COLUMBIA BANKING SYSTEM INC
Form 10-Q
November 02, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2012.

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

For the transition period from to .

Commission File Number 0-20288

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

Washington (State or other jurisdiction of incorporation or organization)	91-1422237 (I.R.S. Employer Identification Number)
1301 “A” Street Tacoma, Washington (Address of principal executive offices)	98402-2156 (Zip Code)

(253) 305-1900
(Issuer’s telephone number, including area code)
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer	ý	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨

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

The number of shares of common stock outstanding at October 31, 2012 was 39,687,880.

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PART I - FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS
CONSOLIDATED BALANCE SHEETS
Columbia Banking System, Inc.
(Unaudited)

			September 30, 2012	December 31, 2011
ASSETS			(in thousands)	
Cash and due from banks			$98,979	$91,364
Interest-earning deposits with banks			463,613	202,925
Total cash and cash equivalents			562,592	294,289
Securities available for sale at fair value (amortized cost of $898,434 and $987,560, respectively)			943,624	1,028,110
Federal Home Loan Bank stock at cost			22,017	22,215
Loans held for sale			3,600	2,148
Loans, excluding covered loans, net of unearned income of ($11,523) and ($16,217), respectively			2,476,844	2,348,371
Less: allowance for loan and lease losses			51,527	53,041
Loans, excluding covered loans, net			2,425,317	2,295,330
Covered loans, net of allowance for loan losses of ($29,157) and ($4,944), respectively			429,286	531,929
Total loans, net			2,854,603	2,827,259
FDIC loss-sharing asset			111,677	175,071
Interest receivable			16,587	15,287
Premises and equipment, net			115,506	107,899
Other real estate owned ($16,511 and $28,126 covered by FDIC loss-share, respectively)			27,386	51,019
Goodwill			115,554	115,554
Core deposit intangible, net			16,803	20,166
Other assets			113,100	126,928
Total assets			$4,903,049	$4,785,945
LIABILITIES AND SHAREHOLDERS' EQUITY				
Deposits:				
Noninterest-bearing			$1,270,321	$1,156,610
Interest-bearing			2,668,534	2,658,919
Total deposits			3,938,855	3,815,529
Federal Home Loan Bank advances			113,080	119,009
Securities sold under agreements to repurchase			25,000	25,000
Other liabilities			64,137	67,069
Total liabilities			4,141,072	4,026,607
Commitments and contingent liabilities				
Shareholders' equity:				
	September 30, 2012	December 31, 2011		
Common stock (no par value)				
Authorized shares	63,033	63,033		
Issued and outstanding	39,689	39,506	581,001	579,136
Retained earnings			152,498	155,069

Accumulated other comprehensive income	28,478	25,133
Total shareholders’ equity	761,977	759,338
Total liabilities and shareholders’ equity	$4,903,049	$4,785,945

See accompanying Notes to unaudited Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF INCOME
Columbia Banking System, Inc.
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands except per share amounts)			
Interest Income				
Loans	$52,600	$59,655	$168,875	$151,446
Taxable securities	4,218	6,037	14,414	16,701
Tax-exempt securities	2,422	2,500	7,442	7,483
Federal funds sold and deposits in banks	229	240	564	722
Total interest income	59,469	68,432	191,295	176,352
Interest Expense				
Deposits	1,339	2,642	4,679	8,569
Federal Home Loan Bank advances	745	807	2,229	2,215
Long-term obligations	—	75	—	579
Other borrowings	120	120	358	377
Total interest expense	2,204	3,644	7,266	11,740
Net Interest Income	57,265	64,788	184,029	164,612
Provision for loan and lease losses	2,875	500	11,125	2,650
Provision (recapture) for losses on covered loans	(3,992)	433	23,381	2,312
Net interest income after provision for loan and lease losses	58,382	63,855	149,523	159,650
Noninterest Income (Loss)				
Service charges and other fees	7,609	6,991	22,222	19,746
Gain on bank acquisitions, net of tax	—	1,830	—	1,830
Merchant services fees	2,054	1,952	6,167	5,393
Gain on sale of investment securities, net	—	—	62	—
Bank owned life insurance	747	523	2,177	1,556
Change in FDIC loss-sharing asset	(12,951)	(10,855)	(14,787)	(32,048)
Other	1,630	1,755	4,650	3,842
Total noninterest income (loss)	(911)	2,196	20,491	319
Noninterest Expense				
Compensation and employee benefits	21,523	21,392	64,484	59,772
Occupancy	4,886	4,815	15,310	13,600
Merchant processing	921	976	2,724	2,764
Advertising and promotion	1,341	1,137	3,342	3,050
Data processing and communications	2,499	2,195	7,263	6,032
Legal and professional fees	2,783	1,957	6,221	4,868
Taxes, licenses and fees	1,124	1,211	3,594	2,983
Regulatory premiums	775	574	2,560	3,553
Net benefit of operation of other real estate owned	(1,069)	(195)	(536)	(423)
Amortization of intangibles	1,093	1,177	3,362	3,116
FDIC clawback liability	334	1,146	100	3,294
Other	4,726	3,550	16,689	11,836
Total noninterest expense	40,936	39,935	125,113	114,445
Income before income taxes	16,535	26,116	44,901	45,524
Income tax provision	4,655	7,244	12,220	12,241
Net Income	$11,880	$18,872	$32,681	$33,283

Earnings per common share				
Basic	$0.30	$0.48	$0.82	$0.84
Diluted	$0.30	$0.48	$0.82	$0.84
Dividends paid per common share	$0.30	$0.06	$0.89	$0.14
Weighted average number of common shares outstanding	39,289	39,131	39,248	39,092
Weighted average number of diluted common shares outstanding	39,291	39,192	39,251	39,167

See accompanying Notes to unaudited Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Columbia Banking System, Inc.
(Unaudited)

	Three Months Ended September 30,	
	2012	2011
	(in thousands)	
Net income as reported	$11,880	$18,872
Unrealized gain from securities:		
Net unrealized holding gain from available for sale securities arising during the period, net of tax of ($1,432) and ($2,808)	2,631	4,988
Reclassification adjustment of net gain from sale of available for sale securities included in income, net of tax of $0 and $0	—	—
Net unrealized gain from securities, net of reclassification adjustment	2,631	4,988
Pension plan liability adjustment:		
Net unrealized gain from unfunded defined benefit plan liability arising during the period, net of tax of $0 and $0	—	—
Amortization of unrecognized net actuarial loss included in net periodic pension cost, net of tax of ($7) and ($8)	13	14
Pension plan liability adjustment, net	13	14
Total comprehensive income	$14,524	$23,874

	Nine Months Ended September 30,	
	2012	2011
	(in thousands)	
Net income as reported	$32,681	$33,283
Unrealized gain from securities:		
Net unrealized holding gain from available for sale securities arising during the period, net of tax of ($1,345) and ($7,733)	3,355	13,768
Reclassification adjustment of net gain from sale of available for sale securities included in income, net of tax of $23 and $0	(39)	—
Net unrealized gain from securities, net of reclassification adjustment	3,316	13,768
Cash flow hedging instruments:		
Reclassification adjustment of net gain included in income, net of tax of $0 and $79	—	(143)
Net change in cash flow hedging instruments	—	(143)
Pension plan liability adjustment:		
Net unrealized gain from unfunded defined benefit plan liability arising during the period, net of tax of $0 and $154	—	(260)
Amortization of unrecognized net actuarial loss included in net periodic pension cost, net of tax of ($31) and ($23)	29	41
Pension plan liability adjustment, net	29	(219)
Total comprehensive income	$36,026	$46,689

See accompanying Notes to unaudited Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Columbia Banking System, Inc.
(Unaudited)

	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
	Number of Shares	Amount			
	(in thousands)				
Balance at January 1, 2011	39,338	$576,905	$117,692	$ 12,281	$706,878
Net income	—	—	33,283	—	33,283
Other comprehensive income	—	—	—	13,406	13,406
Issuance of common stock - stock option and other plans	47	792	—	—	792
Issuance of common stock - restricted stock awards, net of canceled awards	119	1,163	—	—	1,163
Purchase and retirement of common stock	(2)	(32)	—	—	(32)
Cash dividends paid on common stock	—	—	(5,524)	—	(5,524)
Balance at September 30, 2011	39,502	$578,828	$145,451	$ 25,687	$749,966
Balance at January 1, 2012	39,506	$579,136	$155,069	$ 25,133	$759,338
Net income	—	—	32,681	—	32,681
Other comprehensive income	—	—	—	3,345	3,345
Issuance of common stock - stock option and other plans	40	713	—	—	713
Issuance of common stock - restricted stock awards, net of canceled awards	143	1,152	—	—	1,152
Cash dividends paid on common stock	—	—	(35,252)	—	(35,252)
Balance at September 30, 2012	39,689	$581,001	$152,498	$ 28,478	$761,977

See accompanying Notes to unaudited Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS
Columbia Banking System, Inc.
(Unaudited)

	Nine Months Ended September 30,	
	2012	2011 (1)
	(in thousands)	
Cash Flows From Operating Activities		
Net Income	$32,681	$33,283
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan and lease losses and losses on covered loans	34,506	4,962
Stock-based compensation expense	1,152	1,163
Depreciation, amortization and accretion	45,873	35,168
Net realized gain on FDIC-assisted bank acquisitions	—	(1,830)
Net realized gain on sale of securities	(62)	—
Net realized gain on sale of other assets	(35)	(13)
Net realized gain on sale of other real estate owned	(8,604)	(7,069)
Gain on termination of cash flow hedging instruments	—	(222)
Write-down on other real estate owned	7,001	5,392
Net change in:		
Loans held for sale	(1,452)	(1,814)
Interest receivable	(1,300)	(3,384)
Interest payable	(374)	(226)
Other assets	(5,223)	3,186
Other liabilities	(3,881)	1,608
Net cash provided by operating activities	100,282	70,204
Cash Flows From Investing Activities		
Loans originated and acquired, net of principal collected	(72,180)	(69,420)
Purchases of:		
Securities available for sale	(87,346)	(294,678)
Premises and equipment	(12,404)	(10,619)
Proceeds from:		
FDIC reimbursement on loss-sharing asset	49,194	51,000
Sales of securities available for sale	3,845	—
Principal repayments and maturities of securities available for sale	163,584	101,071
Disposal of premises and equipment	25	59
Sales of covered other real estate owned	25,202	14,604
Sales of other real estate and other personal property owned	15,069	10,234
Capital improvements on other real estate properties	(11)	(726)
Decrease in Small Business Administration secured borrowings	—	(642)
Net cash acquired in business combinations	—	247,792
Net cash provided by investing activities	84,978	48,675
Cash Flows From Financing Activities		
Net increase (decrease) in deposits	123,326	(215,701)
Proceeds from:		
Federal Home Loan Bank advances	—	100
Federal Reserve Bank borrowings	—	100
Exercise of stock options	713	792
Payment for:		

Repayment of Federal Home Loan Bank advances	(5,744)	(39,447)
Repayment of Federal Reserve Bank borrowings	—	(100)
Common stock dividends	(35,252)	(5,524)
Purchase and retirement of common stock	—	(32)
Net decrease in other borrowings	—	(25,735)
Net cash provided by (used in) financing activities	83,043	(285,547)
Increase (Decrease) in cash and cash equivalents	268,303	(166,668)
Cash and cash equivalents at beginning of period	294,289	514,130
Cash and cash equivalents at end of period	$562,592	$347,462
Supplemental Information:		
Cash paid during the year for:		
Cash paid for interest	$7,640	$11,967
Cash paid for income tax	$9,605	$12,870
Non-cash investing activities		
Assets acquired in FDIC-assisted acquisitions (excluding cash and cash equivalents)	$—	$485,870
Liabilities assumed in FDIC-assisted acquisitions	$—	$731,832
Loans transferred to other real estate owned	$15,024	$16,505

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

See accompanying Notes to unaudited Consolidated Financial Statements.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
Columbia Banking System, Inc.
1. Basis of Presentation and Significant Accounting Policies
Basis of Presentation
The interim unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. The consolidated financial statements include the accounts of the Company, and its wholly owned banking subsidiary Columbia Bank (the “Bank”). All intercompany transactions and accounts have been eliminated in consolidation. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair statement of the results for the interim periods presented have been included. The results of operations for the nine months ended September 30, 2012 are not necessarily indicative of results to be anticipated for the year ending December 31, 2012. The accompanying interim unaudited consolidated financial statements should be read in conjunction with the financial statements and related notes contained in the Company’s 2011 Annual Report on Form 10-K.
Significant Accounting Policies
The significant accounting policies used in preparation of our consolidated financial statements are disclosed in our 2011 Annual Report on Form 10-K. Other than as discussed below, there have not been any changes in our significant accounting policies compared to those contained in our 2011 Form 10-K disclosure for the year ended December 31, 2011.
2. Accounting Pronouncements Recently Issued
In May 2011, the Financial Accounting Standards Board ("FASB") issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. Generally Accepted Accounting Principles (“GAAP”) and International Financial Reporting Standards (“IFRS”) (Topic 820). ASU 2011-04 developed common requirements between GAAP and IFRS for measuring fair value and for disclosing information about fair value measurements. The Company adopted this ASU during the first quarter of 2012 with no impact on the Company's financial condition or results of operations.
In October 2012, the FASB issued ASU 2012-06, Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution. ASU 2012-06 clarifies that when a reporting entity recognizes an indemnification asset as a result of a government-assisted acquisition of a financial institution and there is a subsequent change in the amount of cash flows expected to be collected on the indemnified asset, the reporting entity should subsequently measure the indemnification asset on the same basis as the underlying loans by taking into account the contractual limitations of the Loss-Sharing Agreement ("LSA"). For amortization of changes in value, the reporting entity should use the term of the LSA if it is shorter than the term of the acquired loans. ASU 2012-06 is effective for interim and annual periods beginning after December 15, 2012. Early adoption is permitted. The Company is evaluating the impact this ASU will have on its financial condition and results of operations.

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3. Securities

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
September 30, 2012				
U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations	$544,106	$19,525	$(423)	$563,208
State and municipal securities	258,130	24,388	(18)	282,500
U.S. government agency and government-sponsored enterprise securities	92,888	1,618	—	94,506
Other securities	3,310	125	(25)	3,410
Total	$898,434	$45,656	$(466)	$943,624
December 31, 2011				
U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations	$678,631	$19,323	$(2,000)	$695,954
State and municipal securities	263,075	22,746	(58)	285,763
U.S. government agency and government-sponsored enterprise securities	42,558	505	—	43,063
Other securities	3,296	64	(30)	3,330
Total	$987,560	$42,638	$(2,088)	$1,028,110

The scheduled contractual maturities of investment securities available for sale at September 30, 2012 are presented as follows:

	September 30, 2012	
	Amortized Cost	Fair Value
	(in thousands)	
Due within one year	$23,144	$26,360
Due after one year through five years	138,171	142,207
Due after five years through ten years	152,525	160,307
Due after ten years	581,285	611,341
Other securities with no stated maturity	3,309	3,409
Total investment securities available-for-sale	$898,434	$943,624

The following table summarizes, as of September 30, 2012, the carrying value of securities pledged as collateral to secure public deposits, borrowings and other purposes as permitted or required by law:

	Carrying Amount
	(in thousands)
To Washington and Oregon State to secure public deposits	$249,626
To Federal Reserve Bank to secure borrowings	51,487
Other securities pledged	46,994
Total securities pledged as collateral	$348,107

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The following tables show the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2012 and December 31, 2011:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
September 30, 2012						
U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations	$33,377	$(272)	$18,445	$(151)	$51,822	(423)
State and municipal securities	636	(4)	424	(14)	1,060	(18)
Other securities	—	—	975	(25)	975	(25)
Total	$34,013	$(276)	$19,844	$(190)	$53,857	$(466)
December 31, 2011						
U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations	$238,875	$(1,999)	$196	$(1)	$239,071	$(2,000)
State and municipal securities	3,820	(24)	950	(34)	4,770	(58)
Other securities	—	—	970	(30)	970	(30)
Total	$242,695	$(2,023)	$2,116	$(65)	$244,811	$(2,088)

At September 30, 2012, there were 18 U.S. government agency and government-sponsored enterprise mortgage-backed securities & collateralized mortgage obligations securities in an unrealized loss position, of which nine were in a continuous loss position for 12 months or more. The decline in fair value is attributable to changes in interest rates relative to where these investments fall within the yield curve and their individual characteristics. Because the Company does not intend to sell these securities nor does the Company consider it more likely than not that it will be required to sell these securities before the recovery of amortized cost basis, which may be upon maturity, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2012.

At September 30, 2012, there were three state and municipal government securities in an unrealized loss position, of which two were in a continuous loss position for 12 months or more. The unrealized losses on state and municipal securities were caused by interest rate changes or widening of market spreads subsequent to the purchase of the individual securities. Management monitors published credit ratings of these securities for adverse changes. As of September 30, 2012, none of the rated obligations of state and local government entities held by the Company had an adverse credit rating. Because the credit quality of these securities are investment grade and the Company does not intend to sell these securities nor does the Company consider it more likely than not that it will be required to sell these securities before the recovery of amortized cost basis, which may be upon maturity, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2012.

At September 30, 2012, there was one other security, a mortgage-backed securities fund in a continuous unrealized loss position for 12 months or more. The decline in fair value is attributable to changes in interest rates and the additional risk premium investors are demanding for investment securities with these characteristics. The Company does not consider this investment to be other-than-temporarily impaired at September 30, 2012 as it has the intent and ability to hold the investment for sufficient time to allow for recovery in the market value.

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Securities Deemed to be Other-Than-Temporarily Impaired

During 2011, the Company determined that one of its state and municipal securities with a par amount of $3.0 million was other-than-temporarily impaired due to it maturing during the period without repaying the principal amount. The Company determined that the entire amount of the other-than-temporary impairment was credit-related as the present value of the expected future cash flows for the defaulted security was zero. The credit-related other-than-temporary impairment of $3.0 million was recorded in the consolidated statements of income for the year ended December 31, 2011. The Company continues to hold this security at September 30, 2012. Based on information available at September 30, 2012, the the fair value of this security has been increased to the original par amount as the Company was notified that there would be a full repayment. The increase in fair value was recorded to accumulated other comprehensive income in the consolidated balance sheet. Subsequent to quarter end, on October 1, 2012, the Company received full payment on this municipal bond, including accrued interest.

4. Noncovered Loans

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

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

	September 30, 2012	December 31, 2011
Noncovered loans:	(in thousands)	
Commercial business	$1,142,737	$1,031,721
Real estate:		
One-to-four family residential	47,656	64,491
Commercial and multifamily residential	1,035,356	998,165
Total real estate	1,083,012	1,062,656
Real estate construction:		
One-to-four family residential	50,381	50,208
Commercial and multifamily residential	51,466	36,768
Total real estate construction	101,847	86,976
Consumer	160,771	183,235
Less: Net unearned income	(11,523)	(16,217)
Total noncovered loans, net of unearned income	2,476,844	2,348,371
Less: Allowance for loan and lease losses	(51,527)	(53,041)
Total noncovered loans, net	$2,425,317	$2,295,330
Loans held for sale	$3,600	$2,148

At September 30, 2012 and December 31, 2011, the Company had no material foreign activities. Substantially all of the Company’s loans and unfunded commitments are geographically concentrated in its service areas within the states of Washington and Oregon.

The Company and its banking subsidiary have granted loans to officers and directors of the Company and related interests. These loans are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collectability. The aggregate dollar amount of these loans was $13.5 million and $9.0 million at September 30, 2012 and December 31, 2011, respectively. During the first nine months of 2012, advances on related party loans were $6.9 million and repayments totaled $2.4 million.

At September 30, 2012 and December 31, 2011, $441.6 million and $462.0 million of commercial and residential real estate loans were pledged as collateral on Federal Home Loan Bank borrowings. The Company has also pledged $61.7 million and $351.3 million of commercial loans to the Federal Reserve Bank for additional borrowing capacity at September 30, 2012 and December 31, 2011, respectively.

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The following is an analysis of noncovered, nonaccrual loans as of September 30, 2012 and December 31, 2011:

	September 30, 2012		December 31, 2011	
	Recorded Investment Nonaccrual Loans	Unpaid Principal Balance Nonaccrual Loans	Recorded Investment Nonaccrual Loans	Unpaid Principal Balance Nonaccrual Loans
Noncovered loans:	(in thousands)			
Commercial business				
Secured	$12,455	$ 21,683	$10,124	$ 16,820
Unsecured	109	109	119	719
Real estate:				
One-to-four family residential	2,220	2,617	2,696	3,011
Commercial & multifamily residential				
Commercial land	3,647	7,581	3,739	7,230
Income property multifamily	6,628	9,233	6,775	9,265
Owner occupied	9,184	12,598	8,971	10,932
Real estate construction:				
One-to-four family residential				
Land and acquisition	3,332	7,360	7,799	16,703
Residential construction	2,027	2,648	2,986	5,316
Commercial & multifamily residential				
Income property multifamily	—	—	7,067	14,912
Consumer	1,987	2,279	3,207	3,960
Total	$41,589	$ 66,108	$53,483	$ 88,868

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The following is an aging of the recorded investment of the noncovered loan portfolio as of September 30, 2012 and December 31, 2011:

	Current Loans	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Nonaccrual Loans	Total Loans
September 30, 2012	(in thousands)						
Noncovered loans:							
Commercial business							
Secured	$1,079,237	$4,735	$572	$—	$5,307	$12,455	$1,096,999
Unsecured	41,414	58	485	—	543	109	42,066
Real estate:							
One-to-four family residential	45,173	31	401	—	432	2,220	47,825
Commercial & multifamily residential							
Commercial land	39,729	93	420	—	513	3,647	43,889
Income property multifamily	576,969	2,281	—	—	2,281	6,628	585,878
Owner occupied	388,011	1,124	—	—	1,124	9,184	398,319
Real estate construction:							
One-to-four family residential							
Land and acquisition	14,139	386	1,225	—	1,611	3,332	19,082
Residential construction	27,390	118	1,395	—	1,513	2,027	30,930
Commercial & multifamily residential							
Income property multifamily	27,027	—	—	—	—	—	27,027
Owner occupied	23,974	—	—	—	—	—	23,974
Consumer	157,901	848	119	—	967	1,987	160,855
Total	$2,420,964	$9,674	$4,617	$—	$14,291	$41,589	$2,476,844

	Current Loans	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Nonaccrual Loans	Total Loans
December 31, 2011	(in thousands)						
Noncovered loans:							
Commercial business							
Secured	$966,563	$1,741	$2,989	$—	$4,730	$10,124	$981,417
Unsecured	46,880	407	—	—	407	119	47,406
Real estate:							
One-to-four family residential	60,764	603	—	—	603	2,696	64,063
Commercial & multifamily residential							
Commercial land	46,161	781	—	—	781	3,739	50,681

Income property multifamily	524,225	2,872	121	—	2,993	6,775	533,993
Owner occupied	394,691	829	298	—	1,127	8,971	404,789
Real estate construction:							
One-to-four family residential							
Land and acquisition	17,249	153	—	—	153	7,799	25,201
Residential construction	19,555	1,390	—	—	1,390	2,986	23,931
Commercial & multifamily residential							
Income property multifamily	13,810	—	—	—	—	7,067	20,877
Owner occupied	12,790	—	—	—	—	—	12,790
Consumer	179,753	141	122	—	263	3,207	183,223
Total	$2,282,441	$8,917	$3,530	$—	$12,447	$53,483	$2,348,371

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The following is an analysis of impaired loans as of September 30, 2012 and December 31, 2011:

	Recorded Investment of Loans Collectively Measured for Contingency Provision	Recorded Investment of Loans Individually Measured for Specific Impairment	Impaired Loans With Recorded Allowance			Impaired Loans Without Recorded Allowance	
			Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance
September 30, 2012	(in thousands)						
Noncovered loans:							
Commercial business							
Secured	$1,088,513	$ 8,486	$1,498	$2,086	$ 315	$6,988	$12,330
Unsecured	41,966	100	100	100	100	—	—
Real estate:							
One-to-four family residential	45,849	1,976	353	366	69	1,623	1,832
Commercial & multifamily residential							
Commercial land	40,824	3,065	205	214	1	2,860	6,470
Income property multifamily	579,603	6,275	—	—	—	6,275	8,574
Owner occupied	384,110	14,209	1,559	1,657	245	12,650	18,162
Real estate construction:							
One-to-four family residential							
Land and acquisition	16,263	2,819	—	—	—	2,819	4,813
Residential construction	28,101	2,829	—	—	—	2,829	3,444
Commercial & multifamily residential							
Income property multifamily	27,027	—	—	—	—	—	—
Owner occupied	23,974	—	—	—	—	—	—
Consumer	159,812	1,043	—	—	—	1,043	1,049
Total	$2,436,042	$ 40,802	$3,715	$4,423	$ 730	$37,087	$56,674

	Recorded Investment of Loans Collectively Measured for Contingency Provision	Recorded Investment of Loans Individually Measured for Specific Impairment	Impaired Loans With Recorded Allowance			Impaired Loans Without Recorded Allowance	
			Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance
December 31, 2011	(in thousands)						
Noncovered loans:							
Commercial business							
Secured	$972,531	$ 8,886	$2,926	$2,927	$ 954	$5,960	$12,109
Unsecured	47,309	97	97	97	97	—	—
Real estate:							
One-to-four family residential	61,584	2,479	582	590	96	1,897	2,136
Commercial & multifamily residential							
Commercial land	46,882	3,799	—	—	—	3,799	6,773
Income property multifamily	527,362	6,631	687	759	63	5,944	7,700

Owner occupied	390,225	14,564	274	274	185	14,290	18,524
Real estate construction:							
One-to-four family residential							
Land and acquisition	17,813	7,388	450	948	—	6,938	11,978
Residential construction	18,847	5,084	59	1,509	59	5,025	5,116
Commercial & multifamily residential							
Income property multifamily	13,810	7,067	—	—	—	7,067	14,947
Owner occupied	12,790	—	—	—	—	—	—
Consumer	180,930	2,293	151	225	30	2,142	2,639
Total	$2,290,083	$ 58,288	$5,226	$7,329	$ 1,484	$53,062	$81,922

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2012		2011		2012		2011	
	Average Recorded Investment Impaired Loans	Interest Recognized on Impaired Loans	Average Recorded Investment Impaired Loans	Interest Recognized on Impaired Loans	Average Recorded Investment Impaired Loans	Interest Recognized on Impaired Loans	Average Recorded Investment Impaired Loans	Interest Recognized on Impaired Loans
Noncovered loans:	(in thousands)							
Commercial business								
Secured	$10,306	$ 6	$8,400	$ (36)	$10,008	$ 14	$17,251	$ 16
Unsecured	118	1	194	(1)	118	5	148	—
Real estate:								
One-to-four family residential	2,014	(9)	2,236	—	2,140	—	2,498	—
Commercial & multifamily residential								
Commercial land	3,079	—	3,790	—	3,242	—	4,380	—
Income property multifamily	7,577	55	7,454	84	7,830	60	9,444	526
Owner occupied	13,185	244	15,799	234	13,668	762	15,427	298
Real estate construction:								
One-to-four family residential								
Land and acquisition	3,213	—	8,202	38	4,876	—	9,368	176
Residential construction	2,792	12	3,713	—	3,539	17	4,397	—
Commercial & multifamily residential								
Income property multifamily	1,877	—	6,800	—	3,961	—	7,064	—
Owner occupied	—	—	—	—	—	—	—	—
Consumer	1,045	11	3,824	12	1,359	33	4,276	13
Total	$45,206	$ 320	$60,412	$ 331	$50,741	$ 891	$74,253	$ 1,029

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There were no Troubled Debt Restructurings ("TDR") during the three and nine months ended September 30, 2012.
The following is an analysis of loans classified as TDR during the three and nine months ended September 30, 2011:

	Three months ended September 30, 2011		
	Number of TDR Modifications	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Noncovered loans:	(dollars in thousands)		
Commercial business:			
Secured	1	$ 226	$ 226
Total	1	$ 226	$ 226

	Nine months ended September 30, 2011		
	Number of TDR Modifications	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Noncovered loans:	(dollars in thousands)		
Commercial business:			
Secured	3	$ 578	$ 578
Real estate:			
Commercial and multifamily residential:			
Income property multifamily	1	623	623
Real estate construction:			
One-to-four family residential:			
Residential construction	1	36	36
Total	5	$ 1,237	$ 1,237

The Company's loans classified as TDR are loans that have been modified or the borrower has been granted special concessions due to financial difficulties that, if not for the challenges of the borrower, the Company would not otherwise consider. The Company had commitments to lend $1.2 million and $535 thousand of additional funds on loans classified as TDR as of September 30, 2012 and December 31, 2011, respectively. The TDR modifications or concessions are made to increase the likelihood that these borrowers with financial difficulties will be able to satisfy their debt obligations as amended. Credit losses for loans classified as TDR are measured on the same basis as impaired loans. For impaired loans, an allowance is established when the collateral value less selling costs (or discounted cash flows or observable market price) of the impaired loan is lower than the recorded investment of that loan. The Company did not have any loans modified as TDR within the past twelve months that have defaulted during the nine months ended September 30, 2012.

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

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

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

The general valuation allowance is systematically calculated quarterly using quantitative and qualitative information about specific loan classes. The minimum required level an entity develops a methodology to determine its allowance for loan and lease losses is by general categories of loans, such as commercial business, real estate, and consumer. However, the Company’s methodology in determining its allowance for loan and lease losses is prepared in a more detailed manner at the loan class level, utilizing specific categories such as commercial business secured, commercial business unsecured, real estate commercial land, and real estate income property multifamily. The quantitative information uses historical losses from a specific loan class and incorporates the loan's risk rating migration from origination to the point of loss.

A loan's risk rating is primarily determined based upon the borrower's ability to fulfill its debt obligation from a cash flow perspective. In the event there is financial deterioration of the borrower, the borrower's other sources of income or repayment are also considered, including recent appraisal values for collateral dependent loans. The qualitative information takes into account general economic and business conditions affecting our market place, seasoning of the loan portfolio, duration of the business cycle, etc. to ensure our methodologies reflect the current economic environment and other factors as using historical loss information exclusively may not give an accurate estimate of inherent losses within the Company's loan portfolio.

When a loan is deemed to be impaired, the Company has to determine if a specific valuation allowance is required for that loan. The specific valuation allowance is a reserve, calculated at the individual loan level, for each loan determined to be both impaired and containing a value less than its recorded investment. The Company measures the impairment based on the discounted expected future cash flows, observable market price, or the fair value of the collateral less selling costs if the loan is collateral dependent or if foreclosure is probable. The specific reserve for each loan is equal to the difference between the recorded investment in the loan and its determined impairment value.

The ALLL is increased by provisions for loan and lease losses ("provision") charged to expense, and is reduced by loans charged off, net of recoveries. While the Company's management believes the best information available is used to determine the ALLL, changes in market conditions could result in adjustments to the ALLL, affecting net income, if circumstances differ from the assumptions used in determining the ALLL.

We have used the same methodology for ALLL calculations during the nine months ended September 30, 2012 and 2011. Adjustments to the percentages of the ALLL allocated to loan categories are made based on trends with respect to delinquencies and problem loans within each class of loans. The Company reviews the ALLL quantitative and qualitative methodology on a quarterly basis and makes adjustments when appropriate. The Company continues to strive towards maintaining a conservative approach to credit quality and will continue to prudently adjust our ALLL as necessary in order to maintain adequate reserves. The Company carefully monitors the loan portfolio and continues to emphasize the importance of credit quality.

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

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The following tables show a detailed analysis of the allowance for loan and lease losses for noncovered loans for the three and nine months ended September 30, 2012 and 2011:

	Beginning Balance	Charge-offs	Recoveries	Provision (Recovery)	Ending Balance	Specific Reserve	General Allocation
Three months ended September 30, 2012	(in thousands)						
Noncovered loans:							
Commercial business							
Secured	$26,505	$(3,744)	$194	$3,007	$25,962	$315	$25,647
Unsecured	772	(31)	83	(56)	768	100	668
Real estate:							
One-to-four family residential	673	(49)	157	(216)	565	69	496
Commercial & multifamily residential							
Commercial land	270	(55)	—	207	422	1	421
Income property multifamily	8,726	(436)	357	387	9,034	—	9,034
Owner occupied	9,037	(101)	89	(694)	8,331	245	8,086
Real estate construction:							
One-to-four family residential							
Land and acquisition	1,651	(307)	404	(279)	1,469	—	1,469
Residential construction	1,197	(18)	—	3	1,182	—	1,182
Commercial & multifamily residential							
Income property multifamily	755	—	63	(456)	362	—	362
Owner occupied	68	—	—	23	91	—	91
Consumer	2,049	(500)	350	267	2,166	—	2,166
Unallocated	493	—	—	682	1,175	—	1,175
Total	$52,196	$(5,241)	$1,697	$2,875	$51,527	$730	$50,797

	Beginning Balance	Charge-offs	Recoveries	Provision (Recovery)	Ending Balance	Specific Reserve	General Allocation
Nine months ended September 30, 2012	(in thousands)						
Noncovered loans:							
Commercial business							
Secured	$24,745	$(8,126)	$1,184	$8,159	$25,962	$315	$25,647
Unsecured	689	(52)	130	1	768	100	668
Real estate:							
One-to-four family residential	654	(499)	202	208	565	69	496
Commercial & multifamily residential							
Commercial land	488	(437)	—	371	422	1	421
Income property multifamily	9,551	(3,959)	710	2,732	9,034	—	9,034
Owner occupied	9,606	(712)	628	(1,191)	8,331	245	8,086
Real estate construction:							
One-to-four family residential							
Land and acquisition	2,331	(809)	827	(880)	1,469	—	1,469
Residential construction	864	(617)	79	856	1,182	—	1,182
Commercial & multifamily residential							

Income property multifamily	665	(93)	64	(274)	362	—	362
Owner occupied	35	—	—	56	91	—	91
Consumer	2,719	(1,968)	809	606	2,166	—	2,166
Unallocated	694	—	—	481	1,175	—	1,175
Total	$53,041	$(17,272)	$4,633	$ 11,125	$51,527	$730	$50,797

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	Beginning Balance	Charge-offs	Recoveries	Provision (Recovery)	Ending Balance	Specific Reserve	General Allocation
Three months ended September 30, 2011	(in thousands)						
Noncovered loans:							
Commercial business							
Secured	$22,320	$(1,904)	$420	$ 2,462	$23,298	$54	$23,244
Unsecured	573	(42)	40	167	738	—	738
Real estate:							
One-to-four family residential	847	(53)	78	70	942	—	942
Commercial & multifamily residential							
Commercial land	894	(4)	—	(130)	760	—	760
Income property multifamily	14,709	(339)	10	(5,407)	8,973	297	8,676
Owner occupied	6,479	(100)	—	311	6,690	408	6,282
Real estate construction:							
One-to-four family residential							
Land and acquisition	2,852	(169)	63	269	3,015	175	2,840
Residential construction	1,704	(14)	56	(222)	1,524	—	1,524
Commercial & multifamily residential							
Income property multifamily	43	(145)	—	157	55	—	55
Owner occupied	34	—	—	(7)	27	—	27
Consumer	2,748	(2,102)	70	2,985	3,701	32	3,669
Unallocated	854	—	—	(155)	699	—	699
Total	$54,057	$(4,872)	$737	$ 500	$50,422	$966	$49,456
	Beginning Balance	Charge-offs	Recoveries	Provision (Recovery)	Ending Balance	Specific Reserve	General Allocation
Nine months ended September 30, 2011	(in thousands)						
Noncovered loans:							
Commercial business							
Secured	$21,811	$(6,025)	$749	$ 6,763	$23,298	$54	$23,244
Unsecured	738	(126)	408	(282)	738	—	738
Real estate:							
One-to-four family residential	1,100	(717)	78	481	942	—	942
Commercial & multifamily residential							
Commercial land	634	(660)	—	786	760	—	760
Income property multifamily	15,210	(979)	65	(5,323)	8,973	297	8,676
Owner occupied	9,692	(723)	31	(2,310)	6,690	408	6,282
Real estate construction:							
One-to-four family residential							
Land and acquisition	3,769	(1,347)	1,831	(1,238)	3,015	175	2,840
Residential construction	2,292	(1,068)	92	208	1,524	—	1,524
Commercial & multifamily residential							
Income property multifamily	274	(1,710)	—	1,491	55	—	55
Owner occupied	70	—	—	(43)	27	—	27

Consumer	2,120	(3,298)	178	4,701	3,701	32	3,669
Unallocated	3,283	—	—	(2,584)	699	—	699
Total	$60,993	$(16,653)	$3,432	$2,650	$50,422	$966	$49,456

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Changes in the allowance for unfunded commitments and letters of credit are summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Balance at beginning of period	$1,665	$1,460	$1,535	$1,165
Net changes in the allowance for unfunded commitments and letters of credit	250	—	380	295
Balance at end of period	$1,915	$1,460	$1,915	$1,460

Risk Elements

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

The monitoring process for the loan portfolio includes periodic reviews of individual loans with risk ratings assigned to each loan. Based on the analysis, loans are given a risk rating of 1-10 based on the following criteria:

- ratings of 1-3 indicate minimal to low credit risk,
- ratings of 4-5 indicate an average credit risk with adequate repayment capacity when prolonged periods of adversity do not exist,
- rating of 6 indicate higher than average risk requiring greater than routine attention by bank personnel due to conditions affecting the borrower, the borrower's industry or economic environment,
- rating of 7 indicate potential weaknesses that, if left uncorrected, may result in deterioration of the repayment prospects for the asset or in the Company's credit position at some future date,
- rating of 8 indicates a loss is possible if loan weaknesses are not corrected,
- rating of 9 indicates loss is highly probable; however, the amount of loss has not yet been determined,
- and a rating of 10 indicates the loan is uncollectable, and when identified is charged-off.

Loans with a risk rating of 1-6 are considered Pass loans and loans with risk ratings of 7, 8, 9 and 10 are considered Special Mention, Substandard, Doubtful and Loss, respectively. Loans with a risk rating of Substandard or worse are reported as classified loans in our allowance for loan and lease losses analysis. We review these loans to assess the ability of our borrowers to service all interest and principal obligations and, as a result, the risk rating may be adjusted accordingly. Risk ratings are reviewed and updated whenever appropriate, with more periodic reviews as the risk and dollar value of loss on the loan increases. In the event full collection of principal and interest is not reasonably assured, the loan is appropriately downgraded and, if warranted, placed on non-accrual status even though the loan may be current as to principal and interest payments. Additionally, we assess whether an impairment of a loan warrants specific reserves or a write-down of the loan.

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The following is an analysis of the credit quality of our noncovered loan portfolio as of September 30, 2012 and December 31, 2011:

	Pass	Special Mention	Substandard	Doubtful	Loss	Total
September 30, 2012	(in thousands)					
Noncovered loans:						
Commercial business:						
Secured	$1,024,510	$18,596	$53,893	$—	$—	$1,096,999
Unsecured	41,496	26	544	—	—	42,066
Real estate:						
One-to-four family residential	45,393	407	2,025	—	—	47,825
Commercial and multifamily residential:						
Commercial land	39,842	—	4,047	—	—	43,889
Income property multifamily	557,868	8,496	19,514	—	—	585,878
Owner occupied	356,582	3,940	37,797	—	—	398,319
Real estate construction:						
One-to-four family residential:						
Land and acquisition	11,467	2,035	5,580	—	—	19,082
Residential construction	25,130	476	5,324	—	—	30,930
Commercial and multifamily residential:						
Income property multifamily	27,027	—	—	—	—	27,027
Owner occupied	23,974	—	—	—	—	23,974
Consumer	154,853	298	5,634	70	—	160,855
Total	$2,308,142	$34,274	$134,358	$70	$—	2,476,844
Less:						
Allowance for loan losses						51,527
Noncovered loans, net						$2,425,317

	Pass	Special Mention	Substandard	Doubtful	Loss	Total
December 31, 2011	(in thousands)					
Noncovered loans:						
Commercial business:						
Secured	$908,883	$18,703	$53,447	$384	$—	$981,417
Unsecured	46,732	318	356	—	—	47,406
Real estate:						
One-to-four family residential	58,517	2,040	3,506	—	—	64,063
Commercial and multifamily residential:						
Commercial land	44,166	5	6,510	—	—	50,681
Income property multifamily	492,922	16,002	25,069	—	—	533,993
Owner occupied	351,928	13,590	39,266	—	5	404,789
Real estate construction:						
One-to-four family residential:						
Land and acquisition	12,349	2,684	10,168	—	—	25,201
Residential construction	16,764	1,649	5,518	—	—	23,931
Commercial and multifamily residential:						

Income property multifamily	12,812	—	8,065	—	—	20,877
Owner occupied	12,790	—	—	—	—	12,790
Consumer	176,304	859	6,060	—	—	183,223
Total	$2,134,167	$55,850	$157,965	$384	$5	2,348,371
Less:						
Allowance for loan losses						53,041
Noncovered loans, net						$2,295,330

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6. Changes in Noncovered Other Real Estate Owned

The following tables set forth activity in noncovered OREO for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Noncovered OREO:				
Balance at beginning of period	$13,925	$22,739	$22,893	$30,991
Transfers in, net of write-downs ($24, $0, $24 and $108, respectively)	139	5,287	6,527	8,434
OREO improvements	—	257	11	726
Additional OREO write-downs	(458)	(644)	(4,232)	(5,090)
Proceeds from sale of OREO property	(3,170)			