

COLUMBIA BANKING SYSTEM INC
Form 10-Q
November 07, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2008.

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

For the transition period from _____ to _____.

Commission File Number 0-20288

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

Washington
(State or other jurisdiction of
incorporation or organization)

91-1422237
(I.R.S. Employer
Identification Number)

1301 "A" Street
Tacoma, Washington
(Address of principal executive offices)

98402-2156
(Zip Code)

(253) 305-1900
(Issuer's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

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

Yes No

The number of shares of common stock outstanding at October 31, 2008 was 18,150,965

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PART I - FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

CONSOLIDATED CONDENSED STATEMENTS OF INCOME (LOSS)

Columbia Banking System, Inc.
(Unaudited)

| (in thousands except per share) | Three Months Ended | | Nine Months Ended | |
|---|--------------------|-----------|-------------------|------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Interest Income | | | | |
| Loans | \$ 35,590 | \$ 42,353 | \$ 114,227 | \$ 112,607 |
| Taxable securities | 4,615 | 4,625 | 14,490 | 14,067 |
| Tax-exempt securities | 1,997 | 2,005 | 5,997 | 5,925 |
| Federal funds sold and deposits in banks | 135 | 395 | 379 | 1,180 |
| Total interest income | 42,337 | 49,378 | 135,093 | 133,779 |
| Interest Expense | | | | |
| Deposits | 10,148 | 16,841 | 36,444 | 42,617 |
| Federal Home Loan Bank advances | 1,887 | 2,454 | 6,464 | 8,117 |
| Long-term obligations | 423 | 584 | 1,339 | 1,604 |
| Other borrowings | 286 | 639 | 652 | 2,183 |
| Total interest expense | 12,744 | 20,518 | 44,899 | 54,521 |
| Net Interest Income | 29,593 | 28,860 | 90,194 | 79,258 |
| Provision for loan and lease losses | 10,500 | 1,231 | 27,926 | 2,198 |
| Net interest income after provision for loan and lease losses | 19,093 | 27,629 | 62,268 | 77,060 |
| Noninterest Income | | | | |
| Service charges and other fees | 3,823 | 3,561 | 11,129 | 9,813 |
| Merchant services fees | 2,081 | 2,251 | 6,159 | 6,344 |
| Redemption of Visa and Mastercard shares | - | - | 3,028 | - |
| Gain on sale of investment securities, net | - | - | 882 | - |
| Loss on impairment of equity securities | (18,517) | - | (18,517) | - |
| Bank owned life insurance ("BOLI") | 533 | 502 | 1,587 | 1,379 |
| Other | 1,134 | 1,317 | 4,248 | 3,013 |
| Total noninterest income | (10,946) | 7,631 | 8,516 | 20,549 |
| Noninterest Expense | | | | |
| Compensation and employee benefits | 12,173 | 12,159 | 37,917 | 34,365 |
| Occupancy | 3,248 | 3,241 | 9,706 | 9,023 |
| Merchant processing | 961 | 880 | 2,731 | 2,587 |
| Advertising and promotion | 579 | 575 | 1,797 | 1,779 |
| Data processing | 909 | 743 | 2,507 | 1,863 |
| Legal and professional fees | 765 | 695 | 1,479 | 2,205 |
| Taxes, licenses and fees | 720 | 773 | 2,267 | 2,089 |
| Net loss (gain) on sale of other real estate owned | 4 | - | (19) | - |
| Other | 4,032 | 3,359 | 11,927 | 9,182 |
| Total noninterest expense | 23,391 | 22,425 | 70,312 | 63,093 |
| Income (loss) before income taxes | (15,244) | 12,835 | 472 | 34,516 |
| Provision (benefit) for income taxes | (6,485) | 3,579 | (3,682) | 9,433 |

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| | | | | |
|--|------------|----------|----------|-----------|
| Net Income (Loss) | \$ (8,759) | \$ 9,256 | \$ 4,154 | \$ 25,083 |
| Net income (loss) per common share | | | | |
| Basic | \$ (0.49) | \$ 0.53 | \$ 0.23 | \$ 1.52 |
| Diluted | \$ (0.49) | \$ 0.53 | \$ 0.23 | \$ 1.51 |
| Dividends paid per common share | \$ 0.17 | \$ 0.17 | \$ 0.51 | \$ 0.49 |
| Weighted average number of common shares outstanding | 17,948 | 17,339 | 17,898 | 16,472 |
| Weighted average number of diluted common shares outstanding | 17,948 | 17,533 | 17,994 | 16,636 |

See accompanying notes to unaudited consolidated condensed financial statements.

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CONSOLIDATED CONDENSED BALANCE SHEETS

Columbia Banking System, Inc.
(Unaudited)

| (in thousands) | September 30, 2008 | December 31, 2007 |
|---|--------------------------|-------------------------|
| ASSETS | | |
| Cash and due from banks | \$ 81,555 | \$ 82,735 |
| Interest-earning deposits with banks | 21,849 | 11,240 |
| Total cash and cash equivalents | 103,404 | 93,975 |
| Securities available for sale at fair value (amortized cost of \$535,620 and \$558,685, respectively) | 536,277 | 561,366 |
| Federal Home Loan Bank stock at cost | 14,785 | 11,607 |
| Loans held for sale | 2,890 | 4,482 |
| Loans, net of deferred loan fees of (\$3,852) and (\$3,931), respectively | 2,216,133 | 2,282,728 |
| Less: allowance for loan and lease losses | 35,814 | 26,599 |
| Loans, net | 2,180,319 | 2,256,129 |
| Interest receivable | 12,980 | 14,622 |
| Premises and equipment, net | 61,153 | 56,122 |
| Other real estate owned | 1,288 | 181 |
| Goodwill | 95,519 | 96,011 |
| Core deposit intangible, net | 6,179 | 7,050 |
| Other assets | 90,186 | 77,168 |
| Total Assets | \$ 3,104,980 | \$ 3,178,713 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Deposits: | | |
| Non-interest bearing | \$ 498,815 | \$ 468,237 |
| Interest-bearing | 1,857,006 | 2,029,824 |
| Total deposits | 2,355,821 | 2,498,061 |
| Short-term borrowings: | | |
| Federal Home Loan Bank advances | 301,000 | 257,670 |
| Securities sold under agreements to repurchase | 25,000 | - |
| Other borrowings | 20,097 | 5,061 |
| Total short-term borrowings | 346,097 | 262,731 |
| Long-term subordinated debt | 25,582 | 25,519 |
| Other liabilities | 41,045 | 50,671 |
| Total liabilities | 2,768,545 | 2,836,982 |
| Commitments and contingent liabilities (note 11) | | |
| Shareholders' equity: | | |
| Preferred stock (no par value) | - | - |
| Authorized, 2 million shares; none outstanding | | |
| | September 30, 2008 | December 31, 2007 |
| Common Stock (no par value) | | |

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| | | | | |
|--|--------|--------|--------------|--------------|
| Authorized shares | 63,034 | 63,034 | | |
| Issued and outstanding | 18,147 | 17,953 | 229,680 | 226,550 |
| Retained earnings | | | 102,965 | 110,169 |
| Accumulated other comprehensive income | | | 3,790 | 5,012 |
| Total shareholders' equity | | | 336,435 | 341,731 |
| Total Liabilities and Shareholders' Equity | | | \$ 3,104,980 | \$ 3,178,713 |

See accompanying notes to unaudited consolidated condensed financial statements.

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CONSOLIDATED CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Columbia Banking System, Inc.
(Unaudited)

| (in thousands) | Common Stock | | Retained Earnings | Accumulated | Total Shareholders' Equity |
|--|------------------|------------|-------------------|-----------------------------------|----------------------------|
| | Number of Shares | Amount | | Other Comprehensive Income (Loss) | |
| Balance at January 1, 2007 | 16,060 | \$ 166,763 | \$ 89,037 | \$ (3,453) | \$ 252,347 |
| Comprehensive income: | | | | | |
| Net income | - | - | 25,083 | - | 25,083 |
| Other comprehensive income, net of tax: | | | | | |
| Net unrealized gain from securities, net of reclassification adjustments | - | - | - | 1,911 | 1,911 |
| Net unrealized gain from cash flow hedging instruments | - | - | - | 794 | 794 |
| Total comprehensive income | | | | | 27,788 |
| Purchase and retirement of common stock | (65) | (2,121) | - | - | (2,121) |
| Acquisitions: | | | | | |
| Shares issued to the shareholders of Mountain Bank Holding Company | 993 | 30,327 | - | - | 30,327 |
| Converted Mountain Bank Holding Company stock options | - | 1,325 | - | - | 1,325 |
| Shares issued to the shareholders of Town Center Bancorp | 705 | 23,869 | - | - | 23,869 |
| Converted Town Center Bancorp stock options | - | 1,598 | - | - | 1,598 |
| Issuance of stock under stock option and other plans | 139 | 2,098 | - | - | 2,098 |
| Stock award compensation expense | 50 | 573 | - | - | 573 |
| Stock option compensation expense | - | 137 | - | - | 137 |
| Tax benefit associated with stock-based compensation | - | 235 | - | - | 235 |
| Cash dividends paid on common stock | - | - | (8,207) | - | (8,207) |
| Balance at September 30, 2007 | 17,882 | \$ 224,804 | \$ 105,913 | \$ (748) | \$ 329,969 |
| Balance at January 1, 2008 | 17,953 | \$ 226,550 | \$ 110,169 | \$ 5,012 | \$ 341,731 |
| Cumulative effect of change in accounting principle (note 2) | | | | | |
| | - | - | (2,137) | - | (2,137) |
| Comprehensive income: | | | | | |
| Net income | - | - | 4,154 | - | 4,154 |
| Other comprehensive loss, net of tax: | | | | | |
| Net unrealized loss from securities, net of reclassification adjustments | - | - | - | (1,302) | (1,302) |
| Net unrealized gain from cash flow hedging instruments | - | - | - | 80 | 80 |
| Total comprehensive income | | | | | 2,932 |
| | 132 | 1,860 | - | - | 1,860 |

Issuance of stock under stock option and other plans

| | | | | | |
|--|--------|------------|------------|----------|------------|
| Stock award compensation expense | 62 | 1,040 | - | - | 1,040 |
| Tax benefit associated with stock-based compensation | - | 230 | - | - | 230 |
| Cash dividends paid on common stock | - | - | (9,221) | - | (9,221) |
| Balance at September 30, 2008 | 18,147 | \$ 229,680 | \$ 102,965 | \$ 3,790 | \$ 336,435 |

See accompanying notes to unaudited consolidated condensed financial statements.

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CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

Columbia Banking System, Inc.
(Unaudited)

| (in thousands) | Nine Months Ended September | |
|--|-----------------------------|-------------|
| | 2008 | 2007 |
| | | 30, |
| Cash Flows From Operating Activities | | |
| Net Income | \$ 4,154 | \$ 25,083 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Provision for loan and lease losses | 27,926 | 2,198 |
| Deferred income tax benefit | (12,318) | (1,194) |
| Excess tax benefit from stock-based compensation | (230) | (235) |
| Stock-based compensation expense | 1,040 | 710 |
| Depreciation, amortization and accretion | 5,389 | 4,607 |
| Net realized gain on sale of securities | (882) | - |
| Net realized gain on sale of other assets | (798) | (8) |
| Impairment charge on investment securities | 18,517 | - |
| Net change in: | | |
| Loans held for sale | 1,592 | (875) |
| Interest receivable | 1,642 | (2,074) |
| Interest payable | (4,591) | 4,606 |
| Other assets | (6,841) | 3,109 |
| Other liabilities | (5,951) | (6,994) |
| Net cash provided by operating activities | 28,649 | 28,933 |
| Cash Flows From Investing Activities | | |
| Purchases of securities available for sale | (86,902) | (2,888) |
| Proceeds from sales of securities available for sale | 51,358 | 28,467 |
| Proceeds from principal repayments and maturities of securities available for sale | 40,328 | 39,033 |
| Proceeds from maturities of securities held to maturity | - | 578 |
| Loans originated and acquired, net of principal collected | 45,605 | (218,350) |
| Purchases of premises and equipment | (8,838) | (4,003) |
| Proceeds from disposal of premises and equipment | 115 | 212 |
| Acquisition of Mt. Rainier and Town Center, net of cash acquired | - | (32,429) |
| Proceeds from sales of Federal Reserve Bank stock | - | 310 |
| Purchase of FHLB stock | (3,178) | - |
| Proceeds from termination of cash flow hedging instruments | 8,093 | - |
| Proceeds from sales of other real estate and other personal property owned | 204 | - |
| Net cash provided by(used in) investing activities | 46,785 | (189,070) |
| Cash Flows From Financing Activities | | |
| Net increase(decrease) in deposits | (142,240) | 149,758 |
| Proceeds from Federal Home Loan Bank advances | 1,784,268 | 2,353,626 |
| Repayment from Federal Home Loan Bank advances | (1,740,938) | (2,315,151) |
| Proceeds from repurchase agreement borrowings | 25,000 | - |
| Repayment of repurchase agreement borrowings | - | (20,000) |
| Net increase in other borrowings | 15,036 | 10 |
| Cash dividends paid on common stock | (9,221) | (8,207) |
| Proceeds from issuance of common stock | 1,860 | 2,098 |

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| | | |
|--|------------|------------|
| Repurchase of common stock | - | (2,121) |
| Excess tax benefit from stock-based compensation | 230 | 235 |
| Net cash provided by(used in) financing activities | (66,005) | 160,248 |
| Increase in cash and cash equivalents | 9,429 | 111 |
| Cash and cash equivalents at beginning of period | 93,975 | 104,344 |
| Cash and cash equivalents at end of period | \$ 103,404 | \$ 104,455 |
| Supplemental Information: | | |
| Cash paid for interest | \$ 49,490 | \$ 49,915 |
| Cash paid for income tax | \$ 9,916 | \$ 10,490 |
| Share-based consideration issued for acquisitions | \$ - | \$ 57,119 |
| Loans transferred to other real estate owned | \$ 1,288 | \$ - |

See accompanying notes to unaudited consolidated condensed financial statements.

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NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Columbia Banking System, Inc.

1. Basis of Presentation and Significant Accounting Policies

(a) Basis of Presentation

The interim unaudited consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for condensed interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain financial information and footnotes have been omitted or condensed. The consolidated condensed financial statements include the accounts of the Company, and its wholly owned banking subsidiary Columbia Bank. All intercompany transactions and accounts have been eliminated in consolidation. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair statement of the results for the interim periods presented have been included. The consolidated financial statements and results of operations presented in this report on Form 10-Q include financial information for Mountain Bank Holding Company and Town Center Bancorp, which were merged into Columbia Bank in the third quarter of 2007. The results of operations for the nine months ended September 30, 2008 are not necessarily indicative of results to be anticipated for the year ending December 31, 2008. The accompanying interim unaudited consolidated condensed financial statements should be read in conjunction with the financial statements and related notes contained in the Company's 2007 Annual Report on Form 10-K.

(b) Significant Accounting Policies

The significant accounting policies used in preparation of our consolidated financial statements are disclosed in our 2007 Annual Report on Form 10-K. There have not been any other changes in our significant accounting policies compared to those contained in our 2007 10-K disclosure for the year ended December 31, 2007.

2. Accounting Pronouncements Recently Issued or Adopted

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162, The Hierarchy of Generally Accepted Accounting Principles ("SFAS 162"). This statement identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles ("GAAP") in the United States (the GAAP hierarchy). This Statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. Adoption of SFAS 162 is not expected to have any effect on the Company's financial condition or results of operations.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133 ("SFAS 161"). This Statement requires enhanced disclosures about an entity's derivative and hedging activities and is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company plans to apply the enhanced disclosure provisions of SFAS 161 to all derivative and hedging activities.

On January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157, Fair Value Measurements ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value under

accounting principles generally accepted in the United States of America, and expands disclosures about fair value measurement. For further information, see Note 6 of the Notes to Unaudited Consolidated Condensed Financial Statements.

On January 1, 2008, the Company began applying the consensus reached by the Emerging Issues Task Force in Issue No. 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements (“EITF 06-4”). EITF 06-4 provides recognition guidance regarding liabilities and related compensation costs for endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods. The Company recognized the effects of applying the consensus through a change in accounting principle with a cumulative-effect charge to retained earnings of \$2.1 million, net of income taxes of \$1.2 million. During the second quarter of 2008 the Company entered into transactions whereby certain current and former officers of the Company agreed to terminate the split-dollar portion of their bank owned life insurance policies in exchange for individual life insurance policies. In the second quarter of 2008 the Company recognized the net effect of those transactions as a reduction of compensation expense totaling \$107,000.

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3. Earnings per share

The following table sets forth the computation of basic and diluted earnings (loss) per share for the three and nine months ended September 30, 2008 and 2007 (in thousands, except for per share data):

| (in thousands except per share) | For The Three Months Ended | | For The Nine Months Ended | |
|--|----------------------------|-----------|---------------------------|-----------|
| | 9/30/2008 | 9/30/2007 | 9/30/2008 | 9/30/2007 |
| Net Income (Loss) | \$ (8,759) | \$ 9,256 | \$ 4,154 | \$ 25,083 |
| Weighted average common shares outstanding (for basic calculation) | 17,948 | 17,339 | 17,898 | 16,472 |
| Dilutive effect of outstanding common stock options and nonvested restricted shares | - | 194 | 96 | 164 |
| Weighted average common stock and common equivalent shares outstanding (for diluted calculation) | 17,948 | 17,533 | 17,994 | 16,636 |
| Earnings (loss) per common share - basic | \$ (0.49) | \$ 0.53 | \$ 0.23 | \$ 1.52 |
| Earnings (loss) per common share - diluted | \$ (0.49) | \$ 0.53 | \$ 0.23 | \$ 1.51 |

Potential dilutive shares are excluded from the computation of earnings per share if their effect is anti-dilutive. Anti-dilutive shares outstanding related to options to acquire common stock for the three and nine month periods ended September 30, 2008 totaled 92,258 and 59,292, respectively. There were no anti-dilutive shares outstanding related to options to acquire common stock for the same periods last year.

4. Dividends

Subsequent to quarter end, on October 23, 2008, the Company declared a quarterly cash dividend of \$0.07 per share, payable on November 19, 2008, to shareholders of record at the close of business November 5, 2008. The decision to reduce the quarterly dividend as compared to recent quarters was based upon the Board of Directors' review of the Company's dividend payout ratio and dividend yield balanced with the Company's desire to retain capital. On July 24, 2008, the Company declared a quarterly cash dividend of \$.17 per share, payable on August 20, 2008, to shareholders of record at the close of business on August 6, 2008. On April 24, 2008, the Company declared a quarterly cash dividend of \$0.17 per share, payable on May 21, 2008, to shareholders of record at the close of business May 7, 2008. On January 24, 2008, the Company declared a quarterly cash dividend of \$0.17 per share, payable on February 20, 2008 to shareholders of record as of the close of business on February 6, 2008. The payment of cash dividends is subject to Federal regulatory requirements for capital levels and other restrictions. In addition, the cash dividends paid by Columbia Bank to the Company are subject to both Federal and State regulatory requirements.

Subsequent to quarter-end, the Company received preliminary approval from the U.S. Department of Treasury to receive additional capital by participating in the Treasury Department's Capital Purchase Program. As a participant in the program, Columbia could issue to the U.S. Treasury up to \$76.9 million in senior preferred shares and related warrants. Receipt of the funding is subject to Columbia's acceptance of the terms of the agreement, satisfaction of closing conditions and registration with the Securities and Exchange Commission. Certain terms of the senior preferred shares restrict the ability of the Company to repurchase and/or pay dividends on common stock.

5. Business Segment Information

The Company is managed along two major lines of business: commercial banking and retail banking. The treasury function of the Company, included in the "Other" category, although not considered a line of business, is responsible for the management of investments and interest rate risk. In addition, the provision for loan and lease losses is included in the "Other" category. On April 1, 2008, the Bank of Astoria banking subsidiary was merged into the Columbia Bank banking subsidiary. This change in internal organizational structure also changes the composition of the Company's reportable segments. Accordingly, segment results for the Bank of Astoria are now included in the Retail Banking segment. Prior period segment reporting has been restated to reflect this change.

The Company generates segment results that include balances directly attributable to business line activities. The financial results of each segment are derived from the Company's general ledger system. Overhead, including sales and back office support functions and other indirect expenses are not allocated to the major lines of business. Goodwill resulting from business combinations is included in the Retail Banking segment. Since the Company is not specifically organized around lines of business, most reportable segments comprise more than one operating activity.

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The principal activities conducted by commercial banking are the origination of commercial business relationships, private banking services and real estate lending. Retail banking includes all deposit products, with their related fee income, and all consumer loan products as well as commercial loan products offered in the Company's branch offices.

Effective January 1, 2008 the Company implemented a more robust internal funds transfer pricing methodology. Internal funds transfer pricing refers to the process we utilize to give an earnings credit to a branch or revenue center for the deposit funds they generate while providing an earnings charge to the centers that use deposit funds to make loans. The implementation of this methodology changed the basis of measurement for segment net interest income as presented in the tables below. Generally, this methodology had the effect of increasing net interest income for the commercial banking segment with a corresponding decrease in net interest income for the retail banking segment. The increase in net interest income for the commercial banking segment is driven primarily by the earnings credit for deposit funds generated within that segment. In prior years, the retail banking segment benefited from the earnings credit for deposit funds generated by the commercial banking segment. Segment net interest income after provision for loan and lease losses for the current quarter and year-to-date periods is not directly comparable to the same line item for the same periods of last year as those prior periods cannot practicably be restated.

The organizational structure of the Company and its business line financial results are not necessarily comparable with information from other financial institutions. Financial highlights by lines of business are as follows:

| (in thousands) | Three Months Ended September 30, 2008 | | | |
|---|---------------------------------------|-------------------|------------|--------------|
| | Commercial Banking | Retail Banking | Other | Total |
| Net interest income | \$ 10,563 | \$ 13,198 | \$ 5,832 | \$ 29,593 |
| Provision for loan and lease losses | - | - | (10,500) | (10,500) |
| Net interest income after provision for loan and lease losses | 10,563 | 13,198 | (4,668) | 19,093 |
| Noninterest income | 846 | 2,171 | (13,963) | (10,946) |
| Noninterest expense | (10,610) | (14,866) | 2,085 | (23,391) |
| Income (loss) before income taxes | 799 | 503 | (16,546) | (15,244) |
| Income tax benefit | | | | 6,485 |
| Net loss | | | | \$ (8,759) |
| Total assets | \$ 1,423,184 | \$ 1,015,412 | \$ 666,384 | \$ 3,104,980 |

| (in thousands) | Three Months Ended September 30, 2007 | | | |
|---|---------------------------------------|-------------------|------------|--------------|
| | Commercial Banking | Retail Banking | Other | Total |
| Net interest income | \$ 11,893 | \$ 17,464 | \$ (497) | \$ 28,860 |
| Provision for loan and lease losses | - | - | (1,231) | (1,231) |
| Net interest income after provision for loan and lease losses | 11,893 | 17,464 | (1,728) | 27,629 |
| Noninterest income | 1,067 | 2,353 | 4,211 | 7,631 |
| Noninterest expense | (3,341) | (7,362) | (11,722) | (22,425) |
| Income (loss) before income taxes | 9,619 | 12,455 | (9,239) | 12,835 |
| Income tax provision | | | | (3,579) |
| Net income | | | | \$ 9,256 |
| Total assets | \$ 1,399,262 | \$ 1,003,947 | \$ 719,535 | \$ 3,122,744 |

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Nine Months Ended September 30, 2008

| (in thousands) | Commercial Banking | Retail Banking | Other | Total |
|---|-----------------------|-------------------|------------|--------------|
| Net interest income | \$ 37,283 | \$ 43,805 | \$ 9,106 | \$ 90,194 |
| Provision for loan and lease losses | - | - | (27,926) | (27,926) |
| Net interest income after provision for loan and lease losses | 37,283 | 43,805 | (18,820) | 62,268 |
| Noninterest income | 2,848 | 6,736 | (1,068) | 8,516 |
| Noninterest expense | (16,577) | (31,965) | (21,770) | (70,312) |
| Income (loss) before income taxes | 23,554 | 18,576 | (41,658) | 472 |
| Income tax benefit | | | | 3,682 |
| Net income | | | | \$ 4,154 |
| Total assets | \$ 1,423,184 | \$ 1,015,412 | \$ 666,384 | \$ 3,104,980 |

Nine Months Ended September 30, 2007

| (in thousands) | Commercial Banking | Retail Banking | Other | Total |
|---|-----------------------|-------------------|------------|--------------|
| Net interest income | \$ 21,055 | \$ 59,537 | \$ (1,334) | \$ 79,258 |
| Provision for loan and lease losses | - | - | (2,198) | (2,198) |
| Net interest income after provision for loan and lease losses | 21,055 | 59,537 | (3,532) | 77,060 |
| Noninterest income | 2,427 | 6,249 | 11,873 | 20,549 |
| Noninterest expense | (8,719) | (20,058) | (34,316) | (63,093) |
| Income (loss) before income taxes | 14,763 | 45,728 | (25,975) | 34,516 |
| Income tax provision | | | | (9,433) |
| Net income | | | | \$ 25,083 |
| Total assets | \$ 1,399,262 | \$ 1,003,947 | \$ 719,535 | \$ 3,122,744 |

6. Fair Value Accounting and Measurement

SFAS 157 defines fair value, establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value. We hold fixed and variable rate interest bearing securities, investments in marketable equity securities and certain other financial instruments, which are carried at fair value. Fair value is determined based upon quoted prices when available or through the use of alternative approaches, such as matrix or model pricing, when market quotes are not readily accessible or available.

The valuation techniques are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our own market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1 – Quoted prices for identical instruments in active markets that are accessible at the measurement date.

Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 – Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable.

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Fair values are determined as follows:

Certain preferred stock securities at fair value are priced using quoted prices for identical instruments in active markets and are classified within level 1 of the valuation hierarchy.

Other securities at fair value are priced using matrix pricing based on the securities' relationship to other benchmark quoted prices, and under the provisions of SFAS 157 are considered a Level 2 input method.

Interest rate swap positions are valued in models, which use as their basis, readily observable market parameters and are classified within level 2 of the valuation hierarchy.

The following table sets forth the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis at September 30, 2008 by level within the fair value hierarchy. As required by SFAS 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

| (in thousands) | Fair value at September 30, 2008 | Fair Value Measurements at Reporting Date Using | | |
|-------------------------------|--|--|------------|---------|
| | | Level 1 | Level 2 | Level 3 |
| Assets | | | | |
| Securities available for sale | \$ 536,277 | \$ 1,512 | \$ 534,765 | \$ - |
| Interest rate swap agreements | \$ 3,703 | \$ - | \$ 3,703 | \$ - |
| Liabilities | | | | |
| Interest rate swap agreements | \$ 3,703 | \$ - | \$ 3,703 | \$ - |

Certain assets and liabilities are measured at fair value on a nonrecurring basis after initial recognition such as loans measured for impairment and OREO. The following methods were used to estimate the fair value of each such class of financial instrument:

Impaired loans - A loan is considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due (both interest and principal) according to the contractual terms of the loan agreement. Impaired loans are measured by the fair market value of the collateral less estimated costs to sell.

Other real estate owned - OREO is real property that the Bank has taken ownership of in partial or full satisfaction of a loan or loans. OREO is recorded at the lower of the carrying amount of the loan or fair value less estimated costs to sell. This amount becomes the property's new basis. Any write-downs based on the property fair value less estimated cost to sell at the date of acquisition are charged to the allowance for loan and lease losses. Management periodically reviews OREO in an effort to ensure the property is carried at the lower of its new basis or fair value, net of estimated costs to sell.

The following table sets forth the Company's financial assets that were accounted for at fair value on a nonrecurring basis at September 30, 2008:

Fair value at

| (in thousands) | Fair Value Measurements at Reporting Date Using | | | |
|-------------------------|---|---------|---------|-----------|
| | September 30, 2008 | Level 1 | Level 2 | Level 3 |
| Impaired loans | \$ 14,453 | \$ - | \$ - | \$ 14,453 |
| Other real estate owned | 1,449 | - | - | 1,449 |
| | \$ 15,902 | \$ - | \$ - | \$ 15,902 |

In accordance with Statement of Financial Accounting Standards No. 114, Accounting by Creditors for Impairment of a Loan, impaired loans, with carrying amounts of \$16,701 had specific valuation allowances totaling \$2,248, which were included in the allowance for loan and lease losses.

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Other real estate owned with a carrying amount of \$1.6 million was acquired during the quarter. In accordance with Statement of Financial Accounting Standards No.144, Accounting for the Impairment or Disposal of Long-Lived Assets, these long-lived assets held for sale were written down to their fair value of \$1.4 million, less cost to sell of \$161,000 (or \$1.3 million), resulting in a loss of \$266,000, which was charged to the allowance for loan and lease losses during the period.

7. Securities

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

| (in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|-------------------|------------------------------|-------------------------------|------------|
| September 30, 2008: | | | | |
| U.S. government-sponsored enterprise preferred stock | \$ 1,512 | \$ - | \$ - | \$ 1,512 |
| U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations | 344,123 | 3,803 | (1,268) | 346,658 |
| State and municipal securities | 188,985 | 2,635 | (4,453) | 187,167 |
| Other securities | 1,000 | - | (60) | 940 |
| Total | \$ 535,620 | \$ 6,438 | \$ (5,781) | \$ 536,277 |
| December 31, 2007: | | | | |
| U.S. government-sponsored enterprise | \$ 61,137 | \$ 216 | \$ (53) | \$ 61,300 |
| U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations | 304,475 | 1,132 | (1,865) | 303,742 |
| State and municipal securities | 190,673 | 3,782 | (490) | 193,965 |
| Other securities | 2,400 | - | (41) | 2,359 |
| Total | \$ 558,685 | \$ 5,130 | \$ (2,449) | \$ 561,366 |

During the quarter, the Federal Home Loan Mortgage Corporation (“Freddie Mac”) and the Federal National Mortgage Association (“Fannie Mae”) were placed into conservatorship in a plan announced by the U.S. Treasury Department (“Treasury”) and the Federal Housing Finance Agency (“FHFA”). The Company holds 400,000 shares of Series Z preferred stock issued by Freddie Mac and 400,000 shares of Series S preferred stock issued by Fannie Mae. Such securities are held in the Company’s available-for-sale investment securities portfolio and, as such, declines in fair value below cost are subject to a potential other than temporary impairment charge to earnings under Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities. The Company’s cost for these securities was \$20 million. The estimated fair market value of these securities declined from \$20 million at June 30, 2008 to \$1.5 million at September 30, 2008. In light of the actions taken by Treasury and FHFA and the accompanying significant decline in the fair value of these securities below cost, the Company has deemed the impairment to be other than temporary and, accordingly, recognized a pre-tax charge to earnings in the third quarter totaling \$18.5 million.

At September 30, 2008, available for sale securities with a carrying amount of \$28.7 million were pledged as collateral for repurchase agreement borrowings. In addition, available for sale securities with a carrying amount of \$6.1 million at September 30, 2008 were pledged as collateral for certain interest rate swap agreements.

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The following tables show the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2008 and December 31, 2007:

September 30, 2008

| (in thousands) | Less than 12 Months | | 12 Months or More | | Total | |
|---|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations | \$ 11,679 | \$ (78) | \$ 53,728 | \$ (1,190) | \$ 65,407 | \$ (1,268) |
| State and municipal securities | 95,609 | (4,037) | 6,158 | (416) | 101,767 | (4,453) |
| Other securities | - | - | 940 | (60) | 940 | (60) |
| Total | \$ 107,288 | \$ (4,115) | \$ 60,826 | \$ (1,666) | \$ 168,114 | \$ (5,781) |

December 31, 2007

| (in thousands) | Less than 12 Months | | 12 Months or More | | Total | |
|---|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. government-sponsored enterprise | \$ - | \$ - | \$ 17,678 | \$ (53) | \$ 17,678 | \$ (53) |
| U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations | 16,897 | (28) | 170,932 | (1,837) | 187,829 | (1,865) |
| State and municipal securities | 19,725 | (112) | 24,549 | (378) | 44,274 | (490) |
| Other securities | - | - | 959 | (41) | 959 | (41) |
| Total | \$ 36,622 | \$ (140) | \$ 214,118 | \$ (2,309) | \$ 250,740 | \$ (2,449) |

U.S. Government Agency and Government-Sponsored Enterprise Mortgage-Backed Securities and Collateralized Mortgage Obligations. At September 30, 2008, there were 21 U.S. government agency and government-sponsored enterprise mortgage-backed securities & collateralized mortgage obligations securities in an unrealized loss position, of which 15 were in a continuous loss position for 12 months or more. The unrealized losses on U.S. Government agency mortgage-backed securities & collateralized mortgage obligations were caused by interest rate increases subsequent to the purchase of the securities. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates rather than credit quality, and because the Company has the ability and intent to hold these investments until a recovery of market value, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2008.

State and Municipal Securities. At September 30, 2008 there were 126 state and municipal government securities in an unrealized loss position, of which 8 were in a continuous loss position for 12 months or more. The unrealized losses on state and municipal securities were caused by interest rate increases subsequent to the purchase of the individual securities. Management monitors published credit ratings of these securities for adverse changes. As of September 30, 2008 none of the obligations of state and local government entities held by the Company had an adverse credit rating. Because the decline in fair value is attributable to changes in interest rates rather than credit quality, and because the Company has the ability and intent to hold these investments until a recovery of market value,

which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2008.

Other Securities. At September 30, 2008, there was one other security, a mortgage-backed securities fund, which was in a continuous loss position for 12 months or more. The unrealized loss on this security was caused by interest rate increases subsequent to the purchase of the security. It is expected that this security would not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates rather than credit quality, and because the Company has the ability and intent to hold this investment until a recovery of market value, the Company does not consider this investment to be other-than-temporarily impaired at September 30, 2008.

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8. Comprehensive Income (Loss)

The components of comprehensive income are as follows:

| (in thousands) | Three Months Ended | |
|--|--------------------|-----------|
| | September 30, | |
| | 2008 | 2007 |
| Net income(loss) as reported | \$ (8,759) | \$ 9,256 |
| Unrealized gain from securities: | | |
| Net unrealized holding gain from available for sale securities arising during the period, net of tax of (\$1,935) and \$(3,259) | 3,513 | 5,974 |
| Reclassification adjustment of net (gain)loss from sale of available for sale securities included in income, net of tax of \$0 and \$0 | - | - |
| Net unrealized gain from securities, net of reclassification adjustment | 3,513 | 5,974 |
| Unrealized gain(loss) from cash flow hedging instruments: | | |
| Net unrealized gain from cash flow hedging instruments arising during the period, net of tax of \$0 and \$(863) | - | 1,583 |
| Reclassification adjustment of net (gain)loss included in income, net of tax of \$197 and \$(13) | (357) | 24 |
| Net unrealized gain(loss) from cash flow hedging instruments | (357) | 1,607 |
| Total comprehensive income (loss) | \$ (5,603) | \$ 16,837 |
| | Nine Months Ended | |
| | September 30, | |
| (in thousands) | 2008 | 2007 |
| Net income as reported | \$ 4,154 | \$ 25,083 |
| Unrealized gain(loss) from securities: | | |
| Net unrealized holding gain(loss) from available for sale securities arising during the period, net of tax of \$410 and \$(992) | (731) | 1,911 |
| Reclassification adjustment of net gain from sale of available for sale securities included in income, net of tax of \$311 and \$0 | (571) | - |
| Net unrealized gain (loss) from securities, net of reclassification adjustment | (1,302) | 1,911 |
| Unrealized gain from cash flow hedging instruments: | | |
| Net unrealized gain from cash flow hedging instruments arising during the period, net of tax of \$(425) and \$(413) | 739 | 756 |
| Reclassification adjustment of net (gain)loss included in income, net of tax of \$363 and \$(20) | (659) | 38 |
| Net unrealized gain from cash flow hedging instruments | 80 | 794 |
| Total comprehensive income | \$ 2,932 | \$ 27,788 |

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

The following table presents activity in the allowance for loan and lease losses for the three and nine months ended September 30, 2008 and 2007:

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|---|--------------------|-----------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Beginning balance | \$ 41,724 | \$ 21,339 | \$ 26,599 | \$ 20,182 |
| Balance established through acquisition | - | 3,192 | - | 3,192 |
| Provision charged to expense | 10,500 | 1,231 | 27,926 | 2,198 |
| Loans charged off | (16,481) | (528) | (19,384) | (854) |
| Recoveries | 71 | 146 | 673 | 662 |
| Ending balance | \$ 35,814 | \$ 25,380 | \$ 35,814 | \$ 25,380 |

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

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|---|--------------------|--------|-------------------|--------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Beginning balance | \$ 459 | \$ 339 | \$ 349 | \$ 339 |
| Net changes in the allowance for unfunded commitments and letters of credit | - | 10 | 110 | 10 |
| Ending balance | \$ 459 | \$ 349 | \$ 459 | \$ 349 |

10. Goodwill and Intangible Assets

At September 30, 2008 and December 31, 2007, the Company had \$95.5 million and \$96.0 million in goodwill, respectively. The change in goodwill from year-end is due to income tax adjustments related to the 2007 acquisitions resulting from the preparation of final income tax returns. At September 30, 2008 and December 31, 2007, the Company had a core deposit intangible (“CDI”) asset of \$6.2 million and \$7.1 million, respectively. In accordance with SFAS No. 142, “Goodwill and Other Intangible Assets”, goodwill is not amortized but is reviewed for potential impairment at the reporting unit level during the third quarter on an annual basis and between annual tests in certain circumstances such as material adverse changes in legal, business, regulatory, and economic factors. An impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. The CDI is evaluated for impairment if events and circumstances indicate a possible impairment. The CDI is amortized on an accelerated basis over an estimated life of approximately 10 years. Amortization expense related to the CDI was \$279,000 and \$96,000 for the three months ended September 30, 2008 and September 30, 2007 and \$871,000 and \$287,000 for the nine months ended September 30, 2008 and September 30, 2007, respectively. The Company estimates that aggregate amortization expense on the CDI will be \$271,000 during the fourth quarter of 2008, \$1.0 million for 2009, \$963,000 for 2010, \$893,000 for 2011 and \$832,000 for 2012. The CDI amortization expense is included in other noninterest expense on the consolidated condensed statements of income.

11. Commitments and Contingent Liabilities

On March 18, 2008 Visa, Inc. (“Visa”) completed its initial public offering (“IPO”). On March 31, 2008 Visa funded a litigation escrow account with \$3.0 billion from the IPO proceeds. Based on the Company’s Visa USA membership

percentage, the expected economic benefit to the Company from this escrow account is \$889,200. Accordingly, the Company recognized a recapture of previously accrued legal expense of \$889,200. This recapture is included in the legal and professional services line item of the consolidated condensed statements of income and is a reduction of the \$1.8 million Visa litigation liability the Company accrued during the fourth quarter of 2007. Subsequent to quarter-end, on October 27, 2008, Visa announced that it had reached a settlement in principle in certain covered litigation with Discover Financial Services. The settlement totals \$1.9 billion, which includes \$1.7 billion from the litigation escrow account, \$80 million from Visa to obtain releases from MasterCard and an additional \$65 million which will be refunded by Morgan Stanley under a separate agreement related to the settlement. On November 5, 2008, Visa announced that the settlement was approved by Visa's former U.S. member financial institutions.

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Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion should be read in conjunction with the unaudited consolidated condensed financial statements of Columbia Banking System, Inc. (referred to in this report as "we", "our", and "the Company") and notes thereto presented elsewhere in this report and with the December 31, 2007 audited consolidated financial statements and its accompanying notes included in our recent Annual Report on Form 10-K. In the following discussion, unless otherwise noted, references to increases or decreases in average balances in items of income and expense for a particular period and balances at a particular date refer to the comparison with corresponding amounts for the period or date one year earlier.

NOTE REGARDING FORWARD LOOKING STATEMENTS

This Quarterly Report on Form 10-Q may be deemed to include forward looking statements, which management believes to be a benefit to shareholders. These forward looking statements describe management's expectations regarding future events and developments such as future operating results, growth in loans and deposits, continued success of our style of banking and the strength of the local economy. The words "will," "believe," "expect," "should," and "anticipate" and words of similar construction are intended in part to help identify forward looking statements. Future events are difficult to predict, and the expectations described above are necessarily subject to risk and uncertainty that may cause actual results to differ materially and adversely. In addition to discussions about risks and uncertainties set forth from time to time in our filings with the SEC, factors that may cause actual results to differ materially from those contemplated by such forward looking statements include, among others, the following possibilities: (1) local and national economic conditions are less favorable than expected or have a more direct and pronounced effect on us than expected and adversely affect our ability to continue internal growth at historical rates and maintain the quality of our earning assets; (2) a continued decline in the housing/real estate market; (3) changes in interest rates significantly reduce interest margins and negatively affect funding sources; (4) deterioration of credit quality that could, among other things, increase defaults and delinquency risks in the Company's loan portfolios (5) projected business increases following strategic expansion activities are lower than expected; (6) competitive pressure among financial institutions increases significantly; (7) legislation or regulatory requirements or changes adversely affect the businesses in which we are engaged; and (8) our ability to realize the efficiencies we expect to receive from our investments in personnel, acquisitions and infrastructure.

CRITICAL ACCOUNTING POLICIES

Management has identified the accounting policies related to the allowance for loan and lease losses as critical to an understanding of our financial statements. These policies and related estimates are discussed in "Item 7. Management Discussion and Analysis of Financial Condition and Results of Operation" under the heading "Allowance for Loan and Lease Losses and Unfunded Loan Commitments and Letters of Credit" in our 2007 Annual Report on Form 10-K. There have not been any material changes in our critical accounting policies relating to the allowance for loan and lease losses as compared to those disclosed in our 2007 Annual Report on Form 10-K.

OVERVIEW

Note: The first nine months of 2007 financial information does not include the results of operations of Mountain Bank Holding Company and Town Center Bancorp prior to the acquisition date of July 23, 2007.

Earnings Summary

The Company reported a net loss for the third quarter of \$8.8 million or (\$0.49) per diluted share, compared to net income of \$9.3 million or \$0.53 per diluted share for the third quarter of 2007. Return on average assets and return on average equity were (1.12%) and (10.10%), respectively, for the third quarter of 2008, compared with returns of 1.24% and 12.18%, respectively for the same period of 2007. The Company's results for the third quarter of 2008 declined from the same period in 2007, as a result of an other than temporary impairment charge of \$18.5 million, before tax, on preferred stock issued by Federal National Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("Freddie Mac") and a provision for loan and lease losses of \$10.5 million as discussed below. The results of the third quarter of 2008 reflect the financial consolidation of Mountain Bank Holding Company and Town Center Bancorp, which were both acquired on July 23, 2007; accordingly, the financial information for the third quarter of 2007 only includes partial results of the two organizations.

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The Company reported net income of \$4.2 million for the first nine months of 2008 or \$0.23 per diluted share, compared with \$25.1 million or \$1.51 per diluted share for the first nine months of 2007. Return on average assets and return on average equity were 0.18% and 1.59%, respectively, for the first nine months of 2008, compared with returns of 1.22% and 12.92%, respectively for the first nine months of 2007. As stated above, the Company's results for the first nine months of 2008 declined from the same period in 2007, as a result of the other than temporary impairment charge of \$18.5 million and a provision for loan and lease losses of \$27.9 million as discussed below. The results of the first nine months reflect the financial consolidation of Mountain Bank Holding Company and Town Center Bancorp, which were both acquired on July 23, 2007; accordingly, the financial information for the first nine months of 2007 does not include the results of the two organizations for the entire period.

Revenue (net interest income plus noninterest income) for the three months ended September 30, 2008 was \$18.6 million, 49% lower than the same period in 2007. The decrease was primarily driven by the reduction in noninterest income resulting from the \$18.5 million impairment loss on preferred stock discussed above.

Revenue (net interest income plus noninterest income) for the first nine months of 2008 was \$98.7 million, 1%, lower than the first nine months of 2007. The reduction in noninterest income for the period stemming from the \$18.5 million impairment loss was partially offset by gains on the sale of investment securities, proceeds from the redemption of Visa and MasterCard shares and increased service charges and other fees. In addition, net interest income increased 14% from the prior year driven primarily by growth in earning assets due, in part, to the third quarter 2007 acquisitions.

Total noninterest expense in the quarter ended September 30, 2008 was \$23.4 million, a 4% increase from the third quarter of 2007. Regulatory premiums, data processing expenses and core deposit intangible expenses increased in the third quarter 2008 primarily due to the third quarter 2007 acquisitions.

Total noninterest expense in the first nine months of 2008 was \$70.3 million, or 11%, higher than in the first nine months of 2007. The increase was due to compensation and occupancy costs related to the third quarter 2007 acquisitions. In addition, regulatory premiums were \$1.2 million higher for the first nine months of 2008 over the same period in 2007, resulting from a credit received in 2007 which offset the majority of the FDIC premiums due. These increases were offset by a partial reversal of legal expenses in the first quarter of 2008, totaling \$889,000, related to certain Visa litigation. Legal expenses related to this litigation were accrued by the Company in the fourth quarter of 2007.

The provision for loan and lease losses for the third quarter of 2008 was \$10.5 million compared with \$1.2 million for the third quarter of 2007. The additional provision is due to the continued weakness in the for-sale housing industry resulting from the slowing economic environment and non-accrual loans of \$76.2 million at September 30, 2008 compared to \$10 million at September 30, 2007. The provision increased the Company's total allowance for loan and lease losses to 1.62% of net loans at September 30, 2008 from 1.17% at year-end. Net charge-offs for the current quarter were \$16.4 million compared to \$382,000 for the third quarter of 2007.

The provision for loan and lease losses for the first nine months of 2008 was \$27.9 million compared with \$2.2 million for the first nine months of 2007. Net charge-offs for the first nine months of 2008 were \$18.7 million as compared to \$192,000 for the first nine months of 2007.

RESULTS OF OPERATIONS

Our results of operations are dependent to a large degree on our net interest income. We also generate noninterest income through service charges and fees, merchant services fees, and bank owned life insurance. Our operating expenses consist primarily of compensation and employee benefits, occupancy, merchant card processing, data

processing and legal and professional fees. Like most financial institutions, our interest income and cost of funds are affected significantly by general economic conditions, particularly changes in market interest rates, and by government policies and actions of regulatory authorities.

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Note: The first nine months of 2007 financial information does not include the results of operations of Mountain Bank Holding Company and Town Center Bancorp prior to the acquisition date of July 23, 2007.

Net Interest Income

For the three months ended September 30, 2008 we experienced a slight decrease in our net interest margin when compared to the same period in 2007. This decrease resulted primarily from a decline in the yield on earning assets. For the third quarter of 2008 interest income decreased 14% while interest expense decreased 38%, when compared to the same period in 2007. The decrease in interest income and interest expense for the period is primarily due to rate decreases on both interest-earning assets and interest-bearing liabilities. For the nine months ended September 30, 2008 interest income increased 1% over the same period in 2007 whereas interest expense decreased 18%. The increase in interest income in the first nine months of the year was driven primarily by loan growth and the decrease in interest expense driven by rate decreases on interest bearing deposits and borrowed funds. Finally, like most financial institutions, changes in the target Federal Funds rate may affect our net interest margin.

The following tables set forth the average balances of all major categories of interest-earning assets and interest-bearing liabilities, the total dollar amounts of interest income on interest-earning assets and interest expense on interest-bearing liabilities, the average yield earned on interest-earning assets and average rate paid on interest-bearing liabilities by category and in total, net interest income and net interest margin.

| (in thousands) | Three months ending September 30, 2008 | | | Three months ending September 30, 2007 | | |
|---|--|------------------------|--------------|--|------------------------|--------------|
| | Average Balances (1) | Interest Earned / Paid | Average Rate | Average Balances (1) | Interest Earned / Paid | Average Rate |
| ASSETS | | | | | | |
| Loans, net (2) | \$ 2,241,574 | \$ 35,696 | 6.34% | \$ 2,102,281 | \$ 42,353 | 7.99% |
| Securities (2) | 558,990 | 7,806 | 5.56% | 572,124 | 7,727 | 5.36% |
| Interest-earning deposits with banks and federal funds sold | 30,330 | 135 | 1.78% | 28,082 | 395 | 5.58% |
| Total interest-earning assets | 2,830,894 | \$ 43,637 | 6.13% | 2,702,487 | \$ 50,475 | 7.41% |
| Other earning assets | 47,795 | | | 44,595 | | |
| Noninterest-earning assets | 227,867 | | | 222,115 | | |
| Total assets | \$ 3,106,556 | | | \$ 2,969,197 | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | | |
| Certificates of deposit | \$ 741,101 | \$ 6,048 | 3.25% | \$ 772,358 | \$ 8,976 | 4.61% |
| Savings accounts | 120,025 | 109 | 0.36% | 116,640 | 131 | 0.45% |
| Interest-bearing demand and money market accounts | 1,035,641 | 3,991 | 1.53% | 1,038,571 | 7,734 | 2.95% |
| Total interest-bearing deposits | 1,896,767 | 10,148 | 2.13% | 1,927,569 | 16,841 | 3.47% |
| Federal Home Loan Bank advances | 293,685 | 1,887 | 2.56% | 178,303 | 2,454 | 5.46% |
| Securities sold under agreements to repurchase | 25,000 | 121 | 1.93% | 44,457 | 637 | 5.68% |
| Other borrowings and interest-bearing liabilities | 18,634 | 165 | 3.52% | 370 | 2 | 2.14% |
| Long-term subordinated debt | 25,569 | 423 | 6.59% | 24,771 | 584 | 9.35% |
| Total interest-bearing liabilities | 2,259,655 | \$ 12,744 | 2.24% | 2,175,470 | \$ 20,518 | 3.74% |

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| | | | | |
|--|--------------|-----------|--------------|-----------|
| Noninterest-bearing deposits | 468,455 | | 455,312 | |
| Other noninterest-bearing liabilities | 34,288 | | 36,916 | |
| Shareholders' equity | 344,158 | | 301,499 | |
| Total liabilities & shareholders' equity | \$ 3,106,556 | | \$ 2,969,197 | |
| Net interest income (2) | | \$ 30,893 | | \$ 29,957 |
| Net interest margin | | | 4.34% | 4.40% |

(1) Nonaccrual loans have been included in the tables as loans carrying a zero yield. Interest reversals for the third quarter ended September 30, 2008 related to nonaccrual loans totaled \$1.4 million. Excluding the impact of interest reversals, net interest margin for the quarter would have been 4.49%. Amortized net deferred loan fees were included in the interest income calculations. The amortization of net deferred loan fees was \$737,000 and \$1.2 million for the three months ended September 30, 2008 and 2007 respectively.

(2) Tax-exempt income is calculated on a tax equivalent basis, based on a marginal tax rate of 35%.

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| (in thousands) | Nine months ending September 30, 2008 | | | Nine months ending September 30, 2007 | | |
|--|--|-----------------------------|-----------------|--|-----------------------------|-----------------|
| | Average Balances (1) | Interest Earned/ Paid | Average Rate | Average Balances (1) | Interest Earned/ Paid | Average Rate |
| ASSETS | | | | | | |
| Loans, net (2) | \$ 2,281,129 | \$ 114,521 | 6.71% | \$ 1,905,945 | \$ 112,607 | 7.90% |
| Securities (2) | 575,215 | 24,278 | 5.64% | 584,057 | 23,239 | 5.32% |
| Interest-earning deposits with banks and federal funds sold | 23,316 | 379 | 2.17% | 29,621 | 1,180 | 5.33% |
| Total interest-earning assets | 2,879,660 | \$ 139,178 | 6.46% | 2,519,623 | \$ 137,026 | 7.27% |
| Other earning assets | 47,579 | | | 40,877 | | |
| Noninterest-earning assets | 231,054 | | | 177,599 | | |
| Total assets | \$ 3,158,293 | | | \$ 2,738,099 | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | | |
| Certificates of deposit | \$ 794,734 | \$ 22,505 | 3.78% | \$ 645,320 | \$ 21,431 | 4.44% |
| Savings accounts | 116,938 | 326 | 0.37% | 110,340 | 349 | 0.42% |
| Interest-bearing demand and money market accounts | 1,038,461 | 13,613 | 1.75% | 973,999 | 20,837 | 2.86% |
| Total interest-bearing deposits | 1,950,133 | 36,444 | 2.50% | 1,729,659 | 42,617 | 3.29% |
| Federal Home Loan Bank advances | 297,154 | 6,464 | 2.91% | 197,294 | 8,117 | 5.50% |
| Securities sold under agreements to repurchase | 23,084 | 381 | 2.21% | 52,967 | 2,177 | 5.50% |
| Other borrowings and interest-bearing liabilities | 9,702 | 271 | 3.73% | 333 | 6 | 2.41% |
| Long-term subordinated debt | 25,548 | 1,339 | 7.00% | 23,194 | 1,604 | 9.25% |
| Total interest-bearing liabilities | 2,305,621 | \$ 44,899 | 2.60% | 2,003,447 | \$ 54,521 | 3.64% |
| Noninterest-bearing deposits | 460,912 | | | 429,836 | | |
| Other noninterest-bearing liabilities | 42,006 | | | 31,085 | | |
| Shareholders' equity | 349,754 | | | 273,731 | | |
| Total liabilities & shareholders' equity | \$ 3,158,293 | | | \$ 2,738,099 | | |
| Net interest income (2) | | \$ 94,279 | | | \$ 82,505 | |
| Net interest margin | | | 4.37% | | | 4.38% |

(1) Nonaccrual loans have been included in the tables as loans carrying a zero yield. Interest reversals for the nine months ended September 30, 2008 related to nonaccrual loans totaled \$3.3 million. Excluding the impact of interest reversals, net interest margin for the nine month period would have been 4.48%. Amortized net deferred loan fees were included in the interest income calculations. The amortization of net deferred loan fees was \$2.8 million and \$2.5 million for the nine months ended September 30, 2008 and 2007, respectively.

(2) Tax-exempt income is calculated on a tax equivalent basis, based on a marginal tax rate of 35%.

Provision for Loan and Lease Losses

During the third quarter of 2008, the Company allocated \$10.5 million to its provision for loan and lease losses, compared to \$1.2 million for the same period in 2007. For the nine months ended September 30, 2008, the Company allocated \$27.9 million to its provision for loan and lease losses, compared to \$2.2 million for the nine months ended September 30, 2007. The additional provision is due to the weakness in the for-sale housing industry resulting from the slowing economic environment and an increase in non-accrual loans. The increased provision increased the Company's total allowance for loan losses to 1.62% of net loans at September 30, 2008. See the discussion under "Nonperforming Assets" for details related to the non-accrual loans.

Noninterest Income

Noninterest income for the third quarter of 2008 reflected a loss of \$10.9 million, compared to income of \$7.6 million during the same period last year. The loss was primarily a result of the \$18.5 million impairment charge on Fannie Mae and Freddie Mac investment securities. In addition, noninterest income in the current quarter was down as compared to last year due to decreases of \$170,000 in merchant card services driven primarily by an increase in interchange expense rates and \$183,000 in other income attributed primarily to a decrease in mortgage banking fees and loan origination fees resulting from decreased volumes. These decreases were partially offset by an increase of \$262,000 in service charges on deposit accounts. The increase in service charges is primarily due to an increased number of transaction accounts.

For the nine months ended September 30, 2008, noninterest income was \$8.5 million, a 59% decrease from \$20.5 million for the nine months ended September 30, 2007, primarily due to the impairment charge on investment securities mentioned above. The decrease in noninterest income was partially offset with proceeds from the redemption of Visa and MasterCard shares of \$3.0 million and a gain on the sale of investment securities of \$882,000. Service charges and other fees increased \$1.3 million, or 13% in the first nine months of 2008 from the 2007 period, reflecting a change in our deposit account fee structure in conjunction with an increase in the number of deposit accounts. Other income increased \$1.2 million, or 41% due in part to the receipt of insurance proceeds received for the death of a former officer in the amount of \$612,000.

Noninterest Expense

Noninterest expense for the third quarter of 2008 was \$23.4 million, a 4% increase from \$22.4 million a year earlier. Regulatory premiums in the current quarter increased \$514,000 from the same period one year ago. This increase is related to a larger deposit base due in part to the third quarter 2007 acquisitions. Finally, data processing expenses and core deposit intangible amortization expense increased \$166,000 and \$184,000 compared to the same period in 2007 also as a result of the 2007 third quarter acquisitions.

Total noninterest expense for the first nine months of 2008 was \$70.3 million, an increase of 11% from \$63.1 million from the 2007 period. Notable increases included compensation and employee benefits and occupancy costs related to the third quarter 2007 acquisitions. Regulatory premiums were \$1.2 million higher for the first nine months of 2008 over the same period last year. This increase relates to a credit we received in 2007 which offset the majority of the FDIC premiums due and the increased deposit account base due in part from the acquisitions.

The following table presents selected items included in other noninterest expense and the associated change from period to period:

| (in thousands) | Three months ended September 30, | | Increase (Decrease) Amount | Nine months ended September 30, | | Increase (Decrease) Amount |
|----------------|-------------------------------------|-------|----------------------------------|------------------------------------|--------|----------------------------------|
| | 2008 | 2007 | | 2008 | 2007 | |
| | \$ 279 | \$ 95 | \$ 184 | \$ 871 | \$ 287 | \$ 584 |

| Core deposit intangible amortization ("CDI") | | | | | | |
|--|----------|----------|--------|-----------|----------|----------|
| Software support & maintenance | 142 | 221 | (79) | 519 | 610 | (91) |
| Telephone & network communications | 377 | 351 | 26 | 1,186 | 901 | 285 |
| Federal Reserve Bank processing fees | 96 | 98 | (2) | 323 | 338 | (15) |
| Supplies | 227 | 402 | (175) | 856 | 979 | (123) |
| Postage | 341 | 435 | (94) | 1,092 | 1,006 | 86 |
| Investor relations | 22 | 22 | - | 163 | 180 | (17) |
| Travel | 108 | 122 | (14) | 342 | 321 | 21 |
| ATM Network | 170 | 193 | (23) | 513 | 483 | 30 |
| Sponsorships and charitable contributions | 177 | 136 | 41 | 480 | 392 | 88 |
| Regulatory premiums | 579 | 65 | 514 | 1,415 | 173 | 1,242 |
| Directors fees | 111 | 96 | 15 | 341 | 311 | 30 |
| Employee expenses | 156 | 162 | (6) | 478 | 482 | (4) |
| Insurance | 127 | 127 | - | 371 | 346 | 25 |
| CRA partnership investment expense (1) | 156 | 78 | 78 | 502 | 366 | 136 |
| Miscellaneous | 964 | 756 | 208 | 2,475 | 2,007 | 468 |
| Total other noninterest expense | \$ 4,032 | \$ 3,359 | \$ 673 | \$ 11,927 | \$ 9,182 | \$ 2,745 |

(1) The amounts shown represent pass-through losses from our interests in certain low-income housing related limited partnerships. As a result of these interests we receive federal low-income housing tax credits available under the Internal Revenue Code. For the nine months ended September 30, 2008, \$383,000 of such credits was taken as a reduction in our current period income tax expense. In addition, our taxable income was decreased by \$172,000 during the nine months ended September 30, 2008 as a result of the tax benefit associated with this investment expense.

In managing our business, we review the efficiency ratio, on a fully taxable-equivalent basis (see definition in table below), which is not defined in accounting principles generally accepted in the United States. Our efficiency ratio [noninterest expense divided by the sum of net interest income and noninterest income on a tax equivalent basis, excluding any gains and losses arising from nonrecurring transactions] was 60.34% for the third quarter 2008 and was 60.62% for the first nine months of 2008, compared to 59.23% and 60.79% for the third quarter and first nine months of 2007, respectively. The third quarter change in the efficiency ratio is due to the increase in non interest expense.

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The following table presents a reconciliation of the financial data utilized to calculate the efficiency ratio (a non-GAAP financial measure) to the same measures calculated and presented in accordance with GAAP:

Reconciliation of Financial Data to GAAP Financial Measures

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|--|--------------------|-----------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Net interest income (1) | \$ 29,593 | \$ 28,860 | \$ 90,194 | \$ 79,258 |
| Tax equivalent adjustment for non-taxable loan and investment securities interest income (2) | 1,300 | 1,097 | 4,085 | 3,247 |
| Adjusted net interest income | \$ 30,893 | \$ 29,957 | \$ 94,279 | \$ 82,505 |
| Noninterest income | \$ (10,946) | \$ 7,631 | \$ 8,516 | \$ 20,549 |
| Gain on sale of investment securities, net | - | - | (882) | - |
| Redemption of Visa and Mastercard shares | - | - | (3,028) | - |
| Death benefit proceeds on former officer covered by BOLI | - | - | (612) | - |
| Tax equivalent adjustment for BOLI income (2) | 294 | 270 | 876 | 742 |
| Other than temporary security impairment expense | 18,517 | - | 18,517 | - |
| Adjusted noninterest income | \$ 7,865 | \$ 7,901 | \$ 23,387 | \$ 21,291 |
| Noninterest expense | \$ 23,391 | \$ 22,425 | \$ 70,312 | \$ 63,093 |
| Net gain (loss) on sale of OREO | (4) | - | 19 | - |
| BOLI policy swap net income | - | - | 107 | - |
| Reversal of previously accrued Visa litigation expense | - | - | 889 | - |
| Adjusted noninterest expense | \$ 23,387 | \$ 22,425 | \$ 71,327 | \$ 63,093 |
| Efficiency ratio | 62.93% | 61.45% | 63.29% | 63.22% |
| Efficiency ratio (fully taxable-equivalent) | 60.34% | 59.23% | 60.62% | 60.79% |
| Tax Rate | 35.00% | 35.00% | 35.00% | 35.00% |

(1) Amount represents net interest income before provision for loan and lease losses.

(2) Fully taxable-equivalent basis: Non taxable revenue is increased by the statutory tax rate to recognize the income tax benefit of the income realized.

Income Taxes

We recorded an income tax benefit of \$6.5 million for the third quarter and \$3.7 million for the first nine months of 2008, compared with a provision of \$3.6 million and \$9.4 million for the same periods in 2007. Our effective tax rate remains lower than the statutory tax rate due to our nontaxable income generated from tax-exempt municipal bonds, investments in bank owned life insurance, and low income housing credits. For additional information, please refer to the Company's annual report on Form 10-K for the year ended December 31, 2007.

Credit Risk Management

The extension of credit in the form of loans or other credit products to individuals and businesses is one of our principal business activities. Our policies and applicable laws and regulations require risk analysis as well as ongoing portfolio and credit management. We manage our credit risk through lending limit constraints, credit review, approval

policies, and extensive, ongoing internal monitoring. We also manage credit risk through diversification of the loan portfolio by type of loan, type of industry, type of borrower and by limiting the aggregation of debt limits to a single borrower. In analyzing our existing portfolio, we review our consumer and residential loan portfolios by their performance as a pool of loans since no single loan is individually significant or judged by its risk rating, size, or potential risk of loss. In contrast, the monitoring process for the commercial business, private banking, real estate construction, and commercial real estate portfolios includes periodic reviews of individual loans with risk ratings assigned to each loan and performance judged on a loan by loan basis. We review these loans to assess the ability of the borrower to service all of its interest and principal obligations and, as a result, the risk rating may be adjusted accordingly. In the event that full collection of principal and interest is not reasonably assured, the loan is appropriately downgraded and, if warranted, placed on nonaccrual status even though the loan may be current as to principal and interest payments. Additionally, we review these types of loans for impairment in accordance with SFAS No. 114, "Accounting by Creditors for the Impairment of a Loan". Impaired loans are considered for nonaccrual status and will typically remain as such until all principal and interest payments are brought current and the prospects for future payments in accordance with the loan agreement appear relatively certain. Loan policies, credit quality criteria, portfolio guidelines and other controls are established under the guidance of our Chief Credit Officer and approved, as appropriate, by the Board. Credit Administration, together with the loan committee, has the responsibility for administering the credit approval process. As another part of its control process, we use an independent internal credit review and examination function to provide assurance that loans and commitments are made and maintained as prescribed by our credit policies. This includes a review of documentation when the loan is initially extended and subsequent monitoring to assess continued performance and proper risk assessment.

We have diversification of loan types within our portfolio. However, we are not immune to the current instability in the residential real estate markets and mortgage-related industries. Accordingly, we will continue to be diligent in our risk management practices and maintain, what we believe, are adequate reserves for probable loan losses.

Loan Portfolio Analysis

We are a full service commercial bank, originating a wide variety of loans, but concentrating our lending efforts on originating commercial business and commercial real estate loans.

The following table sets forth the Company's loan portfolio by type of loan for the dates indicated:

| (in thousands) | September 30, 2008 | % of Total | December 31, 2007 | % of Total |
|---|-----------------------|---------------|----------------------|---------------|
| Commercial business | \$ 780,450 | 35.2% | \$ 762,365 | 33.4% |
| Real estate: | | | | |
| One-to-four family residential | 57,280 | 2.6% | 60,991 | 2.7% |
| Commercial and five or more family residential properties | 841,885 | 38.0% | 852,139 | 37.3% |
| Total real estate | 899,165 | 40.5% | 913,130 | 40.0% |
| Real estate construction: | | | | |
| One-to-four family residential | 236,512 | 10.7% | 269,115 | 11.8% |
| Commercial and five or more family residential properties | 97,297 | 4.4% | 165,490 | 7.2% |
| Total real estate construction | 333,809 | 15.1% | 434,605 | 19.0% |
| Consumer | 206,561 | 9.4% | 176,559 | 7.8% |
| Subtotal | 2,219,985 | 100.2% | 2,286,659 | 100.2% |
| Less: Deferred loan fees | (3,852) | -0.2% | (3,931) | -0.2% |
| Total loans | \$ 2,216,133 | 100.0% | \$ 2,282,728 | 100.0% |
| Loans Held for Sale | \$ 2,890 | | \$ 4,482 | |

Total loans were \$66.6 million, or 3% less than, year-end 2007. The reduction in total loans was driven primarily by decreases in real estate construction related loans. During the period, the Company's exposure to such loans has been

reduced through a combination of loan payoffs and paydowns as well as loan charge-offs. In addition, commercial real estate construction loan totals were reduced through conversion to permanent loans. These reductions are a reflection of management's strategy to shrink the loan portfolio in these loan categories. Consumer loans rose \$30 million, or 17%, from year-end 2007. Home equity lines of credit were the primary driver of consumer loan growth.

Commercial Loans: We are committed to providing competitive commercial lending in our primary market areas. Management expects a continued focus within its commercial lending products and to emphasize, in particular, relationship banking with businesses, and business owners.

Real Estate Loans: These loans are used to collateralize outstanding advances from the FHLB. Generally, our policy is to originate residential loans for sale to third parties. Those residential loans are secured by properties located within our primary market areas, and typically have loan-to-value ratios of 80% or lower.

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Generally, commercial and five-or-more family residential real estate loans are made to borrowers who have existing banking relationships with us. Our underwriting standards generally require that the loan-to-value ratio for these loans not exceed 75% of appraised value, cost, or discounted cash flow value, as appropriate, and that commercial properties maintain debt coverage ratios (net operating income divided by annual debt servicing) of 1.2 or better. However, underwriting standards can be influenced by competition and other factors. We endeavor to maintain the highest practical underwriting standards while balancing the need to remain competitive in our lending practices.

Real Estate Construction Loans: We originate a variety of real estate construction loans. One-to-four family residential construction loans are originated for the construction of custom homes (where the home buyer is the borrower) and to provide financing to builders for the construction of pre-sold homes and speculative residential construction. Underwriting guidelines for these loans vary by loan type but include loan-to-value limits, term limits and loan advance limits, as applicable.

Our underwriting guidelines for commercial and five-or-more family residential real estate construction loans generally require that the loan-to-value ratio not exceed 75% and stabilized debt coverage ratios (net operating income divided by annual debt servicing) of 1.2 or better. As noted above, underwriting standards can be influenced by competition and other factors. However, we endeavor to maintain the highest practical underwriting standards while balancing the need to remain competitive in our lending practices.

Consumer Loans: Consumer loans include automobile loans, boat and recreational vehicle financing, home equity and home improvement loans and miscellaneous personal loans.

Foreign Loans: Our banking subsidiaries are not involved with loans to foreign companies or foreign countries.

Nonperforming Assets

Nonperforming assets consist of: (i) nonaccrual loans; (ii) in most cases restructured loans, for which concessions, including the reduction of interest rates below a rate otherwise available to that borrower or the deferral of interest or principal, have been granted due to the borrower's weakened financial condition (interest on restructured loans is accrued at the restructured rates when it is anticipated that no loss of original principal will occur); (iii) other real estate owned; and (iv) other personal property owned. Collectively, nonaccrual and restructured loans are considered nonperforming loans.

Nonaccrual loans: The consolidated financial statements are prepared according to the accrual basis of accounting. This includes the recognition of interest income on the loan portfolio, unless a loan is placed on a nonaccrual basis, which occurs when there are serious doubts about the collectibility of principal or interest. Generally our policy is to discontinue the accrual of interest on all loans past due 90 days or more and place them on nonaccrual status. As discussed below, in the current quarter we also discontinued the accrual of interest on certain performing loans. The decision to discontinue interest on these performing loans was based upon our assessment that these borrowers will be experiencing significant financial challenges in the near future as a result of an economic downturn centered within their industry and in the markets they serve. When a loan is placed on nonaccrual status, any accrued but unpaid interest on that date is removed from interest income.

At September 30, 2008, total nonperforming assets were \$78.2 million, net of charge-offs of \$16.4 million during the third quarter 2008, compared to \$14.6 million at December 31, 2007 and \$72.3 million at June 30, 2008. The percent of non-performing assets to period-end assets at September 30, 2008 was 2.52% compared to 0.46% for December 31, 2007 and 2.28% at June 30, 2008.

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The following tables set forth, at the dates indicated, information with respect to our nonaccrual loans, restructured loans, total nonperforming loans and total nonperforming assets:

| (in thousands) | September 30, 2008 | December 31, 2007 |
|--|--------------------------|----------------------|
| Nonaccrual: | | |
| Commercial business | \$ 2,845 | \$ 2,170 |
| Real estate: | | |
| One-to-four family residential | - | 204 |
| Commercial and five or more family residential real estate | 4,381 | 1,112 |
| Total real estate | 4,381 | 1,316 |
| Real estate construction: | | |
| One-to-four family residential | 51,658 | 6,005 |
| Commercial and five or more family residential real estate | 15,788 | 3,676 |
| Total real estate construction | 67,446 | 9,681 |
| Consumer | 1,492 | 838 |
| Total nonaccrual loans | 76,164 | 14,005 |
| Restructured: | | |
| Commercial business | 746 | 456 |
| Total nonperforming loans | 76,910 | 14,461 |
| Other real estate owned | 1,288 | 181 |
| Other personal property owned | - | - |
| Total nonperforming assets | \$ 78,198 | \$ 14,642 |

The increase in non-accruals is centered in our real estate construction portfolios, both one-to-four family residential (“for-sale housing”) and commercial real estate, primarily comprised of condominium developments. During the quarter, the for-sale housing portfolio, which currently totals \$237 million, had a net increase in non-accrual loans of approximately \$4 million, bringing the total to about \$51 million.

In our commercial real estate portfolio, which is approximately \$842 million as of September 30, 2008, we experienced an increase of \$1.8 million in non-accrual loans. This segment represents a little over \$4.3 million of the non-accruals as of September 30, 2008.

We are continuing to work with our customers to resolve these issues as quickly as possible; however, given the nature of these types of projects, it is unlikely they will be resolved in the immediate future. Accordingly, the current trend of a larger provision for loan losses as compared to prior periods may continue in the next few quarters dependent upon the economic climate and our customers’ ability to repay.

Allowance for Loan and Lease Losses

At September 30, 2008, our allowance for loan and lease losses (“ALLL”) was \$35.8 million, or 1.62% of total loans (excluding loans held for sale) and 47% of nonperforming loans and 46% of nonperforming assets. This compares with an allowance of \$26.6 million, or 1.17% of the total loan portfolio (excluding loans held for sale), 184% of nonperforming loans and 182% of nonperforming assets at December 31, 2007.

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Adjustments to the percentages of the allowance allocated to loan categories are made based on trends with respect to delinquencies and problem loans within each pool of loans. The Company maintains a conservative approach to credit quality and will continue to prudently add to its loan and lease loss allowance as necessary in order to maintain adequate reserves, factoring in changes and trends in the local and national economy. Management carefully monitors and evaluates the loan portfolio and continues to emphasize credit quality and strengthening of its loan monitoring systems and controls.

In addition to the ALLL, we maintain an allowance for unfunded loan commitments and letters of credit. We report this allowance as a component of other liabilities on our consolidated balance sheet. We determine this amount using estimates of the probability of the ultimate funding and losses related to those credit exposures. This methodology is similar to the methodology we use for determining the adequacy of our ALLL. At September 30, 2008 and December 31, 2007, our allowance for unfunded loan commitments and letters of credit was \$459,000 and \$349,000, respectively.

The following table provides an analysis of the Company's allowance for loan and lease losses at the dates and the periods indicated:

| (in thousands) | Three Months Ended | | Nine Months Ended | |
|--|--------------------|--------------|-------------------|--------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Beginning balance | \$ 41,724 | \$ 21,339 | \$ 26,599 | \$ 20,182 |
| Balance established through acquisition | - | 3,192 | - | 3,192 |
| Charge-offs: | | | | |
| Residential, construction, land & acquisitions | (14,598) | - | (15,285) | - |
| Commercial business | (652) | (459) | (1,011) | (653) |
| Commercial real estate | (946) | - | (1,451) | - |
| Private banking | - | - | (24) | - |
| Consumer | (285) | (69) | (1,613) | (201) |
| Total charge-offs | (16,481) | (528) | (19,384) | (854) |
| Recoveries | | | | |
| Residential construction, land & acquisitions | - | - | 16 | - |
| Commercial business | 23 | 77 | 127 | 485 |
| Commercial real estate: | - | - | 303 | 12 |
| Private banking | 3 | - | 54 | - |
| Consumer | 45 | 69 | 173 | 165 |
| Total recoveries | 71 | 146 | 673 | 662 |
| Net charge-offs | (16,410) | (382) | (18,711) | (192) |
| Provision charged to expense | 10,500 | 1,231 | 27,926 | 2,198 |
| Ending balance | \$ 35,814 | \$ 25,380 | \$ 35,814 | \$ 25,380 |
| Total loans, net at end of period (1) | \$ 2,216,133 | \$ 2,212,751 | \$ 2,216,133 | \$ 2,212,751 |
| Allowance for loan and lease losses to total loans | 1.62% | 1.15% | 1.62% | 1.15% |

(1) Excludes loans held for sale

During the third quarter of 2008, the Company had net loan charge-offs of \$16.4 million, compared to \$382,000 in the same period of 2007. For the first nine months of 2008, the Company had net loan charge-offs of \$18.7 million, compared to \$192,000 during the same period of 2007.

Securities

All of our securities are classified as available for sale and carried at fair value. These securities are used by management as part of our asset/liability management strategy and may be sold in response to changes in interest rates or significant prepayment risk. In accordance with our investment strategy, management monitors market conditions with a view to realize gains on its available for sale securities portfolio when prudent. During the first nine months of 2008, we recorded a gain on sale of investment securities of \$882,000. The gain resulted from the execution of a strategy to extend the weighted average life of approximately \$50 million of the investment portfolio.

On September 7, 2008 the U.S. Department of Treasury (“Treasury”) and Federal Housing Finance Agency (“FHFA”) announced a plan to place the Federal Home Loan Mortgage Corporation (“Freddie Mac”) and the Federal National Mortgage Association (“Fannie Mae”) into conservatorship. Under the plan, the Treasury and the FHFA will purchase senior preferred stock as needed to ensure each company maintains a positive net worth. Common and preferred dividends will be suspended and preferred stock claims will be maintained ahead of common stock but behind the senior preferred stock held by the Treasury and FHFA.

The Company holds 400,000 shares of Series Z preferred stock issued by Freddie Mac and 400,000 shares of Series S preferred stock issued by Fannie Mae. Such securities are held in the Company’s available-for-sale investment securities portfolio and, as such, declines in fair value below cost are subject to a potential other than temporary impairment charge to earnings under Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities. The Company’s cost for such securities was \$20 million. The estimated fair market value of such securities declined from \$20 million at June 30, 2008 to \$1.5 million during the third quarter.

In light of the actions taken by Treasury and FHFA and the accompanying significant decline in the fair value of these securities below cost, the Company has deemed the impairment to be other than temporary and, accordingly, recognized a pre-tax charge to earnings in the third quarter totaling \$18.5 million.

At September 30, 2008, the market value of securities available for sale had an unrealized gain, net of tax, of \$424,000 compared to an unrealized gain, net of tax, of \$1.7 million at December 31, 2007. The change in market value of securities available for sale is due primarily to fluctuations in interest rates. In addition, during the first quarter of 2008, the Company sold certain securities, as described above, which had an unrealized gain, net of tax, of approximately \$126,000 at December 31, 2007. The Company does not consider these remaining investment securities to be other than temporarily impaired. If in the future, however, the impairment is judged to be other than temporary, the cost basis of the individual impaired securities will be written down to fair value and the amount of the write-down will be included in earnings as a realized loss.

The following table sets forth our securities available for sale portfolio by type for the dates indicated:

| (in thousands) | September 30, 2008 | December 31, 2007 |
|---|--------------------------|----------------------|
| U.S. government-sponsored enterprise preferred stock | \$ 1,512 | \$ - |
| U.S. government-sponsored enterprise | - | 61,300 |
| U.S. government agency and government-sponsored enterprise mortgage-backed securities and collateralized mortgage obligations | 346,658 | 303,742 |
| State and municipal securities | 187,167 | 193,965 |
| Other securities | 940 | 2,359 |
| Total | \$ 536,277 | \$ 561,366 |

Liquidity and Sources of Funds

Our primary sources of funds are customer deposits. Additionally, we utilize advances from the Federal Home Loan Bank of Seattle (the "FHLB") and wholesale repurchase agreements to supplement our funding needs. These funds, together with loan repayments, loan sales, retained earnings, equity and other borrowed funds are used to make loans, to acquire securities and other assets, and to fund continuing operations.

Deposit Activities

Our deposit products include a wide variety of transaction accounts, savings accounts and time deposit accounts. Core deposits (demand deposit, savings, money market accounts and certificates of deposit less than \$100,000) decreased \$51.6 million, or 3%, since year-end 2007 while certificates of deposit greater than \$100,000 decreased \$95.3 million, or 22%, from year-end 2007.

We have established a branch system to serve our consumer and business depositors. In addition, management's strategy for funding asset growth is to make use of brokered and other wholesale deposits on an as-needed basis. At September 30, 2008 brokered and other wholesale deposits (excluding public deposits) totaled \$77.5 million, or 3% of total deposits, compared to \$72.8 million, or 3% of total deposits, at year-end 2007. The brokered deposits have varied maturities.

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The following table sets forth the Company's deposit base by type of product for the dates indicated:

| (in thousands) | September 30, 2008 | | December 31, 2007 | | September 30, 2007 | |
|--|---------------------|---------------|---------------------|---------------|---------------------|---------------|
| | Balance | % of Total | Balance | % of Total | Balance | % of Total |
| Core deposits: | | | | | | |
| Demand and other non-interest bearing | \$ 498,815 | 21.2% | \$ 468,237 | 18.7% | \$ 474,600 | 19.2% |
| Interest bearing demand | 437,769 | 18.6% | 478,596 | 19.2% | 451,282 | 18.2% |
| Money market | 582,040 | 24.7% | 609,502 | 24.4% | 593,301 | 24.0% |
| Savings | 121,845 | 5.2% | 115,324 | 4.6% | 118,347 | 4.8% |
| Certificates of deposit less than \$100,000 | 304,310 | 12.9% | 324,734 | 13.0% | 325,739 | 13.1% |
| Total core deposits | 1,944,779 | 82.6% | 1,996,393 | 79.9% | 1,963,269 | 79.2% |
| Certificates of deposit greater than \$100,000 | 333,579 | 14.2% | 428,885 | 17.2% | 453,284 | 18.3% |
| Wholesale certificates of deposit (CDARS®) | 15,233 | 0.6% | 762 | 0.0% | 760 | 0.0% |
| Wholesale certificates of deposit | 62,230 | 2.6% | 72,021 | 2.9% | 60,481 | 2.4% |
| Total deposits | \$ 2,355,821 | 100.0% | \$ 2,498,061 | 100.0% | \$ 2,477,794 | 100.0% |

Borrowings

We rely on FHLB advances as another source of both short and long-term borrowings. FHLB advances are secured by one-to-four family real estate mortgages and certain other assets. At September 30, 2008, we had FHLB advances of \$301 million, compared to advances of \$257.7 million at December 31, 2007.

We also utilize wholesale repurchase agreements as a supplement to our funding sources. Wholesale repurchase agreements are secured by mortgage-backed securities. At September 30, 2008, we had repurchase agreements of \$25.0 million compared to \$0 at December 31, 2007. Management anticipates that we will continue to rely on both FHLB advances and wholesale repurchase agreements in the future, and we will use those funds primarily to make loans and purchase securities.

During 2001, the Company, through a special purpose trust ("the Trust") participated in a pooled trust preferred offering, whereby the Trust issued \$22.0 million of 30 year floating rate capital securities. The capital securities constitute guaranteed preferred beneficial interests in debentures issued by the Trust. The debentures had an initial rate of 7.29% and a rate of 6.38% at September 30, 2008. The floating rate is based on the 3-month LIBOR plus 3.58% and is adjusted quarterly. Through the Trust, we may call the debentures at any time for a premium and after ten years at par, allowing us to retire the debt early if market conditions are favorable. Through recent acquisition, the Company assumed an additional \$3.0 million in floating rate trust preferred obligations; these debentures had a rate of 6.54% at September 30, 2008. The floating rate is based on the 3-month LIBOR plus 3.75% and is adjusted quarterly.

The trust preferred obligations are classified as long-term subordinated debt and our related investment in the Trust is recorded in other assets on the consolidated balance sheets. The balance of the long-term subordinated debt was \$25.6 million at September 30, 2008 and \$25.5 million at December 31, 2007. The subordinated debt payable to the Trust is on the same interest and payment terms as the trust preferred obligations issued by the Trust.

Additionally, we have a \$20.0 million line of credit with a large commercial bank with an interest rate indexed to LIBOR. The outstanding balance on the line of credit was \$20.0 million at September 30, 2008 and \$5.0 million at

December 31, 2007. The line matures on June 30, 2009 and, if not renewed, any principle balance outstanding is due at maturity.

Contractual Obligations & Commitments

We are party to many contractual financial obligations, including repayment of borrowings, operating and equipment lease payments, commitments to extend credit and investments in affordable housing partnerships. At September 30, 2008, we had commitments to extend credit of \$729.7 million compared to \$857.6 million at December 31, 2007.

Capital Resources

Shareholders' equity at September 30, 2008 was \$336.4 million, down \$5.3 million, or 1.5% from \$341.7 million at December 31, 2007. The decrease is due primarily to cash dividends paid of \$9.2 million and offset by net income of \$4.2 million for the first nine months of 2008. Shareholders' equity was 10.8% of total period-end assets at September 30, 2008 and December 31, 2007.

Capital Ratios: Banking regulations require bank holding companies to maintain a minimum "leverage" ratio of core capital to adjusted quarterly average total assets of at least 3%. In addition, banking regulators have adopted risk-based capital guidelines, under which risk percentages are assigned to various categories of assets and off-balance sheet items to calculate a risk-adjusted capital ratio. Tier I capital generally consists of common shareholders' equity and trust preferred obligations, less goodwill and certain identifiable intangible assets, while Tier II capital includes the allowance for loan losses and subordinated debt, both subject to certain limitations. Regulatory minimum risk-based capital guidelines require Tier I capital of 4% of risk-adjusted assets and total capital (combined Tier I and Tier II) of 8% to be considered "adequately capitalized".

Federal Deposit Insurance Corporation regulations set forth the qualifications necessary for a bank to be classified as "well capitalized", primarily for assignment of FDIC insurance premium rates. To qualify as "well capitalized," banks must have a Tier I risk-adjusted capital ratio of at least 6%, a total risk-adjusted capital ratio of at least 10%, and a leverage ratio of at least 5%. Failure to qualify as "well capitalized" can negatively impact a bank's ability to expand and to engage in certain activities.

The Company and its subsidiaries qualify as "well-capitalized" at September 30, 2008 and December 31, 2007.

| | Company | | Columbia Bank | | Requirements | |
|---------------------------------|-----------|------------|---------------|------------|------------------------|------------------|
| | 9/30/2008 | 12/31/2007 | 9/30/2008 | 12/31/2007 | Adequately capitalized | Well-Capitalized |
| Total risk-based capital ratio | 11.24% | 10.90% | 11.14% | 10.49% | 8% | 10% |
| Tier 1 risk-based capital ratio | 9.99% | 9.87% | 9.89% | 9.47% | 4% | 6% |
| Leverage ratio | 8.52% | 8.54% | 8.45% | 8.23% | 4% | 5% |

Application for U.S. Treasury Capital Purchase Program

Subsequent to quarter-end, the Company received preliminary approval from the U.S. Department of Treasury to receive additional capital by participating in the Treasury Department's Capital Purchase Program. As a participant in the program, Columbia could issue to the U.S. Treasury up to \$76.9 million in senior preferred shares and related warrants. Receipt of the funding is subject to Columbia's acceptance of the terms of the agreement, satisfaction of closing conditions and registration with the Securities and Exchange Commission.

Stock Repurchase Program

In March 2002 the Board of Directors approved a stock repurchase program whereby the Company may systematically repurchase up to 500,000 of its outstanding shares of common stock. The Company may repurchase shares from time to time in the open market or in private transactions, under conditions which allow such repurchases to be accretive to earnings while maintaining capital ratios that exceed the guidelines for a well-capitalized financial institution. As of September 30, 2008 we have repurchased 64,788 shares of common stock in this current stock repurchase program, none of which was repurchased in the period covered by this report.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

A number of measures are used to monitor and manage interest rate risk, including income simulations and interest sensitivity (gap) analyses. An income simulation model is the primary tool used to assess the direction and magnitude of changes in net interest income resulting from changes in interest rates. Basic assumptions in the model include prepayment speeds on mortgage-related assets, cash flows and maturities of other investment securities, loan and deposit volumes and pricing. These assumptions are inherently subjective and, as a result, the model cannot precisely estimate net interest income or precisely predict the impact of higher or lower interest rates on net interest income. Actual results will differ from simulated results due to timing, magnitude and frequency of interest rate changes and changes in market conditions and management strategies, among other factors. At September 30, 2008, based on the measures used to monitor and manage interest rate risk, there has not been a material change in the Company's interest rate risk since December 31, 2007. For additional information, refer to "Management's Discussion and Analysis of Financial Condition and Results of Operation" referenced in the Company's 2007 Annual Report on Form 10-K.

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Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

An evaluation was carried out under the supervision and with the participation of the Company's management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934). Based on that evaluation, the CEO and CFO have concluded that as of the end of the period covered by this report, our disclosure controls and procedures are effective in ensuring that the information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 is (i) accumulated and communicated to our management (including the CEO and CFO) to allow timely decisions regarding required disclosure, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Changes in Internal Controls Over Financial Reporting

There was no change in our internal controls over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

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PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

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

Item 1A. RISK FACTORS

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

We cannot predict the effect of the national economic situation on our future results of operations or stock trading price.

The national economy, and the financial services sector in particular, is currently facing challenges of a scope unprecedented in recent history. No one can predict the severity or duration of this downturn. We cannot predict whether, or the extent to which, the more severe regional and local economic downturns that have affected other areas of the country may also occur to the same degree in the markets we serve. Any such further deterioration in our markets could have an adverse effect on our business, financial condition, results of operations and prospects, as discussed in the following risk factors, and could also cause the trading price of our stock to decline.

We cannot predict the effect of the recently enacted federal rescue plan.

Congress recently enacted the Emergency Economic Stabilization Act of 2008, which is intended to stabilize the financial markets, including providing funding of up to \$700 billion to purchase troubled assets and loans from financial institutions and increasing the amount of account insurance coverage from \$100,000 to \$250,000. Most recently, the federal government agreed to invest \$125 billion in preferred stock of nine U.S. financial institutions, and to make available up to another \$125 billion for investment in preferred stock of other U.S. financial institutions, on certain terms and conditions. The full effect of this wide-ranging legislation on the national economy and financial institutions, particularly on mid-sized institutions like us, cannot now be predicted.

Our ability to access markets for funding and acquire and retain customers could be adversely affected to the extent the financial services industry's reputation is damaged.

Reputation risk is the risk to liquidity, earnings and capital arising from negative publicity regarding the financial services industry. The financial services industry continues to be featured in negative headlines about the global credit crisis and the resulting stabilization legislation enacted by the U.S. federal government. These reports can be damaging to the industry's image and potentially erode consumer confidence in insured financial institutions, such as our banking subsidiary.

We have a high concentration of loans secured by real estate.

We have a high concentration of loans secured by real estate. While the concentration is spread amongst varying types of commercial real estate loans, with permanent commercial real estate loans being the largest exposure, our construction and land development loans currently carry a higher degree of risk, and a continued downturn in the real estate market, for any reason, will hurt our business and prospects. In particular, we could be exposed to additional

risk of losses from real estate related loans. Business activities and credit exposure are concentrated in loans secured by real estate. A further downturn in the economies or real estate values in the markets we serve could have a material adverse effect on borrowers' ability to repay their loans, as well as the value of the real property held as collateral securing such loans. Our ability to recover on defaulted loans by foreclosing and selling the real estate collateral would then be diminished and we would be more likely to suffer losses on defaulted loans.

Our loan portfolio mix could result in increased credit risk in an economic downturn.

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

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Changes in economic conditions, in particular a further economic slowdown in Washington and/or Oregon, could hurt the banking business generally.

Our business is directly affected by factors such as economic, market and political conditions in our service areas, broad trends in industry and finance, legislative and regulatory changes, changes in government monetary and fiscal policies and inflation, all of which are beyond our control. We have experienced recent declines in economic indicators and real estate values in several of the markets we serve. A further deterioration in economic conditions in Washington and/or Oregon could result in the following consequences, any of which could have an adverse impact on our prospects, results of operations and financial condition:

- loan delinquencies may increase further;
- problem assets and foreclosures may increase;
- collateral for loans made may decline in value, in turn reducing customers' borrowing power, reducing the value of assets and collateral associated with existing loans;
- demand for banking products and services may decline; and
- low cost or non-interest bearing deposits may decrease.

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

We maintain an ALLL in an amount that we believe is adequate to provide for losses inherent in our loan and lease portfolio. While we strive to carefully monitor credit quality and to identify loans that may become non-performing, at any time there are loans in the portfolio that will result in losses that have not been identified as non-performing or potential problem loans. In the quarter ended September 30, 2008, non-performing loans as a percentage of total loans increased to 3.47%, up from 0.63% for the year ended December 31, 2007. We cannot be sure that we will be able to identify deteriorating loans before they become non-performing assets, or that we will be able to limit losses on those loans that have been identified. As a result, future significant increases to the ALLL may be necessary. Additionally, future increases to the ALLL may be required based on changes in the composition of the loans comprising the portfolio, deteriorating values in underlying collateral (most of which consists of real estate) and changes in the financial condition of borrowers, such as may result from changes in economic conditions, or as a result of incorrect assumptions by management in determining the ALLL. Additionally, federal banking regulators, as an integral part of their supervisory function, periodically review our ALLL. These regulatory agencies may require us to increase the ALLL which could have a negative effect on our financial condition and results of operation.

Fluctuating interest rates can adversely affect our profitability.

Our profitability is dependent to a large extent upon net interest income, which is the difference (or "spread") between the interest earned on loans, securities and other interest-earning assets and interest paid on deposits, borrowings, and other interest-bearing liabilities. Because of the differences in maturities and repricing characteristics of our interest-earning assets and interest-bearing liabilities, changes in interest rates do not produce equivalent changes in interest income earned on interest-earning assets and interest paid on interest-bearing liabilities. Accordingly, fluctuations in interest rates could adversely affect our interest rate spread, and, in turn, our profitability. We cannot provide assurance that we can minimize interest rate risk. In addition, interest rates also affect the amount of money we can lend. When interest rates rise, the cost of borrowing also increases. Accordingly, changes in levels of market interest rates could materially and adversely affect our net interest spread, asset quality, loan origination volume,

business and prospects.

A continued tightening of the credit market may make it difficult to obtain available money to fund loan growth, which could adversely affect our earnings.

A tightening of the credit market and the inability to obtain adequate money to fund continued loan growth may negatively affect asset growth and, therefore, earnings capability. In addition to any deposit growth, maturity of investment securities and loan payments, we also rely on alternative funding sources through correspondent banking and a borrowing line with the FHLB of Seattle and the Federal Reserve Bank to fund loans. In the event of a downturn in the economy, particularly in the housing market, these resources could be negatively affected, which would limit the funds available to us.

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We may grow through future acquisitions, which could, in some circumstances, adversely affect our profitability measures.

We may engage in selected acquisitions of financial institutions in the future. There are risks associated with our acquisition strategy that could adversely impact our profitability. These risks include, among others, incorrectly assessing the asset quality of a particular institution being acquired, encountering greater than anticipated costs of incorporating acquired businesses into our company, and being unable to profitably deploy funds acquired in an acquisition. Furthermore, we cannot provide any assurance as to the extent to which we can continue to grow through acquisitions.

We anticipate issuing capital stock in connection with additional acquisitions. These acquisitions and related issuances of stock may have a dilutive effect on earnings per share and the percentage ownership of current shareholders. We do not currently have any definitive understandings or agreements for any acquisitions that involve the issuance of our capital stock. However, we may continue to expand through acquisitions in the future.

Competition in our market areas may limit our future success.

Commercial banking is a highly competitive business. We compete with other commercial banks, savings and loan associations, credit unions, finance, insurance and other non-depository companies operating in our market areas. We are subject to substantial competition for loans and deposits from other financial institutions. Some of our competitors are not subject to the same degree of regulation and restriction as we are. Some of our competitors have greater financial resources than we do. If we are unable to effectively compete in our market areas, our business, results of operations and prospects could be adversely affected.

The FDIC has increased insurance premiums to rebuild and maintain the federal deposit insurance fund.

Based on recent events and the state of the economy, the FDIC has increased federal deposit insurance premiums beginning in the first quarter of 2009 to double what we originally paid. The increase of these premiums will add to our cost of operations and could have a significant impact on the Company. Further, depending upon any future losses that the FDIC insurance fund may suffer, there can be no assurance that there will not be additional premium increases in order to replenish the fund.

We operate in a highly regulated environment and may be adversely affected by changes in federal, state and local laws and regulations.

We are subject to extensive regulation, supervision and examination by federal and state banking authorities. Any change in applicable regulations or federal, state or local legislation could have a substantial impact on us and our operations. Additional legislation and regulations that could significantly affect our powers, authority and operations may be enacted or adopted in the future, which could have a material adverse effect on our financial condition and results of operations. Further, regulators have significant discretion and authority to prevent or remedy unsafe or unsound practices or violations of laws by financial institutions and holding companies in the performance of their supervisory and enforcement duties. The exercise of regulatory authority may have a negative impact on our results of operations and financial condition.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

Item 5. OTHER INFORMATION

None.

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Item 6. EXHIBITS

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32 Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

COLUMBIA BANKING SYSTEM, INC.

Date: November 7, 2008

By

/s/ MELANIE J. DRESSEL
Melanie J. Dressel
President and Chief Executive Officer
(Principal Executive Officer)

Date: November 7, 2008

By

/s/ GARY R. SCHMINKEY
Gary R. Schminkey
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: November 7, 2008

By

/s/ CLINT E. STEIN
Clint E. Stein
Senior Vice President and
Chief Accounting Officer
(Principal Accounting Officer)