

Section 1: 10-K (FORM 10-K)

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

FORM 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2008 or

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

Commission File Number 0-20288

COLUMBIA BANKING SYSTEM, INC.
(Exact name of registrant 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 98402
(Address of principal executive offices) (Zip code)

Registrant’s Telephone Number, Including Area Code: (253) 305-1900

Securities Registered Pursuant to Section 12(b) of the Act:

Common Stock, No Par Value
(Title of class)

The NASDAQ Stock Market LLC
(Name of each exchange on which registered)

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (17 C.F.R. 229.405) is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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

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☐ Large Accelerated Filer

☒ Accelerated Filer

☐ Non-accelerated Filer

☐ Smaller Reporting Company

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

The aggregate market value of Common Stock held by non-affiliates of the registrant at June 30, 2008 was \$337,951,416 based on the closing sale price of the Common Stock on that date.

The number of shares of registrant’s Common Stock outstanding at January 31, 2009 was 18,173,527.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Registrant’s definitive 2009 Annual Meeting Proxy Statement Dated March 23, 2009.

Part III

COLUMBIA BANKING SYSTEM, INC.
FORM 10-K ANNUAL REPORT
DECEMBER 31, 2008

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus, and any prospectus supplement, including information included or incorporated by reference, may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, statements about our plans, objectives, expectations and intentions that are not historical facts, and other statements identified by words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “should,” “projects,” “seeks,” “estimates” or words of similar meaning. These forward-looking statements are based on current beliefs and expectations of management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations in the forward-looking statements, including those set forth in this prospectus, any accompanying prospectus supplement or the documents incorporated by reference, including the “Risk Factors,” “Business” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” sections of our reports and other documents filed with the SEC:

- ☐ the risks associated with lending and potential adverse changes in credit quality;
- ☐ increased delinquency rates;
- ☐ competition from other financial services companies in our markets;
- ☐ the risks presented by a continuing economic slowdown, which could adversely affect credit quality, collateral values, including real estate collateral, investment values, liquidity and loan originations;
- ☐ demand for banking products and services may decline;
- ☐ legislative or regulatory changes that adversely affect our business or our ability to complete prospective future acquisitions;
- ☐ the risks presented by a continued economic slowdown and the public stock market volatility, which could adversely affect our stock value and our ability to raise capital in the future; and
- ☐ our success in managing risks involved in the foregoing.

Additional factors that could cause actual results to differ materially from those expressed in the forward-looking statements are discussed in “*Risk Factors*” above, in our prospectus supplement and in our reports filed with the SEC. We believe the expectations reflected in our forward-looking statements are reasonable, based on information available to us on the date hereof. However, given the described uncertainties and risks, we cannot guarantee our future performance or results of operations and you should not place undue reliance on these forward-looking statements. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

PART I

ITEM 1. BUSINESS

General

Columbia Banking System, Inc. (referred to in this report as “we,” “our,” and “the Company”) is a registered bank holding company whose wholly owned banking subsidiary, Columbia State Bank (“Columbia Bank”) also does business as Bank of Astoria and Mt. Rainier Bank and conducts full-service commercial banking business in the states of Washington and Oregon. Headquartered in Tacoma, Washington, we provide a full range of banking services to small and medium-sized businesses, professionals and individuals.

The Company was originally organized in 1988 under the name First Federal Corporation, which was later named Columbia Savings Bank. In 1990, an investor group acquired a controlling interest in the Company and a second corporation, Columbia National Bankshares, Inc. ("CNBI"), and CNBI's sole banking subsidiary, Columbia National Bank. In 1993, the Company was reorganized to take advantage of commercial banking business opportunities in our principal market area. The opportunities to capture commercial banking market share were due to increased consolidation of banks, primarily through acquisitions by out-of-state holding companies, which created dislocation of customers. As part of the reorganization, CNBI was merged into the Company and Columbia National Bank was merged into the then newly chartered Columbia Bank. In 1994, Columbia Savings Bank was merged into Columbia Bank. We have grown from four branch offices at January 1, 1993 to 53 branch offices at December 31, 2008.

Recent Acquisitions

On July 23, 2007, the Company completed its acquisition of Mountain Bank Holding Company ("Mt. Rainier"), the parent company of Mt. Rainier National Bank, Enumclaw, Washington. Mt. Rainier was merged into the Company and Mt. Rainier National Bank was merged into Columbia Bank doing business as Mt. Rainier Bank. The results of Mt. Rainier Bank's operations are included in those of Columbia Bank starting on July 23, 2007.

On July 23, 2007, the Company completed its acquisition of Town Center Bancorp ("Town Center"), the parent company of Town Center Bank, Portland, Oregon. Town Center was merged into the Company and Town Center Bank was merged into Columbia Bank. The results of Town Center Bank's operations are included in those of Columbia Bank starting on July 23, 2007.

On October 1, 2004, the Company completed its acquisition of Bank of Astoria, an Oregon state-chartered commercial bank headquartered in Astoria, Oregon. Astoria's results of operations are included in our results beginning October 1, 2004. Astoria operated as a separate banking subsidiary of the Company until April 1, 2008, when it was merged into the Columbia Bank banking subsidiary. This change in internal organizational structure altered the composition of the Company's reportable segments; accordingly, segment results for the Bank of Astoria are now included within the Retail Banking segment. Prior period segment reporting has been restated to reflect this change.

Columbia Bank has 53 branch locations in the Seattle/Tacoma metropolitan area and contiguous parts of the Puget Sound region of Washington State, as well as the Longview and Woodland communities in southwestern Washington State, the Portland, Oregon metropolitan area, and the northern Oregon coast. Included in those 53 branch locations are six branches doing business as Bank of Astoria along the northern coast of Oregon and five branches doing business as Mt. Rainier Bank, in King and Pierce counties in Washington State. Subsequent to year-end, the operations of one branch in each of King, Pierce and Clackamas counties were consolidated into other branches in the same regions. Substantially all of Columbia Bank's loans, loan commitments and core deposits are within its service areas. Columbia Bank is a Washington state-chartered commercial bank, the deposits of which are insured in whole or in part by the FDIC. Columbia Bank is subject to regulation by the FDIC and the Washington State Department of Financial Institutions Division of Banks. Although Columbia Bank is not a member of the Federal Reserve System, the Board of Governors of the Federal Reserve System has certain supervisory authority over the Company, which can also affect Columbia Bank.

Company Management

<u>Name</u>	<u>Principal Position</u>
Melanie J. Dressel	President & Chief Executive Officer
Andrew McDonald	Executive Vice President & Chief Credit Officer
Mark W. Nelson	Executive Vice President & Chief Operating Officer
Kent L Roberts	Executive Vice President & Human Resources Director
Gary R. Schminkey	Executive Vice President & Chief Financial Officer

Financial Information about Segments

The Company is managed along two major lines of business within the Columbia Bank banking subsidiary: commercial banking and retail banking. The treasury function of the Company, although not considered a line of business, is responsible for the management of investments and interest rate risk. Financial information about segments that conform to accounting principles generally accepted in the United States is presented in Note 22 to the Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data" of this report.

Our goal is to be the leading Pacific Northwest regional community banking company while consistently increasing shareholder value. We continue to build on our reputation for excellent customer service in order to be recognized in all markets we serve as the bank of choice for retail deposit customers, small to medium-sized businesses and affluent households.

We have established a network of 53 branches as of December 31, 2008 from which we intend to grow market share. Western Washington locations consist of twenty-four branches in Pierce County, twelve in King County, two in Cowlitz County, two in Thurston County and one each in Kitsap and Whatcom Counties. Oregon locations include three branches in Clackamas County, two branches in Multnomah County, four branches in Clatsop County and two in Tillamook County.

In order to fund our lending activities and to allow for increased contact with customers, we utilize a branch system to better serve both retail and business depositors. We believe this approach will enable us to expand lending activities while attracting a stable core deposit base. In order to support our strategy of market penetration and increased profitability while continuing our personalized banking approach, we have invested in experienced banking and administrative personnel and have incurred related costs in the creation of our branch network.

Business Strategy

Our business strategy is to provide our customers with the financial sophistication and breadth of products of a regional banking company while retaining the appeal and service level of a community bank. We continually evaluate our existing business processes while focusing on maintaining balanced loan and deposit portfolios, expanding total revenue and controlling expenses in an effort to increase our return on average equity and gain operational efficiencies. We believe that as a result of our strong commitment to highly personalized, relationship-oriented customer service, our varied products, our strategic branch locations and the long-standing community presence of our managers, banking officers and branch personnel, we are well positioned to attract and retain new customers and to increase our market share of deposits, loans, and other financial services in the communities we serve. We intend to increase our market share by continuing to leverage our existing branch network, as well as adding new branch locations and considering business combinations that are consistent with our expansion strategy throughout the Pacific Northwest.

Products & Services

We place the highest priority on customer service and assist our customers in making informed decisions when selecting from the products and services we offer. We continuously review our product and service offerings to ensure that we provide our customers with the tools to meet their financial needs. A more complete listing of all the services and products available to our customers can be found on our website: *www.columbiabank.com*. Some of the core products and services we offer include:

Personal Banking	Business Banking
•Checking and Saving Accounts	•Checking & Saving Accounts
•Online Banking	•Online Banking
•Electronic Bill Pay	•Electronic Bill Pay
•Consumer Lending	•Remote Deposit Capture
•Residential Lending	•Cash Management
•Visa Card Services	•Commercial & Industrial Lending
•Investment Services	•Real Estate and Real Estate Construction Lending
•Private Banking	•Equipment Finance
	•Small Business Services
	•Visa Card Services
	•Investment Services
	•International Banking
	•Merchant Card Services

Personal Banking: We offer our personal banking customers an assortment of account products including non-interest and interest bearing checking, savings, money market and certificate of deposit accounts. Overdraft protection is also available with direct links to the customer’s checking account. Our online banking service,

Columbia Online™, provides our personal banking customers with the ability to safely and securely conduct their banking business 24 hours a day, 7 days a week. Personal banking customers are also provided with a variety of borrowing products including fixed and variable rate home equity loans and lines of credit, home mortgages for purchases and refinances, personal loans, and other consumer loans. Eligible personal banking customers with checking accounts are provided a VISA® Check Card which can be used both to make purchases and as an ATM card. A variety of Visa® Credit Cards are also available to eligible personal banking customers.

Columbia Private Banking offers affluent clientele and their businesses complex financial solutions, such as deposit and cash management services, credit services, and wealth management strategies. Each private banker provides advisory services and coordinates a relationship team of experienced financial professionals to meet the unique needs of each discerning customer.

Through CB Financial Services⁽¹⁾, personal banking customers are provided with a full range of investment options including mutual funds, stocks, bonds, retirement accounts, annuities, tax-favored investments, US Government securities as well as long-term care and life insurance policies. Qualified investment professionals are available to provide advisory services⁽²⁾ and assist customers with retirement, education and other financial planning activities.

Business Banking: We offer our business banking customers an assortment of checking, savings, interest bearing money market and certificate of deposit accounts to satisfy all their banking needs. Our Cash Management professionals are available to customize banking solutions with products such as automatic investment and line of credit sweeps; dailyDEPOSIT, our remote deposit product to deposit checks without leaving their place of business; positive pay, to identify fraudulent account activity quickly; and two choices of online banking, Columbia OnLine Business Banking and Streamlined Business Banking. Columbia OnLine Business Banking provides customers with the ability to tailor user access by individual, view balances and transactions, see check images, transfer funds, place stop payments, pay bills electronically, export transaction history in multiple file formats, create wire transfers and originate ACH transactions, such as direct deposit of employees’ payroll. Streamlined Business Banking is our free online solution intended for smaller businesses, or those just starting out. Streamlined Business Banking provides customers with the ability to view balances and transactions, see statements and check images, transfer funds, pay bills electronically and export transaction history in multiple file formats.

We offer a variety of loan products tailored to meet the various needs of business banking customers. Commercial loan products include accounts receivable, inventory and equipment financing as well as Small Business Administration financing. We also offer commercial real estate loan products for construction and development or permanent financing. Real estate lending activities have been focused on construction and permanent loans for both owner occupants and investor oriented real estate properties. In addition, the bank has pursued construction and first mortgages on owner occupied, one- to four-family residential properties. Commercial banking has been directed toward meeting the credit and related deposit needs of various sized businesses and professional practice organizations operating in our primary market areas.

We offer our business banking customers a selection of Visa® Cards including the Business Check Card that works like a check wherever VISA® is accepted including ATM cash withdrawals 24 hours a day, 7 days a week. We partner with First National Bank of Omaha to offer Visa® Credit Cards such as the Corporate Card which can be used all over the world; the Purchasing Card with established purchasing capabilities based on your business needs; as well as the Business Edition® and Business Edition Plus® that earns reward points with every purchase. Our International Banking Department provides both large and small businesses with the ability to buy and sell foreign currencies as well as obtain letters of credit and wire funds to their customers and suppliers in foreign countries.

(1) Securities and insurance products are offered by Primevest Financial Services, Inc., an independent, registered broker/dealer. Member FINRA/SIPC. Investment products are * Not FDIC insured * May lose value * Not bank guaranteed * Not a deposit * Not insured by any federal government agency.

(2) Advisory services may only be offered by Investment Adviser Representatives in connection with an appropriate PRIMEVEST Advisory Services Agreement and disclosure brochure as provided.

Business clients that utilize Columbia’s Merchant Card Services have the ability to accept both Visa® and MasterCard® sales drafts for deposit directly into their business checking account. Merchants are provided with a comprehensive accounting system tailored to meet each merchant’s needs, which includes month-to-date credit card deposit information on a transaction statement. Internet access is available to view merchant reports that allow business customers to review merchant statements, authorized, captured, cleared and settled transactions.

Through CB Financial Services⁽¹⁾, customers are provided with an array of investment options and all the tools and resources necessary to assist them in reaching their investment goals. Some of the investment solutions available to customers include 401(k), Simple IRA, Simple Employee Pensions, Buy-Sell Agreements, Key-Man Insurance, Business Succession Planning and personal investments.

Competition

Our industry is highly competitive. Several other financial institutions with greater resources compete for banking business in our market areas. Among the advantages of some of these institutions are their ability to make larger loans, finance extensive advertising and promotion campaigns, access international financial markets and allocate their investment assets to regions of highest yield and demand. In addition to competition from other banking institutions, we continue to experience competition from non-banking companies such as credit unions, brokerage houses and other financial services companies. We compete for deposits, loans, and other financial services by offering our customers similar breadth of products as our larger competitors while delivering a more personalized service level with faster transaction turnaround time.

Market Areas

Washington: Over half of our total branches within Washington are located in Pierce County, with an estimated population of 805,000 residents. At June 30, 2008 our Pierce County branch locations’ share of the county’s total deposit market was 17%⁽³⁾, ranking first amongst our competition. Also located in Pierce County is our Company headquarters in the city of Tacoma and one nearby operational facility. Some of the most significant contributors to the Pierce County economy are the Port of Tacoma whose activities represent more than 43,000 jobs, McChord Air Force Base and Fort Lewis Army Base that account for nearly 20% of the County’s total employment and the manufacturing industry which supplies the Boeing Company.

We operate twelve branch locations in King County, including Seattle, Bellevue and Redmond. King County, which is Washington’s most highly populated county at approximately 1.9 million residents, is a market that has significant growth potential for our Company and will play a key role in our expansion strategy in the future. At June 30, 2008 our share of the King County deposit market was less than 1%⁽³⁾; however, we have made significant inroads within this market through the strategic expansion of our banking team. The north King County economy is primarily made up of the aerospace, construction, computer software and biotechnology industries. South King County with its close proximity to Pierce County is considered a natural extension of our primary market area. The economy of south King County is primarily comprised of residential communities supported by light industrial, retail, aerospace and distributing and warehousing industries.

Some other market areas served by the Company include Cowlitz County where we operate two branch locations that account for 10%⁽³⁾ of the deposit market share, Thurston County where we operate two branches offices, and Kitsap and Whatcom County where we operate one branch in each county.

(1) Securities and insurance products are offered by Primevest Financial Services, Inc., an independent, registered broker/dealer. Member FINRA/SIPC. Investment products are * Not FDIC insured * May lose value * Not bank guaranteed * Not a deposit * Not insured by any federal government agency.

(3) Source: FDIC Annual Summary of Deposit Report as of June 30, 2008.

Oregon: With the acquisition of Town Center Bancorp in July, 2007, we added five branches in Clackamas and Multnomah counties in the Portland, Oregon area. Our six branches located in the western portions of Clatsop and Tillamook Counties, in the northern Oregon coastal area account for 33%⁽³⁾ and 7%⁽³⁾ of the deposit market share, respectively. In Clatsop County, we ranked first amongst our competition in market share as of June 30, 2008. Oregon market areas provide a significant opportunity for expansion in the future. Both Clatsop and Tillamook Counties are comprised primarily of tourism, forestry and commercial fishing related businesses.

Employees

As of December 31, 2008 the Company and its banking subsidiaries employed approximately 735 full time equivalent employees down from 775 at December 31, 2007. We value our employees and pride ourselves on providing a professional work environment accompanied by comprehensive benefit programs. We are committed to providing flexible and value-added benefits to our employees through a “Total Compensation Philosophy” which incorporates all compensation and benefits. Our continued commitment to employees contributed to Columbia Bank being named one of the 2008 Best Workplaces in Washington by the *Puget Sound Business Journal* and selected as one of Washington’s 100 Best Workplaces by *Washington CEO Magazine*.

Available Information

We file annual reports on Form 10-K, quarterly reports on Form 10-Q, periodic reports on Form 8-K, proxy statements and other information with the United States Securities and Exchange Commission (“SEC”). The public may obtain copies of these reports and any amendments at the SEC’s Internet site, www.sec.gov. Additionally, reports filed with the SEC can be obtained through our website at www.columbiabank.com. These reports are available through our website as soon as reasonably practicable after they are filed electronically with the SEC. Information contained on our website is not intended to be incorporated by reference into this report.

Supervision and Regulation

General

The following discussion describes elements of the extensive regulatory framework applicable to the Company and Columbia State Bank, which operates under the names Columbia State Bank and Mt. Rainier Bank in Washington, and Bank of Astoria in Oregon (collectively, referred to herein as “Columbia Bank”). This regulatory framework is primarily designed for the protection of depositors, federal deposit insurance funds and the banking system as a whole, rather than specifically for the protection of shareholders. Due to the breadth of this regulatory framework, our costs of compliance continue to increase in order to monitor and satisfy these requirements.

To the extent that this section describes statutory and regulatory provisions, it is qualified in its entirety by reference to those provisions. These statutes and regulations, as well as related policies, are subject to change by Congress, state legislatures and federal and state regulators. Changes in statutes, regulations or regulatory policies applicable to us, including interpretation or implementation thereof, could have a material effect on our business or operations.

Federal Bank Holding Company Regulation

General. The Company is a bank holding company as defined in the Bank Holding Company Act of 1956, as amended (“BHCA”), and is therefore subject to regulation, supervision and examination by the Federal Reserve. In general, the BHCA limits the business of bank holding companies to owning or controlling banks and engaging in other activities closely related to banking. The Company must file reports with and provide the Federal Reserve such additional information as it may require. Under the Financial Services Modernization Act of 1999, a bank holding company may apply to the Federal Reserve to become a financial holding company, and thereby engage (directly or through a subsidiary) in certain expanded activities deemed financial in nature, such as securities brokerage and insurance underwriting.

(3) Source: FDIC Annual Summary of Deposit Report as of June 30, 2008.

Holding Company Bank Ownership. The BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve before (i) acquiring, directly or indirectly, ownership or control of any voting shares of another bank or bank holding company if, after such acquisition, it would own or control more than 5% of such shares; (ii) acquiring all or substantially all of the assets of another bank or bank holding company; or (iii) merging or consolidating with another bank holding company.

Holding Company Control of Nonbanks. With some exceptions, the BHCA also prohibits a bank holding company from acquiring or retaining direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or bank holding company, or from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. The principal exceptions to these prohibitions involve certain non-bank activities that, by statute or by Federal Reserve regulation or order, have been identified as activities closely related to the business of banking or of managing or controlling banks.

Transactions with Affiliates. Subsidiary banks of a bank holding company are subject to restrictions imposed by the Federal Reserve Act on extensions of credit to the holding company or its subsidiaries, on investments in their securities and on the use of their securities as collateral for loans to any borrower. These regulations and restrictions may limit the Company’s ability to obtain funds from its subsidiary banks for its cash needs, including funds for payment of dividends, interest and operational expenses.

Tying Arrangements. We are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, sale or lease of property or furnishing of services. For example, with certain exceptions, neither the Company nor its subsidiaries may condition an extension of credit to a customer on either (i) a requirement that the customer obtain additional services provided by us; or (ii) an agreement by the customer to refrain from obtaining other services from a competitor.

Support of Subsidiary Banks. Under Federal Reserve policy, the Company is expected to act as a source of financial and managerial strength to its subsidiary banks. This means that the Company is required to commit, as necessary, resources to support Columbia Bank and the Bank of Astoria. Any capital loans a bank holding company makes to its subsidiary banks are subordinate to deposits and to certain other indebtedness of those subsidiary banks.

State Law Restrictions. As a Washington corporation, the Company is subject to certain limitations and restrictions under applicable Washington corporate law. For example, state law restrictions in Washington include limitations and restrictions relating to indemnification of directors, distributions to shareholders, transactions involving directors, officers or interested shareholders, maintenance of books, records, and minutes, and observance of certain corporate formalities.

Federal and State Regulation of Columbia State Bank

General. The deposits of Columbia Bank, a Washington chartered commercial bank with branches in Washington and Oregon, are insured by the FDIC. As a result, Columbia Bank is subject to supervision and regulation by the Washington Department of Financial Institutions, Division of Banks and the FDIC. With respect to branches of Columbia Bank in Oregon, the Bank is also subject to supervision and regulation by, respectively, the Oregon Department of Consumer and Business Services, as well as the FDIC. These agencies have the authority to prohibit banks from engaging in what they believe constitute unsafe or unsound banking practices.

Community Reinvestment. The Community Reinvestment Act of 1977 requires that, in connection with examinations of financial institutions within their jurisdiction, the Federal Reserve or the FDIC evaluate the record of the financial institution in meeting the credit needs of its local communities, including low and moderate-income neighborhoods, consistent with the safe and sound operation of the institution. A bank’s community reinvestment record is also considered by the applicable banking agencies in evaluating mergers, acquisitions and applications to open a branch or facility.

Insider Credit Transactions. Banks are also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal shareholders or any related interests of such persons. Extensions of credit (i) must be made on substantially the same terms, including interest rates and

collateral, and follow credit underwriting procedures that are at least as stringent as those prevailing at the time for comparable transactions with persons not covered above and who are not employees; and (ii) must not involve more than the normal risk of repayment or present other unfavorable features. Banks are also subject to certain lending limits and restrictions on overdrafts to insiders. A violation of these restrictions may result in the assessment of substantial civil monetary penalties, the imposition of a cease and desist order, and other regulatory sanctions.

Regulation of Management. Federal law (i) sets forth circumstances under which officers or directors of a bank may be removed by the institution’s federal supervisory agency; (ii) places restraints on lending by a bank to its executive officers, directors, principal shareholders, and their related interests; and (iii) prohibits management personnel of a bank from serving as a director or in other management positions of another financial institution whose assets exceed a specified amount or which has an office within a specified geographic area.

Safety and Soundness Standards. Federal law imposes certain non-capital safety and soundness standards upon banks. These standards cover, among other things, internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation and benefits. Additional standards apply to asset quality, earnings and stock valuation. An institution that fails to meet these standards must develop a plan acceptable to its regulators, specifying the steps that the institution will take to meet the standards. Failure to submit or implement such a plan may subject the institution to regulatory sanctions.

State Assessments. Washington state banks that hold public funds are considered public depositaries and are subject to pro rata assessments for the loss of public deposits held at a failed Washington bank that exceed federal deposit insurance limits. Due to the current economic climate it is anticipated that there will be bank failures nationwide, and we may face increased costs if a Washington state public depositary bank fails and we are assessed for such net losses.

Interstate Banking And Branching

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (“Interstate Act”) permits relaxed prior interstate branching restrictions under federal law by permitting nationwide interstate banking and branching under certain circumstances. Generally, bank holding companies may purchase banks in any state, and states may not prohibit these purchases. Additionally, banks are permitted to merge with banks in other states, as long as the home state of neither merging bank has opted out under the legislation. The Interstate Act requires regulators to consult with community organizations before permitting an interstate institution to close a branch in a low-income area. Federal banking agency regulations prohibit banks from using their interstate branches primarily for deposit production and the federal banking agencies have implemented a loan-to-deposit ratio screen to ensure compliance with this prohibition.

Washington and Oregon have both enacted “opting in” legislation in accordance with the Interstate Act provisions allowing banks to engage in interstate merger transactions, subject to certain “aging” requirements. Under Washington law, an out-of-state bank may, subject to Department of Financial Institution approval, open de novo branches in Washington or acquire an in-state branch so long as the home state of the out-of-state bank has reciprocal laws with respect to de novo branching or branch acquisitions. In contrast, Oregon restricts an out-of-state bank from opening de novo branches, and no out-of-state bank may conduct banking business at a branch located in Oregon unless the out-of-state bank has converted from, has assumed all, or substantially all, of Oregon deposit liabilities of or has merged with an insured institution that, by itself or together with any predecessor, has been engaged in banking business in Oregon for at least three years.

Dividends

The principal source of the Company’s cash is from dividends received from its subsidiary banks, which are subject to government regulation and limitations. Regulatory authorities may prohibit banks and bank holding companies from paying dividends in a manner that would constitute an unsafe or unsound banking practice or would reduce the amount of its capital below that necessary to meet minimum applicable regulatory capital requirements. Washington law also limits a bank’s ability to pay dividends that are greater than the bank’s retained earnings without approval of the applicable banking agency.

In addition to the foregoing regulatory restrictions, we are and may in the future become subject to contractual restrictions that would limit or prohibit us from paying dividends on our common stock, including those contained in the securities purchase agreement between us and the Treasury, as described in more detail below.

Capital Adequacy

Regulatory Capital Guidelines. Federal bank regulatory agencies use capital adequacy guidelines in the examination and regulation of bank holding companies and banks. The guidelines are “risk-based,” meaning that they are designed to make capital requirements more sensitive to differences in risk profiles among banks and bank holding companies.

Tier I and Tier II Capital. Under the guidelines, an institution’s capital is divided into two broad categories, Tier I capital and Tier II capital. Tier I capital generally consists of common stockholders’ equity, surplus and undivided profits. Tier II capital generally consists of the allowance for loan losses and hybrid capital instruments. The sum of Tier I capital and Tier II capital represents an institution’s total capital. The guidelines require that at least 50% of an institution’s total capital consist of Tier I capital.

Risk-based Capital Ratios. The adequacy of an institution’s capital is gauged primarily with reference to the institution’s risk-weighted assets. The guidelines assign risk weightings to an institution’s assets in an effort to quantify the relative risk of each asset and to determine the minimum capital required to support that risk. An institution’s risk-weighted assets are then compared with its Tier I capital and total capital to arrive at a Tier I risk-based ratio and a total risk-based ratio, respectively. The guidelines provide that an institution must have a minimum Tier I risk-based ratio of 4% and a minimum total risk-based ratio of 8%.

Leverage Ratio. The guidelines also employ a leverage ratio, which is Tier I capital as a percentage of total assets, less intangibles. The principal objective of the leverage ratio is to constrain the maximum degree to which a bank holding company may leverage its equity capital base. The minimum leverage ratio is 3%; however, for all but the most highly rated bank holding companies and for bank holding companies seeking to expand, regulators expect an additional cushion of at least 1% to 2%.

Prompt Corrective Action. Under the guidelines, an institution is assigned to one of five capital categories depending on its total risk-based capital ratio, Tier I risk-based capital ratio, and leverage ratio, together with certain subjective factors. The categories range from “well capitalized” to “critically undercapitalized.” Institutions that are “undercapitalized” or lower are subject to certain mandatory supervisory corrective actions.

In 2007, the federal banking agencies, including the FDIC and the Federal Reserve, approved final rules to implement new risk-based capital requirements. Presently, this new advanced capital adequacy framework, called Basel II, is applicable only to large and internationally active banking organizations. Basel II changes the existing risk-based capital framework by enhancing its risk sensitivity. Whether Basel II will be expanded to apply to banking organizations like ours is unclear at this time, and what effect such regulations would have on us cannot be predicted, but we do not expect our operations would be significantly impacted.

Regulatory Oversight and Examination

The Federal Reserve conducts periodic inspections of bank holding companies, which are performed both onsite and offsite. The supervisory objectives of the inspection program are to ascertain whether the financial strength of the bank holding company is being maintained on an ongoing basis and to determine the effects or consequences of transactions between a holding company or its non-banking subsidiaries and its subsidiary banks. For holding companies under \$10 billion in assets, the inspection type and frequency varies depending on asset size, complexity of the organization, and the holding company’s rating at its last inspection.

Banks are subject to periodic examinations by their primary regulators. Bank examinations have evolved from reliance on transaction testing in assessing a bank’s condition to a risk-focused approach. These examinations are extensive and cover the entire breadth of operations of the bank. Generally, safety and soundness examinations occur on an 18-month cycle for banks under \$500 million in total assets that are well capitalized and without regulatory issues, and 12-months otherwise. Examinations alternate between the federal and state bank regulatory agency or may occur on a combined schedule. The frequency of consumer compliance and CRA examinations is linked to the size of the institution and its compliance and CRA ratings at its most recent examinations. However, the examination authority of the Federal Reserve and the FDIC allows them to

examine supervised banks as frequently as deemed necessary based on the condition of the bank or as a result of certain triggering events.

Recent Legislation

Emergency Economic Stabilization Act of 2008

In response to the recent financial crisis, the United States government passed the Emergency Economic Stabilization Act of 2008 (the “EESA”) on October 3, 2008, which provides the United States Department of the Treasury (the “Treasury”) with broad authority to implement certain actions intended to help restore stability and liquidity to the U.S. financial markets.

Insurance of Deposit Accounts.

The EESA included a provision for a temporary increase from \$100,000 to \$250,000 per depositor in deposit insurance effective October 3, 2008 through December 31, 2009. Deposit accounts are otherwise insured by the FDIC, generally up to a maximum of \$100,000 per separately insured depositor and up to a maximum of \$250,000 for self-directed retirement accounts.

The FDIC imposes an assessment against institutions for deposit insurance. This assessment is based on the risk category of the institution and ranges from 5 to 43 basis points of the institution’s deposits. In December, 2008, the FDIC adopted a rule that raises the current deposit insurance assessment rates uniformly for all institutions by 7 basis points (to a range from 12 to 50 basis points) for the first quarter of 2009. The rule also gives the FDIC the authority to alter the way it calculates federal deposit insurance assessment rates to adjust for an institutions’ risk beginning in the second quarter of 2009 and thereafter.

In 2006, federal deposit insurance reform legislation was enacted that (i) required the FDIC to merge the Bank Insurance Fund and the Savings Association Insurance Fund into a newly created Deposit Insurance Fund; (ii) increases the amount of deposit insurance coverage for retirement accounts; (iii) allows for deposit insurance coverage on individual accounts to be indexed for inflation starting in 2010; (iv) provides the FDIC more flexibility in setting and imposing deposit insurance assessments; and (v) provides eligible institutions credits on future assessments.

Capital Purchase Program

Pursuant to the EESA, the Treasury has the ability to purchase or insure up to \$700 billion in troubled assets held by financial institutions under the Troubled Asset Relief Program (“TARP”). On October 14, 2008, the Treasury announced it would initially purchase equity stakes in financial institutions under a Capital Purchase Program (the “CPP”) of up to \$350 billion of the \$700 billion authorized under the TARP legislation. The CPP provides direct equity investment of perpetual preferred stock by the Treasury in qualified financial institutions. The program is voluntary and requires an institution to comply with a number of restrictions and provisions, including limits on executive compensation, stock redemptions and declaration of dividends. For publicly traded companies, the CPP also requires the Treasury to receive warrants for common stock equal to 15% of the capital invested by the Treasury. The Company applied for and received approximately \$76 million in the CPP. As a result, the Company is subject to the restrictions described below. The Treasury made an equity investment in the Company through its purchase of the Company’s Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the “Preferred Stock”). The description of the Preferred Stock set forth below is qualified in its entirety by the actual terms of the Preferred Stock, as are stated in the Certificate of Designation for the Preferred Stock, a copy of which was attached as Exhibit 3.1 to our Current Report on Form 8-K filed with the SEC on November 21, 2008 and incorporated by reference.

General. The Preferred Stock constitutes a single series of our preferred stock, consisting of 76,898 shares, no par value per share, having a liquidation preference amount of \$1,000 per share. The Preferred Stock has no maturity date. We issued the shares of Preferred Stock to Treasury on November 21, 2008 in connection with the CPP for a purchase price of \$76,898,000.

Dividend Rate. Dividends on the Preferred Stock are payable quarterly in arrears, when, as and if authorized and declared by our Board of Directors out of legally available funds, on a cumulative basis on the \$1,000 per share liquidation preference amount plus the amount of accrued and unpaid dividends for any prior dividend periods, at a rate of (i) 5% per annum, from the original issuance date to the fifth anniversary of the issuance date, and (ii) 9% per annum, thereafter.

Dividends on the Preferred Stock will be cumulative. If for any reason our Board of Directors does not declare a dividend on the Preferred Stock for a particular dividend period, or if our Board of Directors declares less than a full dividend, we will remain obligated to pay the unpaid portion of the dividend for that period and the unpaid dividend will compound on each subsequent dividend date (meaning that dividends for future dividend periods will accrue on any unpaid dividend amounts for prior dividend periods).

Priority of Dividends. Until the earlier of the third anniversary of Treasury's investment or our redemption or the Treasury's transfer of the Preferred Stock to an unaffiliated third party, we may not declare or pay a dividend or other distribution on our common stock that exceeds \$.07 per share (other than dividends payable solely in common stock), and we generally may not directly or indirectly purchase, redeem or otherwise acquire any shares of common stock, including trust preferred securities.

Liquidation Rights. In the event of any voluntary or involuntary liquidation, dissolution or winding up of the affairs of the Company, holders of the Preferred Stock will be entitled to receive for each share of Preferred Stock, out of the assets of the Company or proceeds available for distribution to our shareholders, subject to any rights of our creditors, before any distribution of assets or proceeds is made to or set aside for the holders of our common stock and any other class or series of our stock ranking junior to the Preferred Stock, payment of an amount equal to the sum of (i) the \$1,000 liquidation preference amount per share and (ii) the amount of any accrued and unpaid dividends on the Preferred Stock (including dividends accrued on any unpaid dividends). To the extent the assets or proceeds available for distribution to shareholders are not sufficient to fully pay the liquidation payments owing to the holders of the Preferred Stock and the holders of any other class or series of our stock ranking equally with the Preferred Stock, the holders of the Preferred Stock and such other stock will share ratably in the distribution. For purposes of the liquidation rights of the Preferred Stock, neither a merger nor consolidation of the Company with another entity nor a sale, lease or exchange of all or substantially all of the Company's assets will constitute a liquidation, dissolution or winding up of the affairs of the Company.

The Securities Purchase Agreement also includes a provision that allows the Treasury to unilaterally amend the CPP transaction documents to comply with federal statutes.

Executive Compensation Restrictions under the CPP.

Entities that participate in the CPP, must comply with certain limits on executive compensation and various reporting requirements. These restrictions apply to the chief executive officer, chief financial officer, plus the next three most highly compensated executive officers. These restrictions include (1) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (2) requiring clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate; (3) prohibiting the financial institution from making any payment which would be deemed to be "golden parachute" based on the Internal Revenue Code provision, to a senior executive; and (4) restricting deductions for tax purposes for executive compensation in excess of \$500,000 for each such senior executive. The CEO and board compensation committee must certify annually that the institution and the board compensation committee have complied with such standards. In addition, the CEO and the board compensation committee must certify, within 120 days of receiving financial assistance, that the compensation committee has reviewed the senior executives' incentive compensation arrangements with the senior risk officers to ensure that these arrangements do not encourage senior executives to take unnecessary and excessive risks that could threaten the value of the financial institution.

Temporary Liquidity Guarantee Program

In October 2008, the FDIC announced the Temporary Liquidity Guarantee Program, which has two components--the Debt Guarantee Program and the Transaction Account Guarantee Program. Under the Transaction Account Guarantee Program any participating depository institution is able to provide full deposit insurance coverage for non-interest bearing transaction accounts, regardless of the dollar amount. Under the

program, effective November 14, 2008, insured depository institutions that have not opted out of the FDIC Temporary Liquidity Guarantee Program will be subject to a 0.10% surcharge applied to non-interest bearing transaction deposit account balances in excess of \$250,000, which surcharge will be added to the institution's existing risk-based deposit insurance assessments. Under the Debt Guarantee Program, qualifying unsecured senior debt issued by a participating institution can be guaranteed by the FDIC. The Company and the Bank chose to participate in both components of the FDIC Temporary Liquidity Guaranty Program.

Proposed Legislation

As indicated by Treasury as of early 2009, additional legislation to be promulgated under the EESA is pending, which among other things is expected to inject more capital from Treasury into financial institutions through the Capital Assistance Program, establish a public-private investment fund for the purchase of troubled assets, and expand the Term Asset-Backed Securities Loan Facility to include commercial mortgage backed-securities.

Proposed legislation is introduced in almost every legislative session that would dramatically affect the regulation of the banking industry. In light of the 2008 financial crisis and a new administration in the White House, it is anticipated that legislation reshaping the regulatory landscape could be proposed in 2009. We cannot predict if any such legislation will be adopted or if it is adopted how it would affect the business of the Company or the Bank. Past history has demonstrated that new legislation or changes to existing laws or regulations usually results in a greater compliance burden and therefore generally increases the cost of doing business.

Other Relevant Legislation

Corporate Governance and Accounting Legislation

Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 (the "Act") addresses among other things, corporate governance, auditing and accounting, enhanced and timely disclosure of corporate information, and penalties for non-compliance. Generally, the Act (i) requires chief executive officers and chief financial officers to certify to the accuracy of periodic reports filed with the Securities and Exchange Commission (the "SEC"); (ii) imposes specific and enhanced corporate disclosure requirements; (iii) accelerates the time frame for reporting of insider transactions and periodic disclosures by public companies; (iv) requires companies to adopt and disclose information about corporate governance practices, including whether or not they have adopted a code of ethics for senior financial officers and whether the audit committee includes at least one "audit committee financial expert;" and (v) requires the SEC, based on certain enumerated factors, to regularly and systematically review corporate filings.

To deter wrongdoing, the Act (i) subjects bonuses issued to top executives to disgorgement if a restatement of a company's financial statements was due to corporate misconduct; (ii) prohibits an officer or director misleading or coercing an auditor; (iii) prohibits insider trades during pension fund "blackout periods"; (iv) imposes new criminal penalties for fraud and other wrongful acts; and (v) extends the period during which certain securities fraud lawsuits can be brought against a company or its officers.

As a publicly reporting company, we are subject to the requirements of the Act and related rules and regulations issued by the SEC and NASDAQ. After enactment, we updated our policies and procedures to comply with the Act's requirements and have found that such compliance, including compliance with Section 404 of the Act relating to management control over financial reporting, has resulted in significant additional expense for the Company. We anticipate that we will continue to incur such additional expense in our ongoing compliance.

Anti-terrorism Legislation

USA Patriot Act of 2001. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, intended to combat terrorism, was renewed with certain amendments in 2006 (the "Patriot Act"). Certain provisions of the Patriot Act were made permanent and other sections were made subject to extended "sunset" provisions. The Patriot Act, in relevant part, (i) prohibits banks from providing correspondent accounts directly to foreign shell banks; (ii) imposes due diligence requirements on banks opening or holding accounts for foreign financial institutions or wealthy foreign

individuals; (iii) requires financial institutions to establish an anti-money-laundering compliance program; and (iv) eliminates civil liability for persons who file suspicious activity reports. The Act also includes provisions providing the government with power to investigate terrorism, including expanded government access to bank account records. While the Patriot Act has had minimal affect on our record keeping and reporting expenses, we do not believe that the renewal and amendment will have a material adverse effect on our business or operations.

Financial Services Modernization

Gramm-Leach-Bliley Act of 1999. The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 brought about significant changes to the laws affecting banks and bank holding companies. Generally, the Act (i) repeals historical restrictions on preventing banks from affiliating with securities firms; (ii) provides a uniform framework for the activities of banks, savings institutions and their holding companies; (iii) broadens the activities that may be conducted by national banks and banking subsidiaries of bank holding companies; (iv) provides an enhanced framework for protecting the privacy of consumer information and requires notification to consumers of bank privacy policies; and (v) addresses a variety of other legal and regulatory issues affecting both day-to-day operations and long-term activities of financial institutions. Bank holding companies that qualify and elect to become financial holding companies can engage in a wider variety of financial activities than permitted under previous law, particularly with respect to insurance and securities underwriting activities.

Financial Services Regulatory Relief Act of 2006. In 2006, the President signed the Financial Services Regulatory Relief Act of 2006 into law (the “Relief Act”). The Relief Act amends several existing banking laws and regulations, eliminates some unnecessary and overly burdensome regulations of depository institutions and clarifies several existing regulations. The Relief Act, among other things, (i) authorizes the Federal Reserve Board to set reserve ratios; (ii) amends regulations of national banks relating to shareholder voting and granting of dividends; (iii) amends several provisions relating to loans to insiders, regulatory applications, privacy notices, and golden parachute payments; and (iv) expands and clarifies the enforcement authority of federal banking regulators. Our business, expenses, and operations have not been significantly impacted by this legislation.

Effects of Government Monetary Policy

Our earnings and growth are affected not only by general economic conditions, but also by the fiscal and monetary policies of the federal government, particularly the Federal Reserve. The Federal Reserve implements national monetary policy for such purposes as curbing inflation and combating recession, but its open market operations in U.S. government securities, control of the discount rate applicable to borrowings from the Federal Reserve, and establishment of reserve requirements against certain deposits, influence the growth of bank loans, investments and deposits, and also affect interest rates charged on loans or paid on deposits. The nature and impact of future changes in monetary policies, such as the recent lowering of the Federal Reserve’s discount rate, and their impact on us cannot be predicted with certainty.

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, are currently facing challenges of a scope unprecedented in recent history. No one can predict the severity or duration of this national downturn, which has adversely impacted the markets we serve. Any further deterioration in our markets would have an adverse effect on our business, financial condition and results of operations.

We cannot predict the effect of recently and pending federal legislation.

On October 3, 2008, Congress enacted the Emergency Economic Stabilization Act of 2008 (“EESA”), which provides the United States Treasury Department (“Treasury”) with broad authority to implement action intended to help restore stability and liquidity to the US financial markets. As indicated by the Treasury as of

early 2009, additional related legislation is pending, which among other things is expected to inject more capital from the Treasury into financial institutions through the Capital Assistance Program, establish a public-private investment fund for the purchase of troubled assets, and expand the Term Asset-Backed Securities Loan Facility to include commercial mortgage backed-securities.

The full effect of the broad legislation already enacted and related legislation expected to be enacted in the near future on the national economy and financial institutions, particularly on mid-sized institutions like us, cannot 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 and national 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 concentration of loans secured by real estate.

The Company has a concentration of loans secured by real estate. The effects of the economic downturn are now significantly impacting our market area. Further downturn in the market areas we serve may cause us to have lower earnings and could increase our credit risk associated with our loan portfolio, as the collateral securing those loans may decrease in value. A continued downturn in the economy could have a material adverse effect both on the borrowers' ability to repay these loans, as well as the value of the real property held as collateral. Our ability to recover on defaulted loans by foreclosing and selling the real estate collateral would then be diminished and we be would more likely to suffer losses on defaulted loans.

Our loan portfolio mix could result in increased credit risk in a prolonged 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. These types of loans 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 considerable increase in our non-performing loans. An increase in non-performing loans could result in a loss of earnings, an increase in the provision for loan losses, or an increase in loan charge-offs, all of which could have an adverse impact on our results of operations and financial condition.

The current economic downturn in the market areas we serve may cause us to have lower earnings and could increase our credit risk associated with our loan portfolio.

The inability of borrowers to repay loans can erode our earnings. Substantially all of our loans are to businesses and individuals in Washington and Oregon, and a continuing decline in the economy of these market areas could impact us adversely. Recently, a series of large Puget Sound-based companies have announced or commenced implementation of substantial employee layoffs and scaled back plans for future growth. A further deterioration in economic conditions in the market areas we serve 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;
- 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;
- certain securities within our investment portfolio could become other than temporarily impaired, requiring a write down through earnings to fair value thereby reducing equity;
- demand for banking products and services may decline
- low cost or non-interest bearing deposits may decrease; and
- substantial increase in office space availability in downtown Seattle.

Our allowance for loan and lease losses (“ALLL”) may not be adequate to cover actual loan losses, which could adversely affect earnings.

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 loan portfolio and the adequacy of our ALLL. These regulatory agencies may require us to recognize further loan loss provisions or charge-offs based upon their judgments, which may be difference from ours. Increases in the ALLL or charge-offs 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 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 the Company’s interest rate spread, and, in turn, profitability.

If the goodwill we have recorded in connection with acquisitions becomes impaired, it could have an adverse impact on our earnings and capital.

Accounting standards require that we account for acquisitions using the purchase method of accounting. Under purchase accounting, if the purchase price of an acquired company exceeds the fair value of its net assets, the excess is carried on the acquirer’s balance sheet as goodwill. In accordance with generally accepted accounting principles, our goodwill is evaluated for impairment on an annual basis or more frequently if events or circumstances indicate that a potential impairment exists. Such evaluation is based on a variety of factors, including the quoted price of our common stock, market prices of common stocks of other banking organizations, common stock trading multiples, discounted cash flows, and data from comparable acquisitions. There can be no assurance that future evaluations of goodwill will not result in an impairment and write-downs, which could be material.

A continued tightening of the credit markets may make it difficult to obtain adequate funding for loan growth, which could adversely affect our earnings.

A continued tightening of the credit market and the inability to obtain or retain adequate liquidity to fund continued loan growth may negatively affect our asset growth and, therefore, our earnings capability. In addition to deposit growth, maturity of investment securities and loan payments, the Company also relies on alternative funding sources through correspondent banking, wholesale certificates of deposit and borrowing lines with the Federal Reserve Bank and FHLB of Seattle to fund loans. In the event the current economic downturn continues, particularly in the housing market, these resources could be negatively affected, both as to price and availability, which would limit and or raise the cost of the funds available to the Company.

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

We have in recent years acquired other financial institutions. We may in the future engage in selected acquisitions of additional financial institutions. There are risks associated with any such acquisitions that could adversely affect our profitability. These risks include, among other things, assessing the asset quality of a financial institution being acquired, encountering greater than anticipated cost of incorporating acquired businesses into our operations, and being unable to profitably deploy funds acquired in an acquisition.

We may issue additional equity in connection with any future acquisitions. Such acquisitions and related issuances of equity may have a dilutive effect on earnings per share and the percentage ownership of current shareholders.

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 and we may separately incur state statutory assessments in the future.

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. The increase of these premiums will add to our cost of operations and could have a significant impact on the Company. Depending on any future losses that the FDIC insurance fund may suffer due to failed institutions, there can be no assurance that there will not be additional significant premium increases in order to replenish the fund.

On February 27, 2009 the FDIC issued a press release announcing their intent to levy a special Deposit Insurance Fund assessment of 20 basis points on insured institutions. The proposed assessment will be calculated on June 30, 2009 deposit balances and collected on September 30, 2009. Based upon the Company’s December 31, 2008 deposits subject to FDIC insurance assessments, if enacted, the special assessment will be approximately \$4.7 million.

Further, under Washington state laws, the Company may incur additional costs if one or more Washington state banks that hold public deposits fail, since, as a public depository, we are subject to Washington statutory pro-rata assessments to cover any net losses in public deposits not otherwise covered by federal deposit insurance or other means.

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 or regulations by financial institutions and holding companies in the performance of their supervisory and enforcement duties. These powers recently have been utilized more frequently due to the current economic conditions we are facing. The exercise of regulatory authority may have a negative impact on our financial condition and results of operations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Locations

The Company’s principal Columbia Bank properties include our corporate headquarters which is located at 13th & A Street, Tacoma, Washington, in Pierce County, where we occupy 62 thousand square feet of office space, 4 thousand square feet of commercial lending space and 750 square feet of branch space under various operating lease agreements, an operations facility in Lakewood, Washington, where we own 58 thousand square feet of office space and an office facility in Tacoma, Washington, that includes a branch where we occupy 26 thousand square feet under various operating lease agreements.

In Pierce County we conduct business in twenty additional branch locations, fourteen of which are owned and six of which are leased under various operating lease agreements. In King County we conduct business in nine branch locations, six of which are owned and three of which are leased. In Kitsap, Thurston, Cowlitz and Whatcom counties we conduct business in six branch locations, five of which are owned and one that is leased under various operating lease agreements. In addition, Columbia Bank, dba Mt. Rainier Bank, conducts business in five branch locations in King and Pierce counties. In the Portland metropolitan area, Columbia Bank conducts business in five branch locations in Clackamas and Multnomah counties. Finally, Columbia Bank, dba Bank of Astoria, conducts business in six branch locations in Clatsop and Tillamook counties, of which all are owned.

During 2008 we consolidated three branches due to overlapping service areas while expanding our geographic footprint along the Oregon coast with the addition of a new branch in Tillamook. During 2009 we intend to continue to evaluate additional opportunities for branch consolidations.

For additional information concerning our premises and equipment and lease obligations, see Note 8 and 16, respectively, to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

ITEM 3. 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 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Quarterly Common Stock Prices and Dividends

Our common stock is traded on the NASDAQ Global Select Market under the symbol “COLB”. Quarterly high and low closing prices and dividend information for the last two years are presented in the following table. The prices shown do not include retail mark-ups, mark-downs or commissions:

			Cash Dividend
	High	Low	Declared
2008			
First quarter	\$ 29.90	\$ 21.07	\$ 0.17
Second quarter	\$ 29.57	\$ 19.31	0.17
Third quarter	\$ 29.00	\$ 8.50	0.17
Fourth quarter	\$ 18.49	\$ 7.64	0.07
For the year	\$ 29.90	\$ 7.64	<u>\$ 0.58</u>
	High	Low	Cash Dividend
	High	Low	Declared
2007			
First quarter	\$ 35.96	\$ 32.36	\$ 0.15
Second quarter	\$ 34.18	\$ 28.35	0.17
Third quarter	\$ 33.41	\$ 24.71	0.17
Fourth quarter	\$ 34.00	\$ 27.19	0.17
For the year	\$ 35.96	\$ 24.71	<u>\$ 0.66</u>

On December 31, 2008, the last sale price for our stock in the over-the-counter market was \$11.93. At January 31, 2009, the number of shareholders of record was 2,284. This figure does not represent the actual number of beneficial owners of common stock because shares are frequently held in “street name” by securities dealers and others for the benefit of individual owners who may vote the shares.

At December 31, 2008, a total of 201,981 stock options were outstanding. Additional information about stock options and other equity compensation plans is included in Note 15 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

The payment of future cash dividends is at the discretion of our Board and subject to a number of factors, including results of operations, general business conditions, growth, financial condition and other factors deemed relevant by the Board of Directors. Our ability to pay future cash dividends is subject to the provisions contained in the agreement that governs our participation in the CPP. Specifically, the Company may not declare a dividend that exceeds \$0.07 per common share until the earlier of the third anniversary of Treasury’s investment or our redemption or the transfer of our Preferred Stock to a third party along with other regulatory requirements and restrictions which are discussed in the Supervision and Regulation section in “Item 1. Business” of this report.

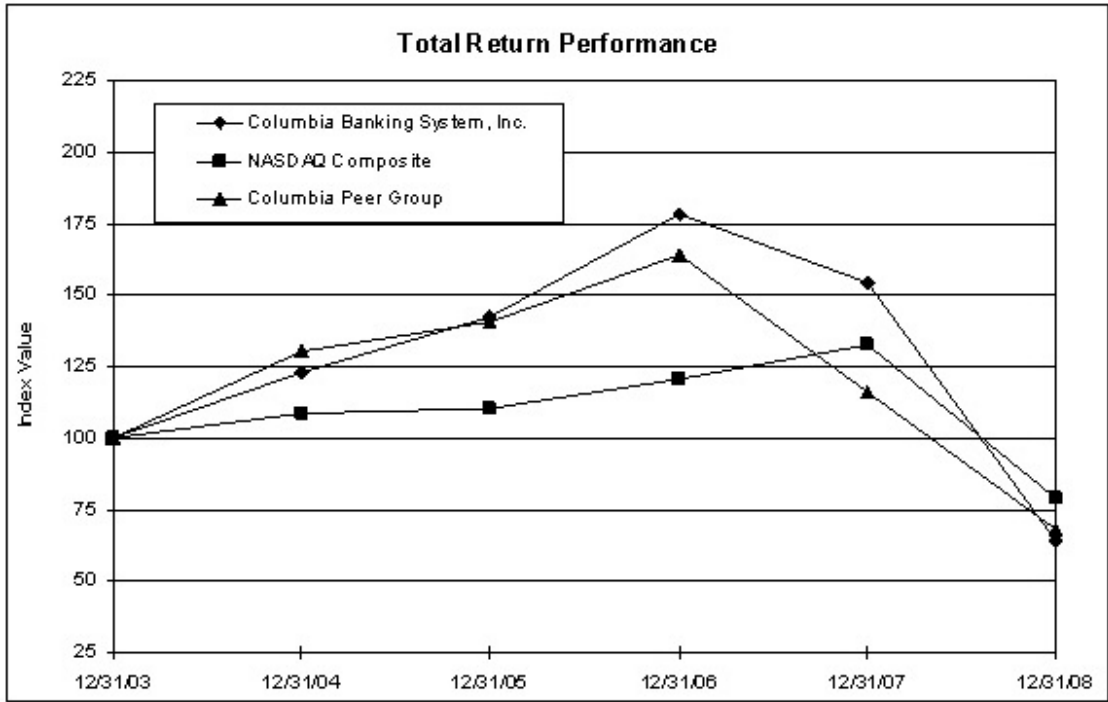
Equity Compensation Plan Information

	Year Ended December 31, 2008		
	Number of Shares to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (1)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Shares Remaining Available for Future Issuance Under Equity Compensation Plans (2)
Equity compensation plans approved by security holders	201,981	\$ 16.49	116,752
Equity compensation plans not approved by security holders	--	--	--

- (1) Consists of shares that are subject to outstanding options.
- (2) Includes 87,611 shares available for future issuance under the stock option and equity compensation plan and 29,141 shares available for purchase under the Employee Stock Purchase Plan as of December 31, 2008.

Five-Year Stock Performance Graph

The following graph shows a five-year comparison of the total return to shareholders of Columbia’s common stock, the Nasdaq Composite Index (which is a broad nationally recognized index of stock performance by companies listed on the Nasdaq Stock Market) and the Columbia Peer Group (comprised of banks with assets of \$1 billion to \$5 billion, all of which are located in the western United States). The definition of total return includes appreciation in market value of the stock as well as the actual cash and stock dividends paid to shareholders. The graph assumes that the value of the investment in Columbia’s common stock, the Nasdaq and the Columbia Peer Group was \$100 on December 31, 2003, and that all dividends were reinvested.



Index	Period Ending December 31,					
	2003	2004	2005	2006	2007	2008
Columbia Banking System, Inc.	100.00	122.54	142.13	177.95	154.04	63.61
NASDAQ Composite	100.00	108.59	110.08	120.56	132.39	78.72
Columbia Peer Group	100.00	130.01	140.31	163.99	115.95	67.67

Source: SNL Financial LC, Charlottesville, VA

ITEM 6. SELECTED FINANCIAL DATA

Five-Year Summary of Selected Consolidated Financial Data (1)					
	2008	2007	2006	2005	2004
For the Year	(dollars in thousands except per share)				
Total revenue	\$ 134,363	\$ 136,568	\$ 122,435	\$ 115,698	\$ 94,187
Net interest income	\$ 119,513	\$ 108,820	\$ 97,763	\$ 90,912	\$ 71,943
Provision for loan and lease losses	\$ 41,176	\$ 3,605	\$ 2,065	\$ 1,520	\$ 995
Noninterest income	\$ 14,850	\$ 27,748	\$ 24,672	\$ 24,786	\$ 22,244
Noninterest expense	\$ 92,125	\$ 88,829	\$ 76,134	\$ 72,855	\$ 61,326
Net income	\$ 5,968	\$ 32,381	\$ 32,103	\$ 29,631	\$ 22,513
Per Common Share					
Net Income (Basic)	\$ 0.31	\$ 1.93	\$ 2.01	\$ 1.89	\$ 1.55
Net Income (Diluted)	\$ 0.31	\$ 1.91	\$ 1.99	\$ 1.87	\$ 1.52
Book Value	\$ 18.82	\$ 19.03	\$ 15.71	\$ 14.29	\$ 13.03
Averages					
Total Assets	\$3,134,054	\$2,837,162	\$2,473,404	\$2,290,746	\$1,919,134
Interest-earning assets	\$2,851,555	\$2,599,379	\$2,265,393	\$2,102,513	\$1,769,470
Loans	\$2,264,486	\$1,990,622	\$1,629,616	\$1,494,567	\$1,186,506
Securities	\$ 565,299	\$ 581,122	\$ 623,631	\$ 605,395	\$ 552,742
Deposits	\$2,382,484	\$2,242,134	\$1,976,448	\$1,923,778	\$1,690,513
Core deposits	\$1,911,897	\$1,887,391	\$1,664,247	\$1,689,270	\$1,502,843
Shareholders' equity	\$ 354,387	\$ 289,297	\$ 237,843	\$ 214,612	\$ 169,414
Financial Ratios					
Net interest margin	4.38%	4.35%	4.49%	4.44%	4.19%
Return on average assets	0.19%	1.14%	1.30%	1.29%	1.17%
Return on average common equity	1.59%	11.19%	13.50%	13.81%	13.29%
Return on average tangible common equity (2)	2.72%	14.53%	15.88%	16.63%	14.02%
Efficiency ratio (3)	59.88%	61.33%	58.95%	61.20%	63.20%
Average equity to average assets	11.31%	10.20%	9.62%	9.37%	8.83%
At Year End					
Total assets	\$3,097,079	\$3,178,713	\$2,553,131	\$2,377,322	\$2,176,730
Loans	\$2,232,332	\$2,282,728	\$1,708,962	\$1,564,704	\$1,359,743
Allowance for loan and lease losses	\$ 42,747	\$ 26,599	\$ 20,182	\$ 20,829	\$ 19,881
Securities	\$ 540,525	\$ 572,973	\$ 605,133	\$ 585,332	\$ 642,759
Deposits	\$2,382,151	\$2,498,061	\$2,023,351	\$2,005,489	\$1,862,866
Core deposits	\$1,941,047	\$1,996,393	\$1,701,528	\$1,703,030	\$1,605,938
Shareholders' equity	\$ 415,385	\$ 341,731	\$ 252,347	\$ 226,242	\$ 203,154
Full-time equivalent employees	735	775	657	651	625
Banking offices	53	55	40	40	39
Nonperforming Assets					
Nonaccrual loans	\$ 106,163	\$ 14,005	\$ 2,414	\$ 4,733	\$ 8,222
Restructured loans	587	456	1,066	124	227
Other real estate owned	2,874	181	-	18	680
Total nonperforming assets	<u>\$ 109,624</u>	<u>\$ 14,642</u>	<u>\$ 3,480</u>	<u>\$ 4,875</u>	<u>\$ 9,129</u>
Nonperforming loans to year end loans	4.78%	0.63%	0.20%	0.31%	0.62%
Nonperforming assets to year end assets	3.54%	0.46%	0.14%	0.21%	0.42%
Allowance for loan and lease losses to year end loans	1.91%	1.17%	1.18%	1.33%	1.46%
Allowance for loan and lease losses to nonperforming loans	40.04%	183.94%	579.94%	428.84%	235.31%
Allowance for loan and lease losses to nonperforming assets	38.99%	181.66%	579.94%	427.26%	217.78%
Net loan charge-offs	\$ 25,028	\$ 380	\$ 2,712	\$ 572	\$ 2,742
Risk-Based Capital Ratios					
Total capital	14.25%	10.90%	13.23%	12.97%	12.99%
Tier 1 capital	12.99%	9.87%	12.21%	11.82%	11.75%
Leverage ratio	11.27%	8.54%	9.86%	9.54%	8.99%

(1) These unaudited schedules provide selected financial information concerning the Company that should be read in conjunction with “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this report.

(2) Net income, excluding core deposit intangible amortization, divided by average daily shareholders’ equity, excluding average goodwill and average core deposit intangible asset.

(3) Noninterest expense divided by the sum of net interest income and noninterest income on a tax equivalent basis, excluding gains/losses on investment securities, net cost (gain) of OREO, reserve for VISA litigation liability and mark-to-market adjustments of interest rate floor instruments.

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 (“GAAP”). The efficiency ratio is calculated by dividing noninterest expense by the sum of net interest income and noninterest income on a tax equivalent basis, excluding gains and losses on investment securities, redemption of Visa and MasterCard shares, death benefit proceeds on a former officer, net cost or gain of other real estate owned (“OREO”), reserve for (reversal of) VISA litigation liability, BOLI policy swap income and mark-to-market adjustments of interest rate floor instruments. Other companies may define or calculate this data differently. We believe this presentation provides investors with a more accurate picture of our operating efficiency. In this presentation, net interest income is adjusted to reflect tax-exempt interest income on an equivalent before-tax basis using the federal statutory tax rate of 35 percent for all years presented. Noninterest income and noninterest expense are adjusted for certain items as discussed above. The efficiency ratio improved during 2008 due to the realization of planned operating efficiencies from the mid-year 2007 acquisitions of Mountain Bank Holding Company and Town Center Bancorp and other expense reduction initiatives implemented by management. Further improvement of the efficiency ratio will depend on increases in net interest income, growth of noninterest income and continued expense control. For additional information see the “Noninterest Expense” section in “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operation” of this report.

Reconciliation of Selected Financial Data to GAAP Financial Measures (3)

	Years ended December 31,				
	2008	2007	2006	2005	2004
	(dollars in thousands)				
Net interest income (1)	\$ 119,513	\$ 108,820	\$ 97,763	\$ 90,912	\$ 71,943
Tax equivalent adjustment for non-taxable loan and investment securities interest income (2)	5,302	4,337	3,882	2,508	2,161
Adjusted net interest income	<u>\$ 124,815</u>	<u>\$ 113,157</u>	<u>\$ 101,645</u>	<u>\$ 93,420</u>	<u>\$ 74,104</u>
Noninterest income	\$ 14,850	\$ 27,748	\$ 24,672	\$ 24,786	\$ 22,244
Other-than-temporary security impairment	19,541				
Gain on sale of investment securities, net	(846)	--	(36)	(6)	6
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)	1,145	1,016	908	849	710
Adjusted noninterest income	<u>\$ 31,050</u>	<u>\$ 28,764</u>	<u>\$ 25,544</u>	<u>\$ 25,629</u>	<u>\$ 22,960</u>
Noninterest expense	\$ 92,125	\$ 88,829	\$ 76,134	\$ 72,855	\$ 61,326
Net gain(cost) on sale of OREO	49	(5)	11	8	13
Interest rate floor valuation adjustment	--	--	(1,164)	--	--
BOLI policy swap net income	(133)	--	--	--	--
(Reserve for)reversal of accrued Visa litigation expense	1,292	(1,777)	--	--	--
Adjusted noninterest expense	<u>\$ 93,333</u>	<u>\$ 87,047</u>	<u>\$ 74,981</u>	<u>\$ 72,863</u>	<u>\$ 61,339</u>
Efficiency ratio	62.46%	65.04%	62.18%	62.97%	65.11%
Efficiency ratio (fully taxable-equivalent)	59.88%	61.33%	58.95%	61.20%	63.19%

- (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 of 35% to recognize the income tax benefit of the income realized.
- (3) These unaudited schedules provide selected financial information concerning the Company that should be read in conjunction with “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operation” of this report.

Consolidated Five-Year Financial Data (1)

	Years ended December 31,				
	2008	2007	2006	2005	2004
	(in thousands, except per share amounts)				
Interest Income:					
Loans	\$ 147,830	\$ 156,253	\$ 123,998	\$ 99,535	\$ 68,908
Taxable securities	18,852	18,614	20,018	18,135	17,051
Tax-exempt securities	7,976	7,923	7,042	4,452	3,770
Federal funds sold and deposits with banks	402	1,427	617	85	337
Total interest income	175,060	184,217	151,675	122,207	90,066
Interest Expense:					
Deposits	45,307	59,930	40,838	25,983	16,537
Federal Home Loan Bank advances	7,482	11,065	10,944	3,515	370
Long-term obligations	1,800	2,177	1,992	1,583	1,162
Other borrowings	958	2,225	138	214	54
Total interest expense	55,547	75,397	53,912	31,295	18,123
Net Interest Income	119,513	108,820	97,763	90,912	71,943
Provision for loan and lease losses	41,176	3,605	2,065	1,520	995
Net interest income after provision for loan and lease losses	78,337	105,215	95,698	89,392	70,948
Noninterest income	14,850	27,748	24,672	24,786	22,244
Noninterest expense	92,125	88,829	76,134	72,855	61,326
Income before income taxes	1,062	44,134	44,236	41,323	31,866
Provision for income taxes	(4,906)	11,753	12,133	11,692	9,353
Net Income	\$ 5,968	\$ 32,381	\$ 32,103	\$ 29,631	\$ 22,513
Net Income Applicable to Common Shareholders	\$ 5,498	\$ 32,381	\$ 32,103	\$ 29,631	\$ 22,513
Earnings per Common Share					
Basic	\$ 0.31	\$ 1.93	\$ 2.01	\$ 1.89	\$ 1.55
Diluted	\$ 0.31	\$ 1.91	\$ 1.99	\$ 1.87	\$ 1.52
Average number of common shares outstanding (basic)	17,914	16,802	15,946	15,708	14,558
Average number of common shares outstanding (diluted)	18,010	16,972	16,148	15,885	14,816
Total assets at year end	\$3,097,079	\$3,178,713	\$2,553,131	\$2,377,322	\$2,176,730
Long-term obligations	\$ 25,603	\$ 25,519	\$ 22,378	\$ 22,312	\$ 22,246
Cash dividends declared on common stock	\$ 0.58	\$ 0.66	\$ 0.57	\$ 0.39	\$ 0.26

(1) These unaudited schedules provide selected financial information concerning the Company that should be read in conjunction with “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operation” of this report.

The following table presents selected unaudited consolidated quarterly financial data for each quarter of 2008 and 2007. The information contained in this table reflects all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results of the interim periods.

	<u>First</u> <u>Quarter</u>	<u>Second</u> <u>Quarter</u>	<u>Third</u> <u>Quarter</u>	<u>Fourth</u> <u>Quarter</u>	<u>Year Ended</u> <u>December</u> <u>31,</u>
	(in thousands, except per share amounts)				
2008					
Total interest income	\$ 48,433	\$ 44,323	\$ 42,337	\$ 39,967	\$ 175,060
Total interest expense	18,106	14,049	12,744	10,648	55,547
Net interest income	<u>30,327</u>	<u>30,274</u>	<u>29,593</u>	<u>29,319</u>	<u>119,513</u>
Provision for loan and lease losses	2,076	15,350	10,500	13,250	41,176
Noninterest income	10,157	9,305	(10,946)	6,334	14,850
Noninterest expense	<u>23,554</u>	<u>23,367</u>	<u>23,391</u>	<u>21,813</u>	<u>92,125</u>
Income (loss) before income taxes	14,854	862	(15,244)	590	1,062
Provision(benefit) for income taxes	3,877	(1,074)	(6,485)	(1,224)	(4,906)
Net Income (Loss)	<u>\$ 10,977</u>	<u>\$ 1,936</u>	<u>\$ (8,759)</u>	<u>\$ 1,814</u>	<u>\$ 5,968</u>
Net Income (Loss) Per Common Share:					
Basic	\$ 0.61	\$ 0.11	\$ (0.49)	\$ 0.07	\$ 0.31
Diluted	\$ 0.61	\$ 0.11	\$ (0.49)	\$ 0.07	\$ 0.31
2007					
Total interest income	\$ 41,146	\$ 43,255	\$ 49,378	\$ 50,438	\$ 184,217
Total interest expense	16,443	17,560	20,518	20,876	75,397
Net interest income	<u>24,703</u>	<u>25,695</u>	<u>28,860</u>	<u>29,562</u>	<u>108,820</u>
Provision for loan and lease losses	638	329	1,231	1,407	3,605
Noninterest income	6,177	6,741	7,631	7,199	27,748
Noninterest expense	<u>20,402</u>	<u>20,266</u>	<u>22,425</u>	<u>25,736</u>	<u>88,829</u>
Income before income taxes	9,840	11,841	12,835	9,618	44,134
Provision for income taxes	2,557	3,297	3,579	2,320	11,753
Net Income	<u>\$ 7,283</u>	<u>\$ 8,544</u>	<u>\$ 9,256</u>	<u>\$ 7,298</u>	<u>\$ 32,381</u>
Net Income Per Common Share:					
Basic	\$ 0.45	\$ 0.53	\$ 0.53	\$ 0.41	\$ 1.93
Diluted	\$ 0.45	\$ 0.53	\$ 0.53	\$ 0.41	\$ 1.91

(1) These unaudited schedules provide selected financial information concerning the Company that should be read in conjunction with “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operation” of this report.

ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

This discussion should be read in conjunction with our Consolidated Financial Statements and related notes in “Item 8. Financial Statements and Supplementary Data” of this report. 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 for the previous year.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus, and any prospectus supplement, including information included or incorporated by reference, may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, statements about our plans, objectives, expectations and intentions that are not historical facts, and other statements identified by words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “should,” “projects,” “seeks,” “estimates” or words of similar meaning. These forward-looking statements are based on current beliefs and expectations of management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations in the forward-looking statements, including those set forth in this prospectus, any accompanying prospectus supplement or the documents incorporated by reference, including the “Risk Factors,” “Business” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” sections of our reports and other documents filed with the SEC:

- ☐ the risks associated with lending and potential adverse changes in credit quality;
- ☐ increased delinquency rates;
- ☐ competition from other financial services companies in our markets;
- ☐ the risks presented by a continuing economic slowdown, which could adversely affect credit quality, collateral values, including real estate collateral, investment values, liquidity and loan originations;
- ☐ demand for banking products and services may decline;
- ☐ legislative or regulatory changes that adversely affect our business or our ability to complete prospective future acquisitions;
- ☐ the risks presented by a continued economic slowdown and the public stock market volatility, which could adversely affect our stock value and our ability to raise capital in the future; and
- ☐ our success in managing risks involved in the foregoing.

Additional factors that could cause actual results to differ materially from those expressed in the forward-looking statements are discussed in “*Risk Factors*” above, in our prospectus supplement and in our reports filed with the SEC. We believe the expectations reflected in our forward-looking statements are reasonable, based on information available to us on the date hereof. However, given the described uncertainties and risks, we cannot guarantee our future performance or results of operations and you should not place undue reliance on these forward-looking statements. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Critical Accounting Policies

We have established certain accounting policies in preparing our Consolidated Financial Statements that are in accordance with accounting principles generally accepted in the United States. Our significant accounting policies are presented in Note 1 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report. Certain of these policies require the use of judgments, estimates and economic assumptions which may prove inaccurate or are subject to variation that may significantly affect our

reported results of operations and financial position for the periods presented or in future periods. Management believes that the judgments, estimates and economic assumptions used in the preparation of the Consolidated Financial Statements are appropriate given the factual circumstances at the time. We consider the following policies to be most critical in understanding the judgments that are involved in preparing our consolidated financial statements.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses (“ALLL”) is established to absorb known and inherent losses in our loan and lease portfolio. Our methodology in determining the appropriate level of the ALLL includes components for a general valuation allowance in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 5, *Accounting for Contingencies*, a specific valuation allowance in accordance with SFAS No. 114, *Accounting by Creditors for Impairment of a Loan* and an unallocated component. Both quantitative and qualitative factors are considered in determining the appropriate level of the ALLL. Quantitative factors include historical loss experience, delinquency and charge-off trends, collateral values, past-due and nonperforming loan trends and the evaluation of specific loss estimates for problem loans. Qualitative factors include existing general economic and business conditions in our market areas as well as the duration of the current business cycle. Changes in any of the factors mentioned could have a significant impact on our calculation of the ALLL. Our ALLL policy and the judgments, estimates and economic assumptions involved are described in greater detail in the “Allowance for Loan and Lease Losses and Unfunded Loan Commitments and Letters of Credit” section of this discussion and in Note 1 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

Valuation and Recoverability of Goodwill

Goodwill represented \$95.5 million of our \$3.10 billion in total assets and \$415.4 million in total shareholders’ equity as of December 31, 2008. Goodwill is assigned to reporting units for purposes of impairment testing. The Company has three reporting units: retail banking, commercial banking, and private banking. The products and services of companies previously acquired are comparable to the Company's retail banking operations. Accordingly, all of the Company's goodwill has been assigned to the retail banking reporting unit for purposes of impairment testing. We review our goodwill for impairment annually, during the third quarter. Goodwill of a reporting unit is also tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Such indicators may include, among others: a significant adverse change in legal factors or in the general business climate; significant decline in our stock price and market capitalization; unanticipated competition; the testing for recoverability of a significant asset group within a reporting unit; and an adverse action or assessment by a regulator. Any adverse change in these factors could have a significant impact on the recoverability of goodwill and could have a material impact on our consolidated financial statements.

When required, the goodwill impairment test involves a two-step process. We first test goodwill for impairment by comparing the fair value of the retail banking reporting unit with its carrying amount. If the fair value of the retail banking reporting unit exceeds the carrying amount of the reporting unit, goodwill is not deemed to be impaired, and no further testing would be necessary. If the carrying amount of the retail banking reporting unit were to exceed the fair value of the reporting unit, we would perform a second test to measure the amount of impairment loss, if any. To measure the amount of any impairment loss, we would determine the implied fair value of goodwill in the same manner as if the retail banking reporting unit were being acquired in a business combination. Specifically, we would allocate the fair value of the retail banking reporting unit to all of the assets and liabilities of the reporting unit in a hypothetical calculation that would determine the implied fair value of goodwill. If the implied fair value of goodwill is less than the recorded goodwill, we would record an impairment charge for the difference.

The accounting estimates related to our goodwill require us to make considerable assumptions about fair values. Our assumptions regarding fair values require significant judgment about economic factors, industry factors and technology considerations, as well as our views regarding the growth and earnings prospects of the retail banking unit. Changes in these judgments, either individually or collectively, may have a significant effect on the estimated fair values.

During the fourth quarter of 2008, due to the poor overall economic conditions, declines in our stock price as well as financial stocks in general, and a challenging operating environment for the financial services industry, we determined a triggering event had occurred and we conducted an interim impairment test of our goodwill. Based on the results of the test, we determined no goodwill impairment charges were required for the year ended December 31, 2008. Even though we determined that there was no goodwill impairment during 2008, continued declines in the value of our stock price and additional adverse changes in the operating environment for the financial services industry may result in a future impairment charge.

Please refer to Note 9 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report for further discussion.

Executive Summary

At December 31, 2008, total loans were \$2.23 billion compared with \$2.28 billion in the prior year, a decrease of \$50 million or 2%. Our decrease in total loans during the year was the result of a lack of demand from qualified borrowers coupled with a deliberate reduction in our residential real estate construction portfolio. Despite the decrease in 2008, over the past five years our banking team has generated a compound annual growth rate for year end loans of 15.7% inclusive of the impact of our three acquisitions during this time period. Nonperforming loans represented 4.78% of total loans at December 31, 2008 compared to 0.63% at the end of 2007. At year end our allowance for loan and lease losses was \$42.7 million compared to \$26.6 million a year ago. The allowance for loan and lease losses represented 1.91% of our total loan portfolio and 40.04% of total nonperforming loans at year end compared to 1.17% and 183.94%, respectively, one year ago. Net charge-offs of \$25.0 million for 2008 were up significantly from \$380 thousand in the prior year. The increase in non-performing loans coupled with the deteriorating economy, caused us to increase our provision for loan and lease losses to \$41.2 million during 2008 from \$3.6 million during 2007.

Deposits decreased \$115.9 million to \$2.38 billion on December 31, 2008 compared to \$2.50 billion one year earlier. Core deposits defined as nonmaturity deposits and time certificate of deposit balances less than \$100,000, declined \$55.3 million or 3%, to \$1.94 billion at year end. Over the past five years core deposits have proven to be a stable source of funds with a compound annual growth rate of 8%. Certificates of deposits over \$100,000 decreased \$60.6 million for 2008. Short-term borrowings decreased \$37.5 million from the prior year to \$225.2 million at December 31, 2008.

Total revenues (net interest income plus noninterest income) decreased 2% to \$134.4 million during 2008 as compared to \$136.6 million during 2007. Net interest income increased \$11 million to \$119.5 million from \$108.8 million in 2007. Noninterest income decreased \$12.9 million to \$14.9 million from \$27.8 million in 2007. The decrease in noninterest income was attributed primarily to a \$19.5 million other-than-temporary-impairment charge related to the decline of our investment in Federal Home Loan Mortgage Corporation (“Freddie Mac”) and the Federal National Mortgage Association (“Fannie Mae”) preferred stock.

Our net interest margin increased 3 basis points to 4.38% during 2008 from 4.35% in the prior year. For the twelve month period, funding costs have decreased as a result of declining rates. The average cost of interest bearing deposits decreased 96 basis points to 2.36% from 3.32% in the prior year while our average borrowing costs decreased to 2.88%, down from 5.69% in the prior year.

Earnings per diluted share common decreased \$1.60 to \$0.31 during 2008 as compared to \$1.91 in 2007. The decrease in earnings per diluted share is reflective of the reduced income resulting from the impairment charge on the Freddie Mac and Fannie Mae preferred stock and the significantly increased loan loss provision. Our return on average tangible common equity, which removes from equity the impact of goodwill arising from acquisitions, was 2.72% for the year as compared to 14.53% in 2007. Return on average common equity declined to 1.59% in 2008 from 11.19% in 2007.

During 2008 our noninterest expense increased 4%, or \$3.3 million, to \$92.1 million. This increase is primarily attributable to increased employee compensation and benefits expense of \$2.6 million and increased regulatory premiums of \$1.6 million. The increase in compensation costs was attributed to net costs of \$2.0 million associated with the BOLI replacement policy transaction resulting from the implementation of EITF 06-4. Compensation costs were also increased in excess of \$1.7 million due to our two mid-year 2007 acquisitions. Employee compensation and benefits were also impacted by increased group medical costs, general wage increases, and expenses related to share-based payments.

Our efficiency ratio [noninterest expense divided by the sum of net interest income and noninterest income on a tax equivalent basis, excluding gain (loss) on sale of investment securities, net cost (gain) of OREO, BOLI policy swap income and expense, recovery of the VISA litigation liability expense, death benefits payable and other than temporary security impairments] was 59.88% for 2008 and 61.33% for 2007. The year over year improvement (decrease) in our efficiency ratio is due to an increase in net interest income coupled with a higher growth rate of noninterest income in proportion to noninterest expense. For discussion over the variances in

noninterest expense and noninterest income see the following “Noninterest Income” and “Noninterest Expense” sections of this discussion.

A priority for us during 2009 is to continue to focus on actively managing our balance sheet in a manner that minimizes our exposure to potential contraction of our net interest margin in light of the current low interest rate environment. In addition, we will continue to focus on expense control and pursue opportunities to reduce expenses including measures such as additional branch consolidations. We will continue in our efforts to increase market share in all the communities we serve through leveraging our strong base of branches in both Washington and Oregon. As strategic opportunities are identified, we will consider new markets and branch locations that fit both our economic model and our corporate culture but such activities will be tempered by the need for fiscal restraint based upon the current general economic conditions.

Results of Operations

Net income for the year decreased to \$6.0 million compared to \$32.4 million in 2007 and \$32.1 million in 2006. On a diluted per share basis, net income for the year was \$0.31 per share, compared with \$1.91 per share in 2007, and \$1.99 per share in 2006.

Our results of operations are dependent to a large degree on net interest income. We also generate noninterest income through service charges and fees and merchant services fees. Our operating expenses consist primarily of compensation, employee benefits, and occupancy. 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 the actions of regulatory authorities.

Business Combinations

In July, 2007, the Company acquired all of the outstanding common stock of Mountain Bank Holding Company (“Mt. Rainier “), the parent company of Mt. Rainier National Bank, headquartered in Enumclaw, Washington and Town Center Bancorp (“Town Center”), the parent company of Town Center Bank, headquartered in Portland, Oregon. The acquisitions were consistent with our expansion strategy and added 7 branches in King and Pierce counties and 5 Oregon branches in the North Clackamas and Southeast Portland areas.

The operating results of Mt. Rainier and Town Center were included in the Company’s operating results beginning July 23, 2007; consequently, 2008 year-to-date operating results are not directly comparable to the 2007 and 2006 results for the same periods. For comparison purposes to prior periods, as of July 23, 2007 Mt. Rainier and Town Center combined contributed \$360 million in assets, \$287 million in loans and \$305 million in deposits.

Net Interest Income

Net interest income is the single largest component of our total revenue. Our net interest income increased 10%, to \$119.5 million in 2008 as compared to \$108.8 million in 2007 and \$97.8 million in 2006. In the current year a decline in interest expense was the primary factor in the growth of our net interest income, decreasing 26% to \$55.5 million. This compares to 2007 and 2006 interest expense of \$75.4 million and \$53.9 million, respectively. The decrease in interest expense during 2008 is primarily due to decreased average rates, whereas the increase during 2007 was attributable to increased volumes of interest bearing liabilities. Interest income decreased \$9.2 million, or 5%, to \$175.1 million during 2008 as compared to \$184.7 million in 2007 and \$151.7 million in 2006. The decline in interest income for 2008 is primarily due to the decline in the yield on earning assets. Net interest reversals in 2008 related to nonaccrual loans totaled approximately \$1.3 million which resulted in a decline of 5 basis points in loan yields. Net interest reversals for the first, second, third and fourth quarters of 2008 were \$83 thousand, \$335 thousand, \$355 thousand and \$506 thousand, respectively. The increase in interest income in 2007 compared to 2006 was attributed to higher loan volumes.

The net interest margin improved slightly due to the decline in interest expense, increasing 3 basis points to 4.38% from 4.35% in 2007 versus 4.49% in 2006. Approximately 32% of our loans are floating rate and tied to short-term indices such as Prime, LIBOR, and the CB Base Rate. The CB Base Rate is an internally derived index established by our pricing committee. Average loan yields decreased 130 basis points with average deposit costs decreasing 96 basis points from 2007. In addition, average borrowing costs from the Federal Home Loan Bank and Federal Reserve Bank decreased 278 basis points. Additional decreases in the Prime rate will negatively impact our net interest margin.

In 2006, we began using derivative instruments to add stability to interest income and to manage our exposure to changes in interest rates. One of the initiatives we undertook to accomplish this objective was the purchase of three prime interest rate floors for a combined notional amount of \$200 million. We utilized these floors to establish a cash flow hedge with several pools of our prime based loans to assist in diminishing our exposure to margin compression in a falling rate environment. Essentially, when the prime rate fell below the strike rate the Company received payment on the difference between the two rates. In March 2006 we paid approximately \$3.1 million for the floors which had an April 2011 expiration date. In January 2008 we elected to take advantage of what we felt was favorable pricing and sold the floors for \$8.1 million. At the time of their sale the floors had a book value of \$1.9 million resulting in a deferred gain of \$6.2 million to be recognized through interest income as the originally hedged forecasted transactions (interest payments on variable-rate loans) affect earnings. We recorded \$1.7 million of the deferred gain to income in 2008 and expect to accrete the remaining deferred gains of \$2.4 million, \$1.7 million, and \$290 thousand in 2009, 2010, and 2011, respectively. Our decision to monetize the gain on these floors removed the uncertainty changing interest rates would have on their realizable value had we held them to maturity and it eliminated the risk that our counterparty to this transaction would not be able to honor their financial commitment. For additional information on our derivatives and hedging activities, see Note 21 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

Average Balances and Net Interest Revenue

The following table sets 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, net interest spread, net interest margin and the ratio of average interest-earning assets to interest-earning liabilities:

	2008			2007			2006		
	Average	Interest Earned/ Paid	Average Rate	Average Balances (1)	Interest Earned/ Paid	Average Rate	Average Balances (1)	Interest Earned/ Paid	Average Rate
	Balances(1)								
ASSETS				(dollars in thousands)					
Loans (1)(2)	2,264,486	\$ 148,240	6.55%	1,990,622	\$ 156,253	7.85%	\$ 1,629,616	\$ 123,998	7.61%
Taxable securities	379,052	18,852	4.97%	395,512	18,685	4.72%	459,638	20,108	4.96%
Tax exempt securities (2)	186,246	12,868	6.91%	185,610	12,189	6.57%	163,993	10,834	6.61%
Interest-earning deposits with banks and federal funds sold	21,771	402	1.85%	27,635	1,427	5.16%	12,146	617	5.08%
Total interest-earning assets	\$ 2,851,555	\$ 180,362	6.33%	\$ 2,599,379	\$ 188,554	7.25%	\$ 2,265,393	\$ 155,557	6.87%
Other earning assets	47,753			42,334			37,725		
Noninterest-earning assets	234,746			195,449			170,286		
Total assets	<u>\$ 3,134,054</u>			<u>\$ 2,837,162</u>			<u>\$ 2,473,404</u>		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Certificates of deposit	\$ 780,092	\$ 28,120	3.60%	\$ 698,078	\$ 31,274	4.48%	\$ 543,053	\$ 20,985	3.86%
Savings accounts	118,073	437	0.37%	111,265	467	0.42%	115,802	436	0.38%
Interest-bearing demand	445,449	6,009	1.35%	435,807	11,026	2.53%	361,618	7,507	2.08%
Money market accounts	578,123	10,741	1.86%	558,510	17,163	3.07%	518,156	11,910	2.30%
Total interest-bearing deposits	1,921,737	45,307	2.36%	1,803,660	59,930	3.32%	1,538,629	40,838	2.65%
Federal Home Loan Bank and Federal Reserve Bank borrowings	297,193	7,573	2.55%	207,521	11,065	5.33%	208,593	10,944	5.25%
Long-term subordinated debt	25,558	1,800	7.04%	23,777	2,177	9.16%	22,343	1,992	8.92%
Other borrowings and interest-bearing liabilities	32,934	867	2.63%	40,606	2,225	5.48%	2,413	138	5.72%
Total interest-bearing liabilities	\$ 2,277,422	\$ 55,547	2.44%	\$ 2,075,564	\$ 75,397	3.63%	\$ 1,771,978	\$ 53,912	3.04%
Noninterest-bearing deposits	460,747			438,474			437,819		
Other noninterest-bearing liabilities	41,498			33,827			25,764		
Shareholders' equity	354,387			289,297			237,843		
Total liabilities & shareholders' equity	<u>\$ 3,134,054</u>			<u>\$ 2,837,162</u>			<u>\$ 2,473,404</u>		
equity									
Net interest income		<u>\$ 124,815</u>			<u>\$ 113,157</u>			<u>\$ 101,645</u>	
Net interest spread			<u>3.89%</u>			<u>3.62%</u>			<u>3.83%</u>
Net interest margin			<u>4.38%</u>			<u>4.35%</u>			<u>4.49%</u>

(1) Nonaccrual loans were included in loans. Amortized net deferred loan fees were included in the interest income calculations. The amortization of net deferred loan fees was \$3.5 million in 2008, \$3.5 million in 2007, \$2.1 million in 2006.

(2) Yields on fully taxable equivalent basis, based on a marginal tax rate of 35%.

A performance metric that we consistently use to evaluate our success in managing our interest-earning assets and interest-bearing liabilities is the level of our net interest margin. Our net interest margin (net interest income on a fully-taxable equivalent basis divided by average interest-earning assets) remained relatively stable during 2008 and 2007 increasing 3 basis points [A basis point is 1/100th of 1%, alternatively 100 basis points equals 1.00]. The increase in our net interest margin during 2008 was primarily due to the decline in yield on interest bearing liabilities. While our net interest margin experienced a very modest increase from 2007 to 2008, for comparative purposes one basis point in the margin equates to approximately \$285,000 per year in net interest income. Accordingly, the 3 basis point increase in the margin during 2008 positively impacted pre-tax earnings by \$855,000.

Net Interest Income Rate & Volume Analysis

The following table sets forth the total dollar amount of change in interest income and interest expense. The changes have been segregated for each major category of interest-earning assets and interest-bearing liabilities into amounts attributable to changes in volume, changes in rates and changes in rates multiplied by volume. Changes attributable to the combined effect of volume and interest rates have been allocated proportionately to the changes due to volume and the changes due to interest rates:

	2008 Compared to 2007			2007 Compared to 2006		
	Increase (Decrease) Due to			Increase (Decrease) Due to		
	Volume	Rate	Total	Volume	Rate	Total
	(in thousands)					
Interest Income						
Loans (TE)(1)	\$ 17,938	\$ (25,951)	\$ (8,013)	\$ 28,337	\$ 3,918	\$ 32,255
Securities (TE)	(888)	1,734	846	(2,258)	2,190	(68)
Interest earning deposits with banks and federal funds sold	(108)	(917)	(1,025)	800	10	810
Interest income (TE)	<u>\$ 16,942</u>	<u>\$ (25,134)</u>	<u>\$ (8,192)</u>	<u>\$ 26,879</u>	<u>\$ 6,118</u>	<u>\$ 32,997</u>
Interest Expense						
Deposits:						
Certificates of deposit	\$ 2,956	\$ (6,110)	\$ (3,154)	\$ 6,945	\$ 3,344	\$ 10,289
Savings accounts	25	(55)	(30)	(19)	50	31
Interest-bearing demand	130	(5,147)	(5,017)	1,877	1,642	3,519
Money market accounts	364	(6,786)	(6,422)	1,240	4,013	5,253
Total interest on deposits	3,475	(18,098)	(14,623)	10,043	9,049	19,092
Federal Home Loan Bank and Federal Reserve Bank borrowings	2,284	(5,776)	(3,492)	(57)	178	121
Long-term subordinated debt	126	(503)	(377)	131	54	185
Other borrowings and interest-bearing liabilities	(202)	(1,156)	(1,358)	2,093	(6)	2,087
Interest expense	<u>\$ 5,683</u>	<u>\$ (25,533)</u>	<u>\$ (19,850)</u>	<u>\$ 12,210</u>	<u>\$ 9,275</u>	<u>\$ 21,485</u>

TE = Taxable equivalent, based on a marginal tax rate of 35%.

(1) Nonaccrual loans were included in their respective loan categories. Amortized net deferred loan fees were included in the interest income calculations. The amortization of net deferred loan fees was \$3.5 million in 2008, \$3.5 million in 2007, \$2.1 million in 2006.

As evidenced by the table presented above, the \$8 million decrease in total interest revenue during 2008 as compared to 2007 was primarily due to the decreased rates on loans. The \$33 million increase in total interest revenue during 2007, as compared to 2006, was primarily due to increased volume of loans. The \$19.8 million decrease in total interest expense in 2008, as compared to 2007, was primarily a result of decreased rates on interest bearing deposits and FHLB advances. The \$21.5 million increase in total interest expense in 2007, as compared to 2006, was a result of increased volume and rates on certificate of deposits and interest bearing demand accounts and the increased volume in other borrowings.

Provision for Loan and Lease Losses

Our provision for loan and lease losses (“the provision”) was \$41.2 million for 2008, compared with \$3.6 million for 2007, and \$2.1 million for 2006. For the years ended December 31, 2008, 2007, and 2006, net loan charge-offs amounted to \$25 million, \$380,000 and \$2.7 million, respectively. Expressed as a percentage of average loans, net charge-offs for the years ended December 31, 2008, 2007 and 2006 were 111 basis points, 2 basis points, and 17 basis points, respectively. The charge-offs during 2008 and 2007 were comprised of several loans. The net charge offs for 2006 were primarily centered in one “legacy credit” originated in December of 1999, which was classified as non-performing in November of 2003. The increased provision in 2008 is due to the weakness in the for-sale housing industry resulting from the declining economic environment and a significant increase in non-accrual loans within this sector of the loan portfolio. This resulted in net loan charge-offs of \$25.0 million, which depleted the allowance. The increased provision in 2007 as compared to 2006 was primarily due to growth in our loan portfolio. The provision is based on management’s estimates resulting from ongoing modeling and qualitative analysis of the characteristics and composition of the loan portfolio. For discussion over the methodology used by management in determining the adequacy of the ALLL see the following “Allowance for Loan and Lease Losses and Unfunded Loan Commitments and Letters of Credit” section of this discussion.

Noninterest Income

The following table presents the significant components of noninterest income and the related dollar and percentage change from period to period:

	Years ended December 31,						
	2008	\$ Change	% Change	2007	\$ Change	% Change	2006
	(dollars in thousands)						
Fees and Other Income							
Service charges, loan fees and other fees	\$ 14,813	\$ 1,315	10%	\$ 13,498	\$ 1,847	16%	\$ 11,651
Merchant services fees	8,040	(333)	(4)%	8,373	59	1%	8,314
Redemption of Visa and Mastercard Shares	3,028	3,028	100%	--	--	0%	--
Gain (loss) on sale of securities, net	846	846	100%	--	(36)	(100)%	36
Impairment charge on investment securities	(19,541)	(19,541)	100%	--	--	0%	--
Bank owned life insurance (BOLI)	2,075	189	10%	1,886	199	12%	1,687
Other Income	5,589	1,598	40%	3,991	1,007	34%	2,984
Total noninterest income	<u>\$ 14,850</u>	<u>\$(12,898)</u>	(46)%	<u>\$ 27,748</u>	<u>\$ 3,076</u>	12%	<u>\$ 24,672</u>

The decrease in noninterest income during 2008 was primarily due to the \$19.5 million impairment charge on Fannie Mae and Freddie Mac investment securities. This decrease was partially offset with proceeds from the redemption of Visa and MasterCard shares of \$3.0 million and a net gain on sale of securities of \$846,000. Service charges and other fees increased \$1.3 million or 10%, reflecting a change in our deposit account fee structure in conjunction with an increase in the number of deposit accounts. The increase in deposit accounts results from a combination of organic growth and accounts obtained from our two acquisitions which closed early in the third quarter of 2007.

Other Noninterest Income: The following table presents selected items of “other noninterest income” and the related dollar and percentage change from period to period:

	Years ended December 31,					
	2008	\$ Change	% Change	2007	\$ Change	% Change
	(dollars in thousands)					
Gain on disposal of assets	\$ 492	\$ 227	86%	\$ 265	\$ (60)	(18)%
Mortgage banking	628	91	17%	537	249	86%
Cash management 12-b1 fees	466	67	17%	399	71	22%
Letter of credit fees	399	- -	0%	399	95	31%
Late charges	338	88	35%	250	18	8%
Currency exchange income	356	40	13%	316	50	19%
New Markets Tax Credit dividend	74	(19)	(20)%	93	1	1%
Miscellaneous fees on loans	915	45	5%	870	633	267%
Interest rate swap income	647	422	188%	225	225	100%
Credit card fees	142	61	75%	81	(2)	(2)%
Life insurance death benefit	612	612	100%	0	- -	0%
Miscellaneous	520	(36)	(6)%	556	(273)	(33)%
Total noninterest income	<u>\$ 5,589</u>	<u>\$ 1,598</u>	40%	<u>\$ 3,991</u>	<u>\$ 1,007</u>	34%

The gain on disposal of assets increased due to the sale of a consolidated branch office with the remainder consisting of the amortized gain on the sale and lease-back of two buildings which occurred in September 2004. The resulting \$1.3 million gain on the sale was deferred and recognized over the life of the leases, the unamortized gain balance at December 31, 2008 and 2007 was \$483,000 and \$565,000, respectively, and is included in other liabilities on our consolidated balance sheets. During 2008, 2007 and 2006 the Company recognized amortized gains associated with the sale and lease-back transaction of \$83,000, \$219,000 and \$246,000, respectively. Interest rate swap income increased due to the addition of approximately \$74 million of notional amount interest rate swap agreements originated during the year. The life insurance death benefit was related to the death of a former officer covered by BOLI.

Noninterest Expense

The following table presents the significant components of noninterest expense and the related dollar and percentage change from period to period:

	Years ended December 31,					
	2008	\$ Change	% Change	2007	\$ Change	% Change
	(dollars in thousands)					
Compensation	\$ 36,895	\$ 2,387	7%	\$ 34,508	\$ 6,322	22%
Employee benefits	12,420	225	2%	12,195	1,612	15%
Occupancy	12,838	516	4%	12,322	1,562	15%
Merchant processing	3,558	88	3%	3,470	109	3%
Advertising and promotion	2,324	(67)	(3)%	2,391	(191)	(7)%
Data processing	3,486	922	36%	2,564	250	11%
Legal and professional services	1,969	(2,943)	(60)%	4,912	2,813	134%
Taxes, license and fees	2,917	35	1%	2,882	383	15%
Net (gain) loss on sale of other real estate owned	(49)	(54)	(1080)%	5	16	(145)%
Regulatory premiums	2,141	1,634	322%	507	238	88%
Other	13,626	553	4%	13,073	(419)	(3)%
Total noninterest expense	<u>\$ 92,125</u>	<u>\$ 3,296</u>	4%	<u>\$ 88,829</u>	<u>\$ 12,695</u>	17%

The current year increase in noninterest expense is primarily attributed to increased employee compensation and benefit costs, higher occupancy expense, data processing expense, regulatory premiums and other miscellaneous expenses. The increase in compensation costs was primarily due to a full year of employee

expenses related to our two acquisitions as well as the BOLI replacement policy transaction we completed upon the implementation of EITF 06-4. For additional information regarding the BOLI replacement policy transaction, please refer to the Compensation Discussion and Analysis disclosure contained within our 2008 Proxy. The increase in compensation and employee benefits for both periods was also impacted by increased group medical costs, general wage increases, and expenses related to share based payments. The increase in occupancy expense during 2007 was primarily related to our expansion efforts within King, Thurston and Whatcom County markets and our two acquisitions. The increase in data processing costs was attributed to the increase in transaction volumes associated with the acquisitions as well as the core software conversion of the Bank of Astoria. The 2008 increase in other expense was primarily in the core deposit intangible amortization and telephone and network expenses, both related to the acquisitions. The decrease in legal and professional fees was attributed to the reversal of previously expensed legal costs in the amount of \$1.3 million related to our Visa litigation reserve. In the fourth quarter of 2007 we established a litigation reserve through legal expense in the amount of \$1.8 million. During 2008 we were able to reduce our litigation reserve by \$1.3 million due to the economic benefit resulting from our pro-rata share of the funds Visa placed into an escrow account established to pay for the settlement of the litigation liabilities. At December 31, 2008 our remaining accrual for the Visa litigation liability was \$485,355.

Other Noninterest Expense: The following table presents selected items of “other noninterest expense” and the related dollar and percentage change from period to period:

	Years ended December 31,					
	2008	\$ Change	% Change	2007	\$ Change	% Change
	(dollars in thousands)					
CRA partnership investment expense (1)	\$ 668	\$ (64)	(9)%	\$ 732	\$ (38)	(5)%
Core deposit intangible amortization ("CDI")	1,142	423	59%	719	267	59%
Software support & maintenance	713	(133)	(16)%	846	126	18%
Federal Reserve Bank processing fees	422	(18)	(4)%	440	(400)	(48)%
Telephone & network communications	1,527	293	24%	1,234	114	10%
Supplies	1,064	(300)	(22)%	1,364	166	14%
Postage	1,420	53	4%	1,367	128	10%
Sponsorships & charitable contributions	642	19	3%	623	(38)	(6)%
Travel	471	18	4%	453	115	34%
Investor relations	182	(46)	(20)%	228	59	35%
Insurance	505	57	13%	448	(25)	(5)%
Director expenses	453	30	7%	423	(19)	(4)%
Employee expenses	599	(64)	(10)%	663	83	14%
ATM Network	659	3	0%	656	63	11%
Miscellaneous	3,159	282	10%	2,877	(1,020)	(26)%
Total other noninterest expense	<u>\$ 13,626</u>	<u>\$ 553</u>	4%	<u>\$ 13,073</u>	<u>\$ (419)</u>	(3)%

(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 twelve months ended December 31, 2008, \$511,201 of such credits was taken as a reduction in our current period income tax expense. In addition, our taxable income was decreased by \$237,000 during the twelve months ended December 31, 2008 as a result of the tax benefit associated with this investment expense.

Income Tax

For the years ended December 31, 2008, 2007, and 2006, we recorded an income tax benefit of \$4.9 million, and income tax provisions of \$11.8 million, and \$12.1 million, respectively. The effective tax benefit was 463% in 2008 and the effective tax rate was 26.6% in 2007 and 27.4% in 2006. Our effective tax rate is less than our statutory rate of 35.52% and has exhibited a declining trend over the past three years. This decline is primarily due to a significant increase in the amount of tax-exempt municipal securities held in the investment portfolio, tax exempt earnings on bank owned life insurance, and tax credits received on investments in

affordable housing partnerships. For additional information, see Note 14 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

Financial Condition

Our total assets declined 3% to \$3.10 billion at December 31, 2008 from \$3.18 billion at December 31, 2007. The decrease in total assets was attributed to a decline in our loan and investment portfolios. The loan portfolio decreased 2% or \$50.4 million to \$2.23 billion. The decline in the loan portfolio can be attributed to a combination of loan payoffs, pay downs, an intentional decline within certain sectors of the portfolio, and loan charge-offs. Our investment portfolio decreased 6% or \$32.4 million. This decrease was primarily a result of investment maturities and scheduled principal reductions and prepayments on mortgage-backed securities. Deposit balances also decreased \$115.9 million or 5% to \$2.4 billion. Noninterest bearing deposits decreased \$2.2 million to \$466.1 million while interest bearing deposits decreased \$113.7 million to \$1.9 billion. Short-term borrowings decreased 14% or \$37.5 million to \$225.2 million. The decreased borrowings were a result of lagging loan demand and the Company’s participation in the U.S. Treasury’s Capital Purchase Program (“CPP”). The Company received \$76.9 million in proceeds from the issuance of preferred stock and warrants to the U.S. Treasury. In the near-term, these proceeds have been held as short-term investments.

Investment Portfolio

Securities Available for Sale

We invest in securities to generate revenues for the Company, to manage liquidity while minimizing interest rate risk, and to provide collateral for certain public deposits and short-term borrowings. The amortized cost amounts represent the Company’s original cost for the investments, adjusted for accumulated amortization or accretion of any yield adjustments related to the security. The estimated fair values are the amounts that we believe the securities could be sold for as of the dates indicated. As of December 31, 2008 we had 130 available for sale securities in an unrealized loss position. Based on past experience with these types of securities and our own financial performance, we have the ability and intent to hold these investments to maturity or until fair value recovers above cost. We review these investments for other-than-temporary impairment on an ongoing basis.

In the third 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 to \$488 thousand at December 31, 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 totaling \$19.5 million. While our review did not result in any additional securities with an other-than-temporary impairment adjustment as of December 31, 2008, we will continue to review our investments for possible adjustments in the future.

Purchases during 2008 totaled \$89.1 million while maturities, repayments and sales totaled \$49.7 million compared to purchases of \$3.7 million and maturities and repayments of \$49.2 million during 2007. At December 31, 2008 U.S. Government agency and government-sponsored enterprise mortgage-backed securities (“MBS”) and collateralized mortgage obligations (“CMO”) comprised 65% of our investment portfolio and state and municipal securities were 35%. There was no impairment charge recognized during 2007 or 2006. Our entire investment portfolio is categorized as available for sale and carried on our balance sheet at their fair values. The average duration of our investment portfolio was 4 years and 10 months at December 31, 2008. For further information on our investment portfolio see Note 4 of the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

The following table presents the contractual maturities and weighted average yield of term securities in our investment portfolio:

Securities Available for Sale

	December 31, 2008		
	Amortized Cost	Fair Value	Yield
	(dollars in thousands)		
U.S. Government agency and government-sponsored enterprise mortgage-backed securities & collateralized mortgage obligations (1)			
Due through 1 year	\$ 58	\$ 59	4.01%
Over 1 through 5 years	2,057	2,078	4.50%
Over 5 through 10 years	139,046	140,318	4.66%
Over 10 years	194,046	199,383	5.26%
Total	<u>\$ 335,207</u>	<u>\$ 341,838</u>	5.01%
State and municipal securities (2)			
Due through 1 year	\$ 1,801	\$ 1,804	3.89%
Over 1 through 5 years	16,091	16,839	6.47%
Over 5 through 10 years	36,028	36,444	5.60%
Over 10 years	134,495	130,566	6.25%
Total	<u>\$ 188,415</u>	<u>\$ 185,653</u>	6.12%

- (1) The maturities reported for mortgage-backed securities collateralized mortgage obligations are based on contractual maturities and principal amortization.
- (2) Yields on fully taxable equivalent basis, based on a marginal tax rate of 35%.

FHLB Stock

As a condition of membership in the Federal Home Loan Bank of Seattle (“FHLB”), the Company is required to purchase and hold a certain amount of FHLB stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB and is calculated in accordance with the Capital Plan of the FHLB. Our FHLB stock has a par value of \$100 and is redeemable at par for cash.

FHLB stock is carried at cost and is subject to recoverability testing per Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The FHLB recently reported that, due to ongoing turmoil in the capital and mortgage markets, they will likely report a risk-based capital deficiency as of December 31, 2008. Under Federal Housing Finance Agency regulations, a Federal Home Loan Bank that fails to meet any regulatory capital requirement may not declare a dividend or redeem or repurchase capital stock. However, the FHLB believes, despite the risk-based capital deficiency, they have adequate capital to cover the risks reflected on their balance sheet. Accordingly, as of December 31, 2008 we did not recognize an impairment charge related to our FHLB stock holdings. We will continue to monitor the financial condition of the FHLB as it relates to, among other things, the recoverability of our investment.

We are a full service commercial bank, which originates a wide variety of loans, and concentrates its lending efforts on originating commercial business and commercial real estate loans. The following table sets forth our loan portfolio by type of loan for the dates indicated:

	December 31,									
	2008	% of Total	2007	% of Total	2006 (dollars in thousands)	% of Total	2005	% of Total	2004	% of Total
Commercial business	\$ 810,922	36.3%	\$ 762,365	33.4%	\$ 617,899	36.1%	\$ 570,974	36.5%	\$ 488,157	35.9%
Real estate:										
One-to-four family residential	57,237	2.6%	60,991	2.7%	51,277	3.0%	74,930	4.8%	49,580	3.7%
Commercial and five or more family residential properties	862,595	38.6%	852,139	37.3%	687,635	40.3%	651,393	41.6%	595,775	43.8%
Total real estate	919,832	41.2%	913,130	40.0%	738,912	43.3%	726,323	46.4%	645,355	47.5%
Real estate construction:										
One-to-four family residential	209,682	9.4%	269,115	11.8%	92,124	5.4%	41,033	2.6%	26,832	2.0%
Commercial and five or more family residential properties	81,176	3.6%	165,490	7.2%	115,185	6.8%	89,134	5.7%	70,108	5.1%
Total real estate construction	290,858	13.0%	434,605	19.0%	207,309	12.2%	130,167	8.3%	96,940	7.1%
Consumer	214,753	9.7%	176,559	7.8%	147,782	8.6%	140,110	9.0%	132,130	9.7%
Subtotal	2,236,365	100.2%	2,286,659	100.2%	1,711,902	100.2%	1,567,574	100.2%	1,362,582	100.2%
Less deferred loan fees and other	(4,033)	(0.2)%	(3,931)	(0.2)%	(2,940)	(0.2)%	(2,870)	(0.2)%	(2,839)	(0.2)%
Total loans	\$ 2,232,332	100.0%	\$ 2,282,728	100.0%	\$ 1,708,962	100.0%	\$ 1,564,704	100.0%	\$ 1,359,743	100.0%
Loans held for sale	\$ 1,964		\$ 4,482		\$ 933		\$ 1,850		\$ 6,019	

At December 31, 2008, total loans were \$2.23 billion compared with \$2.28 billion in the prior year, a decrease of \$50.4 million or 2%. We experienced growth in commercial business, commercial real estate and consumer loans while real estate construction loans declined significantly. Total loans represented 72% of total assets at both December 31, 2008 and December 31, 2007. Although balances declined during 2008, the compound annual growth rate of our loan portfolio over the last five years is 16%.

Commercial Business Loans: Commercial loans increased \$48.6 million, or 6%, to \$810.9 million from year-end 2007, representing 36% of total loans at year end. We are committed to providing competitive commercial banking in our primary market areas. We expect our commercial lending focus to center around expanding our existing banking relationships with businesses and business owners while continuing to build new customer relationships.

Real Estate Loans: Residential one to four family loans are used by us to collateralize advances from the FHLB. Our underwriting standards require that one-to-four family portfolio loans generally be owner-occupied and that loan amounts not exceed 80% (90% with private mortgage insurance) of the appraised value or cost, whichever is lower, of the underlying collateral at origination. We utilize an outsourced residential lending underwriting platform. Residential loans are originated on a pre-sold basis provided they meet the underwriting criteria established by our third party provider. If circumstances warrant, we may originate and retain loans that fall outside the scope of our third party provider’s underwriting guidelines. However, we do not underwrite residential real estate loans for the subprime market.

Commercial and five or more family residential real estate loans reflect a mix of owner occupied and income property transactions. Generally, these 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 or cost, whichever is lower, 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, economic conditions, 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. This segment of the portfolio declined \$143.7 million or 33% to \$290.9 million at year end. The decline in real estate construction loans is a result of loan payoffs and pay downs as well as charge-offs. In addition, commercial real estate construction loans were reduced though conversion to permanent loans as well as pay-offs and charge-offs. We endeavor to limit our construction lending risk through adherence to strict underwriting procedures. Total real estate and real estate construction loans comprised 13% of our loan portfolio as of December 31, 2008 which is a decrease from the 19% at December 31, 2007.

Consumer Loans: Consumer loans made by us include automobile loans, boat and recreational vehicle financing, home equity and home improvement loans, and miscellaneous personal loans. Consumer loans increased \$38.2 million or 22% to \$214.8 million at December 31, 2008.

Foreign Outstanding: We are not involved with loans to foreign companies and foreign countries.

For additional information on our loan portfolio, including amounts pledged as collateral on borrowings, see Note 6 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

Maturities and Sensitivities of Loans to Changes in Interest Rates

The following table presents the maturity distribution of our commercial and real estate construction loan portfolios and the sensitivity of these loans due after one year to changes in interest rates as of December 31, 2008:

	Maturing			
	Due Through 1 Year	Over 1 Through 5 Years	Over 5 Years	Total
	(in thousands)			
Commercial business	\$ 559,938	\$ 180,509	\$ 70,475	\$ 810,922
Real estate construction	244,991	41,473	4,394	290,858
Total	<u>\$ 804,929</u>	<u>\$ 221,982</u>	<u>\$ 74,869</u>	<u>\$ 1,101,780</u>
Fixed rate loans due after 1 year		\$ 150,006	\$ 70,232	\$ 220,238
Variable rate loans due after 1 year		71,976	4,637	76,613
Total		<u>\$ 221,982</u>	<u>\$ 74,869</u>	<u>\$ 296,851</u>

Risk Elements

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

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 our borrowers to service all 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 non-accrual status even though the loan may be current as to principal and interest payments. Additionally, we assess whether an impairment of a loan warrants specific reserves or a write-down of the loan. For additional discussion on our methodology in managing credit risk within our loan portfolio see the following “Allowance for Loan and Lease Losses and Unfunded Loan Commitments and Letters of Credit” section and Note 1 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

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 on-site examination to ensure continued performance and proper risk assessment.

Nonperforming 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 nonaccrual status, which occurs when there are serious doubts about the collectibility of principal or interest. Our policy is generally to discontinue the accrual of interest on all loans past due 90 days or more and place them on nonaccrual status.

Nonperforming Assets: Nonperforming assets consist of: (i) nonaccrual loans, which generally are loans placed on a nonaccrual basis when the loan becomes past due 90 days or when there are otherwise serious doubts about the collectibility of principal or interest within the existing terms of the loan; (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. Nonperforming assets totaled \$109.6 million, or 3.54% of year-end assets at December 31, 2008, compared to \$14.6 million or 0.46% of year end assets at December 31, 2007.

The following table sets forth information with respect to our nonaccrual loans, restructured loans, total nonperforming loans (nonaccrual loans plus restructured loans), other real estate owned, other personal property owned, total nonperforming assets, accruing loans past-due 90 days or more, and potential problem loans:

	December 31,				
	2008	2007	2006	2005	2004
	(dollars in thousands)				
Nonaccrual:					
Commercial business	\$ 2,976	\$ 2,170	\$ 1,777	\$ 4,316	\$ 6,587
Real Estate:					
One-to-four family residential	905	204	366	376	375
Commercial and five or more family residential real estate	5,710	3,476	217	--	440
Real Estate Construction:					
One-to-four family residential	69,668	7,317	--	--	--
Commercial and five or more family residential real estate	25,752	--	--	--	--
Consumer	1,152	838	54	41	820
Total nonaccrual loans:	106,163	14,005	2,414	4,733	8,222
Restructured loans:					
Commercial business	587	456	1,066	124	227
Total nonperforming loans	106,750	14,461	3,480	4,857	8,449
Other real estate owned	2,874	181	--	18	680
Total nonperforming assets	\$ 109,624	\$ 14,642	\$ 3,480	\$ 4,875	\$ 9,129
Accruing loans past-due 90 days or more	\$ --	\$ --	\$ --	\$ --	\$ 4
Foregone interest on nonperforming loans	\$ 4,072	\$ 814	\$ 497	\$ 106	\$ 920
Interest recognized on nonperforming loans	\$ 4,550	\$ 244	\$ 202	\$ 45	\$ 101
Potential problem loans	\$ 17,736	\$ 2,343	\$ 2,288	\$ 2,269	\$ 2,321
Allowance for loan and lease losses	\$ 42,747	\$ 26,599	\$ 20,182	\$ 20,829	\$ 19,881
Allowance for loan and lease losses to nonperforming loans	40.04%	183.94%	579.94%	428.84%	235.31%
Allowance for loan and lease losses to nonperforming assets	38.99%	181.66%	579.94%	427.26%	217.78%
Nonperforming loans to year end loans	4.78%	0.63%	0.20%	0.31%	0.62%
Nonperforming assets to year end assets	3.54%	0.46%	0.14%	0.21%	0.42%

At December 31, 2008 nonperforming assets increased to 3.54% of period end assets up from 0.46% of period-end assets at December 31, 2007. Residential construction loans continue to be the primary driver of nonperforming assets, representing \$69.7 million, or 64% of nonperforming assets. Commercial real estate loans account for another \$30.3 million, or 28% of nonperforming loans. These commercial real estate nonperforming assets are primarily centered in condominium development loans of approximately \$9.1 million and retail development of approximately \$15.0 million. The increase in both of these categories reflects the continued weakness in the for sale housing industry. In addition, the more recent decline in retail sales and consumer spending has negatively affected retail leasing activity in a few of our borrowers’ more recently completed retail development projects.

We remain aggressive in managing our construction loan portfolio and continue to be successful at reducing our overall exposure in the 1-4 family residential construction segment as well as in the commercial real estate construction segment. For the year, total construction loans declined 33.1% due to payoffs and conversions to permanent loan status. Our 1-4 family residential construction loans, where most of our challenges are centered, now represent less than 10% of our entire loan portfolio. While we believe both of these segments will remain challenged during 2009, we believe we have appropriate risk management strategies in place to manage through the current economic cycle.

Other Real Estate Owned: As of December 31, 2008 there was \$2.9 million in other real estate loans which is comprised of property from foreclosed real estate loans. This reflects a current year increase of \$2.7 million compared to an increase of \$181,000 at December 31, 2007.

Other Personal Property Owned: Other personal property owned (“OPPO”) is comprised of other, non-real estate property from foreclosed loans. There were no OPPO assets at December 31, 2008 and 2007.

Potential Problem Loans: Potential problem loans are loans which are currently performing and are not on nonaccrual status, restructured or impaired, but about which there are sufficient doubts as to the borrower’s future ability to comply with repayment terms and which may later be included in nonaccrual, past due, restructured or impaired loans. Potential problem loans totaled \$17.7 million at year end 2008, compared to \$2.3 million at year end 2007. For additional information on our nonperforming loans see Note 6 to our Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

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

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

1. General valuation allowance consistent with SFAS No. 5, “Accounting for Contingencies.”
2. Criticized/classified loss reserves on specific relationships. Specific allowances for identified problem loans are determined in accordance with SFAS No. 114, “Accounting by Creditors for Impairment of a Loan.”
3. The unallocated allowance provides for other credit losses inherent in our loan portfolio that may not have been contemplated in the general and specific components of the allowance. This unallocated amount generally comprises less than 5% of the allowance. The unallocated amount is reviewed periodically based on trends in credit losses, the results of credit reviews and overall economic trends.

On a quarterly basis our Chief Credit Officer reviews with Executive Management and the Board of Directors the various additional factors that management considers when determining the adequacy of the ALLL, including economic and business condition reviews. Factors which influenced management’s judgment in determining the amount of the additions to the ALLL charged to operating expense include the following as of the applicable balance sheet dates:

1. Existing general economic and business conditions affecting our market place
2. Credit quality trends, including trends in nonperforming loans
3. Collateral values
4. Seasoning of the loan portfolio
5. Bank regulatory examination results
6. Findings of internal credit examiners
7. Duration of current business cycle

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

In addition to the ALLL, we maintain an allowance for unfunded loan commitments and letters of credit. We report this allowance as a liability 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. For additional information on our allowance for unfunded loan commitments and letters of credit, see Note 7 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

The following table provides an analysis of our loss experience by loan type for the last five years:

	December 31,				
	2008	2007	2006	2005	2004
	(dollars in thousands)				
Total loans, net at year end (1)	\$2,232,332	\$2,282,728	\$1,708,962	\$1,564,704	\$1,359,743
Daily average loans	\$2,264,486	\$1,990,622	\$1,629,616	\$1,494,567	\$1,186,506
Balance of ALLL at beginning of period	\$ 26,599	\$ 20,182	\$ 20,829	\$ 19,881	\$ 20,261
Balance established through acquisition	--	3,192	--	--	1,367
Charge-offs:					
Commercial business	(2,023)	(781)	(2,077)	(386)	(2,490)
Real Estate:					
One-to-four family residential	(46)	--	--	--	--
Commercial and five or more family residential properties	(3,136)	--	(9)	--	--
Real Estate Construction:					
One-to-four family residential	(18,919)	--	--	--	--
Commercial and five or more family residential properties	--	--	--	(665)	(260)
Consumer	(1,863)	(432)	(1,109)	(221)	(292)
Total charge-offs	<u>(25,987)</u>	<u>(1,213)</u>	<u>(3,195)</u>	<u>(1,272)</u>	<u>(3,042)</u>
Recoveries					
Commercial business	417	530	233	218	124
Real Estate:					
One-to-four family residential	--	--	20	--	1
Commercial and five or more family residential properties	304	12	83	--	--
Real Estate Construction:					
One-to-four family residential	16	--	7	--	25
Commercial and five or more family residential properties	--	--	--	326	--
Consumer	222	291	140	156	150
Total recoveries	<u>959</u>	<u>833</u>	<u>483</u>	<u>700</u>	<u>300</u>
Net charge-offs	(25,028)	(380)	(2,712)	(572)	(2,742)
Provision charged to expense	41,176	3,605	2,065	1,520	995
Balance of ALLL at year-end	<u>\$ 42,747</u>	<u>\$ 26,599</u>	<u>\$ 20,182</u>	<u>\$ 20,829</u>	<u>\$ 19,881</u>
Net charge-offs to average loans outstanding	1.11%	0.02%	0.17%	0.04%	0.23%
Allowance for loan and lease losses to year end loans (1)	1.91%	1.17%	1.18%	1.33%	1.46%

(1) Excludes loans held for sale

The increase in the loan and lease loss provision during 2008 and 2006 was due primarily to increased charge-offs, and in 2008 to increased nonperforming assets, while the increase in the provision for 2007 was primarily due to loan growth.

We have used the same methodology for ALLL calculations during 2008, 2007 and 2006. Adjustments to the percentages of the ALLL allocated to loan categories are made based on trends with respect to delinquencies and problem loans within each pool of loans. We continually review the ALLL quantitative and qualitative methodology and make adjustments appropriate to the loan portfolio. We maintain a conservative approach to credit quality and will continue to prudently add to our ALLL as necessary in order to maintain adequate reserves. We carefully monitor the loan portfolio and continue to emphasize the importance of credit quality while continuously strengthening our loan monitoring systems and controls.

The table below sets forth the allocation of the ALLL by loan category:

Balance at End of Period Applicable to:	December 31,									
	2008		2007		2006		2005		2004	
	Amount	% of Total Loans*	Amount	% of Total Loans*	Amount	% of Total Loans*	Amount	% of Total Loans*	Amount	% of Total Loans*
	(dollars in thousands)									
Commercial business	\$ 12,846	36.3%	\$ 7,068	33.4%	\$ 9,628	36.1%	\$ 12,060	36.5%	\$ 10,222	35.9%
Real estate and construction:										
One-to-four family residential	16,895	12.0%	7,648	14.5%	1,134	8.4%	809	7.4%	678	5.7%
Commercial and five or more family residential properties	12,064	42.1%	11,170	44.3%	8,841	46.9%	6,663	47.1%	7,995	48.7%
Consumer	942	9.6%	713	7.8%	281	8.6%	677	9.0%	985	9.7%
Unallocated	- -	0.0%	- -	0.0%	298	0.0%	620	0.0%	1	0.0%
Total	<u>\$42,747</u>	<u>100.0%</u>	<u>\$26,599</u>	<u>100.0%</u>	<u>\$20,182</u>	<u>100.0%</u>	<u>\$20,829</u>	<u>100.0%</u>	<u>\$19,881</u>	<u>100.0%</u>

* Represents the total of all outstanding loans in each category as a percent of total loans outstanding.

Deposits

The following table sets forth the average amount of and the average rate paid on each significant deposit category:

	Years ended December 31,					
	2008		2007		2006	
	Average Deposits	Rate	Average Deposits	Rate	Average Deposits	Rate
	(dollars in thousands)					
Interest bearing demand	\$ 445,449	1.35%	\$ 435,807	2.53%	\$ 361,618	2.08%
Money market	578,123	1.86%	558,510	3.07%	518,156	2.30%
Savings	118,073	0.37%	111,265	0.42%	115,802	0.38%
Certificates of deposit	780,092	3.60%	698,078	4.48%	543,053	3.86%
Total interest-bearing deposits	1,921,737	2.36%	1,803,660	3.32%	1,538,629	2.65%
Demand and other non-interest bearing	460,747		438,474		437,819	
Total average deposits	<u>\$2,382,484</u>		<u>\$2,242,134</u>		<u>\$1,976,448</u>	

(1) Interest-bearing demand deposits include interest-bearing checking accounts and money market accounts.

During 2008 our total average deposits increased \$140.4 million, or 6% as compared to \$265.7 million or 13% during 2007. Our focus in increasing our deposit base is centered on core deposit growth, which includes interest and non-interest bearing demand, money market, savings accounts and certificates of deposit less than \$100,000. Average core deposits increased \$24.5 million during 2008 and \$223.1 million during 2007.

Competitive pressure from banks in our market areas with strained liquidity positions coupled with generally lower balances held in existing accounts has slowed the growth of our deposit base but, in the long-term, we anticipate continued growth in our core deposits through both the addition of new customers and our current client base. However, with low short-term rates our cost of funds may not decline significantly due to changes in our mix of interest bearing and non-interest bearing accounts, growth in higher yielding deposits, and competitive pressures.

We have established a branch system to serve our customers 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 December 31, 2008 brokered and other wholesale deposits (excluding public deposits) totaled \$102.1 million or 4% of total deposits compared to \$72.8 million or 3% of total deposits, at year-end 2007. At December 31, 2008 public deposits held by the Company totaled \$118.4 million or 5% of total deposits. To assist in guaranteeing our public depositors against loss we pledge collateral, consisting of securities from our investment portfolio, in an amount equal to a minimum of 10% of public funds on deposit. However, each bank in the state does not guarantee each public depositor against loss. Rather, in the event of default of one bank, all participating banks in the state of Washington collectively assure that no loss of funds will be suffered by the public depositor. While this arrangement has been in place in the state of Washington since 1969, an assessment had never been made upon participating banks until February of 2009. The failure of the Bank of Clark County resulted in an assessment of approximately \$200,000 for Columbia out of a total statewide assessment of just over \$15 million. As a result of this assessment and the potential for additional assessments in the future, we are reassessing the costs and benefits of holding public deposits.

The following table sets forth the amount outstanding of time certificates of deposit and other time deposits in amounts of \$100,000 or more by time remaining until maturity and percentage of total deposits:

<u>Amounts maturing in:</u>	December 31, 2008			
	Time Certificates of Deposit of \$100,000 or More		Other Time Deposits of \$100,000 or More	
	<u>Amount</u>	Percent of Total Deposits	<u>Amount</u>	Percent of Total Deposits
		(dollars in thousands)		
Three months or less	\$ 192,544	8%	\$ 17,252	1%
Over 3 through 6 months	74,032	3%	243	0%
Over 6 through 12 months	49,030	2%	- -	0%
Over 12 months	23,365	1%	- -	0%
Total	<u>\$ 338,971</u>	<u>14%</u>	<u>\$ 17,495</u>	<u>1%</u>

Other time deposits of \$100,000 or more set forth in the table above represent brokered and wholesale deposits. We use brokered and other wholesale deposits as part of our strategy for funding growth. In the future, we anticipate continuing the use of such deposits to fund loan demand or treasury functions.

Borrowings

Our borrowings consist primarily of advances from the Federal Home Loan (“FHLB”) and Federal Reserve Bank (“FRB”) as well as securities repurchase agreements. We utilize these borrowings as a supplement to our funding sources. FHLB advances are secured by one-to-four family real estate mortgages, investment securities, and certain other assets. Federal Reserve Bank advances and securities repurchase agreements are secured by investments. We anticipate we will continue to rely on the same funding sources in the future, and will use those funds primarily to make loans and purchase securities.

The following tables set forth the details of FHLB advances and FRB borrowings:

	Years ended December 31,		
	2008	2007	2006
	(dollars in thousands)		
FHLB Advances			
Balance at end of year	\$ 150,000	\$ 257,670	\$ 205,800
Average balance during the year	\$ 282,624	\$ 207,521	\$ 208,594
Maximum month-end balance during the year	\$ 384,000	\$ 264,250	\$ 303,000
Weighted average rate during the year	2.53%	5.27%	5.25%
Weighted average rate at December 31	1.89%	4.59%	5.56%

	Years ended December 31,		
	2008	2007	2006
	(dollars in thousands)		
Federal Reserve Bank Borrowings			
Balance at end of year	\$ 50,000	\$ --	\$ --
Average balance during the year	\$ 14,569	\$ 54	\$ 27
Maximum month-end balance during the year	\$ 120,000	\$ --	\$ --
Weighted average rate during the year	0.62%	5.36%	5.50%
Weighted average rate at December 31	0.60%	0.00%	0.00%

Additionally, we have a \$20.0 million line of credit with a large commercial bank with an interest rate indexed to LIBOR. At December 31, 2008 and 2007, the outstanding balance was \$100,000 and \$5.0 million, respectively with an interest rate of 2.43% at December 31, 2008. For additional information on our borrowings, see Notes 11 and 12 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

For additional information on our borrowings, including amounts pledged as collateral, see Notes 11 and 12 to the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

Long-term Subordinated Debt

During 2001, we participated in a pooled trust preferred offering through our subsidiary trust (the “Trust”), 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 7.00% at December 31, 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 debt at ten years at par, allowing us to retire the debt early if conditions are favorable. Effective December 31, 2003, we adopted Financial Accounting Standards Board Interpretation No. 46 “Consolidation of Variable Interest Entities” whereby the Trust was deconsolidated with the result being that the trust preferred obligations were reclassified as long-term subordinated debt on our December 31, 2003 Consolidated Balance Sheets and our related investment in the Trust was recorded in “other assets” on the Consolidated Balance Sheets. Through the 2007 Town Center Bancorp acquisition, the Company assumed an additional \$3.0 million in floating rate trust preferred obligations; these debentures had a rate of 8.57% at December 31, 2008. The floating rate is based on the 3-month LIBOR plus 3.75% and is adjusted quarterly.

We are party to many contractual financial obligations, including repayment of borrowings, operating and equipment lease payments, and commitments to extend credit. The table below presents certain future financial obligations of the Company:

	Payments due within time period at December 31, 2008				
	0-12 Months	1-3 Years	4-5 Years	Due after Five Years	Total
	(in thousands)				
Operating & equipment leases	\$ 3,371	\$ 6,233	\$ 5,614	\$ 8,839	\$ 24,057
Total deposits	2,264,287	100,376	17,488	--	2,382,151
Federal Home Loan Bank and Federal Reserve Bank borrowings	100,000	--	--	100,000	200,000
Other borrowings	201	--	--	25,000	25,201
Long-term subordinated debt	--	--	--	25,603	25,603
Total	<u>\$2,367,859</u>	<u>\$ 106,609</u>	<u>\$ 23,102</u>	<u>\$ 159,442</u>	<u>\$2,657,012</u>

At December 31, 2008, we had commitments to extend credit of \$703.3 million compared to \$857.6 million at December 31, 2007. For additional information regarding future financial commitments, see Note 18 to our Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report.

Liquidity and Sources of Funds

Our primary sources of funds are net income, loan repayments, maturities and principal payments on investment securities, customer deposits, advances from the FHLB and FRB, securities repurchase agreements and other borrowings. These funds are used to make loans, purchase investments, meet deposit withdrawals and maturing liabilities and cover operational expenses. Scheduled loan repayments and core deposits have proved to be a relatively stable source of funds while other deposit inflows and unscheduled loan prepayments are influenced by interest rate levels, competition and general economic conditions. We manage liquidity through monitoring sources and uses of funds on a daily basis and had unused credit lines with the FHLB, the Federal Reserve Bank and a large commercial bank of \$486 million, \$95 million and \$20 million, respectively, at December 31, 2008, that are available to us as a supplemental funding source. The holding company’s sources of funds are dividends from its banking subsidiaries which are used to fund dividends to common and preferred shareholders and cover operating expenses.

Capital Expenditures

Capital expenditures, primarily consisting of one additional branch location as well as various information technology-related expenditures, are anticipated to be approximately \$2.9 million during 2009.

See the Statement of Cash Flows of the Consolidated Financial Statements in “Item 8. Financial Statements and Supplementary Data” of this report for additional information regarding our sources and uses of funds during 2008, 2007 and 2006.

Capital

Our shareholders’ equity increased to \$415.4 million at December 31, 2008, from \$341.7 million at December 31, 2007. Shareholders’ equity was 13.41% and 10.75% of total assets at December 31, 2008 and 2007. The increase is due primarily to the issuance of preferred stock of \$76.9 million as a result of participation in the U.S. Treasury’s Capital Purchase Program (“CPP”).

On November 21, 2008, the Company issued 76,898 shares of Series A Cumulative Perpetual Preferred Stock (the “Preferred Stock”) and a warrant to purchase common stock to the U.S. Department of Treasury (the “Treasury”) as part of the Treasury’s previously announced Capital Purchase Program. The Preferred Stock is non-voting, has an aggregate liquidation preference of \$76.9 million and an annual dividend rate of 5% for the first five years, and 9% thereafter. Dividends are cumulative and payable quarterly. The Preferred Stock may not be redeemed for a period of three years from the date of issue, except with the proceeds from the issuance of Tier 1-qualifying perpetual preferred or common stock from which the aggregate gross proceeds to the Company are not less than 25% of the issue price of the Preferred Stock. The warrant has an exercise price of \$14.49 and is exercisable for 796,046 shares of common stock, which would be reduced by one-half if the Company raises an additional \$76.9 million through the issuance of Tier 1-qualifying perpetual preferred or common stock by December 31, 2009.

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 preferred stock, 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 banking subsidiary qualify as “well-capitalized” at December 31, 2008 and 2007.

The following table sets forth the Company’s and it’s banking subsidiary’s capital ratios at December 31, 2008 and 2007:

	Company		Columbia Bank		Requirements	
	2008	2007	2008	2007	Adequately capitalized	Well-Capitalized
Total risk-based capital ratio	14.25%	10.90%	11.21%	10.49%	8%	10%
Tier 1 risk-based capital ratio	12.99%	9.87%	9.96%	9.47%	4%	6%
Leverage ratio	11.27%	8.54%	8.64%	8.23%	4%	5%

Dividends

The following table sets forth the dividends paid per common share and the dividend payout ratio (dividends paid per common share divided by basic earnings per share):

	Years ended December 31,		
	2008	2007	2006
Dividends paid per common share	\$ 0.58	\$ 0.66	\$ 0.57
Dividend payout ratio	187%	34%	28%

For quarterly detail of dividends declared during 2008 and 2007 see “Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities” of this report.

Applicable federal, Washington state and Oregon regulations restrict capital distributions, including dividends, by the Company’s banking subsidiaries. Such restrictions are tied to the institution’s capital levels after giving effect to distributions. Our ability to pay cash dividends is substantially dependent upon receipt of dividends from our banking subsidiaries. Additionally, due to our participation in the Treasury’s CPP our quarterly dividend rate is limited to a range of \$0.00 to \$0.07 per common share. For the duration of our participation in the CPP, we would first have to obtain the approval of the Treasury prior to paying a quarterly dividend greater than \$0.07 per common share.

Reference “Item 6. Selected Financial Data” of this report for our return on average assets, return on average equity and average equity to average assets ratios for all reported periods.

Interest Rate Sensitivity

We are exposed to interest rate risk, which is the risk that changes in prevailing interest rates will adversely affect assets, liabilities, capital, income and expenses at different times or in different amounts. Generally, there are four sources of interest rate risk as described below:

- Repricing risk**—Repricing risk is the risk of adverse consequences from a change in interest rates that arises because of differences in the timing of when those interest rate changes affect an institution’s assets and liabilities.
- Basis risk**—Basis risk is the risk of adverse consequence resulting from unequal changes in the spread between two or more rates for different instruments with the same maturity.
- Yield curve risk**—Yield curve risk is the risk of adverse consequence resulting from unequal changes in the spread between two or more rates for different maturities for the same instrument.
- Option risk**—In banking, option risks are known as borrower options to prepay loans and depositor options to make deposits, withdrawals, and early redemptions. Option risk arises whenever bank products give customers the right, but not the obligation, to alter the quantity or the timing of cash flows.

We maintain an asset/liability management policy that provides guidelines for controlling exposure to interest rate risk. The guidelines direct management to assess the impact of changes in interest rates upon both earnings and capital. The guidelines further provide that in the event of an increase in interest rate risk beyond pre-established limits, management will consider steps to reduce interest rate risk to acceptable levels.

The analysis of an institution’s interest rate gap (the difference between the repricing of interest-earning assets and interest-bearing liabilities during a given period of time) is one standard tool for the measurement of the exposure to interest rate risk. We believe that because interest rate gap analysis does not address all factors that can affect earnings performance, it should be used in conjunction with other methods of evaluating interest rate risk.

The table on the following page sets forth the estimated maturity or repricing, and the resulting interest rate gap of our interest-earning assets and interest-bearing liabilities at December 31, 2008. The amounts in the table are derived from our internal data and are based upon regulatory reporting formats. Therefore, they may not be consistent with financial information appearing elsewhere herein that has been prepared in accordance with accounting principles generally accepted in the United States. The amounts could be significantly affected by external factors such as changes in prepayment assumptions, early withdrawal of deposits and competition. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while other types may lag changes in market interest rates.

Additionally, certain assets, such as adjustable-rate mortgages, have features that restrict changes in the interest rates of such assets both on a short-term basis and over the lives of such assets. Further, in the event of a change in market interest rates, prepayment and early withdrawal levels could deviate significantly from those assumed in calculating the tables. Finally, the ability of many borrowers to service their adjustable-rate debt may decrease in the event of a substantial increase in market interest rates.

	Estimated Maturity or Repricing				Total
	0-3 months	4-12 months	Over 1 year through 5 years	Due after 5 years	
December 31, 2008					
Interest-Earning Assets					
Interest-earning deposits	\$ 3,943	\$ --	\$ --	\$ --	\$ 3,943
Loans, net of deferred fees	1,095,819	207,055	727,531	201,927	2,232,332
Loans held for sale	1,964	--	--	--	1,964
Investments	34,876	101,531	223,638	180,480	540,525
Total interest-earning assets	<u>\$1,136,602</u>	<u>\$308,586</u>	<u>\$951,169</u>	<u>\$382,407</u>	\$2,778,764
Allowance for loan and lease losses					(42,747)
Cash and due from banks					84,787
Premises					61,139
Other assets					215,136
Noninterest-earning assets					<u>318,315</u>
Total Assets					<u>\$3,097,079</u>
Interest-Bearing Liabilities					
Interest bearing non-maturity deposits	\$ 530,065	\$ --	\$ --	\$ 641,200	\$1,171,265
Time deposits	361,345	265,935	117,528	--	744,808
Borrowings	124,000	1,000	100,000	--	225,000
Long-term subordinated debt	25,804	--	--	--	25,804
Total interest-bearing liabilities	<u>\$1,041,214</u>	<u>\$266,935</u>	<u>\$217,528</u>	<u>\$641,200</u>	2,166,877
Other liabilities					<u>514,817</u>
Total liabilities					2,681,694
Shareholders' equity					<u>415,385</u>
Total liabilities and shareholders' equity					<u>\$3,097,079</u>
Interest-bearing liabilities as a percent of total interest-earning assets	37.47%	9.61%	7.83%	23.08%	
Rate sensitivity gap	\$ 95,388	\$ 41,651	\$ 733,641	\$(258,793)	
Cumulative rate sensitivity gap	\$ 95,388	\$ 137,039	\$ 870,680	\$ 611,887	
Rate sensitivity gap as a percentage of interest-earning assets	3.43%	1.50%	26.40%	(9.31)%	
Cumulative rate sensitivity gap as a percentage of interest-earning assets	3.43%	4.93%	31.33%	22.02%	

Impact of Inflation and Changing Prices

The impact of inflation on our operations is increased operating costs. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution’s performance than the effect of general levels of inflation. Although interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services, increases in inflation generally have resulted in increased interest rates.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Columbia Banking System, Inc.
Tacoma, Washington

We have audited the accompanying consolidated balance sheets of Columbia Banking System, Inc. and its subsidiaries (the “Company”) as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in shareholders’ equity, and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Columbia Banking Systems, Inc. and its subsidiaries as of December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of December 31, 2008, based on the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2009 expressed an unqualified opinion on the Company’s internal control over financial reporting.

Deloitte & Touche LLP

Seattle, Washington
February 27, 2009

COLUMBIA BANKING SYSTEM, INC.
CONSOLIDATED STATEMENTS OF INCOME

	Years ended December 31,		
	2008	2007	2006
	(in thousands except per share)		
Interest Income			
Loans	\$ 147,830	\$ 156,253	\$ 123,998
Taxable securities	18,852	18,614	20,018
Tax-exempt securities	7,976	7,923	7,042
Federal funds sold and deposits in banks	402	1,427	617
Total interest income	175,060	184,217	151,675
Interest Expense			
Deposits	45,307	59,930	40,838
Federal Home Loan Bank and Federal Reserve Bank borrowings	7,573	11,065	10,944
Long-term obligations	1,800	2,177	1,992
Other borrowings	867	2,225	138
Total interest expense	55,547	75,397	53,912
Net Interest Income	119,513	108,820	97,763
Provision for loan and lease losses	41,176	3,605	2,065
Net interest income after provision for loan and lease losses	78,337	105,215	95,698
Noninterest Income			
Service charges and other fees	14,813	13,498	11,651
Merchant services fees	8,040	8,373	8,314
Redemption of Visa and Mastercard shares	3,028	--	--
Gain on sale of investment securities, net	846	--	36
Impairment charge on investment securities	(19,541)	--	--
Bank owned life insurance ("BOLI")	2,075	1,886	1,687
Other	5,589	3,991	2,984
Total noninterest income	14,850	27,748	24,672
Noninterest Expense			
Compensation and employee benefits	49,315	46,703	38,769
Occupancy	12,838	12,322	10,760
Merchant processing	3,558	3,470	3,361
Advertising and promotion	2,324	2,391	2,582
Data processing	3,486	2,564	2,314
Legal and professional fees	1,969	4,912	2,099
Taxes, licenses and fees	2,917	2,882	2,499
Regulatory premiums	2,141	507	269
Net (gain) loss on sale of other real estate owned	(49)	5	(11)
Other	13,626	13,073	13,492
Total noninterest expense	92,125	88,829	76,134
Income before income taxes	1,062	44,134	44,236
Provision (benefit) for income taxes	(4,906)	11,753	12,133
Net Income	\$ 5,968	\$ 32,381	\$ 32,103
Net Income Applicable to Common Shareholders	\$ 5,498	\$ 32,381	\$ 32,103
Earnings per Common Share			
Basic	\$ 0.31	\$ 1.93	\$ 2.01
Diluted	\$ 0.31	\$ 1.91	\$ 1.99
Dividends paid per common share	\$ 0.58	\$ 0.66	\$ 0.57
Weighted average number of common shares outstanding	17,914	16,802	15,946
Weighted average number of diluted common shares outstanding	18,010	16,972	16,148

See accompanying notes to the Consolidated Financial Statements.

COLUMBIA BANKING SYSTEM, INC.
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2008	2007
	(in thousands)	
ASSETS		
Cash and due from banks	\$ 84,787	\$ 82,735
Interest-earning deposits with banks	3,943	11,240
Total cash and cash equivalents	88,730	93,975
Securities available for sale at fair value (amortized cost of \$525,110 and \$558,685, respectively)	528,918	561,366
Federal Home Loan Bank stock at cost	11,607	11,607
Loans held for sale	1,964	4,482
Loans, net of deferred loan fees of (\$4,033) and (\$3,931), respectively	2,232,332	2,282,728
Less: allowance for loan and lease losses	42,747	26,599
Loans, net	2,189,585	2,256,129
Interest receivable	11,646	14,622
Premises and equipment, net	61,139	56,122
Other real estate owned	2,874	181
Goodwill	95,519	96,011
Core deposit intangible, net	5,908	7,050
Other assets	99,189	77,168
Total Assets	\$3,097,079	\$3,178,713
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	\$ 466,078	\$ 468,237
Interest-bearing	1,916,073	2,029,824
Total deposits	2,382,151	2,498,061
Federal Home Loan Bank and Federal Reserve Bank borrowings	200,000	257,670
Securities sold under agreements to repurchase	25,000	--
Other borrowings	201	5,061
Long-term subordinated debt	25,603	25,519
Other liabilities	48,739	50,671
Total liabilities	2,681,694	2,836,982
Commitments and contingent liabilities (note 18)		
Shareholders' equity:		
	December 31,	
	2008	2007
Preferred stock (76,898 aggregate liquidation preference)		
Authorized shares	2,000	2,000
Issued and outstanding	77	--
Common Stock (no par value)		
Authorized shares	63,033	63,033
Issued and outstanding	18,151	17,953
Retained earnings		
Accumulated other comprehensive income		
Total shareholders' equity	415,385	341,731
Total Liabilities and Shareholders' Equity	\$3,097,079	\$3,178,713

See accompanying notes to Consolidated Financial Statements.

COLUMBIA BANKING SYSTEM, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Preferred Stock		Common Stock		Retained Earnings (in thousands)	Deferred Compensation	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Number of Shares	Amount	Number of Shares	Amount				
Balance at January 1, 2006	--	\$ --	15,831	\$ 163,065	\$ 66,051	\$ (92)	\$ (2,782)	\$ 226,242
Comprehensive income:								
Net income	--	--	--	--	32,103	--	--	32,103
Other comprehensive income (loss), net of tax:								
Net unrealized loss from securities, net of reclassification adjustments	--	--	--	--	--	--	(1,032)	(1,032)
Net unrealized gain from cash flow hedging instruments	--	--	--	--	--	--	361	361
Total comprehensive income								31,432
Transition adjustment related to adoption of SFAS 123(R)	--	--	--	(92)	--	92	--	--
Common stock issued - stock option and other plans	--	--	148	2,090	--	--	--	2,090
Common stock issued - restricted stock awards, net of cancelled awards	--	--	81	--	--	--	--	--
Share-based payment	--	--	--	793	--	--	--	793
Tax benefit associated with share-based payment	--	--	--	907	--	--	--	907
Cash dividends paid on common stock	--	--	--	--	(9,117)	--	--	(9,117)
Balance at December 31, 2006	--	--	16,060	166,763	89,037	--	(3,453)	252,347
Comprehensive income:								
Net income	--	--	--	--	32,381	--	--	32,381
Other comprehensive income, net of tax:								
Net unrealized gain from securities, net of reclassification adjustments	--	--	--	--	--	--	5,540	5,540
Net unrealized gain from cash flow hedging instruments	--	--	--	--	--	--	2,925	2,925
Total comprehensive income								40,846
Acquisitions:								
Shares issued to the shareholders of Mountain Bank Holding Company	--	--	993	31,652	--	--	--	31,652
Shares issued to the shareholders of Town Center Bancorp	--	--	705	25,467	--	--	--	25,467
Common stock issued - stock option and other plans	--	--	193	2,836	--	--	--	2,836
Common stock issued - restricted stock awards, net of cancelled awards	--	--	67	--	--	--	--	--
Purchase and retirement of common stock	--	--	(65)	(2,121)	--	--	--	(2,121)
Share-based payment	--	--	--	974	--	--	--	974
Tax benefit associated with share-based payment	--	--	--	979	--	--	--	979
Cash dividends paid on common stock	--	--	--	--	(11,249)	--	--	(11,249)
Balance at December 31, 2007	--	--	17,953	226,550	110,169	--	5,012	341,731
Cumulative effect of applying EITF 06-4 consensus	--	--	--	--	(2,137)	--	--	(2,137)
Adjusted balance	--	--	17,953	226,550	108,032	--	5,012	339,594
Comprehensive income:								
Net income	--	--	--	--	5,968	--	--	5,968
Other comprehensive income (loss), net of tax:								
Net unrealized gain from securities, net of reclassification adjustments	--	--	--	--	--	--	729	729
Net unrealized loss from cash flow hedging instruments	--	--	--	--	--	--	(352)	(352)
Total comprehensive income								6,345
Issuance of preferred stock and common stock warrant, net	77	73,743	--	3,168	(43)	--	--	76,868
Common stock issued - stock option and other plans	--	--	137	1,906	--	--	--	1,906
Common stock issued - restricted stock awards, net of cancelled awards	--	--	61	--	--	--	--	--
Share-based payment	--	--	--	1,327	22	--	--	1,349
Tax benefit associated with share-based payment	--	--	--	241	--	--	--	241
Accumulated preferred dividends	--	--	--	--	(427)	--	--	(427)
Cash dividends paid on common stock	--	--	--	--	(10,491)	--	--	(10,491)
Balance at December 31, 2008	77	\$ 73,743	18,151	\$ 233,192	\$ 103,061	\$ --	\$ 5,389	\$ 415,385

See accompanying notes to Consolidated Financial Statements.
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COLUMBIA BANKING SYSTEM, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended December 31,		
	2008	2007	2006
	(in thousands)		
Cash Flows From Operating Activities			
Net Income	\$ 5,968	\$ 32,381	\$ 32,103
Adjustments to reconcile net income to net cash provided by operating activities			
Provision for loan and lease losses	41,176	3,605	2,065
Deferred income tax benefit	(14,409)	(2,607)	(1,988)
Stock-based compensation expense	1,349	974	793
Depreciation, amortization and accretion	7,046	6,685	7,713
Net realized gain on sale of securities	(846)	--	(36)
Net realized gain on sale of other real estate and fixed assets	(589)	(216)	(317)
Gain on terminated cash flow hedging instruments	(1,693)	--	--
Impairment charge on investment securities	19,541	--	--
Net change in:			
Loans held for sale	2,518	(3,084)	917
Interest receivable	2,969	(404)	(878)
Interest payable	(4,536)	6,014	744
Other assets	(12,698)	2,945	(4,766)
Other liabilities	(1,431)	4,306	2,011
Net cash provided by operating activities	44,365	50,599	38,361
Cash Flows From Investing Activities			
Purchases of securities available for sale	(89,055)	(3,742)	(177,797)
Proceeds from sales of securities available for sale	53,512	29,867	43,099
Proceeds from principal repayments and maturities of securities available for sale	49,652	48,646	110,144
Proceeds from maturities of securities held to maturity	--	578	703
Loans originated and acquired, net of principal collected	21,702	(288,099)	(147,040)
Purchases of premises and equipment	(10,479)	(5,591)	(4,455)
Proceeds from disposal of premises and equipment	925	216	126
Acquisition of Mt. Rainier and Town Center, net of cash acquired	--	(32,356)	--
Proceeds from sales of Federal Reserve Bank stock	--	310	--
Proceeds from termination of cash flow hedging instruments	8,100	--	--
Proceeds from sales of other real estate and other personal property owned	949	--	29
Net cash provided by(used in) investing activities	35,306	(250,171)	(175,191)
Cash Flows From Financing Activities			
Net increase(decrease) in deposits	(115,910)	170,025	17,862
Proceeds from Federal Home Loan Bank and Federal Reserve Bank borrowings	3,287,268	2,992,548	2,873,249
Repayments of Federal Home Loan Bank and Federal Reserve Bank borrowings	(3,344,938)	(2,948,678)	(2,761,849)
Proceeds from repurchase agreement borrowings	25,000	--	--
Repayment of repurchase agreement borrowings	--	(20,000)	--
Net increase(decrease) in other borrowings	(4,860)	4,863	17,626
Proceeds from issuance of preferred stock, net	76,868	--	--
Cash dividends paid on common stock	(10,491)	(11,249)	(9,117)
Proceeds from issuance of common stock	1,906	2,836	2,090
Repurchase of common stock	--	(2,121)	--
Excess tax benefit from stock-based compensation	241	979	907
Net cash provided by(used in) financing activities	(84,916)	189,203	140,768
Increase(decrease) in cash and cash equivalents	(5,245)	(10,369)	3,938
Cash and cash equivalents at beginning of year	93,975	104,344	100,406
Cash and cash equivalents at end of year	\$ 88,730	\$ 93,975	\$ 104,344
Supplemental Information:			
Cash paid for interest	\$ 60,083	\$ 69,383	\$ 53,168
Cash paid for income tax	\$ 9,937	\$ 13,930	\$ 14,575
Loans foreclosed and transferred to other real estate owned or other personal property owned	\$ 3,564	\$ --	\$ --
Transfer of securities from held to maturity to available for sale	\$ --	\$ 1,258	\$ --
Share-based consideration issued for acquisitions	--	\$ 57,119	\$ --

See accompanying notes to Consolidated Financial Statements.

COLUMBIA BANKING SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Years Ended December 31, 2008, 2007 and 2006

Columbia Banking System, Inc. (the “Company”), through its wholly owned banking subsidiaries, provides a full range of banking services to small and medium-sized businesses, professionals and other individuals generally based in western Washington state and the northern coastal and Portland metropolitan areas of Oregon. At December 31, 2008, the Company conducted its banking services in 53 office locations with the majority of its loans, loan commitments and core deposits geographically concentrated in the Puget Sound region of Washington state.

In Washington state, the Portland metropolitan and northern coastal areas of Oregon, the Company conducts a full-service commercial banking business through its wholly owned banking subsidiary, Columbia State Bank (“Columbia Bank”).

1. Summary of Significant Accounting Policies

Principles of Consolidation

The Consolidated Financial Statements of the Company include the accounts of the Company and its wholly owned banking subsidiary, Columbia Bank. Intercompany balances and transactions have been eliminated in consolidation.

Business Combinations

Statement of Financial Accounting Standards No. 141, *Business Combinations* (“SFAS 141”), requires that all business combinations be accounted for using the purchase method. The purchase method of accounting requires that the cost of an acquired entity be allocated to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition. The difference between the fair values and the purchase price is recorded to Goodwill. Also, under SFAS 141, identified intangible assets acquired in a purchase business combination must be separately valued and recognized on the balance sheet if they meet certain requirements.

Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as “held to maturity” and recorded at amortized cost. Securities not classified as held to maturity, including equity securities with readily determinable fair values, are classified as “available for sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported net of tax as a component of “other comprehensive income (loss)” in the Consolidated Statements of Changes in Shareholders’ Equity.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. In estimating other-than-temporary impairment losses, management considers (1) the reasons for the decline, (2) the length of time and the extent to which the fair value has been less than cost and not as a result of changes in interest rates, (3) the financial condition and near-term prospects of the issuer, and (4) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are determined using the specific identification method.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by aggregate outstanding commitments from investors or current investor yield requirements. The amount by which cost exceeds market for loans held for sale is accounted for as a valuation allowance, and changes in the allowance are included in the determination of net income in the period in which the change occurs. Gains and losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold; the servicing rights on such loans are not retained.

Loans

Loans are stated at their outstanding unpaid principal balance adjusted for charge-offs, the allowance for loan losses, and any deferred loan fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees and direct loan origination costs are deferred and the net amount is recognized as an adjustment to yield over the contractual life of the related loans. Fees related to lending activities other than the origination or purchase of loans are recognized as noninterest income during the period the related services are performed.

The policy of the Company is to discontinue the accrual of interest on all loans past due 90 days or more and place them on nonaccrual status. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on non-accrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses is established as losses are estimated to have occurred through a provision for loan and lease losses charged to earnings. Loan and lease losses are charged against the allowance when management believes the collectibility of a loan balance is unlikely. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan and lease losses is evaluated on a regular basis by management and is based upon management’s periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of general, specific, and unallocated components. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. The specific component relates to loans that are impaired. For impaired loans an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The unallocated allowance provides for other credit losses inherent in the Company’s loan portfolio that may not have been contemplated in the general and specific components of the allowance. This unallocated amount generally comprises less than 5% of the allowance. The unallocated amount is reviewed periodically based on trends in credit losses, the results of credit reviews and overall economic trends.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrowers, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan’s effective interest rate, the loan’s obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Allowance for Unfunded Loan Commitments and Letters of Credit

The allowance for unfunded loan commitments is maintained at a level believed by management to be sufficient to absorb estimated probable losses related to these unfunded credit facilities. The determination of the adequacy of the allowance is based on periodic evaluations of the unfunded credit facilities including an assessment of the probability of commitment usage, credit risk factors for loans outstanding to these same customers, and the terms and expiration dates of the unfunded credit facilities. The allowance for unfunded loan commitments is included in other liabilities on the Consolidated Balance Sheets, with changes to the balance charged against noninterest expense.

Derivatives and Hedging Activities

Statement of Financial Accounting Standards No. 133 *Accounting for Derivative Instruments and Hedging Activities* (“SFAS 133”), as amended and interpreted, establishes accounting and reporting standards for derivative instruments. Generally, derivatives are financial instruments with little or no initial net investment in comparison to their notional amount and whose value is based upon an underlying asset, index, reference rate or other variable. As required by SFAS 133, all derivatives are reported at their fair value on the Consolidated Balance Sheets

The Company enters into derivative contracts to add stability to interest income and to manage its exposure to changes in interest rates. On the date the Company enters into a derivative contract, the derivative instrument is designated as: (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (a “fair value” hedge); (2) a hedge of the variability in expected future cash flows associated with an existing recognized asset or liability or a probable forecasted transaction (a “cash flow” hedge); or (3) held for other economic purposes (an “economic” hedge) and not formally designated as part of qualifying hedging relationships under SFAS 133.

In a fair value hedge, changes in the fair value of the hedging derivative are recognized in earnings and offset by recognizing changes in the fair value of the hedged item attributable to the risk being hedged. To the extent that the hedge is ineffective, the changes in fair value will not offset and the difference is reflected in earnings.

In a cash flow hedge, the effective portion of the change in the fair value of the hedging derivative is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings during the same period in which the hedged item affects earnings. The change in fair value of any ineffective portion of the hedging derivative is recognized immediately in earnings. When a cash flow hedge is discontinued, the net derivative gain or loss continues to be reported in accumulated other comprehensive income unless it is probable that the forecasted transactions will not occur by the end of the originally specified time period. The net derivative gain or loss from a discontinued cash flow hedge is reclassified into earnings during the originally specified time period in which the forecasted transactions were to occur.

Derivatives used for other economic purposes are used as economic hedges in which the Company has not attempted to achieve the highly effective hedge accounting standard under SFAS 133. The changes in fair value of these instruments are recognized immediately in earnings.

The Company formally documents the relationship between the hedging instruments and hedged items, as well as its risk management objective and strategy before initiating a hedge. To qualify for hedge accounting, the derivatives and related hedged items must be designated as a hedge. For hedging relationships in which effectiveness is measured, the correlations between the hedging instruments and hedged items are assessed at inception of the hedge and on an ongoing basis, which includes determining whether the hedge relationship is expected to be highly effective in offsetting changes in fair value or cash flows of hedged items.

Premises and Equipment

Land, buildings, leasehold improvements and equipment are carried at amortized cost. Buildings and equipment are depreciated over their estimated useful lives using the straight-line method. Leasehold improvements are amortized over the shorter of their useful lives or lease terms. Gains or losses on dispositions are reflected in operations. Expenditures for improvements and major renewals are capitalized, and ordinary maintenance, repairs and small purchases are charged to operations as incurred.

Other Real Estate Owned and Other Personal Property Owned

All other real estate and other personal property acquired in satisfaction of a loan are considered held for disposal and reported as “other real estate owned” and “other personal property owned.” Other personal property owned is included in “other assets” in the Consolidated Balance Sheets. Other real estate owned and other personal property owned is carried at the lower of cost or fair value less estimated cost of disposal.

Federal Home Loan Bank Stock

The Company’s investment in Federal Home Loan Bank (“FHLB”) stock is carried at par value. The Company is required to maintain a minimum level of investment in FHLB stock based on specific percentages of its outstanding mortgages, total assets or FHLB advances. Stock redemptions are at the discretion of the FHLB.

Goodwill and Other Intangibles

Net assets of companies acquired in purchase transactions are recorded at fair value at the date of acquisition. Identified intangibles are amortized on an accelerated basis over the period benefited. Goodwill is not amortized but is reviewed for potential impairment during the third quarter on an annual basis or, more frequently, if events or circumstances indicate a potential impairment, at the reporting unit level. The impairment test is performed in two phases. The first step of the goodwill impairment test compares the fair value of the reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired; however, if the carrying amount of the reporting unit exceeds its fair value, an additional procedure must be performed. That additional procedure compares the implied fair value of the reporting unit’s goodwill (as defined in SFAS No. 142, “Goodwill and Other Intangible Assets”) with the carrying amount of that goodwill. An impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value.

Intangible assets are evaluated for impairment if events and circumstances indicate a possible impairment. Such evaluation of other intangible assets is based on undiscounted cash flow projections. At December 31, 2008, intangible assets included on the Consolidated Balance Sheets consist of a core deposit intangible that is amortized using an accelerated method with an original estimated life of approximately 10 years.

Securities Sold Under Agreements to Repurchase

The Company pledges certain financial instruments it owns to collateralize the sales of securities that are subject to an obligation to repurchase the same or similar securities (“repurchase agreements”). Under these arrangements, the Company transfers the assets but still retains effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, repurchase agreements are accounted for as collateralized financing arrangements and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Consolidated Balance Sheets while the securities underlying the agreements remain in the respective asset accounts.

Share-Based Payment

The Company maintains a share-based compensation plan (the “Plan”) as described in Note 15 that provides for the granting of share options and shares to eligible employees and directors. The Company accounts for share options and shares granted under this plan in accordance with the requirements of Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* (“SFAS 123R”). SFAS 123R requires that all share-based compensation be recognized as an expense in the financial statement and that such cost be measured at the fair value of the award on the grant date.

Income Tax

The provision for income tax is based on income and expense reported for financial statement purposes, using the “asset and liability method” for accounting for deferred income tax. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recorded against any deferred tax assets for which it is more likely than not that the deferred tax asset will not be realized.

Earnings per Common Share

Earnings per common share (“EPS”) are computed using the weighted average number of common and diluted common shares outstanding during the period. Basic EPS is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates are used in determining the level of the allowance for loan and lease losses and the evaluation of goodwill for impairment.

Statements of Cash Flows

For purposes of the Consolidated Statements of Cash Flows, cash and cash equivalents include cash and due from banks, interest-earning deposits with banks and federal funds sold with maturities of 90 days or less.

Accounting Pronouncements Recently Issued or Adopted

Recently Issued Accounting Pronouncements

In June 2008, the FASB issued FASB Staff Position No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (“FSP EITF 03-6-1”). Under this FSP, unvested share-based payment awards that contain nonforfeitable rights to dividends will be considered to be a separate class of common stock and will be included in the basic EPS calculation using the two-class method that is described in FASB Statement No. 128, *Earnings per Share*. This FSP will be effective for the Company on January 1, 2009, and will require retrospective adjustment of all prior periods presented.

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 amends and requires enhanced qualitative, quantitative and credit risk disclosures about an entity’s derivative and hedging activities, but does not change the scope or accounting principles of Statement No. 133. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008. Because SFAS 161 impacts the Company’s disclosure and not its accounting treatment for derivative financial instruments and related hedged items, adoption of SFAS 161 will not impact the Company’s financial condition or results of operations.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141R, *Business Combinations* (“SFAS 141R”). This statement establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. This Statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008.

Recently Adopted Accounting Pronouncements

In December 2008, the FASB issued FASB Staff Position No. FAS 140-4 and FIN 46(R)-8, *Disclosure by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities* (“FSP FAS 140-4 and FIN 46(R)-8”). FSP FAS 140-4 and FIN 46(R)-8 amends FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, to require public entities to provide additional disclosures about transfers of financial assets and amends FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, to require public enterprises provide additional disclosures about their involvement in variable interest entities and certain special purpose entities. This FSP was effective for the first reporting period ending after December 15, 2008. Because FSP FAS 140-4 and FIN 46(R)-8 impact disclosures and not the accounting treatment for transfer of financial assets and interest in variable interest entities, adoption of FSP FAS 140-4 and FIN 46(R)-8 did not impact the Company’s financial condition or results of operations.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (“SFAS 157”). This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies whenever assets or liabilities are required or permitted to be measured at fair value under currently existing standards. No additional fair value measurements are required under this Statement. The Company adopted SFAS 157 on January 1, 2008 and there was no effect on our financial condition or results of operations.

In February 2008, the FASB issued FASB Staff Position No. FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement Under Statement 13* (“FSP FAS 157-1”). FSP FAS 157-1 amends FASB Statement No. 157, *Fair Value Measurements*, to exclude FASB Statement No. 13, *Accounting for Leases*, and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under Statement 13. However, the scope exception does not apply to assets acquired and liabilities assumed in a business combination that are required to be measured at fair value under FASB Statement No. 141, *Business Combinations*, or No. 141 (revised 2007), *Business Combinations*, regardless of whether those assets and liabilities are related to leases. FSP FAS 157-1 was effective upon the initial adoption of FASB Statement No. 157. As the Company applied Statement No. 157 in a manner consistent with this FSP, adoption of this FSP had no effect on our financial condition or results of operations.

In October 2008, the FASB issued FASB Staff Position No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (“FSP FAS 157-3”). This FSP clarifies the application of FASB Statement No. 157, *Fair Value Measurements*, in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. This FSP was effective when issued; adoption of this FSP had no effect on our financial condition or results of operations.

In September 2006, the Financial Accounting Standards Board ratified 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. On January 1, 2008 the Company recognized the effects of applying the consensus through a change in accounting principle with a cumulative-effect adjustment to retained earnings of approximately \$2.1 million and an increase in postretirement benefit liability of the same amount.

2. Earnings per Common Share

Information used to calculate earnings per common share was as follows:

	Year Ended December 31,		
	2008	2007	2006
	(in thousands except per share)		
Net income	\$ 5,968	\$ 32,381	\$ 32,103
Accumulated preferred dividends	(427)	--	--
Amortization of preferred stock discount	(43)	--	--
Net income applicable to common shareholders	<u>\$ 5,498</u>	<u>\$ 32,381</u>	<u>\$ 32,103</u>
Basic weighted average common shares outstanding	17,914	16,802	15,946
Dilutive effect of potential common shares from:			
Awards granted under equity incentive program	75	170	202
Common stock warrants	21	--	--
Diluted weighted average common shares outstanding	<u>18,010</u>	<u>16,972</u>	<u>16,148</u>
Earnings per common share			
Basic	\$ 0.31	\$ 1.93	\$ 2.01
Diluted	\$ 0.31	\$ 1.91	\$ 1.99

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 year ended December 31, 2008 totaled 54,912. There were no anti-dilutive shares outstanding related to options to acquire common stock for the years 2007 and 2006.

3. Cash and Cash Equivalents

The Company is required to maintain an average reserve balance with the Federal Reserve Bank or maintain such reserve balance in the form of cash. The average required reserve balance for the years ended December 31, 2008 and 2007 was approximately \$225 thousand and \$1.0 million, respectively, and was met by holding cash and maintaining an average balance with the Federal Reserve Bank.

4. Securities

At December 31, 2008, the Company’s securities portfolio primarily consisted of securities issued by U.S. government agencies, U.S. government-sponsored enterprises and state and municipalities. All of the Company’s mortgage-backed securities and collateralized mortgage obligations are issued by U.S. government agencies and U.S. government-sponsored enterprises and are implicitly guaranteed by the U.S. government. The Company did not have any other issuances in its portfolio which exceeded ten percent of shareholders’ equity.

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

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(in thousands)			
December 31, 2008:				
U.S. Government sponsored enterprise	\$ 488	\$ - -	\$ - -	\$ 488
U.S. Government agency and government-sponsored enterprise mortgage-backed securities & collateralized mortgage obligations	335,207	6,889	(258)	341,838
State and municipal securities	188,415	2,547	(5,309)	185,653
Other securities	1,000	- -	(61)	939
Total	<u>\$ 525,110</u>	<u>\$ 9,436</u>	<u>\$ (5,628)</u>	<u>\$ 528,918</u>
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(in thousands)			
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 & 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	<u>\$ 558,685</u>	<u>\$ 5,130</u>	<u>\$ (2,449)</u>	<u>\$ 561,366</u>

Gross realized losses amounted to \$36 thousand, \$0 and \$504 thousand for the years ended December 31, 2008, 2007 and 2006, respectively. Gross realized gains amounted to \$882 thousand, \$0 and \$540 thousand for the years ended December 31, 2008, 2007 and 2006, respectively.

The following table summarizes the amortized cost and fair value of securities available for sale by contractual maturity groups:

	December 31, 2008	
	Amortized	Fair
	Cost	Value
	(in thousands)	
U.S. Government agency and government-sponsored enterprise mortgage-backed securities & collateralized mortgage obligations (1)		
Due through 1 year	\$ 58	\$ 59
Over 1 through 5 years	2,057	2,078
Over 5 through 10 years	139,046	140,318
Over 10 years	194,046	199,383
Total	<u>\$ 335,207</u>	<u>\$ 341,838</u>
State and municipal securities		
Due through 1 year	\$ 1,801	\$ 1,804
Over 1 through 5 years	16,091	16,839
Over 5 through 10 years	36,028	36,444
Over 10 years	134,495	130,566
Total	<u>\$ 188,415</u>	<u>\$ 185,653</u>

(1) The maturities reported for mortgage-backed securities and collateralized mortgage obligations are based on contractual maturities and principal amortization.

At December 31, 2008 and 2007, available for sale securities with a fair value of \$370.0 million and \$326.6 million, respectively, were pledged to secure public deposits, Federal Home Loan Bank borrowings, and for other purposes as required or permitted by law.

The following tables summarizes information pertaining to securities with gross unrealized losses at December 31, 2008 and 2007, aggregated by investment category and length of time that individual securities have been in a continuous loss position:

	Less than 12 months		12 Months or More		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	Value	Losses	Value	Losses	Value	Losses
December 31, 2008	(in thousands)					
U.S. Government sponsored enterprise	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --
U.S. Government agency and government-sponsored enterprise mortgage-backed securities & collateralized mortgage obligations	562	(3)	17,414	(255)	17,976	(258)
State and municipal securities	95,560	(4,744)	6,863	(565)	102,423	(5,309)
Other securities	--	--	939	(61)	939	(61)
Total	<u>\$ 96,122</u>	<u>\$ (4,747)</u>	<u>\$ 25,216</u>	<u>\$ (881)</u>	<u>\$ 121,338</u>	<u>\$ (5,628)</u>

December 31, 2007	Less than 12 months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
U.S. Government sponsored enterprise	\$ - -	\$ - -	\$ 17,678	\$ (53)	\$ 17,678	\$ (53)
U.S. Government agency and government-sponsored enterprise mortgage-backed securities & 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	<u>\$ 36,622</u>	<u>\$ (140)</u>	<u>\$ 214,118</u>	<u>\$ (2,309)</u>	<u>\$ 250,740</u>	<u>\$ (2,449)</u>

At December 31, 2008, there were 123 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 changes subsequent to the purchase of the individual securities. Management monitors published credit ratings of these securities for adverse changes. As of December 31, 2008 none of the obligations of state and local government entities held by the Company had an adverse credit rating. The decline in fair value is attributable to changes in interest rates relative to where these investments fall within the yield curve and their individual characteristics. Because the credit quality of these securities remains above investment grade and 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 December 31, 2008.

At December 31, 2008, there were 12 U.S. Government agency and government-sponsored enterprise mortgage-backed securities & collateralized mortgage obligations securities in an unrealized loss position, of which 9 were in a continuous loss position for 12 months or more. The unrealized losses on U.S. Government agency and government-sponsored enterprise mortgage-backed securities & collateralized mortgage obligations were caused by interest rate changes 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. The decline in fair value is attributable to changes in interest rates relative to where these investments fall within the yield curve and their individual characteristics. Because the Company 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 December 31, 2008.

At December 31, 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 changes 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. The decline in fair value is attributable to changes in interest rates and the additional risk premium investors are demanding for investment securities with these characteristics. Because the Company has the ability and intent to hold these investments until a recovery of market value, the Company does not consider this investment to be other-than-temporarily impaired at December 31, 2008.

5. Comprehensive Income

The components of comprehensive income are as follows:

	Years Ended December 31,		
	2008	2007	2006
	(in thousands)		
Net income as reported	\$ 5,968	\$ 32,381	\$ 32,103
Unrealized gain(loss) from securities:			
Net unrealized holding gain(loss) from available for sale securities arising during the year, net of tax of \$(699), \$(2,985) and \$572	1,275	5,540	(1,009)
Reclassification adjustment of net gain from sale of available for sale securities included in income, net of tax of \$300, \$0 and \$13	(546)	- -	(23)
Net unrealized gain(loss) from securities, net of reclassification adjustment	729	5,540	(1,032)
Unrealized gain(loss) from cash flow hedging instruments:			
Net unrealized gain from cash flow hedging instruments arising during the year, net of tax of \$410, \$1,552 and \$197	754	2,847	361
Reclassification adjustment of net (gain)loss included in income, net of tax of \$587, \$43 and \$0	(1,106)	78	- -
Net unrealized gain(loss) from cash flow hedging instruments	(352)	2,925	361
Total comprehensive income	\$ 6,345	\$ 40,846	\$ 31,432

6. Loans

The following is an analysis of the loan portfolio by major types of loans (net of deferred loan fees):

	December 31,	
	2008	2007
	(in thousands)	
Commercial business	\$ 810,922	\$ 762,365
Real estate:		
One-to-four family residential	57,237	60,991
Commercial and five or more family residential properties	862,595	852,139
Total real estate	919,832	913,130
Real estate construction:		
One-to-four family residential	209,682	269,115
Commercial and five or more family residential properties	81,176	165,490
Total real estate construction	290,858	434,605
Consumer	214,753	176,559
Subtotal	2,236,365	2,286,659
Less deferred loan fees and other	(4,033)	(3,931)
Total loans, net of deferred loan fees	\$ 2,232,332	\$ 2,282,728
Loans held for sale	\$ 1,964	\$ 4,482

Non-accrual loans totaled \$106.2 million and \$14.0 million at December 31, 2008 and 2007, respectively. The amount of interest income foregone as a result of these loans being placed on non-accrual status totaled \$4.1 million for 2008, \$814,000 for 2007 and \$497,000 for 2006. At December 31, 2008 and 2007, there were no commitments of additional funds for loans accounted for on a non-accrual basis.

At December 31, 2008 and 2007, the total recorded investment in impaired loans was \$106.8 million and \$12.4 million, respectively. At December 31, 2008, \$8.3 million of impaired loans had a specific valuation allowance of \$1.2 million. At December 31, 2007, \$5.2 million of impaired loans had a specific valuation allowance of \$820,000. The average recorded investment in impaired loans for the years ended December 31, 2008, 2007, and 2006, was \$134.1 million, \$11.4 million, and \$5.2 million, respectively. Interest income recognized on impaired loans was \$40 thousand in 2008, \$13,000 in 2007, and \$51,000 in 2006.

At December 31, 2008 and 2007, the Company had no loans to foreign domiciled businesses or foreign countries, or loans related to highly leveraged transactions. Substantially all of the Company’s loans and loan commitments are geographically concentrated in its service areas within Washington and Oregon.

The Company and its banking subsidiary have granted loans to officers and directors of the Company and related interests. These loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collectability. The aggregate dollar amount of these loans was \$8.8 million and \$13.6 million at December 31, 2008 and 2007, respectively. During 2008, \$4.2 million of related party loans were made and repayments totaled \$9.0 million. During 2007, \$7.7 million related party loans were made and repayments totaled \$6.1 million.

At December 31, 2008 and 2007 \$467.7 million and \$106.3 million of commercial and residential real estate loans were pledged as collateral on FHLB borrowings.

7. Allowances for Loan and Lease Losses and Unfunded Loan Commitments and Letters of Credit

Changes in the allowance for loan and lease losses are summarized as follows:

	Years Ended December 31,		
	2008	2007	2006
	(in thousands)		
Balance at beginning of year	\$ 26,599	\$ 20,182	\$ 20,829
Loans charged off	(25,987)	(1,213)	(3,195)
Recoveries	959	833	483
Net chargeoffs	(25,028)	(380)	(2,712)
Balance established in acquisition	- -	3,192	- -

Provision charged to expense	41,176	3,605	2,065
Balance at end of year	<u>\$ 42,747</u>	<u>\$ 26,599</u>	<u>\$ 20,182</u>

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

	Years Ended December 31,		
	2008	2007	2006
	(in thousands)		
Balance at beginning of year	\$ 349	\$ 339	\$ 339
Net changes in the allowance for unfunded loan commitments and letters of credit	151	10	-
Balance at end of year	<u>\$ 500</u>	<u>\$ 349</u>	<u>\$ 339</u>

8. Premises and Equipment

Land, buildings, and furniture and equipment, less accumulated depreciation and amortization, were as follows:

	December 31,	
	2008	2007
	(in thousands)	
Land	\$ 17,507	\$ 15,026
Buildings	44,374	40,321
Leasehold improvements	2,833	2,208
Equipment under capital lease	510	537
Furniture and equipment	22,671	22,685
Vehicles	339	358
Computer software	8,716	7,655
Total cost	<u>96,950</u>	<u>88,790</u>
Less accumulated depreciation and amortization	<u>(35,811)</u>	<u>(32,668)</u>
Total	<u>\$ 61,139</u>	<u>\$ 56,122</u>

Total depreciation and amortization expense on buildings and furniture and equipment was \$5.0 million, \$4.5 million, and \$4.4 million, for the years ended December 31, 2008, 2007, and 2006, respectively.

9. Goodwill and Other Intangibles

The following table summarizes the changes in the Company’s goodwill and core deposit intangible asset for the years ended December 31, 2008 and 2007:

	Goodwill	CDI
	(in thousands)	(in thousands)
Balance at December 31, 2006	\$ 29,723	\$ 2,944
Additions	66,288	4,825
Amortization	- -	(719)
Balance at December 31, 2007	<u>96,011</u>	<u>7,050</u>
Additions	- -	- -
Amortization	- -	(1,142)
Other	(492)	- -
Balance at December 31, 2008	<u>\$ 95,519</u>	<u>\$ 5,908</u>

The change in goodwill from year-end 2007 is due to income tax adjustments related to the 2007 acquisitions resulting from the preparation in 2008 of final income tax returns. Amortization expense on the CDI was \$1.1 million in 2008, \$719 thousand in 2007 and \$452 thousand in 2006. The Company estimates that aggregate amortization expense on the CDI will be \$1.0 million for 2009, \$963 thousand for 2010, \$893 thousand for 2011, \$832 thousand for 2012 and \$780 thousand for 2013.

The products and services of companies previously acquired are comparable to the Company's retail banking operations. Accordingly, goodwill has been assigned to the retail banking reporting unit for purposes of impairment testing. We review our goodwill for impairment annually during the third quarter. Goodwill of a reporting unit shall be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount.

A significant amount of judgment is involved in determining if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Such indicators may include, among others: declines in the value of our stock price, a significant adverse change in legal factors or in the business climate; unanticipated competition; the testing for recoverability of a significant asset group within a reporting unit; and an adverse action or assessment by a regulator. Any adverse change in these factors could have a significant impact on the recoverability of goodwill and could have a material impact on our consolidated financial statements.

The goodwill impairment test involves a two-step process. The first step is a comparison of the reporting unit’s fair value to its carrying value. We estimate fair value using three approaches: allocation of corporate value, discounted cash flow and comparable market statistics. The allocation of corporate value approach applies the aggregate market value of the Company and divides it among the reporting units based on a common financial measure such as assets or earnings. This type of allocation methodology is most effective when the reporting units of the Company are highly similar. A key assumption in this approach is the control premium applied to the aggregate market value. A control premium is utilized as the value of a company from the perspective of a controlling interest is generally higher than the widely quoted market price per share. The discounted cash flow approach uses a reporting unit’s projection of future cash flows that is discounted using a weighted-average cost of capital that reflects current market conditions. Finally, the comparable market statistics approach estimates the value of the Company by comparing it to trading multiples involving similar companies. Key assumptions include the control premium as described above.

If the carrying value of the reporting unit is higher than its fair value, there is an indication that impairment may exist and the second step must be performed to measure the amount of impairment loss, if any. The amount of impairment is determined by comparing the implied fair value of the reporting unit goodwill to the carrying value of the goodwill in the same manner as if the reporting unit was being acquired in a business combination. Specifically, we would allocate the fair value to all of the assets and liabilities of the reporting unit in a hypothetical analysis that would calculate the implied fair value of goodwill. If the implied fair value of goodwill is less than the recorded goodwill, we would record an impairment charge for the difference.

During the third quarter of 2008, we conducted our annual goodwill impairment test and concluded the fair value of the retail banking reporting unit exceeded its carrying value and, accordingly, did not perform the second step of the goodwill impairment test. During the fourth quarter of 2008, due to the poor overall economic conditions, declines in the value of our stock price as well as our competitors and a challenging environment for the financial services industry, we concluded a triggering event had occurred indicating potential impairment. Accordingly we conducted an interim impairment test of our goodwill as of November 30, 2008.

At November 30, 2008 we had three reporting units, retail banking, commercial banking and private banking. Based upon the acquisition history of the Company, all of the Company’s goodwill is assigned to the retail banking reporting unit. As part of our process for performing the step one impairment test of goodwill, we estimated the fair value of the retail banking reporting unit utilizing the three approaches described above. Based on the results of the step one impairment test, a potential impairment loss was indicated. Accordingly, we performed the second step of the impairment test to measure the amount of any impairment loss.

Groups of assets and liabilities of the retail banking reporting unit subject to the most material valuation adjustments in the second step include loans, certificates of deposit and core deposits. The loan portfolio was valued utilizing the comparable market statistics approach. This approach estimates the value of an asset by comparing it to transactions involving similar assets. The key assumption in this approach is the discount percentage applied to the value of the asset. The discounted cash flow approach was also considered in valuing the loan portfolio but was not utilized due to the difficulty in obtaining both accurate estimates of future cash flow amounts and reliable discount rates. The value of the core deposits is the present value of the cost savings generated by core deposits. Key variables in this valuation include the life of the accounts, the interest rates on the deposit accounts, the operating costs of the deposit accounts, the cost of an alternate source of funds and any other income associated with the deposit accounts.

Based upon the pro forma purchase price allocation, we determined that there was no goodwill impairment for the year ended December 31, 2008. Continued declines in the value of our stock price or significant adverse changes in legal factors or in the business climate for the financial services industry may result in a future impairment charge. It is possible that changes in circumstances, existing at the measurement date or at other times in the future, or in management’s judgments, assumptions and estimates made in assessing the fair value of goodwill, could result in an impairment charge of a portion or all of our goodwill. If we recorded an impairment charge, our financial position and results of operations would be adversely affected.

10. **Deposits**

Year-end deposits are summarized in the following table:

<u>Deposit Composition</u>	<u>December 31,</u>	
	<u>2008</u>	<u>2007</u>
	<u>(in thousands)</u>	
Core deposits:		
Demand and other non-interest bearing	\$ 466,078	\$ 468,237
Interest bearing demand	519,124	478,596
Money market	530,065	609,502
Savings	122,076	115,324
Certificates of deposit less than \$100,000	303,704	324,734
Total core deposits	<u>1,941,047</u>	<u>1,996,393</u>
Certificates of deposit greater than \$100,000	338,971	428,885
Wholesale certificates of deposit (CDARS®)	39,903	762
Wholesale certificates of deposit	62,230	72,021
Total deposits	<u>\$2,382,151</u>	<u>\$2,498,061</u>

The following table shows the amount and maturity of time deposits that had balances of \$100,000 or greater:

<u>Years Ending December 31,</u>	<u>(in thousands)</u>
2009	\$ 333,100
2010	11,499
2011	6,961
2012	2,796
2013	2,109
Thereafter	- -
Total	<u>\$ 356,465</u>

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11. Federal Home Loan Bank and Federal Reserve Bank Borrowings

The Company has entered into borrowing arrangements with the Federal Home Loan Bank of Seattle (“FHLB”) to borrow funds under a short-term floating rate cash management advance program and fixed-term loan agreements. All borrowings are secured by stock of the FHLB, certain pledged available for sale investment securities and a blanket pledge of qualifying loans receivable. At December 31, 2008 FHLB advances were scheduled to mature as follows:

	Federal Home Loan Bank Advances					
	Adjustable rate advances		Fixed rate advances		Total advances	
	Wtd Avg Rate	Amount	Wtd Avg Rate	Amount	Wtd Avg Rate	Amount
			(dollars in thousands)			
Due through 1 year	0.63%	\$ 49,000	3.89%	\$ 1,000	0.64%	\$ 50,000
Over 1 through 5 years	- -	- -	2.49%	100,000	2.49%	100,000
Total FHLB advances	0.63%	<u>\$ 49,000</u>	2.50%	<u>\$ 101,000</u>	1.89%	<u>\$ 150,000</u>

The maximum, average outstanding and year-end balances and average interest rates on advances from the FHLB were as follows for the years ended December 31, 2008, 2007 and 2006:

	Years ended December 31,		
	2008	2007	2006
	(dollars in thousands)		
Balance at end of year	\$ 150,000	\$ 257,670	\$ 205,800
Average balance during the year	\$ 282,624	\$ 207,521	\$ 208,594
Maximum month-end balance during the year	\$ 349,000	\$ 264,250	\$ 303,000
Weighted average rate during the year	2.53%	5.27%	5.25%
Weighted average rate at December 31	1.89%	4.59%	5.56%

FHLB advances are collateralized by the following:

	December 31,	
	2008	2007
	(in thousands)	
Fair value of investment securities	\$ 168,537	\$ 274,354
Recorded value of blanket pledge on loans receivable	467,682	106,344
Total	<u>\$ 636,219</u>	<u>\$ 380,698</u>
FHLB Borrowing Capacity	<u>\$ 486,219</u>	<u>\$ 50,998</u>

The Company is also eligible to borrow under the Federal Reserve Bank’s primary credit program, including the Term Auction Facility (“TAF”) auctions. All borrowings are secured by certain pledged available for sale investment securities. At December 31, 2008 Federal Reserve Bank borrowings were scheduled to mature as follows:

	Federal Reserve Bank Borrowings					
	Adjustable rate advances		Fixed rate advances		Total advances	
	Wtd Avg Rate	Amount	Wtd Avg Rate	Amount	Wtd Avg Rate	Amount
			(dollars in thousands)			
Due through 1 year	0.00	% \$ - -	0.60%	\$ 50,000	0.60%	\$ 50,000

The maximum, average outstanding and year-end balances and average interest rates on borrowings from the Federal Reserve Bank were as follows for the years ended December 31, 2008, 2007 and 2006:

	Years ended December 31,		
	2008	2007	2006
	(dollars in thousands)		
Balance at end of year	\$ 50,000	\$ - -	\$ - -
Average balance during the year	\$ 14,569	\$ 54	\$ 27
Maximum month-end balance during the year	\$ 120,000	\$ - -	\$ - -
Weighted average rate during the year	0.62%	5.36%	5.50%
Weighted average rate at December 31	0.60%	0.00%	0.00%

Federal Reserve Bank borrowings are collateralized by the following:

	December 31,	
	2008	2007
	(in thousands)	
Fair value of investment securities	\$ 144,754	\$ 22,672
Federal Reserve Bank borrowing capacity	<u>\$ 94,754</u>	<u>\$ 22,672</u>

12. Other Borrowings

Securities Sold Under Agreements to Repurchase

The Company has entered into wholesale repurchase agreements with certain brokers. At December 31, 2008, the Company held \$25.0 million in whole sale repurchase agreements with an interest rate of 1.88%. Securities available for sale with a carrying amount of \$28.5 million were pledged as collateral for the repurchase agreement borrowings. The broker holds the securities while the Company continues to receive the principal and interest payments from the securities. Upon maturity of the agreement, the pledged securities will be returned to the Company.

Credit Line

The Company has a \$20.0 million unsecured line of credit with a large commercial bank with an interest rate indexed to LIBOR. At December 31, 2008 and 2007, the outstanding balance was \$100 thousand and \$5.0 million, respectively with an interest rate of 2.43% at December 31, 2008.

13. Long-term Subordinated Debt

During 2001, the Company, through its subsidiary 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 7.00% at December 31, 2008. The floating rate is based on the 3-month LIBOR plus 3.58% and is adjusted quarterly. The Company through the Trust may call the debt after ten years at par, allowing the Company to retire the debt early if conditions are favorable. In accordance with FASB Interpretation No. 46 (as revised), “*Consolidation of Variable Interest Entities*”, the Trust is deconsolidated with the result being that the trust preferred obligations are classified as long-term subordinated debt on the Company’s Consolidated Balance Sheet and the Company’s related investment in the Trust of \$681,000 is recorded in other assets. At December 31, 2008 and 2007, the balance of the Company’s investment in the Trust remained at \$681,000. The subordinated debt payable to the Trust is on the same interest and payment terms as the trust preferred obligations issued by the Trust. Through a 2007 acquisition, the Company assumed an additional \$3.0 million in floating rate trust preferred obligations from the Town Center Bancorp Statutory Trust; these debentures had a rate of 8.57% at December 31, 2008. The floating rate is based on the 3-month LIBOR plus 3.75% and is adjusted quarterly. At December 31, 2008 and 2007, the balance of the Company’s investment in this Town Center Bancorp Statutory Trust was \$93,000 which is recorded in other assets on the Consolidated Balance Sheets.

14. Income Tax

The components of income tax expense (benefit) are as follows:

	Years Ended December 31,		
	2008	2007	2006
		(in thousands)	
Current tax expense	\$ 9,503	\$ 14,360	\$ 14,121
Deferred benefit	(14,409)	(2,607)	(1,988)
Total	<u>\$ (4,906)</u>	<u>\$ 11,753</u>	<u>\$ 12,133</u>

Significant components of the Company’s deferred tax assets and liabilities are as follows:

	December 31,	
	2008	2007
	(in thousands)	
Deferred tax assets:		
Allowance for loan and lease losses	\$ 15,139	\$ 9,284
Supplemental executive retirement plan	4,684	4,379
Stock option and restricted stock	873	536
Litigation reserve	199	627
Preferred stock	6,920	- -
Other	1,847	483
Total deferred tax assets	<u>29,662</u>	<u>15,309</u>
Deferred tax liabilities:		
FHLB stock dividends	(1,985)	(2,028)
Purchase accounting	(2,093)	(2,534)
Section 481 adjustment-deferred fees	(105)	(150)
Deferred loan fees	(885)	- -
Unrealized gain on investment securities	(1,353)	(954)
Unrealized gain on cash flow hedging instruments	- -	(1,750)
Depreciation	(753)	(1,165)
Total deferred tax liabilities	<u>(7,174)</u>	<u>(8,581)</u>
Net deferred tax assets	<u>\$ 22,488</u>	<u>\$ 6,728</u>

A reconciliation of the Company’s effective income tax rate with the federal statutory tax rate is as follows:

	Years Ended December 31,					
	2008		2007		2006	
	Amount	Percent	Amount	Percent	Amount	Percent
	(in thousands)					
Income tax based on statutory rate	\$ 372	35%	\$ 15,447	35%	\$ 15,483	35%
Reduction resulting from:						
Tax credits	(725)	(68)%	(711)	(1)%	(566)	(1)%
Tax exempt instruments	(2,810)	(265)%	(2,631)	(6)%	(2,484)	(6)%
Life insurance proceeds	(940)	(89)%	- -	0%	- -	0%
Other nondeductible items	(803)	(76)%	(352)	(1)%	(300)	(1)%
Income tax provision (benefit)	<u>\$ (4,906)</u>	<u>(463)%</u>	<u>\$ 11,753</u>	<u>27%</u>	<u>\$ 12,133</u>	<u>27%</u>

The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, (“FIN 48”) on January 1, 2007. As of December 31, 2008, we had no unrecognized tax benefits. Our policy is to recognize interest and penalties on unrecognized tax benefits in “Provision for income taxes” in the Consolidated Statements of Income. There were no amounts related to interest and penalties recognized for the years ended December 31, 2008 and 2007. The tax years subject to examination by federal and state taxing authorities are the years ending December 31, 2007, 2006, and 2005.

15. Share-Based Payments

At December 31, 2008, the Company had one equity compensation plan (the “Plan”), which is shareholder approved, that provides for the granting of share options and shares to eligible employees and directors up to 2,191,482 shares.

Share Awards: Restricted share awards provide for the immediate issuance of shares of Company common stock to the recipient, with such shares held in escrow until certain service conditions are met, generally five years of continual service. Recipients of restricted shares do not pay any cash consideration to the Company for the shares, have the right to vote all shares subject to such grant, and receive all dividends with respect to such shares, whether or not the shares have vested. The fair value of share awards is equal to the fair market value of the Company’s common stock on the date of grant.

A summary of the status of the Company’s nonvested shares as of December 31, 2008, 2007 and 2006 is presented below:

	Shares	Weighted Average Grant- Date Fair Value
<u>Nonvested Shares</u>		
Nonvested at January 1, 2006	8,000	\$ 24.34
Granted	87,025	33.04
Vested	(6,000)	27.74
Forfeited	(5,850)	33.10
Nonvested at December 31, 2006	83,175	32.58
Granted	76,250	31.63
Vested	(6,500)	28.27
Forfeited	(9,600)	31.32
Nonvested at December 31, 2007	143,325	32.36
Granted	69,360	23.65
Vested	(13,065)	30.89
Forfeited	(8,300)	29.72
Nonvested at December 31, 2008	191,320	\$ 29.41

As of December 31, 2008, there was \$3.3 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted average period of 2.8 years. The total fair value of shares vested during the years ended December 31, 2008, 2007, and 2006 was \$404 thousand, \$184 thousand, and \$166 thousand, respectively.

Share Options: Option awards are generally granted with an exercise price equal to the market price of the Company’s stock at the date of grant; those option awards generally vest based on three years of continual service and are exercisable for a five-year period after vesting. Option awards granted have a 10-year maximum term.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model. The fair value of all options is amortized on a straight-line basis over the requisite service periods, which are generally the vesting periods. The expected life of options granted represents the period of time that they are expected to be outstanding. The expected life is determined based on historical experience with similar awards, giving consideration to the contractual terms and vesting schedules. Expected volatilities of our common stock are estimated at the date of grant based on the historical volatility of the stock. The volatility factor is based on historical stock prices over the most recent period commensurate with the estimated expected life of the award. The risk-free interest rate is based on the U.S. Treasury curve in effect at the time of the award. The expected dividend yield is based on dividend trends and the market value of the Company’s stock price at the time of the award.

Assumptions utilized in the Black-Scholes option valuation model and the resulting fair value for options granted during the years ended December 31, 2008, 2007 and 2006 are summarized as follows:

	For The Twelve Months Ended December 31,		
	2008	2007	2006
Expected Life (in years)	--	4.14	--
Expected Volatility	--	29.47%	--
Weighted Average Risk-free Interest Rate	--	4.53%	--
Expected Annual Dividend Yield	--	2.01%	--
Weighted Average Fair Value	--	\$ 15.61	--

A summary of option activity under the Plan as of December 31, 2008, and changes during the year then ended is presented below:

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (\$000)
Balance at December 31, 2007	331,868	\$ 14.77		
Granted	-	-		
Forfeited	(7,861)	20.87		
Expired	(13,341)	10.82		
Exercised	(108,685)	11.60		
Balance at December 31, 2008	201,981	\$ 16.49	3.3	\$ 110
Total Exercisable at December 31, 2008	201,981	\$ 16.49	3.3	\$ 110

The weighted average grant-date fair value of options granted during the years 2007 \$15.61. No options were granted in 2008 and 2006. The total intrinsic value of options exercised during the years ended December 31, 2008, 2007, and 2006 was \$1.2 million, \$3.3 million, and \$2.7 million, respectively.

As of December 31, 2008, outstanding stock options consist of the following:

Ranges of Exercise Prices	Number of Option Shares	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price of Option Shares	Number of Exercisable Option Shares	Weighted Average Exercise Price of Exercisable Option Shares
\$ 3.09 - 6.17	10,177	2.8	\$ 4.91	10,177	\$ 4.91
6.18 - 9.25	2,326	3.9	6.31	2,326	6.31
9.26 - 12.34	59,364	1.1	11.62	59,364	11.62
12.35 - 15.43	42,236	4.0	13.98	42,236	13.98
15.44 - 18.51	13,749	3.6	17.29	13,749	17.29
18.52 - 21.60	21,648	5.5	18.95	21,648	18.95
21.61 - 24.68	15,500	3.9	22.95	15,500	22.95
24.69 - 27.77	31,310	3.9	25.77	31,310	25.77
27.78 - 30.86	5,671	8.1	30.86	5,671	30.86
	201,981	3.3	\$ 16.49	201,981	\$ 16.49

It is the Company’s policy to issue new shares for share option exercises and share awards. The Company expenses awards of share options and shares on a straight-line basis over the related vesting term of the award. For the 12 months ended December 31, 2008 and 2007, the Company recognized pre-tax share-based compensation expense of \$1.3 million and \$974 thousand, respectively.

16. Regulatory Capital Requirements

The Company (on a consolidated basis) and its banking subsidy are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company and its subsidiaries’ financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and its banking subsidiaries must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification

are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and its banking subsidiaries to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital to risk-weighted assets (as defined in the regulations) and of Tier 1 capital to average assets (as defined in the regulations). Management believes, as of December 31, 2008 and 2007, that the Company and Columbia Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2008, the most recent notification from the Federal Deposit Insurance Corporation categorized Columbia Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk- based, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed Columbia Bank’s category. The Company and its banking subsidiary’s actual capital amounts and ratios as of December 31, 2008 and 2007, are also presented in the following table.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(dollars in thousands)						
As of December 31, 2008						
Total Capital (to risk-weighted assets):						
The Company	\$ 365,797	14.25%	\$ 205,388	8.0%	N/A	N/A
Columbia Bank	\$ 287,665	11.21%	\$ 205,202	8.0%	\$ 256,503	10.0%
Tier 1 Capital (to risk-weighted assets):						
The Company	\$ 333,568	12.99%	\$ 102,694	4.0%	N/A	N/A
Columbia Bank	\$ 255,464	9.96%	\$ 102,601	4.0%	\$ 153,902	6.0%
Tier 1 Capital (to average assets):						
The Company	\$ 333,568	11.27%	\$ 118,418	4.0%	N/A	N/A
Columbia Bank	\$ 255,464	8.64%	\$ 118,288	4.0%	\$ 147,860	5.0%
As of December 31, 2007						
Total Capital (to risk-weighted assets):						
The Company	\$ 285,606	10.90%	\$ 209,618	8.0%	N/A	N/A
Columbia Bank	\$ 257,753	10.49%	\$ 196,532	8.0%	\$ 245,665	10.0%
Tier 1 Capital (to risk-weighted assets):						
The Company	\$ 258,658	9.87%	\$ 104,809	4.0%	N/A	N/A
Columbia Bank	\$ 232,707	9.47%	\$ 98,266	4.0%	\$ 147,399	6.0%
Tier 1 Capital (to average assets):						
The Company	\$ 258,658	8.54%	\$ 121,122	4.0%	N/A	N/A
Columbia Bank	\$ 232,707	8.23%	\$ 113,056	4.0%	\$ 141,320	5.0%

17. Employee Benefit Plans

401(k) Plan

The Company maintains defined contribution and profit sharing plans in conformity with the provisions of section 401(k) of the Internal Revenue Code at Columbia Bank. The Columbia Bank 401(k) and Profit Sharing Plan (the “401(k) Plan”), permits eligible Columbia Bank employees, those who are at least 18 years of age and have completed six months of service, to contribute up to 75% of their eligible compensation to the 401(k) Plan. On a per pay period basis the Company is required to match 50% of employee contributions up to 3% of each employee’s eligible compensation. Additionally, as determined annually by the Board of Directors of the Company, the 401(k) Plan provides for a non-matching discretionary profit sharing contribution. The Company contributed \$818 thousand during 2008, \$811 thousand during 2007, and \$867 thousand during 2006, in matching funds to the 401(k) Plan. The Company’s discretionary profit sharing contributions were \$1.0 million during 2008, \$1.6 million during 2007 and \$1.2 million during 2006.

Employee Stock Purchase Plan

The Company maintains an “Employee Stock Purchase Plan” (the “ESP Plan”) in which substantially all employees of the Company are eligible to participate. The ESP Plan provides participants the opportunity to purchase common stock of the Company at a discounted price. Under the ESP Plan, participants can purchase common stock of the Company for 90% of the lowest price on either the first or last day in each of two six month look-back periods. The look-back periods are January 1st through June 30th and July 1st through December 31st of each calendar year. The 10% discount is recognized by the Company as compensation expense and does not have a material impact on net income or earnings per common share. Participants of the ESP Plan purchased 37,179 shares for \$568 thousand in 2008, 21,633 shares for \$634 thousand in 2007 and 18,952 shares for \$542 thousand in 2006. At December 31, 2008 there were 29,141 shares available for purchase under the ESP plan.

Supplemental Executive Retirement Plan

The Company maintains a supplemental executive retirement plan (the “SERP”), a nonqualified deferred compensation plan that provides retirement benefits to certain highly compensated executives. The SERP is unsecured and unfunded and there are no program assets. Associated with the SERP benefit is a death benefit for each participant’s beneficiary. Beneficiaries are entitled to a split dollar share of proceeds from life insurance policies purchased by the Company. The SERP projected benefit obligation, which represents the vested net present value of future payments to individuals under the plan is accrued over the estimated remaining term of employment of the participants and has been determined by actuarial valuation using Income Tax Regulation 1.72-9, “Table 1 Ordinary Life Annuities,” for the mortality assumptions and a discount rate of 5.75% in 2008 and 2007. Additional assumptions and features of the plan are a normal retirement age of 65 and a 2% annual cost of living benefit adjustment. The projected benefit obligation is included in other liabilities on the Consolidated Balance Sheets.

The following table reconciles the accumulated liability for the projected benefit obligation:

	December 31,	
	2008	2007
	(in thousands)	
Balance at beginning of year	\$ 7,912	\$ 4,182
Benefit expense	917	828
Established through acquisitions	- -	3,203
Benefit payments	(288)	(301)
Balance at end of year	<u>\$ 8,541</u>	<u>\$ 7,912</u>

The benefits expected to be paid in conjunction with the SERP are presented in the following table:

Years Ending December 31,	(in thousands)
2009	\$ 294
2010	380
2011	386
2012	392
2013	398
2014 through 2018	2,911
Total	<u>\$ 4,761</u>

2008 Life Insurance Replacement Policy Program

On January 1, 2008 we recognized the effects of applying the consensus in EITF 06-4 through a change in accounting principle with a cumulative-effect adjustment to retained earnings, net of tax, of approximately \$2.1 million and an increase in postretirement benefit liability of \$3.3 million. During 2008, the Company completed a life insurance replacement policy program in which the individuals participating in the split dollar life insurance arrangements agreed to terminate their postretirement split dollar life insurance benefits. In exchange, the Company purchased replacement life insurance policies for the covered individuals which offered comparable life insurance benefits but for which the Company ultimately receives 100% of the death benefit. The benefit of reversing the postretirement liability accrued under EITF 06-4 coupled with the expense associated with purchasing the replacement policies resulted in the Company recognizing in 2008 a one-time net increase in income before income taxes of approximately \$100 thousand.

18. Commitments and Contingent Liabilities

Lease Commitments: The Company leases locations as well as equipment under various non-cancelable operating leases that expire between 2009 and 2045. The majority of the leases contain renewal options and provisions for increases in rental rates based on an agreed upon index or predetermined escalation schedule. As of December 31, 2008, minimum future rental payments, exclusive of taxes and other charges, of these leases were:

<u>Years Ending December 31,</u>	<u>(in thousands)</u>
2009	\$ 3,371
2010	3,192
2011	3,041
2012	2,851
2013	2,764
Thereafter	8,839
Total minimum payments	<u>\$ 24,058</u>

Total rental expense on buildings and equipment, net of rental income of \$674 thousand, \$669 thousand, and \$768 thousand, was \$3.2 million, \$3.1 million, and \$2.8 million, for the years ended December 31, 2008, 2007, and 2006, respectively.

On September 30, 2004, the Company sold its Broadway and Longview locations. The Company maintains a substantial continuing involvement in the locations through various noncancellable operating leases that do not contain renewal options. The resulting gain on sale of \$1.3 million was deferred using the financing method in accordance with SFAS No. 13, “Accounting for Leases” and is being amortized over the life of the respective leases. At December 31, 2008 and 2007, the deferred gain was \$483 thousand and \$565 thousand, respectively, and is included in “other liabilities” on the Consolidated Balance Sheets.

Financial Instruments with Off-Balance Sheet Risk: In the normal course of business, the Company makes loan commitments (unfunded loans and unused lines of credit) and issues standby letters of credit to accommodate the financial needs of its customers.

Standby letters of credit commit the Company to make payments on behalf of customers under specified conditions. Historically, no significant losses have been incurred by the Company under standby letters of credit. Both arrangements have credit risk essentially the same as that involved in extending loans to customers and are subject to the Company’s normal credit policies, including collateral requirements, where appropriate. At December 31, 2008 and 2007, the Company’s loan commitments amounted to \$703.3 million and \$857.6 million, respectively. Standby letters of credit were \$41.9 million and \$33.6 million at December 31, 2008 and 2007, respectively. In addition, commitments under commercial letters of credit used to facilitate customers’ trade transactions amounted to \$362 thousand and \$1.1 million at December 31, 2008 and 2007, respectively.

Public Funds: The Company’s subsidiary bank is a public depository and, accordingly, accepts deposit funds belonging to, or held for the benefit of, Washington and Oregon states, political subdivisions thereof, municipal corporations, and other public funds. In accordance with applicable state law, in the event of default of one bank, all participating banks in the state collectively assure that no loss of funds is suffered by any public depositor. Generally, in the event of default by a public depository, the assessment attributable to all public depositories is allocated on a pro rata basis in proportion to the maximum liability of each public depository as it existed on the date of loss.

Legal Proceedings: The Company and its subsidiaries are from time to time defendants in and are threatened with various legal proceedings arising from their regular business activities. Management, after consulting with legal counsel, is of the opinion that the ultimate liability, if any, resulting from these pending or threatened actions and proceedings will not have a material effect on the financial statements of the Company.

In 2007 Visa, Inc. (“Visa”) completed a restructuring and issued shares of Visa Inc. Class B common stock to its financial institution members in contemplation of its initial public offering (“IPO”). After the restructuring, member financial institutions became guarantors of certain of Visa’s litigation liabilities (“covered litigation”) based upon their proportionate share of the membership base. Also in 2007, Visa announced that it had reached a settlement in the amount of \$2.07 billion to resolve certain restraint of trade litigation brought by American Express. Accordingly, in 2007, the Company recognized a pre-tax charge of approximately \$1.8 million related to the American Express settlement and the remaining covered litigation. This charge was included in the legal and professional services line item of the 2007 consolidated statement of income.

In March 2008 Visa completed its initial public offering and subsequently funded a litigation escrow account with \$3.0 billion from its IPO proceeds. In November 2008, Visa announced that it had reached a settlement in the amount of \$1.89 billion, \$1.74 billion to be funded from the escrow account, to settle covered litigation with Discover Financial Services. In December 2008, Visa deposited an additional \$1.1 billion into the litigation escrow account. As a result of the settlements with Discover Financial Services and American Express and based on the Company’s Visa USA membership percentage, the Company recognized a reversal of previously accrued legal expense of \$1.3 million. This reversal is included in the legal and professional services line item of the consolidate statements of income. At December 31, 2008 the Company’s remaining reserve for covered litigation was \$485 thousand and we held approximately 73 thousand Class B shares. When Visa funds the litigation escrow account, the Company, and other Visa financial institution members, bears the expense via a reduction of the as converted Class B share count. The Company anticipates the value of its remaining unredeemed Class B Visa common shares will more than offset its liabilities related to the remaining covered litigation.

19. 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.

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 December 31, 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:

	Fair value at December 31, 2008	Fair Value Measurements at Reporting Date Using		
		Level 1	Level 2	Level 3
		(in thousands)		
Assets				
Securities available for sale	\$ 528,918	\$ 488	\$ 528,430	\$ - -
Interest rate swap agreements	\$ 14,933	\$ - -	\$ 14,933	\$ - -
Liabilities				
Interest rate swap agreements	\$ 14,933	\$ - -	\$ 14,933	\$ - -

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 if the loan is collateral dependent.

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 presents the carrying value of certain financial and nonfinancial assets by level within the fair value hierarchy as of December 31, 2008, for which a nonrecurring change in fair value has been recorded during the year ended December 31, 2008:

	Fair value at December 31, 2008	Fair Value Measurements at Reporting Date Using		
		Level 1	Level 2	Level 3
		(in thousands)		
Impaired loans	\$ 7,121	\$ - -	\$ - -	\$ 7,121
Other real estate owned	2,426	- -	- -	2,426
	<u>\$ 9,547</u>	<u>\$ - -</u>	<u>\$ - -</u>	<u>\$ 9,547</u>

In accordance with Statement of Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan*, impaired loans, with carrying amounts of \$8.3 million had specific valuation allowances totaling \$1.2 million, which were included in the allowance for loan and lease losses.

Other real estate owned with a carrying amount of \$2.6 million was acquired during the year ended December 31, 2008. 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 \$2.4 million, less cost to sell of \$270 thousand (or \$2.2 million), resulting in a loss of \$434 thousand, which was charged to the allowance for loan and lease losses during the period.

20. Fair Value of Financial Instruments

The following table summarizes carrying amounts and estimated fair values of selected financial instruments as well as assumptions used by the Company in estimating fair value:

		December 31,			
		2008		2007	
	Assumptions Used in Estimating Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(in thousands)					
Assets					
Cash and due from banks	Approximately equal to carrying value	\$ 84,787	\$ 84,787	\$ 82,735	\$ 82,735
Interest-earning deposits with banks	Approximately equal to carrying value	3,943	3,943	11,240	11,240
Securities available for sale	Quoted market prices, discounted expected future cash flows	528,918	528,918	561,366	561,366
Loans held for sale	Approximately equal to carrying value	1,964	1,964	4,482	4,482
Loans	2008: Comparable market statistics				
	2007: Discounted expected future cash flows, net of ALLL	2,189,585	2,023,405	2,256,129	2,275,949
Liabilities					
Deposits	Fixed-rate certificates of deposit: Discounted expected future cash flows				
	All other deposits: Approximately equal to carrying value	\$2,382,151	\$2,390,024	\$2,498,061	\$2,499,331
Federal Home Loan Bank and Federal Reserve Bank borrowings	Discounted expected future cash flows	200,000	203,898	257,670	257,535
Repurchase agreements	Discounted expected future cash flows	25,000	25,055	--	--
Other borrowings	Approximately equal to carrying value	201	201	5,061	5,061
Long-term obligations	2008: Discounted expected future cash flows				
	2007: Approximately equal to carrying value	25,603	14,813	25,519	25,519

Off-Balance-Sheet Financial Instruments: The fair value of commitments, guarantees, and letters of credit at December 31, 2008 and 2007, approximates the recorded amounts of the related fees, which are not material. The fair value is estimated based upon fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed rate commitments, the fair value estimation takes into consideration an interest rate risk factor. The fair value of guarantees and letters of credit is based on fees currently charged for similar agreements.

21. Derivatives and Hedging Activities

Termination of Hedging Activities: On January 7, 2008, the Company discontinued its three prime rate floor derivative instruments that were previously utilized to hedge the variable cash flows associated with existing variable-rate loan assets based on the prime rate. The Company received \$8.1 million as a result of the termination transaction resulting in a net derivative gain of \$6.2 million. The interest rate floors had an original

maturity date of April 4, 2011. In accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (“SFAS 133”), as amended and interpreted, the net derivative gain related to a discontinued cash flow hedge continues to be reported in accumulated other comprehensive income and is reclassified into earnings in the same periods during which the originally hedged forecasted transactions affect earnings. For the year ended December 31, 2008, \$1.7 million of the net derivative gain was reclassified into earnings. For the year ended December 31, 2009, the Company estimates that \$2.4 million of the net derivative gain will be reclassified from accumulated other comprehensive income into interest income.

Customer Derivatives: The Company periodically enters into certain commercial loan interest rate swap agreements in order to provide commercial loan customers the ability to convert from variable to fixed interest rates. Under these agreements, the Company enters into a variable-rate loan agreement with a customer in addition to a swap agreement. This swap agreement effectively converts the customer’s variable rate loan into a fixed rate. The Company then enters into a corresponding swap agreement with a third party in order to offset its exposure on the variable and fixed components of the customer agreement. At December 31, 2008, the notional amount of such arrangements was \$114.9 million and investment securities with a fair value of \$16.4 million were pledged as collateral to the third parties. As the interest rate swap agreements with the customers and third parties are not designated as hedges under SFAS 133, the instruments are marked to market in earnings.

22. Business Segment Information

The Company is managed along two major lines of business within the Columbia Bank banking subsidiary: 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 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.

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.

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 year is not directly comparable to the same line item for the prior years as those prior years 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:

Condensed Statement of Operations				
	Year Ended December 31, 2008			
	Commercial Banking	Retail Banking	Other	Total
		(in thousands)		
Net interest income	\$ 47,461	\$ 55,411	\$ 16,641	\$ 119,513
Provision for loan and lease losses	--	--	(41,176)	(41,176)
Net interest income after provision for loan and lease losses	47,461	55,411	(24,535)	78,337
Noninterest income	3,624	9,089	2,137	14,850
Noninterest expense	(22,587)	(41,679)	(27,859)	(92,125)
Income (loss) before income taxes	28,498	22,821	(50,257)	1,062
Income tax benefit				4,906
Net income				\$ 5,968
Total assets	\$1,443,029	\$1,000,209	\$ 653,841	\$3,097,079
	Year Ended December 31, 2007			
	Commercial Banking	Retail Banking	Other	Total
		(in thousands)		
Net interest income	\$ 30,062	\$ 82,306	\$ (3,548)	\$ 108,820
Provision for loan and lease losses			(3,605)	(3,605)
Net interest income after provision for loan and lease losses	30,062	82,306	(7,153)	105,215
Noninterest income	3,192	8,571	15,985	27,748
Noninterest expense	(11,582)	(28,181)	(49,066)	(88,829)
Income (loss) before income taxes	21,672	62,696	(40,234)	44,134
Income tax provision				(11,753)
Net income				\$ 32,381
Total assets	\$1,474,678	\$1,068,282	\$ 635,753	\$3,178,713
	Year Ended December 31, 2006			
	Commercial Banking	Retail Banking	Other	Total
		(in thousands)		
Net interest income	\$ 22,870	\$ 79,366	\$ (4,473)	\$ 97,763
Provision for loan and lease losses			(2,065)	(2,065)
Net interest income after provision for loan and lease losses	22,870	79,366	(6,538)	95,698
Noninterest income	2,076	7,700	14,896	24,672
Noninterest expense	(10,197)	(25,642)	(40,295)	(76,134)
Income (loss) before income taxes	14,749	61,424	(31,937)	44,236
Income tax provision				(12,133)
Net income				\$ 32,103
Total assets	\$1,204,269	\$ 682,029	\$ 666,833	\$2,553,131
23. Preferred Stock and Warrant				
On November 21, 2008, the Company entered into a Securities Purchase Agreement-Standard Terms with the U.S. Department of Treasury (the “Treasury”) pursuant to which the Company sold to the Treasury for an aggregate purchase price of \$76.9 million, 76,898 shares of Fixed Rate Cumulative Perpetual Preferred Stock Series A (the “Preferred Stock”) and a warrant to purchase 796,046 shares of common stock (the “Warrant”) as part of the Treasury’s previously announced Troubled Asset Relief Program Capital Purchase Program.				
The Preferred Stock is non-voting, has an aggregate liquidation preference of \$76.9 million and an annual dividend rate of 5% for the first five years, and 9% thereafter. Dividends are cumulative and payable quarterly. The Preferred Stock may not be redeemed for a period of three years from the date of issue, except with the proceeds from the issuance of Tier 1-qualifying perpetual preferred or common stock from which the aggregate gross proceeds to the Company are not less than 25% of the issue price of the Preferred Stock. The Preferred Stock ranks senior to common shares both as to dividend and liquidation preferences. In addition, the Company is subject to the following restrictions:				
Restrictions on Dividends				
For as long as the Preferred Stock is outstanding, the Company may not declare or pay dividends on, or redeem, repurchase, or otherwise acquire shares of its common stock unless all accrued and unpaid dividends on the Preferred Stock are fully paid.				
Increase in Common Dividends				
The Treasury’s consent is required for any increase in common dividends per share until the third anniversary of the issue date unless the Preferred Stock is redeemed in whole prior to the third anniversary or the Treasury has transferred all of the Preferred Stock to third parties.				
Repurchases				
The Treasury’s consent is required for any share repurchases, with certain limited exceptions, until the third anniversary of the date of issue unless the Preferred Stock is redeemed in whole prior to the third anniversary or the Treasury has transferred all of the Preferred Stock to third parties.				
The Warrant has a term of 10 years and is exercisable at any time, in whole or in part, at an exercise price of \$14.49 per share. The Treasury may not exercise the Warrant for, or transfer the Warrant with respect to, more than half of the initial shares of common stock underlying the Warrant prior to the earlier of (i) the date on which the Company receives aggregate gross proceeds of not less than \$76.9 million from one or more Qualified Equity Offerings and (ii) December 31, 2009. The number of shares to be delivered upon settlement of the Warrant will be reduced by 50% if the Company receives aggregate gross proceeds of at least 100% of the aggregate Liquidation Preference of the Preferred Stock from one or more Qualified Equity Offerings prior to December 31, 2009.				

The \$76.9 million in proceeds was allocated to the Preferred Stock and the Warrant based on their relative fair values at issuance (approximately \$73.7 million was allocated to the Preferred Stock and approximately \$3.2 million to the Warrant). The difference between the initial value allocated to the Preferred Stock of approximately \$73.7 million and the liquidation value of \$76.9 million will be charged to retained earnings over the first five years of the contract as an adjustment to the dividend yield using the effective yield method. The amount charged to retained earnings will be deducted from the numerator in calculating basic and diluted earnings per share during the related reporting period (see note 2).

24. Parent Company Financial Information

Condensed Statements of Income—Parent Company Only			
	Years Ended December 31,		
	2008	2007	2006
	(in thousands)		
Income			
Dividend from banking subsidiaries	\$ 3,380	\$ 4,475	\$ 17,200
Interest on securities available for sale	--	--	53
Interest-earning deposits	369	590	435
Other income	54	64	79
Total Income	3,803	5,129	17,767
Expense			
Compensation and employee benefits	754	451	436
Long-term obligations	1,800	2,177	1,992
Other expense	1,435	948	889
Total Expenses	3,989	3,576	3,317
Income (loss) before income tax benefit and equity in undistributed net income of subsidiaries	(186)	1,553	14,450
Income tax benefit	(1,205)	(1,031)	(1,070)
Income before equity in undistributed net income of subsidiaries	1,019	2,584	15,520
Equity in undistributed net income of subsidiaries	4,949	29,797	16,583
Net Income	\$ 5,968	\$ 32,381	\$ 32,103

Condensed Balance Sheets—Parent Company Only			
	December 31,		
	2008	2007	
	(in thousands)		
Assets			
Cash and due from banking subsidiaries	\$ 797	\$ 1,663	
Interest-earning deposits	76,068	9,286	
Total cash and cash equivalents	76,865	10,949	
Investment in banking subsidiaries	362,274	359,084	
Investment in other subsidiaries	774	774	
Other assets	2,273	2,337	
Total Assets	\$ 442,186	\$ 373,144	
Liabilities and Shareholders' Equity			
Long-term subordinated debt	\$ 25,603	\$ 25,519	
Other borrowings	100	5,000	
Other liabilities	1,098	894	
Total liabilities	26,801	31,413	
Shareholders' equity	415,385	341,731	
Total Liabilities and Shareholders' Equity	\$ 442,186	\$ 373,144	

Condensed Statements of Cash Flows—Parent Company Only

	Years Ended December 31,		
	2008	2007	2006
	(in thousands)		
Operating Activities			
Net Income	\$ 5,968	\$ 32,381	\$ 32,103
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed earnings of subsidiaries	(4,949)	(29,797)	(16,583)
Stock-based compensation expense	399	94	185
Net changes in other assets and liabilities	874	(27)	523
Net cash provided by operating activities	2,292	2,651	16,228
Investing Activities			
Proceeds from maturities of securities available for sale	- -	- -	5,000
Acquisition of subsidiaries	- -	(2,497)	- -
Net cash provided by (used in) investing activities	- -	(2,497)	5,000
Financing Activities			
Net increase (decrease) in short-term borrowings	(4,900)	5,000	(2,500)
Cash dividends paid	(10,491)	(11,249)	(9,117)
Proceeds from issuance of preferred stock, net	76,868		
Proceeds from issuance of common stock, net	1,906	2,836	2,090
Excess tax benefit from stock-based compensation	241	979	907
Purchase and retirement of common stock	- -	(2,121)	-
Net cash provided by (used in) financing activities	63,624	(4,555)	(8,620)
Increase (decrease) in cash and cash equivalents	65,916	(4,401)	12,608
Cash and cash equivalents at beginning of year	10,949	15,350	2,742
Cash and cash equivalents at end of year	\$ 76,865	\$ 10,949	\$ 15,350
Supplemental Non-Cash Investing and Financing Activities			
Issuance of stock in acquisitions	\$ - -	\$ 57,119	\$ - -

Quarterly financial information for the years ended December 31, 2008 and 2007 is summarized as follows:

	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>	<u>Year Ended December 31,</u>
	(in thousands, except per share amounts)				
2008					
Total interest income	\$ 48,433	\$ 44,323	\$ 42,337	\$ 39,967	\$ 175,060
Total interest expense	<u>18,106</u>	<u>14,049</u>	<u>12,744</u>	<u>10,648</u>	<u>55,547</u>
Net interest income	30,327	30,274	29,593	29,319	119,513
Provision for loan and lease losses	2,076	15,350	10,500	13,250	41,176
Noninterest income	10,157	9,305	(10,946)	6,334	14,850
Noninterest expense	<u>23,554</u>	<u>23,367</u>	<u>23,391</u>	<u>21,813</u>	<u>92,125</u>
Income (loss) before income taxes	14,854	862	(15,244)	590	1,062
Provision(benefit) for income taxes	<u>3,877</u>	<u>(1,074)</u>	<u>(6,485)</u>	<u>(1,224)</u>	<u>(4,906)</u>
Net Income (Loss)	<u>\$ 10,977</u>	<u>\$ 1,936</u>	<u>\$ (8,759)</u>	<u>\$ 1,814</u>	<u>\$ 5,968</u>
Net Income (Loss) Per Common Share:					
Basic	\$ 0.61	\$ 0.11	\$ (0.49)	\$ 0.07	\$ 0.31
Diluted	\$ 0.61	\$ 0.11	\$ (0.49)	\$ 0.07	\$ 0.31
2007					
Total interest income	\$ 41,146	\$ 43,255	\$ 49,378	\$ 50,438	\$ 184,217
Total interest expense	<u>16,443</u>	<u>17,560</u>	<u>20,518</u>	<u>20,876</u>	<u>75,397</u>
Net interest income	24,703	25,695	28,860	29,562	108,820
Provision for loan and lease losses	638	329	1,231	1,407	3,605
Noninterest income	6,177	6,741	7,631	7,199	27,748
Noninterest expense	<u>20,402</u>	<u>20,266</u>	<u>22,425</u>	<u>25,736</u>	<u>88,829</u>
Income before income taxes	9,840	11,841	12,835	9,618	44,134
Provision for income taxes	<u>2,557</u>	<u>3,297</u>	<u>3,579</u>	<u>2,320</u>	<u>11,753</u>
Net Income	<u>\$ 7,283</u>	<u>\$ 8,544</u>	<u>\$ 9,256</u>	<u>\$ 7,298</u>	<u>\$ 32,381</u>
Net Income Per Common Share:					
Basic	\$ 0.45	\$ 0.53	\$ 0.53	\$ 0.41	\$ 1.93
Diluted	\$ 0.45	\$ 0.53	\$ 0.53	\$ 0.41	\$ 1.91

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

ITEM 9A. 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.

Internal Control Over Financial Reporting

Management’s Annual Report On Internal Control Over Financial Reporting

The Company’s management is responsible for establishing and maintaining adequate internal control over financial reporting, the internal control system has been designed to provide reasonable assurance to the Company’s management and Board of Directors regarding the preparation and fair presentation of the Company’s published financial statements.

Reasonable assurance includes the understanding that there is a remote likelihood that material misstatements will not be prevented or detected on a timely basis.

Management has evaluated the effectiveness of its internal control over financial reporting as of December 31, 2008 based on the control criteria established in a report entitled *Internal Control-Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on such evaluation, management has concluded that the Company’s internal control over financial reporting is effective as of December 31, 2008.

Our independent registered public accounting firm has issued an attestation report our internal control over financial reporting, which appears in this annual report on Form 10K.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Columbia Banking System, Inc.
Tacoma, Washington

We have audited the internal control over financial reporting of Columbia Banking System, Inc. and its subsidiaries (the "Company") as of December 31, 2008, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Because management's assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), management's assessment and our audit of the Company's internal control over financial reporting included controls over the preparation of the schedules equivalent to the basic financial statements in accordance with the instructions for the Consolidated Reports of Condition and Income for Schedules RC, RI, and RI-A. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report On Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles"). A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have not examined and, accordingly, we do not express an opinion or any other form of assurance on management's statement referring to compliance with laws and regulations.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2008 of the Company and our report dated February 27, 2009 expressed an unqualified opinion on those financial statements.

Deloitte & Touche LLP

Seattle, Washington
February, 27 2009

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Information regarding “Directors, Executive Officers and Corporate Governance” is set forth under the headings “Proposal: Election of Directors”, “Management—Executive Officers Who are Not Directors” and “Corporate Governance” in the Company’s 2009 Annual Proxy Statement (“Proxy Statement”) and is incorporated herein by reference.

Information regarding “Compliance with Section 16(a) of the Exchange Act” is set forth under the section “Section 16(a) Beneficial Ownership Reporting Compliance” of the Company’s Proxy Statement and is incorporated herein by reference. Information regarding the Company’s audit committee financial expert is set forth under the heading “Board Structure and Compensation—What Committees has the Board Established” in our Proxy Statement and is incorporated by reference.

On February 25, 2004, consistent with the requirements of the Sarbanes-Oxley Act of 2002, the Company adopted a Code of Ethics applicable to senior financial officers including the principal executive officer. The Code of Ethics was filed as Exhibit 14 to our 2003 Form 10-K Annual Report and can be accessed electronically by visiting the Company’s website at www.columbiabank.com.

ITEM 11. EXECUTIVE COMPENSATION

Information regarding “Executive Compensation” is set forth under the headings “Board Structure and Compensation” and “Executive Compensation” of the Company’s Proxy Statement and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information regarding “Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters” is set forth under the heading “Stock Ownership” of the Company’s Proxy Statement and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information regarding “Certain Relationships and Related Transactions, and Director Independence” is set forth under the headings “Interest of Management in Certain Transactions” and “Corporate Governance—Director Independence” of the Company’s Proxy Statement and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information regarding “Principal Accounting Fees and Services” is set forth under the heading “Independent Public Accountants” of the Company’s Proxy Statement and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements:

The Consolidated Financial Statements and related documents set forth in “Item 8. Financial Statements and Supplementary Data” of this report are filed as part of this report.

(2) Financial Statements Schedules:

All other schedules to the Consolidated Financial Statements required by Regulation S-X are omitted because they are not applicable, not material or because the information is included in the Consolidated Financial Statements and related notes in “Item 8. Financial Statements and Supplementary Data” of this report.

(3) Exhibits:

The response to this portion of Item 15 is submitted as a separate section of this report appearing immediately following the signature page and entitled “Index to Exhibits.”

COLUMBIA BANKING SYSTEM, INC.
(Registrant)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated, on the 27th day of February 2009.

By: /s/ CLINT E. STEIN
Clint E. Stein
Senior Vice President and Chief
Accounting Officer

[John P. Folsom]
[Frederick M. Goldberg]
[Thomas M. Hulbert]
[Thomas L. Matson]
[Daniel C. Regis]

[Donald Rodman]
[William T. Weyerhaeuser]
[James M. Will]

February 27, 2009

INDEX TO EXHIBITS

<u>Exhibit No.</u>	
3.1	Amended and Restated Articles of Incorporation
3.2	Amended and Restated Bylaws
4.1	Specimen of common stock certificate ⁽¹⁾
4.2	Form of Series A Preferred Stock Certificate, together with Certificate of Designations ⁽¹⁾
4.3	Pursuant to Item 601(b) (4) (iii) (A) of Regulation S-K, copies of instruments defining the rights of holders of long-term debt and preferred securities are not filed. The Company agrees to furnish a copy thereof to the Securities and Exchange Commission upon request
4.4	Warrant to Purchase Common Stock of Columbia ⁽²⁾
10.1	Amended and Restated Stock Option and Equity Compensation Plan ⁽³⁾
10.2	Form of Stock Option Agreement ⁽⁴⁾
10.3	Form of Restricted Stock Agreement ⁽⁴⁾
10.4	Form of Stock Appreciation Right Agreement ⁽⁴⁾
10.5	Form of Restricted Stock Unit Agreement ⁽⁴⁾
10.6	Amended and Restated Employee Stock Purchase Plan ⁽⁵⁾
10.7	Office Lease, dated as of December 15, 1999, between the Company and Haub Brothers Enterprises Trust ⁽⁶⁾
10.8	Employment Agreement between the Bank, the Company and Melanie J. Dressel effective August 1, 2004 ⁽⁷⁾
10.9	Severance Agreement between the Company and Mr. Gary R. Schminkey effective November 15, 2005 ⁽⁸⁾
10.10	Form of Change in Control Agreement between the Bank , and Mr. Mark W. Nelson and Mr. Andrew McDonald ⁽⁴⁾
10.11	Form of Long-Term Care Agreement between the Bank, the Company, and each of the following directors: Mr. Folsom, Mr. Hulbert, Mr. Matson, Mr. Rodman, Mr. Weyerhaeuser and Mr. Will ⁽⁹⁾
10.12	Form of Supplemental Executive Retirement Plan between Columbia Banking System, Inc., Columbia State Bank, its wholly owned banking subsidiary, and each of the following executive officers effective August 1, 2001: Melanie J. Dressel and Gary R. Schminkey, and for Mark W. Nelson, whose agreement is effective July 1, 2003 ⁽⁹⁾
10.13	Deferred Compensation Plan (401 Plus Plan) dated December 17, 2003 for directors and key employees ⁽¹⁰⁾
10.14	Change in Control Agreement between the Bank and Mr. Kent L. Roberts dated December 4, 2006 ⁽¹¹⁾
10.15	Form of Supplemental Compensation Agreement between the Bank and Mr. Andrew McDonald ⁽⁴⁾
10.16	Town Center Bancorp 2004 Stock Incentive Plan ⁽¹²⁾
10.17	Town Center Bancorp Form of Restricted Stock Award Agreement ⁽¹²⁾
10.18	Mountain Bank Holding Company Director Stock Option Plan ⁽¹³⁾
10.19	Mountain Bank Holding Company Form of Non-employee Director Stock Option Agreement ⁽¹³⁾

<u>Exhibit No.</u>	
10.20	Mountain Bank Holding Company 1999 Employee Stock Option Plan ⁽¹³⁾
10.21	Mountain Bank Holding Company Form of Employee Stock Option Agreement ⁽¹³⁾
10.22	Mt. Rainier National Bank 1990 Stock Option Plan ⁽¹³⁾
10.23	Letter Agreement with Treasury, including Securities Purchase Agreement ⁽²⁾
10.24	Form of Supplemental Compensation Agreement ⁽⁴⁾
10.25	Amendment to Employment Agreement between the Bank, the Company and Melanie J. Dressel effective February 1, 2009 ⁽¹⁴⁾
14	Code of Ethics ⁽¹²⁾
21	Subsidiaries of the Company
23	Consent of Deloitte & Touche LLP
24	Power of Attorney
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 Filed Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Incorporated by reference to Exhibit 4.3 and 4.4 of the Company’s S-3 Registration Statement (File No. 333-156350) filed December 19, 2008

(2) Incorporated by reference to Exhibits 4.1 and 10.2 of the Company’s Current Report on Form 8-K filed November 21, 2008

(3) Incorporated by reference to Exhibit 99.1 of the Company’s S-8 Registration Statement (File No. 333-125298) filed May 27, 2005

(4) Incorporated by reference to Exhibits 10.2 - 10.5 of the Company’s Annual Report on Form 10-K for the year ended December 31, 2007

(5) Incorporated by reference to Exhibit 99.1 of the Company’s S-8 Registration Statement (File No. 333-135439) filed June 29, 2006

(6) Incorporated by reference to Exhibit 10.5 of the Company’s Annual Report on Form 10-K for the year ended December 31, 2000

(7) Incorporated by reference to Exhibit 10.2 of the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2004

(8) Incorporate by reference to Exhibit 10.11 of the Company’s Annual Report on Form 10-K for the year ended December 31, 2005

(9) Incorporated by reference to Exhibits 10.1—10.3 of the Company’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2001

(10) Incorporated by reference to Exhibits 10.18 and 14 of the Company’s Annual Report on Form 10-K for the year ended December 31, 2003

(11) Incorporated by reference to Exhibit 10.1 of the Company’s Quarterly Report on Form 10-Q for the quarter ended March 31, 2007

(12) Incorporated by reference to Exhibits 10.1 and 10.2 of the Company’s S-8 Registration Statement (File No. 333-145207) filed August 7, 2007

(13) Incorporated by reference to Exhibits 99.1—99.5 of the Company’s S-8 Registration Statement (File No. 333-144811) filed July 24, 2007

(14) Incorporated by reference to Exhibit 10.1 of the Company’s Current Report on Form 8-K filed February 16, 2009

Section 2: EX-3.1 (AMENDED AND RESTATED ARTICLES OF INCORPORATION)

EXHIBIT 3.1

AMENDED AND RESTATED ARTICLES OF INCORPORATION
OF
COLUMBIA BANKING SYSTEM, INC.

The undersigned, being the Secretary of Columbia Banking System, Inc., executes in duplicate the following Amended and Restated Articles of Incorporation for the corporation.

ARTICLE 1

Section 1.1 The name of the corporation shall be COLUMBIA BANKING SYSTEM, INC.

ARTICLE 2

Section 2.1 The corporation’s period of duration shall be perpetual.

ARTICLE 3

Section 3.1 The purpose for which the corporation is organized is the transaction of any and all lawful business for which corporations may be incorporated under the Washington Business Corporation Act.

ARTICLE 4

Section 4.1 The aggregate number of shares which the corporation shall have authority to issue is 63,032,681 common shares with no par value (hereinafter referred to as “the common stock”) and 2,000,000 preferred shares with no par value (hereinafter referred to as “the preferred stock”). The preferred stock is senior to the common stock, and the common stock is subject to the rights and preferences of the preferred stock as provided in the following section.

Section 4.2 The board of directors is hereby vested with authority to divide any or all of the preferred stock into one or more series and, within the limitations set forth in the Washington Business Corporation Act (as amended from time to time), to fix and determine or to amend the relative rights and preferences of the shares of any series so established.

Section 4.3 Fixed Rate Cumulative Perpetual Preferred Stock, Series A. There is hereby created out of the authorized and unissued shares of preferred stock of the corporation a series of preferred stock designated as the “Fixed Rate Cumulative Perpetual Preferred Stock, Series A” (the “**Designated Preferred Stock**”), which series shall have no par value per share and shall have such rights, voting and other powers, preferences and relative, participating, optional or other rights, and the qualifications, limitations and restrictions thereof, of the shares of such series as set forth on the Certificate of Designations attached to these Articles of Incorporation and incorporated herein. The authorized number of shares of Designated Preferred Stock shall be 76,898.

ARTICLE 5

Section 5.1 No shareholder shall have the preemptive right to acquire unissued shares of the corporation.

ARTICLE 6

Section 6.1 Each shareholder entitled to vote at any election for directors shall have the right to vote, in person or by proxy, the number of shares owned by him for as many persons as there are directors to be elected and for whose election he has a right to vote, and no shareholder shall be entitled to cumulate his votes.

ARTICLE 7

Section 7.1 The corporation reserves the right to amend, alter, change or repeal any provision of its Articles of Incorporation to the extent permitted by the laws of the State of Washington. All rights of shareholders are granted subject to this reservation.

ARTICLE 8

Section 8.1 The corporation may enter into a contract and otherwise transact business as vendor, purchaser, or otherwise, with its directors, officers and shareholders, and with corporations, associations, firms and entities in which they are or may become interested as directors, officers, shareholders, members or otherwise, as freely as though such adverse interest did not exist, even though the vote, action or presence of such director, officer or shareholder may be necessary to obligate the corporation upon such contract or transaction; and in the absence of fraud, no such contract or transaction shall be avoided and no such director, officer or shareholder shall be held liable to account to the corporation, by reason of such adverse interest or any fiduciary relationship to the corporation arising out of such office or stock ownership, for any profit or benefit realized by him through any such contract or transaction; provided that the nature of the interest of such director, officer or shareholder, though not necessarily the details or extent thereof, be disclosed or known to the board of directors or shareholders of the corporation, at the meeting thereof at which such contract or transaction is authorized or confirmed. A general notice that a director, officer or shareholder of the corporation is interested in any corporation, association, firm or entity shall be sufficient disclosure as to such director, officer or shareholder with respect to all contracts and transactions with that corporation, association, firm or entity.

ARTICLE 9

Section 9.1 In addition to the requirements of any applicable statute, and notwithstanding any other provisions of any other articles of these Articles of Incorporation, the affirmative vote of not less than 66 2/3% of the total shares attributable to persons other than a Control Person (as defined below), considered for the purposes of this Article 9 as one class, which are entitled to be voted in an election of directors shall be required for the approval of any Business Combination (as defined below) between the corporation and any Control Person.

Section 9.2 The approval requirements of Section 9.1 shall not apply if either:

- (a) The Business Combination is approved by at least a majority of Continuing Directors (as defined below) of the corporation;
- or
- (b) All the following conditions are satisfied:

(i) The cash or fair market value of the property, securities or other consideration to be received per share in the Business Combination by holders of the common stock of the corporation is not less than the higher of: (A) the highest price per share (including brokerage commissions, soliciting dealers, fees and dealer-management compensation) paid by such Control Person in acquiring any of its holdings of the corporation’s common stock; (B) the highest per share market price of the common stock during the three-month period immediately preceding the date of the proxy statement described in (iii) below; or (C) the per share value of the common stock at the end of the fiscal quarter immediately prior to the Business Combination, as determined by an appraisal prepared by persons, selected by the Continuing Directors, who are independent of the corporation and the Control Person, and who are experienced and expert in the area of corporate appraisal.

(ii) After becoming a Control Person and prior to the consummation of such Business Combination (A) such Control Person shall not have acquired any newly issued shares of capital stock, directly or indirectly, from the corporation (except upon conversion of convertible securities acquired by it prior to becoming a Control Person or upon compliance with the provisions of this Article 9 or as a result of a pro rata stock dividend or stock split), and (B) such Control Person shall not have received the benefit, directly or indirectly (except proportionately as a stockholder), of any loans, advances, guarantees, pledges or other financial assistance or tax credits provided by the corporation, or made any major changes in the corporation’s business or equity capital structure; and

(iii) A proxy statement responsive to the requirements of the Securities Exchange Act of 1934, whether or not the corporation is then subject to such requirements, shall be mailed to the public stockholders of the corporation for the purpose of soliciting stockholder approval of such Business Combination.

Section 9.3 For the purpose of this Article 9

(a) The term “Business Combination” shall mean (i) any merger or consolidation of the corporation with or into a Control Person, (ii) any sale, lease, exchange, transfer or other disposition, including without limitation a mortgage or any other security device, of all or any Substantial Part (as defined below) of the assets of the corporation (including without limitation any voting securities of a subsidiary) or of a subsidiary, to a Control Person, (iii) any merger or consolidation of a Control Person with or into the corporation or a subsidiary of the corporation, (iv) any sale, lease, exchange, transfer or other disposition of all or any Substantial Part of the assets of a Control Person to the corporation or a subsidiary of the corporation, (v) the issuance of any securities of the corporation or a subsidiary of the corporation to a Control Person, (vi) the acquisition by the corporation or a subsidiary of the corporation of any securities of a Control Person, (vii) any reclassification of common stock of the corporation, or any recapitalization

involving common stock of the corporation, consummated within five years after a Control Person becomes a Control Person, or (viii) any agreement, contract or other arrangement providing for any of the transactions described in this definition of Business Combination;

(b) The term “Continuing Director” shall mean (i) a director who was a member of the board of directors of the corporation immediately prior to the time that a Control Person became the beneficial owner (as this term is defined in Rule 13d-3 of the General Rules and Regulations under the Securities Exchange Act of 1934 on the date on which this amendment becomes effective) of 10% or more of the outstanding shares of common stock of the corporation or (ii) a person so designated before initially becoming a director by a majority of the then Continuing Directors.

(c) The term “Control Person” shall mean and include any individual, corporation, partnership or other person or entity which, together with their Affiliates and Associates (as those terms are defined on the date on which this amendment becomes effective in Rule 12b-2 of the General Rules and Regulations under the Securities Exchange Act of 1934) is the beneficial owner in the aggregate of 20% or more of the outstanding shares of common stock of the corporation, and any Affiliate or Associate of any such individual, corporation, partnership or other person or entity;

(d) The term “Substantial Part” shall mean more than 10% of the total assets of the corporation in question, as of the end of its most recent fiscal year prior to the time the determination is being made;

(e) Without limitation, any shares of common stock of the corporation which any Control Person has the right to acquire at any time pursuant to any agreement, or upon exercise of conversion rights, warrants or options, or otherwise, shall be deemed outstanding and beneficially owned by such Control Person for purposes of this Article 9; and

(f) For the purposes of Section 9.2(b)(i) of this Article 9, the phrase “other consideration to be received” shall include, without limitation, common stock of the corporation retained by its existing public stockholders in the event of a Business Combination with such Control Person in which the corporation is the surviving corporation.

Section 9.4 For the purposes of this Article 9, a majority of the Continuing Directors shall have the power and duty to determine on the basis of information known to them (a) whether a proposed transaction is subject to the provisions of this Article 9, (b) the amount of shares of the corporation Beneficially Owned by any person, (c) whether a person is an Affiliate or Associate of another, and (d) such other matters as to which a determination may be required by the provisions of this Article 9.

Section 9.5 The provisions set forth in this Article 9 may not be repealed or amended in any respect or in any manner including any merger or consolidation of the corporation with any other corporation unless the surviving corporation’s Articles of Incorporation contain an article to the same effect as this Article 9, except by the affirmative vote of the holders of not less than 66 2/3% of the outstanding shares of common stock of the corporation, subject to the provisions of any series of preferred stock which may at the time be outstanding; provided, however, that if

there is a Control Person such action must be approved by not less than 66 2/3% of the total shares entitled to be voted in an election of directors attributable to shares owned by person other than the Control Persons.

ARTICLE 10

Section 10.1 The board of directors of the corporation, when evaluating any offer of another party to (a) make a tender or exchange offer for any equity security of the corporation, (b) merge or consolidate the corporation with another corporation, or (c) purchase or otherwise acquire all or substantially all of the properties and assets of the corporation, shall, in connection with the exercise of its judgment in determining what is in the best interests of the corporation and its stockholders, give due consideration to all relevant factors, including without limitation the social and economic effects on the employees, customers, suppliers and other constituents of the corporation and its subsidiaries and on the communities in which the corporation and its subsidiaries operate or are located.

ARTICLE 11

Section 11.1 Defined Terms. As used in this Article 11:

(a) “Egregious conduct” by a person shall mean acts or omissions that involve intentional misconduct or a knowing violation of law, conduct violating section 23B. of the Revised Code of Washington, or participation in any transaction from which the person will personally receive a benefit in money, property, or services to which the person is not legally entitled.

(b) “Finally adjudged” shall mean stated in a judgment based upon clear and convincing evidence by a court having jurisdiction, from which there is no further right to appeal.

(c) “Director” shall mean any person who is a director of the corporation and any person who, while a director of the corporation, is serving at the request of the corporation as a director, officer, partner, trustee, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust, or other enterprise, or is a fiduciary or party in interest in relation to any employee benefit plan covering any employee of the corporation or of any employer in which it has an ownership interest; and “conduct as a director” shall include conduct while a director is acting in any of such capacities.

(d) “Officer-director” shall mean any person who is simultaneously both an officer and director of the corporation and any person who, while simultaneously both an officer and director of the corporation, is serving at the request of the corporation as a director, officer, partner, trustee, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust, or other enterprise, or is a fiduciary or party in interest in relation to any employee benefit plan covering any employee of the corporation or of any employer in which it has an ownership interest; and “conduct as an officer-director” shall include conduct while an officer-director is acting as an officer of the corporation or in any of such other capacities.

(e) “Subsidiary corporation” shall mean any corporation at least eighty percent of the voting stock of which is held beneficially by this corporation.

Section 11.2 - Liability of Directors. No director, officer-director, former director or former officer-director of the corporation shall be personally liable to the corporation or its shareholders for monetary damages for conduct as a director or officer-director occurring after the effective date of this Article 11 unless the conduct is finally adjudged to have been egregious conduct, as defined herein.

Section 11.3 - Liability of Subsidiary Directors. No director, officer-director, former director, or former officer-director of a subsidiary corporation shall be personally liable in any action brought directly by this corporation as a shareholder of the subsidiary corporation or derivatively on behalf of the subsidiary corporation (or by any shareholder of this corporation double-derivatively on behalf of this corporation and the subsidiary corporation) for monetary damages for conduct as a director or officer-director of such subsidiary corporation occurring after the effective date of this Article 11 unless the conduct is finally adjudged to have been egregious conduct, as defined herein.

Section 11.4 - Indemnification of Directors. The corporation shall indemnify any person who is, or is threatened to be made, a party to any action, suit, or proceeding, whether civil, criminal, administrative, or investigative, and whether by or in the right of the corporation or its shareholders or by any other party, by reason of the fact that the person is or was a director or officer-director of the corporation or of a subsidiary corporation against judgments, penalties or penalty taxes, fines, settlements (even if paid or payable to the corporation or its shareholders or to a subsidiary corporation) and reasonable expenses, including attorneys’ fees, actually incurred in connection with such proceeding unless the liability and expenses were on account of conduct finally adjudged to be egregious conduct, as defined herein. The reasonable expenses, including attorneys’ fees, of such person incurred in connection with such proceeding shall be paid or reimbursed by the corporation, upon request of such person, in advance of the final disposition of such proceeding upon receipt by the corporation of a written, unsecured promise by the person to repay such amount if it shall be finally adjudged that the person is not eligible for indemnification. All expenses incurred by such person in connection with such proceeding shall be considered reasonable unless finally adjudged to be unreasonable.

Section 11.5 - Procedure. No action by the board of directors, the shareholders, independent counsel, or any other person or persons shall be necessary or appropriate to the determination of the corporation’s indemnification obligation in any specific case, to the determination of the reasonableness of any expenses incurred by a person entitled to indemnification under this Article 11, nor to the authorization of indemnification in any specific case.

Section 11.6 Internal Claims Expected. Notwithstanding section 11.4, the corporation shall not be obligated to indemnify any person for any expenses, including attorneys’ fees, incurred to assert any claim against the corporation (except a claim based on section 11.7) or any person related to or associated with it, including any person who would be entitled hereby to indemnification in connection with the claim.

Section 11.7 - Enforcement of Rights. The corporation shall indemnify any person granted indemnification rights under this Article 11 against any reasonable expenses incurred by the person to enforce such rights.

Section 11.8 - Set-off of Claims. Any person granted indemnification rights herein may directly assert such rights in set-off of any claim raised against the person by or in the right of the corporation and shall be entitled to have the same tribunal which adjudicates the corporation’s claim adjudicate the person’s entitlement to indemnification by the corporation.

Section 11.9 - Continuation of Rights. The indemnification rights provided in this Article 11 shall continue as to a person who has ceased to be a director or officer-director and shall inure to the benefit of the heirs, executors, and administrators of such person.

Section 11.10 - Effect of Amendment or Repeal. Any amendment or repeal of this Article 11 shall not adversely affect any right or protection of a director, officer-director, former director or former officer-director existing at the time of such amendment or repeal with respect to acts or omissions occurring prior to such amendment or repeal.

Section 11.11 - Severability of Provisions. Each of the substantive provisions of this Article 11 is separate and independent of the others, so that if any provision hereof shall be held to be invalid or unenforceable for any reason, such invalidity or unenforceability shall not affect the validity or enforceability of the other provisions.

These Amended and Restated Articles of Incorporation correctly set forth without change the corresponding provisions of the Articles of Incorporation as heretofore amended, and supersede the original Articles of Incorporation and all amendments thereto.

Executed in duplicate this 18th of November, 2008.

COLUMBIA BANKING SYSTEM, INC.

By: /s/ Cathleen Dent
Name: Cathleen Dent
Title: Secretary

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Section 3: EX-3.2 (AMENDED AND RESTATED BYLAWS)

EXHIBIT 3.2

AMENDED AND RESTATED BYLAWS OF
COLUMBIA BANKING SYSTEM, INC.

October 24, 2007

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RESTATED BYLAWS OF
COLUMBIA BANKING SYSTEM, INC.

ARTICLE 1

Meetings of Shareholders

SECTION 1.1 - Shareholder Meetings. Shareholder meetings shall be held at the principal office of the corporation, or at such other location within or without the State of Washington as shall be determined by the Board of Directors and stated in the Notice of Meeting.

SECTION 1.2 - Annual Meeting. The regular annual meeting of the shareholders for the election of directors and for the transaction of such other business as may properly be brought before the meeting shall be held on such day and at such time following the close of the corporation's fiscal year as shall be determined each year by the Board of Directors. If such annual meeting is omitted by oversight or otherwise during such period, a subsequent annual meeting may nonetheless be held, and any business transacted or elections held at such meeting shall be as valid as if the annual meeting had been held during the period provided above.

SECTION 1.3 - Special Meetings. Special meetings of the shareholders may be called at any time by the Chairman, the Chief Executive Officer, the President, a majority of the Board of Directors, or any shareholder or shareholders holding in the aggregate not less than one-tenth of all shares entitled to vote at the special meeting. Shareholders may hold a meeting at any time and place without notice or call, upon appropriate waivers signed by all shareholders who are entitled to vote at a shareholders' meeting.

SECTION 1.4 - Notice. Written notice stating the place, day, and hour of the meeting, and in case of a special meeting the purpose or purposes for which the meeting is called, shall be delivered not less than ten (10) days nor more than sixty (60) days before the date of the meeting, either personally or by mail, by or at the direction of the Chairman, the Chief Executive Officer, the President, the Secretary, or the person or persons calling the meeting to each shareholder of record entitled to vote at such meeting. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail, postage prepaid, addressed to the shareholder at his address as it appears on the stock transfer books of the corporation. Each shareholder shall be responsible for providing the Secretary with the shareholder's current mailing address to which notices of meetings and all other corporate notices may be sent. A shareholder may waive any notice required for any meeting by executing a written waiver of notice either before or after said meeting and such waiver shall be equivalent to the giving of such notice. The attendance of a shareholder at a shareholders' meeting, in person or by proxy, shall constitute a waiver of notice of the meeting.

SECTION 1.5 - Quorum. A majority of the shares entitled to vote shall constitute a quorum at a meeting of shareholders. When a quorum is present at any meeting, action on a matter, other than the election of directors, is approved if the votes cast favoring the action exceed the votes cast opposing the action, unless otherwise provided by the Articles of Incorporation or law.

SECTION 1.6 - Adjournment. A majority of the shares represented at a meeting, even if less than a quorum, may adjourn the meeting from time to time without further notice. At such adjourned meeting at which a quorum shall be present or represented, any business may be transacted which might have been transacted at the meeting as originally stated in the notice of meeting. The shareholders present at a duly organized meeting may continue to transact business until adjournment notwithstanding the withdrawal of enough shareholders to leave less than a quorum.

SECTION 1.7 - Chairman of Meeting. The Chairman, or in his absence, the Chief Executive Officer, or the President, shall preside at all meetings of the shareholders unless the Board of Directors shall otherwise determine. The Board of Directors may appoint any shareholder to act as chairman of the meeting.

SECTION 1.8 - Secretary of Meeting. The Secretary shall act as a secretary at all meeting of the shareholders, and in his absence, the presiding officer may appoint any person to act as secretary.

SECTION 1.9 - Conduct of Meetings. Shareholder meetings shall be conducted in an orderly and fair manner, but the presiding officer shall not be bound by any technical rules of parliamentary procedure.

SECTION 1.10 - Voting. Each outstanding share shall be entitled to one vote on each matter submitted to a vote at a meeting of shareholder.

SECTION 1.11 - Proxies. At all meetings of shareholders, a shareholder may vote by proxy executed in writing by the shareholder or by his duly authorized attorney in fact. Such proxy shall be filed with the Secretary of the corporation before or at the time of the meeting. No proxy shall be valid after eleven (11) months from the date of its execution, unless otherwise provided in the proxy.

SECTION 1.12 - Shareholder Advisor. A shareholder or holder of a valid proxy may be accompanied at any shareholders' meeting by one personal advisor, but no such advisor may address the meeting without the consent of the presiding officer.

SECTION 1.13 - Recording of Proceedings. The proceedings of a shareholders' meeting may not be mechanically or electronically recorded other than by the Secretary or acting secretary without the express approval of all individuals in attendance at the meeting.

SECTION 1.14 - Record Date. For the purpose of determining shareholders entitled to notice of or to vote at any meeting of shareholders or any adjournment thereof, or entitled to receive payment of any dividend, or in order to make a determination of shareholders for any other proper purpose, the Board of Directors may fix in advance a date as the record date for any such determination of shareholders. Such date in any case shall not be more than sixty (60) days and, in case of a meeting of shareholders, not less than ten (10) days prior to the date on which the particular action requiring such determination of shareholders is to be taken. If no record date is fixed by the Board of Directors, the date on which notice of the meeting is mailed or the date on which the resolution of the Board declaring such dividend is adopted, as the case may be, shall be the record date for such determination of shareholders. When a determination of shareholders entitled to vote at any meeting of shareholders has been made as provided in this section, such determination shall apply to any adjournment thereof.

SECTION 1.15 - List of Shareholders. The Secretary of the corporation shall make a complete record of the shareholders entitled to vote at a meeting of shareholders, or any adjournment thereof, arranged in alphabetical order, with the address of and the number of shares held by each as shown on the corporation's stock transfer books on the record date. Such record shall be kept on file at the registered office of the corporation for a period of ten (10) days prior to the meeting of shareholders. Such record shall be produced and kept open at the time and place of the shareholders' meeting and shall be subject to the inspection of any shareholder during the meeting for any proper purpose.

SECTION 1.16 - Shareholder Proposals. At an annual meeting of the shareholders, only such business will be conducted as will have been properly brought before the meeting. To be properly brought before an annual meeting, business must be: (A) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the board of directors, (B) otherwise properly brought before the meeting by or at the direction of the board of directors, or (C) otherwise properly brought before the meeting by a shareholder. For nominations or other business to be properly brought before a shareholder meeting by a shareholder pursuant to clause (C) of the preceding sentence, the shareholder must have given timely notice thereof in writing to the Secretary of the bank and such other business must otherwise be a proper matter for action. To be timely for purposes of advance notice requirements, a shareholder's proposal must be delivered to the Secretary at the principal executive offices of the bank not less than one hundred twenty (120) calendar days in advance of the first anniversary of the date the bank's proxy statement was mailed to shareholders for the preceding year's annual meeting. In no event will the public announcement of an adjournment of a shareholder meeting commence a new time period for the giving of a shareholder's notice as described above. A shareholder's notice to the secretary must set forth as to each matter the proposes to bring before the annual meeting: (a) a brief description of the business desired to be brought before the meeting, (b) the name and address, as they appear on the bank's books, of the shareholder proposing such business, (c) the class and number of shares of the bank which are owned beneficially by such shareholder, (d) any material interest of the shareholder in such business, and (e) any other information that is required to be provided by the shareholder pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (the "1934 Act") (or any successor thereto) in such shareholder's capacity as a proponent of a proposal. Notwithstanding anything in these Bylaws to the contrary, no business will be conducted at any annual meeting except in accordance with the procedures set forth in this section. The Chairman of the annual meeting will, if the facts warrant, determine and declare at the meeting that business was not properly brought before the meeting and in accordance with the provisions of this section, and, if the Chairman should so determine, he will so declare at the meeting that any such business not properly brought before the meeting will not be transacted.

ARTICLE 2

Directors

SECTION 2.1 - Management of Corporation. All corporate powers shall be exercised by, or under authority of, and the business and affairs of the corporation shall be managed under the direction of the Board of Directors (hereinafter sometimes referred to as the “Board”).

SECTION 2.2 - Number of Directors. The initial number of directors is stated in the Articles of Incorporation. The number to be elected by the shareholders shall consist of not less than five (5) nor more than twenty-five (25) persons. The exact number within such minimum and maximum limits shall be fixed and determined by resolution of the Board of Directors. The number of directors elected by the shareholders at the last preceding annual meeting may be increased by not more than two (2) directors by the Board between annual meetings of the shareholders. The Board of Directors may appoint qualified persons to fill vacancies on the Board of Directors, whether caused by resignation, death or otherwise; provided, that at no time shall the total number of directors exceed twenty-five (25)

SECTION 2.3 - Qualifications of Directors. Any person who will not attain the age of 75 before the meeting of shareholders at which elected (or had not attained that age by the date of the last annual meeting of shareholders, if appointed) may become a director of this corporation.

SECTION 2.4 - Nomination of Directors. Only persons who are nominated in accordance with this section will be eligible for election as directors. Nominations of persons for election to the board of directors of the corporation may be made by or at the direction of the board of directors or by any stockholder of the corporation entitled to vote in the election of directors at the meeting who complies with the notice procedures set forth below. Such nominations, other than those made by or at the direction of the board of directors, shall be made pursuant to timely notice in writing to the secretary of the corporation. To be timely for purposes of advance notice requirements, a shareholder nomination must be delivered to the Secretary at the principal executive offices of the corporation not less than one hundred twenty (120) calendar days in advance of the first anniversary of the date the corporation’s proxy statement was released to shareholders for the preceding year’s annual meeting. Such shareholder’s notice shall set forth (i) as to each person, if any, whom the stockholder proposes to nominate for election or re-election as a director: (A) the name, age, business address and residence address of such person, (B) the principal occupation or employment of such person, (C) the class and number of shares of the corporation which are beneficially owned by such person, (D) a description of all arrangements or understandings between the shareholder and each nominee and any other person or persons (naming such person or persons) pursuant to which the nominations are to be made by the shareholder, and (E) any other information relating to such person that is required to be disclosed in solicitations of proxies for elections of directors, or is otherwise required, in each case pursuant to Regulation 14A under the 1934 Act (or any successor thereto) (including without limitation such person’s written consent to being named in the proxy statement, if any, as a nominee and to serving as a director if elected); and (ii) as to such stockholder giving notice (a) the name and address, as they appear in the corporation’s books, of the nominating shareholder; (b) the number of shares of the corporation which are owned beneficially by such shareholder; and (c) any other information that is required to be provided by the shareholder

pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended in such shareholder’s capacity as a proponent of a shareholder nomination. At the request of the board of directors, any person nominated by a stockholder for election as a director shall furnish to the Chairman of the corporation, c/o of the Corporate Secretary, that information required to be set forth in the shareholder’s notice of nomination which pertains to the nominee. No person shall be eligible for election as a director of the corporation unless nominated in accordance with these procedures. The chairman of the meeting shall, if the facts warrant, determine and declare at the meeting that a nomination was not made in accordance with the procedures, and if he should so determine, he shall so declare at the meeting, and the defective nomination shall be disregarded. Nominations submitted pursuant to these procedures will be reviewed and considered by the Nominating Committee.

SECTION 2.5 - Annual Meetings. Immediately after the annual meeting of shareholders, the Directors shall meet to elect officers and transact any other business.

SECTION 2.6 - Place of Meetings. Meetings of the Board of Directors, regular or special, may be held within or without this state.

SECTION 2.7 - Regular Meetings. Regular meetings of the Board of Directors may be held without notice at such time and at such place as the Board may by vote from time to time designate.

SECTION 2.8 - Special Meetings. Special meetings of the Board of Directors may be called by the Chairman, the Chief Executive Officer, the President, or by any two (2) directors.

SECTION 2.9 - Notices. Notices of special meetings of the Board of Directors stating the date, time, place and in general terms the purpose or purposes thereof shall be delivered to each director, by mailing written notice at least two (2) days before the meeting or by telephoning, telegraphing or personally advising each director at least one (1) day before the meeting. A special meeting shall be held not more than twenty (20) days after the delivery of said notice. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail, postage prepaid, addressed to the director at the address provided to the Secretary. An entry of the service of notice, given in the manner above provided, shall be made in the minutes of the proceedings of the Board of Directors, and such entry, if read and approved at the subsequent meeting of the Board, shall be conclusive on the question of service. Attendance of a director at a special meeting shall constitute a waiver of notice of such meeting, except where a director attends a meeting for the express purpose of objecting to the transaction of any business because the meeting was not lawfully called or convened. A director also may waive any notice required for any meeting by executing a written waiver of notice either before or after said meeting, and such waiver shall be equivalent to the giving of such notice.

SECTION 2.10 - Quorum±. A majority of the directors shall constitute a quorum for the transaction of business. Unless otherwise provided in the Articles of Incorporation or these Bylaws, the act of the majority of the directors present at a meeting at which a quorum is present shall be the act of the Board of Directors. A majority of those present at the time and place of any regular or special meeting, although less than a quorum, may adjourn from time to time, without further notice, until a quorum shall attend. When a quorum shall attend, any business may be transacted which might have been transacted at the meeting had the same been held on the date stated in the notice of meeting.

SECTION 2.11 - Attendance by Conference Telecommunication±. Members of the Board of Directors may participate in a meeting of such Board by means of a conference telephone or similar communications equipment, by means of which all person participating in the meeting can hear each other at the same time, and participation by such means shall constitute presence in person at a meeting.

SECTION 2.12 - Consent to Action. Any action which may be taken at a meeting of the Board of Directors, or at a meeting of any committee of the Board, may be taken without a meeting if a consent in writing, setting forth the action so taken shall be signed by all of the directors or all the members of the committee. Such consent shall have the same force and effect as a unanimous vote at a duly convened meeting.

SECTION 2.13 - Compensation. The directors shall receive such reasonable compensation for their services as directors and as members of any committee appointed by the Board as may be prescribed by the Board of Directors, and may be reimbursed by the corporation for ordinary and reasonable expenses incurred in the performance of their duties.

SECTION 2.14 - Manifestation of Dissent. A director of the corporation who is present at a meeting of the Board at which action on any corporate matter is taken shall be presumed to have assented to the action taken unless his dissent shall be entered in the minutes of the meeting or unless he shall file his written dissent to such action with the person acting as the Secretary of the meeting before the adjournment thereof or shall forward such dissent by registered mail to the Secretary of the corporation immediately after the adjournment of the meeting. Such right to dissent shall not apply to a director who voted in favor of such action.

ARTICLE 3

Committees of the Board of Directors

SECTION 3.1 - Executive Committee. By resolution adopted by a majority of the entire Board of Directors, the Board may designate from among its members an Executive Committee of not less than five (5) nor more than nine (9) members, including the Chairman, the Chief Executive Officer, and the President. The Chairman, or in his absence the Chief Executive Officer, shall act as chairman of the Executive Committee. Any member of the Board may serve as an alternate member of the Executive Committee in the absence of a regular member or members. The Executive Committee shall have and may exercise all of the authority of the Board of Directors during the intervals between meetings of the Bank, except that the committee shall not have the authority to: (1) authorize or approve a distribution or issuance of shares, except according to a general formula or method prescribed by the Board of Directors, (2) approve or propose to shareholders actions or proposals requiring shareholder approval, (3) fill vacancies on the Board of Directors or any committee thereof, (4) amend the Articles of Incorporation pursuant to RCW 23B.10.020, (5) adopt, amend or repeal Bylaws, (6) approve a plan of merger not requiring shareholder approval, or (7) authorize or approve the issuance or sale or contract for sale of shares, or determine the designation and relative rights, preferences, and limitations of a class or series of shares, except within certain limits specifically prescribed by the Board of Directors.

SECTION 3.2 - Audit Committee. By resolution adopted by a majority of the entire Board of Directors, the Board may appoint from among its members an Audit Committee of three (3) or more, none of whom shall be active officers of the corporation, and may designate one (1) of such members as chairman of the Committee. The Board may also designate one or more directors as alternates to serve as a member or members of the Committee in the absence of a regular member or members. The Committee shall establish and maintain continuing communications between the Board and the corporation's independent auditors, internal auditors, and members of financial management with respect to the audit of the corporation's accounts and financial affairs and the audit of the corporation's controlled subsidiaries. The Committee shall have such other powers and perform such other duties as may from time to time be prescribed by the Board of Directors.

SECTION 3.3 - Other Committees. By resolution adopted by a majority of the entire Board of Directors, the Board may designate from among its members such other committees as it may deem necessary, each of which shall consist of not less than two (2) directors and have such powers and duties as may from time to time be prescribed by the Board.

SECTION 3.4 - Rules of Procedure. The majority of the members of any committee may fix its rules of procedure. All actions by any committee shall be reported in written minutes available at any reasonable time to any Board member. Such actions shall be subject to revision, alteration and approval by the Board of Directors; provided, that no rights or acts of third parties who have relied in good faith on the authority granted herein shall be affected by such revision or alteration.

ARTICLE 4

Officers and Employees

SECTION 4.1 - Officers. The Board of Directors shall elect a Chairman, a Chief Executive Officer, and a President. It shall also elect one or more Vice Presidents, a Secretary and a Treasurer and such additional officers as in the opinion of the Board the business of the corporation requires. The Board may also elect or appoint, or in its discretion delegate to the Chief Executive Officer the authority to appoint, from time to time such other or additional officers as are desirable for the conduct of the business of the corporation.

SECTION 4.2 - Election. The Chairman, the Chief Executive Officer and the President shall be directors. These persons shall be elected annually by the Board of Directors and they shall hold office at the pleasure of the Board of Directors.

SECTION 4.3 - Removal and Vacancy. Any officer, agent, or employee of the corporation may be removed by the Board of Directors at any time with or without cause. Such removal, however, shall be without prejudice to the contract rights, if any, of the persons so removed. Election or appointment of an officer or agent or employee shall not of itself create contract rights. If any corporate office becomes vacant by reason of death, resignation, removal or otherwise, the Board of Directors or the executive officer possessing delegated authority to appoint such an officer, shall have power to fill such vacancies. In case of the absence or disability of any officer, the Board of Directors or the Chief Executive Officer may delegate the powers or duties of any such officer to another officer for the time being.

SECTION 4.4 - Compensation. The compensation of the Chief Executive Officer shall be fixed by the Board of Directors. Unless fixed by the Board of Directors, the compensation for all other officers, employees or agents of the corporation shall be established by or at the direction of the Chief Executive Officer.

SECTION 4.5 - Exercise of Rights as Stockholders. Unless otherwise ordered by the Board of Directors, the Chief Executive Officer or the Chief Executive Officer's designee acting by written designation, shall have full power and authority on behalf of the corporation to attend and to vote at any meeting of shareholders of any corporation in which this corporation may hold stock, other than in a fiduciary capacity, and may exercise on behalf of this corporation any and all of the rights and powers incident to the ownership of such stock at any such meeting, and shall have power and authority to execute and deliver proxies and consents on behalf of this corporation in connection with the exercise by this corporation of the rights and powers incident to the ownership of such stock. The Board of Directors, from time to time, may confer like powers upon any other person or persons.

SECTION 4.6 - Duties of Chairman of the Board. The Chairman shall preside at all meetings of the shareholders and at meetings of the Board of Directors and the Executive Committee; provided, however, that the Chairman of the Board shall not, by reason of such office, be considered an executive officer of the corporation or be assigned executive responsibilities or participate in the operational management of the corporation.

SECTION 4.7 - Duties of Vice Chairman. The Vice Chairman shall have such powers and exercise such other duties as shall be delegated to such officer by the Chief Executive Officer or the Board.

SECTION 4.8 - Duties of Chief Executive Officer. The Chief Executive Officer shall have general management of the business of the corporation. The Chief Executive Officer shall see that all orders and resolutions of the Board of Directors and the Executive Committee are carried into effect and shall have general supervision over the property, business, and affairs of the corporation and its several officers. The Chief Executive Officer shall be the person to whom the President, and all other officers designated by the Chief Executive Officer, shall report. The Chief Executive Officer may delegate such duties as such officer sees fit to delegate to the President, or other officers of the corporation. The Chief Executive Officer may appoint agents or employees other than those appointed by the Board of Directors, and shall perform such other duties as may be prescribed from time to time by the Board of Directors or by the Bylaws.

SECTION 4.9 - Duties of President. The President shall, subject to the authority granted to the Chief Executive Officer, be the chief operating officer of the corporation and shall have general supervision over the day-to-day business of the corporation. The President shall have such other authority and shall exercise such other duties as shall, from time to time, be delegated to such officer by the Chief Executive Officer or by the Board. Unless otherwise determined by the Board of Directors, the President shall perform all of the duties of the Chief Executive Officer in case of absence or disability of the Chief Executive Officer.

SECTION 4.10 - Duties of Vice President. The Vice Presidents shall have such powers and perform such duties as may be assigned to them by the Board of Directors or the Chief Executive Officer. A Vice President designated by the Board of Directors shall perform all of the duties of the President in case of absence or disability of the President.

SECTION 4.11 - Duties of Secretary. The Secretary shall, subject to the direction of the Chief Executive Officer keep the minutes of all meetings of the shareholders and of the Board of Directors, and to the extent ordered by the Board of Directors or the Chief Executive Officer the minutes of all meetings of all committees. The Secretary shall cause notice to be given of the meetings of the shareholders, of the Board of Directors, and of any committee appointed by the Board. The Secretary shall have custody of the corporate seal and general charge of the records, documents, and papers of the corporation not pertaining to the performance of the duties vested in other officers, which shall at all reasonable times be open to the examination of any director. Without limiting the generality of the foregoing, the Secretary shall have charge (directly or through such transfer agents or registrars as the Board of Directors may appoint) of the issuance, transfer, and registration of certificates for shares of the corporation and of the records pertaining thereto. Said records shall be kept in such manner as to show at any time the number of shares of the corporation issued and outstanding, the manner in which and the time when such shares were paid for, the names and addresses of the holders of

record thereof, the numbers and classes of shares held by each, and the time when each became such holder of record. The Secretary shall perform such other duties as may be assigned by the Board of Directors or the Chief Executive Officer.

SECTION 4.12 - Duties of Treasurer. Except as otherwise set forth herein, the Treasurer shall, subject to the direction of the Chief Executive Officer have general custody of all the property, funds and securities of the corporation and have general supervision of the collection and disbursement of funds of the corporation. The Treasurer shall provide for the keeping of proper records of all transactions of the corporation, and shall perform such other duties as may be assigned to him by the Board of Directors or the Chief Executive Officer.

SECTION 4.13 - Other Officers. Such other officers as shall be appointed by the Board of Directors, or the Chief Executive Officer, acting pursuant to delegated authority of the Board, shall exercise such powers and perform such duties as pertain to their several offices, or as may be conferred upon, or assigned to, them by the Board of Directors or the Chief Executive Officer or such officer’s designee.

SECTION 4.14 - Clerks and Agents. The Chief Executive Officer, or any other officer of the corporation authorized by the Chief Executive Officer, may, subject to the supervision of the Board of Directors, appoint such custodians, bookkeepers and other clerks, agents, and employees as he shall deem advisable for the prompt and orderly transaction of the business of the corporation and shall define their duties, fix the salaries to be paid to them and dismiss them.

ARTICLE 5

Shares and Certificates for Shares

SECTION 5.1 - Consideration. Certificates for shares of the corporation shall be issued only when fully paid for.

SECTION 5.2 - Stock Certificates. Shares may but need not be represented by certificates. Certificates, if utilized, shall be signed by the Chief Executive Officer and the Secretary, or any other two officers as may be designated by the Board of Directors, and may be sealed with the seal of the corporation or a facsimile thereof. The signatures of such officers may be facsimiles. If an officer who has signed or whose facsimile signature has been placed upon such certificate ceases to be an officer before the certificate is issued, it may be issued by the corporation with the same effect as if the person were an officer on the date of issue. Each newly-issued certificate of stock at a minimum shall state:

- (a) the name of the corporation and that it is organized under the laws of the State of Washington;
- (b) the name of the person to whom issued; and
- (c) the number and class of shares and the designation of the series, if any, which such certificate represents.

SECTION 5.3 - Lost Certificates. No new certificates shall be issued until the former certificate for the shares represented thereby shall have been surrendered and cancelled, except in the case of lost or destroyed certificates, and in that case only after the receipt of a bond or other security by the corporation, satisfactory to the Board of Directors, indemnifying the corporation and all persons against loss in consequence of the issuance of such new certificate.

SECTION 5.4 - Transfer of Shares. Shares of the corporation may be transferred by endorsement by the signature of the owner, his agent, attorney or legal representative, and the delivery of the certificate; but no transfer shall be valid except between the parties thereto, until the same shall have been entered upon the books of the corporation, so as to show the names of the parties, by and to whom transferred, the numbers and designation of the shares and the date of transfer.

SECTION 5.5 - Holder of Record. The person registered on the books of the corporation as the owner of the issued shares shall be recognized by the corporation as the person exclusively entitled to have and to exercise the rights and privileges incident to the ownership of such shares. Notwithstanding the preceding sentence, the Board of Directors may adopt by resolution a procedure whereby a shareholder may certify in writing to the corporation that all or a portion of the shares registered in the name of such shareholder are held for the account of a specified person or persons. Upon receipt by the corporation of a certification complying with such an adopted procedure, the person specified in the certification shall be deemed, for the purpose or purposes set forth in the certification, to be the holders of record of the number of shares specified in place of the shareholder making the certification.

SECTION 5.6 - Issuance of Shares. Any shares authorized but not issued by this corporation shall be issued, sold, or otherwise transferred by this corporation only upon authorization of the Board of Directors.

SECTION 5.7 - Subscriptions. A subscription for shares of this corporation shall be in writing and upon such terms as may be approved by the Board of Directors.

SECTION 5.8 - Payment of Subscriptions. A subscription for shares shall be paid in accordance with the terms set forth in the subscription or related subscription agreement, if any. If the subscription or subscription agreement does not require payment on or before a stated date or at a fixed period after a stated date, then payment shall be made in such manner and at such times as may be determined by the Board of Directors and expressed by it in a written call for payment; provided that the call shall be uniform as to all shares of the same class or series and that the call shall be mailed to each subscriber at his last post office address known to the corporation at least thirty (30) days in advance of the date upon which payment or the first installment, if installment payments are called for, is due.

SECTION 5.9 - Default in Payment of Subscriptions. If a payment required by a subscription, a subscription agreement, or a call of the Board of Directors is not paid when due, then the corporation may make written demand for payment upon the defaulting subscriber by personal service or by mailing a copy of the demand to the subscriber at his last post office address known to the corporation. If the payment is not made within twenty (20) days of the serving or mailing of the demand for payment, the corporation may terminate the subscription, forfeit the subscriber’s rights thereunder, retain as liquidated damages any sums previously paid on the subscription, and hold and dispose of the shares as though never subject to the subscription. In lieu of forfeiture, the corporation may proceed to collect the amount due in the same manner as any debt due the corporation.

ARTICLE 6

Seal

SECTION 6.1 - Corporate Seal. In the exercise of its discretion the Board of Directors may adopt and maintain a suitable seal for the corporation.

ARTICLE 7

Miscellaneous Provisions

SECTION 7.1 - Fiscal Year. The fiscal year of the corporation shall be the calendar year.

SECTION 7.2 - Records. The Articles of Incorporation, the Bylaws, and the proceedings of all meetings of the shareholders, the Board of Directors and standing committees of the Board shall be recorded in appropriate minute books provided for that purpose. The minutes of each meeting shall be signed by the Secretary or other officer appointed to act as Secretary.

ARTICLE 8

Bylaws

SECTION 8.1 - Inspection. A copy of the Bylaws, with all amendments thereto, shall at all times be kept in a convenient place at the principal office of the corporation, and shall be open for inspection of all shareholders during normal business hours.

SECTION 8.2 - Amendments. The Bylaws may be amended, altered or repealed, at any regular meeting of the Board of Directors, by a vote of the majority of the whole Board of Directors, provided that a written statement of the proposed action shall have been personally delivered or mailed to all directors at least two (2) days prior to any such meeting.

I HEREBY CERTIFY that the foregoing are the Restated Bylaws of Columbia Banking System, Inc, in effect on this 24th day of October 2007.

Columbia Banking System, Inc.

By: /s/ Cathleen Dent
Name: Cathleen Dent
Title: Secretary

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Section 4: EX-21 (SUBSIDIARIES OF THE COMPANY)

EXHIBIT 21

SUBSIDIARIES OF THE COMPANY

<u>Name of Subsidiary</u>	<u>State of Incorporation</u>	<u>Ownership</u>
Columbia State Bank	Washington	100%
Columbia (WA) Statutory Trust	Washington	100%
Town Center Bancorp Statutory Trust	Delaware	100%

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Section 5: EX-23 (CONSENT OF DELOITTE & TOUCHE LLP)

EXHIBIT 23

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 333-156350 and 333-154418 on Form S-3 and Nos. 33-83676, 33-95766, 333-40316, 333-100420, 333-120131, 333-125298, 333-135439, 333-144811, and 333-145207 on Form S-8 of our reports dated February 27, 2009, relating to the consolidated financial statements of Columbia Banking System, Inc., and the effectiveness of Columbia Banking System, Inc.'s internal control over financial reporting, appearing in this Annual Report on Form 10-K of Columbia Banking System, Inc., for the year ended December 31, 2008.

Deloitte & Touche LLP

Seattle, Washington
February 27, 2009

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Section 6: EX-24 (POWER OF ATTORNEY)

EXHIBIT 24

POWER OF ATTORNEY

The director of Columbia Banking System, Inc. (the “Company”), whose signature appears below, hereby appoints Melanie J. Dressel and William T. Weyerhaeuser, or either of them, as his/her attorney to sign, in his/her name and behalf and in any and all capacities stated below, the Company’s Form 10-K Annual Report pursuant to Section 13 of the Securities Exchange Act of 1934, and likewise to sign any and all amendments and other documents relating thereto as shall be necessary, such person hereby granting to each such attorney power to act with or without the other and full power of substitution and revocation, and hereby ratifying all that any such attorney or his substitute may do by virtue hereof.

This Power of Attorney has been signed by the following persons in the capacity indicated, on the 25th day of February, 2009.

<u>Signature</u>	<u>Title</u>
<u>/s/ WILLIAM WEYERHAEUSER</u> William Weyerhaeuser	Chairman
<u>/s/ MELANIE J. DRESSEL</u> Melanie J. Dressel	President, Chief Executive Officer and Director
<u>/s/ JOHN P. FOLSOM</u> John P. Folsom	Director
<u>/s/ FRED M. GOLDBERG</u> Frederick M. Goldberg	Director
<u>/s/ THOMAS M. HULBERT</u>	Director

Thomas M. Hulbert

/s/ THOMAS L. MATSON
Thomas L. Matson

Director

/s/ DANIEL C. REGIS
Daniel C. Regis

Director

/s/ DONALD RODMAN
Donald Rodman

Director

/s/ JAMES M. WILL
James M. Will

Director

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Section 7: EX-31.1 (CERTIFICATION OF CHIEF EXECUTIVE OFFICER)

EXHIBIT 31.1

CERTIFICATION

I, Melanie J. Dressel, certify that:

1. I have reviewed this annual report on Form 10-K of Columbia Banking System, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: February 27, 2009

/s/ MELANIE J. DRESSEL
Melanie J. Dressel

President and Chief Executive Officer

Section 8: EX-31.2 (CERTIFICATION OF CHIEF FINANCIAL OFFICER)

EXHIBIT 31.2

CERTIFICATION

I, Gary R. Schminkey, certify that:

1. I have reviewed this annual report on Form 10-K of Columbia Banking System, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: February 27, 2009

/s/ GARY R. SCHMINKEY

Gary R. Schminkey
Executive Vice President and
Chief Financial Officer

Section 9: EX-32 (SECTION 906 CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER)

EXHIBIT 32

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Columbia Banking System, Inc. (the “Company”) on Form 10-K for the period ending December 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), we, Melanie J. Dressel,

President and Chief Executive Officer, and Gary R. Schminkey, Executive Vice President and Chief Financial Officer, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: February 27, 2009

/s/ MELANIE J. DRESSEL

Melanie J. Dressel
President and Chief Executive Officer
Columbia Banking System, Inc.

/s/ GARY R. SCHMINKEY

Gary R. Schminkey
Executive Vice President and
Chief Financial Officer
Columbia Banking System, Inc.

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