COLUMBIA BANKING SYSTEM INC
Form 10-K
March 01, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2012 or

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

Commission File Number 0-20288

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

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

1301 “A” Street
Tacoma, Washington 98402
(Address of principal executive offices) (Zip code)
Registrant’s Telephone Number, Including Area Code: (253) 305-1900

Securities Registered Pursuant to Section 12(b) of the Act:
Common Stock, No Par Value
(Title of class)
Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No ý

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (17 C.F.R. 229.405) is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

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

ý Large Accelerated Filer ¨ Accelerated Filer ¨ Non-accelerated Filer ¨ Smaller Reporting Company

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

The aggregate market value of Common Stock held by non-affiliates of the registrant at June 30, 2012 was $731,595,865 based on the closing sale price of the Common Stock on that date.

The number of shares of registrant's Common Stock outstanding at January 31, 2013 was 39,707,319.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Registrant's definitive 2013 Annual Meeting Proxy Statement.	Part III

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FORM 10-K ANNUAL REPORT
DECEMBER 31, 2012

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This annual report on Form 10-K may contain 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 si meaning. 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 titled "Risk Factors," "Business" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Form 10-K, the following factors, among others, could cause actual results to differ materially from the anticipated results:

- local and national economic conditions could be less favorable than expected or could have a more direct and pronounced effect on us than expected and adversely affect our ability to continue internal growth at historical rates and maintain the quality of our earning assets;
- the local housing/real estate markets where we operate and make loans could continue to face challenges;
- the risks presented by a continued challenging economy, including the current uncertainty regarding sequestration, 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 and infrastructure could not be realized;
- the possibility that the proposed acquisition of West Coast Bancorp ("West Coast") does not close when expected 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 acquisition of West Coast is not completed;
- the ability to successfully combine Columbia and the West Coast 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;
- our reliance on FHLB advances and FRB borrowings as additional sources of short and long-term funding;
- changes in the scope and cost of FDIC insurance and other coverages;
- the impact of FDIC-assisted 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;
- 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;
- the terms and costs of the numerous actions taken by the Federal Reserve, the U.S. Congress, the Treasury, the FDIC, the SEC and others in response to the liquidity and credit crisis, or the failure of these actions to help stabilize the financial markets, asset prices, market liquidity, or worsening of current financial market and economic conditions could materially and adversely affect our business, financial condition, results of operations, and the trading price of our common stock;
- 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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PART I

ITEM 1. BUSINESS

General

Columbia Banking System, Inc. (referred to in this report as “we,” “our,”, “the Company”, and "Columbia") is a registered bank holding company whose wholly owned banking subsidiary, Columbia State Bank (“Columbia Bank” or “the Bank”) also does business under the Bank of Astoria name and conducts full-service commercial banking business in the states of Washington and Oregon. Headquartered in Tacoma, Washington, we provide a full range of banking services to small and medium-sized businesses, professionals and individuals.

Columbia Bank was established in 1993 to take advantage of commercial banking business opportunities in our principal market area. The opportunities to capture commercial banking market share were due to increased consolidations of banks, primarily through acquisitions by out-of-state bank holding companies, which created dislocation of customers.

At December 31, 2012 Columbia Bank had 99 branch locations in Washington and Oregon. Included in these branch locations are six Columbia Bank branches doing business in Oregon under the Bank of Astoria name in Astoria, Warrenton, Seaside and Cannon Beach in Clatsop County and in Manzanita and Tillamook in Tillamook County. Substantially all of Columbia Bank’s loans, loan commitments and core deposits are within its service areas. Columbia Bank is a Washington state-chartered commercial bank, the deposits of which are insured in whole or in part by the Federal Deposit Insurance Corporation (“FDIC”). Columbia Bank is subject to regulation by the FDIC and the Washington State Department of Financial Institutions Division of Banks. Although Columbia Bank is not a member of the Federal Reserve System, the Board of Governors of the Federal Reserve System has certain supervisory authority over the Company, which can also affect Columbia Bank.

Business Overview

Our goal is to continue to be a leading Pacific Northwest regional community banking company while consistently increasing shareholder value. We continue to build on our reputation for excellent customer service in order to be recognized as the bank of choice for retail deposit customers, small to medium-sized businesses and affluent households in all markets we serve.

We have established a network of 99 branches in Washington and Oregon as of December 31, 2012 from which we intend to grow market share. We operate 59 branches in western Washington, 15 branches in eastern Washington, 15 branches in western Oregon, and 10 branches in eastern Oregon. Washington counties include: Adams, Asotin, Benton, Clallam, Clark, Cowlitz, Franklin, Jefferson, King, Kitsap, Klickitat, Mason, Pierce, Snohomish, Skagit, Spokane, Thurston, Walla Walla, Whatcom, Whitman and Yakima. Oregon counties include Clackamas, Clatsop, Deschutes, Hood River, Jefferson, Marion, Multnomah, Tillamook, Umatilla, Wasco and Yamhill.

In order to fund our lending activities and to allow for increased contact with customers, we utilize a branch system to better serve both retail and business depositors. We believe this approach enables us to expand lending activities while attracting a stable core deposit base. To support our strategy of market penetration and increased profitability while continuing our personalized banking approach, we have invested in experienced banking and administrative personnel and have incurred related costs in the creation of our branch network.

Business Strategy

Our business strategy is to provide our customers with the financial sophistication and product depth of a regional banking company while retaining the appeal and service level of a community bank. We continually evaluate our existing business processes while focusing on maintaining asset quality and balanced loan and deposit portfolios, building our strong core deposit base, expanding total revenue and controlling expenses in an effort to increase our return on average equity and gain operational efficiencies. As a result of our strong commitment to highly personalized, relationship-oriented customer service, our varied products, our strategic branch locations and the long-standing community presence of our managers, banking officers and branch personnel, we believe we are well positioned to attract and retain new customers and to increase our market share of loans, deposits, investments, and other financial services. We are committed to increasing market share in the communities we serve by continuing to leverage our existing branch network, adding new branch locations and considering business combinations that are

consistent with our expansion strategy throughout the Pacific Northwest.

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To that end, on September 25, 2012, we entered into a definitive agreement to acquire West Coast Bancorp, the parent company of West Coast Bank of Lake Oswego, Oregon, with $2.49 billion in assets at December 31, 2012 ("West Coast"). Under the terms of the merger, West Coast shareholders will receive a combination of Company stock and cash valued at just over $500 million. Regulatory applications have been filed and special shareholder meetings for the Company and West Coast are scheduled for March 18, 2013. The merger is scheduled to close on April 1, 2013.

Products & Services

We place the highest priority on customer service and assist our customers in making informed decisions when selecting from the products and services we offer. We continuously review our product and service offerings to ensure that we provide our customers with the tools to meet their financial needs. A more complete listing of all the services and products available to our customers can be found on our website: www.columbiabank.com. Some of the core products and services we offer include:

Personal Banking

- Checking and Saving Accounts
- Online Banking
- Electronic Bill Pay
- Consumer Lending
- Residential Lending
- VISA® Card Services

Business Banking

- Checking & Saving Accounts
- Online Banking
- Remote Deposit Capture
- Cash Management
- Commercial & Industrial Lending
- VISA® Card Services
- Agricultural Lending
- SBA Lending
- Small Business Services
- International Banking
- Merchant Card Services
- Real Estate and Real Estate Construction Lending

Wealth Management

- Investment Services through CB Financial Services
- Private Banking
- Trust Services
- Professional Banking

Personal Banking: We offer our personal banking customers an assortment of account products including noninterest and interest-bearing checking, savings, money market and certificate of deposit accounts. Overdraft protection is also available with direct links to the customer's checking account. Our online banking service, Columbia Online™, provides our personal banking customers with the ability to safely and securely conduct their banking business 24 hours a day, 7 days a week. Personal banking customers are also provided with a variety of borrowing products including fixed and variable rate home equity loans and lines of credit, home mortgages for purchases and refinances, personal loans, and other consumer loans. Eligible personal banking customers with checking accounts are provided a Visa® Debit Card which can be used both to make purchases and as an ATM card. A variety of Visa® Credit Cards are also available to eligible personal banking customers.

Online Banking

Columbia Bank's Premier Personal Online Banking provides simple navigation, access to important information and frequently used features, as well as the foundation for a best-in-class mobile banking solution.

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Business Banking: We offer our business banking customers the foundation of a variety of checking, savings, interest bearing money market and certificate of deposit accounts to satisfy all their banking needs. In addition to these core banking products we provide a breadth of services to support the complete financial needs of small and middle market businesses including Cash Management, Professional Banking, International Banking, VISA Credit Cards, Merchant Services and Commercial Lending.

Cash Management

Columbia Bank’s diversified Cash Management Programs are tailored to meet specific banking needs of each individual business. We combine technology with integrated operations and local expertise for safe, powerful, flexible solutions. Columbia customers, of all sizes, choose from a full range of transaction and Cash Management tools to gain more control over and make more from their money. Services include Commercial Online Banking, Positive Pay fraud protection, Automated Clearing House (ACH) payments, and Remote Deposit Capture.

Our Cash Management professionals work with businesses to find the best combination of services to meet their needs. This customized, modular approach ensures their business banking operations are cost-effective now, with flexibility for future growth.

International Banking

Columbia Bank’s International services division offers a range of financial services to help forward-thinking independent businesses explore global markets and conduct international trade smoothly and expediently. We are proud to provide small and mid-size business with the same caliber of expertise and personalized service that national banks usually limit to large businesses. Our experience with foreign currency exchange, letters of credit, foreign collections and trade finance services can help independent companies open the door to new markets and suppliers overseas.

Commercial Lending

We offer a variety of loan products tailored to meet the various needs of business banking customers. Commercial loan products include accounts receivable and inventory financing as well as Small Business Administration ("SBA") financing. We also offer commercial real estate loan products for construction and development or permanent financing. Real estate lending activities have been focused on construction and permanent loans for both owner occupants and investor oriented real estate properties. Commercial banking has been directed toward meeting the credit and related deposit needs of various sized businesses and professional practice organizations operating in our primary market areas.

Business VISA® Credit and Debit Cards

We offer our business banking customers a selection of Visa® Cards including the Business Debit Card that works like a check wherever Visa® is accepted. We partner with First National Bank of Omaha to offer Visa® Credit Cards such as the Corporate Card which can be used all over the world as well as the Business Edition® and Business Edition Plus® that earns reward points with every purchase.

Merchant Card Services

Business clients that use Columbia’s Merchant Card Services have the ability to accept Visa®, MasterCard® and Discover® sales drafts for deposit directly into their business checking account. Merchants are provided with a comprehensive accounting system tailored to their needs, which includes month-to-date credit card deposit information on a transaction statement. Internet access is available, allowing business customers to review merchant statements, authorized, captured, cleared and settled transactions.

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Wealth Management: We offer tailored solutions to high net-worth individuals, families and professional businesses in the areas of private banking, professional banking, financial services and trust and estate services.

CB Financial Services

Located at Columbia State Bank, CB Financial Services[1], offers a comprehensive array of financial solutions designed to grow, protect and transition wealth by delivering an unprecedented level of personalized service and expertise.

Comprehensive solutions include:

- Financial Planning: Asset Allocation, Net Worth Analysis, Estate Planning, Retirement Planning, Education Planning, Insurance Analysis, Wealth Transfer.
- Investment Management Solutions: Professional Asset Management[1], Strategic Asset Allocation, Fixed Income (Bond) Investing (Municipal, Corporate, Government), Exchange Traded Funds (ETFs), Annuities, Mutual Funds, Equities.
- Insurance Solutions: Long-Term Care, Disability, Life Insurance (Key Man Life Insurance, Buy-Sell Agreements).
- Retirement Solutions: 401(k) plans, SEPs, IRAs, SIMPLE, Profit Sharing, Non-Qualified Deferred Compensation Plans, Money Pension Plan.

Private Banking

Columbia Private Banking offers affluent clientele and their businesses complex financial solutions, such as deposit and cash management services, credit services, and wealth management strategies. Each private banker provides advisory services[2] and coordinates a relationship team of experienced financial professionals to meet the unique needs of each discerning customer.

Trust Services

Columbia Bank Trust Services offer a wide range of high quality fiduciary, investment and administrative trust services, coupled with local, personalized attention to the unique requirements of each trust. Services include Personal Trusts, Special Needs (Supplemental) Trusts, Estate Settlement Services, Investment Agency and Charitable Management Services.

Our highly skilled and experienced professionals are fully dedicated to providing the information, diligence and care to help our customers achieve their financial goals and plan for a better future.

Professional Banking

Columbia Professional Bankers are uniquely qualified to help medical and dental professionals acquire, build and grow their practice. We offer tailored banking and investment solutions delivered by experienced bankers with the industry knowledge necessary to meet their business's unique needs. No matter what the needs are now or in the years to come, we guide professionals through all their financial options to make their banking as easy and personal as possible.

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(1) Securities, insurance products and advisory services are offered through Cetera Investment Financial Services, Inc., an independent, registered broker/dealer. Member FINRA/SIPC. CB Financial Services is a marketing name for Cetera. * Investment products are Not FDIC insured * No bank guarantee * Not a deposit * Not insured by any federal government agency * May lose value.

(2) Advisory services may only be offered by Investment Adviser Representatives in connection with an appropriate Cetera Advisory Services Agreement and disclosure brochure as provided.

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Competition

Our industry remains highly competitive despite challenging economic conditions. Several other financial institutions with greater resources compete for banking business in our market areas. These competitors have the ability to make larger loans, finance extensive advertising and promotion campaigns, access international financial markets and allocate their investment assets to regions of highest yield and demand. In addition to competition from other banking institutions, we continue to compete with non-banking companies such as credit unions, brokerage houses and other financial services companies. We compete for deposits, loans, and other financial services by offering our customers similar breadth of products as our larger competitors while delivering a more personalized service level with faster transaction turnaround time.

Market Areas

Washington: Approximately 30%, or 22, of our Washington branches are located in Pierce County, with an estimated 2012 population of 808,000 residents. At June 30, 2012 our Pierce County branch locations' share of the county's total deposit market was 18%[(1)], ranking first among our competition. Also located in Pierce County is our Company headquarters in the city of Tacoma and one nearby operational facility. Some of the most significant contributors to the Pierce County economy are the Port of Tacoma whose activities are related to more than 40,000 jobs in the county and well over 100,000 in the state of Washington, Joint Base Lewis-McChord which accounts for nearly 20% of the County's total employment, and the manufacturing industry which supplies the Boeing Company.

We operate 13 branch locations in King County, including Seattle, Bellevue and Redmond. King County, which is Washington's most highly populated county at close to two million residents, is a market that has significant growth potential for our Company. At June 30, 2012 we ranked 14th in our share of the King County deposit market or just over 1%[(1)]; however, we continue to make inroads within this market through the strategic expansion of our banking team. The north King County economy is primarily made up of the aerospace, construction, computer software and biotechnology industries. South King County, with its close proximity to Pierce County, is considered a natural extension of our primary market area. The economy of south King County is predominantly comprised of residential communities supported by light industrial, retail, aerospace and distributing and warehousing industries.

Some other market areas served by the Company include Cowlitz County where we rank second, or 17% [(1)], in deposit market share, operating two branch locations; and Kitsap County, where we operate six branches with 8%[(1)] of the deposit market share. We also have locations in Adams, Asotin, Benton, Clallam, Clark, Franklin, Grant, Jefferson, Klickitat, Skagit, Snohomish, Spokane, Thurston, Walla Walla, Whatcom, Whitman, and Yakima counties.

Oregon: With the acquisition of Columbia River Bank in January 2010, we significantly expanded our market area in western Oregon, and entered the eastern Oregon market area, bringing our total to 25 branch locations in the state. Oregon counties include Clackamas, Clatsop, Deschutes, Hood River, Jefferson, Marion, Multnomah, Tillamook, Umatilla, Wasco and Yamhill. Columbia Bank ranks fourteenth[(1)] in total deposit market share in Oregon, with just over 1% of the deposit market share. We are first[(1)] in deposit market share in Clatsop County (29%), Hood River (23%) and Wasco counties (30%). Oregon market areas provide a significant opportunity for expansion in the future, particularly after the acquisition of West Coast.

For additional information regarding our branches, see Item 2. Properties of this report.

Employees

As of December 31, 2012 the Company and its banking subsidiary employed approximately 1,198 full-time equivalent employees, a 5% decrease from 1,256 employees at December 31, 2011. We value our employees and pride ourselves on providing a professional work environment accompanied by comprehensive benefit programs. We are committed to providing flexible and value-added benefits to our employees through a "Total Compensation Philosophy" which incorporates all compensation and benefits. Our continued commitment to employees contributed to Columbia Bank being again awarded one of the Puget Sound Business Journal's "Washington's Best Workplaces 2012".

(1) Source: FDIC Annual Summary of Deposit Report as of June 30, 2012.

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Available Information

We file annual reports on Form 10-K, quarterly reports on Form 10-Q, periodic reports on Form 8-K, proxy statements and other information with the United States Securities and Exchange Commission (“SEC”). The public may obtain copies of these reports and any amendments at the SEC’s Internet site, www.sec.gov.

Additionally, reports filed with the SEC can be obtained through our website at www.columbiabank.com. These reports are available through our website as soon as reasonably practicable after they are filed electronically with the SEC. Information contained on our website is not intended to be incorporated by reference into this report.

Supervision and Regulation

The following discussion provides an overview of certain elements of the extensive regulatory framework applicable to the Company and Columbia State Bank, which operates under the names Columbia Bank in Washington, and Columbia State Bank and Bank of Astoria in Oregon (collectively, referred to herein as “Columbia Bank”). This regulatory framework is primarily designed for the protection of depositors, federal deposit insurance funds and the banking system as a whole, rather than specifically for the protection of shareholders. Due to the breadth and growth of this regulatory framework, our costs of compliance continue to increase in order to monitor and satisfy these requirements.

To the extent that this section describes statutory and regulatory provisions, it is qualified by reference to those provisions. These statutes and regulations, as well as related policies, are subject to change by Congress, state legislatures and federal and state regulators. Changes in statutes, regulations or regulatory policies applicable to us, including the interpretation or implementation thereof, could have a material effect on our business or operations. In light of the recent financial crisis, numerous changes to the statutes, regulations or regulatory policies applicable to us have been made or proposed. The full extent to which these changes will impact our business is not yet known. However, our continued efforts to monitor and comply with new regulatory requirements add to the complexity and cost of our business.

Federal Bank Holding Company Regulation

General. The Company is a bank holding company as defined in the Bank Holding Company Act of 1956, as amended (“BHCA”), and is therefore subject to regulation, supervision and examination by the Federal Reserve. In general, the BHCA limits the business of bank holding companies to owning or controlling banks and engaging in other activities closely related to banking. The Company must file reports with and provide the Federal Reserve such additional information as it may require. Under the Financial Services Modernization Act of 1999, a bank holding company may apply to the Federal Reserve to become a financial holding company, and thereby engage (directly or through a subsidiary) in certain expanded activities deemed financial in nature, such as securities and insurance underwriting.

Holding Company Bank Ownership. The BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve before (i) acquiring, directly or indirectly, ownership or control of any voting shares of another bank or bank holding company if, after such acquisition, it would own or control more than 5% of such shares; (ii) acquiring all or substantially all of the assets of another bank or bank holding company; or (iii) merging or consolidating with another bank holding company.

Holding Company Control of Nonbanks. With some exceptions, the BHCA also prohibits a bank holding company from acquiring or retaining direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or bank holding company, or from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. The principal exceptions to these prohibitions involve certain non-bank activities that, by statute or by Federal Reserve regulation or order, have been identified as activities closely related to the business of banking or of managing or controlling banks.

Transactions with Affiliates. Subsidiary banks of a bank holding company are subject to restrictions imposed by the Federal Reserve Act on extensions of credit to the holding company or its subsidiaries, on investments in their securities and on the use of their securities as collateral for loans to any borrower. These regulations and restrictions may limit the Company's ability to obtain funds from Columbia Bank for its cash needs, including funds for payment of dividends, interest and operational expenses.

Tying Arrangements. We are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, sale or lease of property or furnishing of services. For example, with certain exceptions, neither

the Company nor its subsidiaries may condition an extension of credit to a customer on either (i) a requirement that the customer obtain additional services provided by us; or (ii) an agreement by the customer to refrain from obtaining other services from a competitor.

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Support of Subsidiary Banks. Under Federal Reserve policy and the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), the Company is expected to act as a source of financial and managerial strength to Columbia Bank. This means that the Company is required to commit, as necessary, resources to support Columbia Bank. Any capital loans a bank holding company makes to its subsidiary banks are subordinate to deposits and to certain other indebtedness of those subsidiary banks.

State Law Restrictions. As a Washington corporation, the Company is subject to certain limitations and restrictions under applicable Washington corporate law. For example, state law restrictions in Washington include limitations and restrictions relating to indemnification of directors, distributions to shareholders, transactions involving directors, officers or interested shareholders, maintenance of books, records, and minutes, and observance of certain corporate formalities.

Federal and State Regulation of Columbia Bank

General. The deposits of Columbia Bank, a Washington chartered commercial bank with branches in Washington and Oregon, are insured by the FDIC. As a result, Columbia Bank is subject to supervision and regulation by the Washington Department of Financial Institutions' Division of Banks and the FDIC. With respect to branches of Columbia Bank in Oregon, the Bank is also subject to supervision and regulation by the Oregon Department of Consumer and Business Services, as well as the FDIC. These agencies have the authority to prohibit banks from engaging in what they believe constitute unsafe or unsound banking practices.

Consumer Protection. The Bank is subject to a variety of federal and state consumer protection laws and regulations that govern its relationship with consumers including laws and regulations that impose certain disclosure requirements and regulate the manner in which we take deposits, make and collect loans, and provide other services. Failure to comply with these laws and regulations may subject the Bank to various penalties, including but not limited to, enforcement actions, injunctions, fines, civil liability, criminal penalties, punitive damages, and the loss of certain contractual rights.

Community Reinvestment. The Community Reinvestment Act ("CRA") of 1977 requires that, in connection with examinations of financial institutions within their jurisdiction, the Federal Reserve or the FDIC evaluate the record of the financial institution in meeting the credit needs of its local communities, including low and moderate-income neighborhoods, consistent with the safe and sound operation of the institution. A bank's community reinvestment record is also considered by the applicable banking agencies in evaluating mergers, acquisitions and applications to open a branch or facility.

Insider Credit Transactions. Banks are also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal shareholders or any related interests of such persons. Extensions of credit (i) must be made on substantially the same terms, including interest rates and collateral, and follow credit underwriting procedures that are at least as stringent as those prevailing at the time for comparable transactions with persons not related to the lending bank; and (ii) must not involve more than the normal risk of repayment or present other unfavorable features. Banks are also subject to certain lending limits and restrictions on overdrafts to insiders. A violation of these restrictions may result in the assessment of substantial civil monetary penalties, regulatory enforcement actions, and other regulatory sanctions.

Regulation of Management. Federal law (i) sets forth circumstances under which officers or directors of a bank may be removed by the institution's federal supervisory agency; (ii) places restraints on lending by a bank to its executive officers, directors, principal shareholders, and their related interests; and (iii) generally prohibits management personnel of a bank from serving as directors or in other management positions of another financial institution whose assets exceed a specified amount or which has an office within a specified geographic area.

Safety and Soundness Standards. Certain non-capital safety and soundness standards are also imposed upon banks. These standards cover internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, such other operational and managerial standards as the agency determines to be appropriate, and standards for asset quality, earnings and stock valuation. An institution that fails to meet these standards may be subject to regulatory sanctions.

Interstate Banking and Branching

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (“Interstate Act”) together with the Dodd-Frank Act relaxed prior interstate branching restrictions under federal law by permitting, subject to regulatory approval, state and federally chartered commercial banks to establish branches in states where the laws permit banks chartered in such states to establish branches. The Interstate Act requires regulators to consult with community organizations before permitting an interstate institution to close a branch in a low-income area. Federal banking agency regulations prohibit banks from using their interstate branches primarily for deposit production and the federal banking agencies have implemented a loan-to-deposit ratio screen to ensure compliance with this prohibition.

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Dividends

The principal source of the Company's cash is from dividends received from Columbia Bank, which are subject to government regulation and limitations. Regulatory authorities may prohibit banks and bank holding companies from paying dividends in a manner that would constitute an unsafe or unsound banking practice or would reduce the amount of its capital below that necessary to meet minimum applicable regulatory capital requirements. Washington law also limits a bank's ability to pay dividends that are greater than the bank's retained earnings without approval of the applicable banking agency. Additionally, current guidance from the Federal Reserve provides, among other things, that dividends per share on the Company's common stock generally should not exceed earnings per share, measured over the previous four fiscal quarters.

Capital Adequacy

Regulatory Capital Guidelines. Federal bank regulatory agencies use capital adequacy guidelines in the examination and regulation of bank holding companies and banks. The guidelines are “risk-based,” meaning that they are designed to make capital requirements more sensitive to differences in risk profiles among banks and bank holding companies.

Tier I and Tier II Capital. Under the guidelines, an institution's capital is divided into two broad categories, Tier I capital and Tier II capital. Tier I capital generally consists of common stockholders' equity (including surplus and undivided profits), qualifying non-cumulative perpetual preferred stock, and qualified minority interests in the equity accounts of consolidated subsidiaries. Tier I capital generally excludes goodwill and intangible assets, net unrealized gains and losses on available for sale securities and accumulated net gains and losses on cash flow hedges. Tier II capital generally consists of the allowance for loan losses, hybrid capital instruments and qualifying subordinated debt. The sum of Tier I capital and Tier II capital represents an institution's total capital. The guidelines require that at least 50% of an institution's total capital consist of Tier I capital.

Risk-based Capital Ratios. The adequacy of an institution's capital is gauged primarily with reference to the institution's risk-weighted assets. The guidelines assign risk weightings to an institution's assets in an effort to quantify the relative risk of each asset and to determine the minimum capital required to support that risk. An institution's risk-weighted assets are then compared with its Tier I capital and total capital to arrive at a Tier I risk-based ratio and a total risk-based ratio, respectively. The guidelines provide that an institution must have a minimum Tier I risk-based ratio of 4% and a minimum total risk-based ratio of 8%.

Leverage Ratio. The guidelines also employ a leverage ratio, which is Tier I capital as a percentage of average total assets, less intangibles. The principal objective of the leverage ratio is to constrain the maximum degree to which a bank holding company may leverage its equity capital base. The minimum leverage ratio is 3%; however, for all but the most highly rated bank holding companies and for bank holding companies seeking to expand, regulators expect an additional cushion of at least 1% to 2%.

Prompt Corrective Action. Under the guidelines, an institution is assigned to one of five capital categories depending on its total risk-based capital ratio, Tier I risk-based capital ratio, and leverage ratio, together with certain subjective factors. The categories range from “well capitalized” to “critically undercapitalized.” Institutions that are “undercapitalized” or lower are subject to certain mandatory supervisory corrective actions. At each successively lower capital category, an insured bank is subject to increased restrictions on its operations. During these challenging economic times, the federal banking regulators have actively enforced these provisions.

Regulatory Oversight and Examination

The Federal Reserve conducts periodic inspections of bank holding companies, which are performed both onsite and offsite. The supervisory objectives of the inspection program are to ascertain whether the financial strength of the bank holding company is being maintained on an ongoing basis and to determine the effects or consequences of transactions between a holding company or its non-banking subsidiaries and its subsidiary banks. For holding companies under $10 billion in assets, the inspection type and frequency varies depending on asset size, complexity of the organization, and the holding company's rating at its last inspection.

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Banks are subject to periodic examinations by their primary regulators. Bank examinations have evolved from reliance on transaction testing in assessing a bank's condition to a risk-focused approach. These examinations are extensive and cover the entire breadth of operations of the bank. Generally, safety and soundness examinations occur on an 18-month cycle for banks under $500 million in total assets that are well capitalized and without regulatory issues, and 12-months otherwise. Examinations alternate between the federal and state bank regulatory agency or may occur on a combined schedule. The frequency of consumer compliance and CRA examinations is linked to the size of the institution and its compliance and CRA ratings at its most recent examinations. However, the examination authority of the Federal Reserve and the FDIC allows them to examine supervised banks as frequently as deemed necessary based on the condition of the bank or as a result of certain triggering events.

Corporate Governance and Accounting

Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 (the “Act”) addresses, among other things, corporate governance, auditing and accounting, enhanced and timely disclosure of corporate information, and penalties for non-compliance. Generally, the Act (i) requires chief executive officers and chief financial officers to certify to the accuracy of periodic reports filed with the SEC; (ii) imposes specific and enhanced corporate disclosure requirements; (iii) accelerates the time frame for reporting of insider transactions and periodic disclosures by public companies; (iv) requires companies to adopt and disclose information about corporate governance practices, including whether or not they have adopted a code of ethics for senior financial officers and whether the audit committee includes at least one “audit committee financial expert;” and (v) requires the SEC, based on certain enumerated factors, to regularly and systematically review corporate filings.

Anti-terrorism

USA Patriot Act of 2001. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, intended to combat terrorism, was renewed with certain amendments in 2006 (the “Patriot Act”). The Patriot Act, in relevant part, (i) prohibits banks from providing correspondent accounts directly to foreign shell banks; (ii) imposes due diligence requirements on banks opening or holding accounts for foreign financial institutions or wealthy foreign individuals; (iii) requires financial institutions to establish an anti-money-laundering compliance program; and (iv) eliminates civil liability for persons who file suspicious activity reports. The Act also includes provisions providing the government with power to investigate terrorism, including expanded government access to bank account records.

Financial Services Modernization

Gramm-Leach-Bliley Act of 1999. The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 brought about significant changes to the laws affecting banks and bank holding companies. Generally, the Act (i) repeals historical restrictions on preventing banks from affiliating with securities firms; (ii) provides a uniform framework for the activities of banks, savings institutions and their holding companies; (iii) broadens the activities that may be conducted by national banks and banking subsidiaries of bank holding companies; (iv) provides an enhanced framework for protecting the privacy of consumer information and requires notification to consumers of bank privacy policies; and (v) addresses a variety of other legal and regulatory issues affecting both day-to-day operations and long-term activities of financial institutions. Bank holding companies that qualify and elect to become financial holding companies can engage in a wider variety of financial activities than permitted under previous law, particularly with respect to insurance and securities underwriting activities.

Deposit Insurance

The Bank's deposits are insured under the Federal Deposit Insurance Act, up to the maximum applicable limits and are subject to deposit insurance assessments designed to tie what banks pay for deposit insurance to the risks they pose. The Dodd-Frank Act broadened the base for FDIC insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution. In addition, the Dodd-Frank Act raised the minimum designated reserve ratio (the FDIC is required to set the reserve ratio each year) of the Deposit Insurance Fund ("DIF") from 1.15% to 1.35%; required that the DIF meet that minimum ratio of insured deposits by 2020; and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. The FDIC has established a higher reserve ratio of 2% as a long-term goal beyond what is required by statute. The deposit insurance assessments to be paid by Columbia Bank could increase as a result.

Insurance of Deposit Accounts. The Emergency Economic Stabilization Act of 2008 (the EESA") included a provision for a temporary increase from $100,000 to $250,000 per depositor in deposit insurance. The temporary increase was made permanent under the Dodd-Frank Act. The FDIC insurance coverage limit applies per depositor, per insured depository institution for each account ownership category. EESA also temporarily raised the limit on federal deposit insurance coverage to an unlimited amount for non-interest or low-interest bearing demand deposits. Unlimited coverage for non-interest transaction accounts expired December 31, 2012.

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Recent Legislation

As a result of the recent financial crises, on July 21, 2010 the Dodd-Frank Act was signed into law. The Dodd-Frank Act significantly changed the bank regulatory structure and is affecting the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies, including the Company and Columbia Bank. The full impact of the Dodd-Frank Act may not be known for years. Some of the provisions of the Dodd-Frank Act that may impact our business are summarized below.

Corporate Governance. The Dodd-Frank Act requires publicly traded companies to provide their shareholders with (i) a non-binding shareholder vote on executive compensation, (ii) a non-binding shareholder vote on the frequency of such vote, (iii) disclosure of “golden parachute” arrangements in connection with specified change in control transactions, and (iv) a non-binding shareholder vote on golden parachute arrangements in connection with these change in control transactions.

Prohibition Against Charter Conversions of Troubled Institutions. The Dodd-Frank Act generally prohibits a depository institution from converting from a state to federal charter, or vice versa, while it is the subject to an enforcement action unless the bank seeks prior approval from its regulator and complies with specified procedures to ensure compliance with the enforcement action.

Consumer Financial Protection Bureau. The Dodd-Frank Act created a new, independent federal agency called the Bureau of Consumer Financial Protection (“CFPB”). The CFPB has broad rulemaking, supervision and enforcement authority for a wide range of consumer protection laws applicable to banks and thrifts with greater than $10 billion in assets. Smaller institutions are subject to certain rules promulgated by the CFPB but will continue to be examined and supervised by their federal banking regulators for compliance purposes.

Repeal of Demand Deposit Interest Prohibition. The Dodd-Frank Act repeals the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.

Proposed Legislation

General. Proposed legislation is introduced in almost every legislative session. Certain of such legislation could dramatically affect the regulation of the banking industry. We cannot predict if any such legislation will be adopted or if it is adopted how it would affect the business of Columbia Bank or the Company. Recent history has demonstrated that new legislation or changes to existing laws or regulations usually results in a greater compliance burden and therefore generally increases the cost of doing business.

Basel III. Basel III updates and revises significantly the current international bank capital accords (so-called “Basel I” and “Basel II”). Basel III is intended to be implemented by participating countries for large, internationally active banks. However, standards consistent with Basel III will be formally implemented in the United States through a series of regulations, some of which may apply to other banks. Among other things, Basel III creates “Tier 1 common equity,” a new measure of regulatory capital closer to pure tangible common equity than the present Tier 1 definition. Basel III also increases minimum capital ratios. Capital buffers are added to each capital ratio to enable banks to absorb losses during a stressed period while remaining above their regulatory minimum ratios. The full impact of the Basel III rules cannot be determined at this time as many regulations are still being written and the implementation date has not yet been finalized.

Effects of Government Monetary Policy

Our earnings and growth are affected not only by general economic conditions, but also by the fiscal and monetary policies of the federal government, particularly the Federal Reserve. The Federal Reserve implements national monetary policy for such purposes as curbing inflation and combating recession, but its open market operations in U.S. government securities, control of the discount rate applicable to borrowings from the Federal Reserve, and establishment of reserve requirements against certain deposits, influence the growth of bank loans, investments and deposits, and also affect interest rates charged on loans or paid on deposits. The nature and impact of future changes in monetary policies and their impact on us cannot be predicted with certainty.

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ITEM 1A. RISK FACTORS

Our business exposes us to certain risks. The following is a discussion of what we currently believe are the most significant risks and uncertainties that may affect our business, financial condition and future results.

A continued slow or fragile economic recovery could adversely affect our future results of operations or market price of our stock.

The national and global economy and the financial services sector in particular continue to face significant challenges, including the current uncertainty regarding sequestration. We cannot accurately predict how quickly or strongly the economy will recover from the recent recession, which has adversely impacted the markets we serve. The U.S. economy has also experienced substantial volatility in the financial markets. Any further deterioration in the economies of the nation as a whole or in our markets would have an adverse effect, which could be material, on our business, financial condition, results of operations and prospects, and could also cause the market price of our stock to decline. While it is impossible to predict how long challenging economic conditions may exist, a slow or fragile recovery could continue to present risks into the future for the industry and our company.

Economic conditions in the market areas we serve may adversely impact our earnings and could increase our credit risk associated with our loan portfolio and the value of our investment portfolio.

Substantially all of our loans are to businesses and individuals in Washington and Oregon, and continuing soft economies in these market areas could have a material adverse effect on our business, financial condition, results of operations and prospects. While housing prices have stabilized, unemployment remains relatively high in both Washington and Oregon. A deterioration in the market areas we serve could result in the following consequences, any of which could have an adverse impact, which could be material, on our business, financial condition, results of operations and prospects:

- loan delinquencies may increase;
- problem assets and foreclosures may increase;
- collateral for loans made may decline further in value, in turn reducing customers’ borrowing power, reducing the value of assets and collateral associated with existing loans;
- certain securities within our investment portfolio could become other than temporarily impaired, requiring a write-down through earnings to fair value, thereby reducing equity;
- low cost or non-interest bearing deposits may decrease; and
- demand for our loan and other products and services may decrease.

Our loan portfolio mix, which has loans secured by real estate, could result in increased credit risk in a challenging economy.

Our loan portfolio is concentrated in commercial real estate and commercial business loans. These types of loans generally are viewed as having more risk of default than residential real estate loans or certain other types of loans or investments. In fact, the FDIC has issued pronouncements alerting banks of its concern about heavy loan concentrations. Because our loan portfolio contains commercial real estate and commercial business loans with relatively large balances, the deterioration of one or a few of these loans may cause a significant increase in our non-performing loans. An increase in non-performing loans could result in a loss of earnings from these loans, an increase in the provision for loan losses, or an increase in loan charge-offs, any of which could have a material adverse impact on our results of operations and financial condition.

Any downturn in the economies or real estate values in the markets we serve could have a material adverse effect on both borrowers’ ability to repay their loans and the value of the real property securing such loans. Our ability to recover on defaulted loans would then be diminished, and we would be more likely to suffer losses on defaulted loans.

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Our Allowance for Loan and Lease Losses (“ALLL”) may not be adequate to cover future loan losses, which could adversely affect earnings.

We maintain an ALLL in an amount that we believe is adequate to provide for losses inherent in our loan portfolio. While we strive to carefully monitor credit quality and to identify loans that may become non-performing, at any time there are loans in the portfolio that could result in losses, but that have not been identified as non-performing or potential problem loans. We cannot be sure that we will be able to identify deteriorating loans before they become non-performing assets, or that we will be able to limit losses on those loans that have been identified. Additionally, the process for determining the ALLL requires different, subjective and complex judgments about the future impact from current economic conditions that might impair the ability of borrowers to repay their loans. As a result, future significant increases to the ALLL may be necessary.

Future increases to the ALLL may be required based on changes in the composition of the loans comprising the portfolio, deteriorating values in underlying collateral (most of which consists of real estate) and changes in the financial condition of borrowers, such as may result from changes in economic conditions, or as a result of actual future events differing from assumptions used by management in determining the ALLL. Additionally, banking regulators, as an integral part of their supervisory function, periodically review our ALLL. These regulatory agencies may require us to increase the ALLL. Any increase in the ALLL would have an adverse effect, which could be material, on our financial condition and results of operations.

Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition.

Our nonperforming assets adversely affect our net income in various ways. Until economic and market conditions improve to pre-recession levels, we expect to continue to incur additional losses relating to elevated levels of nonperforming loans. We do not record interest income on nonaccrual loans, thereby adversely affecting our income, and increasing loan administration costs. Assets acquired by foreclosure or similar proceedings are recorded at the lower of carrying value or fair value less estimated costs to sell. The valuation of these foreclosed assets is periodically updated and resulting losses, if any, are charged to earnings in the period in which they are identified. An increase in the level of nonperforming assets also increases our risk profile and may impact the capital levels our regulators believe is appropriate in light of such risks. We utilize various techniques such as loan sales, workouts, and restructurings to manage our problem assets. Decreases in the value of these problem assets, the underlying collateral, or in the borrowers’ performance or financial condition, could adversely affect our business, results of operations and financial condition. In addition, the resolution of nonperforming assets requires significant commitments of time from management and staff, which can be detrimental to performance of their other responsibilities. We may experience further increases in nonperforming loans in the future.

The pending acquisition of West Coast Bancorp ("West Coast") is subject to closing conditions that, if not satisfied or waived, could result in our inability to consummate the transaction, which may cause the price of our stock to decline.

On September 25, 2012, we entered into an Agreement and Plan of Merger with West Coast. The closing of the transaction is subject to the satisfaction of certain customary conditions, including the receipt of required regulatory approvals and the approval of West Coast's and our respective shareholders. No assurance can be given as to when or whether these approvals will be received. If we do not complete this acquisition, the trading price of our stock may decline to the extent that the current prices reflect a market assumption that the acquisition will be completed. Furthermore, if the merger agreement is terminated (i) due to our failure to obtain requisite approval from our shareholders or (ii) due to our failure to obtain regulatory approval, we will be required to pay West Coast a termination fee of $5 million. In that regard, special shareholder meetings have been called by both Columbia and West Coast to be held March 18, 2013 to act on the transaction and the requisite applications have been filed with the Federal and State bank regulators, with an anticipated closing date of April 1, 2013.

We may fail to realize all of the anticipated benefits of our pending acquisition of West Coast.

The success of our pending acquisition of West Coast will depend on, among other things, the ability to successfully combine Columbia and the West Coast organizations. If we are not able to achieve this objective, the anticipated benefits of the acquisition may not be realized fully or at all, or may take longer than expected to be realized.

Columbia and West Coast have operated and, until the completion of the acquisition, will continue to operate, independently. The companies may have challenges integrating different standards, procedures and policies. It is also possible that clients, customers, depositors and counterparties of West Coast could choose to discontinue their relationships with the combined company post-acquisition, which could adversely affect our future anticipated performance. These transition matters could have an adverse effect on us during the pre-acquisition period and for an undetermined time after the completion of the acquisition.

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Our acquisitions and the integration of acquired businesses may not result in all of the benefits anticipated, and future acquisitions may be dilutive to current shareholders.

We have in the past and may in the future seek to grow our business by acquiring other businesses. Our acquisitions may not have the anticipated positive results, including results relating to: correctly assessing the asset quality of the assets being acquired; the total cost of integration including management attention and resources; the time required to complete the integration successfully; the amount of longer-term cost savings; being able to profitably deploy funds acquired in an acquisition; or the overall performance of the combined entity.

We also may encounter difficulties in obtaining required regulatory approvals and unexpected contingent liabilities can arise from the businesses we acquire. Integration of an acquired business can be complex and costly, sometimes including combining relevant accounting and data processing systems and management controls, as well as managing relevant relationships with employees, clients, suppliers and other business partners. Integration efforts could divert management attention and resources, which could adversely affect our operations or results.

Given the continued market volatility and uncertainty, notwithstanding our loss-sharing arrangements with the FDIC, we may experience increased credit costs or need to take additional markdowns and allowances for loan losses on the assets and loans acquired that could adversely affect our financial condition and results of operations in the future.

We may also experience difficulties in complying with the technical requirements of our loss-sharing agreements with the FDIC, which could result in some assets which we acquire in FDIC-assisted transactions losing their coverage under such agreements.

Acquisitions may also result in business disruptions that cause us to lose customers or cause customers to remove their accounts from us and move their business to competing financial institutions. It is possible that the integration process related to acquisitions could result in the disruption of our ongoing businesses or inconsistencies in standards, controls, procedures and policies that could adversely affect our ability to maintain relationships with clients, customers, depositors and employees. The loss of key employees in connection with an acquisition could adversely affect our ability to successfully conduct our business.

We may engage in future acquisitions involving the issuance of additional common stock and/or cash. Any such acquisitions and related issuances of stock may have a dilutive effect on earnings per share, book value per share or the percentage ownership of current shareholders. The use of cash as consideration in any such acquisitions could impact our capital position and may require us to raise additional capital.

Furthermore, notwithstanding our pending and recent acquisitions, we cannot provide any assurance as to the extent to which we can continue to grow through acquisitions as this will depend on the availability of prospective target opportunities at valuations we find attractive and the competition for such opportunities from other parties.

Our decisions regarding the fair value of assets acquired, including the FDIC loss-sharing assets, could be inaccurate, which could materially and adversely affect our business, financial condition, results of operations, and future prospects.

Management makes various assumptions and judgments about the collectability of the acquired loans, including the creditworthiness of borrowers and the value of the real estate and other assets serving as collateral for the repayment of secured loans. In FDIC-assisted acquisitions that include loss-sharing agreements, we may record a loss-sharing asset which is accounted for on the same basis as the assets covered under the loss-sharing agreements. The FDIC loss-sharing asset primarily represents the present value of the cash flows the Company expects to collect from the FDIC under the loss-sharing agreements.

If our assumptions are incorrect, significant earnings volatility can occur and credit loss provisions may be needed to respond to different economic conditions or adverse developments in the acquired loan portfolio. Any increase in future loan losses could have a material adverse effect on our operating results.

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Our management of capital could adversely affect profitability measures, the market price of our common stock, and dilute the holders of our outstanding common stock.

Our capital ratios are significantly higher than regulatory minimums. We may lower our capital ratios through either selective acquisitions that meet our disciplined criteria, organic loan growth, investment in securities, or a combination of all three. Although we are periodically engaged in discussions with other potential acquisition candidates, we are not currently a party to any purchase or merger agreement other than our pending acquisition of West Coast. Following our pending acquisition of West Coast, there can be no assurance that we will be able to negotiate future acquisitions on terms acceptable to us.

Conversely, there may be circumstances under which it would be prudent to consider alternatives for raising capital to take advantage of significant acquisition opportunities or in response to changing economic conditions. Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at the time, which are outside our control, and our financial performance. Any capital raising alternatives could dilute the holders of our outstanding common stock and may adversely affect the market price of our common stock.

If the goodwill we have recorded in connection with acquisitions becomes impaired, it could have an adverse impact on our earnings and shareholders' equity.

Accounting standards require that we account for acquisitions using the acquisition method of accounting. Under acquisition accounting, if the purchase price of an acquired company exceeds the fair value of its net assets, the excess is carried on the acquirer's balance sheet as goodwill. In accordance with generally accepted accounting principles, our goodwill is evaluated for impairment on an annual basis or more frequently if events or circumstances indicate that a potential impairment exists. Such evaluation may be based on a variety of factors, including the quoted price of our common stock, market prices of common stock of other banking organizations, common stock trading multiples, discounted cash flows, and data from comparable acquisitions. Future evaluations of goodwill may result in impairment and ensuing write-down, which could be material, resulting in an adverse impact on our earnings and shareholders' equity.

Fluctuating interest rates could adversely affect our business.

Significant increases in market interest rates on loans, or the perception that an increase may occur, could adversely affect both our ability to originate new loans and our ability to grow. Conversely, decreases in interest rates could result in an acceleration of loan prepayments. An increase in market interest rates could also adversely affect the ability of our floating-rate borrowers to meet their higher payment obligations. If this occurred, it could cause an increase in nonperforming assets and charge offs, which could adversely affect our business.

Further, our profitability is dependent to a large extent upon net interest income, which is the difference (or "spread") between the interest earned on loans, securities and other interest-earning assets and the interest paid on deposits, borrowings, and other interest-bearing liabilities. Because of the differences in maturities and repricing characteristics of our interest-earning assets and interest-bearing liabilities, changes in interest rates do not produce equivalent changes in interest income earned on interest-earning assets and interest paid on interest-bearing liabilities. Accordingly, fluctuations in interest rates could adversely affect our interest rate spread, and, in turn, our profitability.

The expiration of unlimited FDIC insurance on certain noninterest-bearing transaction accounts may increase our interest expense and reduce our liquidity.

On December 31, 2012, unlimited FDIC insurance on certain noninterest-bearing transaction accounts under the Transaction Account Guarantee ("TAG") program expired. Prior to its expiration, all funds under TAG in a noninterest-bearing transaction account were insured in full by the FDIC from December 31, 2010, through December 31, 2012. This temporary unlimited coverage was in addition to, and separate from, the coverage of at least $250,000 available to depositors under the FDIC's general deposit insurance rules. The reduction in FDIC insurance on these noninterest-bearing transaction accounts to the standard $250,000 maximum may cause depositors to move funds previously held in such noninterest-bearing accounts to interest-bearing accounts, which could increase our costs of funds and negatively impact our results of operations, or may cause depositors to withdraw their deposits and invest funds in other investments. This could reduce the Company's liquidity, or require us to pay higher interest rates to retain deposits in order to maintain our liquidity and could adversely affect the Company's earnings.

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We operate in a highly regulated environment and changes of or increases in, or supervisory enforcement of, banking or other laws and regulations or governmental fiscal or monetary policies could adversely affect us.

We are subject to extensive regulation, supervision and examination by federal and state banking authorities. In addition, as a publicly-traded company, we are subject to regulation by the Securities and Exchange Commission. Any change in applicable regulations or federal, state or local legislation or in policies or interpretations or regulatory approaches to compliance and enforcement, income tax laws and accounting principles could have a substantial impact on us and our operations. Changes in laws and regulations may also increase our expenses by imposing additional fees or taxes or restrictions on our operations. Additional legislation and regulations that could significantly affect our powers, authority and operations may be enacted or adopted in the future, which could have a material adverse effect on our financial condition and results of operations. Failure to appropriately comply with any such laws, regulations or principles could result in sanctions by regulatory agencies or damage to our reputation, all of which could adversely affect our business, financial condition or results of operations.

In that regard, the Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted in July 2010. Among other provisions, the legislation (i) created a new Bureau of Consumer Financial Protection with broad powers to regulate consumer financial products such as credit cards and mortgages, (ii) created a Financial Stability Oversight Council comprised of the heads of other regulatory agencies, (iii) will lead to new capital requirements from federal banking agencies, (iv) places new limits on electronic debit card interchange fees and (v) requires the Securities and Exchange Commission and national stock exchanges to adopt significant new corporate governance and executive compensation reforms. The new legislation and regulations are expected to increase the overall costs of regulatory compliance.

Further, regulators have significant discretion and authority to prevent or remedy unsafe or unsound practices or violations of laws or regulations by financial institutions and holding companies in the performance of their supervisory and enforcement duties. Recently, these powers have been utilized more frequently due to the serious national, regional and local economic conditions we are facing. The exercise of regulatory authority may have a negative impact on our financial condition and results of operations. Additionally, our business is affected significantly by the fiscal and monetary policies of the U.S. federal government and its agencies, including the Federal Reserve Board.

We cannot accurately predict the full effects of recent legislation or the various other governmental, regulatory, monetary and fiscal initiatives which have been and may be enacted on the financial markets, on the Company and on the Bank. The terms and costs of these activities, or any worsening of current financial market and economic conditions, could materially and adversely affect our business, financial condition, results of operations, and the trading price of our common stock.

We may be required, in the future, to recognize impairment with respect to investment securities.

Our securities portfolio currently includes securities with unrecognized losses. We may continue to observe declines in the fair market value of these securities. Securities issued by certain states and municipalities have recently come under scrutiny due to concerns about credit quality. Although management believes the credit quality of the Company’s state and municipal securities portfolio to be good, there can be no assurance that the credit quality of these securities will not decline in the future. We evaluate the securities portfolio for any other than temporary impairment each reporting period, as required by generally accepted accounting principles in the United States of America. There can be no assurance, however, that future evaluations of the securities portfolio will not require us to recognize further impairment charges with respect to these and other holdings. For example, it is possible that government-sponsored programs to allow mortgages to be refinanced to lower rates could materially adversely impact the yield on our portfolio of mortgage-backed securities, since a significant portion of our investment portfolio is composed of such securities.

Substantial competition in our market areas could adversely affect us.

Commercial banking is a highly competitive business. We compete with other commercial banks, savings and loan associations, credit unions, finance, insurance and other non-depository companies operating in our market areas. We also experience competition, especially for deposits, from Internet-based banking institutions, which have grown rapidly in recent years. We are subject to substantial competition for loans and deposits from other financial

institutions. Some of our competitors are not subject to the same degree of regulation and restriction as we are and/or have greater financial resources than we do. Some of our competitors have severe liquidity issues, which could impact the pricing of deposits in our marketplace. If we are unable to effectively compete in our market areas, our business, results of operations and prospects could be adversely affected.

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Changes in accounting standards could materially impact our financial statements.

From time to time the Financial Accounting Standards Board and the SEC change the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can be very difficult to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in our restating prior period financial statements.

There can be no assurance as to the level of dividends we may pay on our common stock.

Holders of our common stock are only entitled to receive such dividends as our Board of Directors may declare out of funds legally available for such payments. Although we have historically declared cash dividends on our common stock, we are not required to do so and there may be circumstances under which we would eliminate our common stock dividend in the future. This could adversely affect the market price of our common stock.

Significant legal or regulatory actions could subject us to substantial uninsured liabilities and reputational harm and have a material adverse effect on our business and results of operations.

We are from time to time subject to claims and proceedings related to our operations. These claims and legal actions, which could include supervisory or enforcement actions by our regulators, or criminal proceedings by prosecutorial authorities, could involve large monetary claims, including civil money penalties or fines imposed by government authorities, and significant defense costs. To mitigate the cost of some of these claims, we maintain insurance coverage in amounts and with deductibles that we believe are appropriate for our operations. However, our insurance coverage does not cover any civil money penalties or fines imposed by government authorities and may not cover all other claims that might be brought against us or continue to be available to us at a reasonable cost. As a result, we may be exposed to substantial uninsured liabilities, which could adversely affect our business, prospects, results of operations and financial condition. Substantial legal liability or significant regulatory action against us could have material adverse financial effects or cause significant reputational harm to us, which in turn could seriously harm our business prospects.

We are subject to a variety of operational risks, including reputational risk, legal risk and compliance risk, and the risk of fraud or theft by employees or outsiders, which may adversely affect our business and results of operations.

We are exposed to many types of operational risks, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, and unauthorized transactions by employees or operational errors, including clerical or record-keeping errors or those resulting from faulty or disabled computer or telecommunications systems. If personal, non-public, confidential or proprietary information of customers in our possession were to be mishandled or misused, we could suffer significant regulatory consequences, reputational damage and financial loss. Such mishandling or misuse could include, for example, if such information were erroneously provided to parties who are not permitted to have the information, either by fault of our systems, employees, or counterparties, or where such information is intercepted or otherwise inappropriately taken by third parties.

Because the nature of the financial services business involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. Our necessary dependence upon automated systems to record and process transactions and our large transaction volume may further increase the risk that technical flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. We also may be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control (for example, computer viruses or electrical or telecommunications outages, or natural disasters, disease pandemics or other damage to property or physical assets) which may give rise to disruption of service to customers and to financial loss or liability. We are further exposed to the risk that our external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as we are) and to the risk that we (or our vendors') business continuity and data security systems prove to be inadequate. The occurrence of any of these risks could result in a diminished ability of us to operate our business (for example, by requiring us to expend significant resources to correct the defect), as well as potential liability to clients, reputational damage and regulatory intervention, which could adversely affect our business, financial condition and results of operations, perhaps materially.

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A failure in or breach of our operational or security systems, or those of our third party service providers, including as a result of cyber attacks, could disrupt our business, result in unintentional disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs and cause losses.

As a financial institution, our operations rely heavily on the secure processing, storage and transmission of confidential and other information on our computer systems and networks. Any failure, interruption or breach in security or operational integrity of these systems could result in failures or disruptions in our online banking system, customer relationship management, general ledger, deposit and loan servicing and other systems. The security and integrity of our systems could be threatened by a variety of interruptions or information security breaches, including those caused by computer hacking, cyber attacks, electronic fraudulent activity or attempted theft of financial assets. We cannot assure you that any such failures, interruption or security breaches will not occur, or if they do occur, that they will be adequately addressed. While we have certain protective policies and procedures in place, the nature and sophistication of the threats continue to evolve. We may be required to expend significant additional resources in the future to modify and enhance our protective measures.

Additionally, we face the risk of operational disruption, failure, termination or capacity constraints of any of the third parties that facilitate our business activities, including exchanges, clearing agents, clearing houses or other financial intermediaries. Such parties could also be the source of an attack on, or breach of, our operational systems. Any failures, interruptions or security breaches in our information systems could damage our reputation, result in a loss of customer business, result in a violation of privacy or other laws, or expose us to civil litigation, regulatory fines or losses not covered by insurance.

We have various anti-takeover measures that could impede a takeover.

Our articles of incorporation include certain provisions that could make it more difficult to acquire us by means of a tender offer, a proxy contest, merger or otherwise. These provisions include certain non-monetary factors that our board of directors may consider when evaluating a takeover offer, and a requirement that any “Business Combination” be approved by the affirmative vote of no less than 66 2/3% of the total shares attributable to persons other than a “Control Person.” These provisions may have the effect of lengthening the time required for a person to acquire control of us through a tender offer, proxy contest or otherwise, and may deter any potentially hostile offers or other efforts to obtain control of us. This could deprive our shareholders of opportunities to realize a premium for their Columbia common stock, even in circumstances where such action is favored by a majority of our shareholders.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

The Company's principal Columbia Bank properties include our corporate headquarters which is located at 13th & A Street, Tacoma, Washington, and an operations facility in Lakewood, Washington.

The Company's branch network as of December 31, 2012 is made up of 99 branches located throughout several Washington and Oregon counties compared to 102 branches at December 31, 2011. The number of branches per county, as well as whether it is owned or operated under a lease agreement is detailed in the following table.

	Number of	Occupancy Type	
County	Branches	Owned	Leased
Pierce	22	16	6
King	13	8	5
Kitsap	6	3	3
Snohomish	5	5	—
Skagit	3	3	—
Other Washington counties	25	20	5
Total Washington branches	74	55	19
Clatsop (dba Bank of Astoria)	4	4	—
Tillamook (dba Bank of Astoria)	2	2	—
Clackamas	4	—	4
Multnomah	2	1	1
Deschutes	4	3	1
Other Oregon counties	9	7	2
Total Oregon branches	25	17	8
Total Columbia Bank branches	99	72	27

For additional information concerning our premises and equipment and lease obligations, see Note 8 and 15, respectively, to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report.

ITEM 3. LEGAL PROCEEDINGS

The Company and its banking subsidiary are parties to routine litigation arising in the ordinary course of business. Management believes that, based on the information currently known to them, any liabilities arising from such litigation will not have a material adverse impact on the Company's financial condition, results of operations or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Quarterly Common Stock Prices and Dividends

Our common stock is traded on the NASDAQ Global Select Market under the symbol “COLB”. Quarterly high and low sales prices and dividend information for the last two years are presented in the following table. The prices shown do not include retail mark-ups, mark-downs or commissions:

			Cash Dividends Declared		
2012	High	Low	Regular	Special	Total Cash Dividends Declared
First quarter	$23.35	$19.65	$0.08	$0.29	$0.37
Second quarter	$23.52	$17.38	0.08	0.14	0.22
Third quarter	$19.85	$17.22	0.09	0.21	0.30
Fourth quarter	$19.15	$16.18	0.09	—	0.09
For the year	$23.52	$16.18	$0.34	$0.64	$0.98

			Cash Dividends Declared		
2011	High	Low	Regular	Special	Total Cash Dividends Declared
First quarter	$22.14	$17.91	$0.03	$—	$0.03
Second quarter	$19.95	$16.56	0.05	—	0.05
Third quarter	$18.14	$14.01	0.06	—	0.06
Fourth quarter	$19.76	$13.46	0.08	0.05	0.13
For the year	$22.14	$13.46	$0.22	$0.05	$0.27

On December 31, 2012, the last sale price for our stock on the NASDAQ Global Select Market was $17.94. At January 31, 2013, the number of shareholders of record was 2,135. This figure does not represent the actual number of beneficial owners of common stock because shares are frequently held in “street name” by securities dealers and others for the benefit of individual owners who may vote the shares.

At December 31, 2012, a total of 25,952 stock options were outstanding. Additional information about stock options and other equity compensation plans is included in Note 19 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

The payment of future cash dividends is at the discretion of our Board and subject to a number of factors, including results of operations, general business conditions, growth, financial condition and other factors deemed relevant to capital management strategies by the Board of Directors. In addition, the payment of cash dividends is subject to Federal regulatory requirements for capital levels and other restrictions. In this regard, current guidance from the Federal Reserve provides, among other things, that dividends per share on the Company’s common stock generally should not exceed earnings per share, measured over the previous four fiscal quarters.

Subsequent to year end, on January 24, 2013 the Company declared a quarterly cash dividend of $0.10 per share payable on February 20, 2013, to shareholders of record at the close of business on February 6, 2013.

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Equity Compensation Plan Information

	Year ended December 31, 2012		
	Number of Shares to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (1)(2)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Shares Remaining Available for Future Issuance Under Equity Compensation Plans (3)
Equity compensation plans approved by security holders	25,952	$ 20.13	1,026,135
Equity compensation plans not approved by security holders	—	—	—

(1) Includes shares to be issued upon exercise of options under plans of Bank of Astoria, Mountain Bank Holding Company and Town Center Bancorp, which were assumed as a result of their acquisitions.
(2) Consists of shares that are subject to outstanding options.
(3) Includes 417,625 shares available for future issuance under the stock option and equity compensation plan and 608,510 shares available for purchase under the Employee Stock Purchase Plan as of December 31, 2012.

Five-Year Stock Performance Graph

The following graph shows a five-year comparison of the total return to shareholders of Columbia's common stock, the Nasdaq Composite Index (which is a broad nationally recognized index of stock performance by companies listed on the Nasdaq Stock Market) and the Columbia Peer Group (comprised of banks with assets of $1 billion to $5 billion, all of which are located in the western United States). The definition of total return includes appreciation in market value of the stock as well as the actual cash and stock dividends paid to shareholders. The graph assumes that the value of the investment in Columbia's common stock, the Nasdaq and the Columbia Peer Group was $100 on December 31, 2007, and that all dividends were reinvested.

Index	Period Ending					
	12/31/2007	12/31/2008	12/31/2009	12/31/2010	12/31/2011	12/31/2012
Columbia Banking System, Inc.	100.00	41.29	56.38	73.53	68.32	66.87
NASDAQ Composite	100.00	60.02	87.24	103.08	102.26	120.42
SNL Columbia Peer Group	100.00	70.80	61.43	66.94	56.80	70.48

Source: SNL Financial LC, Charlottesville, VA

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ITEM 6. SELECTED FINANCIAL DATA

Five-Year Summary of Selected Consolidated Financial Data (1)

	2012	2011	2010	2009	2008
	(dollars in thousands except per share amounts)				
For the Year					
Interest income	$248,504	$251,271	$185,879	$143,035	$175,060
Interest expense	$9,577	$14,535	$21,092	$27,683	$55,547
Net interest income	$238,927	$236,736	$164,787	$115,352	$119,513
Provision for loan and lease losses, excluding covered loans	$13,475	$7,400	$41,291	$63,500	$41,176
Noninterest income (loss)	$27,058	$(9,283)	$52,781	$29,690	$14,850
Noninterest expense	$162,913	$155,759	$137,147	$94,488	$92,125
Net income (loss)	$46,143	$48,037	$30,784	$(3,968)	$5,968
Net income (loss) applicable to common shareholders	$46,143	$48,037	$25,837	$(8,371)	$5,498
Per Common Share					
Earnings (loss) (Basic)	$1.16	$1.22	$0.73	$(0.38)	$0.30
Earnings (loss) (Diluted)	$1.16	$1.21	$0.72	$(0.38)	$0.30
Book Value	$19.25	$19.23	$17.97	$16.13	$18.82
Averages					
Total assets	$4,826,283	$4,509,010	$4,248,590	$3,084,421	$3,134,054
Interest-earning assets	$4,246,724	$3,871,424	$3,583,728	$2,783,862	$2,851,555
Loans, including covered loans	$2,900,520	$2,607,266	$2,485,650	$2,124,574	$2,264,486
Securities	$1,011,294	$928,891	$720,152	$584,028	$565,299
Deposits	$3,875,666	$3,541,399	$3,270,923	$2,378,176	$2,382,484
Core deposits	$3,609,467	$3,218,425	$2,828,246	$1,945,039	$1,911,897
Shareholders’ equity	$761,185	$730,726	$668,469	$462,127	$354,387
Financial Ratios					
Net interest margin	5.77 %	6.27 %	4.76 %	4.33 %	4.38 %
Return on average assets	0.96 %	1.07 %	0.72 %	(0.13)%	0.19 %
Return on average common equity	6.06 %	6.57 %	4.15 %	(2.16)%	1.59 %
Efficiency ratio (tax equivalent) (2)	69.17 %	70.68 %	67.56 %	61.53 %	59.88 %
Average equity to average assets	15.77 %	16.21 %	15.73 %	14.98 %	11.31 %
At Year End					
Total assets	$4,906,335	$4,785,945	$4,256,363	$3,200,930	$3,097,079
Covered assets, net	$407,648	$560,055	$531,504	$—	$—
Loans, excluding covered loans	$2,525,710	$2,348,371	$1,915,754	$2,008,884	$2,232,332
Allowance for noncovered loan and lease losses	$52,244	$53,041	$60,993	$53,478	$42,747
Securities	$1,023,484	$1,050,325	$781,774	$631,645	$540,525
Deposits	$4,042,085	$3,815,529	$3,327,269	$2,482,705	$2,382,151
Core deposits	$3,802,366	$3,510,435	$2,998,482	$2,072,821	$1,941,047
Shareholders’ equity	764,008	759,338	706,878	528,139	415,385
Nonperforming Assets, Excluding Covered Assets					
Nonaccrual loans	37,395	53,483	89,163	110,431	106,163
Other real estate owned and other personal property owned	11,108	31,905	30,991	19,037	2,874
	$48,503	$85,388	$120,154	$129,468	$109,037

Total nonperforming assets, excluding covered assets										
Nonperforming loans to year end loans, excluding covered loans	1.48	%	2.28	%	4.65	%	5.50	%	4.76	%
Nonperforming assets to year end assets, excluding covered assets	1.08	%	2.02	%	3.23	%	4.04	%	3.52	%
Allowance for loan and lease losses to year end loans, excluding covered loans	2.07	%	2.26	%	3.18	%	2.66	%	1.91	%
Allowance for loan and lease losses to nonperforming loans, excluding covered loans	139.71	%	99.17	%	68.41	%	48.43	%	40.27	%
Net loan charge-offs	$14,272		$15,352		$33,776		$52,769		$25,028	
Other nonfinancial data										
Full-time equivalent employees	1,198		1,256		1,092		715		735	
Banking branches	99		102		84		52		53	

(1) These unaudited schedules provide selected financial information concerning the Company that should be read in conjunction with “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this report.

(2) Noninterest expense, excluding net cost of operation of other real estate, FDIC clawback liability expense and acquisition related expenses, divided by the sum of net interest income, excluding incremental accretion income on the acquired loan portfolio and prepayment expenses on FHLB advances, and noninterest income on a tax equivalent basis, excluding gain/loss investment securities, gain on bank acquisition, and the change in FDIC loss-sharing asset.

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Consolidated Five-Year Financial Data (1)

	Years ended December 31,				
	2012	2011	2010	2009	2008
	(in thousands, except per share amounts)				
Interest Income:					
Loans	$219,433	$218,420	$157,292	$117,062	$147,830
Taxable securities	18,276	21,870	18,276	17,300	18,852
Tax-exempt securities	9,941	10,142	9,348	8,458	7,976
Federal funds sold and deposits with banks	854	839	963	215	402
Total interest income	248,504	251,271	185,879	143,035	175,060
Interest Expense:					
Deposits	5,887	10,478	16,733	23,250	45,307
Federal Home Loan Bank advances	2,608	2,980	2,841	2,759	7,482
Prepayment charge on Federal Home Loan Bank advances	603	—	—	—	—
Long-term obligations	—	579	1,029	1,197	1,800
Other borrowings	479	498	489	477	958
Total interest expense	9,577	14,535	21,092	27,683	55,547
Net Interest Income	238,927	236,736	164,787	115,352	119,513
Provision for noncovered loan and lease losses	13,475	7,400	41,291	63,500	41,176
Provision (recapture) for losses on covered loans	25,892	(1,648)	6,055	—	—
Net interest income after provision	199,560	230,984	117,441	51,852	78,337
Noninterest income (loss)	27,058	(9,283)	52,781	29,690	14,850
Noninterest expense	162,913	155,759	137,147	94,488	92,125
Income (loss) before income taxes	63,705	65,942	33,075	(12,946)	1,062
Provision (benefit) for income taxes	17,562	17,905	2,291	(8,978)	(4,906)
Net Income (Loss)	$46,143	$48,037	$30,784	$(3,968)	$5,968
Less: Dividends on preferred stock	—	—	4,947	4,403	470
Net Income (Loss) Applicable to Common Shareholders	$46,143	$48,037	$25,837	$(8,371)	$5,498
Per Common Share					
Earnings (loss) basic	$1.16	$1.22	$0.73	$(0.38)	$0.30
Earnings (loss) diluted	$1.16	$1.21	$0.72	$(0.38)	$0.30
Average number of common shares outstanding (basic)	39,260	39,103	35,209	21,854	17,914
Average number of common shares outstanding (diluted)	39,263	39,180	35,392	21,854	18,010
Total assets at year end	$4,906,335	$4,785,945	$4,256,363	$3,200,930	$3,097,079
Long-term obligations	$—	$—	$25,735	$25,669	$25,603
Cash dividends declared per common share	$0.98	$0.27	$0.04	$0.07	$0.58

(1) These unaudited schedules provide selected financial information concerning the Company that should be read in conjunction with “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operation” of this report.

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Selected Quarterly Financial Data (1)

The following table presents selected unaudited consolidated quarterly financial data for each quarter of 2012 and 2011. The information contained in this table reflects all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results of the interim periods.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year Ended December 31,
	(in thousands, except per share amounts)				
2012					
Total interest income	$69,712	$62,114	$59,469	$57,209	$248,504
Total interest expense	2,649	2,413	2,204	2,311	9,577
Net interest income	67,063	59,701	57,265	54,898	238,927
Provision for noncovered loan and lease losses	4,500	3,750	2,875	2,350	13,475
Provision (recapture) for losses on covered loans	15,685	11,688	(3,992)	2,511	25,892
Noninterest income (loss)	9,574	11,828	(911)	6,567	27,058
Noninterest expense	44,352	39,825	40,936	37,800	162,913
Income before income taxes	12,100	16,266	16,535	18,804	63,705
Provision for income taxes	3,198	4,367	4,655	5,342	17,562
Net income	$8,902	$11,899	$11,880	$13,462	$46,143
Per Common Share (2)					
Earnings (basic)	$0.22	$0.30	$0.30	$0.34	$1.16
Earnings (diluted)	$0.22	$0.30	$0.30	$0.34	$1.16
2011					
Total interest income	$54,611	$53,309	$68,432	$74,919	$251,271
Total interest expense	4,162	3,934	3,644	2,795	14,535
Net interest income	50,449	49,375	64,788	72,124	236,736
Provision for noncovered loan and lease losses	—	2,150	500	4,750	7,400
Provision (recapture) for losses on covered loans	(422)	2,301	433	(3,960)	(1,648)
Noninterest income (loss)	(5,419)	3,542	2,196	(9,602)	(9,283)
Noninterest expense	37,346	37,164	39,935	41,314	155,759
Income before income taxes	8,106	11,302	26,116	20,418	65,942
Provision for income taxes	2,327	2,670	7,244	5,664	17,905
Net income	$5,779	$8,632	$18,872	$14,754	$48,037
Per Common Share (2)					
Earnings (basic)	$0.15	$0.22	$0.48	$0.37	$1.22
Earnings (diluted)	$0.15	$0.22	$0.48	$0.37	$1.21

(1) These unaudited schedules provide selected financial information concerning the Company that should be read in conjunction with “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operation” of this report.

(2) Due to averaging of shares, quarterly earnings per share may not add up to the totals reported for the full year.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

This discussion should be read in conjunction with our Consolidated Financial Statements and related notes in “Item 8. Financial Statements and Supplementary Data” of this report. 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 for the previous year.

Critical Accounting Policies

We have established certain accounting policies in preparing our Consolidated Financial Statements that are in accordance with accounting principles generally accepted in the United States. Our significant accounting policies are presented in Note 1 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report. Certain of these policies require the use of judgments, estimates and economic assumptions which may prove inaccurate or are subject to variation that may significantly affect our reported results of operations and financial position for the periods presented or in future periods. Management believes that the judgments, estimates and economic assumptions used in the preparation of the Consolidated Financial Statements are appropriate given the factual circumstances at the time. We consider the following policies to be most critical in understanding the judgments that are involved in preparing our consolidated financial statements.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses (“ALLL”) is established to absorb known and inherent losses in our loan and lease portfolio. Our methodology in determining the appropriate level of the ALLL includes components for a general valuation allowance in accordance with the Contingencies topic of the Financial Accounting Standards Board Accounting Standards Codification (“FASB ASC”), a specific valuation allowance in accordance with the Receivables topic of the FASB ASC and an unallocated component. Both quantitative and qualitative factors are considered in determining the appropriate level of the ALLL. Quantitative factors include historical loss experience, delinquency and charge-off trends and the evaluation of specific loss estimates for problem loans. Qualitative factors include existing general economic and business conditions in our market areas as well as the duration of the current business cycle. Changes in any of the factors mentioned could have a significant impact on our calculation of the ALLL. Our ALLL policy and the judgments, estimates and economic assumptions involved are described in greater detail in the “Allowance for Noncovered Loan and Lease Losses and Unfunded Commitments and Letters of Credit” section of this discussion and in Note 1 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

Business Combinations

The Company applies the acquisition method of accounting for business combinations. Under the acquisition method, the acquiring entity in a business combination recognizes 100 percent of the assets acquired and liabilities assumed at their acquisition date fair values. Management utilizes prevailing valuation techniques appropriate for the asset or liability being measured in determining these fair values. Any excess of the purchase price over amounts allocated to assets acquired, including identifiable intangible assets, and liabilities assumed is recorded as goodwill. Where amounts allocated to assets acquired and liabilities assumed is greater than the purchase price, a bargain purchase gain is recognized. Acquisition-related costs are expensed as incurred.

Acquired Impaired Loans

Loans acquired at a discount for which it is probable that all contractual payments will not be received are generally accounted for under ASC Topic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality (“ASC 310-30”). In addition, certain acquired loans with evidence of deteriorated credit quality may be accounted for under this topic even if it is not yet probable that all contractual payments will not be received. These loans are recorded at fair value at the time of acquisition. Estimated credit losses are included in the determination of fair value, therefore, an allowance for loan losses is not recorded on the acquisition date. The excess of expected cash flows at acquisition over the initial investment in acquired loans (“accretable yield”) is recorded as interest income over the life of the loans if the timing and amount of the future cash flows is reasonably estimable. Subsequent to acquisition, the Company aggregates individual loans with common risk characteristics into pools of loans. Increases in estimated cash flows

over those expected at the acquisition date are recognized as interest income, prospectively. Decreases in expected cash flows after the acquisition date are recognized by recording an allowance for loan losses.

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Loans accounted for under ASC 310-30 are generally considered accruing and performing loans as the loans accrete interest income over the estimated life of the loan when cash flows are reasonably estimable. Accordingly, acquired impaired loans that are contractually past due are still considered to be accruing and performing loans. If the timing and amount of future cash flows is not reasonably estimable, the loans may be classified as nonaccrual loans and the purchase price discount on those loans is not recorded as interest income until the timing and amount of future cash flows can be reasonably estimated.

FDIC Loss-sharing Asset

In conjunction with certain of the FDIC-assisted acquisitions, the Bank entered into loss-sharing agreements with the FDIC. At the date of the acquisitions, the Company elected to account for amounts receivable under the loss-sharing agreements as an indemnification asset in accordance with the Business Combinations topic of the FASB ASC. Subsequent to initial recognition, the FDIC loss-sharing 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 assets. Any decrease in expected cash flows due to an increase in expected credit losses will increase the FDIC loss-sharing asset and any increase in expected future cash flows due to a decrease in expected credit losses will decrease the FDIC loss-sharing asset. Increases and decreases to the FDIC loss-sharing asset are recorded as adjustments to noninterest income.

Valuation and Recoverability of Goodwill

Goodwill represented $115.6 million of our $4.91 billion in total assets and $764.0 million in total shareholders' equity as of December 31, 2012. The Company has one, single reporting unit. We review goodwill for impairment annually, during the third quarter, and also test for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of our reporting unit below its carrying amount. Such events and circumstances may include among others: a significant adverse change in legal factors or in the general business climate; significant decline in our stock price and market capitalization; unanticipated competition; the testing for recoverability of a significant asset group within the reporting unit; and an adverse action or assessment by a regulator. Any adverse change in these factors could have a significant impact on the recoverability of goodwill and could have a material impact on our consolidated financial statements.

Under the Intangibles – Goodwill and Other topic of the FASB ASC, the testing for impairment may begin with an assessment of qualitative factors to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. When required, the goodwill impairment test involves a two-step process. We first test goodwill for impairment by comparing the fair value of the reporting unit with its carrying amount. If the fair value of the reporting unit exceeds the carrying amount of the reporting unit, goodwill is not deemed to be impaired, and no further testing is necessary. If the carrying amount of the reporting unit were to exceed the fair value of the reporting unit, we would perform a second test to measure the amount of impairment loss, if any. To measure the amount of any impairment loss, we would determine the implied fair value of goodwill in the same manner as if the reporting unit were being acquired in a business combination. Specifically, we would allocate the fair value of the reporting unit to all of the assets and liabilities of the reporting unit in a hypothetical calculation that would determine the implied fair value of goodwill. If the implied fair value of goodwill is less than the recorded goodwill, we would record an impairment charge for the difference.

The accounting estimates related to our goodwill require us to make considerable assumptions about fair values. Our assumptions regarding fair values require significant judgment about economic and industry factors, as well as our views regarding the growth and earnings prospects of the bank. Changes in these judgments, either individually or collectively, may have a significant effect on the estimated fair values.

Based on the results of the annual goodwill impairment test, we determined that no goodwill impairment charges were required and our single reporting unit was not at risk of failing step one. As of December 31, 2012 we determined there were no events or circumstances which would more likely than not reduce the fair value of our reporting unit below its carrying amount.

Even though we determined that there was no goodwill impairment during 2012, additional adverse changes in the operating environment for the financial services industry may result in a future impairment charge.

Please refer to Note 9 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report for further discussion.

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2012 Highlights

- Consolidated net income for 2012 was $46.1 million, or $1.16 per diluted common share, compared with a net income of $48.0 million, or $1.21 per diluted common share, in 2011.
- Net interest income for 2012 increased 1% to $238.9 million compared to $236.7 million for 2011. Interest income was $248.5 million in 2012, compared to $251.3 million in 2011. The decrease was due to the lower average yield on the noncovered loan portfolio. Interest expense decreased $5.0 million due to the average cost of interest-bearing deposits falling 19 basis points.
- Provision expense on noncovered loans was $13.5 million in 2012, compared to $7.4 million in 2011, an increase of 82%. Provision expense on covered loans was $25.9 million in 2012, compared to a provision recapture of $1.6 million in 2011. The noncovered loan provision for the current year approximates current year net charge-offs. The noncovered loan provision in 2011 approximated net charge-offs partially offset by an improvement in credit quality. The increase in the provision on covered loans was due to incremental loan losses incurred in the current period which were in excess of those expected from the remeasurement of cash flows during the prior period.
- Noninterest income was $27.1 million for 2012, an increase from a loss of $9.3 million for 2011. The increase was primarily due to the decrease of $25.0 million in the change in the FDIC loss-sharing asset, $6.5 million in additional investment securities gains, and $3.4 million in additional service charges and other fees.
- Noninterest expense increased 5% to $162.9 million for 2012 due to increases in staffing and occupancy costs related to the three FDIC-assisted transactions that occurred during mid 2011 as well as additional legal and professional expenses incurred in 2012 related to the pending acquisition of West Coast.
- Total assets at December 31, 2012 were $4.91 billion, up 3% from $4.79 billion at the end of 2011. The increase from December 31, 2011 reflects the Company's noncovered loan growth as well as the increase in cash and cash equivalents in anticipation of payment of the cash portion of the West Coast Bancorp acquisition consideration.
- Investment securities available for sale totaled $1.00 billion at December 31, 2012 compared to $1.03 billion at December 31, 2011.
- Loans, excluding covered loans, were $2.53 billion, up 8% from $2.35 billion at the end of 2011. The increase from December 31, 2011 reflects additional loan volume arising from the Company's organic loan growth. Noncovered loan growth during 2012 was $177.3 million and was centered mainly in commercial business and commercial and multifamily residential loans.
- The allowance for noncovered loan and lease losses decreased to $52.2 million at December 31, 2012 from $53.0 million at December 31, 2011 due to improved loan quality. The Company’s allowance amounts to 2.07% of total noncovered loans, compared with 2.26% at the end of 2011.
- Nonperforming assets totaled $48.5 million at December 31, 2012, significantly down from $85.4 million at December 31, 2011. Net loan charge-offs were $14.3 million in 2012, compared with $15.4 million in 2011. Nonaccrual loans decreased $16.1 million to $37.4 million and other real estate owned and other personal property owned decreased $20.8 million to $11.1 million.
- Deposits totaled $4.04 billion at December 31, 2012 compared to $3.82 billion at December 31, 2011. Core deposits totaled $3.80 billion at December 31, 2012, comprising 94% of total deposits compared to $3.51 billion, or 92%, of total deposits at December 31, 2011.
- The Company is well capitalized with a total risk-based capital ratio of 20.62% at December 31, 2012 compared to 21.05% at December 31, 2011.
- The number of branches decreased by 3 from December 31, 2011 to December 31, 2012 as part of the Company's ongoing effort to improve efficiencies.

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Business Combinations

On August 5, 2011, the Bank acquired certain assets and assumed certain liabilities of the Bank of Whitman from the FDIC in an FDIC-assisted transaction. The Bank and the FDIC entered into a modified whole bank purchase and assumption agreement without loss share. The bank acquired approximately $437.5 million in assets, including $200.0 million in loans measured at fair value, and approximately $401.1 million in deposits located in nine branches in eastern Washington. The Bank participated in a competitive bid process in which the accepted bid included no deposit premium on non-brokered deposits and a negative bid of $30.0 million on net assets acquired.

On May 27, 2011, the Bank acquired certain assets and assumed certain liabilities of First Heritage Bank from the FDIC in an FDIC-assisted transaction. The Bank acquired approximately $165.0 million in assets and approximately $159.5 million in deposits located in five branches in the King and Snohomish counties of Washington. First Heritage Bank's loans and other real estate assets acquired of approximately $89.7 million are subject to a loss-sharing agreement with the FDIC. The Bank participated in a competitive bid process in which the accepted bid included a 0.75% deposit premium on non-brokered deposits and a negative bid of $10.5 million on net assets acquired.

On May 20, 2011, the Bank acquired certain assets and assumed certain liabilities of Summit Bank from the FDIC, in an FDIC-assisted transaction. The Bank acquired approximately $131.1 million in assets and approximately $123.3 million in deposits located in three branches in in the northern Puget Sound region of Washington. Summit Bank's loans and other real estate assets acquired of approximately $71.9 million are subject to a loss-sharing agreement with the FDIC. The Bank participated in a competitive bid process in which the accepted bid included a 0.75% deposit premium on non-brokered deposits and a negative bid of $9.5 million on net assets acquired.

On January 29, 2010, the Bank acquired substantially all of the deposits and assets of American Marine Bank from the FDIC, which was appointed receiver of American Marine Bank. The Bank acquired approximately $307.8 million in assets and approximately $254.0 million in deposits located in 11 branches in the western Puget Sound region. American Marine Bank’s loans and other real estate assets acquired of approximately $257.5 million are subject to a loss-sharing agreement with the FDIC. In addition, Columbia State Bank will continue to operate the Trust Division of American Marine Bank. The Bank participated in a competitive bid process in which the accepted bid included a 1% deposit premium on non-brokered deposits and a negative bid of $23.0 million on net assets acquired.

On January 22, 2010, the Bank acquired all of the deposits and certain assets of Columbia River Bank from the FDIC, in an FDIC-assisted transaction. The Bank acquired approximately $912.9 million in assets and approximately $893.4 million in deposits located in 21 branches in Oregon and Washington. Columbia River Bank’s loans and other real estate assets acquired of approximately $696.1 million are subject to a loss-sharing agreement with the FDIC. The Bank participated in a competitive bid process in which the accepted bid included a 1% deposit premium on non-brokered deposits and a negative bid of $43.9 million on net assets acquired.

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RESULTS OF OPERATIONS

Summary

A summary of the Company's results of operations for each of the last five years ended December 31 follows:

	Year ended	Increase (Decrease)		Year ended	Increase (Decrease)		Years ended December 31,		
	2012	Amount	%	2011	Amount	%	2010	2009	2008
	(dollars in thousands, except per share amounts)								
Interest income	$248,504	$(2,767)	(1)	$251,271	$65,392	35	$185,879	$143,035	$175,060
Interest expense	9,577	(4,958)	(34)	14,535	(6,557)	(31)	21,092	27,683	55,547
Net interest income	238,927	2,191	1	236,736	71,949	44	164,787	115,352	119,513
Provision for loan and lease losses	13,475	6,075	82	7,400	(33,891)	(82)	41,291	63,500	41,176
Provision (recapture) for losses on covered loans	25,892	27,540	(1,671)	(1,648)	(7,703)	(127)	6,055	—	—
Noninterest income (loss)	27,058	36,341	(391)	(9,283)	(62,064)	(118)	52,781	29,690	14,850
Noninterest expense:									
Compensation and employee benefits	85,434	3,882	5	81,552	11,772	17	69,780	47,275	49,315
Other expense	77,479	3,272	4	74,207	6,840	10	67,367	47,213	42,810
Total	162,913	7,154	5	155,759	18,612	14	137,147	94,488	92,125
Income (loss) before income taxes	63,705	(2,237)	(3)	65,942	32,867	99	33,075	(12,946)	1,062
Provision (benefit) for income taxes	17,562	(343)	(2)	17,905	15,614	682	2,291	(8,978)	(4,906)
Net income (loss)	$46,143	$(1,894)	(4)	$48,037	$17,253	56	$30,784	$(3,968)	$5,968
Less: Dividends on preferred stock	—	—	—	—	(4,947)	(100)	4,947	4,403	470
Net income (loss) applicable to common shareholders	$46,143	$(1,894)	(4)	$48,037	$22,200	86	$25,837	$(8,371)	$5,498
Earnings (loss) per common share, diluted	$1.16	$(0.05)	(4)	$1.21	$0.49	68	$0.72	$(0.38)	$0.30

Net Interest Income

Net interest income is the difference between interest income and interest expense. Net interest income on a fully taxable-equivalent basis expressed as a percentage of average total interest-earning assets is referred to as the net interest margin, which represents the average net effective yield on interest-earning assets.

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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, net interest spread, net interest margin and the ratio of average interest-earning assets to interest-earning liabilities:

Net Interest Income Summary

	2012			2011			2010		
	Average Balances (1)	Interest Earned/ Paid	Average Rate	Average Balances (1)(3)	Interest Earned/ Paid (3)	Average Rate	Average Balances (1)(3)	Interest Earned/ Paid (3)	Average Rate
	(dollars in thousands)								
ASSETS									
Loans, excluding covered loans, net [1][2]	$2,413,307	$131,413	5.45 %	$2,064,568	$126,520	6.13 %	$2,103,964	$109,039	5.18 %
Covered loans, net [1]	487,213	88,785	18.22 %	542,698	92,467	17.04 %	381,686	48,796	12.78 %
Taxable securities	740,418	18,276	2.47 %	675,010	21,870	3.24 %	491,306	18,276	3.72 %
Tax exempt securities [2]	270,876	15,423	5.69 %	253,881	15,736	6.20 %	228,846	14,505	6.34 %
Interest-earning deposits with banks and federal funds sold	334,910	854	0.26 %	335,267	839	0.25 %	377,926	963	0.25 %
Total interest-earning assets	4,246,724	254,751	6.00 %	3,871,424	257,432	6.65 %	3,583,728	191,579	5.35 %
Other earning assets	76,327			57,518			51,446		
Noninterest-earning assets	503,232			580,068			613,416		
Total assets	$4,826,283			$4,509,010			$4,248,590		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Certificates of deposit	$543,349	$3,257	0.60 %	$636,074	$5,093	0.80 %	$763,829	$8,705	1.14 %
Savings accounts	298,223	77	0.03 %	247,073	152	0.06 %	199,117	287	0.14 %
Interest-bearing demand	790,887	869	0.11 %	704,484	1,393	0.20 %	637,983	2,157	0.34 %
Money market accounts	1,051,171	1,684	0.16 %	969,548	3,840	0.40 %	851,673	5,584	0.66 %
Total interest-bearing deposits	2,683,630	5,887	0.22 %	2,557,179	10,478	0.41 %	2,452,602	16,733	0.68 %
Federal Home Loan Bank advances [4]	100,337	3,211	3.20 %	120,419	2,980	2.47 %	122,860	2,841	2.31 %
Long-term subordinated debt	—	—	— %	14,746	579	3.93 %	25,701	1,029	4.00 %
Other borrowings and interest-bearing liabilities	25,000	479	1.92 %	24,899	498	2.00 %	24,881	489	1.96 %

Total interest-bearing liabilities	2,808,967	9,577	0.34	%	2,717,243	14,535	0.53	%	2,626,044	21,092	0.80	%
Noninterest-bearing deposits	1,192,036				984,220				818,321			
Other noninterest-bearing liabilities	64,095				76,821				135,756			
Shareholders' equity	761,185				730,726				668,469			
Total liabilities & shareholders' equity	$4,826,283				$4,509,010				$4,248,590			
Net interest income		$245,174				$242,897				$170,487		
Net interest spread			5.66	%			6.12	%			4.55	%
Net interest margin			5.77	%			6.27	%			4.76	%
Average interest-earning assets to average interest-bearing liabilities			151.18	%			142.48	%			136.47	%

(1) Nonaccrual loans were included in loans. Amortized net deferred loan fees and net unearned discounts on certain acquired loans were included in the interest income calculations. The amortization of net deferred loan fees was $2.1 million in 2012, $1.3 million in 2011 and $2.1 million in 2010. The amortization of net unearned discounts on certain acquired loans was $5.9 million in 2012 and $14.3 million in 2011. There was no amortization of net unearned discounts in 2010.

(2) Yields on fully taxable equivalent basis, based on a marginal tax rate of 35%. The tax equivalent yield adjustment to interest earned on noncovered loans was $765 thousand, $567 thousand and $543 thousand for the years ended December 31, 2012, 2011, and 2010, respectively. The tax equivalent yield adjustment to interest earned on tax exempt securities was $5.5 million, $5.6 million and $5.2 million for the years ended December 31, 2012, 2011, and 2010, respectively.

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

(4) Federal Home Loan Bank advances includes prepayment charge of $603 thousand in 2012.

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Net interest income is impacted by the volume (changes in volume multiplied by prior rate), interest rate (changes in rate multiplied by prior volume) and the mix of interest-earning assets and interest-bearing liabilities. The following table shows changes in net interest income on a fully taxable-equivalent basis between 2012 and 2011, as well as between 2011 and 2010 broken down between volume and rate. 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:

Changes in Net Interest Income

	2012 Compared to 2011 Increase (Decrease) Due to			2011 Compared to 2010 Increase (Decrease) Due to		
	Volume	Rate	Total	Volume (1)	Rate (1)	Total
	(in thousands)					
Interest Income						
Loans, excluding covered loans, net	$19,937	$(15,044)	$4,893	$(2,076)	$19,558	$17,482
Covered loans, net	(9,845)	6,163	(3,682)	24,412	19,258	43,670
Taxable securities	1,973	(5,567)	(3,594)	6,178	(2,584)	3,594
Tax-exempt securities	1,015	(1,328)	(313)	1,558	(327)	1,231
Interest earning deposits with banks and federal funds sold	(1)	16	15	(107)	(17)	(124)
Interest income	$13,079	$(15,760)	$(2,681)	$29,965	$35,888	$65,853
Interest Expense						
Deposits:						
Certificates of deposit	$(674)	$(1,162)	$(1,836)	$(1,300)	$(2,312)	$(3,612)
Savings accounts	27	(102)	(75)	57	(192)	(135)
Interest-bearing demand	155	(679)	(524)	206	(970)	(764)
Money market accounts	299	(2,455)	(2,156)	694	(2,438)	(1,744)
Total interest on deposits	(193)	(4,398)	(4,591)	(343)	(5,912)	(6,255)
Federal Home Loan Bank and Federal Reserve Bank borrowings	(550)	781	231	(57)	196	139
Long-term subordinated debt	(579)	—	(579)	(431)	(19)	(450)
Other borrowings and interest-bearing liabilities	—	(19)	(19)	2	7	9
Interest expense	$(1,322)	$(3,636)	$(4,958)	$(829)	$(5,728)	$(6,557)
	$14,401	$(12,124)	$2,277	$30,794	$41,616	$72,410

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

Comparison of 2012 with 2011

Taxable-equivalent net interest income totaled $245.2 million in 2012, compared with $242.9 million for 2011. The increase in net interest income during 2012 resulted from the increase in the size of the noncovered loan portfolio as well as lower rates paid on deposits. These increases were partially offset by lower incremental accretion on covered loans and lower yields on the loan and securities portfolios. The incremental accretion income represents the amount of income recorded on the acquired loans above the contractual rate stated in the individual loan rates. The additional income stems from the discount established at the time these loan portfolios were acquired, and increases net interest income and the net interest margin. The incremental accretion income had a positive impact of approximately 144 basis points on the 2012 net interest margin compared to a positive impact of 174 basis points on the 2011 net interest margin.

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The following table shows the effect on the net interest income resulting from accretion of income on acquired impaired loans and loans acquired in the Bank of Whitman transaction:

	Year ended December 31, 2012	Year ended December 31, 2011
	(in thousands)	
Interest income as recorded	$98,583	$109,580
Interest income at stated note rate	37,406	42,220
Incremental accretion income	$61,177	$67,360
Incremental accretion income due to:		
Acquired impaired loans	$55,305	$53,079
Other acquired loans	5,872	14,281
Incremental accretion income	$61,177	$67,360

For discussion over the methodologies used by management in recording interest income on loans please see "Critical Accounting Policies" section of this discussion and Note 1 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

Comparison of 2011 with 2010

Taxable-equivalent net interest income totaled $242.9 million in 2011, compared with $170.5 million for 2010. The significant increase in net interest income during 2011 resulted primarily from income accretion on the acquired loan portfolios. The incremental accretion income represents the amount of income recorded on the acquired loans above the contractual rate stated in the individual loan rates. The additional income increases net interest income and the net interest margin.

Provision for Loan and Lease Losses

The Company accounts for the credit risk associated with lending activities through its allowance for loan and lease losses and provision for loan and lease losses. The provision is the expense recognized in the consolidated statements of income to adjust the allowance to the levels deemed appropriate by management, as determined through its application of the Company’s allowance methodology procedures. Impairment valuation adjustments and allowance for loan and lease losses on acquired loans, including those subject to the Company’s loss-share agreements with the FDIC, are accounted for separately from the allowance for loan and lease losses. For discussion over the methodology used by management in determining the adequacy of the ALLL see the following “Allowance for Loan and Lease Losses and Unfunded Commitments and Letters of Credit” and “Critical Accounting Policies” sections of this discussion.

For noncovered loans, the Company recorded expense of $13.5 million and $7.4 million through the provision for loan and lease losses in 2012 and 2011, respectively. The provision recorded in 2012 reflects management’s ongoing assessment of the credit quality of the Company’s noncovered loan portfolio, which is impacted by various economic trends, including the slow recovery of the Pacific Northwest economy. Additional factors affecting the provision include credit quality migration, size and composition of the loan portfolio and changes in the economic environment during the period. See “Allowance for Loan and Lease Losses and Unfunded Commitments and Letters of Credit” section of this discussion for further information on factors considered by the Company in assessing the credit quality of the loan portfolio and establishing the allowance for loan and lease losses.

The Company recorded expense of $25.9 million through the provision for losses on covered loans in 2012 compared to a recapture of $1.6 million through the provision for losses on covered loans in 2011. The provision recorded in 2012 was due to incremental loan losses incurred in the current period which were in excess of those expected from the remeasurement of cash flows during the prior period. These incremental loan losses reduced expected future cash flows and, when discounted at current yields, resulted in impairment. The $25.9 million in provision expense is partially offset by a $20.7 million favorable adjustment to the change in FDIC loss-sharing asset.

For the years ended December 31, 2012, 2011 and 2010, net noncovered loan charge-offs amounted to $14.3 million, $15.4 million, and $33.8 million, respectively. Loans in the commercial business portfolio accounted for 60% of the 2012 net charge-offs, while loans in the commercial and multifamily residential real estate portfolio accounted for 27% of the 2012 net charge-offs compared to 35% and 21%, respectively, in 2011.

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Noninterest Income (Loss)

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

	Years ended December 31,						
	2012	$ Change	% Change	2011	$ Change	% Change	2010
	(dollars in thousands)						
Service charges and other fees	$29,998	$3,366	13 %	$26,632	$1,934	8 %	$24,698
Gain on bank acquisitions, net of tax	—	(1,830)	(100)%	1,830	(7,988)	(81)%	9,818
Merchant services fees	8,154	769	10 %	7,385	(117)	(2)%	7,502
Investment securities gains (losses)	3,733	6,549	(233)%	(2,816)	(2,874)	(4,955)%	58
Bank owned life insurance (BOLI)	2,861	673	31 %	2,188	147	7 %	2,041
Change in FDIC loss-sharing asset	(24,467)	25,029	(51)%	(49,496)	(54,404)	(1,108)%	4,908
Other	6,779	1,785	36 %	4,994	1,238	33 %	3,756
Total noninterest income	$27,058	$36,341	(391)%	$(9,283)	$(62,064)	(118)%	$52,781

Comparison of 2012 with 2011

The increase in noninterest income from the prior year was primarily due to the decrease of $25.0 million in the change in the FDIC loss-sharing asset, the $6.5 million in additional investment securities gains, and the $3.4 million in additional service charges and other fees. These increases were partially offset by the net of tax gain on bank acquisition of $1.8 million recorded in 2011, with no gain recorded in 2012.

The change in the FDIC loss-sharing asset recognizes the decreased amount that Columbia expects to collect from the FDIC under the terms of its loss-sharing agreements. The Company remeasures contractual and expected cash flows of covered loans on a quarterly basis. 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 accretable yield of the related loan pool is increased and recognized as interest income over the life of the loan portfolio. As a result of the improved expected cash flows, the FDIC loss-sharing asset is reduced first by the amount of any impairment previously recorded and, second, by increased amortization over the remaining life of the related loan portfolio. For additional information on the FDIC loss-sharing asset, please see the “Loss-sharing Asset” section of Management’s Discussion and Analysis and Note 7 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

The increase in investment securities gains was primarily due to the $3.0 million impairment charge recorded during 2011 on a single municipal obligation for which we received full repayment during 2012, resulting in a gain of approximately $3.0 million. The increase in service charges and other fees was primarily due to a larger customer base.

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Other Noninterest Income: The following table presents selected items of “other noninterest income” and the related dollar and percentage change from period to period:

	Years ended December 31,												
	2012	$ Change		% Change		2011 (1)	$ Change		% Change		2010 (1)
	(dollars in thousands)										
Gain on disposal of assets	$91	$2		2	%	$89	$(29	)	(25	)%	$118
Mortgage banking	1,226	497		68	%	729	460		171	%	269
Small Business Administration premiums	607	556		1,090	%	51	(130	)	(72	)%	181
Cash management 12b-1 fees	5	—		—	%	5	(6	)	(55	)%	11
Letter of credit fees	392	(23	)	(6	)%	415	(17	)	(4	)%	432
Late charges	457	95		26	%	362	(94	)	(21	)%	456
Currency exchange income	364	18		5	%	346	(14	)	(4	)%	360
New Markets Tax Credit dividend	2	(50	)	(96	)%	52	(19	)	(27	)%	71
Miscellaneous fees on loans	1,854	180		11	%	1,674	690		70	%	984
Interest rate swap income	522	189		57	%	333	(95	)	(22	)%	428
Credit card fees	325	65		25	%	260	77		42	%	183
Miscellaneous	934	256		38	%	678	415		158	%	263
Total other noninterest income	$6,779	$1,785		36	%	$4,994	$1,238		33	%	$3,756

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

The increase in other noninterest income was due in part to the increases in mortgage banking income and Small Business Administration premiums. We have grown our mortgage services division and had increased volume in our mortgage loan sales during 2012. During 2012, we had a large increase in the volume of our Small Business Association loan sales.

Comparison of 2011 with 2010

Noninterest income for the year ended December 31, 2011 was a loss of $9.3 million, a decrease of $62.1 million from 2010. The decrease in noninterest income from the prior year was primarily due to the $54.4 million decrease in the change in FDIC loss-sharing asset and the $3.0 million impairment charge on investment securities. In addition, in 2011 the Company recorded a gain on bank acquisition of $1.8 million compared to a gain on acquisition of $9.8 million in the prior year. For additional information on the FDIC loss-sharing asset, please see the “Loss-sharing Asset” section of Management’s Discussion and Analysis and Note 7 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

Noninterest Expense

Noninterest expense was $162.9 million in 2012, an increase of $7.2 million, or 5%, over 2011. Noninterest expense increased $18.6 million, or 14%, in 2011 over 2010.

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

	Years ended December 31,						
	2012	$ Change	% Change	2011	$ Change	% Change	2010
	(dollars in thousands)						
Compensation and employee benefits	$85,434	$3,882	5 %	$81,552	$11,772	17 %	$69,780
All other noninterest expense:							
Occupancy	20,031	1,068	6 %	18,963	2,149	13 %	16,814
Merchant processing	3,612	(86)	(2)%	3,698	(666)	(15)%	4,364
Advertising and promotion	3,650	(36)	(1)%	3,686	605	20 %	3,081
Data processing	9,714	1,230	14 %	8,484	(285)	(3)%	8,769
Legal and professional services	8,915	2,429	37 %	6,486	802	14 %	5,684
Taxes, license and fees	4,736	290	7 %	4,446	1,588	56 %	2,858
Regulatory premiums	3,384	(953)	(22)%	4,337	(2,148)	(33)%	6,485
Net cost of operation of noncovered other real estate owned	4,766	(2,650)	(36)%	7,416	1,721	30 %	5,695
Net benefit of operation of covered other real estate owned	(6,735)	1,703	(20)%	(8,438)	(3,530)	72 %	(4,908)
Amortization of intangibles	4,445	126	3 %	4,319	397	10 %	3,922
FDIC clawback expense (recovery)	(54)	(3,710)	(101)%	3,656	3,656	100 %	—
Other	21,015	3,861	23 %	17,154	2,551	17 %	14,603
Total all other noninterest expense	77,479	3,272	4 %	74,207	6,840	10 %	67,367
Total noninterest expense	$162,913	$7,154	5 %	$155,759	$18,612	14 %	$137,147

Comparison of 2012 with 2011

Compensation and employee benefits expense increased to $85.4 million, or 5%, in 2012 from $81.6 million in 2011 reflecting a full year of staffing increases in the current year related to the three FDIC-assisted acquisitions that occurred in 2011.

The remaining noninterest expense categories increased $3.3 million, or 4%, between 2011 and 2012. The increase was primarily due to the $2.4 million increase in legal and professional, which includes $1.8 million of costs related to the recently announced acquisition of West Coast. Occupancy and data processing increased $1.1 million and $1.2 million due to the increase in number of branch locations in operation during 2012 compared to 2011. Though the period end number of branches decreased slightly between 2011 and 2012, the number of branches in operation throughout the year was larger in 2012 due to the three acquisitions that occurred in mid 2011. These increases were partially offset by a reduction of $3.7 million in the FDIC clawback expense. The Company's Purchase & Assumption agreements with the FDIC require the Company to reimburse the FDIC at the conclusion of the loss share agreement period, February 2020 for the Columbia River Bank and American Marine Bank transactions, a calculated amount if total losses on the acquired loan portfolios fail to reach a minimum threshold level. The $3.7 million recorded in 2011 represented the net present value of management's clawback liability estimate of $5.5 million at December 31, 2011. There has not been a material change in this estimate during 2012.

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Other Noninterest Expense: The following table presents selected items of "other noninterest expense" and the related dollar and percentage change from period to period:

	Years ended December 31,						
	2012	$ Change	% Change	2011	$ Change	% Change	2010
	(dollars in thousands)						
CRA partnership investment expense	$609	$11	2 %	$598	$329	122 %	$269
Software support & maintenance	1,574	212	16 %	1,362	305	29 %	1,057
Federal Reserve Bank processing fees	216	(118)	(35)%	334	6	2 %	328
Supplies	1,132	(144)	(11)%	1,276	(171)	(12)%	1,447
Postage	2,088	(43)	(2)%	2,131	362	20 %	1,769
Sponsorships & charitable contributions	780	(343)	(31)%	1,123	359	47 %	764
Travel	1,368	120	10 %	1,248	286	30 %	962
Investor relations	178	4	2 %	174	(6)	(3)%	180
Insurance	1,030	194	23 %	836	55	7 %	781
Director expenses	551	94	21 %	457	16	4 %	441
Employee expenses	739	103	16 %	636	164	35 %	472
ATM Network	1,131	73	7 %	1,058	216	26 %	842
Miscellaneous	9,619	3,698	62 %	5,921	630	12 %	5,291
Total other noninterest expense	$21,015	$3,861	23 %	$17,154	$2,551	17 %	$14,603

Other noninterest expense increased $3.9 million primarily due to the increase of $3.7 million in miscellaneous noninterest expense, which was primarily driven by $2.0 million recorded in other personal property ("OPPO") costs in 2012 compared to $1.1 million recorded in OPPO benefit in 2011.

Comparison of 2011 with 2010

Compensation and employee benefits expense increased to $81.6 million, or 17% in 2011 from $69.8 million in 2010 reflecting staffing increases in 2011 related to the three FDIC-assisted acquisitions. Full-time equivalent staff increased to 1,256 at December 31, 2011 from 1,092 at December 31, 2010.

The remaining noninterest expense categories increased $6.8 million, or 10%, between 2010 and 2011. Occupancy increased $2.1 million due to the increase in branch locations during 2011. Also contributing to the remaining increase in noninterest expense was the Company recording $3.7 million to FDIC clawback expense to create the FDIC clawback liability. The remaining noninterest expense increase was partially offset by a decrease in regulatory premiums of $2.1 million due to a decrease in the assessment rate utilized in calculating premiums due.

Income Tax

For the years ended December 31, 2012, 2011 and 2010 we recorded income tax provisions of $17.6 million, $17.9 million and $2.3 million, respectively. The effective tax rate was 28% in 2012, 27% in 2011 and 7% in 2010. For additional information, see Note 20 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report. Our effective tax rate continues to be less than our federal statutory rate of 35% primarily due to the amount of tax-exempt municipal securities held in the investment portfolio, tax-exempt earnings on bank owned life insurance, and tax credits received on investments in affordable housing partnerships.

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Financial Condition

Our total assets increased 3% to $4.91 billion at December 31, 2012 from $4.79 billion at December 31, 2011. Interest-earning deposits with banks increased $186.4 million as the Company accumulated cash in overnight funds in anticipation of payment of the cash portion of the West Coast acquisition consideration. Our investment portfolio decreased $26.4 million or 3%. Though the net loan portfolio increased only 1% or $37.5 million to $2.86 billion, the noncovered loan portfolio increased $177.3 million or 8%. The increase in the noncovered loan portfolio can be attributed to increases in commercial business loans of $123.4 million and commercial and multifamily residential real estate loans of $63.0 million. The FDIC loss-sharing asset decreased $78.7 million or 45% to $96.4 million at December 31, 2012. The decrease in the FDIC loss-sharing asset was due to $54.6 million in cash received from the FDIC as well as $42.9 million in amortization, partially offset by $20.7 million in loan impairment. Premises and equipment, net increased $10.8 million or 10%, as we purchased 6 branch buildings in 2012 that we had previously leased nearby locations. Deposit balances increased $226.6 million or 6% to $4.04 billion and FHLB advances decreased 94% to $6.6 million. The decrease in FHLB advances is due to the early repayment of $106.4 million during the fourth quarter of 2012.

Investment Portfolio

We invest in securities to generate revenues for the Company, to manage liquidity while minimizing interest rate risk and to provide collateral for certain public deposits and short-term borrowings. The amortized cost amounts represent the Company’s original cost for the investments, adjusted for accumulated amortization or accretion of any yield adjustments related to the security. The estimated fair values are the amounts we believe the securities could be sold for as of the dates indicated. As of December 31, 2012 we had 38 available for sale securities in an unrealized loss position. Based on past experience with these types of securities and our own financial performance, we do not currently intend to sell any impaired securities nor does available evidence suggest it is more likely than not that management will be required to sell any impaired securities before the recovery of the amortized cost basis. We review these investments for other-than-temporary impairment on an ongoing basis.

During the fourth quarter of 2012, the Company received full payment on a municipal bond that was determined to be other-than-temporarily impaired during December 2011. The $2.95 million gain related to this security was recorded in the line item Investment securities gains (losses), net in the Consolidated Statements of Income.

Purchases during 2012 totaled $322.3 million while maturities, repayments and sales totaled $328.2 million compared to purchases of $453.0 million and maturities, repayments and sales of $221.0 million during 2011. At December 31, 2012 U.S. government agency and government-sponsored enterprise mortgage-backed securities (“MBS”) and collateralized mortgage obligations (“CMO”) comprised 57% of our investment portfolio, state and municipal securities were 29%, government agency and government-sponsored enterprise securities were 12%, and government securities were 2%. Our entire investment portfolio is categorized as available for sale and carried on our balance sheet at fair value. The average duration of our investment portfolio was approximately 3 years and 8 months at December 31, 2012.

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The following table presents the contractual maturities and weighted average yield of our investment portfolio:

	December 31, 2012			
	Amortized Cost	Fair Value	Yield	
	(dollars in thousands)			
U.S. government agency and government-sponsored enterprise mortgage-backed securities & collateralized mortgage obligations (1)				
Over 1 through 5 years	$18,044	$18,825	4.41	%
Over 5 through 10 years	85,280	89,070	3.27	%
Over 10 years	457,752	464,474	2.60	%
Total	$561,076	$572,369	2.77	%
State and municipal securities (2)				
Due through 1 year	$25,063	$25,440	6.14	%
Over 1 through 5 years	36,836	38,954	4.52	%
Over 5 through 10 years	56,953	59,917	4.82	%
Over 10 years	146,218	161,264	6.22	%
Total	$265,070	$285,575	5.69	%
U.S. government agency and government-sponsored enterprise securities (1)				
Over 1 through 5 years	$73,091	$73,925	0.84	%
Over 5 through 10 years	46,994	46,576	1.13	%
Total	$120,085	$120,501	0.96	%
U.S. government securities (1)				
Over 5 through 10 years	$19,804	$19,828	1.15	%
Total	$19,804	$19,828	1.15	%

(1) The maturities reported for mortgage-backed securities, collateralized mortgage obligations, government agency, government-sponsored enterprise, and government securities are based on contractual maturities and principal amortization.

(2) Yields on fully taxable equivalent basis, based on a marginal tax rate of 35%.

For further information on our investment portfolio see Note 3 of the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

FHLB Stock

As a condition of membership in the Federal Home Loan Bank of Seattle (“FHLB”), the Company is required to purchase and hold a certain amount of FHLB stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB and is calculated in accordance with the Capital Plan of the FHLB. Our FHLB stock has a par value of $100 and is redeemable at par for cash.

FHLB stock is carried at cost and is subject to recoverability testing per the Financial Services – Depository and Lending topic of the FASB ASC. The FHLB is currently classified as adequately capitalized by the Federal Housing Finance Agency (“Finance Agency”). Accordingly, as of December 31, 2012 we did not recognize an impairment charge related to our FHLB stock holdings. We will continue to monitor the financial condition of the FHLB as it relates to, among other things, the recoverability of our investment.

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Loan Portfolio

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 our loan portfolio by type of loan for the dates indicated:

	December 31,									
	2012	% of Total	2011	% of Total	2010	% of Total	2009	% of Total	2008	% of Total
	(dollars in thousands)									
Commercial business	$1,155,158	45.7 %	$1,031,721	43.9 %	$795,369	41.5 %	$744,440	37.1 %	$810,922	36.3
Real estate:										
One-to-four family residential	43,922	1.7 %	64,491	2.8 %	49,383	2.6 %	63,364	3.1 %	57,237	2.6
Commercial and multifamily residential	1,061,201	42.0 %	998,165	42.5 %	794,329	41.5 %	856,260	42.6 %	862,595	38.6
Total real estate	1,105,123	43.7 %	1,062,656	45.3 %	843,712	43.9 %	919,624	45.7 %	919,832	41.2
Real estate construction:										
One-to-four family residential	50,602	2.0 %	50,208	2.1 %	67,961	3.5 %	107,620	5.4 %	209,682	9.4
Commercial and multifamily residential	65,101	2.7 %	36,768	1.6 %	30,185	1.6 %	41,829	2.1 %	81,176	3.6
Total real estate construction	115,703	4.7 %	86,976	3.7 %	98,146	5.2 %	149,449	7.5 %	290,858	13.0
Consumer	157,493	6.2 %	183,235	7.8 %	182,017	9.5 %	199,987	10.0 %	214,753	9.7
Subtotal	2,533,477	100.3 %	2,364,588	100.7 %	1,919,244	100.2 %	2,013,500	100.2 %	2,236,365	100.2
Less deferred loan fees and other	(7,767)	(0.3)%	(16,217)	(0.7)%	(3,490)	(0.2)%	(4,616)	(0.2)%	(4,033)	(0.2
Total loans not covered under FDIC loss-share agreements, net of deferred fees	2,525,710	100.0 %	2,348,371	100.0 %	1,915,754	100.0 %	2,008,884	100.0 %	2,232,332	100.0
Loans covered under FDIC loss-share										

agreements					
Covered loans	391,337	531,929	517,061	—	—
Total loans, net (before Allowance for Loan and Lease Losses)	$2,917,047	$2,880,300	$2,432,815	$2,008,884	$2,232,332
Loans held for sale	$2,563	$2,148	$754	$—	$1,964

At December 31, 2012, total loans were $2.92 billion compared with $2.88 billion in the prior year, an increase of $36.7 million or 1%. The noncovered loan portfolio increased $177.3 million, or 8% from the previous year. The increase in the noncovered loan portfolio was primarily due to increases in commercial business loans of $123.4 million and commercial and multifamily residential real estate loans of $63.0 million. Net covered loans were $391.3 million at December 31, 2012 compared with $531.9 million in the prior year, a decrease of $140.6 million or 27%. Total loans represented 58% and 59% of total assets at December 31, 2012 and 2011, respectively.

Commercial Business Loans: Commercial business loans increased $123.4 million, or 12%, to $1.16 billion from year-end 2011, representing 46% of total loans at year end. 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

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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.

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 the Company 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 2011 agreements for commercial and single family residential mortgage 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.

The following table is a rollforward of acquired, impaired loans accounted for under ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality for the year ended December 31, 2012:

	Contractual Cash Flows	Nonaccretable Difference	Accretable Yield	Carrying Amount
	(in thousands)			
Balance at January 1, 2012	$835,556	$(91,317)	$(259,669)	$484,570
Principal reductions and interest payments	(175,837)	—	—	(175,837)
Accretion of loan discount	—	—	86,671	86,671
Changes in contractual and expected cash flows due to remeasurement	(73,483)	51,084	(6,746)	(29,145)
Reduction due to removals	(30,128)	2,862	12,856	(14,410)
Balance at December 31, 2012	$556,108	$(37,371)	$(166,888)	$351,849

For additional information on our loan portfolio, including amounts pledged as collateral on borrowings, see Note 4 and Note 7 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report.

Maturities and Sensitivities of Loans to Changes in Interest Rates

The following table presents the maturity distribution of our covered and noncovered commercial and real estate construction loan portfolios and the sensitivity of these loans due after one year to changes in interest rates as of December 31, 2012:

	Maturing Due Through 1 Year	Over 1 Through 5 Years	Over 5 Years	Total
	(in thousands)			
Commercial business	$510,755	$296,309	$345,385	$1,152,449
Real estate construction	75,247	23,795	16,660	115,702
Total	$586,002	$320,104	$362,045	$1,268,151
Fixed rate loans due after 1 year		$151,557	$204,688	$356,245
Variable rate loans due after 1 year		168,547	157,357	325,904
Total		$320,104	$362,045	$682,149

The extension of credit in the form of loans or other credit substitutes to individuals and businesses is one of our principal commerce activities. Our policies, 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.

In analyzing our existing portfolio, we review our consumer and residential loan portfolios by their performance as a pool of loans, since no single loan is individually significant or judged by its risk rating, size or potential risk of loss. In contrast, the monitoring process for the commercial business, real estate construction, and commercial real estate portfolios includes periodic reviews of individual loans with risk ratings assigned to each loan and performance judged on a loan by loan basis.

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. 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 assess whether an impairment of a loan warrants specific reserves or a write-down of the loan. For additional discussion on our methodology in managing credit risk within our loan portfolio see the following “Allowance for Loan and Lease Losses and Unfunded Commitments and Letters of Credit” section and Note 1 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

Loan policies, credit quality criteria, portfolio guidelines and other controls are established under the guidance of our Chief Credit Officer and approved, as appropriate, by the Board. Credit Administration, together with the management loan committee, has 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 reasonable 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 on-site examination to ensure continued performance and proper risk assessment.

Nonperforming 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 nonaccrual status, which occurs when there are serious doubts about the collectability of principal or interest. Our policy is generally to discontinue the accrual of interest on all loans past due 90 days or more and place them on nonaccrual status. Covered loans accounted for under ASC 310-30 are generally considered accruing and performing as the loans accrete interest income over the estimated lives of the loans when cash flows are reasonably estimable. Accordingly, covered impaired loans contractually past due are still considered to be accruing and performing loans.

Nonperforming Assets: Nonperforming assets consist of: (i) nonaccrual loans, which generally are loans placed on a nonaccrual basis when the loan becomes past due 90 days or when there are otherwise serious doubts about the collectability of principal or interest within the existing terms of the loan; (ii) in most cases restructured loans, for which concessions, including the reduction of interest rates below a rate otherwise available to that borrower or the deferral of interest or principal, have been granted due to the borrower’s weakened financial condition (interest on restructured loans is accrued at the restructured rates when it is anticipated that no loss of original principal will occur); (iii) other real estate owned; and (iv) other personal property owned, if applicable. Nonperforming assets totaled $48.5 million, or 1.08% of year-end assets at December 31, 2012, compared to $85.4 million, or 2.02% of year end assets at December 31, 2011.

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The following table sets forth information with respect to our noncovered, nonperforming loans, other real estate owned, other personal property owned, total nonperforming assets, accruing loans past-due 90 days or more, and potential problem loans:

	December 31,				
	2012	2011	2010	2009	2008
	(dollars in thousands)				
Nonaccrual:					
Commercial business	$9,299	$10,243	$32,367	$18,979	$2,976
Real estate:					
One-to-four family residential	2,349	2,696	2,996	1,860	905
Commercial and multifamily residential	19,204	19,485	23,192	24,354	5,710
Real estate construction:					
One-to-four family residential	4,900	10,785	18,004	47,653	69,668
Commercial and multifamily residential	—	7,067	7,584	16,230	25,752
Consumer	1,643	3,207	5,020	1,355	1,152
Total nonaccrual loans:	37,395	53,483	89,163	110,431	106,163
Noncovered real estate owned and other personal property owned	11,108	31,905	30,991	19,037	2,874
Total nonperforming assets	$48,503	$85,388	$120,154	$129,468	$109,037
Accruing loans past-due 90 days or more	$—	$—	$—	$—	$—
Forgone interest on nonperforming loans	$3,388	$5,326	$6,389	$7,637	$4,072
Interest recognized on nonperforming loans	$1,114	$1,017	$2,035	$2,437	$4,550
Potential problem loans	$5,915	$10,618	$3,793	$11,423	$17,736
Allowance for loan and lease losses	$52,244	$53,041	$60,993	$53,478	$42,747
Allowance for loan and lease losses to nonperforming loans	139.71 %	99.17 %	68.41 %	48.43 %	40.27 %
Nonperforming loans to year end loans	1.48 %	2.28 %	4.65 %	5.50 %	4.76 %
Nonperforming assets to year end assets	1.08 %	2.02 %	3.23 %	4.04 %	3.52 %

At December 31, 2012 nonperforming loans decreased to 1.48% of year end loans, down from 2.28% of year end loans at December 31, 2011. Nonperforming commercial business loans declined from $10.2 million, or 19% of nonperforming loans at December 31, 2011 to $9.3 million or 25% of nonperforming loans at year end 2012. The nonperforming residential construction loan sector declined to $4.9 million during 2012, down from $10.8 million, or 20% of nonperforming loans at December 31, 2011. Nonperforming commercial real estate loans improved as well, declining from $26.6 million at December 31, 2011 to $19.2 million at year end 2012.

Other Real Estate Owned: As of December 31, 2012 there was $10.7 million in noncovered other real estate owned (“OREO”) which is comprised of property from foreclosed real estate loans, a decrease of $12.2 million from $22.9 million at December 31, 2011. Additionally, as of December 31, 2012 the Company held $16.3 million in OREO covered under FDIC loss-sharing agreements which are excluded from nonperforming assets. Properties acquired by foreclosure or deed in lieu of foreclosure are transferred to OREO and are recorded at fair value less estimated costs to sell, at the date of transfer of the property. If the carrying value exceeds the fair value at the time of the transfer, the difference is charged to the allowance for loan and lease losses. The fair value of the OREO property is based upon current appraisal. Subsequent losses that result from the ongoing periodic valuation of these properties are charged to the net cost of operation of OREO expense in the period in which they are identified. In general, improvements to the OREO are capitalized and holding costs are charged to the net cost of operation of OREO as incurred.

Potential Problem Loans: Potential problem loans are loans which are currently performing and are not on nonaccrual status, restructured or impaired, but about which there are significant doubts as to the borrower’s future ability to comply with repayment terms and which may later be included in nonaccrual, past due, restructured or impaired loans. Potential problem loans totaled $5.9 million at year end 2012, compared to $10.6 million at year end 2011.

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The following table summarizes activity in noncovered, nonperforming loans for the period indicated:

	Years Ended December 31,	
	2012	2011
	(in thousands)	
Balance, beginning of period	$53,483	$89,163
Loans placed on nonaccrual or restructured	32,325	34,747
Advances	827	1,687
Charge-offs	(12,572)	(15,107)
Loans returned to accrual status	(6,700)	(7,840)
Repayments (including interest applied to principal)	(23,452)	(26,168)
Transfers to OREO/OPPO	(6,516)	(22,999)
Balance, end of period	$37,395	$53,483

Loans are considered impaired when based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement or when a loan has been modified in a troubled debt restructuring. A loan is classified as a troubled debt restructuring when a borrower is experiencing financial difficulties that lead to a restructuring of the loan, and the Company grants concessions to the borrower in the restructuring that it would not otherwise consider. These concessions may include interest rate reductions, principal forgiveness, extension of maturity date and other actions intended to minimize potential losses. Generally, a nonaccrual loan that is restructured remains on nonaccrual status for a period of six months to demonstrate that the borrower can meet the restructured terms. If the borrower's performance under the new terms is not reasonably assured, the loan remains classified as a nonaccrual loan.

The assessment for impairment occurs when and while such loans are designated as classified per the Company’s internal risk rating system or when and while such loans are on nonaccrual. All nonaccrual loans greater than $500,000 are considered impaired and analyzed individually on a quarterly basis. Classified loans with an outstanding balance greater than $500,000 are evaluated for potential impairment on a quarterly basis. The Company’s policy is to record cash receipts on impaired loans first as reductions in principal and then as interest income.

The following table summarizes noncovered, impaired loan financial data at December 31, 2012 and 2011:

	December 31,	
	2012	2011
	(in thousands)	
Impaired loans	$34,661	$58,288
Impaired loans with specific allocations	$4,405	$5,226
Amount of the specific allocations	$1,395	$1,484

Impaired loans with a carrying amount of $34.7 million at December 31, 2012 were subject to specific allocations of allowance for loan and lease losses of $1.4 million and partial charge-offs of $3.1 million during the year. Collateral dependent impaired loans without specific allocations at December 31, 2012 and 2011 either had collateral which exceeded the carrying value of the loans or reflected a partial charge-off to the market value of collateral (less costs to sell), as of the most recent appraisal date. Restructured loans accruing interest totaled $8.5 million and $8.4 million at December 31, 2012 and 2011, respectively.

When a loan with unique risk characteristics has been identified as being impaired, the amount of impairment will be measured by the Company using discounted cash flows, except when it is determined that the primary (remaining) source of repayment for the loan is the operation or liquidation of the underlying collateral. In these cases, the current fair value of the collateral, reduced by costs to sell, will be used in place of discounted cash flows. As a final alternative, the observable market price of the debt may be used to assess impairment. Predominately, the Company uses the fair value of collateral approach based upon a reliable valuation.

When a loan secured by real estate migrates to nonperforming and impaired status and it does not have a market valuation less than one year old, the Company secures an updated market valuation by a third-party appraiser that is reviewed by the Company’s on-staff appraiser. Subsequently, the asset will be appraised annually by a third-party

appraiser or the Company’s on-staff appraiser. The evaluation may occur more frequently if management determines that there has been increased market deterioration within a specific geographical location. Upon receipt and verification of the market valuation,

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the Company will record the loan at the lower of cost or market (less costs to sell) by recording a charge-off to the allowance for loan and lease losses or by designating a specific reserve in accordance with accounting principles generally accepted in the United States.

For additional information on our nonperforming loans see Note 5 to our Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

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

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

1. General valuation allowance consistent with the Contingencies topic of the FASB ASC.
2. Classified loss reserves on specific relationships. Specific allowances for identified problem loans are determined in accordance with the Receivables topic of the FASB ASC.
3. The unallocated allowance provides for other credit losses 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 periodically 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. 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 in “Item 8. Financial Statements and Supplementary Data” of this report.

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Analysis of the ALLL

The following table provides an analysis of our noncovered loan loss experience by loan type for the last five years:

Changes in Allowance for Loan and Lease Losses and
Unfunded Commitments and Letters of Credit

	December 31,				
	2012	2011	2010	2009	2008
	(dollars in thousands)				
Beginning balance	$53,041	$60,993	$53,478	$42,747	$26,599
Charge-offs:					
Commercial business	(10,173)	(7,909)	(14,879)	(12,930)	(2,819)
Real estate:					
One-to-four family residential	(549)	(717)	(406)	(395)	(46)
Commercial and multifamily residential	(5,474)	(3,687)	(6,173)	(1,309)	(966)
Real estate construction:					
One-to-four family residential	(1,606)	(2,487)	(10,856)	(27,711)	(18,340)
Commercial and multifamily residential	(93)	(2,213)	(3,107)	(9,297)	(2,169)
Consumer	(2,534)	(3,918)	(3,982)	(2,879)	(1,647)
Total charge-offs	(20,429)	(20,931)	(39,403)	(54,521)	(25,987)
Recoveries:					
Commercial business	1,548	2,598	2,389	750	272
Real estate:					
One-to-four family residential	285	80	15	68	—
Commercial and multifamily residential	1,599	459	125	25	304
Real estate construction:					
One-to-four family residential	1,488	2,091	1,673	833	16
Commercial and multifamily residential	66	—	775	—	—
Consumer	1,171	351	650	76	367
Total recoveries	6,157	5,579	5,627	1,752	959
Net charge-offs	(14,272)	(15,352)	(33,776)	(52,769)	(25,028)
Provision for loan and lease losses	13,475	7,400	41,291	63,500	41,176
Ending balance	$52,244	$53,041	$60,993	$53,478	$42,747
Loans outstanding at end of period (1)	$2,525,710	$2,348,371	$1,915,754	$2,008,884	$2,232,332
Average amount of loans outstanding (1)	$2,411,493	$2,065,014	$2,102,863	$2,124,574	$2,264,486
Allowance for loan and lease losses to period-end loans	2.07%	2.26%	3.18%	2.66%	1.91%
Net charge-offs to average loans outstanding	0.59%	0.74%	1.61%	2.48%	1.11%
Allowance for unfunded commitments and letters of credit					
Beginning balance	$1,535	$1,165	$775	$500	$349
Net changes in the allowance for unfunded commitments and letters of credit	380	370	390	275	151

Ending balance	$1,915	$1,535	$1,165	$775	$500

(1) Excludes loans held for sale and covered loans.

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We have used the same methodology for ALLL calculations during 2012, 2011 and 2010. Adjustments to the percentages of the ALLL allocated to loan categories are made based on trends with respect to delinquencies and problem loans within each loan class. The Bank reviews the ALLL quantitative and qualitative methodology on a quarterly basis and makes adjustments when appropriate. The Bank maintains a conservative approach to credit quality and will continue to prudently add to our ALLL as necessary in order to maintain adequate reserves. The Bank carefully monitors the loan portfolio and continues to emphasize the importance of credit quality while continuously strengthening loan monitoring systems and controls.

Allocation of the ALLL

The table below sets forth the allocation of the ALLL by loan category:

Balance at End of Period Applicable to:	December 31, 2012 Amount	% of Total Loans*	2011 Amount	% of Total Loans*	2010 Amount	% of Total Loans*	2009 Amount	% of Total Loans*	2008 Amount	% of Total Loans*
	(dollars in thousands)									
Commercial business	$28,023	45.6 %	$25,434	43.9 %	$22,549	41.5 %	$21,969	37.1 %	$12,759	36.3 %
Real estate and construction:										
One-to-four family residential	2,500	3.7 %	3,849	4.9 %	7,161	6.1 %	9,087	8.5 %	16,781	12.0 %
Commercial and multifamily residential	18,273	44.5 %	20,345	43.4 %	25,880	42.8 %	19,703	44.4 %	11,983	42.1 %
Consumer	2,437	6.2 %	2,719	7.8 %	2,120	9.5 %	1,282	10.0 %	935	9.6 %
Unallocated	1,011	— %	694	— %	3,283	— %	1,437	— %	289	— %
Total	$52,244	100.0 %	$53,041	100.0 %	$60,993	100.0 %	$53,478	100.0 %	$42,747	100.0 %

* Represents the total of all outstanding loans in each category as a percent of total loans outstanding.

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 on the covered loans due to an increase in expected credit losses will increase the FDIC indemnification asset and any increase in expected future cash flows on the covered loans due to a decrease in expected credit losses will decrease the FDIC indemnification asset. Changes in the estimated cash flows on covered assets that are immediately recognized in income generally result in a similar immediate adjustment to the loss-sharing asset while changes in expected cash flows on covered assets that are accounted for as an adjustment to yield generally result in adjustments to the amortization or accretion rate for the loss-sharing asset. Increases and decreases to the FDIC loss-sharing asset are recorded as adjustments to noninterest income.

At December 31, 2012, the FDIC loss-sharing asset was $96.4 million which was comprised of a $87.8 million FDIC indemnification asset and a $8.6 million FDIC receivable. The FDIC receivable represents amounts due from the FDIC for claims related to covered losses the Company has incurred less amounts due back to the FDIC relating to

shared recoveries.

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The following table summarizes the activity related to the FDIC loss-sharing asset for the twelve months ended December 31, 2012 and 2011:

	Year Ended December 31,	
	2012	2011
	(in thousands)	
Balance at beginning of period	$175,071	$205,991
Adjustments not reflected in income:		
Established through acquisitions	—	68,734
Cash received from the FDIC	(54,649)	(54,200)
FDIC reimbursable losses, net	399	4,042
Adjustments reflected in income:		
Amortization, net	(42,940)	(46,049)
Loan impairment (recapture)	20,714	(1,318)
Sale of other real estate	(7,789)	(4,346)
Write-downs of other real estate	5,190	1,474
Other	358	743
Balance at end of period	$96,354	$175,071

For additional information on the FDIC loss-sharing asset, please see Note 7 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

Deposits

The following table sets forth the composition of the Company’s deposits by significant category:

	December 31,		
	2012	2011	2010
	(in thousands)		
Core deposits:			
Demand and other noninterest-bearing	$1,321,171	$1,156,610	$895,671
Interest-bearing demand	870,821	735,340	672,307
Money market	1,043,459	1,031,664	920,831
Savings	314,371	283,416	210,995
Certificates of deposit less than $100,000	252,544	303,405	298,678
Total core deposits	3,802,366	3,510,435	2,998,482
Certificates of deposit greater than $100,000	212,924	262,731	266,708
Certificates of deposit insured through CDARS®	26,720	42,080	38,312
Wholesale certificates of deposit	—	—	23,155
Subtotal	4,042,010	3,815,246	3,326,657
Premium resulting from acquisition date fair value adjustment	75	283	612
Total deposits	$4,042,085	$3,815,529	$3,327,269

Deposits totaled $4.04 billion at December 31, 2012 compared to $3.82 billion at December 31, 2011. Core deposits, which include noninterest-bearing deposits and interest-bearing deposits excluding time deposits of $100,000 and over, provide a stable source of low cost funding. Core deposits increased to $3.80 billion at December 31, 2012 compared with $3.51 billion at December 31, 2011. We anticipate continued growth in our core deposits through both the addition of new customers and our current client base.

At December 31, 2012 brokered and other wholesale deposits (excluding public deposits) totaled $26.7 million or 1% of total deposits compared to $42.1 million or 1% of total deposits, at year-end 2011. The decrease in brokered deposits is attributed to a decrease in participation 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 certificates of deposit. Unlike traditional brokered deposits, the Company generally makes CDARS® available only to

existing customers who desire additional deposit insurance coverage rather than as a means of generating additional liquidity.

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At December 31, 2012 public deposits held by the Company totaled $297.8 million compared to $229.5 million at December 31, 2011. Uninsured public deposit balances increased from $179.5 million at December 31, 2011 to $232.7 million at December 31, 2012. The Company is required to fully collateralize Washington state public deposits and 50% of Oregon state public deposits.

The following table sets forth the amount outstanding of time certificates of deposit and other time deposits in amounts of $100,000 or more by time remaining until maturity and percentage of total deposits:

Amounts maturing in:	December 31, 2012					
	Time Certificates of Deposit of $100,000 or More			Other Time Deposits of $100,000 or More		
	Amount	Percent of Total Deposits		Amount	Percent of Total Deposits	
	(dollars in thousands)					
Three months or less	$61,585	1.5	%	$21,767	0.5	%
Over 3 through 6 months	47,559	1.2	%	805	—	%
Over 6 through 12 months	48,518	1.2	%	3,275	0.1	%
Over 12 months	55,262	1.4	%	—	—	%
Total	$212,924	5.3	%	$25,847	0.6	%

Other time deposits of $100,000 or more set forth in the table above represent CDARS®. We use CDARS®, brokered and other wholesale deposits as part of our strategy for funding growth. In the future, we anticipate continuing the use of such deposits to fund loan demand or treasury functions.

The following table sets forth the average amount of and the average rate paid on each significant deposit category:

	Years ended December 31,								
	2012			2011			2010		
	Average Deposits	Rate		Average Deposits	Rate		Average Deposits	Rate	
	(dollars in thousands)								
Interest bearing demand	$790,887	0.11	%	$704,484	0.20	%	$637,983	0.34	%
Money market	1,051,171	0.16	%	969,548	0.40	%	851,673	0.66	%
Savings	298,223	0.03	%	247,073	0.06	%	199,117	0.14	%
Certificates of deposit	543,349	0.60	%	636,074	0.80	%	763,829	1.14	%
Total interest-bearing deposits	2,683,630	0.22	%	2,557,179	0.41	%	2,452,602	0.68	%
Demand and other non-interest bearing	1,192,036			984,220			818,321		
Total average deposits	$3,875,666			$3,541,399			$3,270,923		

Borrowings

Borrowed funds provide an additional source of funding for loan growth. Our borrowed funds consist primarily of borrowings from the Federal Home Loan ("FHLB") and Federal Reserve Bank ("FRB") as well as securities repurchase agreements. FHLB and FRB borrowings are secured by our loan portfolio and investment securities. Securities repurchase agreements are secured by investment securities and commercial loans.

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The Company has not had FRB borrowings in the last three years. The following table sets forth the details of FHLB advances:

	Years ended December 31,		
	2012	2011	2010
	(dollars in thousands)		
FHLB Advances			
Balance at end of year	$6,644	$119,009	$119,405
Average balance during the year	$100,337	$120,419	$123,685
Maximum month-end balance during the year	$118,967	$127,426	$154,916
Weighted average rate during the year	2.79 %	2.76 %	2.75 %
Weighted average rate at December 31	5.42 %	2.81 %	2.81 %

For additional information on our borrowings, including amounts pledged as collateral, see Notes 11 and 12 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report.

Off-Balance Sheet Arrangements

In the normal course of business, the Company is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount reflected in the consolidated balance sheets.

Exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The Company evaluates each client's creditworthiness on a case-by-case basis.

Commitments to extend credit are agreements to lend to a client as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since a portion of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

The Company had off-balance sheet loan commitments aggregating $888.5 million at December 31, 2012, an increase from $709.9 million at December 31, 2011. Standby letters of credit were $19.5 million and $30.9 million at December 31, 2012 and 2011, respectively. In addition, commitments under commercial letters of credit used to facilitate customers' trade transactions amounted to $46 thousand and $243 thousand at December 31, 2012 and 2011, respectively.

Contractual Obligations & Commitments

We are party to many contractual financial obligations, including repayment of borrowings, operating and equipment lease payments, and commitments to extend credit. The table below presents certain future financial obligations of the Company:

	Payments due within time period at December 31, 2012				
	0-12 Months	1-3 Years	4-5 Years	Due after Five Years	Total
	(in thousands)				
Operating & equipment leases	$4,309	$7,472	$3,500	$7,329	$22,610
Total deposits [1]	3,928,679	86,175	26,879	352	4,042,085
Federal Home Loan Bank advances [1]	—	—	—	6,000	6,000
Other borrowings [1]	—	—	—	25,000	25,000
Total	$3,932,988	$93,647	$30,379	$38,681	$4,095,695

(1) In the banking industry, interest-bearing obligations are principally used to fund interest-earning assets. As such, interest charges on contractual obligations were excluded from reported amounts, as the potential cash outflows would have corresponding cash inflows from interest-earning assets.

For additional information regarding future financial commitments, see Note 15 to our Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

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Liquidity and Sources of Funds

In general, our primary sources of funds are net income, loan repayments, maturities and principal payments on investment securities, customer deposits, advances from the FHLB, securities repurchase agreements and other borrowings. These funds are used to make loans, purchase investments, meet deposit withdrawals and maturing liabilities and cover operational expenses. Scheduled loan repayments and core deposits have proved to be a relatively stable source of funds while other deposit inflows and unscheduled loan prepayments are influenced by interest rate levels, competition and general economic conditions. We manage liquidity through monitoring sources and uses of funds on a daily basis and had unused credit lines with the FHLB and the Federal Reserve Bank of $435.2 million and $59.5 million, respectively, at December 31, 2012, that are available to us as a supplemental funding source. The holding company's sources of funds are dividends from its banking subsidiary which are used to fund dividends to shareholders and cover operating expenses.

Capital

Our shareholders' equity increased to $764.0 million at December 31, 2012, from $759.3 million at December 31, 2011. Shareholders' equity was 15.57% and 15.87% of total assets at December 31, 2012 and 2011.

Regulatory Capital. 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 common shareholders' equity, less goodwill and certain identifiable intangible assets, while Tier II capital includes the allowance for loan losses, 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". Federal Deposit Insurance Corporation 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 qualified as "well-capitalized" at December 31, 2012 and 2011.

The following table sets forth the Company's and its banking subsidiary's capital ratios at December 31, 2012 and 2011:

	Company		Columbia Bank		Requirements	
	2012	2011	2012	2011	Adequately capitalized	Well-Capitalized
Total risk-based capital ratio	20.62 %	21.05 %	17.87 %	18.55 %	8 %	10 %
Tier 1 risk-based capital ratio	19.35 %	19.79 %	16.60 %	17.29 %	4 %	6 %
Leverage ratio	12.78 %	12.96 %	11.07 %	11.45 %	4 %	5 %

Stock Repurchase Program

In October 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 may 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. This repurchase program supersedes and replaces the prior stock repurchase program adopted in February 2002.

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Dividends

The following table sets forth the dividends paid per common share and the dividend payout ratio (dividends paid per common share divided by basic earnings per share):

	Years ended December 31,		
	2012	2011	2010
Dividends paid per common share	$0.98	$0.27	$0.04
Dividend payout ratio (1)	84 %	22 %	6 %

(1) Dividends paid per common share as a percentage of earnings per diluted common share

For quarterly detail of dividends declared during 2012 and 2011, including special one-time dividends declared, see "Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities" of this report.

Subsequent to year end, on January 24, 2013 the Company declared a regular quarterly cash dividend of $0.10 per share payable on February 20, 2013, to shareholders of record at the close of business on February 6, 2013.

Applicable federal, Washington state and Oregon state regulations restrict capital distributions, including dividends, by the Company's banking subsidiary. Such restrictions are tied to the institution's capital levels after giving effect to distributions. Our ability to pay cash dividends is substantially dependent upon receipt of dividends from our banking subsidiary. In addition, the payment of cash dividends is subject to Federal regulatory requirements for capital levels and other restrictions. In this regard, current guidance from the Federal Reserve provides, among other things, that dividends per share on the Company's common stock generally should not exceed earnings per share, measured over the previous four fiscal quarters.

Reference "Item 6. Selected Financial Data" of this report for our return on average assets, return on average equity and average equity to average assets ratios for all reported periods.

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Non-GAAP Financial Measures

In addition to capital ratios defined by banking regulators, the Company considers various measures when evaluating capital utilization and adequacy, including:

- Tangible common equity to tangible assets, and
- Tangible common equity to risk-weighted assets.

The Company believes these measures are important because they reflect the level of capital available to withstand unexpected market conditions. Additionally, presentation of these measures allows readers to compare certain aspects of the Company's capitalization to other organizations. These ratios differ from capital measures defined by banking regulators principally in that the numerator excludes shareholders' equity associated with preferred securities, the nature and extent of which varies across organizations. Additionally, these measures present capital adequacy inclusive and exclusive of accumulated other comprehensive income. These calculations are intended to complement the capital ratios defined by banking regulators for both absolute and comparative purposes.

Because generally accepted accounting principles in the United States of America ("GAAP") do not include capital ratio measures, the Company believes there are no comparable GAAP financial measures to these tangible common equity ratios. The following table reconciles the Company's calculation of these measures to amounts reported under GAAP. Despite the importance of these measures to the Company, there are no standardized definitions for them and, as a result, the Company's calculations may not be comparable with other organizations. Also, there may be limits in the usefulness of these measures 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.

	December 31, 2012	December 31, 2011
	(dollars in thousands)	
Shareholders' equity	$764,008	$759,338
Goodwill	(115,554)	(115,554)
Core deposit intangible	(15,721)	(20,166)
Tangible common equity (a)	632,733	623,618
Total assets	4,906,335	4,785,945
Goodwill	(115,554)	(115,554)
Core deposit intangible	(15,721)	(20,166)
Tangible assets (b)	$4,775,060	$4,650,225
Risk-weighted assets, determined in accordance with prescribed regulatory requirements (c)	$3,165,528	$3,024,442
Ratios		
Tangible common equity to tangible assets (a)/(b)	13.25%	13.41%
Tangible common equity to risk-weighted assets (a)/(c)	19.99%	20.62%

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Sensitivity

We are exposed to interest rate risk, which is the risk that changes in prevailing interest rates will adversely affect assets, liabilities, capital, income and expenses at different times or in different amounts. Generally, there are four sources of interest rate risk as described below:

Repricing risk—Repricing risk is the risk of adverse consequences from a change in interest rates that arises because of differences in the timing of when those interest rate changes affect an institution’s assets and liabilities.

Basis risk—Basis risk is the risk of adverse consequence resulting from unequal changes in the spread between two or more rates for different instruments with the same maturity.

Yield curve risk—Yield curve risk is the risk of adverse consequence resulting from unequal changes in the spread between two or more rates for different maturities for the same instrument.

Option risk—In banking, option risks are known as borrower options to prepay loans and depositor options to make deposits, withdrawals, and early redemptions. Option risk arises whenever bank products give customers the right, but not the obligation, to alter the quantity or the timing of cash flows.

We maintain an asset/liability management policy that provides guidelines for controlling exposure to interest rate risk. The guidelines direct management to assess the impact of changes in interest rates upon both earnings and capital. The guidelines further provide that in the event of an increase in interest rate risk beyond pre-established limits, management will consider steps to reduce interest rate risk to acceptable levels.

The analysis of an institution’s interest rate gap (the difference between the repricing of interest-earning assets and interest-bearing liabilities during a given period of time) is one standard tool for the measurement of the exposure to interest rate risk. We believe that because interest rate gap analysis does not address all factors that can affect earnings performance. It should be used in conjunction with other methods of evaluating interest rate risk.

The table on the following page sets forth the estimated maturity or repricing, and the resulting interest rate gap of our interest-earning assets and interest-bearing liabilities at December 31, 2012. The amounts in the table are derived from our internal data and are based upon regulatory reporting formats. Therefore, they may not be consistent with financial information appearing elsewhere herein that has been prepared in accordance with accounting principles generally accepted in the United States. The amounts could be significantly affected by external factors such as changes in prepayment assumptions, early withdrawal of deposits and competition. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while other types may lag changes in market interest rates.

Additionally, certain assets, such as adjustable-rate mortgages, have features that restrict changes in the interest rates of such assets both on a short-term basis and over the lives of such assets. Further, in the event of a change in market interest rates, prepayment and early withdrawal levels could deviate significantly from those assumed in calculating the tables. Finally, the ability of many borrowers to service their adjustable-rate debt may decrease in the event of a substantial increase in market interest rates.

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December 31, 2012	Estimated Maturity or Repricing 0-3 months	4-12 months	Over 1 year through 5 years	Due after 5 years	Total
	(dollars in thousands)				
Interest-Earning Assets					
Interest-earning deposits	$389,353	$—	$—	$—	$389,353
Loans, net of deferred fees	1,292,849	320,535	1,127,010	176,653	2,917,047
Loans held for sale	2,563	—	—	—	2,563
Investments	85,756	125,830	481,294	330,604	1,023,484
Total interest-earning assets	$1,770,521	$446,365	$1,608,304	$507,257	4,332,447
Allowance for loan and lease losses					(52,244)
Cash and due from banks					124,573
Premises and equipment, net					118,708
Other assets					382,851
Total assets					$4,906,335
Interest-Bearing Liabilities					
Interest-bearing non-maturity deposits	$1,043,460	$—	$—	$1,185,191	$2,228,651
Time deposits	150,194	227,396	113,054	1,619	492,263
Borrowings	—	—	—	31,644	31,644
Total interest-bearing liabilities	$1,193,654	$227,396	$113,054	$1,218,454	2,752,558
Other liabilities					1,389,769
Total liabilities					4,142,327
Shareholders' equity					764,008
Total liabilities and shareholders' equity					$4,906,335
Interest-bearing liabilities as a percent of total interest-earning assets	27.55%	5.25%	2.61%	28.12%	
Rate sensitivity gap	$576,867	$218,969	$1,495,250	$(711,197)	
Cumulative rate sensitivity gap	$576,867	$795,836	$2,291,086	$1,579,889	
Rate sensitivity gap as a percentage of interest-earning assets	13.32%	5.05%	34.51%	(16.42)%	
Cumulative rate sensitivity gap as a percentage of interest-earning assets	13.32%	18.37%	52.88%	36.47%	

Interest Rate Sensitivity on Net Interest Income

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. Key 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 uncertain 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.

Based on the results of the simulation model as of December 31, 2012, we would expect a decrease in net interest income of $1.7 million if interest rates gradually decrease from current rates by 100 basis points and an increase in net interest income of $9.2 million if interest rates gradually increase from current rates by 200 basis points over a twelve-month period.

Impact of Inflation and Changing Prices

The impact of inflation on our operations is increased operating costs. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a

more significant impact on a financial institution's performance than the effect of general levels of inflation. Although interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services, increases in inflation generally have resulted in increased interest rates.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Columbia Banking System, Inc.
Tacoma, Washington

We have audited the accompanying consolidated balance sheets of Columbia Banking System, Inc. and its subsidiary (the "Company") as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Columbia Banking System, Inc. and its subsidiary as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2012, based on the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 28, 2013 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP
Seattle, Washington
February 28, 2013

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COLUMBIA BANKING SYSTEM, INC.
CONSOLIDATED BALANCE SHEETS

			December 31, 2012	December 31, 2011
			(in thousands)	
ASSETS				
Cash and due from banks			$124,573	$91,364
Interest-earning deposits with banks			389,353	202,925
Total cash and cash equivalents			513,926	294,289
Securities available for sale at fair value (amortized cost of $969,359 and $987,560, respectively)			1,001,665	1,028,110
Federal Home Loan Bank stock at cost			21,819	22,215
Loans held for sale			2,563	2,148
Loans, excluding covered loans, net of unearned income of ($7,767) and ($16,217), respectively			2,525,710	2,348,371
Less: allowance for loan and lease losses			52,244	53,041
Loans, excluding covered loans, net			2,473,466	2,295,330
Covered loans, net of allowance for loan losses of ($30,056) and ($4,944), respectively			391,337	531,929
Total loans, net			2,864,803	2,827,259
FDIC loss-sharing asset			96,354	175,071
Interest receivable			14,268	15,287
Premises and equipment, net			118,708	107,899
Other real estate owned ($16,311 and $28,126 covered by FDIC loss-share, respectively)			26,987	51,019
Goodwill			115,554	115,554
Core deposit intangible, net			15,721	20,166
Other assets			113,967	126,928
Total assets			$4,906,335	$4,785,945
LIABILITIES AND SHAREHOLDERS' EQUITY				
Deposits:				
Noninterest-bearing			$1,321,171	$1,156,610
Interest-bearing			2,720,914	2,658,919
Total deposits			4,042,085	3,815,529
Federal Home Loan Bank advances			6,644	119,009
Securities sold under agreements to repurchase			25,000	25,000
Other liabilities			68,598	67,069
Total liabilities			4,142,327	4,026,607
Commitments and contingent liabilities (Note 15)				
Shareholders' equity:				
	December 31, 2012	December 31, 2011		
Common stock (no par value)				
Authorized shares	63,033	63,033		
Issued and outstanding	39,686	39,506	581,471	579,136
Retained earnings			162,388	155,069
Accumulated other comprehensive income			20,149	25,133
Total shareholders' equity			764,008	759,338

Total liabilities and shareholders’ equity	$4,906,335	$4,785,945

See accompanying Notes to Consolidated Financial Statements.

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COLUMBIA BANKING SYSTEM, INC.
CONSOLIDATED STATEMENTS OF INCOME

	Years ended December 31,		
	2012	2011	2010
	(in thousands except per share)		
Interest Income			
Loans	$219,433	$218,420	$157,292
Taxable securities	18,276	21,870	18,276
Tax-exempt securities	9,941	10,142	9,348
Federal funds sold and deposits in banks	854	839	963
Total interest income	248,504	251,271	185,879
Interest Expense			
Deposits	5,887	10,478	16,733
Federal Home Loan Bank advances	2,608	2,980	2,841
Prepayment charge on Federal Home Loan Bank advances	603	—	—
Long-term obligations	—	579	1,029
Other borrowings	479	498	489
Total interest expense	9,577	14,535	21,092
Net Interest Income	238,927	236,736	164,787
Provision for loan and lease losses	13,475	7,400	41,291
Provision (recapture) for losses on covered loans	25,892	(1,648)	6,055
Net interest income after provision (recapture) for loan and lease losses	199,560	230,984	117,441
Noninterest Income (Loss)			
Service charges and other fees	29,998	26,632	24,698
Gain on bank acquisitions, net of tax	—	1,830	9,818
Merchant services fees	8,154	7,385	7,502
Investment securities gains (losses), net	3,733	(2,816)	58
Bank owned life insurance	2,861	2,188	2,041
Change in FDIC loss-sharing asset	(24,467)	(49,496)	4,908
Other	6,779	4,994	3,756
Total noninterest income (loss)	27,058	(9,283)	52,781
Noninterest Expense			
Compensation and employee benefits	85,434	81,552	69,780
Occupancy	20,031	18,963	16,814
Merchant processing	3,612	3,698	4,364
Advertising and promotion	3,650	3,686	3,081
Data processing	9,714	8,484	8,769
Legal and professional fees	8,915	6,486	5,684
Taxes, licenses and fees	4,736	4,446	2,858
Regulatory premiums	3,384	4,337	6,485
Net cost (benefit) of operation of other real estate owned	(1,969)	(1,022)	787
Amortization of intangibles	4,445	4,319	3,922
FDIC clawback liability expense (recovery)	(54)	3,656	—
Other	21,015	17,154	14,603
Total noninterest expense	162,913	155,759	137,147
Income before income taxes	63,705	65,942	33,075
Provision for income taxes	17,562	17,905	2,291
Net Income	$46,143	$48,037	$30,784
Net Income Applicable to Common Shareholders	$46,143	$48,037	$25,837

Earnings Per Common Share			
Basic	$1.16	$1.22	$0.73
Diluted	$1.16	$1.21	$0.72
Dividends paid per common share	$0.98	$0.27	$0.04
Weighted average number of common shares outstanding	39,260	39,103	35,209
Weighted average number of diluted common shares outstanding	39,263	39,180	35,392

See accompanying Notes to Consolidated Financial Statements.

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COLUMBIA BANKING SYSTEM, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Years ended December 31,		
	2012	2011	2010
	(in thousands)		
Net income	$46,143	$48,037	$30,784
Other comprehensive income, net of tax:			
Unrealized gain from securities:			
Net unrealized holding gain (loss) from available for sale securities arising during the period, net of tax of $1,902, ($7,462) and ($1,047)	(2,609)	13,285	1,587
Reclassification adjustment of net gain from sale of available for sale securities included in income, net of tax of $1,316, $48 and $20	(2,417)	(85)	(38)
Net unrealized gain (loss) from securities, net of reclassification adjustment	(5,026)	13,200	1,549
Cash flow hedging instruments:			
Reclassification adjustment of net gain included in income, net of tax of $0, $79, and $625	—	(143)	(1,134)
Net change in cash flow hedging instruments	—	(143)	(1,134)
Pension plan liability adjustment:			
Unrecognized net actuarial gain (loss) during the period, net of tax of $0, $154 and ($12)	—	(260)	23
Less: amortization of unrecognized net actuarial gains and losses included in net periodic pension cost, net of tax of ($38), ($31) and ($15)	42	55	27
Pension plan liability adjustment, net	42	(205)	50
Other comprehensive income (loss)	(4,984)	12,852	465
Comprehensive income	$41,159	$60,889	$31,249

See accompanying Notes to Consolidated Financial Statements.

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COLUMBIA BANKING SYSTEM, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Preferred Stock		Common Stock				
	Number of Shares	Amount	Number of Shares	Amount	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
	(in thousands)						
Balance at January 1, 2010	77	$74,301	28,129	$348,706	$93,316	$ 11,816	$528,139
Net income	—	—	—	—	30,784	—	30,784
Other comprehensive income	—	—	—	—	—	465	465
Redemption of preferred stock and common stock warrant	(77)	(76,898)	—	(3,302)	—	—	(80,200)
Accretion of preferred stock discount	—	2,597	—	—	(2,597)	—	—
Issuance of common stock, net of offering costs	—	—	11,040	229,129	—	—	229,129
Issuance of common stock - stock option and other plans	—	—	69	923	—	—	923
Issuance of common stock - restricted stock awards, net of canceled awards	—	—	100	1,424	—	—	1,424
Tax benefit associated with share-based compensation	—	—	—	25	—	—	25
Preferred dividends	—	—	—	—	(2,350)	—	(2,350)
Cash dividends paid on common stock	—	—	—	—	(1,461)	—	(1,461)
Balance at December 31, 2010	—	$—	39,338	$576,905	$117,692	$ 12,281	$706,878
Net income	—	—	—	—	48,037	—	48,037
Other comprehensive income	—	—	—	—	—	12,852	12,852
Issuance of common stock - stock option and other plans	—	—	51	848	—	—	848
Issuance of common stock - restricted stock awards, net of canceled awards	—	—	119	1,635	—	—	1,635
Tax benefit deficiency associated with share-based compensation	—	—	—	(220)	—	—	(220)
Purchase and retirement of common stock	—	—	(2)	(32)	—	—	(32)
Cash dividends paid on common stock	—	—	—	—	(10,660)	—	(10,660)
	—	$—	39,506	$579,136	$155,069	$ 25,133	$759,338

Balance at December 31, 2011							
Net income	—	—	—	—	46,143	—	46,143
Other comprehensive loss	—	—	—	—	—	(4,984)	(4,984)
Issuance of common stock - stock option and other plans	—	—	40	713	—	—	713
Issuance of common stock - restricted stock awards, net of canceled awards	—	—	140	1,622	—	—	1,622
Cash dividends paid on common stock	—	—	—	—	(38,824)	—	(38,824)
Balance at December 31, 2012	—	$—	39,686	$581,471	$162,388	$ 20,149	$764,008

See accompanying Notes to Consolidated Financial Statements.

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COLUMBIA BANKING SYSTEM, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2012	2011	2010
	(in thousands)		
Cash Flows From Operating Activities			
Net Income	$46,143	$48,037	$30,784
Adjustments to reconcile net income to net cash provided by operating activities			
Provision for loan and lease losses and losses on covered loans	39,367	5,752	47,346
Stock-based compensation expense	1,622	1,635	1,424
Depreciation, amortization and accretion	57,305	46,121	11,352
Gain on FDIC-assisted bank acquisitions	—	(1,830)	(9,818)
Investment securities (gain) loss, net	(3,733)	2,816	(58)
Net realized (gain) loss on sale of other assets	(456)	79	(33)
Net realized gain on sale of other real estate owned	(11,634)	(9,310)	(5,253)
Gain on termination of cash flow hedging instruments	—	(222)	(1,759)
Write-down on other real estate owned	8,300	6,307	5,144
Deferred income tax expense (benefit)	(3,656)	(3,783)	15,838
Net change in:			
Loans held for sale	(415)	(1,394)	(754)
Interest receivable	1,019	(1,243)	4,472
Interest payable	(629)	(403)	(784)
Other assets	(2,113)	(19,248)	18,419
Other liabilities	3,779	13,110	7,816
Net cash provided by operating activities	134,899	86,424	124,136
Cash Flows From Investing Activities			
Loans originated and acquired, net of principal collected	(92,088)	(110,577)	164,084
Purchases of:			
Securities available for sale	(322,342)	(453,043)	(179,332)
Premises and equipment	(17,137)	(15,088)	(36,503)
Proceeds from:			
FDIC reimbursement on loss-sharing asset	54,649	54,200	—
Sales of securities available for sale	95,165	72,523	69,328
Principal repayments and maturities of securities available for sale	236,749	148,583	92,840
Sales of loans held for investment and other assets	4,414	46	902
Sales of covered other real estate owned	33,315	20,619	17,890
Sales of other real estate and other personal property owned	15,689	12,278	4,800
Termination of trust subsidiaries	—	774	—
Capital improvements on other real estate properties	(11)	(735)	(1,720)
Increase (decrease) in Small Business Administration secured borrowings	—	(642)	642
Net cash acquired in business combinations	—	247,792	145,534
Net cash provided by (used in) investing activities	8,403	(23,270)	278,465
Cash Flows From Financing Activities			
Net increase (decrease) in deposits	226,556	(204,586)	(302,758)
Proceeds from:			
Issuance of common stock	—	—	229,129
Exercise of stock options	713	848	923

Federal Home Loan Bank advances	100	100	—
Federal Reserve Bank borrowings	100	100	—
Payments for:			
Repayment of Federal Home Loan Bank advances	(112,210)	(42,989)	(36,276)
Repayment of Federal Reserve Bank borrowings	(100)	(100)	—
Preferred stock dividends	—	—	(2,841)
Common stock dividends	(38,824)	(10,660)	(1,461)
Repayment of long-term subordinated debt	—	(25,774)	—
Repurchase of preferred stock and common stock warrant	—	—	(80,200)
Purchase and retirement of common stock	—	(32)	—
Excess tax benefit from stock-based compensation	—	98	25
Net decrease in other borrowings	—	—	(86)
Net cash provided by (used in) financing activities	76,335	(282,995)	(193,545)
Increase (decrease) in cash and cash equivalents	219,637	(219,841)	209,056
Cash and cash equivalents at beginning of period	294,289	514,130	305,074
Cash and cash equivalents at end of period	$513,926	$294,289	$514,130
Supplemental Information:			
Cash paid during the year for:			
Cash paid for interest	$10,206	$14,938	$21,876
Cash paid for income tax	$11,927	$23,025	$6,895
Non-cash investing activities			
Assets acquired in FDIC-assisted acquisitions (excluding cash and cash equivalents)	$—	$485,870	$1,075,166
Liabilities assumed in FDIC-assisted acquisitions	$—	$731,832	$1,210,882
Loans transferred to other real estate owned	$21,627	$24,357	$29,864

See accompanying Notes to Consolidated Financial Statements.

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COLUMBIA BANKING SYSTEM, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Years Ended December 31, 2012, 2011 and 2010

1. Summary of Significant Accounting Policies

Organization

Columbia Banking System, Inc. (the "Corporation") is the holding company for Columbia State Bank (the "Bank"). The Bank provides a full range of financial services through 99 branch locations, including 74 in the State of Washington and 25 in Oregon. Because the Bank comprises substantially all of the business of the Corporation, references to the "Company" mean the Corporation and the Bank together. The Corporation is approved as a bank holding company pursuant to the Gramm-Leach-Bliley Act of 1999.

The Company's accounting and reporting policies conform to accounting principles generally accepted in the United States of America ("GAAP") and practices in the financial services industry. To prepare the financial statements in conformity with GAAP, management must make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and income and expenses during the reporting period. Circumstances and events that differ significantly from those underlying our estimates and assumptions could cause actual financial results to differ from our estimates. The most significant estimates included in the financial statements relate to the allowance for loan and lease losses, business combinations, acquired impaired loans, Federal Deposit Insurance Corporation loss sharing asset and goodwill impairment.

The Company has applied its accounting policies and estimation methods consistently in all periods presented in these financial statements (to the periods in which they applied), except for certain estimates related to the measurement of expected future cash flows on acquired impaired loans. For those certain estimates, in 2011 the Company began utilizing actual historical loan data rather than industry data, which had been utilized in 2010. The results of operations reflect any adjustments, all of which are of a normal recurring nature, and which, in the opinion of management, are necessary for a fair presentation of the results of the periods presented.

Consolidation

The consolidated financial statements of the Company include the accounts of the Corporation and the Bank. Intercompany balances and transactions have been eliminated in consolidation.

Cash and cash equivalents

Cash and cash equivalents include cash and due from banks, and interest bearing balances due from correspondent banks and the Federal Reserve Bank. Cash and cash equivalents have a maturity of 90 days or less at the time of purchase.

Securities

Securities are classified based on management's intention on the date of purchase. All securities are classified as available for sale and are presented at fair value. Unrealized gains or losses on securities available for sale are excluded from net income but are included as separate components of other comprehensive income, net of taxes. Purchase premiums or discounts on securities available for sale are amortized or accreted into income using the interest method over the terms of the individual securities. The Company performs a quarterly assessment to determine whether a decline in fair value below amortized cost is other-than-temporary. Amortized cost includes adjustments made to the cost of an investment for accretion, amortization, collection of cash and previous other-than temporary impairment recognized in earnings. Other-than-temporary impairment exists when it is probable that the Company will be unable to recover the entire amortized cost basis of the security. If the decline in fair value is judged to be other than temporary, the security is written down to fair value which becomes the new cost basis and an impairment loss is recognized.

In performing the quarterly assessment for debt securities, management considers whether or not the Company expects to recover the entire amortized cost basis of the security. In addition, management also considers whether it is more likely than not that it will not have to sell the security before recovery of its cost basis. If the Company intends to sell a security or it is more likely than not it will be required to sell a security prior to recovery of its cost basis, the entire amount of impairment is recognized in earnings. If the Company does not intend to sell the security or it is not more likely than not it will be required to sell the security prior to recovery of its cost basis, the credit loss component

of impairment is recognized in earnings and impairment associated with non-credit factors, such as market liquidity, is recognized in other comprehensive income net of tax. A credit loss is the difference between the cost basis of the security and the present value of cash flows expected to be collected, discounted at the security's effective interest rate at the date of acquisition. The cost basis of an other-than-

temporarily impaired security is written down by the amount of impairment recognized in earnings. The new cost basis is not adjusted for subsequent recoveries in fair value. However, the difference between the new amortized cost basis and the cash flows expected to be collected is accreted as interest income. The total other-than-temporary impairment is presented in the consolidated statements of income with a reduction for the amount of other-than-temporary impairment that is recognized in other comprehensive income, if any.
Realized gains or losses on sales of securities available for sale are recorded using the specific identification method.
Federal Home Loan Bank Stock
The Company's investment in Federal Home Loan Bank ("FHLB") stock is carried at par value because the shares can only be redeemed with the FHLB at par. The Company is required to maintain a minimum level of investment in FHLB stock based on specific percentages of its outstanding mortgages and FHLB advances. Stock redemptions are at the discretion of the FHLB or of the Company, upon five years' prior notice for FHLB Class B stock or six months notice for FHLB Class A stock to the FHLB. FHLB stock is carried at cost and is subject to recoverability testing per the Financial Services—Depository and Lending topic of the FASB Accounting Standards Codification ("ASC").
Loans
Loans are generally carried at the unpaid principal balance, net of premiums, unearned discounts and net deferred loan fees. Net deferred loan fees include deferred unamortized fees less direct incremental loan origination costs. Net deferred loan fees, premiums and unearned discounts on loans are recognized in interest income using either the interest method or straight-line method over the terms of the loans, adjusted for actual prepayments. Interest income is accrued as earned. Fees related to lending activities other than the origination or purchase of loans are recognized as noninterest income during the period the related services are performed.
Nonaccrual loans—Loans are placed on nonaccrual status when a loan becomes contractually past due 90 days with respect to interest or principal unless the loan is both well secured and in the process of collection, or if full collection of interest or principal becomes uncertain. When a loan is placed on nonaccrual status, any accrued and unpaid interest receivable is reversed and the recognition of net deferred loan fees, premiums and unearned discounts ceases. Thereafter, interest collected on the loan is accounted for on the cash collection or cost recovery method until qualifying for return to accrual status. Generally, a loan may be returned to accrual status when the delinquent principal and interest are brought current in accordance with the terms of the loan agreement for a minimum period of six months and future payments are reasonably assured.
Impaired loans—Loans are considered impaired when based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement or when a loan has been modified in a troubled debt restructuring. The assessment for impairment occurs when and while such loans are designated as classified per the Company's internal risk rating system or when and while such loans are on nonaccrual. All nonaccrual loans greater than $500,000 are considered impaired and analyzed individually on a quarterly basis. Classified loans with an outstanding balance greater than $500,000 are evaluated for potential impairment on a quarterly basis.
When a loan with unique risk characteristics has been identified as being impaired, the amount of impairment will be measured by the Company using discounted cash flows, except when it is determined that the primary (remaining) source of repayment for the loan is the operation or liquidation of the underlying collateral. In these cases, the current fair value of the collateral, reduced by costs to sell, will be used in place of discounted cash flows. As a final alternative, the observable market price of the debt may be used to assess impairment. Predominantly, the Company uses the fair value of collateral approach based upon a reliable valuation.
When the measurement of the impaired loan is less than the recorded amount of the loan, an impairment is recognized by recording a charge-off to the allowance for loan and lease losses or by designating a specific reserve. The Company's policy is to record cash receipts received on impaired loans first as reductions to principal and then to interest income.
Restructured Loans—A loan is classified as a troubled debt restructuring when a borrower is experiencing financial difficulties that lead to a restructuring of the loan, and the Company grants concessions to the borrower in the restructuring that it would not otherwise consider. These concessions may include interest rate reductions, principal forgiveness, extension of maturity date and other actions intended to minimize potential losses. Generally, a

nonaccrual loan that is restructured remains on nonaccrual status for a period of six months to demonstrate that the borrower can meet the restructured terms. If the borrower's performance under the new terms is not reasonably assured, the loan remains classified as a nonaccrual loan.

Acquired Impaired Loans—Loans acquired with evidence of credit deterioration since origination for which it is probable that all contractually required payments will not be collected are accounted for under Accounting Standards Codification

(“ASC”) 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, formerly SOP 03-3 Accounting for Certain Loans or Debt Securities Acquired in a Transfer. In addition, because of the significant discounts associated with certain of the acquired loan portfolios, the Company elected to account for those certain acquired loans under ASC 310-30.

In situations where such loans have similar risk characteristics, loans are aggregated into pools to estimate cash flows. A pool is accounted for as a single asset with a single interest rate, cumulative loss rate and cash flow expectation. Expected cash flows at the acquisition date in excess of the fair value of loans are considered to be accretable yield, which is recognized as interest income over the life of the loan pool using a level yield method if the timing and amount of the future cash flows of the pool is reasonably estimable. Subsequent to the acquisition date, any increases in cash flow over those expected at purchase date in excess of fair value are recorded as interest income prospectively. Any subsequent decreases in cash flow over those expected at purchase date due to credit deterioration are recognized by recording an allowance for losses on covered loans. Any disposals of loans, including sales of loans, payments in full or foreclosures result in the removal of the loan from the loan pool at the carrying amount.

Covered Loans—The term covered loans refers to acquired loans that are covered under a loss-sharing agreement with the FDIC. The bulk of covered loans are accounted for under ASC 310-30. See Acquired Impaired Loans for further discussion.

Unfunded loan commitments—Unfunded commitments are generally related to providing credit facilities to clients of the Bank and are not actively traded financial instruments. These unfunded commitments are disclosed as financial instruments with off-balance sheet risk in Note 15 in the Notes to Consolidated Financial Statements.

Allowance for Loan and Lease Losses

The Company accounts for the credit risk associated with lending activities through its allowance for loan and lease losses and provision for loan and lease losses. The provision is the expense recognized in the consolidated statements of income to adjust the allowance to the levels deemed appropriate by management, as determined through application of the Company’s allowance methodology procedures. The provision for loan and lease losses reflects management’s judgment of the adequacy of the allowance for loan and lease losses. Loan and lease losses are charged against the allowance when management believes the collectability of a loan balance is unlikely. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan and lease losses is evaluated on a regular basis by management and is based upon management’s periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of general, specific, and unallocated components. The general component covers loans not specifically measured for impairment and is based on historical loss experience adjusted for qualitative factors. The specific component relates to loans that are impaired. For impaired loans an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The unallocated allowance provides for other credit losses inherent in the Company’s 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 periodically based on trends in credit losses, the results of credit reviews and overall economic trends.

Allowance for Unfunded Commitments and Letters of Credit

The allowance for unfunded commitments is maintained at a level believed by management to be sufficient to absorb estimated probable losses related to these unfunded credit facilities. The determination of the adequacy of the allowance is based on periodic evaluations of the unfunded credit facilities including an assessment of the probability of commitment usage, credit risk factors for loans outstanding to these same customers, and the terms and expiration dates of the unfunded credit facilities. The allowance for unfunded commitments is included in other liabilities on the consolidated balance sheets, with changes to the balance charged against noninterest expense.

Allowance for Loan Losses on Covered Loans

The Company updates its cash flow projections for covered loans accounted for under ASC 310-30 on a quarterly basis. Assumptions utilized in this process include projections related to probability of default, loss severity, prepayment and recovery lag. Projections related to probability of default and prepayment are calculated utilizing a loan migration analysis. The loan migration analysis is a matrix of probability that is used to estimate the probability of a loan pool transitioning into a particular delinquency state 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.

Any decreases in expected cash flows after the acquisition date and subsequent measurement periods are recognized by recording a provision for loan losses. See Acquired Impaired Loans for further discussion.

Premises and Equipment

Land, buildings, leasehold improvements and equipment are stated at cost less accumulated depreciation and amortization. Gains or losses on dispositions are reflected in current operations. Expenditures for improvements and major renewals are capitalized, and ordinary maintenance, repairs and small purchases are charged to operating expenses. Depreciation and amortization are computed based on the straight-line method over the estimated useful lives of the various classes of assets. The ranges of useful lives for the principal classes of assets are as follows:

Buildings and building improvements	5 to 39 years
Leasehold improvements	Term of lease or useful life, whichever is shorter
Furniture, fixtures and equipment	3 to 7 years
Vehicles	5 years
Computer software	3 to 5 years

Software

Capitalized software is stated at cost, less accumulated amortization. Amortization is computed on a straight-line basis and charged to expense over the estimated useful life of the software which is generally three years. Capitalized software is included in Premises and equipment, net in the Consolidated Balance Sheets.

Other Real Estate Owned

Other real estate owned ("OREO") is composed of real estate acquired in satisfaction of loans. Properties acquired by foreclosure or deed in lieu of foreclosure are transferred to OREO and are recorded at fair value less estimated costs to sell, at the date of transfer of the property. If the carrying value exceeds the fair value at the time of the transfer, the difference is charged to the allowance for loan and lease losses. The fair value of the OREO property is based upon current appraisal. Losses that result from the ongoing periodic valuation of these properties are charged to the net cost of operation of OREO in the period in which they are identified. Improvements to the OREO are capitalized and holding costs are charged to the net cost of operation of OREO as incurred.

Covered OREO—Covered OREO includes acquired OREO that is covered under a loss-sharing agreement with the FDIC. These assets were recorded at their fair value on acquisition date. Covered OREO is reported in Other real estate owned in the Consolidated Balance Sheets. Covered OREO is reported exclusive of expected reimbursement cash flows from the FDIC. Upon transferring covered loan collateral to covered OREO status, valuation adjustments arising from acquisition accounting on the related loan are also transferred to covered OREO. Valuation adjustments arising from acquisition accounting on covered OREO result in a reduction of the covered OREO carrying amount and a corresponding increase in the expected FDIC reimbursement, with the estimated net loss to the Company, if any, charged against earnings.

FDIC Loss-sharing Asset

The acquisition date fair value of the reimbursement the Company expected to receive from the FDIC under loss-sharing agreements was recorded in the FDIC loss-sharing asset on the Consolidated Balance Sheet. Subsequent to initial recognition, the FDIC loss-sharing 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 assets. Any decrease in expected cash flows for the covered assets due to an increase in expected credit losses will increase the FDIC loss-sharing asset and any increase in expected future cash flows for the covered assets due to a decrease in expected credit losses will decrease the FDIC loss-sharing asset. Changes in the estimated cash flows on covered assets that are immediately recognized in income generally result in a similar immediate adjustment to the loss-sharing asset while changes in expected cash flows on covered assets that are accounted for as an adjustment to yield generally result in adjustments to the amortization or accretion rate for the loss-sharing asset. Increases and decreases to the FDIC loss-sharing asset are recorded as adjustments to noninterest income.

Goodwill and Intangibles

Net assets of companies acquired in purchase transactions are recorded at fair value at the date of acquisition. Identified intangibles are amortized on an accelerated basis over the period benefited. Goodwill is not amortized but is reviewed for potential impairment during the third quarter on an annual basis or, more frequently, if events or circumstances indicate a

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potential impairment, at the reporting unit level. A reporting unit is an operating segment or one level below an operating segment for which discrete financial information is available and regularly reviewed by management. The Company consists of a single reporting unit. If the fair value of the reporting unit, including goodwill, is determined to be less than the carrying amount of the reporting unit, a further test is required to measure the amount of impairment. If an impairment loss exists, the carrying amount of goodwill is adjusted to a new cost basis. Subsequent reversal of a previously recognized goodwill impairment loss is prohibited.

Intangible assets are evaluated for impairment if events and circumstances indicate a possible impairment. Such evaluation of other intangible assets is based on undiscounted cash flow projections. At December 31, 2012, intangible assets included on the consolidated balance sheets consist of a core deposit intangible amortized using an accelerated method with an original estimated life of approximately 10 years .

Income Taxes

The provision for income taxes includes current and deferred income tax expense on net income adjusted for permanent and temporary differences such as interest income on state and municipal securities and affordable housing credits. Deferred tax assets and liabilities are recognized for the expected future tax consequences of existing temporary differences between the financial reporting and tax reporting basis of assets and liabilities using enacted tax laws and rates. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. On a quarterly basis, management evaluates deferred tax assets to determine if these tax benefits are expected to be realized in future periods. This determination is based on facts and circumstances, including the Company’s current and future tax outlook. To the extent a deferred tax asset is no longer considered “more likely than not” to be realized, a valuation allowance is established.

Advertising

Advertising costs are generally expensed as incurred.

Earnings per Common Share

The Company calculates earnings per common share (“EPS”) using the two-class method in accordance with the Earnings per Share topic of the FASB ASC. The two-class method requires the Company to present EPS as if all of the earnings for the period are distributed to common shareholders and any participating securities, regardless of whether any actual dividends or distributions are made. Under authoritative guidance, all outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends are considered participating securities. The Company grants restricted shares under a share-based compensation plan that qualifies as participating securities. Restricted shares issued under the Company’s share-based compensation plan are entitled to dividends at the same rate as common stock.

Basic EPS are computed by dividing distributed and undistributed earnings available to common shareholders by the weighted average number of common shares outstanding for the period. Distributed and undistributed earnings available to common shareholders represent net income reduced by preferred stock dividends and distributed and undistributed earnings available to participating securities. Common shares outstanding include common stock and vested restricted stock awards. Diluted EPS reflect the assumed conversion of all potential dilutive securities.

Share-Based Payment

The Company accounts for stock options and stock awards in accordance with the Compensation—Stock Compensation topic of the FASB ASC. Authoritative guidance requires the Company to measure the cost of employee services received in exchange for an award of equity instruments, such as stock options or stock awards, based on the fair value of the award on the grant date. This cost must be recognized in the consolidated statements of income over the vesting period of the award.

The Company issues restricted stock awards which generally vest over a four- or five-year period during which time the holder receives dividends and has full voting rights. Restricted stock is valued at the closing price of the Company’s stock on the date of an award.

Derivatives and Hedging Activities

In accordance with the Derivatives and Hedging topic of the FASB ASC, the Company recognizes derivatives as assets or liabilities on the consolidated balance sheets at their fair value. The treatment of changes in the fair value of derivatives depends on the character of the transaction.

The Company enters into derivative contracts to add stability to interest income and to manage its exposure to changes in interest rates. On the date the Company enters into a derivative contract, the derivative instrument is designated as: (1) a hedge

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of the fair value of a recognized asset or liability or of an unrecognized firm commitment (a “fair value” hedge); (2) a hedge of the variability in expected future cash flows associated with an existing recognized asset or liability or a probable forecasted transaction (a “cash flow” hedge); or (3) held for other economic purposes (an “economic” hedge) and not formally designated as part of qualifying hedging relationships under authoritative guidance.
In a fair value hedge, changes in the fair value of the hedging derivative are recognized in earnings and offset by recognizing changes in the fair value of the hedged item attributable to the risk being hedged. To the extent that the hedge is ineffective, the changes in fair value will not offset and the difference is reflected in earnings.
In a cash flow hedge, the effective portion of the change in the fair value of the hedging derivative is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings during the same period in which the hedged item affects earnings. The change in fair value of any ineffective portion of the hedging derivative is recognized immediately in earnings. When a cash flow hedge is discontinued, the net derivative gain or loss continues to be reported in accumulated other comprehensive income unless it is probable that the forecasted transactions will not occur by the end of the originally specified time period. The net derivative gain or loss from a discontinued cash flow hedge is reclassified into earnings during the originally specified time period in which the forecasted transactions were to occur.
The Company formally documents the relationship between the hedging instruments and hedged items, as well as its risk management objective and strategy before initiating a hedge. To qualify for hedge accounting, the derivatives and related hedged items must be designated as a hedge. For hedging relationships in which effectiveness is measured, the correlations between the hedging instruments and hedged items are assessed at inception of the hedge and on an ongoing basis, which includes determining whether the hedge relationship is expected to be highly effective in offsetting changes in fair value or cash flows of hedged items.
Derivatives used for other economic purposes are used as economic hedges in which the Company has not attempted to achieve the highly effective hedge accounting standard under authoritative guidance. The changes in fair value of these instruments are recognized immediately in earnings.
Accounting Pronouncements
During the year ended December 31, 2012, the following Accounting Standards Updates (“ASU”) were issued or became effective:
In October 2012, the FASB issued ASU 2012-06, Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution. ASU 2012-06 clarifies that when a reporting entity recognizes an indemnification asset as a result of a government-assisted acquisition of a financial institution and there is a subsequent change in the amount of cash flows expected to be collected on the indemnified asset, the reporting entity should subsequently measure the indemnification asset on the same basis as the underlying loans by taking into account the contractual limitations of the Loss-Sharing Agreement ("LSA"). For amortization of changes in value, the reporting entity should use the term of the LSA if it is shorter than the term of the acquired loans. ASU 2012-06 is effective for interim and annual periods beginning after December 15, 2012. Early adoption is permitted. Based upon the most recent measurement of expected losses covered under loss-sharing agreements, adoption of the new guidance is expected to result in an additional $6.2 million of indemnification asset amortization over the remaining life of the loss-sharing agreements.
In December 2011, the FASB issued ASU 2011-11, Disclosures about Offsetting Assets and Liabilities (Topic 210). ASU 2011-11 requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. ASU 2011-11 is effective for interim and annual periods beginning on or after January 1, 2013 and should be applied retrospectively for all comparative periods presented. Subsequent to December 31, 2012, the FASB issued ASU 2013-01 which clarifies the scope of ASU 2011-11. Adoption of the new guidance is not expected to have a significant impact on the Company's consolidated financial statements.
In June 2011, the FASB issued ASU 2011-05, Presentation of Comprehensive Income (Topic 220). ASU 2011-05 attempts to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. The effective date of ASU 2011-05 was the first interim or fiscal period beginning after December 15, 2011 and should be applied retrospectively. Early adoption was

permitted. In December 2011, the FASB issued ASU 2011-11, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. ASU 2011-11 deferred the effective date for certain amendments related to the presentation of reclassification of items out of accumulated other comprehensive income. The Company early adopted the remaining applicable amendments in ASU 2011-05 during 2011 and the adoption of this ASU had no impact on the Company's financial condition or results of operations. Subsequent to December 31, 2012, the FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive

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Income. The Update requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component and to present either on the face of the statement where net income is presented, or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2012. The Company is currently in the process of evaluating the ASU but does not expect it will have a material impact on the Company's consolidated financial statements.

In May 2011, the FASB issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. Generally Accepted Accounting Principles ("GAAP") and International Financial Reporting Standards ("IFRS") (Topic 820). ASU 2011-04 developed common requirements between GAAP and IFRS for measuring fair value and for disclosing information about fair value measurements. The effective date of ASU 2011-04 will be during interim or annual period beginning after December 15, 2011 and should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The Company adopted this ASU during the current period with no impact on the Company's financial condition or results of operations.

2. Cash and Cash Equivalents

The Company is required to maintain an average reserve balance with the Federal Reserve Bank or maintain such reserve balance in the form of cash. The average required reserve balance for the years ended December 31, 2012 and 2011 was approximately $28.6 million and $27.0 million, respectively, and was met by holding cash and maintaining an average balance with the Federal Reserve Bank.

3. Securities

At December 31, 2012 the Company's securities portfolio primarily consisted of securities issued by the U.S. government, U.S. government agencies, U.S. government-sponsored enterprises and state and municipalities. All of the Company's mortgage-backed securities and collateralized mortgage obligations are issued by U.S. government agencies and U.S. government-sponsored enterprises and are implicitly guaranteed by the U.S. government. The Company had no other issuances in its portfolio which exceeded ten percent of shareholders' equity.

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2012	(in thousands)			
U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations	$561,076	$16,719	$(5,426)	$572,369
State and municipal securities	265,070	20,893	(388)	285,575
U.S. government agency and government-sponsored enterprise securities	120,085	851	(435)	120,501
U.S. government securities	19,804	39	(15)	19,828
Other securities	3,324	104	(36)	3,392
Total	$969,359	$38,606	$(6,300)	$1,001,665
December 31, 2011				
U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations	$678,631	$19,323	$(2,000)	$695,954
State and municipal securities	263,075	22,746	(58)	285,763
U.S. government agency and government-sponsored enterprise securities				