UMPQUA HOLDINGS CORP
Form 10-Q
November 07, 2014

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, 2014
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: 217,263,879 shares outstanding as of October 31, 2014

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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, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$266,624	$178,685
Interest bearing deposits and temporary investments (restricted cash of $34,976 and $13,384)	1,177,086	611,738
Total cash and cash equivalents	1,443,710	790,423
Investment securities		
Trading, at fair value	9,727	5,958
Available for sale, at fair value	2,400,061	1,790,978
Held to maturity, at amortized cost	5,356	5,563
Loans held for sale ($265,800 and $104,664 at fair value)	265,800	104,664
Non-covered loans and leases	14,975,811	7,354,403
Allowance for non-covered loan and lease losses	(107,807)	(85,314)
Net non-covered loans and leases	14,868,004	7,269,089
Covered loans, net of allowance of $7,828 and $9,771	275,562	363,992
Restricted equity securities	120,759	30,685
Premises and equipment, net	314,364	177,680
Goodwill	1,785,407	764,305
Other intangible assets, net	59,835	12,378
Residential mortgage servicing rights, at fair value	118,725	47,765
Non-covered other real estate owned	31,753	21,833
Covered other real estate owned	2,703	2,102
FDIC indemnification asset	7,811	23,174
Bank owned life insurance	293,511	96,938
Deferred tax asset, net	250,910	16,627
Other assets	234,061	111,958
Total assets	$22,488,059	$11,636,112
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest bearing	$4,741,897	$2,436,477
Interest bearing	11,985,713	6,681,183
Total deposits	16,727,610	9,117,660
Securities sold under agreements to repurchase	339,367	224,882
Term debt	1,057,140	251,494
Junior subordinated debentures, at fair value	247,528	87,274
Junior subordinated debentures, at amortized cost	101,657	101,899
Other liabilities	262,249	125,477
Total liabilities	18,735,551	9,908,686
COMMITMENTS AND CONTINGENCIES (NOTE 10)		
SHAREHOLDERS' EQUITY		
	3,515,621	1,514,485

Common stock, no par value, shares authorized: 400,000,000 in 2014 and 200,000,000 in 2013; issued and outstanding: 217,261,722 in 2014 and 111,973,203 in 2013		
Retained earnings	230,302	217,917
Accumulated other comprehensive income (loss)	6,585	(4,976)
Total shareholders' equity	3,752,508	1,727,426
Total liabilities and shareholders' equity	$22,488,059	$11,636,112

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, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
INTEREST INCOME				
Interest and fees on non-covered loans and leases	$215,197	$93,706	$499,526	$250,685
Interest and fees on covered loans and leases	8,775	11,837	37,424	41,167
Interest and dividends on investment securities:				
Taxable	12,136	7,882	34,155	24,629
Exempt from federal income tax	2,790	2,200	7,599	6,725
Dividends	81	51	259	165
Interest on temporary investments and interest bearing deposits	544	284	1,407	937
Total interest income	239,523	115,960	580,370	324,308
INTEREST EXPENSE				
Interest on deposits	6,773	4,845	16,696	16,587
Interest on securities sold under agreement to repurchase	54	35	298	99
Interest on term debt	3,586	2,338	9,223	6,916
Interest on junior subordinated debentures	3,394	1,933	8,340	5,815
Total interest expense	13,807	9,151	34,557	29,417
Net interest income	225,716	106,809	545,813	294,891
PROVISION FOR NON-COVERED LOAN AND LEASE LOSSES	14,431	3,008	35,230	12,989
RECAPTURE OF PROVISION FOR COVERED LOAN LOSSES	(98)	(1,904)	(230)	(4,744)
Net interest income after provision for loan and lease losses	211,383	105,705	510,813	286,646
NON-INTEREST INCOME				
Service charges on deposit accounts	16,090	8,374	39,228	22,844
Brokerage commissions and fees	4,882	3,854	13,173	11,152
Residential mortgage banking revenue, net	25,996	15,071	60,776	62,928
Gain on investment securities, net	902	3	1,878	18
Loss on junior subordinated debentures carried at fair value	(1,590)	(554)	(3,501)	(1,643)
Change in FDIC indemnification asset	(2,728)	(6,474)	(13,169)	(19,841)
BOLI income	2,161	763	4,864	2,432
Other income	16,211	5,107	26,211	16,766
Total non-interest income	61,924	26,144	129,460	94,656
NON-INTEREST EXPENSE				
Salaries and employee benefits	102,564	53,699	251,340	157,271
Net occupancy and equipment	33,029	16,019	78,276	45,813
Communications	3,932	2,772	11,000	8,802
Marketing	2,739	1,596	4,901	3,753
Services	14,619	6,445	33,010	18,339
FDIC assessments	3,038	1,709	7,476	5,032
Net loss (gain) on non-covered other real estate owned	271	(27)	431	(303)
Net loss (gain) on covered other real estate owned	42	(68)	76	154
Intangible amortization	3,103	1,186	7,105	3,595

Merger related expenses	8,632	4,856	72,146	7,197
Other expenses	10,589	7,417	27,446	19,644
Total non-interest expense	182,558	95,604	493,207	269,297
Income before provision for income taxes	90,749	36,245	147,066	112,005
Provision for income taxes	31,760	12,768	52,092	38,914
Net income	$58,989	$23,477	$94,974	$73,091

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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,	
	2014	2013	2014	2013
Net income	$58,989	$23,477	$94,974	$73,091
Dividends and undistributed earnings allocated to participating securities	142	196	338	576
Net earnings available to common shareholders	$58,847	$23,281	$94,636	$72,515
Earnings per common share:				
Basic	$0.27	$0.21	$0.54	$0.65
Diluted	$0.27	$0.21	$0.54	$0.65
Weighted average number of common shares outstanding:				
Basic	217,245	111,912	175,627	111,934
Diluted	218,941	112,195	176,656	112,154

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

(in thousands)	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Net income	$58,989	$23,477	$94,974	$73,091
Available for sale securities:				
Unrealized gains (losses) arising during the period	(8,862)	5,878	21,052	(35,342)
Reclassification adjustment for net gains realized in earnings (net of tax expense of $361 and $1 for the three months ended September 30, 2014 and 2013, respectively, and net of tax expense of $751 and $7 for the nine months ended September 30, 2014 and 2013, respectively)	(542)	(2)	(1,127)	(11)
Income tax (expense) benefit related to unrealized gains (losses)	3,545	(2,351)	(8,421)	14,137
Net change in unrealized gains (losses)	(5,859)	3,525	11,504	(21,216)
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 $0 and $7 for the three months ended September 30, 2014 and 2013, respectively, and net of tax benefit of $37 and $29 for the nine months ended September 30, 2014 and 2013, respectively)	—	11	57	43
Net change in unrealized losses related to factors other than credit	—	11	57	43
Other comprehensive income (loss), net of tax	(5,859)	3,536	11,561	(21,173)
Comprehensive income	$53,130	$27,013	$106,535	$51,918

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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	Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
BALANCE AT JANUARY 1, 2013	111,889,959	$1,512,400	$187,293	$24,346	$1,724,039
Net income			98,361		98,361
Other comprehensive loss, net of tax				(29,322)	(29,322)
Comprehensive income					$69,039
Stock-based compensation		5,017			5,017
Stock repurchased and retired	(584,677)	(9,360)			(9,360)
Issuances of common stock under stock plans and related net tax benefit	667,921	6,428			6,428
Cash dividends on common stock ($0.60 per share)			(67,737)		(67,737)
Balance at December 31, 2013	111,973,203	$1,514,485	$217,917	$(4,976)	$1,727,426
BALANCE AT JANUARY 1, 2014	111,973,203	$1,514,485	$217,917	$(4,976)	$1,727,426
Net income			94,974		94,974
Other comprehensive income, net of tax				11,561	11,561
Comprehensive income					$106,535
Stock issued in connection with merger (1)	104,385,087	1,989,030			1,989,030
Stock-based compensation		11,597			11,597
Stock repurchased and retired	(397,132)	(7,062)			(7,062)
Issuances of common stock under stock plans and related net tax benefit	1,300,564	7,571			7,571
Cash dividends on common stock ($0.45 per share)			(82,589)		(82,589)
Balance at September 30, 2014	217,261,722	$3,515,621	$230,302	$6,585	$3,752,508

(1) The amount of common stock issued in connection with the merger is net of $784,000 of issuance costs.

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

(in thousands)	Nine Months Ended September 30, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$94,974	$73,091
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of investment premiums, net	15,320	27,984
Gain on sale of investment securities, net	(1,878)	(18)
Loss (gain) on sale of non-covered other real estate owned	267	(751)
Loss (gain) on sale of covered other real estate owned	34	(549)
Valuation adjustment on non-covered other real estate owned	164	448
Valuation adjustment on covered other real estate owned	42	703
Provision for non-covered loan and lease losses	35,230	12,989
Recapture of provision for covered loan losses	(230)	(4,744)
Proceeds from bank owned life insurance	681	1,173
Change in cash surrender value of bank owned life insurance	(4,008)	(3,618)
Change in FDIC indemnification asset	13,169	19,841
Depreciation, amortization and accretion	24,498	13,292
Increase in residential mortgage servicing rights	(16,583)	(15,182)
Change in residential mortgage servicing rights carried at fair value	8,393	757
Change in junior subordinated debentures carried at fair value	4,082	1,637
Stock-based compensation	11,597	3,531
Net decrease (increase) in trading account assets	724	(265)
Gain on sale of loans	(63,729)	(52,899)
Change in loans held for sale carried at fair value	(6,894)	11,099
Origination of loans held for sale	(1,577,920)	(1,368,902)
Proceeds from sales of loans held for sale	1,692,936	1,614,097
Excess tax benefits from the exercise of stock options	(2,046)	(40)
Change in other assets and liabilities:		
Net decrease in other assets	19,949	37,625
Net increase (decrease) in other liabilities	23,203	(11,983)
Net cash provided by operating activities	271,975	359,316
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investment securities available for sale	(346,844)	(51,191)
Purchases of investment securities held to maturity	—	(2,126)
Proceeds from investment securities available for sale	1,116,539	702,910
Proceeds from investment securities held to maturity	566	1,073
Redemption of restricted equity securities	4,190	1,999
Net non-covered loan and lease originations	(867,149)	(352,390)
Net covered loan paydowns	77,358	68,819
Proceeds from sales of non-covered loans	284,274	60,298
Proceeds from insurance settlement on loss of property	—	575
Proceeds from disposals of furniture and equipment	1,923	330
Purchases of premises and equipment	(43,761)	(25,575)
Net (payments to) proceeds from FDIC indemnification asset	(2,359)	4,621
Proceeds from sales of non-covered other real estate owned	10,626	13,940

Proceeds from sales of covered other real estate owned	1,142	9,794
Net cash paid in branch divestiture	(127,557)	—
Cash acquired in merger, net of cash consideration paid	116,867	(149,658)
Net cash provided by investing activities	$225,815	$283,419

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

(in thousands)	Nine Months Ended September 30, 2014	2013
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in deposit liabilities	$739,173	$(311,708)
Net (decrease) increase in securities sold under agreements to repurchase	(470,261)	78,235
Repayment of term debt	(47,003)	(211,204)
Repayment of junior subordinated debentures	—	(8,764)
Dividends paid on common stock	(66,557)	(33,837)
Excess tax benefits from stock based compensation	2,046	40
Proceeds from stock options exercised	5,161	2,511
Retirement of common stock	(7,062)	(4,704)
Net cash provided (used by) financing activities	155,497	(489,431)
Net increase in cash and cash equivalents	653,287	153,304
Cash and cash equivalents, beginning of period	790,423	543,787
Cash and cash equivalents, end of period	$1,443,710	$697,091
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$38,955	$32,419
Income taxes	$6,622	$27,711
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Change in unrealized gains (losses) on investment securities available for sale, net of taxes	$11,504	$(21,216)
Change in unrealized losses on investment securities held to maturity related to factors other than credit, net of taxes	$57	$43
Cash dividend declared on common stock and payable after period-end	$32,684	$16,930
Transfer of non-covered loans to non-covered other real estate owned	$12,271	$14,747
Transfer of covered loans to covered other real estate owned	$1,818	$2,554
Transfer of covered loans to non-covered loans	$9,484	$13,366
Transfer from FDIC indemnification asset to due from FDIC and other	$2,194	$3,530
Acquisitions:		
Assets acquired, including goodwill of $1,021,102	$9,876,718	$376,071
Liabilities assumed	$8,765,353	$219,961

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 – Summary of Significant Accounting Policies

The accounting and financial reporting policies of Umpqua Holdings Corporation 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 2013 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 2013 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, 2014 for potential recognition or disclosure. In management's opinion, all accounting adjustments necessary to accurately reflect the financial position and results of operations on the accompanying financial statements have been made. These adjustments include normal and recurring accruals considered necessary for a fair and accurate presentation. The results for interim periods are not necessarily indicative of results for the full year or any other interim period. Certain reclassifications of prior period amounts have been made to conform to current classifications.

Note 2 – Business Combinations

Sterling Financial Corporation
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 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 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	
Non-covered loans and leases	7,123,168	
Premises and equipment	116,581	
Residential mortgage servicing rights	62,770	
Other intangible assets	54,562	
Non-covered other real estate owned	8,915	
Bank owned life insurance	193,246	
Deferred tax asset	299,627	
Accrued interest receivable	23,553	
Other assets	148,018	
Total assets acquired	9,876,718	
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	83,647	
Total liabilities assumed	$8,765,353	
Net assets acquired		1,111,365
Preliminary goodwill		$1,021,102

Amounts recorded are preliminary estimates of fair value. During the third quarter of 2014, goodwill increased primarily due to revised estimates of fair value for premises and equipment, as well as the deferred tax asset. 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 non-covered impaired loans	$397,765

The operations of Sterling are included in our operating results beginning on April 19, 2014, and contributed the following net interest income, provision for loan losses, non-interest income and expense, income tax benefit, and net income for the three and nine months ended September 30, 2014.

(in thousands)	Sterling Stand-alone	
	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
Net interest income	$119,569	$220,823
Provision for loan losses	9,688	17,423
Non-interest income	34,192	56,494
Non-interest expense, excluding merger expense	78,239	143,371
Merger related expense	8,632	66,163
Income tax provision	20,495	19,394
Net income	$36,707	$30,966

The following table provides a breakout of Merger related expense for the three and nine months ended September 30, 2014.

(in thousands)		
	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
Personnel	$1,251	$16,739
Legal and professional	4,873	18,797
Charitable contributions	—	10,000
Investment banking fees	—	9,573
Contract termination	896	9,749
Communication	53	2,064
Other	1,559	5,224
Total Merger related expense	$8,632	$72,146

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The following table presents unaudited pro forma results of operations for the three and nine months ended September 30, 2014 and 2013, 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 $5.3 million and $12.5 million for the three months ended September 30, 2014 and 2013, respectively, and $77.3 million and $6.2 million for the nine months ended September 30, 2014 and 2013, respectively.

(in thousands, except per share data)

	Pro Forma				
	Three Months Ended September 30,		Nine Months Ended September 30,		
	2014	2013	2014	2013	
Net interest income	$225,716	$223,203	$684,528	$651,484	(1), (2)
Provision for non-covered loan and lease losses	14,431	3,008	35,230	12,989	
Recapture of provision for covered loan losses	(98)	(1,904)	(230)	(4,744)	
Non-interest income	61,924	53,567	155,722	192,285	(3), (4), (5)
Non-interest expense	173,926	191,159	523,805	611,075	(6), (7)
Income before provision for income taxes	99,381	84,507	281,445	224,449	
Provision for income taxes	35,083	28,625	103,810	73,678	
Net income	64,298	55,882	177,635	150,771	
Dividends and undistributed earnings allocated to participating securities	142	196	338	576	
Net earnings available to common shareholders	$64,156	$55,686	$177,297	$150,195	
Earnings per share:					
Basic	$0.30	$0.26	$0.82	$0.70	
Diluted	$0.29	$0.25	$0.81	$0.69	
Average shares outstanding:					
Basic	217,245	216,031	216,884	216,005	
Diluted	218,941	218,559	218,801	218,470	

(1) Includes $29.4 million of incremental loan discount accretion for the three months ended September 30, 2013, and $31.9 million and $99.2 million for the nine months ended September 30, 2014 and 2013, respectively.
(2) Includes a reduction of interest expense of $5.4 million related to deposit and borrowing premiums amortization for the three months ended September 30, 2013, and $5.9 million and $16.9 million for the nine months ended September 30, 2014 and 2013, respectively.
(3) Includes a reduction of service charges on deposit of $1.4 million as a result of passing the $10 billion asset threshold for the three months ended September 30, 2013, and $1.7 million and $4.3 million for the nine months ended September 30, 2014 and 2013, respectively.
(4) Includes a loss on junior subordinated debentures carried at fair value of $966,000 for the three months ended September 30, 2013, and $1.1 million and $2.9 million for nine months ended September 30, 2014 and 2013, respectively.
(5) The nine months ended September 30, 2014 includes the reversal of the $7.0 million loss on the required divestiture of six Sterling stores in connection with the Merger.
(6) Includes $2.0 million of incremental core deposit intangible amortization for the three months ended September 30, 2013, and $2.1 million and $6.0 million for the nine months ended September 30, 2014 and 2013, respectively.

(7) The three and nine months ended September 30, 2014 were adjusted to exclude $8.6 million and $88.0 million of merger expenses, respectively, the three and nine months ended September 30, 2013 were adjusted to include these charges.

Financial Pacific Holding Corp.
On July 1, 2013, the Bank acquired Financial Pacific Holding Corp. ("FPHC") based in Federal Way, Washington, and its subsidiary, Financial Pacific Leasing, Inc. ("FinPac Leasing"), and its subsidiaries, Financial Pacific Funding, Inc. ("FPF"), Financial Pacific Funding II, Inc. ("FPF II") and Financial Pacific Funding III, Inc. ("FPF III"). As part of the same transaction,

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

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

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

A summary of consideration paid, and the assets acquired and liabilities assumed at their fair values, in the acquisition of FinPac are presented below.
(in thousands)

	FinPac July 1, 2013	
Fair value of consideration:		
Cash		$156,110
Fair value of assets acquired:		
Cash and equivalents	$6,452	
Non-covered loans and leases, net	264,336	
Premises and equipment	491	
Other assets	8,015	
Total assets acquired	279,294	
Fair value of liabilities assumed:		
Term debt	211,204	
Other liabilities	8,757	
Total liabilities assumed	$219,961	
Net assets acquired		59,333
Goodwill		$96,777

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

The operations of FinPac are included in our operating results from July 1, 2013, and added revenue of $17.2 million, non-interest expense of $4.2 million, and net income of $4.6 million net of tax, for the three months ended September 30, 2014. For the nine months ended September 30, 2014, FinPac added revenue of $49.5 million, non-interest expense of $12.1 million, and net income of $12.8 million, net of tax. FinPac's results of operations prior to the acquisition are not included in our operating

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results. There are no FinPac merger related expenses for the three and nine months ended September 30, 2014. FinPac merger related expenses were $629,000 and $1.4 million for the three and nine months ended September 30, 2013.

Non-covered leases acquired from FinPac are presented below as of acquisition date:

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

The following table presents unaudited pro forma results of operations for the three and nine months ended September 30, 2013 as if the acquisition of FinPac had occurred on January 1, 2013. The proforma results have been prepared for comparative purposes only and are not necessarily indicative of the results that would have been obtained had the acquisition actually occurred on January 1, 2013. The pro forma results include the impact of certain purchase accounting adjustments which reduced pro forma earnings available to common shareholders by $1.4 million and $2.7 million for the three and nine months ended September 30, 2013, respectively.

(in thousands, except per share data)	Pro Forma	
	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2013
Net interest income	$105,688	$318,904
Provision for non-covered loan and lease losses	4,532	20,826
Recapture of provision for covered loan losses	(1,904)	(4,744)
Non-interest income	26,144	95,968
Non-interest expense	95,130	275,783
Income before provision for income taxes	34,074	123,007
Provision for income taxes	11,900	43,039
Net income	22,174	79,968
Dividends and undistributed earnings allocated to participating securities	248	686
Net earnings available to common shareholders	$21,926	$79,282
Earnings per share:		
Basic	$0.20	$0.71
Diluted	$0.20	$0.71
Average shares outstanding:		
Basic	111,912	111,934
Diluted	112,195	112,154

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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, 2014 and December 31, 2013:

(in thousands)	September 30, 2014			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
AVAILABLE FOR SALE:				
U.S. Treasury and agencies	$214	$16	$—	$230
Obligations of states and political subdivisions	327,857	13,763	(374)	341,246
Residential mortgage-backed securities and collateralized mortgage obligations	2,059,267	15,657	(18,392)	2,056,532
Investments in mutual funds and other equity securities	2,016	37	—	2,053
	$2,389,354	$29,473	$(18,766)	$2,400,061
HELD TO MATURITY:				
Residential mortgage-backed securities and collateralized mortgage obligations	$5,223	$353	$(17)	$5,559
Other investment securities	133	—	—	133
	$5,356	$353	$(17)	$5,692

(in thousands)	December 31, 2013			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
AVAILABLE FOR SALE:				
U.S. Treasury and agencies	$249	$20	$(1)	$268
Obligations of states and political subdivisions	229,969	7,811	(2,575)	235,205
Residential mortgage-backed securities and collateralized mortgage obligations	1,567,001	15,359	(28,819)	1,553,541
Investments in mutual funds and other equity securities	1,959	5	—	1,964
	$1,799,178	$23,195	$(31,395)	$1,790,978
HELD TO MATURITY:				
Residential mortgage-backed securities and collateralized mortgage obligations	$5,563	$330	$(19)	$5,874
	$5,563	$330	$(19)	$5,874

Investment securities that were in an unrealized loss position as of September 30, 2014 and December 31, 2013 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, 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	$—	$—	$12,184	$374	$12,184	$374
Residential mortgage-backed securities and collateralized mortgage obligations	390,787	2,626	519,115	15,766	909,902	18,392
Total temporarily impaired securities	$390,787	$2,626	$531,299	$16,140	$922,086	$18,766
HELD TO MATURITY:						
Residential mortgage-backed securities and collateralized mortgage obligations	$2,283	$17	$—	$—	$2,283	$17
Total temporarily impaired securities	$2,283	$17	$—	$—	$2,283	$17

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

December 31, 2013 (in thousands)	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
AVAILABLE FOR SALE:						
U.S. Treasury and agencies	$—	$—	$32	$1	$32	$1
Obligations of states and political subdivisions	48,342	2,575	—	—	48,342	2,575
Residential mortgage-backed securities and collateralized mortgage obligations	475,982	15,951	249,695	12,868	725,677	28,819
Total temporarily impaired securities	$524,324	$18,526	$249,727	$12,869	$774,051	$31,395
HELD TO MATURITY:						
Residential mortgage-backed securities and collateralized mortgage obligations	$156	$19	$—	$—	$156	$19
Total temporarily impaired securities	$156	$19	$—	$—	$156	$19

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

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, 2014. 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 OTTI.

All of the available for sale residential mortgage-backed securities and collateralized mortgage obligations portfolio in an unrealized loss position at September 30, 2014 are issued or guaranteed by governmental agencies. The unrealized losses on residential mortgage-backed securities and collateralized mortgage obligations were caused by changes in market interest rates or the widening of market spreads subsequent to the initial purchase of these securities, and not concerns regarding the underlying credit of the issuers or the underlying collateral. It is expected that these securities will not be settled at a price less than the amortized cost of each investment. Because the decline in fair value is attributable to changes in interest rates or widening market spreads and not credit quality, and because the Bank does not intend to sell the securities in this class and it is

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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 OTTI.

The following table presents the maturities of investment securities at September 30, 2014:

(in thousands)	Available For Sale		Held To Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
AMOUNTS MATURING IN:				
Three months or less	$7,563	$7,593	$—	$—
Over three months through twelve months	52,418	53,214	—	—
After one year through five years	1,746,126	1,761,633	41	42
After five years through ten years	530,060	522,827	18	19
After ten years	51,171	52,741	5,163	5,497
Other investment securities	2,016	2,053	134	134
	$2,389,354	$2,400,061	$5,356	$5,692

The amortized cost and fair value of collateralized mortgage obligations and mortgage-backed securities are presented by expected average life, rather than contractual maturity, in the preceding table. Expected maturities may differ from contractual maturities because borrowers have the right to prepay underlying loans without prepayment penalties. The following table presents the gross realized gains and gross realized losses on the sale of securities available for sale for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months Ended			
	September 30, 2014		September 30, 2013	
	Gains	Losses	Gains	Losses
Obligations of states and political subdivisions	$—	$—	$3	$—
Residential mortgage-backed securities and collateralized mortgage obligations	902	—	—	—
Other debt securities	—	—	—	—
	$902	$—	$3	$—
	Nine Months Ended			
	September 30, 2014		September 30, 2013	
	Gains	Losses	Gains	Losses
Obligations of states and political subdivisions	$3	$1	$10	$1
Residential mortgage-backed securities and collateralized mortgage obligations	1,876	—	—	—
Other debt securities	—	—	9	—
	$1,879	$1	$19	$1

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The following table presents, as of September 30, 2014, 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	$7,526	$7,842
To state and local governments to secure public deposits	1,627,608	1,634,162
Other securities pledged principally to secure repurchase agreements	498,315	497,031
Total pledged securities	$2,133,449	$2,139,035

Note 4 – Non-Covered Loans and Leases

The following table presents the major types of non-covered loans and leases, net as of September 30, 2014 and December 31, 2013, respectively:

(in thousands)	September 30, 2014	December 31, 2013
Commercial real estate		
Non-owner occupied term, net	$3,273,932	$2,328,260
Owner occupied term, net	2,636,951	1,259,583
Multifamily, net	2,536,710	403,537
Construction & development, net	245,457	245,231
Residential development, net	73,781	88,413
Commercial		
Term, net	1,110,028	770,845
LOC & other, net	1,338,821	987,360
Leases and equipment finance, net	492,221	361,591
Residential		
Mortgage, net	2,085,266	597,201
Home equity loans & lines, net	818,765	264,269
Consumer & other, net	363,879	48,113
Total loans and leases, net of deferred fees and costs	$14,975,811	$7,354,403

The non-covered loan balances are net of net deferred loan costs of $20.2 million as of September 30, 2014 and net of net deferred loan fees of $495,000 at December 31, 2013. Net non-covered loans include discounts on acquired loans of $244.2 million and $3.3 million as of September 30, 2014 and December 31, 2013, respectively. As of September 30, 2014, non-covered loans totaling $8.1 billion were pledged to secure borrowings and available lines of credit.

Purchased loans and leases are recorded at their fair value at the acquisition date. Credit discounts are included in the determination of fair value; therefore, an allowance for loan and lease losses is not recorded at the acquisition date. Acquired loans are evaluated upon acquisition and classified as either purchased impaired or purchased non-impaired. Purchased impaired loans reflect credit deterioration since origination such that it is probable at acquisition that the Company will be unable to collect all contractually required payments. The outstanding contractual unpaid principal balance of non-covered purchased impaired loans, excluding purchase accounting adjustments, was $519.8 million and $35.1 million at September 30, 2014 and December 31, 2013, respectively. The carrying balance of non-covered purchased impaired loans was $367.1 million and $21.9 million at September 30, 2014 and December 31, 2013, 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, 2014 and 2013:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Balance, beginning of period	$105,505	$170	$1,140	$770
Additions	—	—	110,757	—
Accretion to interest income	(9,779)	(54)	(15,856)	(205)
Disposals	(4,111)	(222)	(4,426)	(671)
Reclassifications from nonaccretable difference	2,794	1,334	2,794	1,334
Balance, end of period	$94,409	$1,228	$94,409	$1,228

Note 5 – Allowance for Non-Covered 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, 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, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral. In these cases, we use the current fair value of the collateral, less selling costs, instead of discounted cash flows. If we determine that the value of the impaired loan is less than the recorded investment in the loan, we either recognize an impairment reserve as a specific allowance to be provided for in the allowance for loan and lease losses or charge-off the impaired balance on collateral-dependent loans if it is determined that such amount represents a confirmed loss. Loans determined to be impaired with a specific allowance are excluded from the formula allowance so as not to double-count the loss exposure. The non-accrual impaired loans as of period-end have already been partially charged-off to their estimated net realizable value, and are expected to be resolved over the coming quarters with no additional material loss, absent further decline in market prices.

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

Unallocated Allowance

The Bank may also maintain an unallocated allowance amount to provide for other credit losses inherent in a loan and lease portfolio that may not have been contemplated in the credit loss factors. This unallocated amount generally comprises less than 5% of the allowance, but may be maintained at higher levels during times of deteriorating economic conditions characterized by falling real estate values. The unallocated amount is reviewed quarterly based on trends in credit losses, the results of credit reviews, overall economic trends and other qualitative factors.

Management believes that the ALLL was adequate as of September 30, 2014. 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.

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

The following table summarizes activity related to the allowance for non-covered loan and lease losses by non-covered loan and lease portfolio segment for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months Ended September 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$51,958	$32,587	$11,403	$2,047	$97,995
Charge-offs	(595)	(4,212)	(714)	(1,222)	(6,743)
Recoveries	293	1,332	37	462	2,124
Provision	701	8,883	1,459	3,388	14,431
Balance, end of period	$52,357	$38,590	$12,185	$4,675	$107,807

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

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(in thousands)	Nine Months Ended September 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$53,433	$24,191	$6,827	$863	$85,314
Charge-offs	(3,119)	(11,979)	(1,296)	(1,728)	(18,122)
Recoveries	1,264	3,292	204	625	5,385
Provision	779	23,086	6,450	4,915	35,230
Balance, end of period	$52,357	$38,590	$12,185	$4,675	$107,807

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

The following table presents the allowance and recorded investment in non-covered loans and leases by portfolio segment as of September 30, 2014 and 2013:

(in thousands)	September 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Allowance for non-covered loans and leases:					
Collectively evaluated for impairment	$51,201	$38,577	$12,185	$4,675	$106,638
Individually evaluated for impairment	1,156	13	—	—	1,169
Loans acquired with deteriorated credit quality	—	—	—	—	—
Total	$52,357	$38,590	$12,185	$4,675	$107,807
Non-covered loans and leases:					
Collectively evaluated for impairment	$8,388,428	$2,891,941	$2,858,947	$363,031	$14,502,347
Individually evaluated for impairment	85,804	20,445	—	128	106,377
Loans acquired with deteriorated credit quality	292,599	28,684	45,084	720	367,087
Total	$8,766,831	$2,941,070	$2,904,031	$363,879	$14,975,811

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

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The non-covered loan and lease balances are net of net deferred loans costs of $20.2 million at September 30, 2014 and net of net deferred fees of $6.2 million at September 30, 2013.

Summary of Reserve for Unfunded Commitments Activity

The following table presents a summary of activity in the RUC and unfunded commitments for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Balance, beginning of period	$4,845	$1,327	$1,436	$1,223
Net change to other expense	(457)	48	(1,014)	152
Acquired reserve	—	—	3,966	—
Balance, end of period	$4,388	$1,375	$4,388	$1,375

(in thousands)	Total
Unfunded loan and lease commitments:	
September 30, 2014	$2,949,211
September 30, 2013	$1,610,735

Non-covered 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, 2014 and 2013:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Commercial real estate				
Non-owner occupied term	$—	$4,927	$14,799	$7,777
Owner occupied term	22,884	—	71,128	—
Multifamily	35,306	—	60,508	—
Construction & development	—	—	566	3,515
Residential development	—	—	800	363
Commercial				
Term	4,199	1,098	30,068	47,635
LOC & other	299	—	5,361	—
Residential				
Mortgage	54,917	1,008	60,951	1,008
Home equity loans & lines	—	—	24,445	—
Consumer & other	—	—	7,344	—
Total	$117,605	$7,033	$275,970	$60,298

Asset Quality and Non-Performing Loans and Leases

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

Bank's Credit

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

Non-Covered Non-Accrual Loans and Leases and Loans and Leases Past Due

The following table summarizes our non-covered non-accrual loans and leases and loans and leases past due, by loan and lease class, as of September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014						
	Greater than 30 to 59 Days Past Due	60 to 89 Days Past Due	90 Days and Greater and Accruing	Total Past Due	Non-Accrual	Current & Other (1)	Total non-cover Loans and Leases
Commercial real estate							
Non-owner occupied term, net	$2,290	$6,180	$225	$8,695	$ 15,675	$3,249,562	$3,273,932
Owner occupied term, net	1,874	5,706	—	7,580	3,555	2,625,816	2,636,951
Multifamily, net	422	—	—	422	1,311	2,534,977	2,536,710
Construction & development, net	—	1,204	—	1,204	—	244,253	245,457
Residential development, net	468	—	—	468	—	73,313	73,781
Commercial							
Term, net	961	944	17	1,922	17,051	1,091,055	1,110,028
LOC & other, net	950	2,672	225	3,847	1,879	1,333,095	1,338,821
Leases and equipment finance, net	1,571	3,438	447	5,456	2,795	483,970	492,221
Residential							
Mortgage, net	10	1,254	5,421	6,685	3	2,078,578	2,085,266
Home equity loans & lines, net	772	750	959	2,481	—	816,284	818,765
Consumer & other, net	2,117	442	122	2,681	128	361,070	363,879
Total, net of deferred fees and costs	$11,435	$22,590	$7,416	$41,441	$ 42,397	$14,891,973	$14,975,811

(1) Other includes purchased credit impaired non-covered loans of $367.1 million.

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(in thousands)	December 31, 2013						
	Greater than 30 to 59 Days Past Due	60 to 89 Days Past Due	90 Days and Greater and Accruing	Total Past Due	Non-Accrual	Current & Other (1)	Total non-cover Loans and Leases
Commercial real estate							
Non-owner occupied term, net	$3,618	$352	$—	$3,970	$ 9,193	$2,315,097	$2,328,260
Owner occupied term, net	1,320	340	610	2,270	6,204	1,251,109	1,259,583
Multifamily, net	—	—	—	—	935	402,602	403,537
Construction & development, net	—	—	—	—	—	245,231	245,231
Residential development, net	—	—	—	—	2,801	85,612	88,413
Commercial							
Term, net	901	1,436	—	2,337	8,723	759,785	770,845
LOC & other, net	619	224	—	843	1,222	985,295	987,360
Leases and equipment finance, net	2,202	1,706	517	4,425	2,813	354,353	361,591
Residential							
Mortgage, net	1,050	342	2,070	3,462	—	593,739	597,201
Home equity loans & lines, net	473	563	160	1,196	—	263,073	264,269
Consumer & other, net	69	75	73	217	—	47,896	48,113
Total, net of deferred fees and costs	$10,252	$5,038	$3,430	$18,720	$ 31,891	$7,303,792	$7,354,403

(1) Other includes purchased credit impaired non-covered loans of $21.9 million

Non-Covered Impaired Loans

Loans with no related allowance reported generally represent non-accrual loans. The Bank recognizes the charge-off on impaired loans in the period it arises for collateral-dependent loans. Therefore, the non-accrual loans as of September 30, 2014 have already been written down to their estimated net realizable value and are expected to be resolved with no additional material loss, absent further decline in market prices. The valuation allowance on impaired loans primarily represents the impairment reserves on performing restructured loans, and is measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan's carrying value.

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The following table summarizes our non-covered impaired loans by loan class as of September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014			
	Unpaid	Recorded Investment		
	Principal	Without	With	Related
	Balance	Allowance	Allowance	Allowance
Commercial real estate				
Non-owner occupied term, net	$62,131	$33,035	$25,334	$613
Owner occupied term, net	11,661	3,555	7,677	378
Multifamily, net	5,185	1,311	3,519	68
Construction & development, net	1,091	—	1,091	7
Residential development, net	10,285	2,675	7,607	90
Commercial				
Term, net	34,251	17,052	269	9
LOC & other, net	9,248	1,879	1,245	4
Leases, net	—	—	—	—
Residential				
Mortgage, net	—	—	—	—
Home equity loans & lines, net	501	—	—	—
Consumer & other, net	294	128	—	—
Total, net of deferred fees and costs	$134,647	$59,635	$46,742	$1,169

(in thousands)	December 31, 2013			
	Unpaid	Recorded Investment		
	Principal	Without	With	Related
	Balance	Allowance	Allowance	Allowance
Commercial real estate				
Non-owner occupied term, net	$50,602	$18,285	$31,362	$928
Owner occupied term, net	11,876	6,204	5,202	198
Multifamily, net	1,416	935	—	—
Construction & development, net	10,609	8,498	1,091	11
Residential development, net	22,513	5,776	11,927	648
Commercial				
Term, net	22,750	8,723	300	8
LOC & other, net	7,144	1,222	1,258	4
Leases, net	—	—	—	—
Residential				
Mortgage, net	—	—	—	—
Home equity loans & lines, net	—	—	—	—
Consumer & other, net	—	—	—	—
Total, net of deferred fees and costs	$126,910	$49,643	$51,140	$1,797

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The following table summarizes our average recorded investment and interest income recognized on impaired non-covered loans by loan class for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Commercial real estate				
Non-owner occupied term, net	$55,246	$573	$62,246	$389
Owner occupied term, net	11,686	79	8,222	49
Multifamily, net	4,830	113	1,082	—
Construction & development, net	5,288	11	13,607	122
Residential development, net	12,190	124	19,442	165
Commercial				
Term, net	18,381	4	11,622	4
LOC & other, net	3,478	13	2,268	13
Residential				
Mortgage, net	—	—	238	—
Home equity loans & lines, net	—	—	—	—
Consumer & other, net	64	—	—	—
Total, net of deferred fees and costs	$111,163	$917	$118,727	$742

(in thousands)	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Commercial real estate				
Non-owner occupied term, net	$53,460	$1,532	$67,281	$1,155
Owner occupied term, net	11,989	231	6,475	146
Multifamily, net	2,737	113	723	—
Construction & development, net	7,423	33	15,001	363
Residential development, net	14,128	373	23,513	474
Commercial				
Term, net	14,512	12	12,688	13
LOC & other, net	2,928	38	4,389	39
Residential				
Mortgage, net	—	—	191	—
Home equity loans & lines, net	—	—	120	—
Consumer & other, net	32	—	1	—
Total, net of deferred fees and costs	$107,209	$2,332	$130,382	$2,190

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

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Non-Covered Credit Quality Indicators

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

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

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

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

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

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

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

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

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

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

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cases, once the collateral is valued and appropriate margin applied, the remaining un-collateralized portion will be charged-off. The remaining balance, properly margined, may then be upgraded to substandard, however must remain on non-accrual.

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

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

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

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

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

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

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

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

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

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

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

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The following table summarizes our internal risk rating by loan and lease class for the non-covered loan and lease portfolio as of September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014						
	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Impaired (1)	Total
Commercial real estate							
Non-owner occupied term, net	$3,004,702	$107,055	$103,479	$327	$—	$58,369	$3,273,932
Owner occupied term, net	2,469,495	68,393	86,640	571	620	11,232	2,636,951
Multifamily, net	2,515,322	10,213	6,345	—	—	4,830	2,536,710
Construction & development, net	236,693	4,367	3,306	—	—	1,091	245,457
Residential development, net	61,061	776	1,662	—	—	10,282	73,781
Commercial							
Term, net	1,063,690	14,065	14,690	251	11	17,321	1,110,028
LOC & other, net	1,272,032	40,874	22,476	225	90	3,124	1,338,821
Leases and equipment finance, net	484,056	3,687	1,351	2,551	576	—	492,221
Residential							
Mortgage, net	2,061,460	4,811	7,545	—	11,450	—	2,085,266
Home equity loans & lines, net	810,760	4,468	1,591	—	1,946	—	818,765
Consumer & other, net	360,396	2,769	360	—	226	128	363,879
Total, net of deferred fees and costs	$14,339,667	$261,478	$249,445	$3,925	$14,919	$106,377	$14,975,811

(1) Impaired loans includes 6.3% classified as watch, 2.8% classified as special mentioned, 89.7% classified as substandard, and 1.2% classified as doubtful.

(in thousands)	December 31, 2013						
	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Impaired (1)	Total
Commercial real estate							
Non-owner occupied term, net	$2,073,366	$108,263	$96,984	$—	$—	$49,647	$2,328,260
Owner occupied term, net	1,182,865	27,615	37,524	173	—	11,406	1,259,583
Multifamily, net	385,335	5,574	11,693	—	—	935	403,537
Construction & development, net	230,262	2,054	3,326	—	—	9,589	245,231
Residential development, net	67,019	1,836	1,855	—	—	17,703	88,413
Commercial							
Term, net	718,778	23,393	19,651	—	—	9,023	770,845
LOC & other, net	951,109	24,197	9,574	—	—	2,480	987,360
Leases and equipment finance, net	351,971	4,585	1,706	2,996	333	—	361,591
Residential							
Mortgage, net	593,723	1,405	743	—	1,330	—	597,201
Home equity loans & lines, net	263,070	1,038	25	—	136	—	264,269
Consumer & other, net	47,895	144	33	—	41	—	48,113
	$6,865,393	$200,104	$183,114	$3,169	$1,840	$100,783	$7,354,403

Total, net of deferred fees and costs

(1) Impaired loans includes 6.4% classified as watch, 3.7% classified as special mentioned, and 89.9% classified as substandard.

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Troubled Debt Restructurings

At September 30, 2014 and December 31, 2013, impaired loans of $63.5 million and $68.8 million, respectively, were classified as accruing restructured loans. The restructurings were granted in response to borrower financial difficulty, and generally provide for a temporary modification of loan repayment terms. The restructured loans on accrual status represent the only impaired loans accruing interest. In order for a restructured loan to be considered for accrual status, the loan's collateral coverage generally will be greater than or equal to 100% of the loan balance, the loan is current on payments, and the borrower must either prefund an interest reserve or demonstrate the ability to make payments from a verified source of cash flow. Impaired restructured loans carry a specific allowance and the allowance on impaired restructured loans is calculated consistently across the portfolios.

There were no available commitments for troubled debt restructurings outstanding as of September 30, 2014 and December 31, 2013.

The following tables present troubled debt restructurings by accrual versus non-accrual status and by loan segment as of September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014		
	Accrual Status	Non-Accrual Status	Total Modifications
Commercial real estate, net	$61,657	$4,808	$66,465
Commercial, net	1,245	2,510	3,755
Residential, net	605	—	605
Total, net of deferred fees and costs	$63,507	$7,318	$70,825

(in thousands)	December 31, 2013		
	Accrual Status	Non-Accrual Status	Total Modifications
Commercial real estate, net	$67,060	$2,196	$69,256
Commercial, net	1,258	2,603	3,861
Residential, net	473	—	473
Total, net of deferred fees and costs	$68,791	$4,799	$73,590

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

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

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

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

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

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

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

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The following table presents newly non-covered restructured loans that occurred during the three and nine months ended September 30, 2014 and three and nine months ended September 30, 2013:

(in thousands)	Three Months Ended September 30, 2014					
	Rate Modifications	Term Modifications	Interest Only Modifications	Payment Modifications	Combination Modifications	Total Modifications
Commercial real estate, net	$—	$1,088	$—	$—	$—	$1,088
Commercial, net	—	—	—	—	—	—
Residential, net	—	—	—	—	—	—
Consumer & other, net	—	—	—	—	—	—
Total, net of deferred fees and costs	$—	$1,088	$—	$—	$—	$1,088

	Three Months Ended September 30, 2013					
	Rate Modifications	Term Modifications	Interest Only Modifications	Payment Modifications	Combination Modifications	Total Modifications
Commercial real estate, net	$—	$—	$—	$—	$—	$—
Commercial, net	—	—	—	—	3,588	3,588
Residential, net	—	—	—	—	—	—
Consumer & other, net	—	—	—	—	—	—
Total, net of deferred fees and costs	$—	$—	$—	$—	$3,588	$3,588

	Nine Months Ended September 30, 2014					
	Rate Modifications	Term Modifications	Interest Only Modifications	Payment Modifications	Combination Modifications	Total Modifications
Commercial real estate, net	$—	$2,332	$—	$—	$3,519	$5,851
Commercial, net	—	—	—	—	—	—
Residential, net	—	—	—	—	138	138
Consumer & other, net	—	—	—	—	—	—
Total	$—	$2,332	$—	$—	$3,657	$5,989

(in thousands)	Nine Months Ended September 30, 2013					
	Rate Modifications	Term Modifications	Interest Only Modifications	Payment Modifications	Combination Modifications	Total Modifications
Commercial real estate, net	$—	$—	$4,291	$—	$—	$4,291
Commercial, net	—	—	—	—	4,040	4,040
Residential, net	—	—	—	—	478	478
Consumer & other, net	—	—	—	—	—	—
	$—	$—	$4,291	$—	$4,518	$8,809

Total, net of deferred fees
and costs

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

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There were no financing receivables modified as troubled debt restructurings within the previous 12 months for which there was a payment default during the three and nine months ended September 30, 2014 and 2013.

Note 6 – Covered Assets and Indemnification Asset

Covered Loans, Net
Loans acquired in a Federal Deposit Insurance Corporation ("FDIC")-assisted acquisition that are subject to a loss-share agreement are referred to as covered loans and reported separately in our statements of financial condition. Covered loans are reported exclusive of the cash flow reimbursements expected from the FDIC.

The following table presents the major types of covered loans as of September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014	December 31, 2013
Commercial real estate		
Non-owner occupied term, net	$149,521	$206,902
Owner occupied term, net	45,919	49,817
Multifamily, net	29,001	37,671
Construction & development, net	2,359	3,455
Residential development, net	3,068	7,286
Commercial		
Term, net	9,630	15,719
LOC & other, net	5,920	6,698
Residential		
Mortgage, net	17,067	22,316
Home equity loans & lines, net	17,289	19,637
Consumer & other, net	3,616	4,262
Total, net of deferred fees and costs	$283,390	$373,763
Allowance for covered loans	(7,828)	(9,771)
Total	$275,562	$363,992

The outstanding contractual unpaid principal balance, excluding purchase accounting adjustments, at September 30, 2014 was $336.9 million as compared to $462.4 million at December 31, 2013.

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

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

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The following table presents the changes in the accretable yield for the three and nine months ended September 30, 2014 and 2013 for the covered loan portfolio:

(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Balance, beginning of period	$95,022	$154,803	$126,484	$183,388
Accretion to interest income	(8,478)	(11,457)	(36,461)	(40,041)
Disposals	(2,723)	(3,726)	(19,977)	(11,179)
Reclassifications from nonaccretable difference	6,201	2,696	19,976	10,148
Balance, end of period	$90,022	$142,316	$90,022	$142,316

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Allowance for Covered Loan Losses

The following table summarizes activity related to the allowance for covered loan losses by covered loan portfolio segment for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months Ended September 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$4,962	$2,839	$550	$149	$8,500
Charge-offs	(509)	(212)	(13)	(47)	(781)
Recoveries	100	80	12	15	207
(Recapture) provision	(271)	(66)	238	1	(98)
Balance, end of period	$4,282	$2,641	$787	$118	$7,828

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

(in thousands)	Nine Months Ended September 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$6,105	$2,837	$660	$169	$9,771
Charge-offs	(1,555)	(1,126)	(177)	(110)	(2,968)
Recoveries	729	326	147	53	1,255
(Recapture) provision	(997)	604	157	6	(230)
Balance, end of period	$4,282	$2,641	$787	$118	$7,828

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

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The following table presents the allowance and recorded investment in covered loans by portfolio segment as of September 30, 2014 and 2013:

(in thousands)	September 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Allowance for covered loans:					
Loans acquired with deteriorated credit quality (1)	$4,200	$2,537	$733	$71	$7,541
Collectively evaluated for impairment (2)	82	104	54	47	287
Total	$4,282	$2,641	$787	$118	$7,828
Covered loans:					
Loans acquired with deteriorated credit quality (1)	$229,469	$8,924	$29,227	$1,312	$268,932
Collectively evaluated for impairment (2)	399	6,626	5,129	2,304	14,458
Total	$229,868	$15,550	$34,356	$3,616	$283,390

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

(1) The valuation allowance is netted against the carrying value of the covered loan balance.
(2) The allowance on covered loan losses includes an allowance on covered loan advances on acquired loans subsequent to acquisition.

The valuation allowance on covered loans was reduced by recaptured provision of $311,000 and $1.6 million for the three and nine months ended September 30, 2014, respectively, and $2.4 million and $7.9 million for the three and nine months ended September 30, 2013, respectively.

Covered Credit Quality Indicators

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

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The following table summarizes our internal risk rating grouping by covered loans, net as of September 30, 2014 and December 31, 2013:

(in thousands)	September 30, 2014					
	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Total
Commercial real estate						
Non-owner occupied term, net	$93,662	$18,128	$35,905	$—	$—	$147,695
Owner occupied term, net	28,917	4,874	11,028	—	—	44,819
Multifamily, net	18,061	1,664	8,820	—	—	28,545
Construction & development, net	1,160	—	830	—	—	1,990
Residential development, net	—	221	2,313	—	—	2,534
Commercial						
Term, net	3,361	536	3,199	—	—	7,096
LOC & other, net	5,813	—	—	—	—	5,813
Residential						
Mortgage, net	17,005	—	—	—	—	17,005
Home equity loans & lines, net	16,486	—	79	—	—	16,565
Consumer & other, net	3,500	—	—	—	—	3,500
Total, net of deferred fees and costs and allowance for loan losses	$187,965	$25,423	$62,174	$—	$—	$275,562

(in thousands)	December 31, 2013					
	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Total
Commercial real estate						
Non-owner occupied term, net	$133,452	$26,321	$44,279	$—	$—	$204,052
Owner occupied term, net	30,119	3,370	14,971	213	—	48,673
Multifamily, net	24,213	2,563	10,409	—	—	37,185
Construction & development, net	1,117	—	1,686	—	—	2,803
Residential development, net	492	224	5,541	54	—	6,311
Commercial						
Term, net	3,753	3,141	6,128	258	—	13,280
LOC & other, net	4,630	991	681	—	—	6,302
Residential						
Mortgage, net	22,175	—	—	—	—	22,175
Home equity loans & lines, net	19,043	—	76	—	—	19,119
Consumer & other, net	4,092	—	—	—	—	4,092
Total, net of deferred fees and costs and allowance for loan losses	$243,086	$36,610	$83,771	$525	$—	$363,992

FDIC Indemnification Asset

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

FDIC indemnification asset.

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

The following table summarizes the activity related to the FDIC indemnification asset for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Balance, beginning of period	$11,293	$36,263	$23,174	$52,798
Change in FDIC indemnification asset	(2,728)	(6,474)	(13,169)	(19,841)
Transfers to due from FDIC and other	(754)	(362)	(2,194)	(3,530)
Balance, end of period	$7,811	$29,427	$7,811	$29,427

Note 7–Goodwill and Other Intangible Assets

The following tables summarize the changes in the Company's goodwill and other intangible assets for the year ended December 31, 2013, and the nine months ended September 30, 2014. Goodwill and all other intangible assets are related to the Community Banking segment.

(in thousands)	Goodwill		
	Gross	Accumulated Impairment	Total
Balance, December 31, 2012	$781,106	$(112,934)	$668,172
Net additions	96,777	—	96,777
Reductions	(644)	—	(644)
Balance, December 31, 2013	877,239	(112,934)	764,305
Net additions	1,021,102	—	1,021,102
Reductions	—	—	—
Balance, September 30, 2014	$1,898,341	$(112,934)	$1,785,407

Goodwill represents the excess of the total purchase price paid over the fair value of the assets acquired, net of the fair values of liabilities assumed. Additional information on the acquisitions and purchase price allocations is provided in Note 2. The reduction to goodwill in 2013 of $644,000 relates to purchase accounting adjustments.

(in thousands)	Other Intangible Assets		
	Gross	Accumulated Amortization	Net
Balance, December 31, 2012	$58,909	(41,750)	$17,159
Net additions	—	—	—
Amortization	—	(4,781)	(4,781)
Balance, December 31, 2013	58,909	(46,531)	12,378
Net additions	54,562	—	54,562

Amortization	—	(7,105)	(7,105)
Balance, September 30, 2014	$113,471	$(53,636)	$59,835

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Intangible additions in 2014 relate to the Merger and represent the value of the core deposits, which includes all deposits except certificates of deposit. The value of the core deposit intangible assets were determined by an analysis of the cost differential between the core deposits inclusive of estimated servicing costs and alternative funding sources. The core deposit intangible recorded in connection with the Merger will be amortized on an accelerated basis over a period of 10 years.

The Company conducts its annual evaluation of goodwill for impairment as of its year end of December 31. Goodwill and other intangibles are required to be analyzed for impairment if certain triggering events occur. During the nine months ended September 30, 2014, management determined that no trigger events occurred that required an impairment analysis. The table below presents the forecasted amortization expense for intangible assets acquired in all mergers:

(in thousands)	
Year	Expected Amortization
Remainder of 2014	$3,102
2015	11,225
2016	8,622
2017	6,756
2018	6,166
Thereafter	23,964
	$59,835

Note 8 – Residential Mortgage Servicing Rights

The following table presents the changes in the Company's residential mortgage servicing rights ("MSR") for the three and nine months ended September 30, 2014 and 2013:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Balance, beginning of period	$114,192	$38,192	$47,765	$27,428
Acquired/purchased MSR	—	—	62,770	—
Additions for new MSR capitalized	8,813	4,072	16,583	15,182
Changes in fair value:				
Due to changes in model inputs or assumptions(1)	(672)	3,406	(2,543)	3,739
Other(2)	(3,608)	(3,817)	(5,850)	(4,496)
Balance, end of period	$118,725	$41,853	$118,725	$41,853

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

Information related to our residential mortgage serviced loan portfolio as of September 30, 2014 and December 31, 2013 is as follows:

(dollars in thousands)	September 30, 2014	December 31, 2013
Balance of residential mortgage loans serviced for others	$11,300,947	$4,362,499
MSR as a percentage of serviced loans	1.05%	1.09%

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The amount of contractually specified servicing fees, late fees and ancillary fees earned, recorded in residential mortgage banking revenue, was $6.2 million and $14.5 million for the three and nine months ended September 30, 2014, as compared to $2.7 million and $7.5 million for the three and nine months ended September 30, 2013.

Key assumptions used in measuring the fair value of MSR as of September 30, 2014 and December 31, 2013 are as follows:

	September 30, 2014		December 31, 2013	
Constant prepayment rate	11.52	%	12.74	%
Discount rate	9.16	%	8.69	%
Weighted average life (years)	6.7		6.0	

A sensitivity analysis of the current fair value to changes in discount and prepayment speed assumptions as of September 30, 2014 and December 31, 2013 is as follows:

(in thousands)	September 30, 2014		December 31, 2013	
Constant prepayment rate				
Effect on fair value of a 10% adverse change	$(4,822	)	$(2,255	)
Effect on fair value of a 20% adverse change	$(9,275	)	$(4,323	)
Discount rate				
Effect on fair value of a 100 basis point adverse change	$(4,722	)	$(1,832	)
Effect on fair value of a 200 basis point adverse change	$(9,120	)	$(3,534	)

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

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Note 9 – Junior Subordinated Debentures

Following is information about the Company's wholly-owned trusts ("Trusts") as of September 30, 2014:

(dollars in thousands) Trust Name	Issue Date	Issued Amount	Carrying Value (1)	Rate (2)	Effective Rate (3)	Maturity Date
AT FAIR VALUE:						
Umpqua Statutory Trust II	October 2002	$20,619	$15,028	Floating rate, LIBOR plus 3.35%, adjusted quarterly	4.92%	October 2032
Umpqua Statutory Trust III	October 2002	30,928	22,736	Floating rate, LIBOR plus 3.45%, adjusted quarterly	5.01%	November 2032
Umpqua Statutory Trust IV	December 2003	10,310	7,104	Floating rate, LIBOR plus 2.85%, adjusted quarterly	4.48%	January 2034
Umpqua Statutory Trust V	December 2003	10,310	7,081	Floating rate, LIBOR plus 2.85%, adjusted quarterly	4.49%	March 2034
Umpqua Master Trust I	August 2007	41,238	23,281	Floating rate, LIBOR plus 1.35%, adjusted quarterly	2.81%	September 2037
Umpqua Master Trust IB	September 2007	20,619	13,684	Floating rate, LIBOR plus 2.75%, adjusted quarterly	4.50%	December 2037
Sterling Capital Trust III	April 2003	14,433	11,075	Floating rate, LIBOR plus 3.25%, adjusted quarterly	4.55%	April 2033
Sterling Capital Trust IV	May 2003	10,310	7,824	Floating rate, LIBOR plus 3.15%, adjusted quarterly	4.46%	May 2033
Sterling Capital Statutory Trust V	May 2003	20,619	15,708	Floating rate, L		