017                     | 3,361                    |
| 2018                     | 2,500                    |

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## 10. Derivatives and Balance Sheet Offsetting

The Company periodically enters into certain commercial loan interest rate swap agreements in order to provide commercial loan customers the ability to convert from variable to fixed interest rates. Under these agreements, the Company enters into a variable-rate loan agreement with a customer in addition to a swap agreement. This swap agreement effectively converts the customer's variable rate loan into a fixed rate. The Company then enters into a corresponding swap agreement with a third party in order to offset its exposure on the variable and fixed components of the customer agreement. As the interest rate swap agreements with the customers and third parties are not designated as hedges under the Derivatives and Hedging topic of the FASB ASC, the instruments are marked to market in earnings. The notional amount of open interest rate swap agreements at June 30, 2014 and December 31, 2013 was \$208.3 million and \$179.5 million, respectively. There was no impact to the statement of income for the three month periods ending June 30, 2014 and 2013.

The following table presents the fair value of derivatives not designated as hedging instruments at June 30, 2014 and December 31, 2013:

|                         | Asset Derivatives      |                        | Liability Derivatives       |                            |            |
|-------------------------|------------------------|------------------------|-----------------------------|----------------------------|------------|
|                         | June 30, 2014          | December 31, 2013      | June 30, 2014               | December 31, 2013          |            |
| Balance Sheet Location  | Fair Value             | Balance Sheet Location | Fair Value                  | Balance Sheet Location     | Fair Value |
| (in thousands)          |                        |                        |                             |                            |            |
| Interest rate contracts | Other assets \$ 10,559 | Other assets \$ 9,044  | Other liabilities \$ 10,559 | Other liabilities \$ 9,044 |            |

The Company is party to interest rate swap agreements and repurchase agreements that are subject to enforceable master netting arrangements or similar agreements. Under these agreements, the Company may have the right to net settle multiple contracts with the same counterparty. The following tables show the gross interest rate swap agreements and repurchase agreements in the consolidated balance sheets and the respective collateral received or pledged in the form of other financial instruments, which are generally marketable securities. The collateral amounts in these tables are limited to the outstanding balances of the related asset or liability. Therefore, instances of overcollateralization are not shown.

|                              | Gross Amounts of Recognized Assets/Liabilities | Gross Amounts Offset in the Consolidated Balance Sheets | Net Amounts of Assets/Liabilities Presented in the Consolidated Balance Sheets | Gross Amounts Not Offset in the Consolidated Balance Sheets Collateral Posted | Net Amount |
|------------------------------|--|---|--|---|------------|
| June 30, 2014 (in thousands) |  |   |  |   |            |
| Assets                       |  |   |  |   |            |
| Interest rate contracts      | \$ 10,559                                      | \$—   | \$ 10,559  | \$—   | \$ 10,559  |
| Liabilities                  |  |   |  |   |            |
| Interest rate contracts      | \$ 10,559                                      | \$—   | \$ 10,559  | \$(10,559)  | \$—        |
| Repurchase agreements        | \$ 25,000                                      | \$—   | \$ 25,000  | \$(25,000)  | \$—        |
| December 31, 2013            |  |   |  |   |            |
| Assets                       |  |   |  |   |            |
| Interest rate contracts      | \$ 9,044                                       | \$—   | \$ 9,044   | \$—   | \$ 9,044   |
| Liabilities                  |  |   |  |   |            |
| Interest rate contracts      | \$ 9,044                                       | \$—   | \$ 9,044   | \$(9,044)   | \$—        |
| Repurchase agreements        | \$ 25,000                                      | \$—   | \$ 25,000  | \$(25,000)  | \$—        |

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11. Shareholders' Equity

**Preferred Stock.** In conjunction with the acquisition of West Coast, the Company issued 8,782 shares of mandatorily convertible cumulative participating preferred stock, Series B ("Series B Preferred Stock"). The Series B Preferred Stock is not subject to the operation of a sinking fund. The Series B Preferred Stock is not redeemable by the Company and is perpetual with no maturity. The holders of Series B Preferred Stock have no general voting rights. If the Company declares and pays a dividend to its common shareholders, it must declare and pay to its holders of Series B Preferred Stock, on the same date, a dividend in an amount per share of the Series B Preferred Stock that is intended to provide such holders dividends in the amount they would have received if shares of Series B Preferred Stock had been converted into common stock as of that date. The outstanding shares of Series B Preferred Stock are convertible into 102,363 shares of Company common stock.

**Warrants to Purchase Common Stock.** In conjunction with the acquisition of West Coast, the Company issued Amended and Restated Warrants (the "Warrants") to purchase shares of Company common stock at an exercise price of \$8.58 per share. The Company's Amended and Restated Warrants amended and restated Class C Warrants previously issued by West Coast. The Warrants were immediately exercisable and will expire on October 23, 2016. At June 30, 2014, the aggregate number of shares of Company common stock and value called for by warrants outstanding was 582,799 and \$5.0 million, respectively. This reflects the exercise of 1,631,840 warrant shares during the six month period ended June 30, 2014. As the warrants contain a cashless exercise feature, the net shares issued by the Company as a result of this exercise activity was 1,139,698.

**Dividends.** On January 23, 2014 the Company declared a quarterly cash dividend of \$0.12 per common share and common share equivalent for holders of preferred stock, payable on February 19, 2014 to shareholders of record at the close of business February 5, 2014. On April 23, 2014, the Company declared a regular quarterly cash dividend of \$0.12 per common share, and common share equivalent for holders of preferred stock, and a special, one-time cash dividend of \$0.12 per common share, and common share equivalent for holders of preferred stock, both payable on May 21, 2014 to shareholders of record at the close of business May 7, 2014. Subsequent to quarter end, on July 23, 2014, the Company declared a regular quarterly cash dividend of \$0.14 per common share, and common share equivalent for holders of preferred stock and a special, one-time cash dividend of \$0.14 per common share, and common share equivalent for holders of preferred stock, both payable on August 20, 2014 to shareholders of record at the close of business August 6, 2014. The payment of cash dividends is subject to federal regulatory requirements for capital levels and other restrictions. In addition, the cash dividends paid by Columbia Bank to the Company are subject to both federal and state regulatory requirements.



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## 12. Accumulated Other Comprehensive Income (Loss)

The following table shows changes in accumulated other comprehensive income (loss) by component for the three and six month periods ended June 30, 2014 and 2013:

|   | Unrealized Gains<br>and Losses on<br>Available-for-Sale<br>Securities (1)<br>(in thousands) |   | Unrealized Gains<br>and Losses on<br>Pension Plan<br>Liability (1) |   | Total (1)  |
|---|---|---|--|---|------------|
| Three months ended June 30, 2014  |   |   |  |   |            |
| Beginning balance   | \$ (3,131   | ) | \$ (1,912  | ) | \$ (5,043  |
| Other comprehensive income before reclassifications                             | 8,768   |   | —  |   | 8,768      |
| Amounts reclassified from accumulated other comprehensive loss <sup>(2)</sup>   | (189  | ) | 24   | ) | (165       |
| Net current-period other comprehensive income                                   | 8,579   |   | 24   |   | 8,603      |
| Ending balance  | \$ 5,448  |   | \$ (1,888  | ) | \$ 3,560   |
| Three months ended June 30, 2013  |   |   |  |   |            |
| Beginning balance   | \$ 18,185   |   | \$ (1,466  | ) | \$ 16,719  |
| Other comprehensive loss before reclassifications                               | (25,930   | ) | —  | ) | (25,930    |
| Amounts reclassified from accumulated other comprehensive income <sup>(2)</sup> | (59   | ) | 60   | ) | 1          |
| Net current-period other comprehensive income (loss)                            | (25,989   | ) | 60   | ) | (25,929    |
| Ending balance  | \$ (7,804   | ) | \$ (1,406  | ) | \$ (9,210  |
| Six months ended June 30, 2014  |   |   |  |   |            |
| Beginning balance   | \$ (10,108  | ) | \$ (1,936  | ) | \$ (12,044 |
| Other comprehensive income before reclassifications                             | 15,887  |   | —  |   | 15,887     |
| Amounts reclassified from accumulated other comprehensive income <sup>(2)</sup> | (331  | ) | 48   | ) | (283       |
| Net current-period other comprehensive income                                   | 15,556  |   | 48   |   | 15,604     |
| Ending balance  | \$ 5,448  |   | \$ (1,888  | ) | \$ 3,560   |
| Six months ended June 30, 2013  |   |   |  |   |            |
| Beginning balance   | \$ 20,918   |   | \$ (769  | ) | \$ 20,149  |
| Other comprehensive loss before reclassifications                               | (28,423   | ) | (756   | ) | (29,179    |
| Amounts reclassified from accumulated other comprehensive income <sup>(2)</sup> | (299  | ) | 119  | ) | (180       |
| Net current-period other comprehensive loss                                     | (28,722   | ) | (637   | ) | (29,359    |
| Ending balance  | \$ (7,804   | ) | \$ (1,406  | ) | \$ (9,210  |

(1) All amounts are net of tax. Amounts in parenthesis indicate debits.

(2) See following table for details about these reclassifications.

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The following table shows details regarding the reclassifications from accumulated other comprehensive income for the three month periods ended June 30, 2014 and 2013:

|  | Amount Reclassified from Accumulated Other Comprehensive Loss |         |                                |          | Affected line Item in the Consolidated Statement of Income |
|--|---|---------|--------------------------------|----------|--|
|  | Three Months Ended June 30, 2014                              |         | Six Months Ended June 30, 2013 |          |  |
|  |   |         |                                |          |  |
|  | (in thousands)  |         |                                |          |  |
| Unrealized gains and losses on available-for-sale securities |   |         |                                |          |  |
| Investment securities gains                                  | \$296   | \$92    | \$519                          | \$462    | Investment securities gains, net                           |
|  | 296   | 92      | 519                            | 462      | Total before tax   |
|  | (107  | ) (33   | ) (188                         | ) (163   | ) Income tax provision                                     |
|  | \$189   | \$59    | \$331                          | \$299    | Net of tax   |
| Amortization of pension plan liability                       |   |         |                                |          |  |
| Actuarial losses   | \$(37   | ) \$(92 | ) \$(74                        | ) \$(184 | ) Compensation and employee benefits                       |
|  | (37   | ) (92   | ) (74                          | ) (184   | ) Total before tax   |
|  | 13  | 32      | 26                             | 65       | Income tax benefit   |
|  | \$(24   | ) \$(60 | ) \$(48                        | ) \$(119 | ) Net of tax   |

### 13. Fair Value Accounting and Measurement

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

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

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

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

Fair values are determined as follows:

Securities at fair value are priced using a combination of market activity, industry recognized information sources, yield curves, discounted cash flow models and other factors. These fair value calculations are considered a Level 2 input method under the provisions of the Fair Value Measurements and Disclosures topic of the FASB ASC for all securities other than U.S. Treasury notes, which are considered a Level 1 input method.

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



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The following table sets forth the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis at June 30, 2014 and December 31, 2013 by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

|   | Fair value<br>(in thousands) | Fair Value Measurements at Reporting Date Using |             |         |
|---|------------------------------|---|-------------|---------|
|   |                              | Level 1   | Level 2     | Level 3 |
| June 30, 2014   | (in thousands)               |   |             |         |
| Assets  |                              |   |             |         |
| Securities available for sale:  |                              |   |             |         |
| U.S. government agency and government-sponsored enterprise mortgage-back securities and collateralized mortgage obligations | \$862,618                    | \$—   | \$862,618   | \$—     |
| State and municipal debt securities   | 380,506                      | —   | 380,506     | —       |
| U.S. government agency and government-sponsored enterprise securities   | 321,389                      | —   | 321,389     | —       |
| U.S. government securities  | 20,337                       | 20,337  | —           | —       |
| Other securities  | 5,167                        | —   | 5,167       | —       |
| Total securities available for sale   | \$1,590,017                  | \$20,337  | \$1,569,680 | \$—     |
| Other assets (Interest rate contracts)  | \$10,559                     | \$—   | \$10,559    | \$—     |
| Liabilities   |                              |   |             |         |
| Other liabilities (Interest rate contracts)   | \$10,559                     | \$—   | \$10,559    | \$—     |
| December 31, 2013   | (in thousands)               |   |             |         |
| Assets  |                              |   |             |         |
| Securities available for sale:  |                              |   |             |         |
| U.S. government agency and government-sponsored enterprise mortgage-back securities and collateralized mortgage obligations | \$948,408                    | \$—   | \$948,408   | \$—     |
| State and municipal debt securities   | 364,470                      | —   | 364,470     | —       |
| U.S. government agency and government-sponsored enterprise securities   | 326,039                      | —   | 326,039     | —       |
| U.S. government securities  | 20,114                       | 20,114  | —           | —       |
| Other securities  | 5,080                        | —   | 5,080       | —       |
| Total securities available for sale   | \$1,664,111                  | \$20,114  | \$1,643,997 | \$—     |
| Other assets (Interest rate contracts)  | \$9,044                      | \$—   | \$9,044     | \$—     |
| Liabilities   |                              |   |             |         |
| Other liabilities (Interest rate contracts)   | \$9,044                      | \$—   | \$9,044     | \$—     |

There were no transfers between Level 1 and Level 2 of the valuation hierarchy during the six month periods ended June 30, 2014 and 2013. The Company recognizes transfers between levels of the valuation hierarchy based on the valuation level at the end of the reporting period.

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## Nonrecurring Measurements

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

**Impaired loans**—A loan is considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due (both interest and principal) according to the contractual terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, a loan's observable market price, or the fair market value of the collateral less estimated costs to sell if the loan is a collateral-dependent loan. Generally, the Company utilizes the fair market value of the collateral to measure impairment. The impairment evaluations are performed in conjunction with the ALLL process on a quarterly basis by officers in the Special Credits group, which reports to the Chief Credit Officer. The Real Estate Appraisal Services Department ("REASD"), which also reports to the Chief Credit Officer, is responsible for obtaining appraisals from third-parties or performing internal evaluations. If an appraisal is obtained from a third-party, the REASD reviews the appraisal to evaluate the adequacy of the appraisal report, including its scope, methods, accuracy, and reasonableness.

**Other real estate owned and other personal property owned ("OPPO")**—OREO and OPPO are real and personal property that the Bank has taken ownership of in partial or full satisfaction of a loan or loans. OREO and OPPO are generally measured based on the item's fair market value as indicated by an appraisal or a letter of intent to purchase. OREO and OPPO are recorded at the lower of carrying amount or fair value less estimated costs to sell. This amount becomes the property's new basis. Any write-downs based on the property fair value less estimated costs to sell at the date of acquisition are charged to the allowance for loan and lease losses. Management periodically reviews OREO and OPPO in an effort to ensure the property is carried at the lower of its new basis or fair value, net of estimated costs to sell. Any write-downs subsequent to acquisition are charged to earnings. The initial and subsequent write-down evaluations are performed by officers in the Special Credits group, which reports to the Chief Credit Officer. The REASD obtains appraisals from third-parties for OREO and OPPO and performs internal evaluations. If an appraisal is obtained from a third-party, the REASD reviews the appraisal to evaluate the adequacy of the appraisal report, including its scope, methods, accuracy, and reasonableness.

The following tables set forth the Company's assets that were measured using fair value estimates on a nonrecurring basis during the three and six month periods ended June 30, 2014 and 2013:

|                 | Fair value at<br>June 30, 2014 | Fair Value Measurements at Reporting Date |         |          | Using<br>Losses During the<br>Three Months Ended<br>June 30, 2014 | Losses During<br>the<br>Six Months Ended<br>June 30, 2014 |
|-----------------|--------------------------------|---|---------|----------|---|---|
|                 |                                | Level 1                                   | Level 2 | Level 3  |   |   |
|                 | (in thousands)                 |   |         |          |   |   |
| Noncovered OREO | \$ 1,389                       | \$ —                                      | \$ —    | \$ 1,389 | \$ 636  | \$ 1,180  |
| Covered OREO    | 1,837                          | —   | —       | 1,837    | 226   | 422   |
|                 | \$ 3,226                       | \$ —                                      | \$ —    | \$ 3,226 | \$ 862  | \$ 1,602  |
|                 | Fair value at<br>June 30, 2013 | Fair Value Measurements at Reporting Date |         |          | Using<br>Losses During the<br>Three Months Ended<br>June 30, 2013 | Losses During the<br>Six Months Ended<br>June 30, 2013    |
|                 |                                | Level 1                                   | Level 2 | Level 3  |   |   |
|                 | (in thousands)                 |   |         |          |   |   |
| Impaired loans  | \$ 4,198                       | \$ —                                      | \$ —    | \$ 4,198 | \$ 656  | \$ 730  |
| Noncovered OREO | 1,965                          | —   | —       | 1,965    | 469   | 500   |
| Covered OREO    | 395                            | —   | —       | 395      | 29  | 94  |
|                 | \$ 6,558                       | \$ —                                      | \$ —    | \$ 6,558 | \$ 1,154  | \$ 1,324  |

The losses on impaired loans disclosed above represent the amount of the specific reserve and/or charge-offs during the period applicable to loans held at period end. The amount of the specific reserve is included in the allowance for

loan and lease losses. The losses on OREO and OPPO disclosed above represent the write-downs taken at foreclosure that were charged to the allowance for loan and lease losses, as well as subsequent write-downs from updated appraisals that were charged to earnings.

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## Quantitative information about Level 3 fair value measurements

The range and weighted-average of the significant unobservable inputs used to fair value our Level 3 nonrecurring assets, along with the valuation techniques used, are shown in the following table:

|                 | Fair value at<br>June 30, 2014<br>(dollars in thousands) | Valuation<br>Technique             | Unobservable<br>Input            | Range (Weighted<br>Average) (1) |
|-----------------|--|------------------------------------|----------------------------------|---------------------------------|
| Noncovered OREO | \$1,389  | Fair Market Value<br>of Collateral | Adjustment to<br>Appraisal Value | N/A (2)                         |
| Covered OREO    | 1,837  | Fair Market Value<br>of Collateral | Adjustment to<br>Appraisal Value | N/A (2)                         |

(1) Discount applied to appraisal value, letter of intent to purchase, or stated value (in the case of accounts receivable, inventory and equipment).

(2) Quantitative disclosures are not provided for noncovered OREO and covered OREO because there were no adjustments made to the appraisal value during the current period.

|                                       | Fair value at<br>June 30, 2013<br>(dollars in thousands) | Valuation<br>Technique             | Unobservable<br>Input            | Range (Weighted<br>Average) (1) |
|---------------------------------------|--|------------------------------------|----------------------------------|---------------------------------|
| Impaired loans                        | \$3,777  | Fair Market Value<br>of Collateral | Adjustment to<br>Appraisal Value | N/A (2)                         |
| Impaired loans - other collateral (3) | 421  | Fair Market Value<br>of Collateral | Adjustment to<br>Stated value    | (50%) (4)                       |
| Noncovered OREO                       | 1,965  | Fair Market Value<br>of Collateral | Adjustment to<br>Appraisal Value | N/A (2)                         |
| Covered OREO                          | 395  | Fair Market Value<br>of Collateral | Adjustment to<br>Appraisal Value | N/A (2)                         |

(1) Discount applied to appraisal value, letter of intent to purchase, or stated value (in the case of accounts receivable, inventory and equipment).

(2) Quantitative disclosures are not provided for impaired loans collateralized by real estate, noncovered OREO and covered OREO because there were no adjustments made to the appraisal value during the current period.

(3) Other collateral consists of accounts receivable and inventory.

(4) As there was only one impaired loan collateralized by other collateral, a range of discounts could not be provided.

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## Fair value of financial instruments

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

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

Cash and due from banks and interest-earning deposits with banks—The fair value of financial instruments that are short-term or reprice frequently and that have little or no risk are considered to have a fair value that approximates carrying value (Level 1).

Securities available for sale—Securities at fair value, other than U.S. Treasury Notes, are priced using a combination of market activity, industry recognized information sources, yield curves, discounted cash flow models and other factors (Level 2). U.S. Treasury Notes are priced using quotes in active markets (Level 1).

Federal Home Loan Bank stock—The fair value is based upon the par value of the stock which equates to its carrying value (Level 2).

Loans—Loans are not recorded at fair value on a recurring basis. Nonrecurring fair value adjustments are periodically recorded on impaired loans that are measured for impairment based on the fair value of collateral. For most performing loans, fair value is estimated using expected duration and lending rates that would have been offered on June 30, 2014 or December 31, 2013, for loans which mirror the attributes of the loans with similar rate structures and average maturities. The fair values resulting from these calculations are reduced by an amount representing the change in estimated fair value attributable to changes in borrowers' credit quality since the loans were originated. For nonperforming loans, fair value is estimated by applying a valuation discount based upon loan sales data from the FDIC. For covered loans, fair value is estimated by discounting the expected future cash flows using a lending rate that would have been offered on June 30, 2014 (Level 3).

FDIC loss-sharing asset —The fair value of the FDIC loss-sharing asset is estimated based on discounting the expected future cash flows using an estimated market rate (Level 3).

Interest rate contracts—Interest rate swap positions are valued in models, which use readily observable market parameters as their basis (Level 2).

Deposits—For deposits with no contractual maturity, the fair value is equal to the carrying value (Level 1). The fair value of fixed maturity deposits is based on discounted cash flows using the difference between the deposit rate and current market rates for deposits of similar remaining maturities (Level 2).

FHLB advances—The fair value of Federal Home Loan Bank of Seattle (the "FHLB") advances is estimated based on discounting the future cash flows using the market rate currently offered (Level 2).

Repurchase Agreements—The fair value of securities sold under agreement to repurchase is estimated based on discounting the future cash flows using the market rate currently offered (Level 2).

Other Financial Instruments—The majority of our commitments to extend credit and standby letters of credit carry current market interest rates if converted to loans, as such, carrying value is assumed to equal fair value.



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The following tables summarize carrying amounts and estimated fair values of selected financial instruments as well as assumptions used by the Company in estimating fair value at June 30, 2014 and December 31, 2013:

|                                      | June 30, 2014                        |               |              |            |           |
|--------------------------------------|--------------------------------------|---------------|--------------|------------|-----------|
|                                      | Carrying<br>Amount<br>(in thousands) | Fair<br>Value | Level 1      | Level 2    | Level 3   |
| <b>Assets</b>                        |                                      |               |              |            |           |
| Cash and due from banks              | \$ 193,816                           | \$ 193,816    | \$ 193,816   | \$—        | \$—       |
| Interest-earning deposits with banks | 30,646                               | 30,646        | 30,646       | —          | —         |
| Securities available for sale        | 1,590,017                            | 1,590,017     | 20,338       | 1,569,679  | —         |
| FHLB stock                           | 31,912                               | 31,912        | —            | 31,912     | —         |
| Loans                                | 4,645,280                            | 4,790,933     | —            | —          | 4,790,933 |
| FDIC loss-sharing asset              | 27,981                               | 9,502         | —            | —          | 9,502     |
| Interest rate contracts              | 10,559                               | 10,559        | —            | 10,559     | —         |
| <b>Liabilities</b>                   |                                      |               |              |            |           |
| Deposits                             | \$ 5,985,069                         | \$ 5,983,825  | \$ 5,513,961 | \$ 469,864 | \$—       |
| FHLB Advances                        | 110,587                              | 111,060       | —            | 111,060    | —         |
| Repurchase agreements                | 25,000                               | 26,231        | —            | 26,231     | —         |
| Interest rate contracts              | 10,559                               | 10,559        | —            | 10,559     | —         |
|                                      | December 31, 2013                    |               |              |            |           |
|                                      | Carrying<br>Amount<br>(in thousands) | Fair<br>Value | Level 1      | Level 2    | Level 3   |
| <b>Assets</b>                        |                                      |               |              |            |           |
| Cash and due from banks              | \$ 165,030                           | \$ 165,030    | \$ 165,030   | \$—        | \$—       |
| Interest-earning deposits with banks | 14,531                               | 14,531        | 14,531       | —          | —         |
| Securities available for sale        | 1,664,111                            | 1,664,111     | 20,114       | 1,643,997  | —         |
| FHLB stock                           | 32,529                               | 32,529        | —            | 32,529     | —         |
| Loans held for sale                  | 735                                  | 735           | —            | 735        | —         |
| Loans                                | 4,444,842                            | 4,605,038     | —            | —          | 4,605,038 |
| FDIC loss-sharing asset              | 39,846                               | 11,248        | —            | —          | 11,248    |
| Interest rate contracts              | 9,044                                | 9,044         | —            | 9,044      | —         |
| <b>Liabilities</b>                   |                                      |               |              |            |           |
| Deposits                             | \$ 5,959,475                         | \$ 5,958,747  | \$ 5,449,546 | \$ 509,201 | \$—       |
| FHLB Advances                        | 36,606                               | 35,080        | —            | 35,080     | —         |
| Repurchase agreements                | 25,000                               | 26,361        | —            | 26,361     | —         |
| Interest rate contracts              | 9,044                                | 9,044         | —            | 9,044      | —         |

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## 14. Earnings per Common Share

The Company applies the two-class method of computing basic and diluted EPS. Under the two-class method, EPS is determined for each class of common stock and participating security according to dividends declared and participation rights in undistributed earnings. The Company issues restricted shares under share-based compensation plans and preferred shares which qualify as participating securities.

The following table sets forth the computation of basic and diluted earnings per share for the three and six months ended June 30, 2014 and 2013:

|   | Three Months Ended              |          | Six Months Ended |          |
|---|---------------------------------|----------|------------------|----------|
|   | June 30,                        | 2013     | June 30,         | 2013     |
|   | 2014                            |          | 2014             |          |
|   | (in thousands except per share) |          |                  |          |
| Basic EPS:  |                                 |          |                  |          |
| Net income  | \$21,227                        | \$14,591 | \$41,071         | \$26,767 |
| Less: Earnings allocated to participating securities  |                                 |          |                  |          |
| Preferred shares  | 41                              | 29       | 79               | 30       |
| Nonvested restricted shares   | 206                             | 124      | 378              | 244      |
| Earnings allocated to common shareholders   | \$20,980                        | \$14,438 | \$40,614         | \$26,493 |
| Weighted average common shares outstanding  | 52,088                          | 50,788   | 51,600           | 45,099   |
| Basic earnings per common share   | \$0.40                          | \$0.28   | \$0.79           | \$0.59   |
| Diluted EPS:  |                                 |          |                  |          |
| Earnings allocated to common shareholders (1)   | \$20,981                        | \$14,441 | \$40,617         | \$26,495 |
| Weighted average common shares outstanding  | 52,088                          | 50,788   | 51,600           | 45,099   |
| Dilutive effect of equity awards  | 406                             | 1,337    | 863              | 659      |
| Weighted average diluted common shares outstanding  | 52,494                          | 52,125   | 52,463           | 45,758   |
| Diluted earnings per common share   | \$0.40                          | \$0.28   | \$0.77           | \$0.58   |
| Potentially dilutive share options that were not included in the computation of diluted EPS because to do so would be anti-dilutive | 63                              | 143      | 73               | 76       |

(1) Earnings allocated to common shareholders for basic and diluted EPS may differ under the two-class method as a result of adding common stock equivalents for options and warrants to dilutive shares outstanding, which alters the ratio used to allocate earnings to common shareholders and participating securities for the purposes of calculating diluted EPS.

## 15. Subsequent Event

On July 23, 2014, we entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Intermountain Community Bancorp, an Idaho corporation (“Intermountain”). The Merger Agreement provides that, upon the terms and subject to the conditions set forth therein, Intermountain will merge with and into Columbia (the “Merger”), with Columbia continuing as the surviving corporation. Immediately after the Merger, Panhandle State Bank, an Idaho state-chartered bank and wholly-owned subsidiary of Intermountain, will merge with and into our wholly-owned subsidiary, Columbia Bank. The closing of the transaction is subject to the satisfaction of certain customary conditions, including, among other things, the receipt of required regulatory approvals and the approval of Intermountain’s shareholders. Under the terms of the merger agreement, Intermountain shareholders are entitled to receive in respect of each share of Intermountain common stock, consideration in the form of cash, Columbia common stock or a unit consisting of a mix of 0.6426 of a share of Columbia common stock and \$2.2930 in cash. Based on Columbia’s closing stock price as of July 23, 2014, the merger consideration was valued at \$121.5 million, or approximately \$18.22 per Intermountain share. The value of the merger consideration will fluctuate based on the value of Columbia’s stock until closing.



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

This discussion should be read in conjunction with the unaudited consolidated financial statements of Columbia Banking System, Inc. (referred to in this report as "we", "our", "Columbia" and "the Company") and notes thereto presented elsewhere in this report and with the December 31, 2013 audited consolidated financial statements and its accompanying notes included in our Annual Report on Form 10-K. In the following discussion, unless otherwise noted, references to increases or decreases in average balances in items of income and expense for a particular period and balances at a particular date refer to the comparison with corresponding amounts for the period or date one year earlier.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

- local and national economic conditions could be less favorable than expected or could have a more direct and pronounced effect on us than expected and adversely affect our ability to continue internal growth and maintain the quality of our earning assets;
- the local housing/real estate markets where we operate and make loans could face challenges;
- the risks presented by an uncertain economy, which could adversely affect credit quality, collateral values, including real estate collateral, investment values, liquidity and loan originations and loan portfolio delinquency rates;
- the efficiencies and enhanced financial and operating performance we expect to realize from investments in personnel, acquisitions (including the proposed Intermountain merger) and infrastructure may not be realized;
- the possibility that the proposed merger with Intermountain does not close in a timely manner or at all because required regulatory, shareholder or other approvals and other conditions to closing are not received or satisfied on a timely basis or at all;
- the effect on the trading price of our stock if the merger with Intermountain is not completed;
- the ability to successfully combine Columbia and the Intermountain organizations;
- interest rate changes could significantly reduce net interest income and negatively affect funding sources;
- projected business increases following strategic expansion or opening of new branches could be lower than expected;
- changes in the scope and cost of Federal Deposit Insurance Corporation ("FDIC") insurance and overall regulatory costs;
- the impact of acquired loans on our earnings;
- changes in accounting principles, policies, and guidelines applicable to bank holding companies and banking;
- competition among financial institutions could increase significantly;
- continued consolidation in the Pacific Northwest financial services industry resulting in the creation of larger financial institutions who may have greater resources could change the competitive landscape;
- the goodwill we have recorded in connection with acquisitions could become impaired, which may have an adverse impact on our earnings and capital;
- the reputation of the financial services industry could deteriorate, which could adversely affect our ability to access markets for funding and to acquire and retain customers;
- our ability to effectively manage credit risk, interest rate risk, market risk, operational risk, legal risk, liquidity risk and regulatory and compliance risk; and
- our profitability measures could be adversely affected if we are unable to effectively manage our capital.

You should take into account that forward-looking statements speak only as of the date of this report. Given the described uncertainties and risks, we cannot guarantee our future performance or results of operations and you should not place undue reliance on these forward-looking statements. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required under federal securities laws.

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**CRITICAL ACCOUNTING POLICIES**

Management has identified the accounting policies related to the allowance for loan and lease losses, business combinations, acquired impaired loans, FDIC loss sharing asset and the valuation and recoverability of goodwill as critical to an understanding of our financial statements. These policies and related estimates are discussed in “Item 7. Management Discussion and Analysis of Financial Condition and Results of Operation” under the headings “Allowance for Loan and Lease Losses”, “Business Combinations”, “Acquired Impaired Loans”, “FDIC Loss Sharing Asset” and “Valuation and Recoverability of Goodwill” in our 2013 Annual Report on Form 10-K. There have not been any material changes in our critical accounting policies as compared to those disclosed in our 2013 Annual Report on Form 10-K.

**RESULTS OF OPERATIONS**

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

On April 1, 2013, the Company completed its acquisition of West Coast. The Company acquired approximately \$2.63 billion in assets, including \$1.41 billion in loans measured at fair value, and approximately \$1.88 billion in deposits. Due to the timing of this acquisition, our results of operations for the six month period ended June 30, 2014 include the acquisition for the full six month period, however the prior year period only includes the acquisition for three months of the six month period. See Note 3 to the Consolidated Financial Statements in “Item 1. Financial Statements (unaudited)” of this report for further information regarding this acquisition.

**Earnings Summary**

The Company reported net income for the second quarter of \$21.2 million or \$0.40 per diluted common share, compared to \$14.6 million or \$0.28 per diluted common share for the second quarter of 2013. For the first six months of 2014, the Company reported net income of \$41.1 million, or \$0.77 per diluted common share, compared to \$26.8 million, or \$0.58 per diluted common share, for the first six months of 2013.

The increase in net income for the current quarter compared to the prior year period was due to a combination of higher noninterest income and lower noninterest expense, partially offset by a decrease in net interest income. The increase in net income for the first six months of 2014 compared to the same prior year period was due to higher net interest income and higher noninterest income, partially offset by higher noninterest expense.

**Comparison of current quarter to prior year period**

Revenue (net interest income plus noninterest income) for the three months ended June 30, 2014 was \$89.8 million, 3% more than the same period in 2013. The increase in revenue was a result of higher noninterest income due to a decrease in the expense recorded for the change in the FDIC loss-sharing asset, partially offset by a decrease in loan interest income as a result of lower incremental accretion on the acquired loan portfolios. For a more complete discussion of these topics, please refer to the net interest income and noninterest income sections contained in the ensuing pages.

The provision for loan and lease losses for the second quarter of 2014 was \$600 thousand for the noncovered loan portfolio and \$1.5 million for the covered loan portfolio compared to a provision of \$2.0 million for the noncovered loan portfolio and a provision recapture of \$1.7 million for the covered loan portfolio during the second quarter of 2013. The small provision for the noncovered portfolio was primarily due to net charge-offs for the period, partially offset by improving asset quality metrics, and the provision for the covered loan portfolio was primarily due to a decrease in the expected present value of future cash flows as remeasured during the current quarter when compared to the prior quarter’s remeasurement.

Total noninterest expense for the quarter ended June 30, 2014 was \$57.8 million, down from \$64.5 million for the second quarter of 2013. The decrease from the prior-year period was primarily due to higher acquisition-related expenses recorded during the second quarter of 2013. For a more complete discussion of this topic, please refer to the noninterest expense section contained in the ensuing pages.



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Net income was negatively affected by the pre-tax earnings impact of the FDIC acquired loan portfolios for both the current and prior year periods. The negative effect of the FDIC acquired loan portfolios was larger in the prior year period primarily due to greater amortization of the FDIC loss-sharing asset recorded in the prior year period. The following table illustrates the impact to earnings associated with the Company's FDIC acquired loan portfolios for the periods indicated:

|  | Three Months Ended June 30, |            | Six Months Ended June 30, |            |
|--|-----------------------------|------------|---------------------------|------------|
|  | 2014                        | 2013       | 2014                      | 2013       |
|  | ( in thousands)             |            |                           |            |
| Incremental accretion income on FDIC acquired loans      | \$5,829                     | \$8,475    | \$12,522                  | \$17,920   |
| Recapture (provision) for losses on covered loans        | (1,517 )                    | 1,712      | (3,939 )                  | 732        |
| Change in FDIC loss-sharing asset <sup>(1)</sup>         | (5,050 )                    | (13,137 )  | (9,869 )                  | (23,620 )  |
| FDIC clawback liability recovery (expense)               | 103                         | (199 )     | (101 )                    | (430 )     |
| Pre-tax earnings impact of FDIC acquired loan portfolios | \$(635 )                    | \$(3,149 ) | \$(1,387 )                | \$(5,398 ) |

(1) For additional information on the FDIC loss-sharing asset, please see the "FDIC Loss-sharing Asset" section of Management's Discussion and Analysis and Note 8 to the Consolidated Financial Statements in "Item 1. Financial Statements (unaudited)" of this report.

#### Comparison of current year-to-date to prior year period

Revenue (net interest income plus noninterest income) for the six months ended June 30, 2014 was \$177.7 million, compared to \$141.9 million for the same period in 2013. The increase in revenue was a result of higher net interest income and higher noninterest income primarily due to the timing of the acquisition of West Coast in the middle of the prior year period. For a more complete discussion of this topic, please refer to the net interest income section and noninterest income sections contained in the ensuing pages.

The provision for loan and lease losses for the six months ended June 30, 2014 was \$100 thousand for the noncovered loan portfolio and a provision of \$3.9 million for the covered loan portfolio compared to a provision of \$1.0 million for the noncovered loan portfolio and a provision recapture of \$732 thousand for the covered loan portfolio during the first six months of 2013. The \$100 thousand provision for the noncovered loan portfolio was driven by net charge offs experienced during the period, partially offset by improving credit metrics within the noncovered loan portfolio. The \$3.9 million in provision for losses on covered loans was primarily due to a decrease in the present value of expected future cash flows as remeasured during the current period when compared to the prior period's remeasurement.

Total noninterest expense for the six months ended June 30, 2014 was \$115.2 million, a 12% increase from the first six months of 2013. The increase from the prior-year period was primarily due to the timing of the West Coast acquisition being in the middle of the prior year period. For a more complete discussion of this topic, please refer to the noninterest expense section contained in the ensuing pages.

#### Net Interest Income

##### Comparison of current quarter to prior year period

Net interest income for the second quarter of 2014 was \$75.1 million, a decrease of 6% from \$80.0 million for the same quarter in 2013. The decrease in net interest income was due to lower incremental accretion income on acquired loans. For additional information on the Company's accounting policies related to recording interest income on loans, please refer to "Item 8. Financial Statements and Supplementary Data" in our 2013 Annual Report on Form 10-K.

The Company's net interest margin (tax equivalent) decreased to 4.86% in the second quarter of 2014, from 5.19% for the same quarter last year. This decrease was also due to lower incremental accretion income on acquired loan portfolios. The Company's operating net interest margin (tax equivalent) decreased modestly to 4.27% from 4.34% due to lower rates on loans.



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## Comparison of current year-to-date to prior year period

Net interest income for the six months ended June 30, 2014 was \$149.1 million, an increase of 12% from \$133.5 million for the same period in 2013. The increase in net interest income was primarily due to higher average loan balances during the current year as the acquisition of West Coast occurred in the middle of the prior year six month period. The Company's net interest margin (tax equivalent) decreased to 4.86% for the first six months of 2014, from 5.13% for the prior year period. The decrease in the Company's net interest margin (tax equivalent) was primarily due to lower accretion income on the acquired loan portfolios. As shown in the table below, the Company recorded \$23.6 million in total incremental accretion during the six months ended June 30, 2014, a decrease of \$3.9 million from the prior year period. The Company's operating net interest margin (tax equivalent) for the six months ended June 30, 2014 decreased modestly to 4.23% from 4.28% due to lower rates on loans.

The following table shows the impact to interest income of incremental accretion income as well as the net interest margin and operating net interest margin for the periods presented:

|   | Three Months Ended June 30, |          | Six Months Ended June 30, |          |   |
|---|-----------------------------|----------|---------------------------|----------|---|
|   | 2014                        | 2013     | 2014                      | 2013     |   |
|   | (dollars in thousands)      |          |                           |          |   |
| Incremental accretion income due to:                          |                             |          |                           |          |   |
| FDIC acquired impaired loans                                  | \$5,734                     | \$7,837  | \$12,223                  | \$16,212 |   |
| Other FDIC acquired loans                                     | 95                          | 638      | 299                       | 1,708    |   |
| Other acquired loans  | 5,481                       | 9,635    | 11,096                    | 9,635    |   |
| Incremental accretion income                                  | \$11,310                    | \$18,110 | \$23,618                  | \$27,555 |   |
| Net interest margin (tax equivalent)                          | 4.86                        | % 5.19   | % 4.86                    | % 5.13   | % |
| Operating net interest margin (tax equivalent) <sup>(1)</sup> | 4.27                        | % 4.34   | % 4.23                    | % 4.28   | % |

(1) Operating net interest margin (tax equivalent) is a non-GAAP measurement. See Non-GAAP measures section of Item 2, Management's Discussion and Analysis.

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

|  | Three Months Ended June 30,<br>2014 |                           |                 | Three Months Ended June 30,<br>2013 |                           |                 |
|--|-------------------------------------|---------------------------|-----------------|-------------------------------------|---------------------------|-----------------|
|  | Average<br>Balances                 | Interest<br>Earned / Paid | Average<br>Rate | Average<br>Balances                 | Interest<br>Earned / Paid | Average<br>Rate |
|  | (dollars in thousands)              |                           |                 |                                     |                           |                 |
| <b>ASSETS</b>  |                                     |                           |                 |                                     |                           |                 |
| Loans, excluding covered loans,<br>net <sup>(1) (3)</sup>      | \$4,373,439                         | \$56,807                  | 5.20 %          | \$4,192,519                         | \$60,881                  | 5.81 %          |
| Covered loans, net <sup>(2)</sup>                              | 272,917                             | 10,622                    | 15.57 %         | 378,662                             | 14,074                    | 14.87 %         |
| Taxable securities   | 1,281,753                           | 6,382                     | 1.99 %          | 1,328,806                           | 4,890                     | 1.47 %          |
| Tax exempt securities <sup>(3)</sup>                           | 364,240                             | 4,192                     | 4.60 %          | 336,375                             | 3,890                     | 4.63 %          |
| Interest-earning deposits with banks<br>and federal funds sold | 46,753                              | 30                        | 0.26 %          | 47,919                              | 33                        | 0.27 %          |
| Total interest-earning assets                                  | 6,339,102                           | \$78,033                  | 4.92 %          | 6,284,281                           | \$83,768                  | 5.33 %          |
| Other earning assets   | 130,462                             |                           |                 | 113,403                             |                           |                 |
| Noninterest-earning assets                                     | 759,623                             |                           |                 | 713,273                             |                           |                 |
| Total assets   | \$7,229,187                         |                           |                 | \$7,110,957                         |                           |                 |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                    |                                     |                           |                 |                                     |                           |                 |
| Certificates of deposit  | \$480,459                           | \$325                     | 0.27 %          | \$590,261                           | \$535                     | 0.36 %          |
| Savings accounts   | 527,370                             | 14                        | 0.01 %          | 477,574                             | 28                        | 0.02 %          |
| Interest-bearing demand  | 1,187,274                           | 115                       | 0.04 %          | 1,059,772                           | 153                       | 0.06 %          |
| Money market accounts  | 1,612,607                           | 275                       | 0.07 %          | 1,858,974                           | 338                       | 0.07 %          |
| Total interest-bearing deposits                                | 3,807,710                           | 729                       | 0.08 %          | 3,986,581                           | 1,054                     | 0.11 %          |
| Federal Home Loan Bank advances<br><sup>(4)</sup>              | 68,306                              | 115                       | 0.67 %          | 106,309                             | 849                       | 3.19 %          |
| Other borrowings   | 25,000                              | 119                       | 1.90 %          | 68,205                              | 376                       | 2.21 %          |
| Total interest-bearing liabilities                             | 3,901,016                           | \$963                     | 0.10 %          | 4,161,095                           | \$2,279                   | 0.22 %          |
| Noninterest-bearing deposits                                   | 2,161,171                           |                           |                 | 1,838,221                           |                           |                 |
| Other noninterest-bearing liabilities                          | 82,073                              |                           |                 | 60,261                              |                           |                 |
| Shareholders' equity   | 1,084,927                           |                           |                 | 1,051,380                           |                           |                 |
| Total liabilities & shareholders'<br>equity                    | \$7,229,187                         |                           |                 | \$7,110,957                         |                           |                 |
| Net interest income (tax equivalent)                           |                                     | \$77,070                  |                 |                                     | \$81,489                  |                 |
| Net interest margin (tax equivalent)                           |                                     |                           | 4.86 %          |                                     |                           | 5.19 %          |

Nonaccrual loans have been included in the tables as loans carrying a zero yield. Amortized net deferred loan fees and net unearned discounts on certain acquired loans were included in the interest income calculations. The (1) amortization of net deferred loan fees was \$1.2 million and \$840 thousand for the three months ended June 30, 2014 and 2013, respectively. The accretion of net unearned discounts on certain acquired loans was \$5.6 million and \$10.3 million for the three months ended June 30, 2014 and 2013, respectively.

Incremental accretion on acquired impaired loans is included in covered loan interest earned. The incremental (2) accretion income on acquired impaired loans was \$5.7 million and \$7.8 million for the three months ended June 30, 2014 and 2013, respectively.

(3) Tax-exempt income is calculated on a tax equivalent basis. The tax equivalent yield adjustment to interest earned on noncovered loans was \$425 thousand and \$118 thousand for the three months ended June 30, 2014 and 2013, respectively. The tax equivalent yield adjustment to interest earned on tax exempt securities was \$1.5 million and

\$1.4 million for the three months ended June 30, 2014 and 2013, respectively.

Federal Home Loan Bank advances includes a prepayment charge of \$1.5 million during the three months ended (4) June 30, 2013. As a result of the prepayment, the Company recorded \$874 thousand in premium amortization, which partially offset the impact of the prepayment charge.

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

|  | Six Months Ended June 30,<br>2014 |                           |                 | Six Months Ended June 30,<br>2013 |                           |                 |
|--|-----------------------------------|---------------------------|-----------------|-----------------------------------|---------------------------|-----------------|
|  | Average<br>Balances               | Interest<br>Earned / Paid | Average<br>Rate | Average<br>Balances               | Interest<br>Earned / Paid | Average<br>Rate |
|  | (dollars in thousands)            |                           |                 |                                   |                           |                 |
| <b>ASSETS</b>  |                                   |                           |                 |                                   |                           |                 |
| Loans, excluding covered loans,<br>net <sup>(1) (3)</sup>      | \$4,311,118                       | \$ 111,753                | 5.18 %          | \$3,380,360                       | \$94,045                  | 5.56 %          |
| Covered loans, net <sup>(2)</sup>                              | 280,915                           | 21,574                    | 15.36 %         | 390,954                           | 29,066                    | 14.87 %         |
| Taxable securities   | 1,305,584                         | 13,134                    | 2.01 %          | 1,056,992                         | 9,124                     | 1.73 %          |
| Tax exempt securities <sup>(3)</sup>                           | 358,497                           | 8,301                     | 4.63 %          | 303,122                           | 7,457                     | 4.92 %          |
| Interest-earning deposits with banks<br>and federal funds sold | 36,043                            | 44                        | 0.24 %          | 184,581                           | 234                       | 0.25 %          |
| Total interest-earning assets                                  | 6,292,157                         | \$ 154,806                | 4.92 %          | 5,316,009                         | \$ 139,926                | 5.26 %          |
| Other earning assets   | 128,703                           |                           |                 | 97,094                            |                           |                 |
| Noninterest-earning assets                                     | 765,849                           |                           |                 | 574,140                           |                           |                 |
| Total assets   | \$7,186,709                       |                           |                 | \$5,987,243                       |                           |                 |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                    |                                   |                           |                 |                                   |                           |                 |
| Certificates of deposit  | \$491,731                         | \$ 687                    | 0.28 %          | \$536,750                         | \$ 1,115                  | 0.42 %          |
| Savings accounts   | 520,678                           | 28                        | 0.01 %          | 402,584                           | 44                        | 0.02 %          |
| Interest-bearing demand  | 1,178,042                         | 223                       | 0.04 %          | 950,352                           | 331                       | 0.07 %          |
| Money market accounts  | 1,599,686                         | 543                       | 0.07 %          | 1,477,098                         | 653                       | 0.09 %          |
| Total interest-bearing deposits                                | 3,790,137                         | 1,481                     | 0.08 %          | 3,366,784                         | 2,143                     | 0.13 %          |
| Federal Home Loan Bank advances<br><sup>(4)</sup>              | 69,491                            | 229                       | 0.66 %          | 56,751                            | 920                       | 3.24 %          |
| Other borrowings   | 25,000                            | 238                       | 1.90 %          | 46,722                            | 495                       | 2.12 %          |
| Total interest-bearing liabilities                             | 3,884,628                         | \$ 1,948                  | 0.10 %          | 3,470,257                         | \$ 3,558                  | 0.21 %          |
| Noninterest-bearing deposits                                   | 2,145,407                         |                           |                 | 1,545,749                         |                           |                 |
| Other noninterest-bearing liabilities                          | 80,485                            |                           |                 | 60,570                            |                           |                 |
| Shareholders' equity   | 1,076,189                         |                           |                 | 910,667                           |                           |                 |
| Total liabilities & shareholders'<br>equity                    | \$7,186,709                       |                           |                 | \$5,987,243                       |                           |                 |
| Net interest income (tax equivalent)                           |                                   | \$ 152,858                |                 |                                   | \$ 136,368                |                 |
| Net interest margin (tax equivalent)                           |                                   |                           | 4.86 %          |                                   |                           | 5.13 %          |

Nonaccrual loans have been included in the tables as loans carrying a zero yield. Amortized net deferred loan fees were included in the interest income calculations. The amortization of net deferred loan fees was \$2.1 million and (1) \$1.5 million for the six months ended June 30, 2014 and 2013, respectively. The accretion of net unearned discounts on other FDIC acquired loans and other acquired loans was \$11.4 million and \$11.3 million for the six months ended June 30, 2014 and 2013, respectively.

Incremental accretion on acquired impaired loans is included in covered loan interest earned. The incremental (2) accretion income on acquired impaired loans was \$12.2 million and \$16.2 million for the six months ended June 30, 2014 and 2013, respectively.

(3) Tax-exempt income is calculated on a tax equivalent basis. The tax equivalent yield adjustment to interest earned on noncovered loans was \$782 thousand and \$246 thousand for the six months ended June 30, 2014 and 2013, respectively. The tax equivalent yield adjustment to interest earned on tax exempt securities was \$3.0 million and

\$2.7 million for the six months ended June 30, 2014 and 2013, respectively.

Federal Home Loan Bank advances includes a prepayment charge of \$1.5 million during the six months ended (4) June 30, 2013. As a result of the prepayment, the Company recorded \$874 thousand in premium amortization, which partially offset the impact of the prepayment charge.

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

|   | Three Months Ended June 30,<br>2014 Compared to 2013 |             |           |
|---|--|-------------|-----------|
|   | Increase (Decrease) Due to                           |             | Total     |
|   | Volume   | Rate        |           |
|   | (in thousands)                                       |             |           |
| Interest Income   |  |             |           |
| Loans, excluding covered loans, net                         | \$2,547  | \$(6,621)   | \$(4,074) |
| Covered loans, net  | (4,089)  | ) 637       | (3,452)   |
| Taxable securities  | (179)  | ) 1,671     | 1,492     |
| Tax exempt securities                                       | 322  | (20)        | ) 302     |
| Interest earning deposits with banks and federal funds sold | (1)  | ) (2)       | (3)       |
| Interest income   | \$(1,400)  | ) \$(4,335) | \$(5,735) |
| Interest Expense  |  |             |           |
| Deposits:   |  |             |           |
| Certificates of deposit                                     | \$(88)   | ) \$(122)   | \$(210)   |
| Savings accounts  | 3  | (17)        | (14)      |
| Interest-bearing demand                                     | 17   | (55)        | (38)      |
| Money market accounts                                       | (43)   | ) (20)      | (63)      |
| Total interest on deposits                                  | (111)  | ) (214)     | (325)     |
| Federal Home Loan Bank advances                             | (229)  | ) (505)     | (734)     |
| Interest expense  | \$(551)  | ) \$(765)   | \$(1,316) |

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

|   | Six Months Ended June 30,<br>2014 Compared to 2013 |          |              |
|---|--|----------|--------------|
|   | Increase (Decrease) Due to                         |          | Total        |
|   | Volume   | Rate     |              |
|   | (in thousands)                                     |          |              |
| Interest Income   |  |          |              |
| Loans, excluding covered loans, net                         | \$24,478   | \$(6,770 | ) \$17,708   |
| Covered loans, net  | (8,423   | ) 931    | (7,492 )     |
| Taxable securities  | 2,354  | 1,656    | 4,010        |
| Tax exempt securities                                       | 1,302  | (458     | ) 844        |
| Interest earning deposits with banks and federal funds sold | (181   | ) (9     | ) (190 )     |
| Interest income   | \$19,530   | \$(4,650 | ) \$14,880   |
| Interest Expense  |  |          |              |
| Deposits:   |  |          |              |
| Certificates of deposit                                     | \$(87  | ) \$(341 | ) \$(428 )   |
| Savings accounts  | 10   | (26      | ) (16 )      |
| Interest-bearing demand                                     | 67   | (175     | ) (108 )     |
| Money market accounts                                       | 51   | (161     | ) (110 )     |
| Total interest on deposits                                  | 41   | (703     | ) (662 )     |
| Federal Home Loan Bank advances                             | 170  | (861     | ) (691 )     |
| Other borrowings  | (211   | ) (46    | ) (257 )     |
| Interest expense  | \$—  | \$(1,610 | ) \$(1,610 ) |
| Provision for Loan and Lease Losses                         |  |          |              |

## Comparison of current quarter to prior year period

During the second quarter of 2014, the Company recorded a \$600 thousand provision expense for the noncovered loan portfolio and provision expense of \$1.5 million for the covered loan portfolio compared with a provision expense of \$2.0 million and a provision recapture of \$1.7 million, respectively, during the second quarter of 2013.

The \$600 thousand provision expense recorded during the current quarter for noncovered loan losses was primarily due to net loan charge-offs experienced in the quarter, partially offset by improving asset quality metrics. The amount of provision was calculated in accordance with the Company's methodology for determining the ALLL, discussed in Note 6 to the Consolidated Financial Statements in "Item 1. Financial Statements (unaudited)" of this report.

The \$1.5 million in provision expense for losses on covered loans in the current period was primarily due to the decrease in the present value of expected future cash flows as remeasured during the current quarter, compared to the present value of expected future cash flows during the first quarter, net of the actual cash flows received during the quarter. The decrease in the present value of expected future cash flows was due to a decline in the credit quality of the covered portfolio, as measured by past due status. The \$1.5 million in provision expense was substantially offset by a \$1.2 million favorable adjustment to the change in FDIC loss-sharing asset.

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## Comparison of current year-to-date to prior year period

The provision for loan and lease losses for the six months ended June 30, 2014 was \$100 thousand for the noncovered loan portfolio and \$3.9 million for the covered loan portfolio compared with provision expense of \$1.0 million and a provision recapture of \$732 thousand, respectively, during the same period of 2013. The \$3.9 million in provision expense for losses on covered loans in the current period was primarily due to the decrease in the present value of expected future cash flows as remeasured during the current period, compared to the present value of expected future cash flows at the end of 2013, net of activity during the period. The decrease in the present value of expected future cash flows was due to a decline in the credit quality of the covered portfolio, as measured by past due status. The \$3.9 million in provision was substantially offset by a \$3.1 million favorable adjustment to the change in FDIC loss-sharing asset.

The \$100 thousand provision expense for noncovered loan losses was primarily due to net loan charge-offs experienced in the period, partially offset by improving asset quality metrics. Net noncovered loan charge-offs for the six months ended June 30, 2014 were \$2.9 million compared to \$1.6 million for the same period of 2013. The amount of provision was calculated in accordance with the Company's methodology for determining the ALLL, discussed in Note 6 to the Consolidated Financial Statements in "Item 1. Financial Statements (unaudited)" of this report and was based upon improving credit metrics in the noncovered loan portfolio.

## Noninterest Income

The following table presents the significant components of noninterest income and the related dollar and percentage change from period to period:

|                                   | Three Months Ended<br>June 30, |           |           |          | Six Months Ended<br>June 30, |           |           |           |      |   |
|-----------------------------------|--------------------------------|-----------|-----------|----------|------------------------------|-----------|-----------|-----------|------|---|
|                                   | 2014                           | 2013      | \$ Change | % Change | 2014                         | 2013      | \$ Change | % Change  |      |   |
|                                   | (dollars in thousands)         |           |           |          |                              |           |           |           |      |   |
| Service charges and other fees    | \$ 13,790                      | \$ 13,560 | \$ 230    | 2        | %                            | \$ 26,726 | \$ 21,154 | \$ 5,572  | 26   | % |
| Merchant services fees            | 2,040                          | 2,013     | 27        | 1        | %                            | 3,910     | 3,864     | 46        | 1    | % |
| Investment securities gains, net  | 296                            | 92        | 204       | 222      | %                            | 519       | 462       | 57        | 12   | % |
| Bank owned life insurance         | 976                            | 1,008     | (32)      | (3)      | %                            | 1,941     | 1,706     | 235       | 14   | % |
| Other                             | 2,575                          | 3,272     | (697)     | (21)     | %                            | 5,408     | 4,900     | 508       | 10   | % |
| Subtotal                          | 19,677                         | 19,945    | (268)     | (1)      | %                            | 38,504    | 32,086    | 6,418     | 20   | % |
| Change in FDIC loss-sharing asset | (5,050)                        | (13,137)  | 8,087     | (62)     | %                            | (9,869)   | (23,620)  | 13,751    | (58) | % |
| Total noninterest income          | \$ 14,627                      | \$ 6,808  | \$ 7,819  | 115      | %                            | \$ 28,635 | \$ 8,466  | \$ 20,169 | 238  | % |

## Comparison of current quarter to prior year period

Noninterest income was \$14.6 million for the second quarter of 2014, compared to \$6.8 million for the same period in 2013. The increase was primarily due to lower expense recorded for the change in FDIC loss-sharing asset, which was \$8.1 million less in the current quarter compared to the second quarter of 2013.

The change in FDIC loss-sharing asset is a significant component of noninterest income. Changes in the asset are primarily driven by amortization of the asset and the provision recorded for reimbursable losses on covered loans. For the second quarter of 2014, there was \$5.8 million of amortization of the asset partially offset by a \$1.2 million increase in the asset related to the provision recorded for reimbursable losses on covered loans. For the same period in 2013, there was \$9.8 million of amortization of the asset as well as a \$1.4 million decrease in the asset related to the recapture of provision recorded for reimbursable losses on covered loans. For additional information on the FDIC loss-sharing asset, please see the "FDIC Loss-sharing Asset" section of Management's Discussion and Analysis and Note 8 to the Consolidated Financial Statements in "Item 1. Financial Statements (unaudited)" of this report.





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## Comparison of current year-to-date to prior year period

For the six months ended June 30, 2014, noninterest income was \$28.6 million compared to \$8.5 million for the same period in 2013. The decrease was primarily due to lower expense recorded for the change in FDIC loss-sharing asset, which was \$13.8 million less in the current period compared to the prior year period. The increase was also driven by an increase of \$5.6 million in service charges and other fees due to the increased customer base from the West Coast acquisition, which occurred in the middle of the prior year six month period.

## Noninterest Expense

The following table presents the significant components of noninterest expense and the related dollar and percentage change from period to period:

|   | Three Months Ended     |          |           |          | Six Months Ended |           |           |          |
|---|------------------------|----------|-----------|----------|------------------|-----------|-----------|----------|
|   | June 30,<br>2014       | 2013 (1) | \$ Change | % Change | June 30,<br>2014 | 2013 (1)  | \$ Change | % Change |
|   | (dollars in thousands) |          |           |          |                  |           |           |          |
| Compensation and employee benefits                          | \$31,064               | \$35,657 | \$(4,593) | (13)%    | \$62,402         | \$57,310  | \$5,092   | 9%       |
| All other noninterest expense:                              |                        |          |           |          |                  |           |           |          |
| Occupancy   | 8,587                  | 7,543    | 1,044     | 14%      | 16,831           | 12,296    | 4,535     | 37%      |
| Merchant processing   | 998                    | 852      | 146       | 17%      | 1,978            | 1,709     | 269       | 16%      |
| Advertising and promotion                                   | 950                    | 1,160    | (210)     | (18)%    | 1,719            | 2,030     | (311)     | (15)%    |
| Data processing and communications                          | 3,680                  | 3,638    | 42        | 1%       | 7,200            | 6,218     | 982       | 16%      |
| Legal and professional services                             | 2,303                  | 5,504    | (3,201)   | (58)%    | 4,472            | 7,554     | (3,082)   | (41)%    |
| Taxes, license and fees                                     | 1,051                  | 1,204    | (153)     | (13)%    | 2,231            | 2,591     | (360)     | (14)%    |
| Regulatory premiums   | 1,073                  | 1,177    | (104)     | (9)%     | 2,249            | 2,034     | 215       | 11%      |
| Net cost of operation of noncovered other real estate owned | 730                    | 393      | 337       | 86%      | 1,057            | 339       | 718       | 212%     |
| Net benefit of operation of covered other real estate owned | (827)                  | (3,221)  | 2,394     | (74)%    | (1,008)          | (5,668)   | 4,660     | (82)%    |
| Amortization of intangibles                                 | 1,480                  | 1,693    | (213)     | (13)%    | 3,060            | 2,722     | 338       | 12%      |
| Other (1)   | 6,675                  | 8,904    | (2,229)   | (25)%    | 12,959           | 13,418    | (459)     | (3)%     |
| Total all other noninterest expense                         | 26,700                 | 28,847   | (2,147)   | (7)%     | 52,748           | 45,243    | 7,505     | 17%      |
| Total noninterest expense                                   | \$57,764               | \$64,504 | \$(6,740) | (10)%    | \$115,150        | \$102,553 | \$12,597  | 12%      |

(1) Reclassified to conform to the current period's presentation. The reclassification was limited to removing the separate line item for FDIC clawback liability expense within noninterest expense and including the prior period activity in the line item for other noninterest expense.

## Comparison of current quarter to prior year period

Total noninterest expense for the second quarter of 2014 was \$57.8 million, a decrease of \$6.7 million from a year earlier. The decrease from the prior year period was primarily due to acquisition-related expenses which were \$672 thousand during the current quarter compared to \$9.2 million for the prior year period. This decrease was partially offset by a decrease in the net benefit of operation of covered other real estate owned, which declined from \$3.2 million to \$827 thousand.

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## Comparison of current year-to-date to prior year period

For the six months ended June 30, 2014, noninterest expense was \$115.2 million, an increase of \$12.6 million, or 12% from \$102.6 million a year earlier. The increase from the prior-year period was due to additional ongoing noninterest expense stemming from the growth resulting from the West Coast acquisition, which occurred in the middle of the prior year six month period. The increase in noninterest expense was also due to a reduction in the net benefit of covered other real estate owned.

The following table shows the impact of the acquisition-related expenses for the periods indicated to the various components of noninterest expense:

|  | Three Months Ended |         | Six Months Ended |         |
|--|--------------------|---------|------------------|---------|
|  | June 30,<br>2014   | 2013    | June 30,<br>2014 | 2013    |
|  | (in thousands)     |         |                  |         |
| Noninterest Expense  |                    |         |                  |         |
| Compensation and employee benefits                               | \$73               | \$3,416 | \$654            | \$3,416 |
| Occupancy  | 547                | 228     | 686              | 233     |
| Advertising and promotion  | —                  | 489     | —                | 505     |
| Data processing and communications                               | —                  | 436     | —                | 476     |
| Legal and professional fees                                      | 26                 | 3,522   | 213              | 4,030   |
| Other  | 26                 | 1,143   | 85               | 1,297   |
| Total impact of acquisition-related costs to noninterest expense | \$672              | \$9,234 | \$1,638          | \$9,957 |

The following table presents selected items included in other noninterest expense and the associated change from period to period:

|   | Three Months Ended June |          | Increase<br>(Decrease)<br>Amount | Six Months Ended June 30, |          | Increase<br>(Decrease)<br>Amount |
|---|-------------------------|----------|----------------------------------|---------------------------|----------|----------------------------------|
|   | 30,<br>2014             | 2013 (1) |                                  | 2014                      | 2013 (1) |                                  |
|   | (in thousands)          |          |                                  |                           |          |                                  |
| Postage                                   | \$920                   | \$1,053  | \$(133 )                         | \$1,822                   | \$1,526  | \$296                            |
| Software support & maintenance            | 456                     | 966      | (510 )                           | 1,006                     | 1,328    | (322 )                           |
| Supplies                                  | 376                     | 481      | (105 )                           | 756                       | 691      | 65                               |
| Insurance                                 | 398                     | 593      | (195 )                           | 800                       | 854      | (54 )                            |
| ATM Network                               | 179                     | 728      | (549 )                           | 468                       | 999      | (531 )                           |
| Travel                                    | 527                     | 502      | 25                               | 949                       | 772      | 177                              |
| Employee expenses                         | 249                     | 270      | (21 )                            | 548                       | 469      | 79                               |
| Sponsorships and charitable contributions | 519                     | 364      | 155                              | 1,121                     | 609      | 512                              |
| Directors fees                            | 162                     | 175      | (13 )                            | 331                       | 328      | 3                                |
| Federal Reserve Bank processing fees      | 69                      | 48       | 21                               | 136                       | 93       | 43                               |
| CRA partnership investment expense        | 263                     | 340      | (77 )                            | 529                       | 340      | 189                              |
| Investor relations                        | 140                     | 196      | (56 )                            | 178                       | 334      | (156 )                           |
| Other personal property owned             | (20 )                   | 200      | (220 )                           | (144 )                    | 96       | (240 )                           |
| FDIC clawback expense (1)                 | (103 )                  | 199      | (302 )                           | 101                       | 430      | (329 )                           |
| Miscellaneous                             | 2,540                   | 2,789    | (249 )                           | 4,358                     | 4,549    | (191 )                           |
| Total other noninterest expense (1)       | \$6,675                 | \$8,904  | \$(2,229 )                       | \$12,959                  | \$13,418 | \$(459 )                         |

(1) Reclassified to conform to the current period's presentation. The reclassification was limited to adding a separate line item for FDIC clawback liability expense to the table above as it is now a component of other noninterest expense.



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## Income Taxes

We recorded an income tax provision of \$8.6 million for the second quarter of 2014, compared to a provision of \$7.4 million for the same period in 2013. For the six months ended June 30, 2014 and 2013, we recorded an income tax provision of \$17.4 million and \$12.3 million, respectively, with an effective tax rate of 30% and 32%, respectively. Our effective tax rate remains lower than the statutory tax rate due to our nontaxable income generated from tax-exempt loans and municipal bonds, investments in bank owned life insurance, and low income housing credits. For additional information, please refer to the Company's annual report on Form 10-K for the year ended December 31, 2013.

## FINANCIAL CONDITION

Total assets were \$7.30 billion as of June 30, 2014, an increase of \$135.9 million, or 2% from \$7.16 billion at December 31, 2013. The increase was primarily due to increases in noncovered loans and cash and cash equivalents, partially offset by a decrease in investment securities.

## Investment Securities

At June 30, 2014, the Company held investment securities totaling \$1.59 billion compared to \$1.66 billion at December 31, 2013. All of our securities are classified as available for sale and carried at fair value. The decrease in the investment securities portfolio from year-end is due to \$114.0 million in maturities and sales and \$7.3 million in premium amortization, partially offset by \$22.8 million in purchases and a \$24.4 million increase in fair value of securities in the portfolio. The average duration of our investment portfolio was approximately 3 years and 9 months at June 30, 2014. This duration takes into account calls, where appropriate, and consensus prepayment speeds.

The investment securities are used by the Company as a component of its balance sheet management strategies. From time-to-time, securities may be sold to reposition the portfolio in response to strategies developed by the Company's asset liability committee. In accordance with our investment strategy, management monitors market conditions with a view to realize gains on its available for sale securities portfolio when prudent.

The Company performs a quarterly assessment of the debt and equity securities in its investment portfolio that have an unrealized loss to determine whether the decline in the fair value of these securities below their amortized cost basis is other-than-temporary. Impairment is considered other-than-temporary when it becomes probable that the Company will be unable to recover the entire amortized cost basis of its investment. The Company's impairment assessment takes into consideration factors such as the length of time and the extent to which the market value has been less than cost, defaults or deferrals of scheduled interest or principal, external credit ratings and recent downgrades, internal assessment of credit quality, and whether the Company intends to sell the security and whether it is more likely than not it will be required to sell the security prior to recovery of its amortized cost basis. If a decline in fair value is judged to be other-than-temporary, the cost basis of the individual security is written down to fair value which then becomes the new cost basis. The new cost basis is not adjusted for subsequent recoveries in fair value.

When there are credit losses associated with an impaired debt security and the Company does not have the intent to sell the security and it is more likely than not that it will not have to sell the security before recovery of its cost basis, the Company will separate the amount of the impairment into the amount that is credit-related and the amount related to non-credit factors. The credit-related impairment is recognized in earnings and the non-credit-related impairment is recognized in accumulated other comprehensive income.

At June 30, 2014, the market value of securities available for sale had a net unrealized gain of \$8.0 million compared to a net unrealized loss of \$16.4 million at December 31, 2013. The change in valuation was the result of fluctuations in market interest rates subsequent to purchase. At June 30, 2014, the Company had \$742.7 million of investment securities with gross unrealized losses of \$18.1 million; however, we did not consider these investment securities to be other-than-temporarily impaired.

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The following table sets forth our securities portfolio by type for the dates indicated:

|   | June 30, 2014<br>(in thousands) | December 31, 2013 |
|---|---------------------------------|-------------------|
| Securities Available for Sale   |                                 |                   |
| U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations | \$ 862,618                      | \$ 948,408        |
| State and municipal securities  | 380,506                         | 364,470           |
| U.S. government and government-sponsored enterprise securities  | 321,389                         | 326,039           |
| U.S. government securities  | 20,337                          | 20,114            |
| Other securities  | 5,167                           | 5,080             |
| Total   | \$ 1,590,017                    | \$ 1,664,111      |

For further information on our investment portfolio see Note 4 of the Consolidated Financial Statements in “Item 1. Financial Statements (unaudited)” of this report.

**Credit Risk Management**

The extension of credit in the form of loans or other credit products to individuals and businesses is one of our principal business activities. Our policies and applicable laws and regulations require risk analysis as well as ongoing portfolio and credit management. We manage our credit risk through lending limit constraints, credit review, approval policies, and extensive, ongoing internal monitoring. We also manage credit risk through diversification of the loan portfolio by type of loan, type of industry, type of borrower and by limiting the aggregation of debt to a single borrower. The monitoring process for our loan portfolio includes periodic reviews of individual loans with risk ratings assigned to each loan. We review these loans to assess the ability of the borrower to service all of its interest and principal obligations and, as a result, the risk rating may be adjusted accordingly. In the event that full collection of principal and interest is not reasonably assured, the loan is appropriately downgraded and, if warranted, placed on nonaccrual status even though the loan may be current as to principal and interest payments. Additionally, we review these types of loans for impairment in accordance with the Receivables topic of the FASB ASC. Impaired loans are considered for nonaccrual status and will typically remain as such until all principal and interest payments are brought current and the prospects for future payments in accordance with the loan agreement appear relatively certain.

Loan policies, credit quality criteria, loan portfolio guidelines and other credit approval processes are established under the guidance of our Chief Credit Officer and approved, as appropriate, by the Board of Directors. The Company’s Credit Administration department and loan committee have the responsibility for administering the credit approval process. As another part of its control process, we use an independent internal credit review and examination function to provide assurance that loans and commitments are made and maintained as prescribed by our credit policies. This includes a review of documentation when the loan is initially extended and subsequent monitoring to assess continued performance and proper risk assessment.

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## Loan Portfolio Analysis

We are a full service commercial bank, which originates a wide variety of loans, and focuses its lending efforts on originating commercial business and commercial real estate loans.

The following table sets forth the Company's loan portfolio by type of loan for the dates indicated:

|   | June 30, 2014          | % of Total | December 31,<br>2013 | % of Total |    |
|---|------------------------|------------|----------------------|------------|----|
|   | (dollars in thousands) |            |                      |            |    |
| Commercial business   | \$ 1,735,588           | 39.0       | % \$ 1,561,782       | 37.0       | %  |
| Real estate:  |                        |            |                      |            |    |
| One-to-four family residential  | 102,632                | 2.3        | % 108,317            | 2.6        | %  |
| Commercial and multifamily residential  | 2,127,520              | 47.8       | % 2,080,075          | 49.2       | %  |
| Total real estate   | 2,230,152              | 50.1       | % 2,188,392          | 51.8       | %  |
| Real estate construction:   |                        |            |                      |            |    |
| One-to-four family residential  | 61,481                 | 1.4        | % 54,155             | 1.3        | %  |
| Commercial and multifamily residential  | 134,140                | 3.0        | % 126,390            | 3.0        | %  |
| Total real estate construction  | 195,621                | 4.4        | % 180,545            | 4.3        | %  |
| Consumer  | 348,439                | 7.8        | % 357,014            | 8.5        | %  |
| Subtotal  | 4,509,800              | 101.3      | % 4,287,733          | 101.6      | %  |
| Less: Net unearned income   | (57,126)               | ) (1.3     | )% (68,282           | ) (1.6     | )% |
| Total noncovered loans, net of unearned income  | 4,452,674              | 100.0      | % 4,219,451          | 100.0      | %  |
| Less: Allowance for loan and lease losses   | (49,494)               | )          | (52,280)             | )          |    |
| Noncovered loans, net   | 4,403,180              |            | 4,167,171            |            |    |
| Covered loans, net of allowance for loan losses<br>of (\$19,801) and (\$20,174), respectively | 242,100                |            | 277,671              |            |    |
| Total loans, net  | \$ 4,645,280           |            | \$ 4,444,842         |            |    |
| Loans held for sale   | \$ 750                 |            | \$ 735               |            |    |

Total noncovered loans increased \$233.2 million, or 6%, from year-end 2013. The increase in noncovered loans was driven by significant originations during the period. The noncovered loan portfolio continues to be diversified, with the intent to mitigate risk by minimizing concentration in any one segment. The \$57.1 million in unearned income recorded at June 30, 2014 was comprised of \$49.7 million in discount on acquired loans and \$7.4 million in deferred loan fees. The \$68.3 million in unearned income recorded at December 31, 2013 consisted of \$61.4 million in discount on acquired loans and \$6.9 million in deferred loan fees.

**Commercial Loans:** We are committed to providing competitive commercial lending in our primary market areas. Management expects a continued focus within its commercial lending products and to emphasize, in particular, relationship banking with businesses, and business owners.

**Real Estate Loans:** One-to-four family residential loans are secured by properties located within our primary market areas and, typically, have loan-to-value ratios of 80% or lower at origination. Our underwriting standards for commercial and multifamily residential loans generally require that the loan-to-value ratio for these loans not exceed 75% of appraised value, cost, or discounted cash flow value, as appropriate, and that commercial properties maintain debt coverage ratios (net operating income divided by annual debt servicing) of 1.2 or better. However, underwriting standards can be influenced by competition and other factors. We endeavor to maintain the highest practical underwriting standards while balancing the need to remain competitive in our lending practices.

**Real Estate Construction Loans:** We originate a variety of real estate construction loans. Underwriting guidelines for these loans vary by loan type but include loan-to-value limits, term limits and loan advance limits, as applicable. Our underwriting guidelines for commercial and multifamily residential real estate construction loans generally require that the loan-to-value ratio not exceed 75% and stabilized debt coverage ratios (net operating income divided by annual debt servicing) of 1.2 or better. As noted above, underwriting standards can be influenced by competition and other factors. However, we endeavor to maintain the highest practical underwriting standards while balancing the need to remain competitive in our lending practices.





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**Consumer Loans:** Consumer loans include automobile loans, boat and recreational vehicle financing, home equity and home improvement loans and miscellaneous personal loans.

**Foreign Loans:** The Company has no material foreign activities. Substantially all of the Company's loans and unfunded commitments are geographically concentrated in its service areas within the states of Washington and Oregon.

**Covered Loans:** Covered loans are comprised of loans and loan commitments acquired in connection with the 2011 FDIC-assisted acquisitions of First Heritage Bank and Summit Bank, as well as the 2010 FDIC-assisted acquisitions of Columbia River Bank and American Marine Bank. These loans are generically referred to as covered because they are generally subject to one of the loss-sharing agreements between Columbia Bank and the FDIC. The loss-sharing agreements relating to the 2010 FDIC-assisted transactions limit the Company's losses to 20% of the contractual balance outstanding up to a stated threshold amount of \$206.0 million for Columbia River Bank and \$66.0 million for American Marine Bank. If losses exceed the stated threshold, the Company's share of the remaining losses decreases to 5%. The loss-sharing agreements relating to the 2011 FDIC-assisted transactions limit the Company's losses to 20% of the contractual balance outstanding. The loss-sharing provisions of the 2010 and 2011 agreements for non-single family and single family loans are in effect for five years and ten years, respectively, from the acquisition dates and the loss recovery provisions for such loans are in effect for eight years and ten years, respectively, from the acquisition dates. At June 30, 2014, approximately 94% of covered loans were subject to an FDIC loss-sharing agreement and approximately 88% were accounted for as acquired, impaired loans. The five year loss-sharing period for the loans subject to the non-single family loss-sharing agreements from the 2010 FDIC-assisted acquisitions will expire on March 31, 2015. Approximately 64% of the carrying value of our covered loans at June 30, 2014 are covered under those 2010 loss-sharing agreements.

The following tables are a rollforward of acquired, impaired loans accounted for under ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality for the six months ended June 30, 2014 and 2013:

|   | Contractual<br>Cash Flows<br>(in thousands) | Nonaccretable<br>Difference | Accretable<br>Yield | Carrying<br>Amount |
|---|---|-----------------------------|---------------------|--------------------|
| Balance at January 1, 2014  | \$364,336                                   | \$(11,855 )                 | \$(103,907 )        | \$248,574          |
| Principal reductions  | (47,348 )                                   | —                           | —                   | (47,348 )          |
| Accretion of loan discount  | —   | —                           | 20,624              | 20,624             |
| Changes in contractual and expected cash flows due to remeasurement | 5,973                                       | 1,742                       | (12,054 )           | (4,339 )           |
| Disposals   | (8,116 )                                    | 151                         | 2,826               | (5,139 )           |
| Balance at June 30, 2014  | \$314,845                                   | \$(9,962 )                  | \$(92,511 )         | \$212,372          |
|   | Contractual<br>Cash Flows<br>(in thousands) | Nonaccretable<br>Difference | Accretable<br>Yield | Carrying<br>Amount |
| Balance at January 1, 2013  | \$556,108                                   | \$(37,371 )                 | \$(166,888 )        | \$351,849          |
| Principal reductions  | (74,550 )                                   | —                           | —                   | (74,550 )          |
| Accretion of loan discount  | —   | —                           | 27,997              | 27,997             |
| Changes in contractual and expected cash flows due to remeasurement | (11,621 )                                   | 17,223                      | (5,151 )            | 451                |
| Disposals   | (9,822 )                                    | 471                         | 3,531               | (5,820 )           |
| Balance at June 30, 2013  | \$460,115                                   | \$(19,677 )                 | \$(140,511 )        | \$299,927          |

For additional information on our loan portfolio, including amounts pledged as collateral on borrowings, see Note 5 and Note 8 to the Consolidated Financial Statements in "Item 1. Financial Statements (unaudited)" of this report.

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## Nonperforming Assets

Nonperforming assets consist of: (i) nonaccrual loans; (ii) other real estate owned; and (iii) other personal property owned.

Nonaccrual noncovered loans: The consolidated financial statements are prepared according to the accrual basis of accounting. This includes the recognition of interest income on the loan portfolio, unless a loan is placed on a nonaccrual basis, which occurs when there are serious doubts about the collectability of principal or interest.

Generally, our policy is to discontinue the accrual of interest on all loans past due 90 days or more and place them on nonaccrual status. When a noncovered loan is placed on nonaccrual status, any accrued but unpaid interest on that date is removed from interest income.

Covered loans: We consider covered loans to be performing due to the application of the yield accretion method under ASC Topic 310-30. Topic 310-30 allows us to aggregate credit-impaired loans acquired in the same fiscal quarter into one or more pools, provided the loans have common risk characteristics. A pool is then accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. The covered loans acquired are and will continue to be subject to the Company's internal and external credit review and monitoring. Any credit deterioration experienced subsequent to the initial acquisition will result in a provision for loan losses being charged to earnings. These provisions will be mostly offset by an increase to the FDIC loss-sharing asset and will be recognized in noninterest income.

The following table set forth, at the dates indicated, information with respect to our noncovered nonaccrual loans and total noncovered nonperforming assets:

|  | June 30,<br>2014 | December 31,<br>2013 |
|--|------------------|----------------------|
|  | (in thousands)   |                      |
| Nonperforming assets, excluding covered assets                       |                  |                      |
| Nonaccrual loans:  |                  |                      |
| Commercial business  | \$11,484         | \$12,609             |
| Real estate:   |                  |                      |
| One-to-four family residential                                       | 3,024            | 2,667                |
| Commercial and multifamily residential                               | 11,039           | 11,043               |
| Total real estate  | 14,063           | 13,710               |
| Real estate construction:  |                  |                      |
| One-to-four family residential                                       | 1,040            | 3,705                |
| Total real estate construction                                       | 1,040            | 3,705                |
| Consumer   | 4,026            | 3,991                |
| Total nonaccrual loans   | 30,613           | 34,015               |
| Noncovered other real estate owned and other personal property owned | 15,203           | 23,918               |
| Total nonperforming noncovered assets                                | \$45,816         | \$57,933             |
| <br>   |                  |                      |
| Total assets   | \$7,297,458      | \$7,161,582          |
| Covered assets, net  | 255,151          | 289,790              |
| Noncovered assets  | \$7,042,307      | \$6,871,792          |

At June 30, 2014, nonperforming noncovered assets were \$45.8 million, compared to \$57.9 million at December 31, 2013. Nonperforming noncovered assets decreased \$12.1 million during the six months ended June 30, 2014 as a result of \$6.2 million in loan payments, \$5.4 million in loans returning to accrual status, \$9.4 million in OREO sales, \$4.7 million in loan, OREO, and OPPO write-downs, partially offset by \$13.6 million in new nonaccrual loans. The percent of nonperforming, noncovered assets to period-end noncovered assets at June 30, 2014 was 0.65% compared to 0.84% for December 31, 2013.

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Other Real Estate Owned: During the six months ended June 30, 2014, noncovered OREO decreased \$8.6 million. The following table sets forth activity in noncovered OREO for the six months ended June 30, 2014 and 2013:

|   | Six Months Ended June 30, |          |
|---|---------------------------|----------|
|   | 2014                      | 2013     |
|   | (in thousands)            |          |
| Noncovered OREO:  |                           |          |
| Balance, beginning of period                                  | \$23,834                  | \$10,676 |
| Established through acquisitions                              | —                         | 14,708   |
| Transfers in, net of write-downs (\$0 and \$43, respectively) | 2,334                     | 4,777    |
| Additional OREO write-downs                                   | (1,565                    | ) (570   |
| Proceeds from sale of OREO property                           | (10,298                   | ) (5,623 |
| Gain on sale of OREO, net                                     | 898                       | 371      |
| Total noncovered OREO, end of period                          | \$15,203                  | \$24,339 |

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

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

On a quarterly basis our Chief Credit Officer reviews with Executive Management and the Board of Directors the various additional factors that management considers when determining the adequacy of the ALLL, including economic and business condition reviews. Factors which influenced management’s judgment in determining the amount of the additions to the ALLL charged to operating expense include the following as of the applicable balance sheet dates:

- Existing general economic and business conditions affecting our market place
- Credit quality trends
- Historical loss experience
- Seasoning of the loan portfolio
- Bank regulatory examination results
- Findings of internal credit examiners
- Duration of current business cycle
- Specific loss estimates for problem loans

The ALLL is increased by provisions for loan and lease losses (“provision”) charged to expense, and is reduced by loans charged off, net of recoveries or recapture of previous provision. While we believe the best information available is used by us to determine the ALLL, changes in market conditions could result in adjustments to the ALLL, affecting net income, if circumstances differ from the assumptions used in determining the ALLL.

In addition to the ALLL, we maintain an allowance for unfunded commitments and letters of credit. We report this allowance as a liability on our Consolidated Balance Sheet. We determine this amount using estimates of the probability of the ultimate funding and losses related to those credit exposures. This methodology is similar to the methodology we use for determining the adequacy of our ALLL. For additional information on our allowance for unfunded commitments and letters of credit, see Note 6 to the Consolidated Financial Statements presented elsewhere in this report.



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At June 30, 2014, our ALLL for noncovered loans was \$49.5 million, or 1.11% of total noncovered loans (excluding loans held for sale) and 162% of nonperforming, noncovered loans. This compares with an allowance of \$52.3 million, or 1.24% of total noncovered loans (excluding loans held for sale), and 154% of nonperforming, noncovered loans at December 31, 2013. This decrease in the allowance relative to noncovered loans in the current period as compared to December 31, 2013 reflects improvements in core asset quality during the current year. The increase relative to nonperforming, noncovered loans was the result of the nonperforming, noncovered loans decreasing by \$3.4 million to \$30.6 million in the current period as compared to \$34.0 million as of December 31, 2013.

The following table provides an analysis of the Company's ALLL for noncovered loans at the dates and the periods indicated:

|   | Three Months Ended June 30, |             | Six Months Ended June 30, |             |
|---|-----------------------------|-------------|---------------------------|-------------|
|   | 2014                        | 2013        | 2014                      | 2013        |
|   | (in thousands)              |             |                           |             |
| Beginning balance   | \$50,442                    | \$51,119    | \$52,280                  | \$52,244    |
| Charge-offs:  |                             |             |                           |             |
| Commercial business   | (1,717 )                    | (961 )      | (1,950 )                  | (2,275 )    |
| One-to-four family residential  | —                           | (28 )       | (207 )                    | (144 )      |
| Commercial and multifamily residential                                      | (1,963 )                    | (614 )      | (2,986 )                  | (1,397 )    |
| One-to-four family residential construction                                 | —                           | —           | —                         | (133 )      |
| Consumer  | (909 )                      | (638 )      | (1,636 )                  | (809 )      |
| Total charge-offs   | (4,589 )                    | (2,241 )    | (6,779 )                  | (4,758 )    |
| Recoveries:   |                             |             |                           |             |
| Commercial business   | 1,712                       | 352         | 2,202                     | 465         |
| One-to-four family residential  | 12                          | 141         | 40                        | 141         |
| Commercial and multifamily residential                                      | 537                         | 84          | 576                       | 171         |
| One-to-four family residential construction                                 | 442                         | 49          | 484                       | 2,188       |
| Consumer  | 338                         | 194         | 591                       | 241         |
| Total recoveries  | 3,041                       | 820         | 3,893                     | 3,206       |
| Net charge-offs   | (1,548 )                    | (1,421 )    | (2,886 )                  | (1,552 )    |
| Provision (recapture) for loan and lease losses                             | 600                         | 2,000       | 100                       | 1,000       |
| Ending balance  | \$49,494                    | \$51,698    | \$49,494                  | \$51,692    |
| Total noncovered loans, net at end of period, excluding loans held of sale  | \$4,452,674                 | \$4,181,018 | \$4,452,674               | \$4,181,018 |
| Allowance for loan and lease losses to period-end noncovered loans          | 1.11                        | % 1.24      | % 1.11                    | % 1.24      |
| Allowance for unfunded commitments and letters of credit                    |                             |             |                           |             |
| Beginning balance   | \$2,455                     | \$1,915     | \$2,505                   | \$1,915     |
| Net changes in the allowance for unfunded commitments and letters of credit | (100 )                      | 550         | (150 )                    | 550         |
| Ending balance  | \$2,355                     | \$2,465     | \$2,355                   | \$2,465     |

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## FDIC Loss-sharing Asset

The Company has elected to account for amounts receivable under loss-sharing agreements with the FDIC as an indemnification asset in accordance with the Business Combinations topic of the FASB ASC. The FDIC indemnification asset is initially recorded at fair value, based on the discounted expected future cash flows under the loss-sharing agreements.

Subsequent to initial recognition, the FDIC indemnification asset is reviewed quarterly and adjusted for any changes in expected cash flows. These adjustments are measured on the same basis as the related covered loans. Any decrease in expected cash flows from the covered assets due to an increase in expected credit losses will increase the FDIC indemnification asset and any increase in expected future cash flows from the covered assets due to a decrease in expected credit losses will decrease the FDIC indemnification asset. Increases and decreases to the FDIC loss-sharing asset are recorded as adjustments to noninterest income.

At June 30, 2014, the FDIC loss-sharing asset was \$28.0 million which was comprised of a \$25.0 million FDIC indemnification asset and a \$2.9 million FDIC receivable. The FDIC receivable represents the amounts due from the FDIC for claims related to covered losses the Company has incurred net of amounts due to the FDIC relating to shared recoveries.

The following table summarizes the activity related to the FDIC loss-sharing asset for the three and six months ended June 30, 2014 and 2013:

|  | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
|--|-----------------------------|----------|---------------------------|----------|
|  | 2014                        | 2013     | 2014                      | 2013     |
|  | (in thousands)              |          |                           |          |
| Balance at beginning of period             | \$36,837                    | \$83,115 | \$39,846                  | \$96,354 |
| Adjustments not reflected in income:       |                             |          |                           |          |
| Cash payments from the FDIC                | (3,442)                     | (3,268)  | (1,765)                   | (6,387)  |
| FDIC reimbursable losses (recoveries), net | (364)                       | 664      | (231)                     | 1,027    |
| Adjustments reflected in income:           |                             |          |                           |          |
| Amortization, net                          | (5,764)                     | (9,801)  | (12,216)                  | (19,580) |
| Loan impairment (recapture)                | 1,214                       | (1,370)  | 3,151                     | (585)    |
| Sale of other real estate                  | (965)                       | (2,251)  | (1,721)                   | (3,597)  |
| Write-downs of other real estate           | 276                         | 102      | 792                       | 154      |
| Other                                      | 189                         | 183      | 125                       | (12)     |
| Balance at end of period                   | \$27,981                    | \$67,374 | \$27,981                  | \$67,374 |

For additional information on the FDIC loss-sharing asset, please see Note 8 to the Consolidated Financial Statements presented elsewhere in this report.

## Liquidity and Sources of Funds

Our primary sources of funds are customer deposits. Additionally, we utilize advances from the FHLB of Seattle, the FRB of San Francisco, and wholesale repurchase agreements to supplement our funding needs. These funds, together with loan repayments, loan sales, retained earnings, equity and other borrowed funds are used to make loans, to acquire securities and other assets, and to fund continuing operations.

## Deposit Activities

Our deposit products include a wide variety of transaction accounts, savings accounts and time deposit accounts. Core deposits (demand deposit, savings, money market accounts and certificates of deposit less than \$100,000) increased \$38.7 million since year-end 2013.

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We have established a branch system to serve our consumer and business depositors. In addition, management's strategy for funding asset growth is to make use of brokered and other wholesale deposits on an as-needed basis. The Company participates in the Certificate of Deposit Account Registry Service (CDARS®) program. CDARS® is a network that allows participating banks to offer extended FDIC deposit insurance coverage on time deposits. The Company also participates in a similar program to offer extended FDIC deposit insurance coverage on money market accounts. These extended deposit insurance programs are generally available only to existing customers and are not used as a means of generating additional liquidity. At June 30, 2014, CDARS® deposits and brokered money market deposits were \$67.1 million, or 1% of total deposits, compared to \$61.3 million at year-end 2013. The brokered deposits have varied maturities.

The following table sets forth the Company's deposit base by type of product for the dates indicated:

|   | June 30, 2014 |            | December 31, 2013 |            |   |
|---|---------------|------------|-------------------|------------|---|
|   | Balance       | % of Total | Balance           | % of Total |   |
| (dollars in thousands)  |               |            |                   |            |   |
| Core deposits:  |               |            |                   |            |   |
| Demand and other non-interest bearing                         | \$2,190,161   | 36.6       | % \$2,171,703     | 36.4       | % |
| Interest bearing demand                                       | 1,189,620     | 19.9       | % 1,170,006       | 19.6       | % |
| Money market  | 1,553,269     | 26.0       | % 1,569,261       | 26.3       | % |
| Savings   | 532,276       | 8.9        | % 496,444         | 8.3        | % |
| Certificates of deposit less than \$100,000                   | 269,721       | 4.4        | % 288,943         | 4.9        | % |
| Total core deposits   | 5,735,047     | 95.8       | % 5,696,357       | 95.5       | % |
| Certificates of deposit greater than \$100,000                | 182,697       | 3.1        | % 201,498         | 3.5        | % |
| Certificates of deposit insured by CDARS®                     | 18,690        | 0.3        | % 19,488          | 0.3        | % |
| Brokered money market accounts                                | 48,408        | 0.8        | % 41,765          | 0.7        | % |
| Subtotal  | 5,984,842     | 100.0      | % 5,959,108       | 100.0      | % |
| Premium resulting from acquisition date fair value adjustment | 227           |            | 367               |            |   |
| Total deposits  | \$5,985,069   |            | \$5,959,475       |            |   |

**Borrowings**

We rely on FHLB advances and FRB borrowings as another source of both short and long-term funding. FHLB advances and FRB borrowings are secured by bonds within our investment portfolio, and residential, commercial and commercial real estate loans. At June 30, 2014, we had FHLB advances of \$110.6 million compared to \$36.6 million at December 31, 2013.

We also utilize wholesale repurchase agreements as a supplement to our funding sources. Our wholesale repurchase agreements are secured by mortgage-backed securities. At June 30, 2014 and December 31, 2013, we had repurchase agreements of \$25.0 million, which mature in 2018. Management anticipates we will continue to rely on FHLB advances, FRB borrowings, and wholesale repurchase agreements in the future and we will use those funds primarily to make loans and purchase securities.

**Contractual Obligations, Commitments & Off-Balance Sheet Arrangements**

We are party to many contractual financial obligations, including repayment of borrowings, operating and equipment lease payments, off-balance sheet commitments to extend credit and investments in affordable housing partnerships. At June 30, 2014, we had commitments to extend credit of \$1.36 billion compared to \$1.41 billion at December 31, 2013.



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## Capital Resources

Shareholders' equity at June 30, 2014 was \$1.09 billion, an increase from \$1.05 billion at December 31, 2013. Shareholders' equity was 15% of total period-end assets at June 30, 2014 and December 31, 2013.

Capital Ratios: Banking regulations require bank holding companies to maintain a minimum "leverage" ratio of core capital to adjusted quarterly average total assets of at least 3%. In addition, banking regulators have adopted risk-based capital guidelines, under which risk percentages are assigned to various categories of assets and off-balance sheet items to calculate a risk-adjusted capital ratio. Tier I capital generally consists of preferred stock, common shareholders' equity, and trust preferred obligations, less goodwill and certain identifiable intangible assets, while Tier II capital includes the allowance for loan losses and subordinated debt, both subject to certain limitations. Regulatory minimum risk-based capital guidelines require Tier I capital of 4% of risk-adjusted assets and total capital (combined Tier I and Tier II) of 8% to be considered "adequately capitalized".

FDIC regulations set forth the qualifications necessary for a bank to be classified as "well capitalized", primarily for assignment of FDIC insurance premium rates. To qualify as "well capitalized," banks must have a Tier I risk-adjusted capital ratio of at least 6%, a total risk-adjusted capital ratio of at least 10%, and a leverage ratio of at least 5%. Failure to qualify as "well capitalized" can negatively impact a bank's ability to expand and to engage in certain activities. The Company and its banking subsidiary qualify as "well-capitalized" at June 30, 2014 and December 31, 2013. The following table presents the regulatory standards for adequately capitalized and well-capitalized institutions and the capital ratios for the Company and its banking subsidiary at June 30, 2014 and December 31, 2013:

|                                 | Company       |                   | Columbia Bank |                   | Requirements |         | Adequately capitalized | Well-Capitalized |   |
|---------------------------------|---------------|-------------------|---------------|-------------------|--------------|---------|------------------------|------------------|---|
|                                 | June 30, 2014 | December 31, 2013 | June 30, 2014 | December 31, 2013 |              |         |                        |                  |   |
| Total risk-based capital ratio  | 14.52         | % 14.68           | % 13.75       | % 13.52           | % 8.00       | % 10.00 | %                      |                  | % |
| Tier I risk-based capital ratio | 13.27         | % 13.43           | % 12.50       | % 12.27           | % 4.00       | % 6.00  | %                      |                  | % |
| Leverage ratio                  | 10.52         | % 10.19           | % 9.91        | % 9.29            | % 4.00       | % 5.00  | %                      |                  | % |

## Stock Repurchase Program

In 2011, the Board of Directors approved a stock repurchase program authorizing the Company to repurchase up to 2 million shares of its outstanding shares of common stock. The Company intends to purchase the shares from time to time in the open market or in private transactions, under conditions which allow such repurchases to be accretive to earnings per share while maintaining capital ratios that exceed the guidelines for a well-capitalized financial institution. No shares were repurchased under the stock repurchase program during the first six months of 2014.

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## Non-GAAP Financial Measures

The Company considers operating net interest margin (tax equivalent) to be an important measurement as it more closely reflects the ongoing operating performance of the Company. Despite the importance of the operating net interest margin (tax equivalent) to the Company, there is no standardized definition for it and, as a result, the Company's calculations may not be comparable with other organizations. Also, there may be limits in the usefulness of this measure to investors. As a result, the Company encourages readers to consider its consolidated financial statements in their entirety and not to rely on any single financial measure.

The following table reconciles the Company's calculation of the operating net interest margin (tax equivalent) to the net interest margin (tax equivalent) for the periods indicated:

|  | Three Months Ended June 30, |             | Six Months Ended June 30, |             |   |
|--|-----------------------------|-------------|---------------------------|-------------|---|
|  | 2014                        | 2013        | 2014                      | 2013        |   |
| Operating net interest margin non-GAAP reconciliation:                   | (dollars in thousands)      |             |                           |             |   |
| Net interest income (tax equivalent) (1)                                 | \$77,070                    | \$81,489    | \$152,858                 | \$136,368   |   |
| Adjustments to arrive at operating net interest income (tax equivalent): |                             |             |                           |             |   |
| Incremental accretion income on FDIC acquired impaired loans             | (5,734 )                    | (7,837 )    | (12,223 )                 | (16,212 )   |   |
| Incremental accretion income on other FDIC acquired loans                | (95 )                       | (638 )      | (299 )                    | (1,708 )    |   |
| Incremental accretion income on other acquired loans                     | (5,481 )                    | (9,635 )    | (11,096 )                 | (9,635 )    |   |
| Premium amortization on acquired securities                              | 1,554                       | 3,054       | 3,179                     | 3,054       |   |
| Interest reversals on nonaccrual loans                                   | 392                         | 145         | 680                       | 394         |   |
| Prepayment charges on FHLB advances                                      | —                           | 1,548       | —                         | 1,548       |   |
| Operating net interest income (tax equivalent) (1)                       | 67,706                      | 68,126      | 133,099                   | 113,809     |   |
| Average interest earning assets  | \$6,339,102                 | \$6,284,281 | \$6,292,157               | \$5,316,009 |   |
| Net interest margin (tax equivalent) (1)                                 | 4.86                        | % 5.19      | % 4.86                    | % 5.13      | % |
| Operating net interest margin (tax equivalent) (1)                       | 4.27                        | % 4.34      | % 4.23                    | % 4.28      | % |

(1) Tax-exempt interest income has been adjusted to a tax equivalent basis. The amount of such adjustment was an addition to net interest income of \$1.9 million and \$1.5 million for the three months ended June 30, 2014 and 2013, respectively, and \$3.8 million and \$2.9 million for the six months ended June 30, 2014 and 2013, respectively.

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**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

A number of measures are used to monitor and manage interest rate risk, including income simulations and interest sensitivity (gap) analysis. An income simulation model is the primary tool used to assess the direction and magnitude of changes in net interest income resulting from changes in interest rates. Basic assumptions in the model include prepayment speeds on mortgage-related assets, cash flows and maturities of other investment securities, loan and deposit volumes and pricing. These assumptions are inherently subjective and, as a result, the model cannot precisely estimate net interest income or precisely predict the impact of higher or lower interest rates on net interest income. Actual results will differ from simulated results due to timing, magnitude and frequency of interest rate changes and changes in market conditions and management strategies, among other factors. At June 30, 2014, based on the measures used to monitor and manage interest rate risk, there has not been a material change in the Company's interest rate risk since December 31, 2013. For additional information, refer to Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's 2013 Annual Report on Form 10-K.

**Item 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

An evaluation was carried out under the supervision and with the participation of the Company's management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934). Based on that evaluation, the CEO and CFO have concluded that as of the end of the period covered by this report, our disclosure controls and procedures are effective in ensuring that the information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 is (i) accumulated and communicated to our management (including the CEO and CFO) to allow timely decisions regarding required disclosure, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

**Changes in Internal Controls Over Financial Reporting**

There was no change in our internal controls over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

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## PART II - OTHER INFORMATION

## Item 1. LEGAL PROCEEDINGS

In our Form 10-Q for the quarter ended March 31, 2013, we initially reported on an Objection to Personal Representative's Petition and Petition for Surcharge of Personal Representative in Linn County Circuit Court that was served on West Coast Trust, which as a result of our acquisition of West Coast, is now a subsidiary of the Company. There have been no material developments in this case since the filing of our last report on Form 10-Q for the quarter ended March 31, 2014 and the case remains on appeal.

## Item 1A. RISK FACTORS

Refer to Item 1A of Part I of the Company's Annual Report on Form 10-K for the year ended December 31, 2013 for a discussion of risk factors relating to the Company's business. The Company believes that there has been no material change in its risk factors as previously disclosed in the Company's Form 10-K.

## Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) Not applicable

(b) Not applicable

(c) The following table provides information about repurchases of common stock by the Company during the quarter ended June 30, 2014:

| Period               | Total Number of Common Shares Purchased (1) | Average Price Paid per Common Share | Total number of Shares Purchased as Part of Publicly Announced Plan (2) | Maximum Number of Remaining Shares That May Be Purchased at Period End Under the Plan |
|----------------------|---|-------------------------------------|---|---|
| 4/1/2014 - 4/30/2014 | 2,259                                       | \$27.43                             | —   | 2,000,000   |
| 5/1/2014 - 5/31/2014 | 691   | 24.70                               | —   | 2,000,000   |
| 6/1/2014 - 6/30/2014 | —   | —                                   | —   | 2,000,000   |
|                      | 2,950                                       | \$26.79                             | —   |   |

(1) Common shares repurchased by the Company during the quarter consist of cancellation of 2,950 shares of common stock to pay withholding taxes. During the three months ended June 30, 2014, no shares were repurchased pursuant to the Company's publicly announced corporate stock repurchase plan described in (2) below.

(2) The repurchase plan, which was approved by the Board and announced in 2011, originally authorized the repurchase of up to 2 million shares.

## Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

## Item 4. MINE SAFETY DISCLOSURES

Not applicable.

## Item 5. OTHER INFORMATION

None.

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Item 6. EXHIBITS

10.1\*+ Change in Control Agreement between the Bank and Andrew McDonald dated June 1, 2014

31.1+ Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2+ Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32+ Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101+ The following financial information from Columbia Banking System, Inc's. Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 is formatted in XBRL: (i) the Unaudited Consolidated Balance Sheets, (ii) the Unaudited Consolidated Statements of Income, (iii) the Unaudited Consolidated Statements of Comprehensive Income, (iv) the Unaudited Consolidated Statements of Changes in Shareholders' Equity, (v) the Unaudited Consolidated Statements of Cash Flows, and (vi) the Notes to Unaudited Consolidated Financial Statements.

\* Management contract or compensatory plan or arrangement

+ Filed herewith

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

COLUMBIA BANKING SYSTEM, INC.

Date: August 6, 2014

By /s/ MELANIE J. DRESSEL  
Melanie J. Dressel  
President and Chief Executive  
Officer  
(Principal Executive Officer)

Date: August 6, 2014

By /s/ CLINT E. STEIN  
Clint E. Stein  
Executive Vice President and  
Chief Financial Officer  
(Principal Financial and Accounting  
Officer)

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- \* Management contract or compensatory plan or arrangement
- + Filed herewith