UMPQUA HOLDINGS CORP
Form 10-Q
November 06, 2013

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

FORM 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the quarterly period ended: September 30, 2013
or
[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the transition period from to .

Commission File Number: 001-34624

Umpqua Holdings Corporation

(Exact Name of Registrant as Specified in Its Charter)

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

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

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

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

[X] Yes [ ] No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

[X] Yes [ ] No

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

[X] Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

[ ] Yes [X] No

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

Common stock, no par value: 111,929,202 shares outstanding as of October 31, 2013

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

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

	September 30, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$193,188	$223,532
Interest bearing deposits	503,369	315,053
Temporary investments	534	5,202
Total cash and cash equivalents	697,091	543,787
Investment securities		
Trading, at fair value	4,012	3,747
Available for sale, at fair value	1,910,082	2,625,229
Held to maturity, at amortized cost	5,766	4,541
Loans held for sale, at fair value	113,993	320,132
Non-covered loans and leases	7,228,904	6,681,080
Allowance for non-covered loan and lease losses	(84,694)	(85,391)
Net non-covered loans and leases	7,144,210	6,595,689
Covered loans, net of allowance of $11,918 and $18,275	397,083	477,078
Restricted equity securities	31,444	33,443
Premises and equipment, net	173,876	162,667
Goodwill and other intangible assets, net	778,094	685,331
Mortgage servicing rights, at fair value	41,853	27,428
Non-covered other real estate owned	18,249	17,138
Covered other real estate owned	2,980	10,374
FDIC indemnification asset	29,427	52,798
Other assets	221,137	236,061
Total assets	$11,569,297	$11,795,443
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest bearing	$2,421,008	$2,278,914
Interest bearing	6,646,232	7,100,361
Total deposits	9,067,240	9,379,275
Securities sold under agreements to repurchase	215,310	137,075
Term debt	252,017	253,605
Junior subordinated debentures, at fair value	86,718	85,081
Junior subordinated debentures, at amortized cost	101,979	110,985
Other liabilities	120,038	105,383
Total liabilities	9,843,302	10,071,404
COMMITMENTS AND CONTINGENCIES (NOTE 10)		
SHAREHOLDERS' EQUITY		
Common stock, no par value, 200,000,000 shares authorized; issued and outstanding: 111,928,762 in 2013 and 111,889,959 in 2012	1,513,225	1,512,400
Retained earnings	209,597	187,293
Accumulated other comprehensive income	3,173	24,346

Total shareholders' equity	1,725,995	1,724,039
Total liabilities and shareholders' equity	$11,569,297	$11,795,443

See notes to condensed consolidated financial statements

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

(in thousands, except per share amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
INTEREST INCOME				
Interest and fees on non-covered loans and leases	$93,706	$78,090	$250,685	$233,386
Interest and fees on covered loans and leases	11,837	20,325	41,167	54,603
Interest and dividends on investment securities:				
Taxable	7,882	13,057	24,629	47,712
Exempt from federal income tax	2,200	2,302	6,725	6,870
Dividends	51	3	165	37
Interest on temporary investments and interest bearing deposits	284	331	937	736
Total interest income	115,960	114,108	324,308	343,344
INTEREST EXPENSE				
Interest on deposits	4,845	7,623	16,587	24,637
Interest on securities sold under agreement to repurchase and federal funds purchased	35	73	99	232
Interest on term debt	2,338	2,335	6,916	6,944
Interest on junior subordinated debentures	1,933	2,037	5,815	6,124
Total interest expense	9,151	12,068	29,417	37,937
Net interest income	106,809	102,040	294,891	305,407
PROVISION FOR NON-COVERED LOAN AND LEASE LOSSES	3,008	7,078	12,989	16,883
(RECAPTURE OF) PROVISION FOR COVERED LOAN LOSSES	(1,904)	2,927	(4,744)	4,302
Net interest income after provision for (recapture of) loan and lease losses	105,705	92,035	286,646	284,222
NON-INTEREST INCOME				
Service charges on deposit accounts	8,374	7,122	22,844	20,978
Brokerage commissions and fees	3,854	3,186	11,152	9,662
Mortgage banking revenue, net	15,071	24,346	62,928	53,069
Gain on investment securities, net	3	21	18	1,199
Loss on junior subordinated debentures carried at fair value	(554)	(554)	(1,643)	(1,649)
Change in FDIC indemnification asset	(6,474)	(4,759)	(19,841)	(10,644)
Other income	5,870	4,317	19,198	17,227
Total non-interest income	26,144	33,679	94,656	89,842
NON-INTEREST EXPENSE				
Salaries and employee benefits	53,699	49,543	157,271	146,615
Net occupancy and equipment	16,019	13,441	45,813	40,519
Communications	2,772	2,740	8,802	8,527
Marketing	1,596	1,104	3,753	3,855
Services	6,445	5,910	18,339	18,703
Supplies	742	627	2,120	1,936
FDIC assessments	1,709	1,699	5,032	5,553

Net (gain) loss on non-covered other real estate owned	(27)	2,168	(303)	6,244
Net (gain) loss on covered other real estate owned	(68)	461	154	3,084
Intangible amortization	1,186	1,189	3,595	3,612
Merger related expenses	4,856	85	7,197	338
Other expenses	6,675	8,007	17,524	22,620
Total non-interest expense	95,604	86,974	269,297	261,606
Income before provision for income taxes	36,245	38,740	112,005	112,458
Provision for income taxes	12,768	13,587	38,914	38,525
Net income	$23,477	$25,153	$73,091	$73,933

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

(in thousands, except per share amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Net income	$23,477	$25,153	$73,091	$73,933
Dividends and undistributed earnings allocated to participating securities	196	170	576	499
Net earnings available to common shareholders	$23,281	$24,983	$72,515	$73,434
Earnings per common share:				
Basic	$0.21	$0.22	$0.65	$0.66
Diluted	$0.21	$0.22	$0.65	$0.65
Weighted average number of common shares outstanding:				
Basic	111,912	111,899	111,934	111,928
Diluted	112,195	112,151	112,154	112,159

See notes to condensed consolidated financial statements

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

(in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Net income	$23,477	$25,153	$73,091	$73,933
Available for sale securities:				
Unrealized gains (losses) arising during the period	5,878	1,863	(35,342)	(2,167)
Reclassification adjustment for net gains realized in earnings (net of tax expense $1 and $8 for the three months ended September 30, 2013 and 2012, respectively, and net of tax expense of $7 and $480 for the nine months ended September 30, 2013 and 2012, respectively)	(2)	(13)	(11)	(719)
Income tax (expense) benefit related to unrealized losses	(2,351)	(745)	14,137	867
Net change in unrealized gains (losses)	3,525	1,105	(21,216)	(2,019)
Held to maturity securities:				
Accretion of unrealized losses related to factors other than credit to investment securities held to maturity (net of tax benefit of $7 and $23 for the three months ended September 30, 2013 and 2012, respectively, and net of tax benefit of $29 and $76 for the nine months ended September 30, 2013 and 2012, respectively)	11	35	43	114
Net change in unrealized losses related to factors other than credit	11	35	43	114
Other comprehensive income (loss), net of tax	3,536	1,140	(21,173)	(1,905)
Comprehensive income	$27,013	$26,293	$51,918	$72,028

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

(in thousands, except shares)

	Common Stock		Retained	Accumulated Other Comprehensive	
	Shares	Amount	Earnings	Income	Total
BALANCE AT JANUARY 1, 2012	112,164,891	$1,514,913	$123,726	$33,774	$1,672,413
Net income			101,891		101,891
Other comprehensive loss, net of tax				(9,428)	(9,428)
Comprehensive income					$92,463
Stock-based compensation		4,041			4,041
Stock repurchased and retired	(596,000)	(7,436)			(7,436)
Issuances of common stock under stock plans and related net tax benefit	321,068	882			882
Cash dividends on common stock ($0.34 per share)			(38,324)		(38,324)
Balance at December 31, 2012	111,889,959	$1,512,400	$187,293	$24,346	$1,724,039
BALANCE AT JANUARY 1, 2013	111,889,959	$1,512,400	$187,293	$24,346	$1,724,039
Net income			73,091		73,091
Other comprehensive loss, net of tax				(21,173)	(21,173)
Comprehensive income					$51,918
Stock-based compensation		3,531			3,531
Stock repurchased and retired	(319,164)	(4,704)			(4,704)
Issuances of common stock under stock plans and related net tax benefit	357,967	1,998			1,998
Cash dividends on common stock ($0.45 per share)			(50,787)		(50,787)
Balance at September 30, 2013	111,928,762	$1,513,225	$209,597	$3,173	$1,725,995

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

	Nine months ended September 30, 2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$73,091	$73,933
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of investment premiums, net	27,984	33,023
Gain on sale of investment securities, net	(18)	(1,199)
(Gain) loss on sale of non-covered other real estate owned	(751)	481
Gain on sale of covered other real estate owned	(549)	(1,031)
Valuation adjustment on non-covered other real estate owned	448	5,763
Valuation adjustment on covered other real estate owned	703	4,115
Provision for non-covered loan and lease losses	12,989	16,883
(Recapture of) provision for covered loan losses	(4,744)	4,302
Proceeds from bank owned life insurance	1,173	—
Change in FDIC indemnification asset	19,841	10,644
Depreciation, amortization and accretion	13,292	11,848
Increase in mortgage servicing rights	(15,182)	(11,923)
Change in mortgage servicing rights carried at fair value	757	5,618
Change in junior subordinated debentures carried at fair value	1,637	1,633
Stock-based compensation	3,531	2,981
Net increase in trading account assets	(265)	(744)
Gain on sale of loans	(52,899)	(50,668)
Change in loans held for sale carried at fair value	11,099	(11,324)
Origination of loans held for sale	(1,368,902)	(1,359,520)
Proceeds from sales of loans held for sale	1,614,097	1,294,321
Excess tax benefits from the exercise of stock options	(40)	(51)
Change in other assets and liabilities:		
Net decrease (increase) in other assets	34,007	(9,348)
Net (decrease) increase in other liabilities	(11,983)	22,493
Net cash provided by operating activities	359,316	42,230
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investment securities available for sale	(51,191)	(784,797)
Purchases of investment securities held to maturity	(2,126)	(931)
Proceeds from investment securities available for sale	702,910	1,018,791
Proceeds from investment securities held to maturity	1,073	511
Redemption of restricted equity securities	1,999	1,216
Net non-covered loan and lease originations	(352,390)	(391,733)
Net covered loan paydowns	68,819	85,510
Proceeds from sales of non-covered loans	60,298	13,496
Proceeds from insurance settlement on loss of property	575	1,425
Proceeds from fee on termination of merger transaction	—	1,600
Proceeds from disposals of furniture and equipment	330	1,700
Purchases of premises and equipment	(25,575)	(17,155)
Net proceeds from FDIC indemnification asset	4,621	26,615

Proceeds from sales of non-covered other real estate owned	13,940	18,834
Proceeds from sales of covered other real estate owned	9,794	11,523
Net cash paid in acquisition	(149,658)	—
Net cash provided (used) by investing activities	283,419	(13,395)

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

(in thousands)

	Nine months ended September 30, 2013	2012
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net decrease in deposit liabilities	(311,708)	(136,519)
Net increase in securities sold under agreements to repurchase	78,235	36,446
Repayment of term debt	(211,204)	—
Repayment of junior subordinated debentures	(8,764)	—
Dividends paid on common stock	(33,837)	(25,919)
Excess tax benefits from stock based compensation	40	51
Proceeds from stock options exercised	2,511	324
Retirement of common stock	(4,704)	(5,378)
Net cash used by financing activities	(489,431)	(130,995)
Net increase (decrease) in cash and cash equivalents	153,304	(102,160)
Cash and cash equivalents, beginning of period	543,787	598,766
Cash and cash equivalents, end of period	$697,091	$496,606
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$32,419	$40,653
Income taxes	$27,711	$31,825
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Change in unrealized losses on investment securities available for sale, net of taxes	$(21,216)	$(2,019)
Change in unrealized losses on investment securities held to maturity related to factors other than credit, net of taxes	$43	$114
Cash dividend declared on common stock and payable after period-end	$16,930	$10,140
Transfer of non-covered loans to non-covered other real estate owned	$14,747	$10,167
Transfer of covered loans to covered other real estate owned	$2,554	$3,227
Transfer of covered loans to non-covered loans	$13,366	$14,367
Transfer from FDIC indemnification asset to due from FDIC and other	$3,530	$19,939
Acquisitions:		
Assets acquired	$376,071	$—
Liabilities assumed	$219,961	$—

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 – Summary of Significant Accounting Policies

The accounting and financial reporting policies of Umpqua Holdings Corporation (referred to in this report as “we”, “our” or “the Company”) conform to accounting principles generally accepted in the United States of America. The accompanying interim consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material inter-company balances and transactions have been eliminated. The consolidated financial statements have not been audited. A more detailed description of our accounting policies is included in the 2012 Annual Report filed on Form 10-K. These interim condensed consolidated financial statements should be read in conjunction with the financial statements and related notes contained in the 2012 Annual Report filed on Form 10-K. References to "Bank" refer to our subsidiary Umpqua Bank, an Oregon state-chartered commercial bank, and references to "Umpqua Investments" refer to our subsidiary Umpqua Investments, Inc., a registered broker-dealer and investment adviser.

In preparing these financial statements, the Company has evaluated events and transactions subsequent to September 30, 2013 for potential recognition or disclosure. In management’s opinion, all accounting adjustments necessary to accurately reflect the financial position and results of operations on the accompanying financial statements have been made. These adjustments include normal and recurring accruals considered necessary for a fair and accurate presentation. The results for interim periods are not necessarily indicative of results for the full year or any other interim period. Certain reclassifications of prior period amounts have been made to conform to current classifications.

Note 2 – Business Combinations

Sterling Financial Corporation
On September 11, 2013, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with Sterling Financial Corporation, a Washington corporation ("Sterling"). The Merger Agreement provides that Sterling will merge with and into the Company (the "Merger"), with the Company as the surviving corporation in the Merger. Immediately following the Merger, Sterling's wholly owned subsidiary, Sterling Savings Bank, will merge with and into the Bank (the "Bank Merger"), with the Bank as the surviving bank in the Bank Merger. Holders of shares of common stock of Sterling will have the right to receive 1.671 shares of the Company's common stock and $2.18 in cash for each share of Sterling common stock.

The completion of the Merger is subject to customary conditions, including (1) adoption of the Merger Agreement by Sterling's shareholders and by the Company's shareholders, (2) approval of an amendment to the Company's articles of incorporation to increase the number of authorized shares of the Company's common stock, (3) authorization for listing on the NASDAQ of the shares of the Company's common stock to be issued in the Merger, (4) the receipt of required regulatory approvals for the Merger and the Bank Merger from the Federal Reserve Board, Federal Deposit Insurance Corporation and Oregon and Washington state bank regulators, in each case without the imposition of any materially burdensome regulatory condition, (5) effectiveness of the registration statement on Form S-4 for the Company's common stock to be issued in the Merger, and (6) the absence of any order, injunction or other legal restraint preventing the completion of the Merger or making the completion of the Merger illegal. Each party's obligation to complete the Merger is also subject to certain additional customary conditions. The Merger Agreement provides certain termination rights for both the Company and Sterling and further provides that, upon termination of the Merger Agreement under certain circumstances, the Company or Sterling, as applicable, will be obligated to pay the other party a termination fee of $75 million.

The Merger is expected to be completed in the first half of 2014. A summary of the terms of the Merger Agreement and other related agreements are summarized in, and the Merger Agreement has been filed as an exhibit to, the Current Report on Form 8-K filed by the Company with the Securities and Exchange Commission on September 17, 2013.

Financial Pacific Holding Corp.

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

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

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

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

The operations of FinPac are included in our operating results from July 1, 2013, and added revenue of $14.8 million, non-interest expense of $3.5 million , and net income of $6.0 million net of tax, for the three and nine months ended September 30, 2013. FinPac's results of operations prior to the acquisition are not included in our operating results. Merger related expenses of $629,000 and $1.4 million for the three and nine months ended September 30, 2013 have been incurred in connection with the acquisition of FinPac and are recognized within the merger related expenses line item on the Consolidated Statements of Income.

A summary of the net assets acquired and the estimated fair value adjustments of FinPac are presented below:
(in thousands)

	FinPac July 1, 2013	
Cost basis net assets	$61,446	
Cash payment paid	(156,110	)
Fair value adjustments:		
Non-covered loans and leases, net	6,881	
Other intangible assets	(8,516	)
Other assets	(1,650	)
Term debt	(400	)
Other liabilities	1,355	
Goodwill	$(96,994	)

The statement of assets acquired and liabilities assumed at their fair values of FinPac are presented below. Additional adjustments to the purchase price allocation may be required, specifically to leases, other assets, other liabilities and taxes.
(in thousands)

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	FinPac July 1, 2013
Assets Acquired:	
Cash and equivalents	$6,452
Non-covered loans and leases, net	264,336
Premises and equipment	491
Goodwill	96,994
Other assets	7,798
Total assets acquired	$376,071
Liabilities Assumed:	
Term debt	211,204
Other liabilities	8,757
Total liabilities assumed	219,961
Net Assets Acquired	$156,110

Non-covered leases acquired from FinPac that are not subject to the requirements of FASB ASC 310-30 Loans and Debt Securities Acquired with Deteriorated Credit Quality ("ASC 310-30") are presented below at acquisition:
(in thousands)

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

The following tables present unaudited pro forma results of operations for the three and nine months ended September 30, 2013 and 2012 as if the acquisition of FinPac had occurred on January 1, 2012. The proforma results have been prepared for comparative purposes only and are not necessarily indicative of the results that would have been obtained had the acquisitions actually occurred on January 1, 2012.

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(in thousands, except per share data)

	Three months ended September 30, 2013				
	Company	FinPac (a)	Pro Forma Adjustments		Pro Forma Combined
Net interest income	$92,311	$14,498	$(1,121)	(b)	$105,688
Provision for non-covered loan and lease losses	1,228	1,780	1,524	(d)	4,532
Recapture of provision for covered loan losses	(1,904)	—	—		(1,904)
Non-interest income	25,815	329	—		26,144
Non-interest expense	92,108	3,496	(474)	(c)	95,130
Income before provision for income taxes	26,694	9,551	(2,171)		34,074
Provision for income taxes	9,169	3,599	(868)	(e)	11,900
Net income	17,525	5,952	(1,303)		22,174
Dividends and undistributed earnings allocated to participating securities	196	—	52		248
Net earnings available to common shareholders	$17,329	$5,952	$(1,355)		$21,926
Earnings per share:					
Basic	$0.15				$0.20
Diluted	$0.15				$0.20
Average shares outstanding:					
Basic	111,912				111,912
Diluted	112,195				112,195

(a) FinPac amounts represent results from July 1, 2013 to September 30, 2013.
(b) Consists of change in yields due to fair value adjustments.
(c) Consists of merger related expenses of $629,000 at the Bank, additional expense related to restricted stock, and FinPac amortization of intangible assets, director compensation and travel, and management fees.
(d) Consists of adjustment to FinPac provision for credit losses due to purchase accounting adjustments.
(e) Income tax effect of pro forma adjustments at 40%.

(in thousands, except per share data)

	Nine months ended September 30, 2013				
	Company	FinPac (a)	Pro Forma Adjustments		Pro Forma Combined
Net interest income	$280,393	$40,024	$(1,513)	(b)	$318,904
Provision for non-covered loan and lease losses	11,209	5,052	4,565	(d)	20,826
Recapture of provision for covered loan losses	(4,744)	—	—		(4,744)
Non-interest income	94,327	1,641	—		95,968
Non-interest expense	265,801	11,784	(1,802)	(c)	275,783
Income before provision for income taxes	102,454	24,829	(4,276)		123,007
Provision for income taxes	35,315	9,434	(1,710)	(e)	43,039
Net income	67,139	15,395	(2,566)		79,968
Dividends and undistributed earnings allocated to participating securities	576	—	110		686
Net earnings available to common shareholders	$66,563	$15,395	$(2,676)		$79,282
Earnings per share:					
Basic	$0.59				$0.71
Diluted	$0.59				$0.71
Average shares outstanding:					
Basic	111,934				111,934
Diluted	112,154				112,154

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(a) FinPac amounts represent results from January 1, 2013 to September 30, 2013.
(b) Consists of interest expense benefit of FinPac utilizing Bank funding, and change in yields due to fair value adjustments.
(c) Consists of merger related expenses of $1.4 million at the Bank, additional expense related to restricted stock, and FinPac amortization of intangible assets, director compensation and travel, and management fees.
(d) Consists of adjustment to FinPac provision for credit losses due to purchase accounting adjustments.
(e) Income tax effect of pro forma adjustments at 40%.

(in thousands, except per share data)

	Three months ended September 30, 2012				
	Company	FinPac (a)	Pro Forma Adjustments		Pro Forma Combined
Net interest income	$102,040	$12,030	$1,167	(b)	$115,237
Provision for non-covered loan and lease losses	7,078	2,516	1,361	(d)	10,955
Provision for covered loan losses	2,927	—	—		2,927
Non-interest income	33,679	749	—		34,428
Non-interest expense	86,974	3,836	(303)	(c)	90,507
Income before provision for income taxes	38,740	6,427	109		45,276
Provision for income taxes	13,587	2,425	44	(e)	16,056
Net income	25,153	4,002	65		29,220
Dividends and undistributed earnings allocated to participating securities	170	—	27		197
Net earnings available to common shareholders	$24,983	$4,002	$38		$29,023
Earnings per share:					
Basic	$0.22				$0.26
Diluted	$0.22				$0.26
Average shares outstanding:					
Basic	111,899				111,899
Diluted	112,151				112,151

(a) FinPac amounts represent results from July 1, 2012 to September 30, 2012.
(b) Consists of interest expense benefit of FinPac utilizing Bank funding, and change in yields due to fair value adjustments.
(c) Consists of additional expense related to restricted stock, and FinPac amortization of intangible assets, director compensation and travel, and management fees.
(d) Consists of adjustment to FinPac provision for credit losses due to purchase accounting adjustments.
(e) Income tax effect of pro forma adjustments at 40%.

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(in thousands, except per share data)

	Nine months ended September 30, 2012				
	Company	FinPac (a)	Pro Forma Adjustments		Pro Forma Combined
Net interest income	$305,407	$35,897	$3,509	(b)	$344,813
Provision for non-covered loan and lease losses	16,883	8,213	415	(d)	25,511
Provision for covered loan losses	4,302	—	—		4,302
Non-interest income	89,842	2,751	—		92,593
Non-interest expense	261,606	11,545	(910)	(c)	272,241
Income before provision for income taxes	112,458	18,890	4,004		135,352
Provision for income taxes	38,525	7,131	1,601	(e)	47,257
Net income	73,933	11,759	2,403		88,095
Dividends and undistributed earnings allocated to participating securities	499	—	96		595
Net earnings available to common shareholders	$73,434	$11,759	$2,307		$87,500
Earnings per share:					
Basic	$0.66				$0.78
Diluted	$0.65				$0.78
Average shares outstanding:					
Basic	111,928				111,928
Diluted	112,159				112,159

(a) FinPac amounts represent results from January 1, 2012 to September 30, 2012.
(b) Consists of interest expense benefit of FinPac utilizing Bank funding, and change in yields due to fair value adjustments.
(c) Consists of additional expense related to restricted stock, and FinPac amortization of intangible assets, director compensation and travel, and management fees.
(d) Consists of adjustment to FinPac provision for credit losses due to purchase accounting adjustments.
(e) Income tax effect of pro forma adjustments at 40%.

Circle Bancorp

On November 14, 2012, the Company acquired all of the assets and liabilities of Circle Bancorp (“Circle”), which has been accounted for under the acquisition method of accounting for cash consideration of $24.9 million, including the redemption of all common and preferred shares and outstanding warrants and options. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the acquisition dates, and are subject to change for up to one year after the closing date of the acquisition. This acquisition was consistent with the Company's overall banking expansion strategy and provided further opportunity to enter growth markets in the San Francisco Bay Area of California. Upon completion of the acquisition, all Circle Bank branches operated under the Umpqua Bank name. The acquisition added Circle Bank's network of six branches in Corte Madera, Novato, Petaluma, San Francisco, San Rafael and Santa Rosa, California to Umpqua Bank's network of locations in California, Oregon, Washington and Nevada. The application of the acquisition method of accounting resulted in the recognition of $11.9 million of goodwill. There is no tax deductible goodwill or other intangibles.

The operations of Circle are included in our operating results from November 15, 2012, and added revenue of $4.2 million and $13.3 million, non-interest expense of $1.3 million and $5.2 million, and net income of $1.7 million and $4.5 million net of tax, for the three and nine months ended September 30, 2013. Circle's results of operations prior to the acquisition are not included in our operating results. Merger-related expenses of $32,000 and $981,000 for the three and nine months ended September 30, 2013 have been incurred in connection with the acquisition of Circle and recognized within the merger related expenses line item on the Consolidated Statements of Income.
A summary of the net assets acquired and the estimated fair value adjustments of Circle are presented below:

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(in thousands)

	Circle Bank November 14, 2012
Cost basis net assets	$17,127
Cash payment paid	(24,860)
Fair value adjustments:	
Non-covered loans and leases, net	(2,622)
Other intangible assets	830
Non-covered other real estate owned	(487)
Deposits	(904)
Term debt	(2,404)
Other	1,398
Goodwill	$(11,922)

The statement of assets acquired and liabilities assumed at their fair values of Circle are presented below:
(in thousands)

	Circle Bank November 14, 2012
Assets Acquired:	
Cash and equivalents	$39,328
Investment securities	793
Non-covered loans and leases, net	246,665
Premises and equipment	7,695
Restricted equity securities	2,491
Goodwill	11,922
Other intangible assets	830
Non-covered other real estate owned	1,602
Other assets	6,469
Total assets acquired	$317,795
Liabilities Assumed:	
Deposits	$250,408
Junior subordinated debentures	8,764
Term debt	55,404
Other liabilities	3,219
Total liabilities assumed	$317,795

Non-covered loans acquired from Circle that are not subject to the requirements of FASB ASC 310-30 Loans and Debt Securities Acquired with Deteriorated Credit Quality ("ASC 310-30") are presented below at acquisition:
(in thousands)

	November 14, 2012
Contractually required principal payments	$242,999
Purchase adjustment for credit	(5,760)
Balance of performing non-covered loans	$240,850

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Non-covered loans acquired from Circle that are subject to the requirements of ASC 310-30 are presented below at acquisition and as of September 30, 2013 and December 31, 2012:

(in thousands)

	November 14, 2012	December 31, 2012	September 30, 2013
Contractually required principal payments	$12,252	$12,231	$5,606
Carrying balance of acquired purchase credit impaired non-covered loans	$5,815	$5,809	$2,263

The acquisition of Circle is not considered significant to the Company's financial statements and therefore pro forma financial information is not included.

Note 3 – Investment Securities

The following table presents the amortized costs, unrealized gains, unrealized losses and approximate fair values of investment securities at September 30, 2013 and December 31, 2012:

September 30, 2013
(in thousands)

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
AVAILABLE FOR SALE:				
U.S. Treasury and agencies	$256	$22	$—	$278
Obligations of states and political subdivisions	233,499	9,146	(2,114)	240,531
Residential mortgage-backed securities and collateralized mortgage obligations	1,668,904	18,140	(19,900)	1,667,144
Other debt securities	60	74	—	134
Investments in mutual funds and other equity securities	1,959	36	—	1,995
	$1,904,678	$27,418	$(22,014)	$1,910,082
HELD TO MATURITY:				
Residential mortgage-backed securities and collateralized mortgage obligations	$5,766	$265	$(1)	$6,030
	$5,766	$265	$(1)	$6,030

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December 31, 2012
(in thousands)

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
AVAILABLE FOR SALE:				
U.S. Treasury and agencies	$45,503	$318	$(1)	$45,820
Obligations of states and political subdivisions	245,606	18,119	—	263,725
Residential mortgage-backed securities and collateralized mortgage obligations	2,291,253	28,747	(6,624)	2,313,376
Other debt securities	143	79	—	222
Investments in mutual funds and other equity securities	1,959	127	—	2,086
	$2,584,464	$47,390	$(6,625)	$2,625,229
HELD TO MATURITY:				
Obligations of states and political subdivisions	$595	$1	$—	$596
Residential mortgage-backed securities and collateralized mortgage obligations	3,946	197	(7)	4,136
	$4,541	$198	$(7)	$4,732

Investment securities that were in an unrealized loss position as of September 30, 2013 and December 31, 2012 are presented in the following tables, based on the length of time individual securities have been in an unrealized loss position. In the opinion of management, these securities are considered only temporarily impaired due to changes in market interest rates or the widening of market spreads subsequent to the initial purchase of the securities, and not due to concerns regarding the underlying credit of the issuers or the underlying collateral.

September 30, 2013
(in thousands)

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
AVAILABLE FOR SALE:						
U.S. Treasury and agencies	$—	$—	$—	$—	$—	$—
Obligations of states and political subdivisions	47,814	2,114	—	—	47,814	2,114
Residential mortgage-backed securities and collateralized mortgage obligations	440,921	13,680	264,968	6,220	705,889	19,900
Total temporarily impaired securities	$488,735	$15,794	$264,968	$6,220	$753,703	$22,014
HELD TO MATURITY:						
Residential mortgage-backed securities and collateralized mortgage obligations	$—	$—	$46	$1	$46	$1
Total temporarily impaired securities	$—	$—	$46	$1	$46	$1

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

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December 31, 2012
(in thousands)

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
AVAILABLE FOR SALE:						
U.S. Treasury and agencies	$—	$—	$59	$1	$59	$1
Residential mortgage-backed securities and						
collateralized mortgage obligations	780,234	5,548	106,096	1,076	886,330	6,624
Total temporarily impaired securities	$780,234	$5,548	$106,155	$1,077	$886,389	$6,625
HELD TO MATURITY:						
Residential mortgage-backed securities and						
collateralized mortgage obligations	$—	$—	$48	$7	$48	$7
Total temporarily impaired securities	$—	$—	$48	$7	$48	$7

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

The unrealized losses on obligations of political subdivisions were caused by changes in market interest rates or the widening of market spreads subsequent to the initial purchase of these securities. Management monitors published credit ratings of these securities and no adverse ratings changes have occurred since the date of purchase of obligations of political subdivisions which are in an unrealized loss position as of September 30, 2013. Because the decline in fair value is attributable to changes in interest rates or widening market spreads and not credit quality, and because the Bank does not intend to sell the securities in this class and it is not likely that the Bank will be required to sell these securities before recovery of their amortized cost basis, which may include holding each security until maturity, the unrealized losses on these investments are not considered other-than-temporarily impaired.

All of the available for sale residential mortgage-backed securities and collateralized mortgage obligations portfolio in an unrealized loss position at September 30, 2013 are issued or guaranteed by governmental agencies. The unrealized losses on residential mortgage-backed securities and collateralized mortgage obligations were caused by changes in market interest rates or the widening of market spreads subsequent to the initial purchase of these securities, and not concerns regarding the underlying credit of the issuers or the underlying collateral. It is expected that these securities will not be settled at a price less than the amortized cost of each investment. Because the decline in fair value is attributable to changes in interest rates or widening market spreads and not credit quality, and because the Bank does not intend to sell the securities in this class and it is not likely that the Bank will be required to sell these securities before recovery of their amortized cost basis, which may include holding each security until contractual maturity, the unrealized losses on these investments are not considered other-than-temporarily impaired.

We review investment securities on an ongoing basis for the presence of other-than-temporary impairment ("OTTI") or permanent impairment, taking into consideration current market conditions, fair value in relationship to cost, extent and nature of the change in fair value, issuer rating changes and trends, whether we intend to sell a security or if it is likely that we will be required to sell the security before recovery of our amortized cost basis of the investment, which may be maturity, and other factors. For debt securities, if we intend to sell the security or it is likely that we will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If we do not intend to sell the security and it is not likely that we will be required to sell the security but we do not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income ("OCI"). Impairment losses related to all other factors are presented as separate categories within OCI. For investment securities held to maturity, this amount is accreted over the remaining life of the debt security prospectively

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based on the amount and timing of future estimated cash flows. The accretion of the OTTI amount recorded in OCI will increase the carrying value of the investment, and would not affect earnings. If there is an indication of additional credit losses the security is re-evaluated according to the procedures described above.

The following table presents the maturities of investment securities at September 30, 2013:

(in thousands)

	Available For Sale		Held To Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
AMOUNTS MATURING IN:				
Three months or less	$18,573	$18,569	$—	$—
Over three months through twelve months	191,763	194,660	338	378
After one year through five years	1,294,846	1,303,726	863	1,085
After five years through ten years	361,759	354,446	89	89
After ten years	35,778	36,687	4,476	4,478
Other investment securities	1,959	1,994	—	—
	$1,904,678	$1,910,082	$5,766	$6,030

The amortized cost and fair value of collateralized mortgage obligations and mortgage-backed securities are presented by expected average life, rather than contractual maturity, in the preceding table. Expected maturities may differ from contractual maturities because borrowers have the right to prepay underlying loans without prepayment penalties.

The following table presents the gross realized gains and gross realized losses on the sale of securities available for sale for the three and nine months ended September 30, 2013 and 2012:

(in thousands)

	Three months ended September 30, 2013		Three months ended September 30, 2012	
	Gains	Losses	Gains	Losses
U.S. Treasury and agencies	$—	$—	$—	$—
Obligations of states and political subdivisions	3	—	8	—
Residential mortgage-backed securities and collateralized mortgage obligations	—	—	—	—
Other debt securities	—	—	13	—
	$3	$—	$21	$—

(in thousands)

	Nine months ended September 30, 2013		Nine months ended September 30, 2012	
	Gains	Losses	Gains	Losses
U.S. Treasury and agencies	$—	$—	$371	$—
Obligations of states and political subdivisions	10	1	10	1
Residential mortgage-backed securities and collateralized mortgage obligations	—	—	1,484	683
Other debt securities	9	—	18	—
	$19	$1	$1,883	$684

The following table presents, as of September 30, 2013, investment securities which were pledged to secure borrowings, public deposits, and repurchase agreements as permitted or required by law:

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(in thousands)

	Amortized Cost	Fair Value
To Federal Home Loan Bank to secure borrowings	$16,831	$17,287
To state and local governments to secure public deposits	810,529	808,734
Other securities pledged principally to secure repurchase agreements	307,164	304,093
Total pledged securities	$1,134,524	$1,130,114

Note 4 – Non-Covered Loans and Leases

The following table presents the major types of non-covered loans and leases recorded in the balance sheets as of September 30, 2013 and December 31, 2012:

(in thousands)

	September 30, 2013	December 31, 2012
Commercial real estate		
Term & multifamily	$4,005,983	$3,938,443
Construction & development	247,809	202,118
Residential development	78,998	57,209
Commercial		
Term	769,173	797,802
LOC & other	1,283,129	923,328
Residential		
Mortgage	550,200	476,579
Home equity loans & lines	256,202	260,797
Consumer & other	43,621	37,327
Total	7,235,115	6,693,603
Deferred loan fees, net	(6,211)	(12,523)
Total	$7,228,904	$6,681,080

As of September 30, 2013, loans totaling $5.4 billion were pledged to secure borrowings and available lines of credit.

At September 30, 2013, non-covered loans accounted for under ASC 310-30 were $24.7 million. At December 31, 2012, non-covered accounted for under ASC 310-30 were $19.3 million.

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

The Bank has a management Allowance for Loan and Lease Losses (“ALLL”) Committee, which is responsible for, among other things, regularly reviewing the ALLL methodology, including loss factors, and ensuring that it is designed and applied in accordance with generally accepted accounting principles. The ALLL Committee reviews and approves loans and leases recommended for impaired status. The ALLL Committee also approves removing loans and leases from impaired status. The Bank's Audit and Compliance Committee provides board oversight of the ALLL process and reviews and approves the ALLL methodology on a quarterly basis.

Our methodology for assessing the appropriateness of the ALLL consists of three key elements, which include 1) the formula allowance; 2) the specific allowance; and 3) the unallocated allowance. By incorporating these factors into a single allowance requirement analysis, all risk-based activities within the loan portfolio are simultaneously considered.

Formula Allowance

The Bank performs regular credit reviews of the loan and lease portfolio to determine the credit quality and adherence to underwriting standards. When loans and leases are originated, they are assigned a risk rating that is reassessed periodically

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during the term of the loan or lease through the credit review process. The Bank's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. The 10 risk rating categories are a primary factor in determining an appropriate amount for the formula allowance.

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

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

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

Changes to risk factors – Risk factors are assigned at origination and may be changed periodically based on management's evaluation of the following factors: loss experience; changes in the level of non-performing loans and leases; regulatory exam results; changes in the level of adversely classified loans and leases (positive or negative); improvement or deterioration in local economic conditions; and any other factors deemed relevant.

Specific Allowance
Regular credit reviews of the portfolio also identify loans that are considered potentially impaired. Potentially impaired loans are referred to the ALLL Committee which reviews and approves designated loans as impaired. A loan is considered impaired, when based on current information and events, we determine that we will probably not be able to collect all amounts due according to the loan contract, including scheduled interest payments. When we identify a loan as impaired, we measure the impairment using discounted cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral. In these cases, we use the current fair value of the collateral, less selling costs, instead of discounted cash flows. If we determine that the value of the impaired loan is less than the recorded investment in the loan, we either recognize an impairment reserve as a specific allowance to be provided for in the allowance for loan and lease losses or charge-off the impaired balance on collateral dependent loans if it is determined that such amount represents a confirmed loss. Loans determined to be impaired with a specific allowance are excluded from the formula allowance so as not to double-count the loss exposure. The non-accrual impaired loans as of period end have already been partially charged-off to their estimated net realizable value, and are expected to be resolved over the coming quarters with no additional material loss, absent further decline in market prices.

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

Unallocated Allowance
The Bank may also maintain an unallocated allowance amount to provide for other credit losses inherent in a loan and lease portfolio that may not have been contemplated in the credit loss factors. This unallocated amount generally comprises less than 5% of the allowance, but may be maintained at higher levels during times of deteriorating economic conditions characterized by falling real estate values. The unallocated amount is reviewed quarterly with consideration of factors including, but not limited to:
• Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses;
• Changes in international, national, regional, and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments;

• Changes in the nature and volume of the portfolio and in the terms of loans and leases;
• Changes in the experience and ability of lending management and other relevant staff;
• Changes in the volume and severity of past due loans, the volume of nonaccrual loans and leases, and the volume and severity of adversely classified or graded loans;
• Changes in the quality of the institution's loan and lease review system;
• Changes in the value of underlying collateral for collateral-depending loans;
• The existence and effect of any concentrations of credit, and changes in the level of such concentrations; and
• The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institutions' existing portfolio.

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These factors are evaluated through a management survey of the Chief Credit Officer, Chief Lending Officer, Senior Credit Officers, Special Assets Manager, and Credit Review Manager. The survey requests responses to evaluate current changes in the nine qualitative factors. This information is then incorporated into our understanding of the reasonableness of the formula factors and our evaluation of the unallocated portion of the ALLL.

Management believes that the ALLL was adequate as of September 30, 2013. There is, however, no assurance that future loan and lease losses will not exceed the levels provided for in the ALLL and could possibly result in additional charges to the provision for loan and lease losses. In addition, bank regulatory authorities, as part of their periodic examination of the Bank, may require additional charges to the provision for loan and lease losses in future periods if warranted as a result of their review. Approximately 75% of our loan and lease portfolio is secured by real estate, and a significant decline in real estate market values may require an increase in the allowance for loan and lease losses. The recent U.S. recession, the housing market downturn, and declining real estate values in our markets have negatively impacted aspects of our loan and lease portfolio. A continued deterioration in our markets may adversely affect our loan and lease portfolio and may lead to additional charges to the provision for loan and lease losses.

The reserve for unfunded commitments (“RUC”) is established to absorb inherent losses associated with our commitment to lend funds, such as with a letter or line of credit. The adequacy of the ALLL and RUC are monitored on a regular basis and are based on management's evaluation of numerous factors. For each portfolio segment, these factors include:

- The quality of the current loan and lease portfolio;
- The trend in the loan portfolio's risk ratings;
- Current economic conditions;
- Loan and lease concentrations;
- Loan and lease growth rates;
- Past-due and non-performing trends;
- Evaluation of specific loss estimates for all significant problem loans;
- Historical short (one year), medium (three year), and long-term charge-off rates;
- Recovery experience; and
- Peer comparison loss rates.

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

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

The following table summarizes activity related to the allowance for non-covered loan and lease losses by non-covered loan and lease portfolio segment for three and nine months ended September 30, 2013 and 2012, respectively:

(in thousands)

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

Three months ended September 30, 2012

	Commercial Real Estate	Commercial	Residential	Consumer & Other	Unallocated	Total
Balance, beginning of period	$56,341	$19,587	$6,652	$1,038	$—	$83,618
Charge-offs	(4,892)	(1,782)	(516)	(454)	—	(7,644)
Recoveries	1,020	409	171	107	—	1,707
Provision	2,779	2,540	1,381	331	47	7,078
Balance, end of period	$55,248	$20,754	$7,688	$1,022	$47	$84,759

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(in thousands)

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

	Nine months ended September 30, 2012					
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Unallocated	Total
Balance, beginning of period	$59,574	$20,485	$7,625	$867	$4,417	$92,968
Charge-offs	(18,007)	(8,741)	(4,030)	(1,159)	—	(31,937)
Recoveries	2,327	3,856	338	324	—	6,845
Provision	11,354	5,154	3,755	990	(4,370)	16,883
Balance, end of period	$55,248	$20,754	$7,688	$1,022	$47	$84,759

The following table presents the allowance and recorded investment in non-covered loans and leases by portfolio segment and balances individually or collectively evaluated for impairment as of September 30, 2013 and 2012, respectively:

(in thousands)

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

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(in thousands)

	September 30, 2012					
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Unallocated	Total
Allowance for non-covered loans and leases:						
Collectively evaluated for impairment	$54,115	$20,754	$7,683	$1,022	$47	$83,621
Individually evaluated for impairment	1,133	—	5	—	—	1,138
Total	$55,248	$20,754	$7,688	$1,022	$47	$84,759
Non-covered loans and leases:						
Collectively evaluated for impairment	$3,816,106	$1,602,735	$654,956	$37,874		$6,111,671
Individually evaluated for impairment	129,690	18,371	793	—		148,854
Total	$3,945,796	$1,621,106	$655,749	$37,874		$6,260,525

The gross non-covered loan and lease balance excludes deferred loans fees of $6.2 million at September 30, 2013 and $12.1 million at September 30, 2012.

Summary of Reserve for Unfunded Commitments Activity

The following table presents a summary of activity in the reserve for unfunded commitments (“RUC”) and unfunded commitments for the three and nine months ended September 30, 2013 and 2012, respectively:

(in thousands)

	Three months ended September 30, 2013				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$196	$855	$200	$76	$1,327
Net change to other expense	3	11	24	10	48
Balance, end of period	$199	$866	$224	$86	$1,375

	Three months ended September 30, 2012				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$107	$790	$162	$67	$1,126
Net change to other expense	18	1,607	2	4	1,631
Balance, end of period	$125	$2,397	$164	$71	$2,757

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(in thousands)

	Nine months ended September 30, 2013				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$172	$807	$173	$71	$1,223
Net change to other expense	27	59	51	15	152
Balance, end of period	$199	$866	$224	$86	$1,375

	Nine months ended September 30, 2012				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$59	$633	$185	$63	$940
Net change to other expense	66	1,764	(21)	8	1,817
Balance, end of period	$125	$2,397	$164	$71	$2,757

(in thousands)

	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Unfunded loan commitments:					
September 30, 2013	$222,879	$1,011,643	$322,612	$53,601	$1,610,735
September 30, 2012	$139,479	$900,875	$255,499	$55,312	$1,351,165

Non-covered loans sold

In the course of managing the loan portfolio, at certain times, management may decide to sell loans. The following table summarizes loans sold by loan portfolio during the three and nine months ended September 30, 2013 and 2012, respectively:

(In thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Commercial real estate				
Term & multifamily	$4,927	$6,410	$7,777	$11,350
Construction & development	—	—	3,515	—
Residential development	—	12	363	12
Commercial				
Term	1,098	—	47,635	—
LOC & other	—	1,110	—	1,942
Residential				
Mortgage	1,008	—	1,008	192
Home equity loans & lines	—	—	—	—
Consumer & other	—	—	—	—
Total	$7,033	$7,532	$60,298	$13,496

Asset Quality and Non-Performing Loans

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

Bank's Credit Quality Group is charged with monitoring asset quality, establishing credit policies and procedures and enforcing the consistent

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

A loan is considered impaired when, based on current information and events, we determine it is probable that we will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Generally, when non-covered loans are identified as impaired, they are moved to the Special Assets Division. When we identify a loan as impaired, we measure the loan for potential impairment using discounted cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral. In these cases, we will use the current fair value of collateral, less selling costs. The starting point for determining the fair value of collateral is through obtaining external appraisals. Generally, external appraisals are updated every 12 months. We obtain appraisals from a pre-approved list of independent, third party, local appraisal firms. Approval and addition to the list is based on experience, reputation, character, consistency and knowledge of the respective real estate market. At a minimum, it is ascertained that the appraiser is: (a) currently licensed in the state in which the property is located, (b) is experienced in the appraisal of properties similar to the property being appraised, (c) is actively engaged in the appraisal work, (d) has knowledge of current real estate market conditions and financing trends, (e) is reputable, and (f) is not on Freddie Mac’s or the Bank’s Exclusionary List of appraisers and brokers. In certain cases appraisals will be reviewed by our Real Estate Valuation Services Group to ensure the quality of the appraisal and the expertise and independence of the appraiser. Upon receipt and review, an external appraisal is utilized to measure a loan for potential impairment. Our impairment analysis documents the date of the appraisal used in the analysis, whether the officer preparing the report deems it current, and, if not, allows for internal valuation adjustments with justification. Typical justified adjustments might include discounts for continued market deterioration subsequent to appraisal date, adjustments for the release of collateral contemplated in the appraisal, or the value of other collateral or consideration not contemplated in the appraisal. An appraisal over one year old in most cases will be considered stale dated and an updated or new appraisal will be required. Any adjustments from appraised value to net realizable value are detailed and justified in the impairment analysis, which is reviewed and approved by senior credit quality officers and the Bank's ALLL Committee. Although an external appraisal is the primary source to value collateral dependent loans, we may also utilize values obtained through purchase and sale agreements, negotiated short sales, broker price opinions, or the sales price of the note. These alternative sources of value are used only if deemed to be more representative of value based on updated information regarding collateral resolution. Impairment analyses are updated, reviewed and approved on a quarterly basis at or near the end of each reporting period. Appraisals or other alternative sources of value received subsequent to the reporting period, but prior to our filing of periodic reports, are considered and evaluated to ensure our periodic filings are materially correct and not misleading. Based on these processes, we do not believe there are significant time lapses for the recognition of additional loan loss provisions or charge-offs from the date they become known.

Loans and leases are classified as non-accrual when collection of principal or interest is doubtful—generally if they are past due as to maturity or payment of principal or interest by 90 days or more—unless such loans are well-secured and in the process of collection. Additionally, all loans that are impaired are considered for non-accrual status. Loans placed on non-accrual will typically remain on non-accrual status until all principal and interest payments are brought current and the prospects for future payments in accordance with the loan agreement appear relatively certain.

Loans are reported as restructured when the Bank grants a concession(s) to a borrower experiencing financial difficulties that it would not otherwise consider. Examples of such concessions include a reduction in the loan rate, forgiveness of principal or accrued interest, extending the maturity date or providing a lower interest rate than would be normally available for a transaction of similar risk. As a result of these concessions, restructured loans are impaired as the Bank will not collect all amounts due, both principal and interest, in accordance with the terms of the original loan agreement. Impairment reserves on non-collateral dependent restructured loans are measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan's carrying value. These impairment reserves are recognized as a specific component to be provided for in the allowance for loan and lease losses.

Loans and leases are reported as past due when installment payments, interest payments, or maturity payments are past due based on contractual terms. All loans determined to be impaired are individually assessed for impairment except for impaired homogeneous loans which are collectively evaluated for impairment in accordance with FASB ASC 450, Contingencies ("ASC 450"). The specific factors considered in determining that a loan is impaired include borrower financial capacity, current economic, business and market conditions, collection efforts, collateral position and other factors deemed relevant. Generally, impaired loans are placed on non-accrual status and all cash receipts are applied to the principal balance. Continuation of accrual status and recognition of interest income is generally limited to performing restructured loans.

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The Bank has written down impaired, non-accrual loans as of September 30, 2013 to their estimated net realizable value, and expects resolution with no additional material loss, absent further decline in market prices.

Non-Covered Non-Accrual Loans and Loans Past Due

The following table summarizes our non-covered non-accrual loans and leases and loans and leases past due by loan and lease class as of September 30, 2013 and December 31, 2012:

(in thousands)

	September 30, 2013						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days and Accruing	Total Past Due	Nonaccrual	Current & Other (1)	Total Non-covered Loans and Leases
Commercial real estate							
Term & multifamily	$6,349	$3,389	$1,402	$11,140	$18,529	$3,976,314	$4,005,983
Construction & development	—	—	—	—	5,130	242,679	247,809
Residential development	768	605	—	1,373	2,871	74,754	78,998
Commercial							
Term	2,760	238	—	2,998	10,534	755,641	769,173
LOC & other	2,110	3,330	470	5,910	2,741	1,274,478	1,283,129
Residential							
Mortgage	562	898	2,690	4,150	—	546,050	550,200
Home equity loans & lines	492	453	346	1,291	—	254,911	256,202
Consumer & other	53	53	28	134	—	43,487	43,621
Total	$13,094	$8,966	$4,936	$26,996	$39,805	$7,168,314	$7,235,115
Deferred loan fees, net							(6,211)
Total							$7,228,904

(1) Other includes non-covered loans accounted for under ASC 310-30.

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(in thousands)

	December 31, 2012						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days and Accruing	Total Past Due	Nonaccrual	Current & Other (1)	Total Non-covered Loans and Leases
Commercial real estate							
Term & multifamily	$7,747	$2,784	$—	$10,531	$43,290	$3,884,622	$3,938,443
Construction & development	283	—	—	283	4,177	197,658	202,118
Residential development	479	—	—	479	5,132	51,598	57,209
Commercial							
Term	3,009	746	81	3,836	7,040	786,926	797,802
LOC & other	1,647	1,503	—	3,150	7,027	913,151	923,328
Residential							
Mortgage	2,906	602	3,303	6,811	—	469,768	476,579
Home equity loans & lines	1,398	214	758	2,370	49	258,378	260,797
Consumer & other	282	191	90	563	21	36,743	37,327
Total	$17,751	$6,040	$4,232	$28,023	$66,736	$6,598,844	$6,693,603
Deferred loan fees, net							(12,523)
Total							$6,681,080

(1) Other includes non-covered loans accounted for under ASC 310-30.

Non-Covered Impaired Loans

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The following table summarizes our non-covered impaired loans by loan class as of September 30, 2013 and December 31, 2012:

(in thousands)

	September 30, 2013		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
With no related allowance recorded:			
Commercial real estate			
Term & multifamily	$30,320	$27,685	$—
Construction & development	14,710	13,690	—
Residential development	10,876	6,046	—
Commercial			
Term	16,262	10,535	—
LOC & other	1,193	636	—
Residential			
Mortgage	—	—	—
Home equity loans & lines	159	—	—
Consumer & other	—	—	—
With an allowance recorded:			
Commercial real estate			
Term & multifamily	36,692	36,692	1,278
Construction & development	1,091	1,091	11
Residential development	12,178	12,178	105
Commercial			
Term	300	300	6
LOC & other	1,265	1,265	4
Residential			
Mortgage	—	—	—
Home equity loans & lines	—	—	—
Consumer & other	—	—	—
Total:			
Commercial real estate	105,867	97,382	1,394
Commercial	19,020	12,736	10
Residential	159	—	—
Consumer & other	—	—	—
Total	$125,046	$110,118	$1,404

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(in thousands)

	December 31, 2012		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
With no related allowance recorded:			
Commercial real estate			
Term & multifamily	$49,953	$43,406	$—
Construction & development	18,526	15,638	—
Residential development	9,293	6,091	—
Commercial			
Term	13,729	10,532	—
LOC & other	10,778	7,846	—
Residential			
Mortgage	—	—	—
Home equity loans & lines	50	49	—
Consumer & other	21	21	—
With an allowance recorded:			
Commercial real estate			
Term & multifamily	41,016	41,016	1,198
Construction & development	1,091	1,091	14
Residential development	16,593	16,593	184
Commercial			
Term	—	—	—
LOC & other	—	—	—
Residential			
Mortgage	—	—	—
Home equity loans & lines	126	126	5
Consumer & other	—	—	—
Total:			
Commercial real estate	136,472	123,835	1,396
Commercial	24,507	18,378	—
Residential	176	175	5
Consumer & other	21	21	—
Total	$161,176	$142,409	$1,401

Loans with no related allowance reported generally represent non-accrual loans. The Bank recognizes the charge-off of impairment reserves on impaired loans in the period it arises for collateral dependent loans. Therefore, the non-accrual loans as of September 30, 2013 have already been written-down to their estimated net realizable value, based on net realizable value, and are expected to be resolved with no additional material loss, absent further decline in market prices. The valuation allowance on impaired loans primarily represents the impairment reserves on performing restructured loans, and is measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan's carrying value.

At September 30, 2013 and December 31, 2012, impaired loans of $69.5 million and $70.6 million were classified as accruing restructured loans, respectively. The restructurings were granted in response to borrower financial difficulty, and generally provide for a temporary modification of loan repayment terms. The restructured loans on accrual status represent the only impaired loans accruing interest at each respective date. In order for a restructured loan to be considered for accrual status, the loan's collateral coverage generally will be greater than or equal to 100% of the loan balance, the loan is current on payments,

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and the borrower must either prefund an interest reserve or demonstrate the ability to make payments from a verified source of cash flow. The Bank had no obligation to lend additional funds on the restructured loans as of September 30, 2013.

The following table summarizes our average recorded investment and interest income recognized on impaired non-covered loans by loan class for the three and nine months ended September 30, 2013 and 2012:

(in thousands)

	Three months ended September 30, 2013		Three months ended September 30, 2012	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial real estate				
Term & multifamily	$35,289	$—	$45,832	$—
Construction & development	11,155	—	16,990	—
Residential development	5,576	—	14,748	—
Commercial				
Term	11,297	—	12,037	—
LOC & other	1,000	—	6,731	—
Residential				
Mortgage	—	—	—	—
Home equity loans & lines	—	—	729	—
Consumer & other	—	—	—	—
With an allowance recorded:				
Commercial real estate				
Term & multifamily	36,261	438	28,918	352
Construction & development	2,452	122	2,712	169
Residential development	13,866	165	15,575	199
Commercial				
Term	325	4	182	44
LOC & other	1,268	13	—	—
Residential				
Mortgage	238	—	—	—
Home equity loans & lines	—	—	127	2
Consumer & other	—	—	—	—
Total:				
Commercial real estate	104,599	725	124,775	720
Commercial	13,890	17	18,950	44
Residential	238	—	856	2
Consumer & other	—	—	—	—
Total	$118,727	$742	$144,581	$766

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	Nine months ended September 30, 2013		Nine months ended September 30, 2012	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial real estate				
Term & multifamily	$37,484	$—	$45,462	$—
Construction & development	12,902	—	18,464	—
Residential development	8,046	—	17,874	—
Commercial				
Term	11,546	—	12,325	—
LOC & other	3,239	—	7,975	—
Residential				
Mortgage	—	—	—	—
Home equity loans & lines	88	—	364	—
Consumer & other	1	—	—	—
With an allowance recorded:				
Commercial real estate				
Term & multifamily	36,995	1,301	25,916	785
Construction & development	2,099	363	2,727	513
Residential development	15,467	474	18,873	600
Commercial				
Term	1,142	13	554	140
LOC & other	1,150	39	994	—
Residential				
Mortgage	191	—	—	—
Home equity loans & lines	32	—	128	5
Consumer & other	—	—	—	—
Total:				
Commercial real estate	112,993	2,138	129,316	1,898
Commercial	17,077	52	21,848	140
Residential	311	—	492	5
Consumer & other	1	—	—	—
Total	$130,382	$2,190	$151,656	$2,043

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

Non-Covered Credit Quality Indicators

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

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

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

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

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

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

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

- Borrower may be experiencing declining operating trends, strained cash flows or less-than anticipated performance. Cash flow should still be adequate to cover debt service, and the negative trends should be identified as being of a short-term or temporary nature.
- The borrower may have experienced a minor, unexpected covenant violation.
- Companies who may be experiencing tight working capital or have a cash cushion deficiency.
- A loan or lease may also be a watch if financial information is late, there is a documentation deficiency, the borrower has experienced unexpected management turnover, or if they face industry issues that, when combined with performance factors create uncertainty in their future ability to perform.
- Delinquent payments, increasing and material overdraft activity, request for bulge and/or out-of-formula advances may be an indicator of inadequate working capital and may suggest a lower rating.
- Failure of the intended repayment source to materialize as expected, or renewal of a loan (other than cash/marketable security secured or lines of credit) without reduction are possible indicators of a watch or worse risk rating.

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

- Performance is poor or significantly less than expected. There may be a temporary debt-servicing deficiency or inadequate working capital as evidenced by a cash cushion deficiency, but not to the extent that repayment is compromised. Material violation of financial covenants is common.
-

Loans or leases with unresolved material issues that significantly cloud the debt service outlook, even though a debt servicing deficiency does not currently exist.

- Modest underperformance or deviation from plan for real estate loans where absorption of rental/sales units is necessary to properly service the debt as structured. Depth of support for interest carry provided by owner/guarantors may mitigate and provide for improved rating.
- This rating may be assigned when a loan officer is unable to supervise the credit properly, an inadequate loan agreement, an inability to control collateral, failure to obtain proper documentation, or any other deviation from prudent lending practices.
- Unlike a substandard credit, there should be a reasonable expectation that these temporary issues will be corrected within the normal course of business, rather than liquidation of assets, and in a reasonable period of time.

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Substandard—A substandard asset, risk rated 8, is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified substandard. Loans and leases are classified as substandard when they have unsatisfactory characteristics causing unacceptable levels of risk. A substandard loan or lease normally has one or more well-defined weaknesses that could jeopardize repayment of the debt. The likely need to liquidate assets to correct the problem, rather than repayment from successful operations is the key distinction between special mention and substandard. The following are examples of well-defined weaknesses:

• Cash flow deficiencies or trends are of a magnitude to jeopardize current and future payments with no immediate relief. A loss is not presently expected, however the outlook is sufficiently uncertain to preclude ruling out the possibility.
• The borrower has been unable to adjust to prolonged and unfavorable industry or economic trends.
• Material underperformance or deviation from plan for real estate loans where absorption of rental/sales units is necessary to properly service the debt and risk is not mitigated by willingness and capacity of owner/guarantor to support interest payments.
• Management character or honesty has become suspect. This includes instances where the borrower has become uncooperative.
• Due to unprofitable or unsuccessful business operations, some form of restructuring of the business, including liquidation of assets, has become the primary source of loan repayment. Cash flow has deteriorated, or been diverted, to the point that sale of collateral is now the Bank's primary source of repayment (unless this was the original source of repayment). If the collateral is under the Bank's control and is cash or other liquid, highly marketable securities and properly margined, then a more appropriate rating might be special mention or watch.
• The borrower is bankrupt, or for any other reason, future repayment is dependent on court action.
• There is material, uncorrectable faulty documentation or materially suspect financial information.

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

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

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

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

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

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

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

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

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

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

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

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

The following table summarizes our internal risk rating by loan and lease class for the non-covered loan and lease portfolio as of September 30, 2013 and December 31, 2012:

(in thousands)

	September 30, 2013						
	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Impaired	Total
Commercial real estate							
Term & multifamily	$3,646,254	$147,094	$148,258	$—	$—	$64,377	$4,005,983
Construction & development	227,008	1,894	4,126	—	—	14,781	247,809
Residential development	54,480	2,896	3,398	—	—	18,224	78,998
Commercial							
Term	722,140	15,210	20,988	—	—	10,835	769,173
LOC & other	1,227,521	35,349	15,830	2,364	164	1,901	1,283,129
Residential							
Mortgage	546,048	1,466	570	—	2,116	—	550,200
Home equity loans & lines	254,912	945	15	—	330	—	256,202
Consumer & other	43,487	106	15	—	13	—	43,621
Total	$6,721,850	$204,960	$193,200	$2,364	$2,623	$110,118	$7,235,115
Deferred loan fees, net							(6,211)
Total							$7,228,904

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(in thousands)

	December 31, 2012						
	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Impaired	Total
Commercial real estate							
Term & multifamily	$3,515,753	$203,643	$134,625	$—	$—	$84,422	$3,938,443
Construction & development	166,660	12,666	6,063	—	—	16,729	202,118
Residential development	25,082	4,379	5,064	—	—	22,684	57,209
Commercial							
Term	718,122	22,255	46,893	—	—	10,532	797,802
LOC & other	880,385	19,521	15,576	—	—	7,846	923,328
Residential							
Mortgage	469,325	3,507	1,120	—	2,627	—	476,579
Home equity loans & lines	258,252	1,612	—	—	758	175	260,797
Consumer & other	36,797	419	57	—	33	21	37,327
Total	$6,070,376	$268,002	$209,398	$—	$3,418	$142,409	$6,693,603
Deferred loan fees, net							(12,523)
Total							$6,681,080

The percentage of non-covered impaired loans classified as watch, special mention, and substandard was 5.9%, 2.8%, and 91.3%, respectively, as of September 30, 2013. The percentage of non-covered impaired loans classified as watch, special mention, and substandard was 9.0%, 1.7%, and 89.3%, respectively, as of December 31, 2012.

Troubled Debt Restructurings

At September 30, 2013 and December 31, 2012, impaired loans of $69.5 million and $70.6 million were classified as accruing restructured loans, respectively. The restructurings were granted in response to borrower financial difficulty, and generally provide for a temporary modification of loan repayment terms. The restructured loans on accrual status represent the only impaired loans accruing interest. In order for a restructured loan to be considered for accrual status, the loan’s collateral coverage generally will be greater than or equal to 100% of the loan balance, the loan is current on payments, and the borrower must either prefund an interest reserve or demonstrate the ability to make payments from a verified source of cash flow. Impaired restructured loans carry a specific allowance and the allowance on impaired restructured loans is calculated consistently across the portfolios.

There were no available commitments for troubled debt restructurings outstanding as of September 30, 2013 and none as of December 31, 2012.

The following tables present troubled debt restructurings by accrual versus non-accrual status and by loan class as of September 30, 2013 and December 31, 2012:

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(in thousands)

	September 30, 2013		
	Accrual Status	Non-Accrual Status	Total Modifications
Commercial real estate			
Term & multifamily	$42,753	$2,907	$45,660
Construction & development	9,651	—	9,651
Residential development	15,353	2,498	17,851
Commercial			
Term	—	3,849	3,849
LOC & other	1,265	—	1,265
Residential			
Mortgage	475	—	475
Home equity loans & lines	—	—	—
Consumer & other	—	—	—
Total	$69,497	$9,254	$78,751

(in thousands)

	December 31, 2012		
	Accrual Status	Non-Accrual Status	Total Modifications
Commercial real estate			
Term & multifamily	$39,613	$16,605	$56,218
Construction & development	12,552	3,516	16,068
Residential development	17,141	4,921	22,062
Commercial			
Term	350	4,641	4,991
LOC & other	820	1,493	2,313
Residential			
Mortgage	—	—	—
Home equity loans & lines	126	—	126
Consumer & other	—	—	—
Total	$70,602	$31,176	$101,778

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

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

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

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

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

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

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

The following tables present newly non-covered restructured loans that occurred during the three and nine months ended September 30, 2013 and 2012, respectively:

(in thousands)

	Three months ended September 30, 2013					
	Rate Modifications	Term Modifications	Interest Only Modifications	Payment Modifications	Combination Modifications	Total Modifications
Commercial real estate						
Term & multifamily	$—	$—	$—	$—	$—	$—
Construction & development	—	—	—	—	—	—
Residential development	—	—	—	—	—	—
Commercial						
Term	—	—	—	—	3,588	3,588
LOC & other	—	—	—	—	—	—
Residential						
Mortgage	—	—	—	—	—	—
Home equity loans & lines	—	—	—	—	—	—
Consumer & other	—	—	—	—	—	—
Total	$—	$—	$—	$—	$3,588	$3,588

	Three months ended September 30, 2012					
	Rate Modifications	Term Modifications	Interest Only Modifications	Payment Modifications	Combination Modifications	Total Modifications
Commercial real estate						
Term & multifamily	$14,920	$—	$—	$—	$2,554	$17,474
Construction & development	—	—	—	—	—	—
Residential development	—	—	—	—	—	—
Commercial						
Term	—	—	—	820	—	820
LOC & other	—	—	—	—	—	—
Residential						
Mortgage	—	—	—	—	—	—
Home equity loans & lines	—	—	—	—	—	—
Consumer & other	—	—	—	—	—	—
Total	$14,920	$—	$—	$820	$2,554	$18,294

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(in thousands)

	Nine months ended September 30, 2013					
	Rate Modifications	Term Modifications	Interest Only Modifications	Payment Modifications	Combination Modifications	Total Modifications
Commercial real estate						
Term & multifamily	$—	$—	$4,291	$—	$—	$4,291
Construction & development	—	—	—	—	—	—
Residential development	—	—	—	—	—	—
Commercial						
Term	—	—	—	—	3,588	3,588
LOC & other	—	—	—	—	452	452
Residential						
Mortgage	—	—	—	—	478	478
Home equity loans & lines	—	—	—	—	—	—
Consumer & other	—	—	—	—	—	—
Total	$—	$—	$4,291	$—	$4,518	$8,809

	Nine months ended September 30, 2012					
	Rate Modifications	Term Modifications	Interest Only Modifications	Payment Modifications	Combination Modifications	Total Modifications
Commercial real estate						
Term & multifamily	$14,920	$—	$—	$—	$3,357	$18,277
Construction & development	—	—	—	—	—	—
Residential development	—	—	—	—	—	—
Commercial						
Term	—	—	—	820	—	820
LOC & other	—	—	—	—	—	—
Residential						
Mortgage	—	—	—	—	—	—
Home equity loans & lines	—	—	—	—	—	—
Consumer & other	—	—	—	—	—	—
Total	$14,920	$—	$—	$820	$3,357	$19,097

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

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The following tables represent financing receivables modified as troubled debt restructurings within the previous 12 months for which there was a payment default during the three and nine months ended September 30, 2013 and 2012, respectively:

(in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Commercial real estate				
Term & multifamily	$—	$—	$—	$217
Construction & development	—	—	—	—
Residential development	—	—	—	633
Commercial				
Term	—	—	—	—
LOC & other	—	—	—	26
Residential				
Mortgage	—	—	—	—
Home equity loans & lines	—	—	—	—
Consumer & other	—	—	—	—
Total	$—	$—	$—	$876

Note 6 – Covered Assets and Indemnification Asset

Covered Loans

Loans acquired in a FDIC-assisted acquisition that are subject to a loss-share agreement are referred to as “covered loans” and reported separately in our statements of financial condition. Covered loans are reported exclusive of the cash flow reimbursements expected from the FDIC.

Acquired loans are valued as of acquisition date in accordance with ASC 805. Loans purchased 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 FASB ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality (“ASC 310-30”). Because of the significant fair value discounts associated with the acquired portfolios, the concentration of real estate related loans (to finance or secured by real estate collateral) and the decline in real estate values in the regions serviced, and after considering the underwriting standards of the acquired originating bank, the Company elected to account for all acquired loans under ASC 310-30. Under ASC 805 and ASC 310-30, loans are to be recorded at fair value at acquisition date, factoring in credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for loan losses is not carried over or recorded as of the acquisition date. We have aggregated the acquired loans into various loan pools based on multiple layers of common risk characteristics for the purpose of determining their respective fair values as of their acquisition dates, and for applying the subsequent recognition and measurement provisions for income accretion and impairment testing.

The covered loans acquired are, and will continue to be, subject to the Company’s internal and external credit review and monitoring. To the extent there is experienced or projected credit deterioration on the acquired loan pools subsequent to amounts estimated at the previous remeasurement date, this deterioration will be measured, and a provision for credit losses will be charged to earnings. Additionally, provision for credit losses will be recorded on advances on covered loans subsequent to acquisition date in a manner consistent with the allowance for non-covered loan and lease losses. These provisions will be mostly offset by an increase to the FDIC indemnification asset through the life of the loss sharing agreement, which is recognized in non-interest income.

Covered Loans

The following table presents the major types of covered loans as of September 30, 2013 and December 31, 2012:

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(in thousands)

	September 30, 2013			
	Evergreen	Rainier	Nevada Security	Total
Commercial real estate				
Term & multifamily	$58,522	$168,193	$88,714	$315,429
Construction & development	3,770	—	4,161	7,931
Residential development	3,105	—	5,431	8,536
Commercial				
Term	5,826	1,074	9,923	16,823
LOC & other	3,433	5,937	2,148	11,518
Residential				
Mortgage	3,126	18,392	1,786	23,304
Home equity loans & lines	3,257	15,404	2,036	20,697
Consumer & other	1,023	3,710	30	4,763
Total	$82,062	$212,710	$114,229	$409,001
Allowance for covered loans				(11,918)
Total				$397,083

	December 31, 2012			
	Evergreen	Rainier	Nevada Security	Total
Commercial real estate				
Term & multifamily	$72,888	$199,685	$105,436	$378,009
Construction & development	4,941	637	6,133	11,711
Residential development	3,840	—	5,954	9,794
Commercial				
Term	9,961	2,230	11,333	23,524
LOC & other	4,984	7,081	2,932	14,997
Residential				
Mortgage	3,948	22,059	1,818	27,825
Home equity loans & lines	3,478	17,178	2,786	23,442
Consumer & other	1,855	4,143	53	6,051
Total	$105,895	$253,013	$136,445	$495,353
Allowance for covered loans				(18,275)
Total				$477,078

The outstanding contractual unpaid principal balance, excluding purchase accounting adjustments, at September 30, 2013 was $105.6 million, $247.3 million and $155.8 million, for Evergreen, Rainier, and Nevada Security, respectively, as compared to $137.7 million, $297.0 million and $198.4 million, for Evergreen, Rainier, and Nevada Security, respectively, at December 31, 2012.

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

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

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The following table presents the changes in the accretable yield for the three and nine months ended September 30, 2013 and 2012 for each respective acquired loan portfolio:

(in thousands)

	Three months ended September 30, 2013			
	Evergreen	Rainier	Nevada Security	Total
Balance, beginning of period	$27,162	$85,823	$41,818	$154,803
Accretion to interest income	(2,816)	(5,221)	(3,420)	(11,457)
Disposals	(1,148)	(2,205)	(373)	(3,726)
Reclassifications (to)/from nonaccretable difference	(325)	3,664	(643)	2,696
Balance, end of period	$22,873	$82,061	$37,382	$142,316

	Three months ended September 30, 2012			
	Evergreen	Rainier	Nevada Security	Total
Balance, beginning of period	$48,064	$123,501	$54,623	$226,188
Accretion to interest income	(6,139)	(8,361)	(5,316)	(19,816)
Disposals	(1,989)	(5,677)	(1,650)	(9,316)
Reclassifications from nonaccretable difference	3,261	3,336	3,094	9,691
Balance, end of period	$43,197	$112,799	$50,751	$206,747

(in thousands)

	Nine months ended September 30, 2013			
	Evergreen	Rainier	Nevada Security	Total
Balance, beginning of period	$34,567	$102,468	$46,353	$183,388
Accretion to interest income	(9,879)	(18,290)	(11,872)	(40,041)
Disposals	(2,510)	(5,529)	(3,140)	(11,179)
Reclassifications from nonaccretable difference	695	3,412	6,041	10,148
Balance, end of period	22,873	$82,061	$37,382	$142,316

	Nine months ended September 30, 2012			
	Evergreen	Rainier	Nevada Security	Total
Balance, beginning of period	$56,479	$120,333	$61,021	$237,833
Accretion to interest income	(14,918)	(23,216)	(14,924)	(53,058)
Disposals	(5,671)	(14,363)	(3,069)	(23,103)
Reclassifications from nonaccretable difference	7,307	30,045	7,723	45,075
Balance, end of period	$43,197	$112,799	$50,751	$206,747

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Allowance for Covered Loan Losses

The following table summarizes activity related to the allowance for covered loan losses by covered loan portfolio segment for the three and nine months ended September 30, 2013 and 2012, respectively:

(in thousands)

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

	Three months ended September 30, 2012				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$7,461	$4,547	$664	$305	$12,977
Charge-offs	(480)	(450)	(73)	(45)	(1,048)
Recoveries	371	215	68	22	676
Provision (recapture)	1,884	990	79	(26)	2,927
Balance, end of period	$9,236	$5,302	$738	$256	$15,532

(in thousands)

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

	Nine months ended September 30, 2012				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$8,939	$3,964	$991	$426	$14,320
Charge-offs	(2,570)	(1,257)	(510)	(578)	(4,915)
Recoveries	1,012	596	147	70	1,825
Provision	1,855	1,999	110	338	4,302
Balance, end of period	$9,236	$5,302	$738	$256	$15,532

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The following table presents the allowance and recorded investment in covered loans by portfolio segment as of September 30, 2013 and 2012:

(in thousands)

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

	September 30, 2012				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Allowance for covered loans:					
Loans acquired with deteriorated credit quality (1)	$8,662	$4,785	$694	$211	$14,352
Collectively evaluated for impairment (2)	574	517	44	45	1,180
Total	$9,236	$5,302	$738	$256	$15,532
Covered loans:					
Loans acquired with deteriorated credit quality (1)	$424,547	$28,141	$48,838	$3,699	$505,225
Collectively evaluated for impairment (2)	2,942	15,097	4,591	2,722	25,352
Total	$427,489	$43,238	$53,429	$6,421	$530,577

(1) In accordance with ASC 310-30, the valuation allowance is netted against the carrying value of the covered loan balance.

(2) The allowance on covered loan losses includes an allowance on covered loan advances on acquired loans subsequent to acquisition.

The valuation allowance on covered loans was reduced by recaptured provision of $2.4 million and $7.9 million for the three and nine months ended September 30, 2013, and $0.5 million and $3.7 million for the three and nine months ended September 30, 2012.

Covered Credit Quality Indicators

Covered loans are risk rated in a manner consistent with non-covered loans. As previously noted, the Bank's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. The 10 risk rating groupings are described fully in Note 5. The following table includes loans acquired with deteriorated credit quality accounted for under ASC 310-30, and advances made subsequent to acquisition on covered loans.

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The following table summarizes our internal risk rating grouping by covered loans, net as of September 30, 2013 and December 31, 2012:

(in thousands)

	September 30, 2013					
	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Total
Commercial real estate						
Term & multifamily	$201,171	$38,536	$70,787	$241	$—	$310,735
Construction & development	1,153	—	5,501	—	—	6,654
Residential development	504	599	5,764	603	—	7,470
Commercial						
Term	4,857	3,027	5,566	415	—	13,865
LOC & other	8,054	1,298	1,185	48	—	10,585
Residential						
Mortgage	23,161	—	—	—	—	23,161
Home equity loans & lines	19,921	—	116	—	—	20,037
Consumer & other	4,576	—	—	—	—	4,576
Total	$263,397	$43,460	$88,919	$1,307	$—	$397,083

	December 31, 2012					
	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Total
Construction & development						
Term & multifamily	$243,723	$47,880	$62,811	$14,925	$—	$369,339
Construction & development	1,792	195	4,315	3,386	—	9,688
Residential development	—	391	6,658	1,309	—	8,358
Commercial						
Term	9,020	3,401	4,986	2,021	—	19,428
LOC & other	11,498	354	1,080	1,181	—	14,113
Residential						
Mortgage	27,596	—	—	—	—	27,596
Home equity loans & lines	22,790	—	77	—	—	22,867
Consumer & other	5,689	—	—	—	—	5,689
Total	$322,108	$52,221	$79,927	$22,822	$—	$477,078

Covered Other Real Estate Owned

All other real estate owned (“OREO”) acquired in FDIC-assisted acquisitions that are subject to a FDIC loss-share agreement are referred to as “covered OREO” and reported separately in our statements of financial position. Covered OREO is reported exclusive of expected reimbursement cash flows from the FDIC. Foreclosed covered loan collateral is transferred into covered OREO at the collateral’s net realizable value, less selling costs.

Covered OREO was initially recorded at its estimated fair value on the acquisition date based on similar market comparable valuations less estimated selling costs. Subsequent to acquisition, loan collateral transferred to OREO is at its net realizable value. Any subsequent valuation adjustments due to declines in fair value will be charged to non-interest expense, and will be mostly offset by non-interest income representing the corresponding increase to the FDIC indemnification asset for the offsetting loss reimbursement amount. Any recoveries of previous valuation adjustments will be credited to non-interest expense with a corresponding charge to non-interest income for the portion of the recovery that is due to the FDIC.

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The following table summarizes the activity related to the covered OREO for the three and nine months ended September 30, 2013 and 2012:

(in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Balance, beginning of period	$3,484	$9,191	$10,374	$19,491
Additions to covered OREO	—	1,881	2,554	3,227
Dispositions of covered OREO	(480)	(2,192)	(9,245)	(10,492)
Valuation adjustments in the period	(24)	(769)	(703)	(4,115)
Balance, end of period	$2,980	$8,111	$2,980	$8,111

FDIC Indemnification Asset

The Company has elected to account for amounts receivable under the loss-share agreement as an indemnification asset in accordance with FASB ASC 805, Business Combinations. The FDIC indemnification asset is initially recorded at fair value, based on the discounted value of expected future cash flows under the loss-share agreement. The difference between the present value and the undiscounted cash flows the Company expects to collect from the FDIC will be accreted into non-interest income over the life of the FDIC indemnification asset.

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

The following table summarizes the activity related to the FDIC indemnification asset for each respective acquired portfolio for the three and nine months ended September 30, 2013 and 2012:

(in thousands)

	Three months ended September 30, 2013			
	Evergreen	Rainier	Nevada Security	Total
Balance, beginning of period	$11,648	$10,467	$14,148	$36,263
Change in FDIC indemnification asset	(3,661)	(707)	(2,106)	(6,474)
Transfers to due from FDIC and other	(227)	(37)	(98)	(362)
Balance, end of period	$7,760	$9,723	$11,944	$29,427

	Three months ended September 30, 2012			
	Evergreen	Rainier	Nevada Security	Total
Balance, beginning of period	$22,301	$20,571	$25,933	$68,805
Change in FDIC indemnification asset	(1,731)	(2,887)	(141)	(4,759)
Transfers to due from FDIC and other	(1,215)	(944)	(1,381)	(3,540)
Balance, end of period	$19,355	$16,740	$24,411	$60,506

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(in thousands)

	Nine months ended September 30, 2013			
	Evergreen	Rainier	Nevada Security	Total
Balance, beginning of period	$14,876	$15,110	$22,812	$52,798
Change in FDIC indemnification asset	(6,359)	(4,479)	(9,003)	(19,841)
Transfers to due from FDIC and other	(757)	(908)	(1,865)	(3,530)
Balance, end of period	$7,760	$9,723	$11,944	$29,427

	Nine months ended September 30, 2012			
	Evergreen	Rainier	Nevada Security	Total
Balance, beginning of period	$28,547	$28,272	$34,270	$91,089
Change in FDIC indemnification asset	(5,830)	(5,803)	989	(10,644)
Transfers to due from FDIC and other	(3,362)	(5,729)	(10,848)	(19,939)
Balance, end of period	$19,355	$16,740	$24,411	$60,506

Note 7 – Mortgage Servicing Rights

The following table presents the changes in the Company's mortgage servicing rights ("MSR") for the three and nine months ended September 30, 2013 and 2012:

(in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Balance, beginning of period	$38,192	$22,513	$27,428	$18,184
Additions for new mortgage servicing rights capitalized	4,072	5,642	15,182	11,923
Changes in fair value:				
Due to changes in model inputs or assumptions(1)	3,406	(2,770)	3,739	(3,833)
Other(2)	(3,817)	(896)	(4,496)	(1,785)
Balance, end of period	$41,853	$24,489	$41,853	$24,489

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

Information related to our serviced loan portfolio as of September 30, 2013 and December 31, 2012 is as follows:

(dollars in thousands)

	September 30, 2013	December 31, 2012
Balance of loans serviced for others	$4,195,759	$3,162,080
MSR as a percentage of serviced loans	1.00%	0.87%

The amount of contractually specified servicing fees, late fees and ancillary fees earned, recorded in mortgage banking revenue on the Condensed Consolidated Statements of Income, was $2.7 million and $7.5 million for the three and nine months ended September 30, 2013, as compared to $1.7 million and $4.6 million for the three and nine months ended September 30, 2012.

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Key assumptions used in measuring the fair value of MSR as of September 30, 2013 and December 31, 2012 are as follows:

	September 30, 2013	December 31, 2012
Constant prepayment rate	16.04 %	21.39 %
Discount rate	8.69 %	8.65 %
Weighted average life (years)	4.9	4.7

A sensitivity analysis of the current fair value to changes in discount and prepayment speed assumptions as of September 30, 2013 and December 31, 2012 is as follows:

	September 30, 2013	December 31, 2012
Constant prepayment rate		
Effect on fair value of a 10% adverse change	$(2,232)	$(1,445)
Effect on fair value of a 20% adverse change	$(4,268)	$(2,754)
Discount rate		
Effect on fair value of a 100 basis point adverse change	$(1,561)	$(889)
Effect on fair value of a 200 basis point adverse change	$(3,017)	$(1,720)

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

Note 8 – Non-covered Other Real Estate Owned, Net

The following table presents the changes in non-covered other real estate owned ("OREO") for the three and nine months ended September 30, 2013 and 2012:

(in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Balance, beginning of period	$13,235	$26,884	$17,138	$34,175
Additions to OREO	7,715	1,174	14,747	10,167
Dispositions of OREO	(2,690)	(7,750)	(13,188)	(19,315)
Valuation adjustments in the period	(11)	(1,044)	(448)	(5,763)
Balance, end of period	$18,249	$19,264	$18,249	$19,264

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Note 9 – Junior Subordinated Debentures

Following is information about the Company’s wholly-owned trusts (“Trusts”) as of September 30, 2013:

(dollars in thousands)

Trust Name	Issue Date	Issued Amount	Carrying Value (1)	Rate (2)	Effective Rate (3)	Maturity Date	Redemption Date
AT FAIR VALUE:							
Umpqua Statutory Trust II	October 2002	$20,619	$14,713	Floating (4)	5.07%	October 2032	October 2007
Umpqua Statutory Trust III	October 2002	30,928	22,276	Floating (5)	5.16%	November 2032	November 2007
Umpqua Statutory Trust IV	December 2003	10,310	6,935	Floating (6)	4.64%	January 2034	January 2009
Umpqua Statutory Trust V	December 2003	10,310	6,915	Floating (6)	4.63%	March 2034	March 2009
Umpqua Master Trust I	August 2007	41,238	22,496	Floating (7)	2.94%	September 2037	September 2012
Umpqua Master Trust IB	September 2007	20,619	13,383	Floating (8)	4.63%	December 2037	December 2012
		134,024	86,718				
AT AMORTIZED COST:							
HB Capital Trust I	March 2000	5,310	6,231	10.875%	8.37%	March 2030	March 2010
Humboldt Bancorp Statutory Trust I	February 2001	5,155	5,829	10.200%	8.35%	February 2031	February 2011
Humboldt Bancorp Statutory Trust II	December 2001	10,310	11,284	Floating (9)	3.04%	December 2031	December 2006
Humboldt Bancorp Statutory Trust III	September 2003	27,836	30,377	Floating (10)	2.51%	September 2033	September 2008
CIB Capital Trust	November 2002	10,310	11,142	Floating (5)	3.04%	November 2032	November 2007
Western Sierra Statutory Trust I	July 2001	6,186	6,186	Floating (11)	3.85%	July 2031	July 2006
Western Sierra Statutory Trust II	December 2001	10,310	10,310	Floating (9)	3.85%	December 2031	December 2006
Western Sierra Statutory Trust III	September 2003	10,310	10,310	Floating (12)	3.17%	September 2033	September 2008
Western Sierra Statutory Trust IV	September 2003	10,310	10,310	Floating (12)	3.17%	September 2033	September 2008
		96,037	101,979				
	Total	$230,061	$188,697				

(1) Includes purchase accounting adjustments, net of accumulated amortization, for junior subordinated debentures assumed in connection with previous mergers as well as fair value adjustments related to trusts recorded at fair value.
(2) Contractual interest rate of junior subordinated debentures.
(3) Effective interest rate based upon the carrying value as of September 30, 2013.

(4) Rate based on LIBOR plus 3.35%, adjusted quarterly.
(5) Rate based on LIBOR plus 3.45%, adjusted quarterly.
(6) Rate based on LIBOR plus 2.85%, adjusted quarterly.
(7) Rate based on LIBOR plus 1.35%, adjusted quarterly.
(8) Rate based on LIBOR plus 2.75%, adjusted quarterly.
(9) Rate based on LIBOR plus 3.60%, adjusted quarterly.
(10) Rate based on LIBOR plus 2.95%, adjusted quarterly.
(11) Rate based on LIBOR plus 3.58%, adjusted quarterly.
(12) Rate based on LIBOR plus 2.90%, adjusted quarterly.

The Trusts are reflected as junior subordinated debentures in the Condensed Consolidated Balance Sheets. The common stock issued by the Trusts is recorded in other assets in the Condensed Consolidated Balance Sheets, and totaled $6.9 million at September 30, 2013 and $7.2 million at December 31, 2012.

On January 1, 2007, the Company selected the fair value measurement option for certain pre-existing junior subordinated debentures (the Umpqua Statutory Trusts). The remaining junior subordinated debentures as of the adoption date were acquired through business combinations and were measured at fair value at the time of acquisition. In 2007, the Company issued two series of trust preferred securities and elected to measure each instrument at fair value. Accounting for the junior subordinated debentures originally issued by the Company at fair value enables us to more closely align our financial performance with the economic value of those liabilities. Additionally, we believe it improves our ability to manage the market and interest rate risks associated with the junior subordinated debentures. The junior subordinated debentures measured at fair value and amortized cost are presented as separate line items on the balance sheet. The ending carrying (fair) value of the junior subordinated debentures measured at fair value represents the estimated amount that would be paid to transfer these liabilities in an orderly transaction amongst market participants under current market conditions as of the measurement date.

The significant inputs utilized in the estimation of fair value of these instruments are the credit risk adjusted spread and three month LIBOR. The credit risk adjusted spread represents the nonperformance risk of the liability, contemplating the inherent risk of the obligation. Generally, an increase in the credit risk adjusted spread and/or a decrease in the three month LIBOR will result in positive fair value adjustments. Conversely, a decrease in the credit risk adjusted spread and/or an increase in the three month LIBOR will result in negative fair value adjustments.

Through the first quarter of 2010 we obtained valuations from a third-party pricing service to assist with the estimation and determination of fair value of these liabilities. In these valuations, the credit risk adjusted interest spread for potential new issuances through the primary market and implied spreads of these instruments when traded as assets on the secondary market, were estimated to be significantly higher than the contractual spread of our junior subordinated debentures measured at fair value. The difference between these spreads has resulted in the cumulative gain in fair value, reducing the carrying value of these instruments as reported on our Consolidated Balance Sheets. In July 2010, the Dodd-Frank Wall Street Reform and consumer Protection Act (the "Dodd-Frank Act") was signed into law which, among other things, limits the ability of certain bank holding companies to treat trust preferred security debt issuances as Tier 1 capital. This law may require many banks to raise new Tier 1 capital and has effectively closed the trust-preferred securities markets from offering new issuances in the future. As a result of this legislation, our third-party pricing service noted that they were no longer able to provide reliable fair value estimates related to these liabilities given the absence of observable or comparable transactions in the market place in recent history or as anticipated into the future.

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

The Company’s specific credit risk is implicit in the credit risk adjusted spread used to determine the fair value of our junior subordinated debentures. As our Company is not specifically rated by any credit agency, it is difficult to specifically attribute changes in our estimate of the applicable credit risk adjusted spread to specific changes in our own creditworthiness versus changes in the market’s required return from similar companies. As a result, these considerations must be largely based off of qualitative considerations as we do not have a credit rating and we do not regularly issue senior or subordinated debt that would provide us an independent measure of the changes in how the market quantifies our perceived default risk.

On a quarterly basis we assess entity-specific qualitative considerations that if not mitigated or represents a material change from the prior reporting period may result in a change to the perceived creditworthiness and ultimately the estimated credit risk adjusted spread utilized to value these liabilities. Entity-specific considerations that positively impact our creditworthiness include: our strong capital position resulting from our successful public stock offerings in 2009 and 2010 that offers us flexibility to pursue business opportunities such as mergers and acquisitions, or expand our footprint and product offerings; having significant levels of on and off-balance sheet liquidity; being profitable (after excluding the one-time goodwill impairment charge recognized in 2009); and, having an experienced management team. However, these positive considerations are mitigated by significant risks and uncertainties that impact our creditworthiness and ability to maintain capital adequacy in the future. Specific risks and concerns include: given our concentration of loans secured by real estate in our loan portfolio, a continued and sustained deterioration of the real estate market may result in declines in the value of the underlying collateral and increased delinquencies that could result in an increase of charge-offs; despite recent improvement, our credit quality metrics remain negatively elevated since 2007 relative to historical standards; the continuation of current economic downturn that has been particularly severe in our primary markets could adversely affect our business; recent increased regulation facing our industry, such as the Emergency Economic Stabilization Act of 2008, the American Recovery and Reinvestment Act of 2009 and the Dodd-Frank Act, will increase the cost of compliance and restrict our ability to conduct business consistent with

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historical practices, require that we hold additional capital and could negatively impact profitability; we have a significant amount of goodwill and other intangible assets that dilute our available tangible common equity; and the carrying value of certain material, recently recorded assets on our balance sheet, such as the FDIC loss-sharing indemnification asset, are highly reliant on management estimates, such as the timing or amount of losses that are estimated to be covered, and the assumed continued compliance with the provisions of the applicable loss-share agreement. To the extent assumptions ultimately prove incorrect or should we consciously forego or unknowingly violate the guidelines of the agreement, an impairment of the asset may result which would reduce capital.

Additionally, the Company periodically utilizes an external valuation firm to determine or validate the reasonableness of the assessments of inputs and factors that ultimately determines the estimated fair value of these liabilities. The extent we involve or engage these external third parties correlates to management’s assessment of the current subordinated debt market, how the current environment and market compares to the preceding quarter, and perceived changes in the Company’s own creditworthiness during the quarter. In periods of potential significant valuation changes and at year-end reporting periods we typically engage third parties to perform a full independent valuation of these liabilities. For periods where management has assessed the market and other factors impacting the underlying valuation assumptions of these liabilities, and has determined significant changes to the valuation of these liabilities in the current period are remote, the scope of the valuation specialist’s review is limited to a review the reasonableness of management’s assessment of inputs. Based on the procedures and methodology as described above, the Company has determined that the underlying inputs and assumptions have not materially changed since that last third-party independent valuation prepared in the fourth quarter of 2012.

Absent changes to the significant inputs utilized in the discounted cash flow model used to measure the fair value of these instruments at each reporting period, the cumulative discount for each junior subordinated debenture will reverse over time, ultimately returning the carrying values of these instruments to their notional values at their expected redemption dates, in a manner similar to the effective yield method as if these instruments were accounted for under the amortized cost method. This will result in recognizing losses on junior subordinated debentures carried at fair value on a quarterly basis within non-interest income. For the three and nine months ended September 30, 2013, we recorded a loss of $554,000 and $1.6 million and for the three and nine months ended September 30, 2012, we recorded a loss of $554,000 and $1.6 million resulting from the change in fair value of the junior subordinated debentures recorded at fair value. Observable activity in the junior subordinated debenture and related markets in future periods may change the effective rate used to discount these liabilities, and could result in additional fair value adjustments (gains or losses on junior subordinated debentures measured at fair value) outside the expected periodic change in fair value had the fair value assumptions remained unchanged.

On July 2, 2013, the federal banking regulators approved the final proposed rules that revise the regulatory capital rules to incorporate certain revisions by the Basel Committee on Banking Supervision to the Basel capital framework ("Basel III"). Under the final rule, consistent with Section 171 of the Dodd-Frank Act, bank holding companies with less than $15 billion assets as of December 31, 2009 will be grandfathered and may continue to include these instruments in Tier 1 capital, subject to certain restrictions. However, if an institution grows above $15 billion as a result of an acquisition (as would result from the proposed merger with Sterling), or organically grows above $15 billion and then makes an acquisition, the combined trust preferred issuances would be phased out of Tier 1 and into Tier 2 capital (75% in 2015 and 100% in 2016 and later). As the Company had less than $15 billion in assets at December 31, 2009, the Company will be able to continue to include its existing trust preferred securities, less the common stock of the Trusts, in the Company's Tier 1 capital. If the Company exceeds $15 billion in consolidated assets other than in an organic manner and these instruments no longer qualify as Tier 1 capital, it is possible the Company may accelerate redemption of the existing junior subordinated debentures. This could result in adjustments to the fair value of these instruments including the acceleration of losses on junior subordinated debentures carried at fair value within non-interest income. The Company currently does not intend to redeem the junior subordinated debentures following the proposed merger in order to support regulatory total capital levels. At September 30, 2013, the Company's restricted core capital elements were 18.8% of total core capital, net of goodwill and any associated deferred tax liability.

Note 10 – Commitments and Contingencies

Lease Commitments — The Bank leases 159 sites under non-cancelable operating leases. The leases contain various provisions for increases in rental rates, based either on changes in the published Consumer Price Index or a predetermined escalation schedule. Substantially all of the leases provide the Company with the option to extend the lease term one or more times following expiration of the initial term.

Rent expense for the three and nine months ended September 30, 2013 was $4.9 million and $14.2 million and for the three and nine months ended September 30, 2012 was $4.2 million and $12.8 million. Rent expense was offset by rent income for the three and nine months ended September 30, 2013 of $148,000 and $596,000 and for the three and nine months ended September 30, 2012 of $248,000 and $856,000.

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

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

(in thousands)	As of September 30, 2013
Commitments to extend credit	$1,614,682
Commitments to extend overdrafts	$202,021
Forward sales commitments	$184,576
Commitments to originate loans held for sale	$112,421
Standby letters of credit	$49,428

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

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

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

Standby letters of credit and financial guarantees written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements, including international trade finance, commercial paper, bond financing and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds cash, marketable securities, or real estate as collateral supporting those commitments for which collateral is deemed necessary. The Bank was not required to perform on any financial guarantees and had $116,000 in recoveries in the three and nine months ended September 30, 2013 and incurred none and $78,000 in losses in connection with standby letters of credit during the three and nine months ended September 30, 2013. The Bank was not required to perform on any financial guarantees and incurred no losses in connection with standby letters of credit during the three and nine months ended September 30, 2012. At September 30, 2013, approximately $31.1 million of standby letters of credit expire within one year, and $18.3 million expire thereafter. Upon issuance, the Bank recognizes a liability equivalent to the amount of fees received from the customer for these standby letter of credit commitments. Fees are recognized ratably over the term of the standby letter of credit. The estimated fair value of guarantees associated with standby letters of credit was $206,000 as of September 30, 2013.

Mortgage loans sold to investors may be sold with servicing rights retained, for which the Bank makes only standard legal representations and warranties as to meeting certain underwriting and collateral documentation standards. In the past two years, the Bank has had to repurchase fewer than 20 loans due to deficiencies in underwriting or loan documentation and has not realized significant losses related to these repurchases. Management believes that any liabilities that may result from such recourse provisions are not significant.

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Legal Proceedings—The Bank owns 468,659 shares of Class B common stock of Visa Inc. which are convertible into Class A common stock at a conversion ratio of 0.4206 per Class A share. As of September 30, 2013, the value of the Class A shares was $191.10 per share. Utilizing the conversion ratio, the value of unredeemed Class A equivalent shares owned by the Bank was $37.7 million as of September 30, 2013, and has not been reflected in the accompanying financial statements. The shares of Visa Inc. Class B common stock are restricted and may not be transferred. Visa member banks are required to fund an escrow account to cover settlements, resolution of pending litigation and related claims. If the funds in the escrow account are insufficient to settle all the covered litigation, Visa Inc. may sell additional Class A shares and use the proceeds to settle litigation, thereby reducing the conversion ratio. If funds remain in the escrow account after all litigation is settled, the Class B conversion ratio will be increased to reflect that surplus.

On July 13, 2012, Visa Inc. announced that it had entered into a memorandum of understanding obligating it to enter into a settlement agreement to resolve the multi-district interchange litigation brought by the class plaintiffs in the matter styled In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation, Case No. 5-MD-1720 (JG) (JO) pending in the U.S. District Court for the Eastern District of New York. The claims originally were brought by a class of U.S. retailers in 2005. The proposed settlement is subject to court approval and Visa's share of the settlement to be paid is estimated to be approximately $4.4 billion. However, certain trade associations and merchants are actively opposing the proposed settlement and it is unknown when or if the proposed settlement will be approved. A fairness hearing was held on September 12, 2013 to determine if the settlement will be finally approved. It is not known when the Court will issue an order related to the motion for final approval of the settlement. The effect of this proposed settlement on the value of the Bank's Class B common stock is unknown at this time.

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

Concentrations of Credit Risk— The Bank grants real estate mortgage, real estate construction, commercial, agricultural and installment loans and leases to customers throughout Oregon, Washington, California, and Nevada. In management's judgment, a concentration exists in real estate-related loans, which represented approximately 75% and 79% of the Bank's non-covered loan and lease portfolio at September 30, 2013 and December 31, 2012. Commercial real estate concentrations are managed to assure wide geographic and business diversity. Although management believes such concentrations have no more than the normal risk of collectability, a substantial decline in the economy in general, material increases in interest rates, changes in tax policies, tightening credit or refinancing markets, or a decline in real estate values in the Bank's primary market areas in particular, could have an adverse impact on the repayment of these loans. Personal and business incomes, proceeds from the sale of real property, or proceeds from refinancing, represent the primary sources of repayment for a majority of these loans.

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

Note 11 – Derivatives

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

The Bank enters into forward delivery contracts to sell residential mortgage loans or mortgage-backed securities to broker/dealers at specific prices and dates in order to hedge the interest rate risk in its portfolio of mortgage loans held for sale and its residential mortgage loan commitments. Credit risk associated with forward contracts is limited to the replacement cost of those forward contracts in a gain position. There were no counterparty default losses on forward contracts in the three and nine months ended September 30, 2013 and 2012. Market risk with respect to forward contracts arises principally from changes in the value of contractual positions due to changes in interest rates. The Bank limits its exposure to market risk by monitoring differences between commitments to customers and forward contracts with broker/dealers. In the event the Company has forward delivery contract commitments in excess of available mortgage loans, the Company completes the transaction by either paying or receiving a fee to or from the broker/dealer equal to the increase or decrease in the market value of the forward

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contract. At September 30, 2013, the Bank had commitments to originate mortgage loans held for sale totaling $112.4 million and forward sales commitments of $184.6 million.

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

The Bank executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps are simultaneously hedged by offsetting the interest rate swaps that the Bank executes with a third party, such that the Bank minimizes its net risk exposure. As of September 30, 2013, the Bank had 239 interest rate swaps with an aggregate notional amount of $1.2 billion related to this program.

In connection with the interest rate swap program with commercial customers, the Bank has agreements with its derivative counterparties that contain a provision where if the Bank defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Bank could also be declared in default on its derivative obligations. The Bank also has agreements with its derivative counterparties that contain a provision where if the Bank fails to maintain its status as a well/adequately capitalized institution, then the counterparty could terminate the derivative positions and the Bank would be required to settle its obligations under the agreements. Similarly, the Bank could be required to settle its obligations under certain of its agreements if specific regulatory events occur, such as if the Bank were issued a prompt corrective action directive or a cease and desist order, or if certain regulatory ratios fall below specified levels. If the Bank had breached any of these provisions at September 30, 2013, it could have been required to settle its obligations under the agreements at the termination value.

As of September 30, 2013, the termination value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was $12.0 million. The Bank has collateral posting requirements for initial or variation margins with its clearing members and clearing houses and has been required to post collateral against its obligations under these agreements of $10.4 million as of September 30, 2013. The Bank also has minimum collateral posting thresholds with certain of its derivative counterparties, and has been required to post collateral against its obligations under these agreements of $3.3 million as of September 30, 2013.

The fair value of the interest rate swaps is determined using the market standard methodology of netting the discounted future fixed cash receipts (or payments) and the discounted expected variable cash payments (or receipts). The variable cash payments (or receipts) are based on the expectation of future interest rates (forward curves) derived from observed market interest rate curves. In addition, to comply with the provisions of ASC 820, the Bank incorporates credit valuation adjustments ("CVA") to appropriately reflect nonperformance risk in the fair value measurements of its derivatives. The CVA is calculated by determining the total expected exposure of the derivatives (which incorporates both the current and potential future exposure) and then applying the counterparties' credit spreads to the exposure. For derivatives with two-way exposure, specifically, the Bank's interest rate swaps, the counterparty's credit spread is applied to the Bank's exposure to the counterparty, and the Bank's own credit spread is applied to the counterparty's exposure to the Bank, and the net CVA is reflected in the Bank's derivative valuations. The total expected exposure of a derivative is derived using market-observable inputs, such as yield curves and volatilities. For the Bank's own credit spread and for counterparties having publicly available credit information, the credit spreads over LIBOR used in the calculations represent implied credit default swap spreads obtained from a third party credit data provider. For counterparties without publicly available credit information, which are primarily commercial banking customers, the credit spreads over LIBOR used in the calculations are estimated by the Bank based on current market conditions, including consideration of current borrowing spreads for similar customers and transactions, review of existing collateralization or other credit enhancements, and changes in credit sector and entity-specific credit information. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Bank has considered the impact of netting and any applicable credit enhancements. Effective January 1, 2012, the Company made an accounting policy election to use the exception commonly referred to as the "portfolio exception" with respect to measuring counterparty credit risk for its interest rate swap derivative instruments that are subject to master netting agreements with commercial banking customers that are hedged with offsetting interest rate swaps with third parties.

As of January 1, 2013, the Bank changed its valuation methodology for interest rate swap derivatives to discount cash flows based on Overnight Index Swap ("OIS") rates. Fully collateralized trades are discounted using OIS with no additional economic adjustments to arrive at fair value. Uncollateralized or partially-collateralized trades are also discounted at OIS, but include appropriate economic adjustments for funding costs (e.g., a LIBOR-OIS basis adjustment to approximate uncollateralized cost of funds) and credit risk. The Company is making the changes to better align its inputs, assumptions, and pricing methodologies with those used in its principal market by most dealers and major market participants. The changes in

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valuation methodology are applied prospectively as a change in accounting estimate and are immaterial to the Company's financial statements.

As of September 30, 2013, the net CVA increased the settlement values of the Bank’s net derivative assets by $1.2 million. During the three and nine months ended September 30, 2013, the Bank recognized a loss of $0.7 million and a gain of $1.1 million, and during the three and nine months ended September 30, 2012, the Bank recognized a loss of $235,000 and $352,000, respectively related to credit valuation adjustments on nonhedge derivative instruments, which is included in noninterest income. Various factors impact changes in the CVA over time, including changes in the credit spreads of the parties to the contracts, as well as changes in market rates and volatilities, which affect the total expected exposure of the derivative instruments.

The following tables summarize the types of derivatives, separately by assets and liabilities, their locations on the Condensed Consolidated Balance Sheets, and the fair values of such derivatives as of September 30, 2013 and December 31, 2012:

(in thousands)

		Asset Derivatives		Liability Derivatives	
Derivatives not designated	Balance Sheet	September 30,	December 31,	September 30,	December 31,
as hedging instrument	Location	2013	2012	2013	2012
Interest rate lock commitments	Other assets/Other liabilities	$3,008	$1,496	$—	$18
Interest rate forward sales commitments	Other assets/Other liabilities	—	133	3,784	905
Interest rate swaps	Other assets/Other liabilities	14,477	22,213	13,211	22,048
Total		$17,485	$23,842	$16,995	$22,971

The following table summarizes the types of derivatives, their locations within the Condensed Consolidated Statements of Income, and the gains (losses) recorded during the three and nine months ended September 30, 2013 and 2012:

(in thousands)

		Three months ended		Nine months ended	
Derivatives not designated	Income Statement	September 30,		September 30,	
as hedging instrument	Location	2013	2012	2013	2012
Interest rate lock commitments	Mortgage banking revenue	$2,370	$1,680	$1,530	$2,216
Interest rate forward sales commitments	Mortgage banking revenue	(3,239)	(11,695)	11,508	(21,504)
Interest rate swaps	Other income	(738)	(235)	1,101	(352)
Total		$(1,607)	$(10,250)	$14,139	$(19,640)

The following table summarizes the offsetting derivatives assets that have a right of offset as of September 30, 2013 and December 31, 2012:

(in thousands)

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	Gross Amounts of Recognized Assets/Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets/Liabilities presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		
				Financial Instruments	Collateral Posted	Net Amount
September 30, 2013						
Derivative Assets						
Interest rate swaps	$ 14,477	$—	$ 14,477	$(3,503)	$—	$10,974
Derivative Liabilities						
Interest rate swaps	$ 13,211	$—	$ 13,211	$(3,503)	$(9,708)	$—
December 31, 2012						
Derivative Assets						
Interest rate swaps	$ 22,213	$—	$ 22,213	$(16)	$—	$22,197
Derivative Liabilities						
Interest rate swaps	$ 22,048	$—	$ 22,048	$(16)	$(22,032)	$—

Note 12 – Shareholders' Equity

Stock-Based Compensation

The compensation cost related to stock options, restricted stock and restricted stock units (included in salaries and employee benefits) was $1.3 million and $3.5 million for the three and nine months ended September 30, 2013 as compared to $1.0 million and $3.0 million for the three and nine months ended September 30, 2012. The total income tax benefit recognized related to stock-based compensation was $524,000 and $1.4 million for the three and nine months ended September 30, 2013 as compared to $415,000 and $1.2 million for the three and nine months ended September 30, 2012.

The following table summarizes information about stock option activity for the nine months ended September 30, 2013:

(in thousands, except per share data)

	Nine months ended September 30, 2013			
	Options Outstanding	Weighted-Avg Exercise Price	Weighted-Avg Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Balance, beginning of period	1,850	$15.37		
Exercised	(209)	$12.02		
Forfeited/expired	(348)	$17.40		
Balance, end of period	1,293	$15.37	4.78	$3,873
Options exercisable, end of period	935	$16.89	3.91	$2,145

The total intrinsic value (which is the amount by which the stock price exceeded the exercise price on the date of exercise) of options exercised during the three and nine months ended September 30, 2013 was $630,000 and $767,000 as compared to three and nine months ended September 30, 2012 of $65,000 and $82,000. During the three and nine months ended September 30, 2013, the amount of cash received from the exercise of stock options was $1.7 million and $2.5 million as compared to the three and nine months ended September 30, 2012 of $246,000 and $324,000.

The fair value of each option grant is estimated as of the grant date using the Black-Scholes option-pricing model. There were no stock options granted in the three and nine months ended September 30, 2013 and 2012.

The Company grants restricted stock periodically for the benefit of employees and directors. Restricted shares issued prior to 2011 generally vest on an annual basis over five years. Restricted shares issued since 2011 generally vest over a three year period, subject to time or time plus performance vesting conditions. The following table summarizes information about nonvested restricted share activity for the nine months ended September 30, 2013:

(in thousands, except per share data)

	Nine months ended September 30, 2013	
	Restricted Shares Outstanding	Weighted Average Grant Date Fair Value
Balance, beginning of period	763	$12.39
Granted	465	$13.06
Released	(149)	$12.19
Forfeited/expired	(83)	$11.75
Balance, end of period	996	$12.79

The total fair value of restricted shares vested and released during the three and nine months ended September 30, 2013 was $108,000 and $1.9 million as compared to the three and nine months ended September 30, 2012 of $136,000 and $1.8 million.

The Company granted restricted stock units as a part of the 2007 Long Term Incentive Plan for the benefit of certain executive officers. Restricted stock unit grants are subject to performance-based vesting as well as other approved vesting conditions. The total number of restricted stock units granted represents the maximum number of restricted stock units eligible to vest based upon the performance and service conditions set forth in the grant agreements. There were no restricted stock units vested and released and there were none and 35,000 restricted stock units forfeited during the three and nine months ended September 30, 2013, and 95,000 restricted stock units with a weighted average grant date fair value of $10.41 remain outstanding at September 30, 2013.

As of September 30, 2013, there was $0.9 million of total unrecognized compensation cost related to nonvested stock options which is expected to be recognized over a weighted-average period of 1 year. As of September 30, 2013, there was $7.2 million of total unrecognized compensation cost related to nonvested restricted stock which is expected to be recognized over a weighted-average period of 1.7 years. As of September 30, 2013, there was $228,000 of total unrecognized compensation cost related to nonvested restricted stock units which is expected to be recognized over a weighted-average period of 0.5 years, assuming expected performance conditions are met.

For the three and nine months ended September 30, 2013, the Company received income tax benefits of $294,000 and $1.1 million, respectively, as compared to the three and nine months ended September 30, 2012 of $79,000 and $764,000 related to the exercise of non-qualified employee stock options, disqualifying dispositions on the exercise of incentive stock options, the vesting of restricted shares and the vesting of restricted stock units. In the nine months ended September 30, 2013, the Company had net tax deficiencies (tax deficiency resulting from tax deductions less than the compensation cost recognized) of $20,000, compared to $60,000 of net tax deficiencies (tax deficiency resulting from tax deductions less than the compensation cost recognized) for the nine months ended September 30, 2012. Only cash flows from gross excess tax benefits are classified as financing cash flows.

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

Note 13 – Income Taxes

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, as well as the Oregon and California state jurisdictions. Additionally, as a result of the FinPac acquisition, the Company will now be subject to filings in the majority of states and in Canada. The Company is no longer subject to U.S. federal or other state tax authority examinations for years before 2009, except in California for years before 2005 and for Canadian tax authority examinations for years before 2012. During 2010, the Internal Revenue Service concluded an examination of the Company's U.S. income tax returns through 2008. The results of these examinations had no significant impact on the Company's financial statements.

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The Company had gross unrecognized tax benefits relating to California tax incentives of $602,000 recorded as of September 30, 2013. If recognized, the unrecognized tax benefit would reduce the 2013 annual effective tax rate by 0.3%. During the nine months ended September 30, 2013, the Company recognized an expense of $18,000 in interest relating to its liability for unrecognized tax benefits. Interest expense is reported by the Company as a component of tax expense. As of September 30, 2013, the accrued interest related to unrecognized tax benefits is $187,000.

Note 14 – Earnings Per Common Share

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

Net earnings, less any preferred dividends accumulated for the period (whether or not declared), is allocated between the common stock and participating securities pursuant to the two-class method. Basic earnings per common share is computed by dividing net earnings available to common shareholders by the weighted average number of common shares outstanding during the period, excluding participating nonvested restricted shares.

Diluted earnings per common share is computed in a similar manner, except that first the denominator is increased to include the number of additional common shares that would have been outstanding if potentially dilutive common shares, excluding the participating securities, were issued using the treasury stock method. For all periods presented, stock options, certain restricted stock awards and restricted stock units are the only potentially dilutive non-participating instruments issued by the Company. Next, we determine and include in diluted earnings per common share calculation the more dilutive effect of the participating securities using the treasury stock method or the two-class method. Undistributed losses are not allocated to the nonvested share-based payment awards (the participating securities) under the two-class method as the holders are not contractually obligated to share in the losses of the Company.

The following is a computation of basic and diluted earnings per common share for the three and nine months ended September 30, 2013 and 2012:

(in thousands, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
NUMERATORS:				
Net income	$23,477	$25,153	$73,091	$73,933
Less:				
Dividends and undistributed earnings allocated to participating securities (1)	196	170	576	499
Net earnings available to common shareholders	$23,281	$24,983	$72,515	$73,434
DENOMINATORS:				
Weighted average number of common shares outstanding - basic	111,912	111,899	111,934	111,928
Effect of potentially dilutive common shares (2)	283	252	220	231
Weighted average number of common shares outstanding - diluted	112,195	112,151	112,154	112,159
EARNINGS PER COMMON SHARE:				

Basic	$0.21	$0.22	$0.65	$0.66
Diluted	$0.21	$0.22	$0.65	$0.65

(1) Represents dividends paid and undistributed earnings allocated to nonvested restricted stock awards.
(2) Represents the effect of the assumed exercise of stock options, vesting of non-participating restricted shares, and vesting of restricted stock units, based on the treasury stock method.

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The following table presents the weighted average outstanding securities that were not included in the computation of diluted earnings per common share because their effect would be anti-dilutive for the three and nine months ended September 30, 2013 and 2012.

(in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Stock options	363	1,141	738	1,313

Note 15 – Segment Information

The Company operates three primary segments: Community Banking, Home Lending and Wealth Management. The Community Banking segment's principal business focus is the offering of loan and deposit products to business and retail customers in its primary market areas. As of September 30, 2013, the Community Banking segment operated 206 locations throughout Oregon, California, Washington, and Nevada.

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

The Wealth Management segment consists of the operations of Umpqua Investments, which offers a full range of retail brokerage services and products to its clients who consist primarily of individual investors, and Umpqua Private Bank, which serves high net worth individuals with liquid investable assets and provides customized financial solutions and offerings. The Company accounts for intercompany fees and services between Umpqua Investments and the Bank at estimated fair value according to regulatory requirements for services provided. Intercompany items relate primarily to management services, referral fees and deposit rebates.

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

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Segment Information

(in thousands)

	Three months ended September 30, 2013			
	Community Banking	Wealth Management	Home Lending	Consolidated
Interest income	$106,848	$3,746	$5,366	$115,960
Interest expense	8,359	178	614	9,151
Net interest income	98,489	3,568	4,752	106,809
Provision for non-covered loan and lease losses	3,008	—	—	3,008
(Recapture of) provision for covered loan losses	(1,904)	—	—	(1,904)
Non-interest income	6,970	4,070	15,104	26,144
Non-interest expense	81,561	4,298	9,745	95,604
Income before income taxes	22,794	3,340	10,111	36,245
Provision for income taxes	7,395	1,329	4,044	12,768
Net income	15,399	2,011	6,067	23,477
Dividends and undistributed earnings allocated to participating securities	196	—	—	196
Net earnings available to common shareholders	$15,203	$2,011	$6,067	$23,281

	Nine months ended September 30, 2013			
	Community Banking	Wealth Management	Home Lending	Consolidated
Interest income	$296,943	$10,957	$16,408	$324,308
Interest expense	26,920	551	1,946	29,417
Net interest income	270,023	10,406	14,462	294,891
Provision for non-covered loan and lease losses	12,989	—	—	12,989
(Recapture of) provision for covered loan losses	(4,744)	—	—	(4,744)
Non-interest income	19,608	11,803	63,245	94,656
Non-interest expense	225,880	12,531	30,886	269,297
Income before income taxes	55,506	9,678	46,821	112,005
Provision for income taxes	16,323	3,863	18,728	38,914
Net income	39,183	5,815	28,093	73,091
Dividends and undistributed earnings allocated to participating securities	576	—	—	576
Net earnings available to common shareholders	$38,607	$5,815	$28,093	$72,515

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(in thousands)

	Three months ended September 30, 2012			
	Community Banking	Wealth Management	Home Lending	Consolidated
Interest income	$105,352	$3,235	$5,521	$114,108
Interest expense	11,137	197	734	12,068
Net interest income	94,215	3,038	4,787	102,040
Provision for non-covered loan and lease losses	7,078	—	—	7,078
Provision for covered loan losses	2,927	—	—	2,927
Non-interest income	5,805	3,370	24,504	33,679
Non-interest expense	72,947	3,743	10,284	86,974
Income before income taxes	17,068	2,665	19,007	38,740
Provision for income taxes	5,031	953	7,603	13,587
Net income	12,037	1,712	11,404	25,153
Dividends and undistributed earnings allocated to participating securities	170	—	—	170
Net earnings available to common shareholders	$11,867	$1,712	$11,404	$24,983

	Nine months ended September 30, 2012			
	Community Banking	Wealth Management	Home Lending	Consolidated
Interest income	$318,007	$10,704	$14,633	$343,344
Interest expense	35,245	694	1,998	37,937
Net interest income	282,762	10,010	12,635	305,407
Provision for non-covered loan and lease losses	16,883	—	—	16,883
Provision for covered loan losses	4,302	—	—	4,302
Non-interest income	26,178	10,220	53,444	89,842
Non-interest expense	223,939	11,423	26,244	261,606
Income before income taxes	63,816	8,807	39,835	112,458
Provision for income taxes	19,422	3,169	15,934	38,525
Net income	44,394	5,638	23,901	73,933
Dividends and undistributed earnings allocated to participating securities	499	—	—	499
Net earnings available to common shareholders	$43,895	$5,638	$23,901	$73,434

(in thousands)

	September 30, 2013			
	Community Banking	Wealth Management	Home Lending	Consolidated
Total assets	$10,799,306	$117,534	$652,457	$11,569,297
Total loans and leases (covered and non-covered)	$7,031,325	$101,934	$492,728	$7,625,987
Total deposits	$8,652,751	$363,010	$51,479	$9,067,240

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(in thousands)

	December 31, 2012			
	Community Banking	Wealth Management	Home Lending	Consolidated
Total assets	$10,984,996	$90,370	$720,077	$11,795,443
Total loans and leases (covered and non-covered)	$6,713,792	$74,132	$370,234	$7,158,158
Total deposits	$8,968,867	$382,033	$28,375	$9,379,275

Note 16 – Fair Value Measurement

The following table presents estimated fair values of the Company's financial instruments as of September 30, 2013 and December 31, 2012, whether or not recognized or recorded at fair value in the Condensed Consolidated Balance Sheets:

(in thousands)

	September 30, 2013		December 31, 2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
FINANCIAL ASSETS:				
Cash and cash equivalents	$697,091	$697,091	$543,787	$543,787
Trading securities	4,012	4,012	3,747	3,747
Securities available for sale	1,910,082	1,910,082	2,625,229	2,625,229
Securities held to maturity	5,766	6,030	4,541	4,732
Loans held for sale	113,993	113,993	320,132	320,132
Non-covered loans and leases, net	7,144,210	7,110,101	6,595,689	6,652,179
Covered loans, net	397,083	449,239	477,078	543,628
Restricted equity securities	31,444	31,444	33,443	33,443
Mortgage servicing rights	41,853	41,853	27,428	27,428
Bank owned life insurance assets	94,637	94,637	93,831	93,831
FDIC indemnification asset	29,427	6,980	52,798	18,714
Derivatives	17,485	17,485	23,842	23,842
Visa Class B common stock	—	35,786	—	28,385
FINANCIAL LIABILITIES:				
Deposits	$9,067,240	$9,077,231	$9,379,275	$9,396,646
Securities sold under agreements to repurchase	215,310	215,310	137,075	137,075
Term debt	252,017	279,183	253,605	289,404
Junior subordinated debentures, at fair value	86,718	86,718	85,081	85,081
Junior subordinated debentures, at amortized cost	101,979	71,553	110,985	78,529
Derivatives	16,995	16,995	22,971	22,971

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Fair Value of Assets and Liabilities Not Measured at Fair Value

The following table presents information about the level in the fair value hierarchy for the Company's assets and liabilities that are not measured at fair value as of September 30, 2013 and December 31, 2012:

(in thousands)

	September 30, 2013			
Description	Total	Level 1	Level 2	Level 3
ASSETS				
Cash and cash equivalents	$697,091	$697,091	$—	$—
Securities held to maturity	4,012	—	—	4,012
Non-covered loans and leases, net	7,110,101	—	—	7,110,101
Covered loans, net	449,239	—	—	449,239
Restricted equity securities	31,444	31,444	—	—
Bank owned life insurance assets	94,637	94,637	—	—
FDIC indemnification asset	6,980	—	—	6,980
Visa Class B common stock	35,786	—	—	35,786
LIABILITIES				
Deposits				
Non-maturity deposits	$7,434,771	$7,434,771	$—	$—
Deposits with stated maturities	1,642,460	—	1,642,460	—
Securities sold under agreements to repurchase	215,310	—	215,310	—
Term debt	279,183	—	279,183	—
Junior subordinated debentures, at amortized cost	71,553	—	—	71,553

(in thousands)

	December 31, 2012			
Description	Total	Level 1	Level 2	Level 3
ASSETS				
Cash and cash equivalents	$543,787	$543,787	$—	$—
Securities held to maturity	4,732	—	—	4,732
Non-covered loans and leases, net	6,652,179	—	—	6,652,179
Covered loans, net	543,628	—	—	543,628
Restricted equity securities	33,443	33,443	—	—
Bank owned life insurance assets	93,831	93,831	—	—
FDIC indemnification asset	18,714	—	—	18,714
Visa Class B common stock	28,385	—	—	28,385
LIABILITIES				
Deposits				
Non-maturity deposits	$7,376,288	$7,376,288	$—	$—
Deposits with stated maturities	2,020,358	—	2,020,358	—
Securities sold under agreements to repurchase	137,075	—	137,075	—
Term debt	289,404	—	289,404	—
Junior subordinated debentures, at amortized cost	78,529	—	—	78,529

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Fair Value of Assets and Liabilities Measured on a Recurring Basis

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring basis as of September 30, 2013 and December 31, 2012:

(in thousands)

	September 30, 2013			
Description	Total	Level 1	Level 2	Level 3
Trading securities				
Obligations of states and political subdivisions	$551	$—	$551	$—
Equity securities	3,364	3,364	—	—
Other investments securities(1)	97	—	97	—
Available for sale securities				
U.S. Treasury and agencies	278	—	278	—
Obligations of states and political subdivisions	240,531	—	240,531	—
Residential mortgage-backed securities and collateralized mortgage obligations	1,667,144	—	1,667,144	—
Other debt securities	134	—	134	—
Investments in mutual funds and other equity securities	1,995	—	1,995	—
Loans held for sale, at fair value	113,993		113,993	
Mortgage servicing rights, at fair value	41,853	—	—	41,853
Derivatives				
Interest rate lock commitments	3,008	—	—	3,008
Interest rate forward sales commitments	—	—	—	—
Interest rate swaps	14,477	—	14,477	—
Total assets measured at fair value	$2,087,425	$3,364	$2,039,200	$44,861
Junior subordinated debentures, at fair value	$86,718	$—	$—	$86,718
Derivatives				
Interest rate lock commitments	—	—	—	—
Interest rate forward sales commitments	3,784	—	3,784	—
Interest rate swaps	13,211	—	13,211	—
Total liabilities measured at fair value	$103,713	$—	$16,995	$86,718

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(in thousands)

	December 31, 2012			
Description	Total	Level 1	Level 2	Level 3
Trading securities				
Obligations of states and political subdivisions	$1,216	$—	$1,216	$—
Equity securities	2,408	2,408	—	—
Other investments securities(1)	123	—	123	—
Available for sale securities				
U.S. Treasury and agencies	45,820	—	45,820	—
Obligations of states and political subdivisions	263,725	—	263,725	—
Residential mortgage-backed securities and collateralized mortgage obligations	2,313,376	—	2,313,376	—
Other debt securities	222	—	222	—
Investments in mutual funds and other equity securities	2,086	—	2,086	—
Loans held for sale, at fair value	320,132		320,132	
Mortgage servicing rights, at fair value	27,428	—	—	27,428
Derivatives				
Interest rate lock commitments	1,496	—	—	1,496
Interest rate forward sales commitments	133	—	133	—
Interest rate swaps	22,213	—	22,213	—
Total assets measured at fair value	$3,000,378	$2,408	$2,969,046	$28,924
Junior subordinated debentures, at fair value	$85,081	$—	$—	$85,081
Derivatives				
Interest rate lock commitments	18	—	—	18
Interest rate forward sales commitments	905	—	905	—
Interest rate swaps	22,048	—	22,048	—
Total liabilities measured at fair value	$108,052	$—	$22,953	$85,099

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Junior Subordinated Debentures - The fair value of junior subordinated debentures is estimated using an income approach valuation technique. The ending carrying (fair) value of the junior subordinated debentures measured at fair value represents the estimated amount that would be paid to transfer these liabilities in an orderly transaction amongst market participants. Due to credit concerns in the capital markets and inactivity in the trust preferred markets that have limited the observability of market spreads, we have classified this as a Level 3 fair value measure. For further discussion of the valuation technique and inputs, see Note 9.

Derivative Instruments - The fair value of the interest rate lock commitments and forward sales commitments are estimated using quoted or published market prices for similar instruments, adjusted for factors such as pull-through rate assumptions based on historical information, where appropriate. The pull-through rate assumptions are considered Level 3 valuation inputs and are significant to the interest rate lock commitment valuation; as such, the interest rate lock commitment derivatives are classified as Level 3. The fair value of the interest rate swaps is determined using a discounted cash flow technique incorporating credit valuation adjustments to reflect nonperformance risk in the measurement of fair value. Although the Bank has determined that the majority of the inputs used to value its interest rate swap derivatives fall within Level 2 of the fair value hierarchy, the CVA associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of September 30, 2013, the Bank has assessed the significance of the impact of the CVA on the overall valuation of its interest rate swap positions and has determined that the CVA are not significant to the overall valuation of its interest rate swap derivatives. As a result, the Bank has classified its interest rate swap derivative valuations in Level 2 of the fair value hierarchy.

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

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The following table provides a description of the valuation technique, unobservable input, and qualitative information about the unobservable inputs for the Company's assets and liabilities classified as Level 3 and measured at fair value on a recurring basis at September 30, 2013:

(in thousands)

Financial Instrument	Valuation Technique	Unobservable Input	Weighted Average (Range)
Mortgage servicing rights	Discounted cash flow		
		Constant Prepayment Rate	16.04%
		Discount Rate	8.69%
Interest rate lock commitment	Internal Pricing Model		
		Pull-through rate	73.9%
Junior subordinated debentures	Discounted cash flow		
		Credit Spread	6.21%

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

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

Management believes that the credit risk adjusted spread utilized in the fair value measurement of the junior subordinated debentures carried at fair value is indicative of the nonperformance risk premium a willing market participant would require under current market conditions, that is, the inactive market. Management attributes the change in fair value of the junior subordinated debentures during the period to market changes in the nonperformance expectations and pricing of this type of debt, and not as a result of changes to our entity-specific credit risk. The widening of the credit risk adjusted spread above the Company's contractual spreads has primarily contributed to the positive fair value adjustments. Future contractions in the credit risk adjusted spread relative to the spread currently utilized to measure the Company's junior subordinated debentures at fair value as of September 30, 2013, or the passage of time, will result in negative fair value adjustments. Generally, an increase in the credit risk adjusted spread and/or a decrease in the three month LIBOR swap curve will result in positive fair value adjustments (and decrease the fair value measurement). Conversely, a decrease in the credit risk adjusted spread and/or an increase in the three month LIBOR swap curve will result in negative fair value adjustments (and increase the fair value measurement).

The following table provides a reconciliation of assets and liabilities measured at fair value using significant unobservable inputs (Level 3) on a recurring basis during the three and nine months ended September 30, 2013 and 2012.

(in thousands)

Three months ended September 30,	Beginning Balance	Change included in earnings	Purchases and issuances	Sales and settlements	Ending Balance	Net change in unrealized gains or (losses) relating to items held at end of period

2013