UMPQUA HOLDINGS CORP
Form 10-Q
November 05, 2015

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, 2015
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: 220,217,028 shares outstanding as of October 31, 2015

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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, 2015 | December 31, 2014 |
|---|---|---|
| ASSETS | | |
| Noninterest bearing cash | $283,773 | $282,455 |
| Interest bearing cash and temporary investments (restricted cash of $70,707 and $47,717) | 673,843 | 1,322,716 |
| Total cash and cash equivalents | 957,616 | 1,605,171 |
| Investment securities | | |
| Trading, at fair value | 9,509 | 9,999 |
| Available for sale, at fair value | 2,482,478 | 2,298,555 |
| Held to maturity, at amortized cost | 4,699 | 5,211 |
| Loans held for sale ($395,421 and $286,802, at fair value) | 398,015 | 286,802 |
| Loans and leases | 16,387,934 | 15,327,732 |
| Allowance for loan and lease losses | (130,133) | (116,167) |
| Net loans and leases | 16,257,801 | 15,211,565 |
| Restricted equity securities | 46,904 | 119,334 |
| Premises and equipment, net | 330,306 | 317,834 |
| Goodwill | 1,788,640 | 1,786,225 |
| Other intangible assets, net | 48,314 | 56,733 |
| Residential mortgage servicing rights, at fair value | 124,814 | 117,259 |
| Other real estate owned | 23,892 | 37,942 |
| FDIC indemnification asset | 892 | 4,417 |
| Bank owned life insurance | 297,321 | 294,296 |
| Deferred tax asset, net | 149,320 | 230,442 |
| Other assets | 241,783 | 228,118 |
| Total assets | $23,162,304 | $22,609,903 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Deposits | | |
| Noninterest bearing | $5,207,129 | $4,744,804 |
| Interest bearing | 12,259,895 | 12,147,295 |
| Total deposits | 17,467,024 | 16,892,099 |
| Securities sold under agreements to repurchase | 323,722 | 313,321 |
| Term debt | 889,358 | 1,006,395 |
| Junior subordinated debentures, at fair value | 253,665 | 249,294 |
| Junior subordinated debentures, at amortized cost | 101,334 | 101,576 |
| Other liabilities | 291,649 | 269,592 |
| Total liabilities | 19,326,752 | 18,832,277 |
| COMMITMENTS AND CONTINGENCIES (NOTE 9) | | |
| SHAREHOLDERS' EQUITY | | |
| Common stock, no par value, shares authorized: 400,000,000 in 2015 and 2014; issued and outstanding: 220,216,672 in 2015 and 220,161,120 in 2014 | 3,517,751 | 3,519,316 |
| Retained earnings | 303,729 | 246,242 |

| | | |
|---|---|---|
| Accumulated other comprehensive income | 14,072 | 12,068 |
| Total shareholders' equity | 3,835,552 | 3,777,626 |
| Total liabilities and shareholders' equity | $23,162,304 | $22,609,903 |

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, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| INTEREST INCOME | | | | |
| Interest and fees on loans and leases | $219,488 | $223,972 | $651,979 | $536,950 |
| Interest and dividends on investment securities: | | | | |
| Taxable | 11,639 | 12,136 | 34,458 | 34,155 |
| Exempt from federal income tax | 2,637 | 2,790 | 8,014 | 7,599 |
| Dividends | 113 | 81 | 382 | 259 |
| Interest on temporary investments and interest bearing deposits | 440 | 544 | 1,814 | 1,407 |
| Total interest income | 234,317 | 239,523 | 696,647 | 580,370 |
| INTEREST EXPENSE | | | | |
| Interest on deposits | 7,450 | 6,773 | 21,934 | 16,696 |
| Interest on securities sold under agreement to repurchase | 43 | 54 | 134 | 298 |
| Interest on term debt | 3,629 | 3,586 | 10,585 | 9,223 |
| Interest on junior subordinated debentures | 3,465 | 3,394 | 10,208 | 8,340 |
| Total interest expense | 14,587 | 13,807 | 42,861 | 34,557 |
| Net interest income | 219,730 | 225,716 | 653,786 | 545,813 |
| PROVISION FOR LOAN AND LEASE LOSSES | 8,153 | 14,333 | 32,044 | 35,000 |
| Net interest income after provision for loan and lease losses | 211,577 | 211,383 | 621,742 | 510,813 |
| NON-INTEREST INCOME | | | | |
| Service charges on deposits | 15,638 | 16,090 | 44,759 | 39,228 |
| Brokerage revenue | 5,003 | 4,882 | 14,420 | 13,173 |
| Residential mortgage banking revenue, net | 24,041 | 25,996 | 92,282 | 60,776 |
| Gain on investment securities, net | 220 | 902 | 355 | 1,878 |
| Gain on loan sales | 5,212 | 8,309 | 20,651 | 9,383 |
| Loss on junior subordinated debentures carried at fair value | (1,590) | (1,590) | (4,717) | (3,501) |
| Change in FDIC indemnification asset | 1,432 | (2,728) | (1,053) | (13,169) |
| BOLI income | 1,656 | 2,161 | 6,460 | 4,864 |
| Other income | 8,737 | 8,143 | 31,186 | 18,237 |
| Total non-interest income | 60,349 | 62,165 | 204,343 | 130,869 |
| NON-INTEREST EXPENSE | | | | |
| Salaries and employee benefits | 105,974 | 102,564 | 324,683 | 251,340 |
| Occupancy and equipment, net | 37,235 | 33,029 | 104,253 | 78,276 |
| Communications | 4,443 | 3,932 | 15,131 | 11,000 |
| Marketing | 2,860 | 2,739 | 7,936 | 4,901 |
| Services | 10,285 | 14,619 | 35,063 | 33,010 |
| FDIC assessments | 3,369 | 3,038 | 9,738 | 7,476 |
| (Gain) loss on other real estate owned, net | (158) | 313 | 2,136 | 507 |
| Intangible amortization | 2,806 | 3,103 | 8,419 | 7,105 |
| Merger related expenses | 5,991 | 8,632 | 41,870 | 72,146 |
| Other expenses | 9,881 | 10,589 | 28,452 | 27,446 |
| Total non-interest expense | 182,686 | 182,558 | 577,681 | 493,207 |
| Income before provision for income taxes | 89,240 | 90,990 | 248,404 | 148,475 |

| | | | | |
|---|---|---|---|---|
| Provision for income taxes | 31,633 | 32,107 | 88,884 | 53,399 |
| Net income | $57,607 | $58,883 | $159,520 | $95,076 |

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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, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Net income | $57,607 | $58,883 | $159,520 | $95,076 |
| Dividends and undistributed earnings allocated to participating securities | 84 | 142 | 261 | 338 |
| Net earnings available to common shareholders | $57,523 | $58,741 | $159,259 | $94,738 |
| Earnings per common share: | | | | |
| Basic | $0.26 | $0.27 | $0.72 | $0.54 |
| Diluted | $0.26 | $0.27 | $0.72 | $0.54 |
| Weighted average number of common shares outstanding: | | | | |
| Basic | 220,297 | 217,245 | 220,370 | 175,627 |
| Diluted | 220,904 | 218,941 | 221,062 | 176,656 |

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, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Net income | $57,607 | $58,883 | $159,520 | $95,076 |
| Available for sale securities: | | | | |
| Unrealized gains (losses) arising during the period | 15,258 | (8,862) | 3,695 | 21,052 |
| Reclassification adjustment for net gains realized in earnings (net of tax expense of $88 and $361 for the three months ended September 30, 2015 and 2014, respectively, and net of tax expense of $142 and $751 for the nine months ended September 30, 2015 and 2014, respectively) | (132) | (542) | (213) | (1,127) |
| Income tax (expense) benefit related to unrealized gains | (6,103) | 3,545 | (1,478) | (8,421) |
| Net change in unrealized gains (losses) | 9,023 | (5,859) | 2,004 | 11,504 |
| 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 $37 for the nine months ended September 30, 2014) | — | — | — | 57 |
| Net change in unrealized losses related to factors other than credit | — | — | — | 57 |
| Other comprehensive income (loss), net of tax | 9,023 | (5,859) | 2,004 | 11,561 |
| Comprehensive income | $66,630 | $53,024 | $161,524 | $106,637 |

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

| (in thousands, except shares) | Common Stock Shares | Common Stock Amount | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total |
|---|---|---|---|---|---|
| BALANCE AT JANUARY 1, 2014 | 111,973,203 | $1,514,485 | $217,917 | $(4,976) | $1,727,426 |
| Cumulative effect adjustment | | | (3,509) | | (3,509) |
| Restated balance at January 1, 2014 | | | 214,408 | | 1,723,917 |
| Net income, retrospectively adjusted | | | 147,658 | | 147,658 |
| Other comprehensive income, net of tax | | | | 17,044 | 17,044 |
| Stock issued in connection with merger (1) | 104,385,087 | 1,989,030 | | | 1,989,030 |
| Stock-based compensation | | 15,292 | | | 15,292 |
| Stock repurchased and retired | (403,828) | (7,183) | | | (7,183) |
| Issuances of common stock under stock plans and related net tax benefit (2) | 4,206,658 | 7,692 | | | 7,692 |
| Cash dividends on common stock ($0.60 per share) | | | (115,824) | | (115,824) |
| Balance at December 31, 2014 | 220,161,120 | $3,519,316 | $246,242 | $12,068 | $3,777,626 |
| | | | | | |
| BALANCE AT JANUARY 1, 2015 | 220,161,120 | $3,519,316 | $246,242 | $12,068 | $3,777,626 |
| Net income | | | 159,520 | | 159,520 |
| Other comprehensive income, net of tax | | | | 2,004 | 2,004 |
| Stock-based compensation | | 11,275 | | | 11,275 |
| Stock repurchased and retired | (778,579) | (14,536) | | | (14,536) |
| Issuances of common stock under stock plans and related net tax benefit | 834,131 | 1,696 | | | 1,696 |
| Cash dividends on common stock ($0.46 per share) | | | (102,033) | | (102,033) |
| Balance at September 30, 2015 | 220,216,672 | $3,517,751 | $303,729 | $14,072 | $3,835,552 |

(1) The amount of common stock issued in connection with the merger is net of $784,000 of issuance costs.
(2) The shares issued include 2,889,896 of warrants exercised.

See notes to condensed consolidated financial statements

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

| (in thousands) | Nine Months Ended September 30, 2015 | 2014 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | $159,520 | $95,076 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization of investment premiums, net | 18,135 | 15,320 |
| Gain on sale of investment securities, net | (355) | (1,878) |
| (Gain) loss on sale of other real estate owned, net | (646) | 301 |
| Valuation adjustment on other real estate owned | 2,782 | 206 |
| Provision for loan and lease losses | 32,044 | 35,000 |
| Change in cash surrender value of bank owned life insurance | (6,588) | (4,008) |
| Change in FDIC indemnification asset | 1,053 | 13,169 |
| Depreciation and amortization | 37,716 | 27,299 |
| Increase in residential mortgage servicing rights | (27,812) | (16,583) |
| Change in residential mortgage servicing rights carried at fair value | 20,257 | 8,393 |
| Change in junior subordinated debentures carried at fair value | 4,371 | 4,082 |
| Stock-based compensation | 11,275 | 11,597 |
| Net decrease in trading account assets | 490 | 724 |
| Gain on sale of loans | (115,399) | (63,729) |
| Change in loans held for sale carried at fair value | (5,716) | (6,894) |
| Origination of loans held for sale | (2,703,100) | (1,523,959) |
| Proceeds from sales of loans held for sale | 2,694,945 | 1,638,975 |
| Excess tax benefits from the exercise of stock options | (563) | (2,046) |
| Change in other assets and liabilities: | | |
| Net increase in other assets | 67,919 | 19,847 |
| Net increase in other liabilities | 23,317 | 23,203 |
| Net cash provided by operating activities | 213,645 | 274,095 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of investment securities available for sale | (706,964) | (346,844) |
| Proceeds from investment securities available for sale | 508,428 | 1,116,539 |
| Proceeds from investment securities held to maturity | 481 | 566 |
| Redemption of restricted equity securities | 72,430 | 4,190 |
| Net loan and lease originations | (1,313,156) | (792,592) |
| Proceeds from sales of loans | 246,100 | 284,274 |
| Proceeds from disposals of furniture and equipment | 3,571 | 1,923 |
| Purchases of premises and equipment | (59,117) | (43,761) |
| Net proceeds from (payments to) FDIC indemnification asset | 1,571 | (2,359) |
| Proceeds from bank owned life insurance | 4,485 | 681 |
| Proceeds from sales of other real estate owned | 18,747 | 11,768 |
| Net cash paid in branch divestiture | — | (127,557) |
| Cash acquired in merger, net of cash consideration paid | — | 116,867 |
| Net cash (used) provided by investing activities | $(1,223,424) | $223,695 |

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

| (in thousands) | Nine Months Ended September 30, 2015 | 2014 |
|---|---|---|
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net increase in deposit liabilities | $578,995 | $739,173 |
| Net increase (decrease) in securities sold under agreements to repurchase | 10,401 | (470,261) |
| Repayment of term debt | (114,999) | (47,003) |
| Dividends paid on common stock | (99,333) | (66,557) |
| Excess tax benefits from stock based compensation | 563 | 2,046 |
| Proceeds from stock options exercised | 1,133 | 5,161 |
| Retirement of common stock | (14,536) | (7,062) |
| Net cash provided by financing activities | 362,224 | 155,497 |
| Net (decrease) increase in cash and cash equivalents | (647,555) | 653,287 |
| Cash and cash equivalents, beginning of period | 1,605,171 | 790,423 |
| Cash and cash equivalents, end of period | $957,616 | $1,443,710 |
| | | |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Cash paid during the period for: | | |
| Interest | $50,156 | $38,955 |
| Income taxes | $17,334 | $6,622 |
| SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES: | | |
| Change in unrealized gains on investment securities available for sale, net of taxes | $2,004 | $11,504 |
| Change in unrealized losses on investment securities held to maturity related to factors other than credit, net of taxes | $— | $57 |
| Cash dividend declared on common stock and payable after period-end | $35,285 | $32,684 |
| Transfer of loans to other real estate owned | $6,833 | $14,089 |
| Transfer from FDIC indemnification asset to due from FDIC and other | $2,472 | $2,194 |
| Acquisitions: | | |
| Assets acquired, including goodwill of $1,024,335 | $— | $9,877,740 |
| Liabilities assumed | $— | $8,769,608 |

See notes to condensed consolidated financial statements

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 – Summary of Significant Accounting Policies

The accounting and financial reporting policies of Umpqua Holdings Corporation conform to accounting principles generally accepted in the United States of America. The accompanying interim condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material inter-company balances and transactions have been eliminated. The condensed consolidated financial statements have not been audited. A more detailed description of our accounting policies is included in the 2014 Annual Report filed on Form 10-K. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes contained in the 2014 Annual Report filed on Form 10-K. All references in this report to "Umpqua," "we," "our," "us," the "Company" or similar references mean Umpqua Holdings Corporation, and include our consolidated subsidiaries where the context so requires. References to "Bank" refer to our subsidiary Umpqua Bank, an Oregon state-chartered commercial bank, and references to "Umpqua Investments" refer to our subsidiary Umpqua Investments, Inc., a registered broker-dealer and investment adviser. The Bank also has a wholly-owned subsidiary, Financial Pacific Leasing Inc., a commercial equipment leasing company.

In preparing these condensed consolidated financial statements, the Company has evaluated events and transactions subsequent to September 30, 2015 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.

Application of new accounting guidance
As of January 1, 2015, Umpqua adopted the Financial Accounting Standards Board's ("FASB") Accounting Standard Update ("ASU") No. 2014-01, Investments - Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects. Application of ASU No. 2014-01 provides for a consistent accounting method for our investments in qualified affordable housing projects using a proportional amortization method. As required by ASU No. 2014-01, the new accounting methodology has been retrospectively applied resulting in changes to other non-interest income, tax expense, and net income, deferred tax asset, other assets, and retained earnings in the prior periods presented. The effect of this change was a decrease in net income of $110,000 and $330,000 for the three and nine months ended September 30, 2015, respectively. The effect of this change on the revised September 30, 2014 income statements was a decrease in net income of $107,000 for the three months ended September 30, 2014 and an increase of $102,000 for the nine months ended September 30, 2014. Retained earnings as of January 1, 2014, has been adjusted down by $3.5 million for the effect of the retroactive application of the new standard.

As of January 1, 2015, Umpqua applied FASB ASU No. 2014-04, Receivables -Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. ASU 2014-04 clarifies when a repossession or foreclosure has occurred. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. As of September 30, 2015, Umpqua had $2.4 million of foreclosed residential real estate property held as other real estate owned. Umpqua's recorded investment in consumer mortgage loans collateralized by residential real estate property in process of foreclosure was $4.1 million as of September 30, 2015.

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Note 2 – Business Combinations

Sterling Financial Corporation

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

The structure of the transaction was as follows:

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

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

| | Sterling April 18, 2014 | |
|---|---|---|
| Fair value of consideration to Sterling shareholders: | | |
| Cash paid | | $136,200 |
| Liability recorded for warrants' cash payment per share | | 6,453 |
| Fair value of common shares issued | | 1,939,497 |
| Fair value of warrants, common stock options, and restricted stock exchanged | | 50,317 |
| Total consideration | | 2,132,467 |
| Fair value of assets acquired: | | |
| Cash and cash equivalents | $253,067 | |
| Investment securities | 1,378,300 | |
| Loans held for sale | 214,911 | |
| Loans and leases | 7,123,168 | |
| Premises and equipment | 116,576 | |
| Residential mortgage servicing rights | 62,770 | |
| Other intangible assets | 54,562 | |
| Other real estate owned | 8,666 | |
| Bank owned life insurance | 193,246 | |
| Deferred tax asset | 300,015 | |
| Accrued interest receivable | 23,553 | |
| Other assets | 148,906 | |
| Total assets acquired | 9,877,740 | |
| Fair value of liabilities assumed: | | |
| Deposits | 7,086,052 | |
| Securities sold under agreements to repurchase | 584,746 | |
| Term debt | 854,737 | |
| Junior subordinated debentures | 156,171 | |
| Other liabilities | 87,902 | |
| Total liabilities assumed | $8,769,608 | |
| Net assets acquired | | 1,108,132 |
| Goodwill | | $1,024,335 |

The primary reason for the Merger was to continue the Company's growth strategy, including expanding our geographic footprint in markets throughout the West Coast. All of the goodwill recorded has been attributed to the Community Banking segment and reporting unit. None of the goodwill will be deductible for income tax purposes.

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

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

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

The operations of Sterling are included in our operating results beginning on April 19, 2014, and contributed an estimated net interest income of $106.9 million and $328.2 million and net income of $34.7 million and $97.6 million for the three and nine months ended September 30, 2015, respectively.

The following table provides a breakout of Merger related expense for the three and nine months ended September 30, 2015.

| (in thousands) | Three Months Ended September 30, 2015 | Nine Months Ended September 30, 2015 |
|---|---|---|
| Personnel | $2,665 | $10,395 |
| Legal and professional | 2,238 | 19,977 |
| Contract termination | 154 | 154 |
| Premises and Equipment | 1,473 | 6,738 |
| Communication | 548 | 1,980 |
| Other | (1,087) | 2,626 |
| Total Merger related expense | $5,991 | $41,870 |

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The following table presents unaudited pro forma results of operations for the three and nine months ended September 30, 2014, as if the Sterling Merger had occurred on January 1, 2013. The pro forma results have been prepared for comparative purposes only and are not necessarily indicative of the results that would have been obtained had the acquisition actually occurred on January 1, 2013. The pro forma results include the impact of certain purchase accounting adjustments including accretion of loan discount, intangible assets amortization and deposit and borrowing premium accretion. These purchase accounting adjustments increased pro forma net income by $1.6 million and $50.5 million for the three and nine months ended September 30, 2014.

| (in thousands, except per share data) | Pro Forma | | |
|---|---|---|---|
| | Three Months Ended | Nine Months Ended | |
| | September 30, 2014 | September 30, 2014 | |
| Net interest income | $225,715 | $682,679 | (1), (2), (3) |
| Provision for loan and lease losses | 14,333 | 35,000 | |
| Non-interest income | 62,163 | 157,134 | (4), (5), (6) |
| Non-interest expense | 179,918 | 565,573 | (7), (8) |
| Income before provision for income taxes | 93,627 | 239,240 | |
| Provision for income taxes | 33,122 | 88,325 | |
| Net income | 60,505 | 150,915 | |
| Dividends and undistributed earnings allocated to participating securities | 142 | 338 | |
| Net earnings available to common shareholders | $60,363 | $150,577 | |
| Earnings per share: | | | |
| Basic | $0.28 | $0.69 | |
| Diluted | $0.28 | $0.69 | |
| Average shares outstanding: | | | |
| Basic | 217,245 | 216,884 | |
| Diluted | 218,941 | 218,801 | |

(1) Includes zero and $31.9 million of incremental loan discount accretion for the three and nine months ended September 30, 2014.
(2) Includes a reduction of interest income of zero and $1.8 million related to investment securities premiums amortization for the three and nine months ended September 30, 2014.
(3) Includes a reduction of interest expense of zero and $5.9 million related to deposit and borrowing premiums amortization for the three and nine months ended September 30, 2014.
(4) Includes a reduction of service charges on deposits of zero and $1.7 million as a result of passing the $10 billion asset threshold for the three and nine months ended September 30, 2014.
(5) Includes a loss on junior subordinated debentures carried at fair value of zero and $1.1 million for the three and nine months ended September 30, 2014.
(6) Includes the reversal of the $7.0 million loss on the required divestiture of six Sterling stores in connection with the Merger for the nine months ended September 30, 2014.
(7) Includes a net increase of zero and $2.1 million of incremental core deposit intangible amortization for the three and nine months ended September 30, 2014.
(8) Includes a net decrease of $2.6 million and $46.1 million of merger expenses for the three and nine months ended September 30, 2014.

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Note 3 – Investment Securities

The following table presents the amortized costs, unrealized gains, unrealized losses and approximate fair values of investment securities at September 30, 2015 and December 31, 2014:

| (in thousands) | September 30, 2015 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| AVAILABLE FOR SALE: | | | | |
| Obligations of states and political subdivisions | $314,305 | $12,974 | $(815) | $326,464 |
| Residential mortgage-backed securities and collateralized mortgage obligations | 2,143,275 | 18,866 | (8,208) | 2,153,933 |
| Investments in mutual funds and other equity securities | 2,016 | 65 | — | 2,081 |
| | $2,459,596 | $31,905 | $(9,023) | $2,482,478 |
| HELD TO MATURITY: | | | | |
| Residential mortgage-backed securities and collateralized mortgage obligations | $4,699 | $582 | $(1) | $5,280 |
| | $4,699 | $582 | $(1) | $5,280 |

| (in thousands) | December 31, 2014 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| AVAILABLE FOR SALE: | | | | |
| U.S. Treasury and agencies | $213 | $16 | $— | $229 |
| Obligations of states and political subdivisions | 325,189 | 14,056 | (841) | 338,404 |
| Residential mortgage-backed securities and collateralized mortgage obligations | 1,951,514 | 17,398 | (11,060) | 1,957,852 |
| Investments in mutual funds and other equity securities | 2,016 | 54 | — | 2,070 |
| | $2,278,932 | $31,524 | $(11,901) | $2,298,555 |
| HELD TO MATURITY: | | | | |
| Residential mortgage-backed securities and collateralized mortgage obligations | $5,088 | $358 | $(15) | $5,431 |
| Other investment securities | 123 | — | — | 123 |
| | $5,211 | $358 | $(15) | $5,554 |

Investment securities that were in an unrealized loss position as of September 30, 2015 and December 31, 2014 are presented in the following tables, based on the length of time individual securities have been in an unrealized loss position. In the opinion of management, these securities are considered only temporarily impaired due to changes in market interest rates or the widening of market spreads subsequent to the initial purchase of the securities, and not due to concerns regarding the underlying credit of the issuers or the underlying collateral.

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| September 30, 2015 (in thousands) | Less than 12 Months | | 12 Months or Longer | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| AVAILABLE FOR SALE: | | | | | | |
| Obligations of states and political subdivisions | $12,536 | $158 | $8,034 | $657 | $20,570 | $815 |
| Residential mortgage-backed securities and collateralized mortgage obligations | 463,453 | 3,239 | 312,840 | 4,969 | 776,293 | 8,208 |
| Total temporarily impaired securities | $475,989 | $3,397 | $320,874 | $5,626 | $796,863 | $9,023 |
| HELD TO MATURITY: | | | | | | |
| Residential mortgage-backed securities and collateralized mortgage obligations | $39 | $1 | $— | $— | $39 | $1 |
| Total temporarily impaired securities | $39 | $1 | $— | $— | $39 | $1 |

| December 31, 2014 (in thousands) | Less than 12 Months | | 12 Months or Longer | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| AVAILABLE FOR SALE: | | | | | | |
| Obligations of states and political subdivisions | $11,100 | $547 | $8,550 | $294 | $19,650 | $841 |
| Residential mortgage-backed securities and collateralized mortgage obligations | 220,577 | 815 | 495,096 | 10,245 | 715,673 | 11,060 |
| Total temporarily impaired securities | $231,677 | $1,362 | $503,646 | $10,539 | $735,323 | $11,901 |
| HELD TO MATURITY: | | | | | | |
| Residential mortgage-backed securities and collateralized mortgage obligations | $224 | $15 | $— | $— | $224 | $15 |
| Total temporarily impaired securities | $224 | $15 | $— | $— | $224 | $15 |

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, 2015. 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, 2015 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 be settled at a price at least equal to 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, these investments are not considered other-than-temporarily impaired.

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The following table presents the maturities of investment securities at September 30, 2015:

| (in thousands) | Available For Sale | | Held To Maturity | |
|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| AMOUNTS MATURING IN: | | | | |
| Three months or less | $13,055 | $13,108 | $— | $— |
| Over three months through twelve months | 82,603 | 83,377 | 9 | 12 |
| After one year through five years | 1,778,642 | 1,798,598 | 391 | 934 |
| After five years through ten years | 431,360 | 431,514 | 239 | 273 |
| After ten years | 151,920 | 153,800 | 4,060 | 4,061 |
| Other investment securities | 2,016 | 2,081 | — | — |
| | $2,459,596 | $2,482,478 | $4,699 | $5,280 |

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 losses on the sale of securities available for sale for the three and nine months ended September 30, 2015 and 2014:

| (in thousands) | Three Months Ended | | | |
|---|---|---|---|---|
| | September 30, 2015 | | September 30, 2014 | |
| | Gains | Losses | Gains | Losses |
| U.S. Treasury and agencies | $13 | $— | $— | $— |
| Obligations of states and political subdivisions | 6 | — | — | — |
| Residential mortgage-backed securities and collateralized mortgage obligations | 634 | 433 | 902 | — |
| | $653 | $433 | $902 | $— |

| | Nine Months Ended | | | |
|---|---|---|---|---|
| | September 30, 2015 | | September 30, 2014 | |
| | Gains | Losses | Gains | Losses |
| U.S. Treasury and agencies | $13 | $— | $— | $— |
| Obligations of states and political subdivisions | 6 | — | 3 | 1 |
| Residential mortgage-backed securities and collateralized mortgage obligations | 1,177 | 841 | 1,876 | — |
| | $1,196 | $841 | $1,879 | $1 |

The following table presents, as of September 30, 2015, investment securities which were pledged to secure borrowings, public deposits, and repurchase agreements as permitted or required by law:

| (in thousands) | Amortized Cost | Fair Value |
|---|---|---|
| To Federal Home Loan Bank to secure borrowings | $825 | $850 |
| To state and local governments to secure public deposits | 1,633,090 | 1,651,026 |
| Other securities pledged principally to secure repurchase agreements | 508,903 | 511,231 |
| Total pledged securities | $2,142,818 | $2,163,107 |

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Note 4 – Loans and Leases

The following table presents the major types of loans and leases, net of deferred fees and costs, as of September 30, 2015 and December 31, 2014:

| (in thousands) | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Commercial real estate | | |
| Non-owner occupied term, net | $3,148,288 | $3,290,610 |
| Owner occupied term, net | 2,655,340 | 2,633,864 |
| Multifamily, net | 2,961,609 | 2,638,618 |
| Construction & development, net | 287,757 | 258,722 |
| Residential development, net | 94,380 | 81,846 |
| Commercial | | |
| Term, net | 1,398,346 | 1,396,089 |
| LOC & other, net | 1,014,523 | 1,029,620 |
| Leases and equipment finance, net | 679,033 | 523,114 |
| Residential | | |
| Mortgage, net | 2,740,228 | 2,233,735 |
| Home equity loans & lines, net | 910,287 | 852,478 |
| Consumer & other, net | 498,143 | 389,036 |
| Total loans and leases, net of deferred fees and costs | $16,387,934 | $15,327,732 |

The loan balances are net of deferred fees and costs of $42.8 million and $26.3 million as of September 30, 2015 and December 31, 2014, respectively. Net loans include discounts on acquired loans of $131.9 million and $236.6 million as of September 30, 2015 and December 31, 2014, respectively. As of September 30, 2015, loans totaling $9.4 billion were pledged to secure borrowings and available lines of credit.

The outstanding contractual unpaid principal balance of purchased impaired loans, excluding acquisition accounting adjustments, was $599.2 million and $770.9 million at September 30, 2015 and December 31, 2014, respectively. The carrying balance of purchased impaired loans was $448.1 million and $562.9 million at September 30, 2015 and December 31, 2014, respectively.

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The following table presents the changes in the accretable yield for purchased impaired loans for the three and nine months ended September 30, 2015 and 2014:

| (in thousands) | Three Months Ended September 30, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Evergreen | Rainier | Nevada Security | Circle | Sterling | Total |
| Balance, beginning of period | $7,057 | $43,242 | $17,453 | $422 | $97,188 | $165,362 |
| Accretion to interest income | (1,228) | (3,585) | (2,107) | (56) | (7,456) | (14,432) |
| Disposals | (844) | (1,468) | (1,230) | (69) | (2,958) | (6,569) |
| Reclassifications from nonaccretable difference | 745 | 872 | 1,992 | — | 1,676 | 5,285 |
| Balance, end of period | $5,730 | $39,061 | $16,108 | $297 | $88,450 | $149,646 |

| | Three Months Ended September 30, 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Evergreen | Rainier | Nevada Security | Circle | Sterling | Total |
| Balance, beginning of period | $10,576 | $56,609 | $27,837 | $965 | $104,540 | $200,527 |
| Additions | — | — | — | — | — | — |
| Accretion to interest income | (1,546) | (4,134) | (2,798) | (36) | (9,743) | (18,257) |
| Disposals | (320) | (1,051) | (1,352) | — | (4,111) | (6,834) |
| Reclassifications from (to) nonaccretable difference | 2,213 | 3,260 | 728 | (49) | 2,843 | 8,995 |
| Balance, end of period | $10,923 | $54,684 | $24,415 | $880 | $93,529 | $184,431 |

| (in thousands) | Nine Months Ended September 30, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Evergreen | Rainier | Nevada Security | Circle | Sterling | Total |
| Balance, beginning of period | $9,466 | $49,989 | $23,666 | $796 | $117,782 | $201,699 |
| Accretion to interest income | (3,748) | (10,522) | (6,822) | (205) | (21,567) | (42,864) |
| Disposals | (3,227) | (4,081) | (3,295) | (331) | (10,891) | (21,825) |
| Reclassifications from nonaccretable difference | 3,239 | 3,675 | 2,559 | 37 | 3,126 | 12,636 |
| Balance, end of period | $5,730 | $39,061 | $16,108 | $297 | $88,450 | $149,646 |

| | Nine Months Ended September 30, 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Evergreen | Rainier | Nevada Security | Circle | Sterling | Total |
| Balance, beginning of period | $20,063 | $71,789 | $34,632 | $1,140 | $— | $127,624 |
| Additions | — | — | — | — | 110,757 | 110,757 |
| Accretion to interest income | (9,998) | (14,671) | (11,792) | (211) | (15,645) | (52,317) |
| Disposals | (5,061) | (9,658) | (5,258) | — | (4,426) | (24,403) |
| Reclassifications from (to) nonaccretable difference | 5,919 | 7,224 | 6,833 | (49) | 2,843 | 22,770 |
| Balance, end of period | $10,923 | $54,684 | $24,415 | $880 | $93,529 | $184,431 |

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Loans acquired in an FDIC-assisted acquisition that are subject to a loss-share agreement are referred to as covered loans. Covered loans are reported exclusive of the cash flow reimbursements expected from the FDIC. The following table summarizes the activity related to the FDIC indemnification asset for the three and nine months ended September 30, 2015 and 2014:

| (in thousands) | Three Months ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Balance, beginning of period | $432 | $11,293 | $4,417 | $23,174 |
| Change in FDIC indemnification asset | 1,432 | (2,728) | (1,053) | (13,169) |
| Transfers to due from FDIC and other | (972) | (754) | (2,472) | (2,194) |
| Balance, end of period | $892 | $7,811 | $892 | $7,811 |

Loans and leases sold

In the course of managing the loan and lease portfolio, at certain times, management may decide to sell loans and leases. The following table summarizes loans and leases sold by loan portfolio during the three and nine months ended September 30, 2015 and 2014:

| (in thousands) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Commercial real estate | | | | |
| Non-owner occupied term, net | $— | $— | $7,181 | $14,799 |
| Owner occupied term, net | 20,003 | 22,884 | 39,963 | 71,128 |
| Multifamily, net | — | 35,306 | 435 | 60,508 |
| Construction & development, net | — | — | — | 566 |
| Residential development, net | — | — | — | 800 |
| Commercial | | | | |
| Term, net | 1,079 | 4,199 | 4,499 | 30,068 |
| LOC & other, net | — | 299 | — | 5,361 |
| Residential | | | | |
| Mortgage, net | 54,938 | 54,917 | 173,371 | 60,951 |
| Home equity loans & lines. net | — | — | — | 24,445 |
| Consumer & other, net | — | — | — | 7,344 |
| Total, net of deferred fees and costs | $76,020 | $117,605 | $225,449 | $275,970 |

Note 5 – Allowance for Loan and Lease Loss and Credit Quality

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

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

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

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

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

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

Specific Allowance
Regular credit reviews of the portfolio identify loans that are considered potentially impaired. Potentially impaired loans are referred to the ALLL Committee which reviews and approves designated loans as impaired. A loan is considered impaired when, based on current information and events, we determine that we will probably not be able to collect all amounts due according to the loan contract, including scheduled interest payments. When we identify a loan as impaired, we measure the impairment using discounted cash flows or estimated note sale price, 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 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.

Management believes that the ALLL was adequate as of September 30, 2015. There is, however, no assurance that future loan and lease losses will not exceed the levels provided for in the ALLL and could possibly result in additional charges to the provision for loan and lease losses.

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

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

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Activity in the Allowance for Loan and Lease Losses

The following table summarizes activity related to the allowance for loan and lease losses by loan and lease portfolio segment for the three and nine months ended September 30, 2015 and 2014:

| (in thousands) | Three Months Ended September 30, 2015 | | | | |
|---|---|---|---|---|---|
| | Commercial Real Estate | Commercial | Residential | Consumer & Other | Total |
| Balance, beginning of period | $58,164 | | | | |