

COBIZ FINANCIAL INC  
Form 10-Q  
October 26, 2012  
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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-Q

**x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the quarterly period ended September 30, 2012.**

**o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the transitions period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 001-15955**

**CoBiz Financial Inc.**

(Exact name of registrant as specified in its charter)

**COLORADO**  
(State or other jurisdiction of

**84-0826324**  
(I.R.S. Employer

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incorporation or organization)

Identification No.)

**821 17th Street**

**Denver, CO**

(Address of principal executive offices)

**80202**

(Zip Code)

**(303) 312-3400**

(Registrant's telephone number, including area code)

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

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

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

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

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting company ☐

(do not check if a 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 ☒

There were 39,731,703 shares of the registrant's Common Stock, \$0.01 par value per share, outstanding at October 22, 2012.

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## Condensed Consolidated Balance Sheets

At September 30, 2012 and December 31, 2011

(unaudited)

(in thousands, except share amounts)	September 30, 2012	December 31, 2011
<b>Assets</b>		
Cash and due from banks	\$ 45,336	\$ 39,148
Interest-bearing deposits and federal funds sold	11,912	20,062
Total cash and cash equivalents	57,248	59,210
Investment securities available for sale (cost of \$573,278 and \$613,264, respectively)	592,134	623,522
Investment securities held to maturity (fair value of \$218 and \$238, respectively)	212	232
Other investments	8,884	9,554
Total investments	601,230	633,308
Loans - net of allowance for loan losses of \$46,437 and \$55,629, respectively	1,764,970	1,581,795
Intangible assets - net of amortization of \$5,800 and \$5,189, respectively	3,148	3,399
Bank-owned life insurance	40,722	39,767
Premises and equipment - net of depreciation of \$34,536 and \$32,320, respectively	7,289	8,388
Accrued interest receivable	9,068	8,273
Deferred income taxes, net	30,505	33,018
Other real estate owned - net of valuation allowance of \$8,257 and \$7,668, respectively	13,619	18,502
Other	32,155	37,844
<b>TOTAL ASSETS</b>	<b>\$ 2,559,954</b>	<b>\$ 2,423,504</b>
<b>Liabilities</b>		
Deposits		
Noninterest-bearing demand	\$ 823,363	\$ 720,813
Interest-bearing demand	117,915	10,385
NOW and money market	813,202	773,826
Savings	10,659	10,631
Eurodollar		97,748
Certificates of deposits	283,637	305,003
Total deposits	2,048,776	1,918,406
Securities sold under agreements to repurchase	124,836	127,948
Other short-term borrowings		20,000
Accrued interest and other liabilities	42,162	43,918
Junior subordinated debentures	72,166	72,166
Subordinated notes payable	20,984	20,984
<b>TOTAL LIABILITIES</b>	<b>2,308,924</b>	<b>2,203,422</b>
<b>Commitments and contingencies</b>		

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**Shareholders' Equity**

Preferred, \$.01 par value; 2,000,000 shares authorized; 57,366 issued and outstanding (\$57,366 liquidation value)	1	1
Common, \$.01 par value; 50,000,000 shares authorized; 39,729,306 and 37,089,753 issued and outstanding, respectively	390	368
Additional paid-in capital	235,639	222,200
Accumulated earnings (deficit)	9,362	(3,571)
Accumulated other comprehensive income, net of income tax of \$3,456 and \$666, respectively	5,638	1,084
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>251,030</b>	<b>220,082</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$ 2,559,954</b>	<b>\$ 2,423,504</b>

See Notes to Condensed Consolidated Financial Statements

Table of Contents**CoBiz Financial Inc. and Subsidiaries**

## Condensed Consolidated Statements of Income and Comprehensive Income

For the Three and nine months ended September 30, 2012 and 2011

(unaudited)

(in thousands, except per share amounts)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
<b>INTEREST INCOME:</b>				
Interest and fees on loans	\$ 21,895	\$ 22,186	\$ 64,571	\$ 66,657
Interest and dividends on investment securities:				
Taxable securities	4,457	5,337	15,001	17,035
Nontaxable securities	3	2	11	9
Dividends on securities	68	59	226	176
Interest on federal funds sold and other	26	28	76	103
Total interest income	26,449	27,612	79,885	83,980
<b>INTEREST EXPENSE:</b>				
Interest on deposits	1,546	1,896	4,743	6,280
Interest on short-term borrowings and securities sold under agreements to repurchase	137	225	445	650
Interest on subordinated debentures	1,519	1,517	4,523	4,501
Total interest expense	3,202	3,638	9,711	11,431
NET INTEREST INCOME BEFORE PROVISION	23,247	23,974	70,174	72,549
Provision for loan losses	(2,506)		(4,396)	3,622
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	25,753	23,974	74,570	68,927
<b>NONINTEREST INCOME:</b>				
Service charges	1,218	1,274	3,686	3,737
Investment advisory and trust income	1,450	1,291	3,934	4,260
Insurance income	2,971	2,952	9,810	9,633
Investment banking income	253	205	475	1,806
Other income	1,345	329	5,296	3,437
Total noninterest income	7,237	6,051	23,201	22,873
<b>NONINTEREST EXPENSE:</b>				
Salaries and employee benefits	15,296	14,584	46,620	46,025
Occupancy expenses, premises and equipment	3,398	3,358	10,357	10,034
Amortization of intangibles	292	160	611	479
FDIC and other assessments	456	627	1,337	2,901
Other real estate owned and loan workout costs	477	821	1,814	2,654
Net other than temporary impairment losses on securities recognized in earnings	35	136	297	507
Loss on securities, other assets and other real estate owned	30	720	750	2,654
Other	3,030	2,824	9,724	8,680
Total noninterest expense	23,014	23,230	71,510	73,934
INCOME BEFORE INCOME TAXES	9,976	6,795	26,261	17,866
Provision for income taxes	3,627	2,352	9,222	6,358
NET INCOME	\$ 6,349	\$ 4,443	\$ 17,039	\$ 11,508
<b>OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:</b>				

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Unrealized gain (loss) on securities	2,313	(2,732)	5,332	(263)
Unrealized loss on derivatives	(156)	(3,723)	(778)	(4,451)
OTHER COMPREHENSIVE INCOME (LOSS)	2,157	(6,455)	4,554	(4,714)
COMPREHENSIVE INCOME (LOSS)	\$ 8,506	\$ (2,012)	\$ 21,593	\$ 6,794
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS				
	\$ 5,632	\$ 1,908	\$ 14,888	\$ 7,078
EARNINGS PER COMMON SHARE:				
Basic	\$ 0.14	\$ 0.05	\$ 0.38	\$ 0.19
Diluted	\$ 0.14	\$ 0.05	\$ 0.38	\$ 0.19

See Notes to Condensed Consolidated Financial Statements

Table of Contents**CoBiz Financial Inc. and Subsidiaries**

## Condensed Consolidated Statements of Cash Flows

For the nine months ended September 30, 2012 and 2011

(unaudited)

(in thousands)	For the nine months ended September 30,	
	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 17,039	\$ 11,508
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization on investment securities	2,556	1,866
Depreciation and amortization	3,049	2,770
Amortization of net loan fees	(648)	(422)
Provision for loan and credit losses	(4,396)	3,622
Stock-based compensation	1,510	1,137
Federal Home Loan Bank stock dividend	(59)	(8)
Deferred income taxes	(693)	650
Increase in cash surrender value of bank-owned life insurance	(955)	(896)
Supplemental executive retirement plan	181	99
Net losses on asset valuations and disposals	1,047	3,161
Other operating activities, net	(1,430)	186
Changes in operating assets and liabilities:		
Accrued interest and other liabilities	(5,080)	(1,519)
Accrued interest receivable	(795)	129
Other assets	8,837	564
Net cash provided by operating activities	20,163	22,847
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of other investments	(2,706)	(3,315)
Proceeds from other investments	3,771	1,881
Purchases of investment securities available for sale	(148,043)	(158,532)
Proceeds from sale of investment securities available for sale	7,206	8,916
Maturities of investment securities available for sale	178,882	160,056
Maturities of investment securities held to maturity	20	22
Restricted cash	(5)	7,359
Purchase of bank-owned life insurance		(2,486)
Net proceeds from sale of loans, OREO and repossessed assets	5,603	10,346
Loan originations and repayments, net	(180,564)	(34,892)
Purchase of premises and equipment	(1,258)	(1,385)
Other investing activities, net	(358)	10
Net cash used in investing activities	(137,452)	(12,020)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net increase in demand, NOW, money market, Eurodollar and savings accounts	151,736	81,474
Net decrease in certificates of deposits	(21,366)	(90,325)
Net increase (decrease) in short-term borrowings	(20,000)	60,361
Net decrease in securities sold under agreements to repurchase	(3,112)	(25,813)
Proceeds from issuance of common stock, net	12,206	362
Proceeds from issuance of series C preferred stock, net		57,346



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Redemption of TARP preferred stock		(64,450)
Dividends paid on common stock	(1,954)	(1,102)
Dividends paid on preferred stock	(2,151)	(2,394)
Other financing activities, net	(32)	(14)
Net cash provided by financing activities	115,327	15,445
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,962)	26,272
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	59,210	24,166
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 57,248	\$ 50,438

See Notes to Condensed Consolidated Financial Statements

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**1. Condensed Consolidated Financial Statements**

The accompanying unaudited condensed consolidated financial statements of CoBiz Financial Inc. (Parent), and its subsidiaries: CoBiz Bank (Bank); CoBiz Insurance, Inc.; CoBiz GMB, Inc.; Financial Designs Ltd. (FDL); and CoBiz IM, Inc. (CoBiz IM), all collectively referred to as the Company or CoBiz, conform to accounting principles generally accepted in the United States of America for interim financial information and prevailing practices within the banking industry. The Bank operates in its Colorado market areas under the name Colorado Business Bank (CBB) and in its Arizona market areas under the name Arizona Business Bank (ABB).

The Bank is a commercial banking institution with nine locations in the Denver metropolitan area; one in Boulder; two near Vail; and six in the Phoenix metropolitan area. As a state chartered bank, deposits are insured by the Bank Insurance Fund of the Federal Deposit Insurance Corporation (FDIC) and the Bank is subject to supervision, regulation and examination by the Federal Reserve, Colorado Division of Banking and the FDIC. Pursuant to such regulations, the Bank is subject to special restrictions, supervisory requirements and potential enforcement actions. CoBiz Insurance, Inc. provides commercial and personal property and casualty insurance brokerage, employee benefits consulting, and risk management consulting services to small and medium-sized businesses and individuals. CoBiz Insurance, Inc. operates in the Denver metropolitan market as CoBiz Insurance Colorado and in the Phoenix metropolitan market as CoBiz Insurance Arizona. CoBiz GMB, Inc. provides investment banking services to middle-market companies through its wholly-owned subsidiary, Green Manning & Bunch, Ltd. (GMB). FDL provides wealth transfer and related administrative support to individuals, families and employers. CoBiz IM provides investment management services to institutions and individuals through its subsidiary, CoBiz Investment Management, LLC.

The following is a summary of certain of the Company's significant accounting and reporting policies.

**Basis of Presentation** These financial statements and notes thereto should be read in conjunction with, and are qualified in their entirety by, the Company's Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the U.S. Securities and Exchange Commission (SEC).

The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting only of normally recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2012, are not necessarily indicative of the results that may be expected for the full year ending December 31, 2012.

The consolidated financial statements include entities in which the Parent has a controlling financial interest. These entities include; the Bank; FDL; CoBiz Insurance, Inc.; CoBiz GMB, Inc.; and CoBiz IM. Intercompany balances and transactions are eliminated in consolidation. The Company determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity (VIE).

The voting interest model is used when the equity investment is sufficient to absorb the expected losses and the equity investment has all of the characteristics of a controlling financial interest. Under the voting interest model, the party with the controlling voting interest consolidates the

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legal entity. The VIE model is used when any of the following conditions exist: the equity investment at risk is not sufficient to finance the entity's activities without additional subordinated financial support; the holders of the equity investment do not have a controlling voting interest; or the holders of the equity investment are not obligated to absorb the expected losses or residual returns of the legal entity. An enterprise is considered to have a controlling financial interest of a VIE if it has both the power to direct the activities that most significantly impact economic performance and the obligation to absorb losses, or receive benefits, that are significant to the VIE. An enterprise that has a controlling financial interest is considered the primary beneficiary and must consolidate the VIE.

The Company has investments in three limited partnerships that are each considered a VIE. The Company has determined that it is not the primary beneficiary of these partnerships. Where the Company is not a primary beneficiary of a VIE, but can exert significant influence over the investee, the Company uses the equity method of accounting. The Company considered all facts and circumstances in its assessment of the activities that most significantly impact the VIE's economic performance, including its rights and responsibilities and related party interests. In addition, the Company considered all economic interests in its assessment of the obligation to absorb losses or the right to receive benefits from the VIE. The maximum exposure to loss with these VIEs is the Company's current investment in addition to its commitments to make future capital contributions. The primary source of loss exposure on these VIEs is credit risk on the underlying investments of the partnerships.

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The following table summarizes the Company's assets, commitments and loss exposure on VIEs.

(in thousands)	At September 30, 2012	
	Balance	Balance Sheet Classification
Investments in limited partnerships:		
Assets	\$ 8,890	Other assets
Commitments	6,021	Commitments and contingencies
Maximum exposure to loss	14,911	

**Cash and Cash Equivalents** The Company considers all liquid investments with original maturities of three months or less to be cash equivalents. Cash and cash equivalents include amounts that the Company is required to maintain at the Federal Reserve Bank of Kansas City to meet certain regulatory reserve balance requirements. The following table shows supplemental disclosures of certain cash and noncash items:

(in thousands)	Nine months ended September 30,	
	2012	2011
Cash paid (received) during the period for:		
Interest	\$ 9,503	\$ 11,855
Income taxes	(3,013)	6,857
Other noncash activities:		
Trade date accounting for investment securities	1,011	
Loans transferred to held for sale	2,171	4,278
Loans transferred to OREO and repossessed assets	264	5,780
Financed sales of OREO and loans held for sale		660

**Investments** The Company classifies its investment securities as held to maturity, available for sale or trading, according to management's intent.

Available for sale securities consist of residential mortgage-backed securities (MBS), bonds, notes and debentures not classified as held to maturity securities and are reported at fair value as determined by quoted market prices. Unrealized holding gains and losses, net of tax, are reported as a net amount in accumulated other comprehensive income (loss) until realized.

Investment securities held to maturity consist of residential mortgage-backed securities, bonds, notes and debentures for which the Company has the positive intent and ability to hold to maturity and are reported at cost, adjusted for amortization or accretion of premiums and discounts.

Premiums and discounts, adjusted for prepayments as applicable, are recognized in interest income using the level-yield method over the period to maturity. Other than temporary declines in the fair value of individual investment securities held to maturity and available for sale are charged against earnings. Gains and losses on disposal of investment securities are determined using the specific-identification method.

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Other-than-temporary-impairment (OTTI) on debt securities is separated between the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between a security's amortized cost basis and the discounted present value of expected future cash flows. The amount due to all other factors is recognized in other comprehensive income.

**Bank Stocks** Federal Home Loan Bank of Topeka (FHLB), Federal Reserve Bank and other correspondent bank stocks are accounted for under the cost method.

**Loans held for investment** Loans that the Company has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal balance adjusted for any charge-offs, the allowance for loan losses, deferred fees and costs on originated loans, and unamortized premiums or discounts on purchased loans. Interest is accrued and credited to income daily based on the principal balance outstanding. The accrual of interest income is generally discontinued when a loan becomes 90 days past due as to principal and interest. When a loan is designated as nonaccrual, the current period's accrued interest receivable is charged against current earnings while any portions relating

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to prior periods are charged against the allowance for loan losses. Interest payments received on nonaccrual loans are generally applied to the principal balance of the loan. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured and there has been demonstrated performance in accordance with contractual terms. The Company may elect to continue the accrual of interest when the loan is in the process of collection and the realizable value of collateral is sufficient to cover the principal balance and accrued interest.

**Loans Held For Sale** Loans held for sale include loans the Company has demonstrated the ability and intent to sell. Loans held for sale are primarily nonperforming loans. Loans held for sale are carried at the lower of cost or fair value and are evaluated on a loan-by-loan basis.

**Loan Origination Fees and Costs** Loan fees and certain costs of originating loans are deferred and the net amount is amortized over the contractual life of the related loans in accordance with Accounting Standards Codification (ASC) Topic 310-20, *Nonrefundable Fees and Other Costs*.

**Allowance for Loan Losses** The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged against earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability 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 new information becomes available.

**Impaired loans** Impaired loans, with the exception of groups of smaller-balance homogenous loans that are collectively evaluated for impairment, are defined as loans for which, 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 of less than 90 days and monthly payment shortfalls of less than 10% of the contractual payment on a consumer loan generally are not classified as impaired if the Company ultimately expects to recover its full investment. The Company 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 borrower, 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 by 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. Loans that are deemed to be impaired are evaluated in accordance with ASC Topic 310-10-35, *Receivables - Subsequent Measurement* (ASC 310) and ASC Topic 450-20, *Loss Contingencies* (ASC 450).

Included in impaired loans are troubled debt restructurings. A troubled debt restructuring is a formal restructure of a loan where the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower. The concessions may be granted in various forms, including but not limited to reduction in the stated interest rate, reduction in the loan balance or accrued interest, or extension of the maturity date. Troubled debt restructurings are evaluated in accordance with ASC Topic 310-10-40, *Troubled Debt Restructurings by Creditors*. Interest payments on impaired loans are typically applied to principal unless collectability of principal is reasonably assured. Loans that have been modified in a formal restructuring are typically returned to accrual status when there has been a sustained period of performance (generally six months) under the modified terms, the borrower has shown the ability and willingness to repay and the Company

expects to collect all amounts due under the modified terms.

**Allowance for Credit Losses** The allowance for credit losses is established as losses are estimated to have occurred through a provision for credit losses charged to earnings. The allowance for credit losses represents management's recognition of a separate reserve for off-balance sheet loan commitments and letters of credit. While the allowance for loan losses is recorded as a contra-asset to the loan portfolio on the condensed consolidated balance sheets, the allowance for credit losses is recorded under the caption "Accrued interest and other liabilities". Although the allowances are presented separately on the balance sheets, any losses incurred from credit losses would be reported as a charge-off in the allowance for loan losses, as any loss would be recorded after the off-balance sheet commitment had been funded.

**Intangible Assets** Intangible assets, primarily consisting of customer contracts and relationships, are being amortized by the straight-line method over 10 to 15 years.

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**Derivative Instruments** Derivative financial instruments are accounted for at fair value. The Company utilizes interest rate swaps to hedge a portion of its exposure to interest rate changes. These instruments are accounted for as cash flow hedges, as defined by ASC Topic 815, *Derivatives and Hedging* (ASC 815). The Company also has a derivative program that offers interest-rate caps, floors, swaps and collars to customers of the Bank. The fair value amounts recognized for derivative instruments and the fair value amounts recognized for the right to reclaim or obligation to return cash collateral are offset when represented under a master netting arrangement.

**Stock-Based Compensation** Pursuant to ASC Topic 718, *Compensation – Stock Compensation* (ASC 718), the Company recognizes the fair value of stock-based awards to employees as compensation cost over the requisite service period.

**Earnings Per Common Share** Basic earnings per share is based on the two-class method prescribed in ASC Topic 260, *Earnings Per Share* (ASC 260). The weighted-average number of shares outstanding used to compute diluted earnings per share include the number of additional common shares that would be outstanding if the potential dilutive common shares and common share equivalents had been issued at the beginning of the period.

**Fair Value Measurements** The Company measures financial assets, financial liabilities, nonfinancial assets and nonfinancial liabilities pursuant to ASC Topic 820, *Fair Value Measurements and Disclosures* (ASC 820). ASC 820 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements.

## 2. Recent Accounting Pronouncements

Effective January 2012, the Company adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2011-03, *Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements* (ASU 2011-03). ASU 2011-03 is intended to improve financial reporting of repurchase agreements and refocus the assessment of effective control on a transferor's contractual rights and obligations rather than practical ability to perform those rights and obligations. The guidance in ASU 2011-03 was effective for the first interim or annual period beginning on or after December 15, 2011. The adoption of this update did not have a material impact on the consolidated financial statements.

Effective January 2012, the Company adopted ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04). ASU 2011-04 represents the converged guidance of the FASB and the International Accounting Standards Board (IASB) on fair value measurement. A variety of measures are included in the update intended to either clarify existing fair value measurement requirements, change particular principles requirements for measuring fair value or for disclosing information about fair value measurements. For many of the requirements, the FASB does not intend to change the application of existing requirements under Accounting Standards Codification (ASC) Topic 820, Fair Value Measurements. ASU 2011-04 was effective for interim and annual periods beginning after December 15, 2011. The adoption of this update did not have a material impact on the consolidated financial statements.

Effective January 2012, the Company adopted ASU No. 2011-05, *Presentation of Comprehensive Income* (ASU 2011-05). ASU 2011-05 is intended to increase the prominence of items reported in other comprehensive income and to facilitate convergence of accounting guidance in this area with that of the IASB. The amendments require that all non-owner changes in stockholders' equity be presented in a single continuous statement of comprehensive income or in two separate but consecutive statements. In December 2011, the FASB issued ASU No. 2011-12,



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*Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 (ASU 2011-12).* ASU 2011-12 defers the provisions of ASU 2011-05 that require the presentation of reclassification adjustments on the face of both the statement of income and statement of other comprehensive income. Amendments under ASU 2011-05 that were not deferred under ASU 2011-12 will be applied retrospectively for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this update did not have a material impact on the consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities* (ASU 2011-11). The amendments in ASU 2011-11 require the disclosure of information on offsetting and related arrangements for financial and derivative instruments to enable users of its financial statements to understand the effect of those arrangements on its financial position. Amendments under ASU 2011-11 will be applied retrospectively for fiscal years, and interim periods within those years, beginning after January 1, 2013. The Company is evaluating the effect, if any, adoption of ASU 2011-11 will have on its consolidated financial statements.

Table of Contents**3. Earnings per Common Share and Dividends Declared per Common Share**

Earnings per common share is calculated based on the two-class method prescribed in ASC 260, *Earnings per Share*. The two-class method is an allocation of undistributed earnings to common stock and securities that participate in dividends with common stock. The Company's restricted stock awards are considered participating securities since the recipients receive non-forfeitable dividends on unvested awards. The impact of participating securities is included in the common shareholder basic earnings per share for the three and nine months ended September 30, 2012 and 2011. The weighted average shares outstanding used in the calculation of basic and diluted loss per share are as follows:

(in thousands, except share amounts)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net income	\$ 6,349	\$ 4,443	\$ 17,039	\$ 11,508
Preferred stock dividends	(717)	(2,535)	(2,151)	(4,430)
Net income available to common shareholders	5,632	1,908	14,888	7,078
Dividends and undistributed earnings allocated to participating securities	(94)	(8)	(219)	(56)
Net income available to basic common shares (1)	\$ 5,538	\$ 1,900	\$ 14,669	\$ 7,022
Weighted average common shares - issued	39,706,862	37,042,719	38,977,807	37,005,380
Average unvested restricted share awards	(678,527)	(295,229)	(592,426)	(336,148)
Weighted average common shares outstanding - basic	39,028,335	36,747,490	38,385,382	36,669,232
Effect of dilutive stock options and awards outstanding	93,526	102,366	42,079	154,573
Weighted average common shares outstanding - diluted	39,121,861	36,849,856	38,427,461	36,823,805
Weighted average antidilutive common shares outstanding (2)	2,360,825	3,400,827	2,855,022	3,258,673
Basic earnings per share	\$ 0.14	\$ 0.05	\$ 0.38	\$ 0.19
Diluted earnings per share	\$ 0.14	\$ 0.05	\$ 0.38	\$ 0.19
Dividends declared per share	\$ 0.02	\$ 0.01	\$ 0.05	\$ 0.03

(1) Earnings allocated to common shareholders for basic EPS under the two-class method may differ from earnings allocated for diluted EPS when use of the treasury method results in greater dilution than the two-class method.

(2) Antidilutive shares excluded from the diluted earnings per share computation.

Dividends on the Senior Non-Cumulative Perpetual Preferred Stock, Series C Preferred Stock began accruing at 5.0% when issued in conjunction with the Company's participation in the SBLF during 2011. The dividend rate can fluctuate between 1% and 5% depending on the change in the level of Qualified Small Business Lending (QSBL) as illustrated in following chart.

Relative increase in QSBL to Baseline	Dividend Rate
Less than 2.5%	5.0%
Between 2.5% and 5.0%	4.0%

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Between 5.0% and 7.5%	3.0%
Between 7.5% and 10.0%	2.0%
10.0% or more	1.0%

On March 23, 2012, the Company completed an underwritten public offering of 2,100,000 shares of the Company's common stock at a price of \$6.00 per share. The offering provided net proceeds to the Company of approximately \$11.8 million after deducting underwriting discounts and commissions and estimated offering expenses.

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#### 4. Comprehensive Income (Loss)

Comprehensive income is the total of (1) net income plus (2) all other changes in net assets arising from non-owner sources, which are referred to as other comprehensive income (OCI). Presented below are the changes in other comprehensive income for the periods indicated.

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Other comprehensive income (loss) items:				
Unrealized gain (loss) on available for sale securities	\$ 3,321	\$ (4,538)	\$ 8,229	\$ (756)
Reclassification for (gain) loss to operations	167	182	(339)	(98)
Change in OTTI-related component of unrealized gain (loss)	242	(50)	709	430
Unrealized loss on derivatives	(770)	(6,416)	(2,780)	(8,315)
Reclassification for loss to operations	519	410	1,525	1,135
	3,479	(10,412)	7,344	(7,604)
Deferred tax benefit (expense):				
Unrealized gain (loss) on available for sale securities	(1,262)	1,724	(3,127)	287
Reclassification for (gain) loss to operations	(63)	(69)	129	37
Change in OTTI-related component of unrealized gain (loss)	(92)	19	(269)	(163)
Unrealized loss on derivatives	293	2,439	1,057	3,160
Reclassification for loss to operations	(198)	(156)	(580)	(431)
	(1,322)	3,957	(2,790)	2,890
Other comprehensive income (loss), net of tax	\$ 2,157	\$ (6,455)	\$ 4,554	\$ (4,714)

(in thousands)	Available for sale securities	Derivatives designated as hedging instruments	Accumulated other comprehensive income
Balance at December 31, 2011	\$ 6,359	\$ (5,275)	\$ 1,084
Net change	5,332	(778)	4,554
Balance at September 30, 2012	\$ 11,691	\$ (6,053)	\$ 5,638

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The amortized cost and estimated fair values of investment securities are summarized as follows:

(in thousands)	At September 30, 2012				At December 31, 2011			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
<b>Available for sale securities:</b>								
Mortgage-backed securities	\$ 383,372	\$ 13,821	\$	\$ 397,193	\$ 408,963	\$ 11,650	\$ 61	\$ 420,552
U.S. government agencies	17,993	60		18,053	43,915	290		44,205
Trust preferred securities	73,872	2,907	234	76,545	98,997	2,193	2,172	99,018
Corporate debt securities	94,513	2,969	242	97,240	57,317	338	838	56,817
Private-label MBS	2,599	110	548	2,161	3,137		1,147	1,990
Municipal securities	929	13		942	935	5		940
Total	\$ 573,278	\$ 19,880	\$ 1,024	\$ 592,134	\$ 613,264	\$ 14,476	\$ 4,218	\$ 623,522
<b>Held to maturity securities:</b>								
Mortgage-backed securities	\$ 212	\$ 6	\$	\$ 218	\$ 232	\$ 6	\$	\$ 238

Proceeds from the sale of investments and the gain (loss) recognized on securities sold or called are summarized as follows:

(in thousands)	For the three months ended September 30,				For the nine months ended September 30,			
	2012		2011		2012		2011	
Proceeds	\$	4,656	\$	5,722	\$	7,206	\$	8,916
Gain (loss)		(133)		(46)		636		605

The amortized cost and estimated fair value of investments in debt securities at September 30, 2012, by contractual maturity are shown below. Expected maturities can differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties.

(in thousands)	Available for sale		Held to maturity	
	Amortized cost	Estimated fair value	Amortized cost	Estimated fair value
Due in one year or less	\$ 5,015	\$ 5,041	\$	\$
Due after one year through five years	82,621	84,825		
Due after five years through ten years	25,800	26,370		

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Due after ten years	73,871	76,544				
Mortgage-backed securities	385,971	399,354	212			218
	\$ 573,278	\$ 592,134	\$ 212	\$		218

Investment securities with an approximate fair value of \$153.0 million and \$181.0 million were pledged to secure public deposits of \$130.1 million and \$102.3 million at September 30, 2012 and December 31, 2011, respectively. Securities sold under agreements to repurchase of \$124.8 million and \$127.9 million at September 30, 2012 and December 31, 2011, respectively, consisted primarily of mortgage-backed securities with an estimated fair value of \$136.8 million and \$138.8 million, respectively.

Changes in interest rates and market liquidity may cause adverse fluctuations in the market price of securities resulting in temporary unrealized losses. In reviewing the realizable value of its securities in a loss position, the Company considered

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the following factors: (1) the length of time and extent to which the market had been less than cost; (2) the financial condition and near-term prospects of the issuer; (3) investment downgrades by rating agencies; and (4) whether it is more likely than not that the Company will have to sell the security before a recovery in value. When it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the security, and the fair value of the investment security is less than its amortized cost, an other-than-temporary impairment is recognized in earnings.

For debt securities that are considered other-than temporarily impaired and that the Company does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, an OTTI is recognized. OTTI is separated into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between a security's amortized cost basis and the discounted present value of expected future cash flows. The amount due to all other factors is recognized in other comprehensive income.

There were 14 and 49 securities in the tables below at September 30, 2012 and December 31, 2011, respectively, in an unrealized loss position.

September 30, 2012 (in thousands)	Less than 12 months		12 months or greater		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
Trust preferred securities	\$ 9,580	\$ 200	\$ 1,349	\$ 34	\$ 10,929	\$ 234
Corporate debt securities			9,170	242	9,170	242
Private-label MBS			1,796	548	1,796	548
Total	\$ 9,580	\$ 200	\$ 12,315	\$ 824	\$ 21,895	\$ 1,024

December 31, 2011 (in thousands)	Less than 12 months		12 months or greater		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
Mortgage-backed securities	\$ 31,855	\$ 61	\$	\$	\$ 31,855	\$ 61
Trust preferred securities	39,838	2,008	1,246	164	41,084	2,172
Corporate debt securities	25,048	634	4,796	204	29,844	838
Private-label MBS			1,990	1,147	1,990	1,147
Total	\$ 96,741	\$ 2,703	\$ 8,032	\$ 1,515	\$ 104,773	\$ 4,218

The credit component of OTTI recognized in earnings is presented as an addition in two parts based upon whether the current period is the first time the debt security was credit impaired or if it is additional credit impairment. The credit loss component is reduced if the Company sells, intends to sell or believes it will be required to sell previously credit impaired debt securities. Additionally, the credit loss component is reduced if the Company receives cash flows in excess of what it expected to receive over the remaining life of the credit impaired debt security or when the security matures.

The following table presents a roll-forward of the credit loss component of OTTI on debt securities recognized in earnings during the three and nine months ended September 30, 2012 and 2011.

For the three months ended  
September 30,

For the nine months ended  
September 30,

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(in thousands)	2012		2011		2012		2011	
Beginning balance	\$	2,815	\$	2,153	\$	2,553	\$	1,782
Additions:								
Additional credit impairment		35		136		297		507
Ending balance	\$	2,850	\$	2,289	\$	2,850	\$	2,289

During the three and nine months ended September 30, 2012 and 2011, the Company recognized credit related OTTI in earnings on two private-label MBS. In determining the credit loss, the Company estimated expected future cash flows of the security by estimating the expected future cash flows of the underlying collateral and applying those collateral cash flows, together with any credit enhancements such as subordination interests owned by third parties to the security. The expected future cash flows of the underlying collateral are determined using the remaining contractual cash flows adjusted



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for future expected credit losses (which consider current and future delinquencies, default rates and loss severities) and prepayments. The expected cash flows of the security are then discounted to arrive at a present value amount.

At September 30, 2012, gross unrealized losses of \$0.5 million on private-label MBS were recognized in other comprehensive income.

The following table presents a summary of the significant inputs considered in determining the measurement of the credit loss component recognized in earnings during the nine months ended September 30, 2012. A range of inputs is provided for securities with multiple impairments during the nine months ended, September 30, 2012.

Inputs	Security #1	Security #2
Prepayment speed (CPR) (1)	0.4 - 3.9%	0.2 - 4.3%
Default rate (CDR) (2)	6.2 - 6.3%	3.8 - 5.2%
Severity (3)	50.3 - 54.1%	48.5 - 49.9%
Credit impairment (in thousands)	\$ 266	\$ 31

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- (1) Estimated prepayments as a percentage of outstanding loans
- (2) Estimated default rate as a percentage of outstanding loans
- (3) Estimated loss rate on collateral liquidations

Certain characteristics of the loans underlying the impaired private-label MBS are included in the following table, at September 30, 2012.

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	Underlying Loan Characteristics		
	Security #1	Security #2	Security #3
Amortized cost (in thousands)	\$ 254	\$ 582	\$ 1,763
Estimated fair value (in thousands)	\$ 364	\$ 251	\$ 1,546
Purpose:			
Purchase	64.1%	62.6%	65.8%
Equity take out	31.7%	30.3%	8.5%
Refinance	4.3%	7.1%	25.7%
Type:			
Single family	66.6%	57.7%	70.0%
2-4 family	8.5%	7.0%	0.5%
Condominium	1.9%	7.2%	28.5%
Planned unit development	22.9%	27.6%	0.8%
Owner occupied	100.0%	90.5%	91.1%
Vacation	0.0%	0.5%	8.9%
Investment	0.0%	9.1%	0.0%
Terms:			
30 year amortization	100.0%	99.3%	100.0%
40 year amortization	0.0%	0.7%	0.0%
ARM	100.0%	100.0%	100.0%
Geography:			
Northern CA	29.0%	26.2%	14.0%
Southern CA	33.8%	37.4%	15.0%
Current Averages:			
Loan rate	3.2%	3.1%	2.9%
LTV based on origination value	76.0%	73.6%	66.3%
Loan balance	\$ 461,800	\$ 364,400	\$ 198,700
Age (months)	90	93	102
FICO at origination	716	716	737
Delinquent 60+ days	12.2%	18.5%	6.7%
Delinquent 90+ days	9.8%	17.6%	6.1%

Other investments at September 30, 2012 and December 31, 2011, consist of the following:

(in thousands)	September 30, 2012	December 31, 2011
Bank stocks at cost	\$ 6,709	\$ 7,382
Investment in statutory trusts equity method	2,175	2,172
	\$ 8,884	\$ 9,554

Bank stocks consist primarily of stock in the FHLB which is part of the Federal Home Loan Bank System (FHLB System). The purpose of the FHLB investment relates to maintenance of a borrowing base with the FHLB. FHLB stock holdings are largely dependent upon the Company's liquidity position. To the extent the need for wholesale funding increases or decreases, the Company may purchase additional or sell excess FHLB stock, respectively. The Company evaluates impairment in this investment based on the ultimate recoverability of the par value and at September 30, 2012, did not consider the investment to be other-than-temporarily impaired.

**6. Loans**

The following disclosure reports the Company's loan portfolio segments and classes. Segments are groupings of similar loans at a level which the Company has adopted systematic methods of documentation for determining its allowance for loan and credit losses. Classes are a disaggregation of the portfolio segments. The Company's loan portfolio segments are:

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- **Commercial Loans** Commercial loans consist of loans to small and medium-sized businesses in a wide variety of industries. The Bank's areas of emphasis in commercial lending include, but are not limited to, loans to wholesalers, manufacturers, construction and business services companies. Commercial loans are generally collateralized by inventory, accounts receivable, equipment, real estate and other commercial assets, and may be supported by other credit enhancements such as personal guarantees. Risk arises primarily due to a difference between expected and actual cash flows of the borrowers. However, the recoverability of the Company's investment in these loans is also dependent on other factors primarily dictated by the type of collateral securing these loans. The fair value of the collateral securing these loans may fluctuate as market conditions change. In the case of loans secured by accounts receivable, the recovery of the Company's investment is dependent upon the borrowers' ability to collect amounts due from its customers.
  
- **Real Estate - Mortgage Loans** Real estate mortgage loans include various types of loans for which the Company holds real property as collateral. Commercial real estate lending activity is typically restricted to owner-occupied properties or to investor properties that are owned by customers with a current banking relationship. The primary risks of real estate mortgage loans include the borrower's inability to pay, material decreases in the value of the real estate that is being held as collateral and significant increases in interest rates, which may make the real estate mortgage loan unprofitable. Real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy.
  
- **Land Acquisition and Development Loans** The Company has a portfolio of loans for the acquisition and future development of land for residential building projects, as well as finished lots prepared to enter the construction phase. Due to overall market illiquidity and the significant value declines on raw land, the Company has ceased new lending activities for the acquisition and future development of land. The primary risks include the borrower's inability to pay and the inability of the Company to recover its investment due to a decline in the fair value of the underlying collateral.
  
- **Real Estate Construction Loans** The Company originates loans to finance construction projects including one- to four-family residences, multifamily residences, senior housing, and industrial projects. Residential construction loans are due upon the sale of the completed project and are generally collateralized by first liens on the real estate and have floating interest rates. Construction loans are considered to have higher risks due to the ultimate repayment being sensitive to interest rate changes, governmental regulation of real property and the availability of long-term financing. Additionally, economic conditions may impact the Company's ability to recover its investment in construction loans. Adverse economic conditions may negatively impact the real estate market which could affect the borrowers' ability to complete and sell the project. Additionally, the fair value of the underlying collateral may fluctuate as market conditions change.
  
- **Consumer Loans** The Company provides a broad range of consumer loans to customers, including personal lines of credit, home equity loans, jumbo mortgage loans and automobile loans. Repayment of these loans is dependent on the borrowers' ability to pay and the fair value of the underlying collateral.
  
- **Other Loans** Other loans include lending products, such as taxable and tax-exempt leasing, not defined as commercial, real estate, acquisition and development, construction loans or consumer.

The loan portfolio segments at September 30, 2012 and December 31, 2011 were as follows:

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(in thousands)	September 30, 2012		December 31, 2011	
Commercial	\$	664,131	\$	569,032
Real estate - mortgage		851,635		784,874
Land acquisition & development		54,222		62,056
Real estate - construction		56,591		63,491
Consumer		137,387		116,772
Other		48,083		41,300
Loans held for investment		1,812,049		1,637,525
Allowance for loan losses		(46,437)		(55,629)
Unearned net loan fees		(642)		(101)
Total net loans	\$	1,764,970	\$	1,581,795

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Loan sales for the three and nine months ended September 30, 2012 and 2011 were immaterial. The Company purchased 26 loans, during the nine months ended September 30, 2012 totaling \$8.5 million primarily comprised of other loans. For the nine months ended September 30, 2011, the Company purchased 33 loans totaling \$21.4 million comprised of other loans (\$19.7 million) and real estate-mortgage loans (\$1.7 million).

The Company uses qualifying loans as collateral for advances and a line of credit from the FHLB. The FHLB line of credit, which had a zero balance outstanding at September 30, 2012, was collateralized by loans of \$728.1 million with a lending value of \$439.2 million.

The Company maintains a loan review program independent of the lending function that is designed to reduce and control risk in the lending function. It includes the continuous monitoring of lending activities with respect to underwriting and processing new loans, preventing insider abuse and timely follow-up and corrective action for loans showing signs of deterioration in quality. The Company also has a systematic process to evaluate individual loans and pools of loans within our loan portfolio. The Company maintains a loan grading system whereby each loan is assigned a grade between 1 and 8, with 1 representing the highest quality credit, 7 representing a nonaccrual loan where collection or liquidation in full is highly questionable and improbable, and 8 representing a loss that has been or will be charged-off. Grades are assigned based upon the degree of risk associated with repayment of a loan in the normal course of business pursuant to the original terms. Loans that are graded 5 or lower are categorized as non-classified credits while loans graded 6 and higher are categorized as classified credits. Loan grade changes are evaluated on a monthly basis. Loans above a certain dollar amount that are adversely graded are reported to the Problem Loan Committee of the Bank and the Chief Credit Officer along with current financial information, a collateral analysis and an action plan.

The loan portfolio showing total non-classified and classified balances by loan class at September 30, 2012 and December 31, 2011 is summarized below:

(in thousands)	At September 30, 2012		Total
	Non-classified	Classified	
Commercial			
Manufacturing	\$ 80,890	\$ 8,669	\$ 89,559
Finance and insurance	74,915	1,018	75,933
Health care	83,871	305	84,176
Real estate services	77,066	8,229	85,295
Construction	54,343	5,192	59,535
Retail trade	28,256	539	28,795
Wholesale trade	56,640	941	57,581
Other	179,702	3,555	183,257
	635,683	28,448	664,131
Real estate - mortgage			
Residential & commercial owner-occupied	402,941	22,045	424,986
Residential & commercial investor	405,577	20,916	426,493
Other	156		156
	808,674	42,961	851,635
Land acquisition & development			
Commercial	13,216	8,498	21,714
Residential	21,421	4,323	25,744
Other	2,387	4,377	6,764
	37,024	17,198	54,222
Real estate - construction			
Residential & commercial owner-occupied	25,048		25,048
Residential & commercial investor	30,896	647	31,543

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	55,944	647	56,591
Consumer	135,759	1,628	137,387
Other	48,083		48,083
Total loans held for investment	\$ 1,721,167	\$ 90,882	\$ 1,812,049
Unearned net loan fees			(642)
Net loans held for investment			\$ 1,811,407

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(in thousands)	At December 31, 2011		
	Non-classified	Classified	Total
Commercial			
Manufacturing	\$ 64,936	\$ 14,899	\$ 79,835
Finance and insurance	77,968	1,106	79,074
Health care	55,885	358	56,243
Real estate services	75,520	10,678	86,198
Construction	40,095	6,343	46,438
Retail trade	27,016	756	27,772
Wholesale trade	58,420	3,681	62,101
Other	126,715	4,656	131,371
	526,555	42,477	569,032
Real estate - mortgage			
Residential & commercial owner-occupied	387,453	33,764	421,217
Residential & commercial investor	339,968	23,689	363,657
	727,421	57,453	784,874
Land acquisition & development			
Commercial	14,220	10,052	24,272
Residential	25,282	5,347	30,629
Other	7,003	152	7,155
	46,505	15,551	62,056
Real estate - construction			
Residential & commercial owner-occupied	16,401		16,401
Residential & commercial investor	37,364	9,726	47,090
	53,765	9,726	63,491
Consumer	112,541	4,231	116,772
Other	41,300		41,300
Total loans held for investment	\$ 1,508,087	\$ 129,438	\$ 1,637,525
Unearned net loan fees			(101)
Net loans held for investment			\$ 1,637,424



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Transactions in the allowance for loan losses by segment for the three and nine months ended September 30, 2012 and 2011 are summarized below:

(in thousands)	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Allowance for loan losses, beginning of period:				
Commercial	\$ 11,868	\$ 16,042	\$ 14,048	\$ 17,169
Real estate - mortgage	18,622	20,614	19,889	17,677
Land acquisition & development	11,724	12,690	11,013	14,938
Real estate - construction	2,598	3,161	2,746	6,296
Consumer	3,215	3,687	4,837	3,373
Other	600	479	551	354
Unallocated	2,474	5,247	2,545	6,085
Total	51,101	61,920	55,629	65,892
Provision for loan losses:				
Commercial	\$ 205	\$ 69	\$ (2,544)	\$ 537
Real estate - mortgage	213	71	(427)	4,758
Land acquisition & development	(1,872)	(611)	471	(2,004)
Real estate - construction	(769)	400	(580)	534
Consumer	(241)	12	(1,264)	451
Other	(105)	85	(44)	210
Unallocated	63	(26)	(8)	(864)
Total	(2,506)		(4,396)	3,622
Charge-offs:				
Commercial	\$ (147)	\$ (1,264)	\$ (982)	\$ (3,618)
Real estate - mortgage	(1,490)	89	(2,517)	(2,138)
Land acquisition & development	(876)	(402)	(3,115)	(1,635)
Real estate - construction	(530)	(1,813)	(867)	(5,098)
Consumer	66	16	(635)	(184)
Other	(8)	(61)	(20)	(61)
Total	(2,985)	(3,435)	(8,136)	(12,734)
Recoveries:				
Commercial	\$ 143	\$ 377	\$ 1,547	\$ 1,136
Real estate - mortgage	114	541	514	1,018
Land acquisition & development	641	225	1,248	603
Real estate - construction	3	53	3	69
Consumer	(74)	11	28	86
Other		3		3
Total	827	1,210	3,340	2,915
Allowance for loan losses, end of period:				
Commercial	\$ 12,069	\$ 15,224	\$ 12,069	\$ 15,224
Real estate - mortgage	17,459	21,315	17,459	21,315
Land acquisition & development	9,617	11,902	9,617	11,902
Real estate - construction	1,302	1,801	1,302	1,801
Consumer	2,966	3,726	2,966	3,726
Other	487	506	487	506
Unallocated	2,537	5,221	2,537	5,221
Total	\$ 46,437	\$ 59,695	\$ 46,437	\$ 59,695



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The allowance for loan losses (ALL) is established for the purpose of recognizing estimated loan impairments before loan losses on individual loans result in a charge-off. The ALL reflects probable but unconfirmed loan impairments in the Company's loan portfolio as of the balance sheet date.

The Company estimates the ALL in accordance with ASC 310 for purposes of evaluating loan impairment on a loan-by-loan basis and ASC 450 for purposes of collectively evaluating loan impairment by grouping loans with common risk characteristics (i.e. risk classification, past-due status, type of loan, and collateral). The ALL is comprised of the following components:

- **Specific Reserves** The Company continuously evaluates its reserve for loan losses to maintain an adequate level to absorb loan losses inherent in the loan portfolio. Reserves on loans identified as impaired, including troubled debt restructurings, are based on discounted expected cash flows using the loan's initial effective interest rate, the observable market value of the loan or the fair value of the collateral for certain collateral-dependent loans. The fair value of the collateral is determined in accordance with ASC 820. Loans are considered to be impaired in accordance with the provisions of ASC 310, when it is probable that all amounts due in accordance with the contractual terms will not be collected. Factors contributing to the determination of specific reserves include the financial condition of the borrower, changes in the value of pledged collateral and general economic conditions. Troubled debt restructurings meet the definition of an impaired loan under ASC 310 and therefore, troubled debt restructurings are subject to impairment evaluation on a loan-by-loan basis.

For collateral dependent loans that have been specifically identified as impaired, the Company measures fair value based on third-party appraisals, adjusted for estimated costs to sell the property. Upon impairment, the Company will obtain a new appraisal if one had not been previously obtained in the last 6-12 months. For credits over \$2.0 million, the Company engages an additional third-party appraiser to review the appraisal. For credits under \$2.0 million, the Company's internal appraisal department reviews the appraisal. All appraisals are reviewed for reasonableness based on recent sales transactions that may have occurred subsequent to or right at the time of the appraisal. Based on this analysis the appraised value may be adjusted downward if there is evidence that the appraised value may not be indicative of fair value. Each appraisal is updated on an annual basis, either through a new appraisal or through the Company's comprehensive internal review process.

Values are reviewed and monitored internally and fair value is re-assessed at least quarterly or more frequently when events or circumstances occur that indicate a change in fair value. It has been the Company's experience that appraisals quickly become outdated due to the volatile real estate environment. As such, fair value based on property appraisals may be adjusted to reflect estimated declines in the fair value of properties since the time the last appraisal was performed.

- **General Reserves** General reserves are considered part of the allocated portion of the allowance. The Company uses a comprehensive loan grading process for our loan portfolios. Based on this process, a loss factor is assigned to each pool of graded loans. A combination of loss experience and external loss data is used in determining the appropriate loss factor. This estimate represents the probable incurred losses within the portfolio. In evaluating the adequacy of the ALL, management considers historical losses (Migration), as well as other factors including changes in:

- Lending policies and procedures
- National and local economic and business conditions and developments

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- Nature and volume of portfolio
- Trends of the volume and severity of past-due and classified loans
- Trends in the volume of nonaccrual loans, troubled debt restructurings, and other loan modifications
- Credit concentrations

Troubled debt restructurings have a direct impact on the allowance to the extent a loss has been recognized in relation to the loan modified. This is consistent with the Company's consideration of Migration in determining general reserves.

The aforementioned factors enable management to recognize environmental conditions contributing to inherent losses in the portfolio, which have not yet manifested in Migration. Due to current and recent adverse economic conditions resulting in increased loan loss levels for the Company, management relies more heavily on actual empirical charge-off history. Management believes Migration history adequately captures a great percentage of probable incurred losses within the portfolio.

In addition to the allocated reserve for graded loans, a portion of the allowance is determined by segmenting the portfolio into product groupings with similar risk characteristics and by loan origination date (vintage). Part of the

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segmentation involves assigning increased reserve factors to those lending activities deemed higher-risk such as leverage-financings, unsecured loans, certain loans lacking personal guarantees, land acquisition and development loans, and speculative real-estate loans.

- **Unallocated Reserves** The unallocated reserve, which is judgmentally determined, is maintained to recognize the imprecision in estimating and measuring loss when evaluating reserves for individual loans or pools of loans. The unallocated reserve consists of a missed grade component that is intended to capture the inherent risk that certain loans may be assigned an incorrect loan grade.

In assessing the reasonableness of management's assumptions, consideration is given to select peer ratios, industry standards and directional consistency of the ALL. Ratio analysis highlights divergent trends in the relationship of the ALL to nonaccrual loans, to total loans and to historical charge-offs. Although these comparisons can be helpful as a supplement to assess reasonableness of management assumptions, they are not, by themselves, sufficient basis for determining the adequacy of the ALL. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including the performance of our loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The following table summarizes loans held for investment and the allowance for loan and credit losses on the basis of the impairment method:

(in thousands)	At September 30, 2012				At December 31, 2011			
	Individually evaluated for impairment		Collectively evaluated for impairment		Individually evaluated for impairment		Collectively evaluated for impairment	
	Loans held for investment	Allowance for loan losses	Loans held for investment	Allowance for loan losses	Loans held for investment	Allowance for loan losses	Loans held for investment	Allowance for loan losses
Commercial	\$ 18,979	\$ 2,861	\$ 644,901	\$ 9,208	\$ 10,948	\$ 1,905	\$ 558,014	\$ 12,143
Real estate - mortgage	35,625	3,202	815,199	14,257	34,811	4,870	749,680	15,019
Land acquisition & development	14,120	3,911	40,100	5,706	8,435	2,245	53,542	8,768
Real estate - construction	3,417	484	52,763	818	6,985	1,259	56,156	1,487
Consumer	664	637	136,635	2,329	2,527	2,509	114,149	2,328
Other			49,004	487			42,177	551
Unallocated				2,537				2,545
Total	\$ 72,805	\$ 11,095	\$ 1,738,602	\$ 35,342	\$ 63,706	\$ 12,788	\$ 1,573,718	\$ 42,841

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Information on impaired loans at September 30, 2012 and December 31, 2011 is reported in the following tables:

(in thousands)	At September 30, 2012				
	Unpaid principal balance	Recorded investment in impaired loans	Recorded investment with a related ALL	Recorded investment with no related ALL	Related allowance
Commercial					
Manufacturing	\$ 4,384	\$ 4,356	\$ 4,216	\$ 140	\$ 474
Finance and insurance	1,018	1,018	1,018		186
Real estate services	7,699	7,699	7,699		901
Construction	2,640	2,603	2,185	418	650
Retail trade	1,402	365	3	362	3
Wholesale trade	511	123	43	80	30
Other	3,330	2,816	2,278	538	616
	20,984	18,980	17,442	1,538	2,860
Real estate - mortgage					
Residential & commercial owner-occupied	9,570	8,302	4,306	3,996	685
Residential & commercial investor	11,621	11,621	8,663	2,958	1,102
	21,191	19,923	12,969	6,954	1,787
Land acquisition & development					
Commercial	9,972	8,421	7,267	1,154	2,148
Residential	4,296	3,976	3,279	697	1,155
Other	1,723	1,723	1,723		609
	15,991	14,120	12,269	1,851	3,912
Real estate - construction					
Residential & commercial investor	3,053	647	647		390
Consumer	664	665	654	11	637
Total	\$ 61,883	\$ 54,335	\$ 43,981	\$ 10,354	\$ 9,586

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(in thousands)	For the three months ended September 30,			For the nine months ended September 30,		
	2012	2011	2011	2012	2011	2011
	Average recorded investment	Interest income recognized	Average recorded investment	Average recorded investment	Interest income recognized	Average recorded investment
Commercial						
Manufacturing	\$ 4,494	\$ 62	\$ 200	\$ 4,752	\$ 294	\$ 246
Finance and insurance	956	23	98	799	42	379
Healthcare			45	2		15
Real estate services	7,613	77	2,382	6,904	198	2,361
Construction	2,688	21	1,268	2,106	96	1,640
Retail trade	389	6	639	447	6	1,159
Wholesale trade	142		151	245	9	173
Other	2,810	26	1,276	2,534	78	1,422
	19,092	215	6,059	17,789	723	7,395
Real estate - mortgage						
Residential & commercial owner-occupied	9,695	14	9,761	9,860	34	9,274
Residential & commercial investor	11,696	80	7,199	10,224	285	4,034
	21,391	94	16,960	20,084	319	13,308
Land acquisition & development						
Commercial	9,028	65	2,239	7,663	194	2,348
Residential	4,095	73	3,238	3,296	147	4,412
Other	1,774			1,015		
	14,897	138	5,477	11,974	341	6,760
Real estate - construction						
Residential & commercial investor	1,357		7,826	4,715	30	9,233
Consumer	770	11	2,723	987	12	2,675
Total	\$ 57,507	\$ 458	\$ 39,045	\$ 55,549	\$ 1,425	\$ 39,371

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(in thousands)	At December 31, 2011				
	Unpaid principal balance	Recorded investment in impaired loans	Recorded investment with a related ALL	Recorded investment with no related ALL	Related allowance
Commercial					
Manufacturing	\$ 207	\$ 179	\$	\$ 179	\$
Finance and insurance	147	147	147		97
Real estate services	7,907	7,907	7,907		1,561
Construction	752	701	27	674	12
Retail trade	2,142	555	156	399	32
Wholesale trade	333	144	14	130	14
Other	1,707	1,315	994	321	224
	13,195	10,948	9,245	1,703	1,940
Real estate - mortgage					
Residential & commercial owner-occupied	10,083	9,504	8,456	1,048	2,244
Residential & commercial investor	9,352	9,258	8,392	866	1,200
	19,435	18,762	16,848	1,914	3,444
Land acquisition & development					
Commercial	7,075	6,400	5,394	1,006	1,620
Residential	3,314	2,035	1,381	654	625
	10,389	8,435	6,775	1,660	2,245
Real estate - construction					
Residential & commercial investor	8,861	6,985	2,452	4,533	1,259
Consumer	2,528	2,527	2,509	18	2,509
Total	\$ 54,408	\$ 47,657	\$ 37,829	\$ 9,828	\$ 11,397

Interest income of \$0.5 million and \$1.4 million recognized on impaired loans during the three and nine months ended September 30, 2012, respectively, represents primarily interest earned on troubled debt restructurings that meet the definition of an impaired loan pursuant to ASU 310-10-35-16 and are subject to disclosure requirement under ASU 310-10-50-15. For the three and nine months ending September 30, 2011, interest income recognized on impaired loans was immaterial.

The table below summarizes transactions as it relates to troubled debt restructurings during the nine months ended September 30, 2012:

(in thousands)	Performing	Nonperforming	Total
Beginning balance at December 31, 2011	\$ 20,633	\$ 9,188	\$ 29,821
New restructurings	23,910	6,314	30,224
Transfers out (1)		(4,243)	(4,243)
Change in accrual status	(3,119)	3,119	
Paydowns	(6,787)	(355)	(7,142)
Charge-offs		(3,975)	(3,975)
Ending balance at September 30, 2012	\$ 34,637	\$ 10,048	\$ 44,685

(1) In accordance with ASC 310-40-50-2, these loans are no longer subject to disclosure requirements as these loans are in compliance with their modified terms and had a market rate of interest at the time of restructuring.





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The below table provides information regarding troubled debt restructurings that occurred during the three and nine months ended September 30, 2012. Pre-modification outstanding recorded investment reflects the Company's recorded investment immediately before the modification. Post-modification outstanding recorded investment represents the Company's recorded investment at the end of the reporting period.

(in thousands)	For the three months ended September 30, 2012			For the nine months ended September 30, 2012		
	Number of contracts	Pre- modification outstanding recorded investment	Post-modification outstanding recorded investment	Number of contracts	Pre- modification outstanding recorded investment	Post-modification outstanding recorded investment
Commercial	7	\$ 1,133	\$ 1,062	31	\$ 11,853	\$ 9,901
Real estate - mortgage	3	2,401	1,596	6	6,261	5,439
Land acquisition & development	3	2,057	1,876	9	8,262	7,782
Real estate - construction	3	210	189			
Consumer				5	680	648
	16	\$ 5,801	\$ 4,723	51	\$ 27,056	\$ 23,770

Troubled debt restructurings during the three and nine months ended September 30, 2012 resulted primarily from the extension of repayment terms and interest rate reductions. The Company recognized charge-offs of \$0.3 million in conjunction with current period troubled debt restructurings.

Loans modified as troubled debt restructurings within the previous twelve months having a payment default during the nine months ended September 30, 2012 are included below:

Troubled debt restructurings that subsequently defaulted (in thousands)	Number of contracts	Recorded investment
Commercial	4	\$ 2,157
Real estate - mortgage	1	1,860
Land acquisition & development	1	75
Total	6	\$ 4,092

At September 30, 2012 and December 31, 2011 there were \$0.8 million and \$0.3 million in outstanding commitments on restructured loans, respectively.

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The Company's nonaccrual loans by class at September 30, 2012 and December 31, 2011 are reported in the following table:

(in thousands)	At	
	September 30, 2012	December 31, 2011
Commercial		
Manufacturing	\$ 140	\$ 179
Finance and insurance	84	93
Real estate services		566
Construction	959	701
Retail trade	365	555
Wholesale trade	123	144
Other	1,027	867
Total commercial	2,698	3,105
Real estate - mortgage		
Residential & commercial owner-occupied	7,333	5,357
Residential & commercial investor	3,107	3,938
Total real estate - mortgage	10,440	9,295
Land acquisition & development		
Commercial	2,125	3,077
Residential	1,173	2,035
Other	1,723	
Total land acquisition & development	5,021	5,112
Real estate - construction		
Residential & commercial investor	647	6,985
Consumer	665	2,527
Total nonaccrual loans	\$ 19,471	\$ 27,024

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The following table summarizes the aging of the Company's loan portfolio at September 30, 2012.

At September 30, 2012

(in thousands)	30 - 59 Days past due	60 - 89 Days past due	90+ Days past due	Total past due	Current	Total loans	Recorded investment in loans 90 days or more past due and accruing
Commercial							
Manufacturing	\$ 485	\$ 1,887	\$ 6	\$ 2,378	\$ 87,181	\$ 89,559	\$ 6
Finance and insurance		286		286	75,647	75,933	
Health care					84,176	84,176	
Real estate services					85,295	85,295	
Construction	341	399	482	1,222	58,313	59,535	
Retail trade	60			60	28,735	28,795	
Wholesale trade	471	14	48	533	57,048	57,581	
Other	1,126	340	713	2,179	181,078	183,257	225
	2,483	2,926	1,249	6,658	657,473	664,131	231
Real estate - mortgage							
Residential & commercial owner-occupied	1,281	1,011	2,356	4,648	420,338	424,986	952
Residential & commercial investor		364	2,780	3,144	423,349	426,493	
Other					156	156	
	1,281	1,375	5,136	7,792	843,843	851,635	952
Land acquisition & development							
Commercial			1,155	1,155	20,559	21,714	
Residential			402	402	25,342	25,744	
Other					6,764	6,764	
			1,557	1,557	52,665	54,222	
Real estate - construction							
Residential & commercial owner-occupied					25,048	25,048	
Residential & commercial investor			646	646	30,897	31,543	
			646	646	55,945	56,591	
Consumer	8	19	9	36	137,351	137,387	
Other					48,083	48,083	
Total loans held for investment	\$ 3,772	\$ 4,320	\$ 8,597	\$ 16,689	\$ 1,795,360	\$ 1,812,049	\$ 1,183
Unearned net loan fees						(642)	
Net loans held for investment						\$ 1,811,407	

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During the second quarter of 2012, the Company acquired a property and casualty book of business for \$0.4 million. In addition a review of an existing customer relationship intangible asset resulted in a shortening of its useful life from 15 to 10 years, the effects of which will be recognized prospectively in accordance with ASC Topic 350, Intangibles-Goodwill and Other.

Intangible assets and related amortization at the dates indicated consist of the following:

(in thousands)		Customer contracts, lists and relationships
December 31, 2011	\$	3,399
Acquired relationships		360
Amortization		(611)
September 30, 2012	\$	3,148

**8. Derivatives**

ASC 815 contains the authoritative guidance on accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and hedging activities. As required by ASC 815, the Company records all derivatives on the consolidated balance sheets at fair value.

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity and credit risk, primarily by managing the amount, sources, and duration of its assets and liabilities and the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and unknown cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company's known or expected cash receipts and its known or expected cash payments principally related to certain variable-rate loan assets and variable-rate borrowings.

The Company's objective in using derivatives is to minimize the impact of interest rate fluctuations on the Company's interest expense. To accomplish this objective, the Company uses interest-rate swaps as part of its cash flow hedging strategy. The Company also offers an interest-rate hedge program that includes derivative products such as swaps, caps, floors and collars to assist its customers in managing their interest-rate risk profile. In order to eliminate the interest-rate risk associated with offering these products, the Company enters into derivative contracts with third parties to offset the customer contracts. These customer accommodation interest rate swap contracts are not designated as hedging instruments.

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The table below presents the fair value of the Company's derivative financial instruments as well as the classification within the condensed consolidated balance sheets.

(in thousands)	Balance sheet classification	Asset derivatives		Balance sheet classification	Liability derivatives	
		Fair value at			Fair value at	
		September 30, 2012	December 31, 2011		September 30, 2012	December 31, 2011
Derivatives designated as hedging :						
Instruments under ASC 815						
Interest rate swap	Other assets	\$	\$	Accrued interest and other liabilities	\$ 9,763	\$ 8,508
Derivatives not designated as hedging :						
Instruments under ASC 815						
Interest rate swap	Other assets	\$ 9,543	\$ 7,943	Accrued interest and other liabilities	\$ 10,233	\$ 8,720

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**Cash Flow Hedges of Interest Rate Risk** For hedges of the Company's variable-rate borrowings, interest-rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments. The Company has executed a series of interest-rate swap transactions in order to fix the effective interest rate for payments due on its junior subordinated debentures with the objective of reducing the Company's exposure to adverse changes in cash flows relating to payments on its LIBOR-based floating rate debt. The swaps have contractual lives ranging between five and 14 years. Select critical terms of the cash flow hedges are as follows:

(in thousands)	Notional	Fixed rate	Termination date
Hedged item - Junior subordinated debentures issued by:			
CoBiz Statutory Trust I	\$ 20,000	6.04%	March 17, 2015
CoBiz Capital Trust II	\$ 30,000	5.99%	April 23, 2020
CoBiz Capital Trust III	\$ 20,000	5.02%	March 30, 2024

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. These derivatives are used to hedge the variable cash outflows associated with its junior subordinated debentures. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. The Company's derivatives did not have any hedge ineffectiveness recognized in earnings during the three or nine months ended September 30, 2012 and 2011.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are received/made on the Company's variable-rate liabilities. During the next 12 months, the Company estimates that \$2.1 million will be reclassified as an increase to interest expense.

**Non-designated Hedges** Derivatives not designated as hedges are not speculative and result from a service the Company provides to its customers. The Company executes interest-rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest-rate swaps are simultaneously hedged by offsetting interest-rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions. As the interest-rate swaps associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings. At September 30, 2012, the Company had 110 interest-rate swaps with an aggregate notional amount of \$235.8 million related to this program. Gains and losses arising from changes in the fair value of these swaps are included in Other income in the accompanying condensed consolidated statements of operations and were immaterial for the periods ending September 30, 2012 and 2011.

The table below summarizes gains and losses recognized in OCI in conjunction with our derivatives designated as hedging instruments for the three and nine months ended September 30, 2012 and 2011.

	Loss recognized in OCI (Effective portion) for the three months ended September 30,			Loss reclassified from accumulated OCI into earnings (Effective portion) for the three months ended September 30,		
(in thousands)	2012		2011	2012		2011
Cash flow hedges:						
Interest rate swap	\$	(770)	\$ (6,006)	\$	(519)	\$ (410)

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(in thousands)	Loss recognized in OCI (Effective portion)				Loss reclassified from accumulated OCI into earnings (Effective portion)			
	for the nine months ended September 30, 2012		for the nine months ended September 30, 2011		for the nine months ended September 30, 2012		for the nine months ended September 30, 2011	
Cash flow hedges:								
Interest rate swap	\$	(2,780)	\$	(7,180)	\$	(1,525)	\$	(1,135)

The Company has agreements with its derivative counterparties that contain a provision where if the Company defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations. Also, the Company has agreements with certain of its derivative counterparties that contain a provision where if the Bank fails to maintain its



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status as a well or adequately capitalized institution, then the counterparty could terminate the derivative positions and the Company would be required to settle its obligations under the agreements.

At September 30, 2012, the fair value of derivatives in a net liability position, including accrued interest but excluding any adjustment for nonperformance risk, related to these agreements was \$20.6 million. The Company has minimum collateral posting thresholds with certain of its derivative counterparties and has posted collateral of \$29.2 million against its obligations under these agreements. At September 30, 2012, the Company was not in default with any of its debt or capitalization covenants.

## 9. Employee benefit and stock compensation plans

**Stock Options and Awards** - During the three and nine months ended September 30, 2012, the Company recognized compensation expense (net of estimated forfeitures) of \$0.5 million and \$1.5 million for share-based compensation awards for which the requisite service was rendered in the period compared to \$0.4 million and \$1.1 million in the prior year periods. Estimated forfeitures are periodically evaluated based on historical and expected forfeiture behavior.

The Company uses the Black-Scholes model to estimate the fair value of stock options using various interest, dividend, volatility and expected life assumptions. Expected life is evaluated on an ongoing basis using historical and expected exercise behavior assumptions.

The following table summarizes changes in option awards during the nine months ended September 30, 2012.

	Shares		Weighted average exercise price
Outstanding at December 31, 2011	2,421,886	\$	12.63
Granted	67,150		6.56
Exercised	(8,867)		6.10
Forfeited	(555,724)		12.94
Outstanding at September 30, 2012	1,924,445	\$	12.36
Exercisable at September 30, 2012	1,649,371	\$	13.38

The weighted average grant date fair value of options granted during the nine months ended September 30, 2012 was \$2.75.

The following table summarizes changes in stock awards for the nine months ended September 30, 2012.

Weighted average  
grant date

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	Shares	fair value
Unvested at December 31, 2011	290,954	\$ 6.59
Granted	503,057	5.64
Vested	(88,252)	5.89
Forfeited	(25,066)	5.78
Unvested at September 30, 2012	680,693	\$ 5.93

At September 30, 2012, there was \$3.2 million of total unrecognized compensation expense related to unvested share-based compensation arrangements granted under the Company's equity incentive plans. The cost is expected to be recognized over a weighted average period of 2.0 years.

**Supplemental Executive Retirement Plan** The Company had a Supplemental Executive Retirement Plan (SERP) for five active key executives. The SERP provided for target retirement benefits, as a percentage of pay, beginning at age 60 or after 10 years of service. The target percentage was 50% of pay based on the executives' average monthly compensation during any five calendar years during which the executives compensation was highest during participation. At September 30, 2012, all participants were fully vested. At September 30, 2012 and December 31, 2011, the Company had accrued \$4.8 million and \$4.6 million, respectively, for the expected benefits under the SERP which are included in the consolidated balance sheets under the caption Accrued interest and other liabilities.

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In 2012, the Company's Compensation Committee conducted a review of the SERP as part of its ongoing assessment of overall compensation and determined that the SERP was no longer aligned with the Company's compensation objectives. On March 22, 2012, the Company terminated the SERP and no additional benefits will accrue to the participants. With the termination of the SERP, the benefits previously accrued will be distributed to the participants in accordance with the plan provisions, IRS code section 409A and the Pension Benefit Guaranty Corporation requirements.

**10. Segments**

The Company's segments consist of Commercial Banking, Investment Banking, Wealth Management, Insurance and Corporate Support and Other. The financial information for each business segment reflects that information which is specifically identifiable or which is allocated based on an internal allocation method. Results of operations and selected financial information by operating segment are as follows:

**Three months ended September 30, 2012**

<b>Income Statement (in thousands)</b>	<b>Commercial Banking</b>	<b>Investment Banking</b>	<b>Wealth Management</b>	<b>Insurance</b>	<b>Corporate Support and Other</b>	<b>Consolidated</b>
Total interest income	\$ 26,364	\$ 1	\$	\$ 2	\$ 82	\$ 26,449
Total interest expense	1,730		10		1,462	3,202
Provision for loan losses	(2,324)				(182)	(2,506)
Noninterest income	2,495	253	2,013	2,412	64	7,237
Noninterest expense	7,261	833	2,128	2,444	10,348	23,014
Management fees and allocations	5,704	33	150	86	(5,973)	
Provision (benefit) for income taxes	8,374	(266)	(62)	(9)	(4,410)	3,627
Net income (loss)	\$ 8,114	\$ (346)	\$ (213)	\$ (107)	\$ (1,099)	\$ 6,349

**Nine months ended September 30, 2012**

<b>Income Statement (in thousands)</b>	<b>Commercial Banking</b>	<b>Investment Banking</b>	<b>Wealth Management</b>	<b>Insurance</b>	<b>Corporate Support and Other</b>	<b>Consolidated</b>
Total interest income	\$ 79,599	\$ 5	\$	\$ 3	\$ 278	\$ 79,885
Total interest expense	5,309		31		4,371	9,711
Provision for loan losses	(3,528)				(868)	(4,396)
Noninterest income	8,890	475	6,408	7,339	89	23,201
Noninterest expense	24,333	2,527	6,971	7,090	30,589	71,510
Management fees and allocations	15,799	114	476	296	(16,685)	
Provision (benefit) for income taxes	23,058	(829)	(246)	108	(12,869)	9,222
Net income (loss)	\$ 23,518	\$ (1,332)	\$ (824)	\$ (152)	\$ (4,171)	\$ 17,039

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## Three months ended September 30, 2011

Income Statement (in thousands)	Commercial Banking	Investment Banking	Wealth Management	Insurance	Corporate Support and Other	Consolidated
Total interest income	\$ 27,797	\$ 1	\$	\$ 1	\$ (187)	\$ 27,612
Total interest expense	2,155		2	1	1,480	3,638
Provision for loan losses	(2,068)				2,068	
Noninterest income	1,653	205	2,154	2,089	(50)	6,051
Noninterest expense	7,403	868	2,191	2,181	10,587	23,230
Management fees and allocations	5,705	47	164	115	(6,031)	
Provision (benefit) for income taxes	8,149	(253)	(4)	(29)	(5,511)	2,352
Net income (loss)	\$ 8,106	\$ (456)	\$ (199)	\$ (178)	\$ (2,830)	\$ 4,443

## Nine months ended September 30, 2011

Income Statement (in thousands)	Commercial Banking	Investment Banking	Wealth Management	Insurance	Corporate Support and Other	Consolidated
Total interest income	\$ 83,706	\$ 6	\$ 2	\$ 1	\$ 265	\$ 83,980
Total interest expense	7,050		28	4	4,349	11,431
Provision for loan losses	(157)				3,779	3,622
Noninterest income	7,177	1,806	6,815	7,078	(3)	22,873
Noninterest expense	23,027	2,741	6,967	6,849	34,350	73,934
Management fees and allocations	17,063	118	472	288	(17,941)	
Provision (benefit) for income taxes	22,510	(363)	(72)	100	(15,817)	6,358
Net income (loss)	\$ 21,390	\$ (684)	\$ (578)	\$ (162)	\$ (8,458)	\$ 11,508

**11. Fair Value Measurements**

ASC 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing an asset or liability. As a basis for considering market participant assumptions in fair value measurements, ASC 820 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

- Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

- Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates and yield curves that are observable at commonly quoted intervals.

- Level 3 inputs are unobservable inputs for the asset or liability, which is typically based on an entity's own assumptions, as there is little, if any, related market activity.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability. The Company evaluates fair value measurement inputs on an ongoing basis in order to determine if there is a change of sufficient significance to warrant a transfer between levels. For example, changes in market activity or the addition of new unobservable inputs could, in the Company's judgment, cause a transfer to either a higher or lower level. For the three and nine months ended September 30, 2012 and the year ended December 31, 2011, there were no transfers between levels.

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A description of the valuation methodologies used for financial instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

**Available for sale securities** At September 30, 2012, the Company holds, as part of its investment portfolio, available for sale securities reported at fair value consisting of MBS, municipal securities and trust preferred securities. The fair value of the majority of MBS and municipal securities are determined using widely accepted valuation techniques including matrix pricing and broker-quote based applications. Inputs include benchmark yields, reported trades, issuer spreads, prepayment speeds and other relevant items. As a result, the Company has determined that these valuations fall within Level 2 of the fair value hierarchy. Private-label MBS are valued using broker-dealer quotes. As the private-label MBS market has become increasingly illiquid, these securities are being valued more often based on modeling techniques rather than observable trades. Accordingly, the Company has determined the appropriate input level for the private-label MBS is Level 3. The Company also holds trust preferred securities (TPS) that are recorded at fair values based on unadjusted quoted market prices for identical securities in an active market. The majority of the TPS are actively traded in the market and as a result, the Company has determined that the valuation of these securities falls within Level 1 of the fair value hierarchy. The Company also holds a small number of TPS for which unadjusted market prices are not available or the market is not active and is therefore classified as Level 2. For these securities, broker-dealer quotes, valuations based on similar but not identical securities or the most recent market trade (which may not be current), are used.

During the nine months ended September 30, 2012, the Company recognized credit related OTTI of \$0.3 million. OTTI for the three months ended September 30, 2012 was immaterial. For the three and nine months ended September 30, 2011, the Company recognized credit related OTTI of \$0.1 million and \$0.5 million, respectively. Credit related OTTI is reported in Net other than temporary impairment losses on securities recognized in earnings and non-credit related OTTI is reported in Loss on securities, other assets and other real estate owned in the condensed consolidated statement of operations.

**Derivative financial instruments** The Company uses interest-rate swaps as part of its cash flow strategy to manage its interest-rate risk. The valuation of these instruments is determined using widely accepted valuation techniques as discussed further below. The fair values of interest-rate swaps are determined using the market standard methodology of netting the discounted future fixed cash receipts (or payments) and the discounted expected variable cash payments (or receipts). The variable cash payments (or receipts) are based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves.

Pursuant to guidance in ASC 820, credit valuation adjustments are incorporated into the valuation to appropriately reflect both the Company's own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings and thresholds. The Company has made an accounting policy election to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio.

The Company uses Level 2 and Level 3 inputs to determine the valuation of its derivatives portfolio. The valuation of derivative instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs (Level 2 inputs), including interest rate curves and implied volatilities. The estimates of fair value are made using a standardized methodology that nets the discounted expected future cash receipts and cash payments (based on observable market inputs). Level 3 inputs include the credit valuation adjustments which use estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. At September 30, 2012 and December 31, 2011, the Company assessed the impact of the Level 3 inputs on the overall derivative valuations in terms of the significance of the credit valuation adjustments in basis points and as a percentage of the overall derivative portfolio valuation and the overall notional value. The Company's assessment determined that credit valuation adjustments were not significant to the overall valuation of the portfolio. In addition, the significance of the credit value adjustments and overall derivative portfolio to the Company's financial statements was

considered. As a result of the insignificance of the credit value adjustments to the derivative portfolio valuations and the Company's financial statements, the Company classified the derivative valuations in their entirety in Level 2.

**Impaired Loans** Certain collateral-dependent impaired loans are reported at the fair value of the underlying collateral. Impairment is measured based on the fair value of the collateral, which is typically derived from appraisals that take into consideration prices in observed transactions involving similar assets and similar locations. Each appraisal is updated on an annual basis, either through a new appraisal or through the Company's comprehensive internal review process. Appraised values are reviewed and monitored internally and fair value is assessed at least quarterly or more frequently when circumstances occur that indicate a change in fair value. The Company classified impaired loans as Level 3.

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The following tables present the Company's assets and liabilities measured at fair value on a recurring basis at September 30, 2012 and December 31, 2011, aggregated by the level in the fair value hierarchy within which those measurements fall.

(in thousands)	Balance at September 30, 2012	Quoted prices in active markets for identical assets (Level 1)	Fair value measurements using:	
			Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Available for sale securities:				
Mortgage-backed securities	\$ 397,193	\$	\$ 397,193	\$
U.S. government agencies	18,053		18,053	
Trust preferred securities	76,545	63,169	13,376	
Corporate debt securities	97,240		97,240	
Private-label MBS	2,161			2,161
Municipal securities	942		942	
Total available for sale securities	592,134	63,169	526,804	2,161
Derivatives:				
Reverse interest rate swap	9,543		9,543	
Total assets	\$ 601,677	\$ 63,169	\$ 536,347	\$ 2,161
Liabilities				
Derivatives:				
Cash flow hedge - interest rate swap	\$ 9,763	\$	\$ 9,763	\$
Reverse interest rate swap	10,233		10,233	
Total liabilities	\$ 19,996	\$	\$ 19,996	\$

(in thousands)	Balance at December 31, 2011	Quoted prices in active markets for identical assets (Level 1)	Fair value measurements using:	
			Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Available for sale securities:				
Mortgage-backed securities	\$ 420,552	\$	\$ 420,552	\$
U.S. government agencies	44,205		44,205	
Trust preferred securities	99,018	90,904	8,114	
Corporate debt securities	56,817		56,817	
Private-label MBS	1,990			1,990
Municipal securities	940		940	
Total available for sale securities	623,522	90,904	530,628	1,990
Derivatives:				
Reverse interest rate swap	7,943		7,943	
Total assets	\$ 631,465	\$ 90,904	\$ 538,571	\$ 1,990
Liabilities				
Derivatives:				
Cash flow hedge - interest rate swap	\$ 8,508	\$	\$ 8,508	\$
Reverse interest rate swap	8,720		8,720	
Total liabilities	\$ 17,228	\$	\$ 17,228	\$





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A reconciliation of the beginning and ending balances of assets measured at fair value, on a recurring basis, using Level 3 inputs follows:

(in thousands)	For the three months ended September 30, 2012	For the nine months ended September 30, 2012	For the year ended December 31, 2011
Beginning balance	\$ 2,027	\$ 1,990	\$ 2,432
Realized loss on OTTI	(35)	(297)	(771)
Paydowns	(73)	(241)	(545)
Net accretion (amortization)			165
Unrealized gain included in comprehensive income	242	709	709
Ending balance	\$ 2,161	\$ 2,161	\$ 1,990

Fair value is used on a nonrecurring basis to evaluate certain financial assets and financial liabilities in specific circumstances. The following table presents the Company's assets measured at fair value on a nonrecurring basis at the dates specified in the following table, aggregated by the level in the fair value hierarchy within which those measurements fall.

(in thousands)	Total	Quoted prices in active markets for identical assets (Level 1)	Fair value measurements using: Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Impaired loans, net of specific reserve:				
At September 30, 2012	\$ 15,842	\$	\$	\$ 15,842
At December 31, 2011	\$ 50,883	\$	\$	\$ 50,883

During the three and nine months ended September 30, 2012, the Company recorded provision for loan loss reversals of \$2.1 million and \$0.6 million, respectively, on impaired loans. Net charge-offs of \$2.2 million and \$4.8 million on impaired loans were recorded for the three and nine months ended September 30, 2012, respectively.

Fair value is also used on a nonrecurring basis for nonfinancial assets and nonfinancial liabilities such as foreclosed assets, other real estate owned, intangible assets, nonfinancial assets and liabilities evaluated in a goodwill impairment analysis and other nonfinancial assets measured at fair value for purposes of assessing impairment. A description of the valuation methodologies used for nonfinancial assets measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

**Other real estate owned (OREO)** OREO represents real property taken by the Company either through foreclosure or through a deed in lieu thereof from the borrower. The fair value of OREO is based on property appraisals adjusted at management's discretion to reflect a further decline in the fair value of properties since the time the appraisal analysis was performed. It has been the Company's experience that appraisals quickly become outdated due to the volatile real-estate environment. Therefore, the inputs used to determine the fair value of OREO and repossessed assets fall within Level 3. The Company may include within OREO other repossessed assets received as partial satisfaction of a loan. Other repossessed assets are not material and do not typically have readily determinable market values and are considered Level 3 inputs.

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**Intangible assets** Intangible assets are subject to impairment testing whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The fair value of intangible assets is based on an income approach using a present value model, considered a Level 3 input by the Company.

The following tables present the Company's nonfinancial assets measured at fair value on a nonrecurring basis at September 30, 2012 and December 31, 2011, aggregated by the level in the fair value hierarchy within which those measurements fall.

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(in thousands)	Total	Fair value measurements using:			Year to date loss
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
OREO and repossessed assets:					
At September 30, 2012	\$ 14,116	\$	\$	\$ 14,116	\$ (1,658)
At December 31, 2011	\$ 19,476	\$	\$	\$ 19,476	\$ (2,885)
Intangible assets:					
At December 31, 2011	\$	\$	\$	\$	\$ (57)

In the first quarter of 2011, the Company sold a small insurance book of business and recorded a loss of \$0.1 million on the intangible sale.

In accordance with ASC 310, the fair value of OREO recorded as an asset is reduced by estimated selling costs. The following table is a reconciliation of the fair value measurement of OREO disclosed pursuant to ASC 820 to the amount recorded on the condensed consolidated balance sheet:

(in thousands)	At September 30, 2012	At December 31, 2011
OREO recorded at fair value	\$ 14,116	\$ 19,476
Estimated selling costs	(497)	(974)
OREO	\$ 13,619	\$ 18,502

Valuation adjustments on OREO and additional gains or losses at the time OREO is sold are recognized in current earnings under the caption Loss on securities, other assets and other real estate owned. Below is a summary of OREO transactions during the nine months ended September 30, 2012:

(in thousands)	OREO
At December 31, 2011	\$ 18,502
Foreclosed loans	510
Charge-offs	(246)
Transferred in	264
OREO sales	(3,489)
Net loss on sale and valuation adjustments	(1,658)
At September 30, 2012	13,619
Estimated selling costs	497
OREO recorded at fair value	\$ 14,116

The following table provides information describing the valuation processes used to determine recurring and nonrecurring fair value measurements categorized within Level 3 of the fair value hierarchy.



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Category	Fair Value	Valuation Technique	Unobservable Input	Range
Private-label MBS	\$ 2,161	Consensus pricing	Broker quotes	20% - 79% of face value
<b>Impaired loans</b>				
Commercial	\$ 1,842	Property appraisals (1)	Management discount for property type and recent market volatility	20%
Real estate - mortgage	9,706	Property appraisals (1)	Management discount for property type and recent market volatility	10% - 20%
Land acquisition & development	4,010	Property appraisals (1)	Management discount for property type and recent market volatility	20% - 30%
Real estate - construction	257	Property appraisals (1)	Management discount for property type and recent market volatility	10% - 20%
Consumer	27	Property appraisals (1)	Management discount for property type and recent market volatility	10% - 30%
<b>Total</b>	<b>\$ 15,842</b>			
<b>OREO</b>				
Commercial	\$ 5,045	Property appraisals (1)	Management discount for property type and recent market volatility	20%
Residential	3,078	Property appraisals (1)	Management discount for property type and recent market volatility	10% - 20%
Land acquisition & development	5,993	Property appraisals (1)	Management discount for property type and recent market volatility	20% - 30%
<b>Total</b>	<b>\$ 14,116</b>			

(1) The fair value of OREO and collateral-dependent impaired loans is based on third-party property appraisals. The majority of the appraisals utilize a single valuation approach or a combination of approaches including a market approach, where prices and other relevant information generated by market transactions involving identical or comparable properties are used to determine fair value. Appraisals may also utilize an income approach, such as the discounted cash flow method, to estimate future income and profits or cash flows. Appraisals may include an as is sales comparison approach and an upon completion valuation approach. Adjustments are routinely made in the appraisal process by third-party appraisers to adjust for differences between the comparable sales and income data. Adjustments also result from the consideration of relevant economic and demographic factors with the potential to affect property values. Also, prospective values are based on the market conditions which exist at the date of inspection combined with informed forecasts based on current trends in supply and demand for the property types under appraisal.

The following table includes the estimated fair value of the Company's financial instruments. The methodologies for estimating the fair value of financial assets and financial liabilities measured at fair value on a recurring and nonrecurring basis are discussed above. The methodologies for estimating the fair value for other financial assets and financial liabilities are discussed below. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data in order to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts at September 30, 2012 and December 31, 2011.



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(in thousands)	September 30, 2012		December 31, 2011	
	Carrying value	Estimated fair value	Carrying value	Estimated fair value
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 57,248	\$ 57,248	\$ 59,210	\$ 59,210
Restricted cash	4,540	4,540	4,535	4,535
Investment securities available for sale	592,134	592,134	623,522	623,522
Investment securities held to maturity	212	218	232	238
Other investments	8,884	8,884	9,554	9,554
Loans net	1,764,970	1,771,936	1,581,795	1,587,352
Accrued interest receivable	9,068	9,068	8,273	8,273
Interest rate swaps	9,543	9,543	7,943	7,943
<b>Financial liabilities:</b>				
Deposits	\$ 2,048,776	\$ 2,049,466	\$ 1,918,406	\$ 1,919,284
Other short-term borrowings			20,000	20,000
Securities sold under agreements to repurchase	124,836	127,229	127,948	130,990
Accrued interest payable	632	632	529	529
Junior subordinated debentures	72,166	72,166	72,166	72,166
Subordinated notes payable	20,984	21,895	20,984	22,380
Interest rate swaps	19,996	19,996	17,228	17,228

The fair value estimation methodologies utilized by the Company for financial instruments and the classification level within the fair value hierarchy that those instruments fall are summarized as follows:

**Cash and cash equivalents** The carrying amount of cash and cash equivalents is a reasonable estimate of fair value which is classified as Level 2.

**Restricted cash** The carrying amount of restricted cash is a reasonable estimate of fair value which is classified as Level 2.

**Other investments** Included in this category are the Company's investment in the FHLB and other equity method investments. Due to restrictions on transferability, it is not practical to estimate fair value on the FHLB investment which is reported at carrying value. The fair value of other equity method investments approximates fair value and is classified as Level 2.

**Loans** The fair value of loans is estimated by discounting future contractual cash flows using estimated market rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. In computing the estimate of fair value for all loans, the estimated cash flows and/or carrying value have been reduced by specific and general reserves for loan losses. The fair value of loans is classified as Level 3 within the fair value hierarchy.

**Accrued interest receivable/payable** The fair value of accrued interest receivable/payable approximates the carrying amount due to the short-term nature of these amounts and is classified as Level 2.



**Deposits** The fair value of certificates of deposit is estimated by discounting the expected life using an index of the U.S. Treasury curve. Non-maturity deposits are reflected at their carrying value for purposes of estimating fair value. The fair value of all deposits is classified as Level 2.

**Short-term borrowings** The estimated fair value of short-term borrowings approximates their carrying value, due to their short-term nature and is classified as Level 2.

**Securities sold under agreements to repurchase** Estimated fair value is based on discounting cash flows for comparable instruments and is classified as Level 2.

**Junior subordinated debentures** The estimated fair value of junior subordinated debentures approximates their carrying value, due to the variable interest rate paid on the debentures and is classified as Level 2.

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**Subordinated notes payable** The estimated fair value of subordinated notes payable is based on discounting cash flows for comparable instruments and is classified as Level 3.

**Commitments to extend credit and standby letters of credit** The Company's off-balance sheet commitments are funded at current market rates at the date they are drawn upon. It is management's opinion that the fair value of these commitments would approximate their carrying value, if drawn upon, and are classified as Level 3.

The fair value estimates presented herein are based on pertinent information available to management at September 30, 2012 and December 31, 2011. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

**12. Regulatory Matters**

The following table shows capital amounts, ratios and regulatory thresholds at September 30, 2012:

**At September 30, 2012**  
(in thousands)

	<b>Company</b>		<b>Bank</b>	
Shareholders' equity	\$	251,030	\$	266,823
Disallowed intangible assets		(3,080)		
Unrealized gain on available for sale securities		(11,691)		(11,691)
Unrealized loss on cash flow hedges		6,053		
Subordinated debentures		70,000		
Disallowed deferred tax asset		(858)		
Other deductions		(8)		
Tier I regulatory capital	\$	311,446	\$	255,132
Subordinated notes payable	\$	20,984	\$	
Allowance for loan losses		26,077		25,886
Total risk-based regulatory capital	\$	358,507	\$	281,018

<b>At September 30, 2012</b> (in thousands)	<b>Company</b>			<b>Bank</b>		
	<b>Tier I</b>	<b>Risk-based Total capital</b>	<b>Leverage Tier I</b>	<b>Tier I</b>	<b>Risk-based Total capital</b>	<b>Leverage Tier I</b>
Regulatory capital	\$ 311,446	\$ 358,507	\$ 311,446	\$ 255,132	\$ 281,018	\$ 255,132
Well-capitalized requirement	123,945	206,576	125,483	123,092	205,153	124,043
Regulatory capital - excess	\$ 187,501	\$ 151,931	\$ 185,963	\$ 132,040	\$ 75,865	\$ 131,089
Capital ratios	15.1%	17.4%	12.4%	12.4%	13.7%	10.3%
Minimum capital requirement	4.0%	8.0%	4.0%	4.0%	8.0%	4.0%
Well capitalized requirement (1)	6.0%	10.0%	5.0%	6.0%	10.0%	5.0%

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(1) The ratios for the well-capitalized requirement are only applicable to the Bank. However, the Company manages its capital position as if the requirement applies to the consolidated entity and has presented the ratios as if they also applied to the Company.

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Other income and Other expense as shown in the condensed consolidated statements of income and comprehensive income is detailed in the following schedules to the extent the components exceed one percent of the aggregate of total interest income and other income.

Other noninterest income (in thousands)	Three months ended September 30,				Nine months ended September 30,			
	2012		2011		2012		2011	
Loan Fees	\$	355	\$	344	\$	954	\$	1,032
Other customer service fees		358		319		1,074		929
Bank-owned life insurance earnings		344		321		955		896
Private equity investment income (loss)		(107)		(503)		1,763		359
Other income (loss)		395		(152)		550		221
Total	\$	1,345	\$	329	\$	5,296	\$	3,437

Other noninterest expense (in thousands)	Three months ended September 30,				Nine months ended September 30,			
	2012		2011		2012		2011	
Marketing	\$	718	\$	762	\$	2,696	\$	2,536
Service contracts		508		287		1,676		892
Professional fees		515		522		1,481		1,512
Other expense		1,289		1,253		3,871		3,740
Total	\$	3,030	\$	2,824	\$	9,724	\$	8,680

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

This discussion should be read in conjunction with our condensed consolidated financial statements and notes thereto included in this Form 10-Q. Certain terms used in this discussion are defined in the notes to these financial statements. For a description of our accounting policies, see Note 1 of the Notes to Consolidated Financial Statements included in our Form 10-K for the year ended December 31, 2011. For a discussion of the segments included in our principal activities, see Note 10 of the notes to the condensed consolidated financial statements.

**Executive Summary**

CoBiz Financial Inc. is a \$2.6 billion financial holding company offering a broad array of financial service products to its target market of professionals, small and medium-sized businesses, and high-net-worth individuals primarily in Arizona and Colorado. Our operating segments include: Commercial Banking, Investment Banking, Wealth Management and Insurance.

Earnings are derived primarily from our net interest income, which is interest income less interest expense, and our noninterest income earned from fee-based business lines and banking service fees, offset by noninterest expense. As the majority of our assets are interest-earning and our liabilities are interest-bearing, changes in interest rates impact our net interest margin, the largest component of our operating revenue (defined as net interest income plus noninterest income). We manage our interest-earning assets and interest-bearing liabilities to reduce the impact of interest rate changes on our operating results. We also have focused on reducing our dependency on the net interest margin by increasing our noninterest income from complementary financial service firms that include investment banking, wealth management and insurance brokerage.

**Industry Overview**

At the September 2012 meeting, the Federal Open Market Committee (FOMC) kept the target range for federal funds rate at 0-25 basis points noting that while economic activity continues to expand at a moderate pace, growth in employment and business investment spending remain slow. With inflation expected to run below the Federal Reserve's 2% objective, the FOMC again extended the horizon for rate hikes through mid-2015. The FOMC also announced plans to purchase additional agency mortgage backed securities which together with existing programs will increase holdings of long-term securities by \$85 billion each month through the end of the year, intended to keep downward pressure on longer-term interest rates. The FOMC made assurances that it will closely monitor new developments and appropriately evaluate the costs and benefits of ongoing actions. In an October 14, 2012 speech, Chairman Bernanke reaffirmed the FOMC's statements saying that the pace of our recovery has been frustratingly slow. Facing many economic headwinds ranging from fiscal contraction at all levels of government and European recession concerns to a still-weak housing market and cautious consumer spending, the pace of economic growth has been insufficient to support significant improvement in the job market.

Labor markets have improved in 2012 with the national unemployment rate decreasing to 7.8% in September, down from respective averages of 9.0% and 9.6% in 2011 and 2010 and the lowest level in since January 2009. The private sector has added 146,000 jobs per month on average so far in 2012, slower than the average monthly 2011 rate of 153,000 jobs per month. Despite the lower unemployment rate, driven in part by job seekers ending their search, sentiment according to the October PNC Economic Outlook survey among small- and medium-sized business fell from six months earlier with respect to a number of matters including near-term hiring and capital expenditure plans. Nearly 30% of PNC respondents indicated their business has no current need for credit, up from 13% six months ago, and fewer than half expect sales increases in

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the next six months. Pessimism is almost certainly heightened given the upcoming U.S. elections which may cause business owners to act more cautiously through the remainder of 2012 and into 2013.

There have been 43 bank failures through September 2012, roughly half of the bank closures through this time last year. There were 140, 157 and 92 bank failures during the years 2009, 2010 and 2011, respectively. The FDIC's problem list fell for a fifth consecutive quarter to 732 institutions, down from 813 at the beginning of 2012 and remains well above the 252 problem institutions reported at the end of 2008.

In the second quarter of 2012, FDIC insured commercial banks and savings institutions reported combined earnings of \$34.5 billion, the 12th consecutive year-over-year increase in quarterly income, and nearly 90% of all institutions reported profitability. Earnings improvement is again attributed to reductions in loan loss provisioning which outweighed downward pressure on net interest margin. Average net interest margin fell to a three-year industry-wide low in the second quarter, down year over year from 3.61% to 3.46%. Net charge-offs declined for the eighth consecutive quarter from year-earlier levels in tandem with falling delinquent loan balances which have fallen for a ninth consecutive quarter. More than 60% of institutions reported loan growth in the second quarter and total loans industry-wide has grown in four of the past five quarters. Unlimited deposit insurance coverage, available until the end of 2012 under the Dodd-Frank Wall Street Reform

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and Consumer Protection Act (Dodd-Frank Act), continues to attract new deposits. Of the total \$1.6 trillion of noninterest-bearing transaction account deposits held by domestic banks at June 30, 2012, approximately \$1.4 trillion is in excess of the basic \$250,000 insured-deposit limit and only temporarily covered. Significant uncertainty exists in the industry about the outcome and impact to both community and large banks upon expiration of the unlimited insurance law at the end of 2012 and no legislative resolution is expected ahead of the November U.S. elections.

The banking industry and SEC-registered companies continue to be impacted by new legislative and regulatory reform proposals. In June 2012, the Board of Governors of the Federal Reserve Bank, the FDIC, and the Office of the Comptroller of the Currency (OCC) approved three notices of proposed rulemaking (NPRs) designed to improve the resiliency of the U.S. banking system; increase the quantity and quality of regulatory capital; enhance risk sensitivity; address weaknesses identified over the past several years; and address certain requirements of the Dodd-Frank Act. The NPRs would replace the federal banking agencies' general risk-based capital rules; establish regulatory capital requirements for savings and holding companies; and restructure the capital rules into an integrated regulatory capital framework. The first two NPRs apply to all US depository institutions, bank holding companies (except those with less than \$500 million in consolidated assets) and savings and loan holding companies. The third NPR applies only to banking organizations that are subject to either the advanced approaches risk-based capital rule or the Market Risk Rule.

On July 14, 2011, the Federal Reserve Board announced the approval of a final rule to repeal Regulation Q, which prohibited the payment of interest on demand deposits by member banks of the Federal Reserve System. Beginning on July 21, 2011, member banks were allowed to pay interest on demand deposits as established by the Dodd-Frank Act.

**Financial and Operational Highlights**

Noted below are some of the Company's significant financial performance measures and operational results for the first nine months of 2012:

- Net income and earnings per share improved for the three and nine months ended September 30, 2012 over the prior year.

INCOME STATEMENT (in thousands, except per share amounts)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net interest income before provision	\$ 23,247	\$ 23,974	\$ 70,174	\$ 72,549
Provision for loan losses	(2,506)		(4,396)	3,622
Noninterest income	7,237	6,051	23,201	22,873
Net income	6,349	4,443	17,039	11,508
Diluted earnings per common share	\$ 0.14	\$ 0.05	\$ 0.38	\$ 0.19
Net interest margin	4.00%	4.32%	4.14%	4.38%
Return on average assets	1.00%	0.74%	0.92%	0.64%
Return on average shareholders' equity	10.23%	8.50%	9.56%	7.42%

- Credit quality improvements resulted in a net reversal of provision for loan and credit losses for the three and nine months ended September 30, 2012 of \$2.5 million and \$4.4 million, respectively.

- Net interest margin contracted 32 basis points to 4.00% and 24 basis points to 4.14% during the respective three and nine months ended September 30, 2012 when compared to the prior year periods. The decreases were primarily due to the low rate environment that has accelerated investment prepayments and lowered the yield on new lending activity.

<b>BALANCE SHEET AND CREDIT QUALITY</b> <b>(in thousands)</b>	<b>At September 30,</b> <b>2012</b>	<b>At December 31,</b> <b>2011</b>
Total assets	\$ 2,559,954	\$ 2,423,504
Total loans	1,811,407	1,637,424
Total deposits	2,048,776	1,918,406
Total shareholders' equity	251,030	220,082
Allowance for loan losses	\$ 46,437	\$ 55,629
Nonperforming assets	34,273	45,738
Allowance for loan and credit losses to total loans	2.57%	3.40%
Nonperforming assets to total assets	1.34%	1.89%

- Annualized loan growth of 10% in the current quarter and 14% for the first nine months of 2012.



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- The allowance for loan and credit losses decreased to 2.57% of total loans at September 30, 2012, from 3.40% at December 31, 2011, driven by sustained improvement in credit quality and partially offset by growth in the loan portfolio. The allowance was 225% of nonperforming loans at September 30, 2012.
- Other real estate owned (OREO) and repossessed assets decreased 26% to \$13.6 million during the first nine months of 2012. Excluding the largest OREO of \$5.4 million in Colorado, the Company currently holds six properties in Colorado and 10 in Arizona with an average carrying value of less than \$0.6 million.
- Noninterest-bearing demand deposits grew to \$823.4 million at September 30, 2012 and comprise 40.2% of total deposits.
- The Company's total risk-based capital ratio was 17.4% at September 30, 2012 compared to 16.3% at the end of 2011 and 15.7% at the comparable prior-year quarter end.

**Critical Accounting Policies**

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form 10-Q. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. In making those critical accounting estimates, we are required to make assumptions about matters that may be highly uncertain at the time of the estimate. Different estimates we could reasonably have used, or changes in the assumptions that could occur, could have a material effect on our financial condition or results of operations. In addition to the discussion on fair value measurements and deferred taxes below, a description of our critical accounting policies was provided in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the year ended December 31, 2011.

*Fair Value Measurements.* The Company measures or monitors certain assets and liabilities on a fair value basis in accordance with GAAP. ASC 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing an asset or liability. As a basis for considering market participant assumptions in fair value measurements, ASC 820 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy). Fair value may be used on a recurring basis for certain assets and liabilities such as available for sale securities and derivatives in which fair value is the primary basis of accounting. Similarly, fair value may be used on a nonrecurring basis to evaluate certain assets or liabilities such as impaired loans and other real estate owned (OREO). Depending on the nature of the asset or liability, the Company uses various valuation techniques and assumptions in accordance with ASC 820 to determine the instrument's fair value. At September 30, 2012, \$601.7 million or 23.5% of total assets represented assets recorded at fair value on a recurring basis. At September 30, 2012, \$20.0 million or 0.9% of total liabilities represented liabilities recorded at fair value on a recurring basis. Assets recorded at fair value on a nonrecurring basis represented \$30.0 million or 1.2% of total assets.

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At September 30, 2012, the Company holds, as part of its investment portfolio, available for sale securities reported at fair value consisting of MBS, government agencies, municipal securities, and corporate debt securities. The fair value of the majority of these securities is determined using widely accepted valuation techniques, including matrix pricing and broker-quote based applications, considered Level 2 inputs. The Company also holds trust preferred securities, the majority of which are recorded at fair value based on quoted market prices, considered by the Company Level 1 inputs. Certain private-label MBS valued using broker-dealer quotes based on proprietary broker models, which are considered by the Company an unobservable input (Level 3), totaled \$2.2 million at September 30, 2012. Investments incorporating Level 3 inputs as part of their valuation represent less than 0.1% of total assets at the report date. The Company recognized losses of \$0.3 million on the private-label MBS for the nine months ended September 30, 2012, the majority being recognized in the first quarter of 2012. Unrealized losses on the private-label MBS of \$0.5 million were recorded in accumulated other comprehensive income at September 30, 2012.

The Company uses interest-rate swaps as part of its cash flow strategy to manage its interest-rate risk. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. To comply with the provisions of ASC 820, credit valuation adjustments are incorporated into the valuation to appropriately reflect both the Company's own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation

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adjustments associated with its derivatives utilize Level 3 inputs (i.e. estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties). However, at September 30, 2012 and December 31, 2011, the Company concluded that the impact of the credit valuation adjustments on the overall valuation of its derivative positions is not significant. Therefore, the Company has determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

Certain collateral-dependent impaired loans are reported at the fair value of the underlying collateral. Impairment is measured based on the fair value of the collateral, which is typically derived from appraisals taking into consideration prices in observed transactions involving similar assets and similar locations, in accordance with GAAP.

OREO and repossessed assets represents real property taken by the Bank either through foreclosure or through a deed in lieu thereof from the borrower. At the time of foreclosure, OREO is measured at fair value, less selling costs, which becomes its new costs basis. Subsequent to acquisition, OREO is carried at the lower of cost or fair value, less selling costs. Fair values are based on property appraisals, generally considered a Level 2 input by the Company. However, where the Company has adjusted an appraisal valuation downward due to its expectation of market conditions, the adjusted value is considered a Level 3 input.

*Deferred Tax Assets.* At September 30, 2012, the Company has recorded net deferred tax assets of \$30.5 million which relate to expected future deductions arising in large part from the allowance for loan losses. Since there is no absolute assurance that these assets will be realized, the Company evaluates its ability to carryback losses, its tax planning strategies and forecasts of future earnings to determine the need for a valuation allowance on these assets. If current available information raises doubt as to the realization of the deferred tax assets, an additional valuation allowance may be established.

**Financial Condition**

Total assets at September 30, 2012 were \$2.56 billion, increasing \$136.5 million or 5.6% from \$2.42 billion at December 31, 2011. Assets are comprised primarily of loans net of allowance for losses and investment securities, collectively making up over 92% of total assets. Total liabilities at September 30, 2012, were \$2.31 billion, increasing \$105.5 million or 4.8% from \$2.20 billion at December 31, 2011. Liabilities consist primarily of deposits and securities sold under agreements to repurchase, comprising over 90% of total liabilities. Shareholder equity at September 30, 2012 was \$251.0 million, increasing \$30.9 million or 14.1% from \$220.1 million at December 31, 2011. During the first quarter of 2012, the Company completed an underwritten public offering of 2,100,000 shares of the Company's common stock at a price of \$6.00 per share. Proceeds from the offering, net of underwriting discounts, commissions and selling costs were \$11.8 million. The following paragraphs discuss changes in the relative mix of certain assets and liability classes and reasons for such changes.

*Investments.* The Company manages its investment portfolio to provide interest income and to meet the collateral requirements for public deposits, customer repurchases and wholesale borrowings. Investments account for 23.5% of total assets at September 30, 2012, compared to 26.1% at December 31, 2011.

The investment portfolio is primarily comprised of MBS explicitly (GNMA) and implicitly (FNMA and FHLMC) backed by the U.S. Government. The portfolio does not include any securities exposed to sub-prime mortgage loans. The investment portfolio also includes single-issuer trust preferred securities and corporate debt securities. The corporate debt securities portfolio is mainly comprised of five issuers in

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the Fortune 100. Over 50% of the corporate debt securities portfolio is investment grade with a rating of A- or better. None of the issuing institutions are in default, nor have interest payments on the trust preferred securities been deferred.

The net unrealized gain on available for sale securities increased \$8.6 million to \$18.9 million at September 30, 2012 from \$10.3 million at December 31, 2011. OTTI of \$0.3 million on two private-label MBS was recognized in earnings during the nine months ended September 30, 2012. OTTI for the three months ended September 30, 2012 was not material. At September 30, 2012, an unrealized loss of \$0.5 million on private-label MBS was recognized in other comprehensive income. The Company may recognize additional losses on these securities if the underlying credit metrics were to worsen in the future.

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AVAILABLE FOR SALE SECURITIES (in thousands)	September 30, 2012		% of portfolio	Unrealized gain (loss)	% of unrealized gain (loss)
	Amortized cost	Fair value			
Mortgage-backed securities	\$ 383,372	\$ 397,193	67.1	\$ 13,821	73.2%
U.S. government agencies	17,993	18,053	3.0	60	0.3%
Trust preferred securities	73,872	76,545	12.9	2,673	14.2%
Corporate debt securities	94,513	97,240	16.4	2,727	14.5%
Private-label MBS	2,599	2,161	0.4	(438)	(2.3)%
Municipal securities	929	942	0.2	13	0.1%
Total available for sale securities	\$ 573,278	\$ 592,134	100.0	\$ 18,856	100.0%

*Loans.* Gross loans held for investment increased \$174.0 million or 10.6% to \$1.81 billion at September 30, 2012, compared to December 31, 2011. During the nine months ended September 30, 2012, the Company advanced \$395.4 million in new credit relationships and an additional \$204.9 million on existing lines. Credit extensions during this period were offset by paydowns, maturities and transfers to OREO of \$418.2 million and gross charge-offs of \$8.1 million.

LOANS (in thousands)	September 30, 2012		December 31, 2011		September 30, 2011	
	Amount	% of portfolio	Amount	% of portfolio	Amount	% of portfolio
Commercial	\$ 663,880	37.6	\$ 568,962	36.0	\$ 587,345	36.7
Owner-occupied real estate	425,217	24.1	421,350	26.6	425,062	26.6
Investor real estate	425,607	24.1	363,141	22.9	357,709	22.3
Land acquisition & development	54,220	3.0	61,977	3.9	67,944	4.3
Real estate construction	56,180	3.2	63,141	4.0	68,442	4.3
Consumer	137,299	7.8	116,676	7.4	112,709	7.0
Other	49,004	2.8	42,177	2.7	40,588	2.5
Total loans	1,811,407	102.6	1,637,424	103.5	1,659,799	103.7
Less allowance for loan losses	(46,437)	(2.6)	(55,629)	(3.5)	(59,695)	(3.7)
Total net loans	\$ 1,764,970	100.0	\$ 1,581,795	100.0	\$ 1,600,104	100.0

Growth in total loans during the nine months ended September 30, 2012, was primarily the result of gains in the commercial and real estate mortgage segments, respectively accounting for 55% and 38% of loan growth since December 31, 2011. The land acquisition and development (Land A&D) segment continues to decrease as a result of ongoing efforts to reduce high-risk loan concentration levels.

The allowance for loan losses decreased \$9.2 million during the nine months ended September 30, 2012 as a result of net charge-offs of \$4.8 million and release of net excess reserves of \$4.4 million. Reduction in the allowance for loan losses is the result of continued credit quality improvement across all loan segments. See the *Provision and Allowance for Loan and Credit Losses* section and Note 6 to the condensed consolidated financial statements for additional discussion.

*Deferred Income Taxes.* Net deferred income taxes decreased \$2.5 million to \$30.5 million at September 30, 2012, from \$33.0 million at December 31, 2011. The decrease was primarily related the decline in the allowance for loan and lease losses.

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*Other Real Estate Owned and Repossessed Assets.* OREO and repossessed assets decreased \$4.9 million to \$13.6 million at September 30, 2012, from \$18.5 million at December 31, 2011. During the nine months ended September 30, 2012, the Company received proceeds of \$3.5 million on the sale of 12 properties. Total losses recognized on OREO sales and valuation adjustments totaled \$1.7 million during the first nine months of 2012. At September 30, 2012, \$4.6 million of OREO was in Arizona and \$9.0 million was in Colorado.

*Other Assets.* Other assets decreased \$5.7 million to \$32.2 million at September 30, 2012 from \$37.8 million at December 31, 2011. The change is primarily due to the receipt of \$5.1 million in federal tax refunds and amortization of prepaid FDIC insurance deposits.

*Deposits.* Total deposits increased \$130.4 million to \$2.05 billion at September 30, 2012 from \$1.92 billion at December 31, 2011.

Noninterest-bearing demand deposits led growth among all deposit types, increasing \$102.6 million during the first nine months of 2012. The Company's deposit portfolio composition changed during the first quarter of 2012 as the Company began offering interest-bearing demand deposits in late 2011 and eliminated its Eurodollar account product in early 2012 in response to the Dodd-Frank Act repeal of the prohibition of paying interest on demand deposits. Interest-bearing accounts earn interest at rates based on competitive market factors and our desire to increase or

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decrease certain types of maturities or deposits. The Company's noninterest-bearing deposit levels increased to 40.2% of total deposits at September 30, 2012 compared to 37.6% at December 31, 2011.

The Company views its reciprocal Certificate of Deposit Account Registry Service® (CDARS) accounts as customer-related accounts. The CDARS program is provided through a third party and designed to provide full FDIC insurance on deposit amounts larger than the stated maximum by exchanging or reciprocating larger depository relationships with other member banks. Depositor funds are broken into smaller amounts and placed with other banks that are members of the network. Each member bank issues CDs in amounts under \$250,000, so the entire deposit is eligible for FDIC insurance. CDARS are technically brokered deposits, however, the Company considers the reciprocal deposits placed through the CDARS program as core funding due to the customer relationship that generated the transaction and does not report the balances as brokered sources in its internal or external financial reports.

	September 30, 2012		December 31, 2011		September 30, 2011	
<b>DEPOSITS AND CUSTOMER REPURCHASE AGREEMENTS</b>						
(in thousands)	Amount	% of portfolio	Amount	% of portfolio	Amount	% of portfolio
NOW and money market	\$813,202	37.4	\$773,826	37.8	\$718,689	35.7
Interest-bearing demand	117,915	5.4	10,385	0.5		
Savings	10,659	0.5	10,631	0.5	10,251	0.5
Eurodollar			97,748	4.8	104,971	5.2
Certificates of deposits under \$100,000	30,574	1.4	34,575	1.7	36,126	1.8
Certificates of deposits \$100,000 and over	162,595	7.5	180,790	8.8	208,965	10.4
Reciprocal CDARS	90,468	4.2	89,638	4.4	93,909	4.6
Total interest-bearing deposits	1,225,413	56.4	1,197,593	58.5	1,172,911	58.2
Noninterest-bearing demand deposits	823,363	37.9	720,813	35.2	707,606	35.2
Customer repurchase agreements	124,836	5.7	127,948	6.3	131,877	6.6
Total deposits and customer repurchase agreements	\$2,173,612	100.0	\$2,046,354	100.0	\$2,012,394	100.0

*Securities Sold Under Agreements to Repurchase.* Securities sold under agreement to repurchase are transacted with customers as a way to enhance our customers' interest-earning ability. The Company does not consider customer repurchase agreements to be a wholesale funding source, but rather an additional treasury management service provided to our customer base. Our customer repurchase agreements are based on an overnight investment sweep that can fluctuate based on our customers' operating account balances. Securities sold under agreements to repurchase were stable, in 2012 compared to December 31, 2011.

*Other Short-Term Borrowings.* Other short-term borrowings normally consist of federal funds purchased and overnight and term borrowings from the Federal Home Loan Bank (FHLB). Short-term borrowings are used as part of our liquidity management strategy and fluctuate based on the Company's cash position. The Company's wholesale funding needs are largely dependent on core deposit levels which can be volatile in uncertain economic conditions and sensitive to competitive pricing. A decline in deposits and growth in the loan portfolio increases the Company's need for wholesale borrowings. At September 30, 2012, the Company had no short-term borrowings outstanding. At December 31, 2011, short-term borrowings outstanding totaled \$20.0 million. If the Company is unable to retain deposits or maintain deposit balances at a level sufficient to fund asset growth, the composition of interest-bearing liabilities may shift toward additional wholesale funds, which historically bear a higher interest cost than core deposits.

*Accrued Interest and Other Liabilities.* Accrued interest and other liabilities were relatively stable, decreasing \$1.8 million, or 4.0%, to \$42.2 million at September 30, 2012, compared to \$43.9 million at December 31, 2011.

**Results of Operations***Overview*

The following table presents the condensed consolidated statements of operations for the three and nine months ended September 30, 2012 and 2011.

(in thousands)	Three months ended September 30,				Nine months ended September 30,			
	2012	2011	Increase (decrease)		2012	2011	Increase (decrease)	
			Amount	%			Amount	%
<b>INCOME</b>								
<b>STATEMENT DATA</b>								
Interest income	\$ 26,449	\$ 27,612	\$ (1,163)	(4.2)	\$ 79,885	\$ 83,980	\$ (4,095)	(4.9)
Interest expense	3,202	3,638	(436)	(12.0)	9,711	11,431	(1,720)	(15.0)
NET INTEREST								
INCOME BEFORE								
PROVISION	23,247	23,974	(727)	(3.0)	70,174	72,549	(2,375)	(3.3)
Provision for loan								
losses	(2,506)		(2,506)	(100.0)	(4,396)	3,622	(8,018)	(221.4)
NET INTEREST								
INCOME AFTER								
PROVISION	25,753	23,974	1,779	7.4	74,570	68,927	5,643	8.2
Noninterest income	7,237	6,051	1,186	19.6	23,201	22,873	328	1.4
Noninterest expense	23,014	23,230	(216)	(0.9)	71,510	73,934	(2,424)	(3.3)
INCOME BEFORE								
INCOME TAXES	9,976	6,795	3,181	46.8	26,261	17,866	8,395	47.0
Provision for income								
taxes	3,627	2,352	1,275	54.2	9,222	6,358	2,864	45.0
NET INCOME	\$ 6,349	\$ 4,443	\$ 1,906	42.9	\$ 17,039	\$ 11,508	\$ 5,531	48.1



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Annualized return on average assets for the three and nine months ended September 30, 2012 was 1.00% and 0.92%, respectively, compared to 0.74% and 0.64% during the comparable prior year periods. Annualized return on average shareholders' equity for the three and nine months ended September 30, 2012 was 10.23% and 9.56%, respectively, compared to 8.50% and 7.42% for the prior-year periods. Improvement in both earnings metrics is attributable to negative provision for loan losses, offset in part by lower interest income. The Company's efficiency ratio was 75.28% and 75.46% for the three and nine months ended September 30, 2012, respectively, compared to 74.52% and 74.17% in the prior-year periods.

*Net Interest Income.* The largest component of our net income is normally our net interest income. Net interest income is the difference between interest income, principally from loans and investment securities, and interest expense, principally on customer deposits and borrowings. Changes in net interest income result from changes in volume, net interest spread and net interest margin. Volume refers to the average dollar levels of interest-earning assets and interest-bearing liabilities. Net interest spread refers to the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities. Net interest margin refers to net interest income divided by average interest-earning assets and is influenced by the level and relative mix of interest-earning assets and interest-bearing liabilities.

As the majority of our assets are interest-earning and our liabilities are interest-bearing, changes in interest rates may impact our net interest margin. The FOMC uses the federal funds rate, which is the interest rate used by banks to lend to each other, to influence interest rates and the national economy. Changes in the fed funds rate have a direct correlation to changes in the prime rate, the underlying index for most of the variable-rate loans issued by the Company. The FOMC has held the target federal funds rate at a range of 0-25 basis points since December 2008.

The following table sets forth the average amounts outstanding for each category of interest-earning assets and interest-bearing liabilities, the interest earned or paid on such amounts on a taxable equivalent basis, and the average rate earned or paid for the three and nine months ended September 30, 2012 and 2011.

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(in thousands)	Three months ended September 30,					
	Average balance	2012 Interest earned or paid	Average yield or cost (1)	Average balance	2011 Interest earned or paid	Average yield or cost (1)
<b>Assets</b>						
Federal funds sold and other	\$ 28,933	\$ 26	0.35%	\$ 26,980	\$ 27	0.39%
Investment securities (2)	607,696	4,535	2.99%	610,128	5,413	3.55%
Loans (2)(3)	1,780,352	22,411	4.93%	1,656,737	22,516	5.32%
Allowance for loan losses	(51,016)			(63,056)		
Total interest-earning assets	\$ 2,365,965	\$ 26,972	4.37%	\$ 2,230,789	\$ 27,956	4.77%
Noninterest-earning assets	164,034			155,148		
Total assets	\$ 2,529,999			\$ 2,385,937		
<b>Liabilities and Shareholders Equity</b>						
<b>Equity</b>						
<b>Deposits</b>						
NOW and money market	\$ 782,546	\$ 924	0.47%	\$ 726,054	\$ 1,072	0.59%
Interest-bearing demand	121,979	164	0.53%			0.00%
Savings	10,601	3	0.11%	10,473	4	0.15%
Eurodollar			0.00%	97,005	180	0.73%
<b>Certificates of deposit</b>						
Reciprocal	91,515	114	0.49%	93,158	130	0.55%
Under \$100,000	30,838	46	0.59%	36,585	79	0.86%
\$100,000 and over	165,152	296	0.71%	216,096	431	0.79%
Total interest-bearing deposits	\$ 1,202,631	\$ 1,547	0.51%	\$ 1,179,371	\$ 1,896	0.64%
<b>Other borrowings</b>						
<b>Securities sold under agreements to repurchase</b>						
	151,222	120	0.31%	160,807	216	0.53%
Other short-term borrowings	21,191	17	0.31%	13,914	9	0.25%
Long-term debt	93,150	1,518	6.38%	93,150	1,517	6.37%
Total interest-bearing liabilities	\$ 1,468,194	\$ 3,202	0.86%	\$ 1,447,242	\$ 3,638	0.99%
Noninterest-bearing demand accounts	776,636			701,488		
Total deposits and interest-bearing liabilities	2,244,830			2,148,730		
Other noninterest-bearing liabilities	38,386			29,745		
Total liabilities	2,283,216			2,178,475		
Total equity	246,783			207,462		
Total liabilities and equity	\$ 2,529,999			\$ 2,385,937		
<b>Net interest income - taxable equivalent</b>						
		\$ 23,770			\$ 24,318	
Net interest spread			3.51%			3.78%
Net interest margin			4.00%			4.32%
<b>Ratio of average interest-earning assets to average interest-bearing liabilities</b>						
	161.15%			154.14%		

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(in thousands)	For the nine months ended September 30,					
	Average balance	2012 Interest earned or paid	Average yield or cost (1)	Average balance	2011 Interest earned or paid	Average yield or cost (1)
<b>Assets</b>						
Federal funds sold and other	\$ 23,872	\$ 76	0.42%	\$ 34,350	\$ 102	0.39%
Investment securities (2)	623,865	15,265	3.26%	620,093	17,268	3.71%
Loans (2)(3)	1,713,940	65,884	5.05%	1,650,171	67,469	5.39%
Allowance for loan losses	(53,256)			(63,717)		
Total interest earning-assets	\$ 2,308,421	\$ 81,225	4.52%	\$ 2,240,897	\$ 84,839	4.85%
Noninterest-earning assets	168,958			159,721		
Total assets	\$ 2,477,379			\$ 2,400,618		
<b>Liabilities and Shareholders Equity</b>						
<b>Equity</b>						
Deposits						
NOW and money market	\$ 771,182	\$ 2,850	0.49%	\$ 708,065	\$ 3,359	0.63%
Interest-bearing demand	112,068	457	0.54%			0.00%
Savings	10,623	9	0.11%	9,906	14	0.19%
Eurodollar			0.00%	95,964	536	0.74%
Certificates of deposit						
Brokered under \$100,000			0.00%	7		1.37%
Reciprocal	91,884	342	0.50%	113,202	537	0.63%
Under \$100,000	31,980	155	0.65%	38,873	279	0.96%
\$100,000 and over	166,020	931	0.75%	225,938	1,555	0.92%
Total interest-bearing deposits	\$ 1,183,757	\$ 4,744	0.54%	\$ 1,191,955	\$ 6,280	0.70%
Other borrowings						
Securities sold under agreements to repurchase	135,985	324	0.31%	159,494	632	0.52%
Other short-term borrowings	52,068	121	0.31%	9,351	18	0.25%
Long-term debt	93,150	4,522	6.38%	93,150	4,501	6.37%
Total interest-bearing liabilities	\$ 1,464,960	\$ 9,711	0.88%	\$ 1,453,950	\$ 11,431	1.04%
Noninterest-bearing demand accounts	736,226			713,306		
Total deposits and interest-bearing liabilities	2,201,186			2,167,256		
Other noninterest-bearing liabilities	38,236			26,114		
Total liabilities	2,239,422			2,193,370		
Total equity	237,957			207,248		
Total liabilities and equity	\$ 2,477,379			\$ 2,400,618		
Net interest income - taxable equivalent		\$ 71,514			\$ 73,408	
Net interest spread			3.64%			3.81%
Net interest margin			4.14%			4.38%
Ratio of average interest-earning assets to average interest-bearing liabilities	157.58%			154.12%		

(1) Average yield or cost for the three and nine months ended September 30, 2012 and 2011 has been annualized, and is not necessarily indicative of results for the entire year.

(2) Yields include adjustments for tax-exempt interest income based on the Company's effective tax rate.

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- (3) Loan fees included in interest income are not material. Nonaccrual loans are included with average loans outstanding.

Net interest income on a taxable equivalent basis for the three and nine months ended September 30, 2012 decreased \$0.5 million and \$1.9 million to \$23.8 million and \$71.5 million, respectively. Average interest-earning assets for the three and nine months ended September 30, 2012 increased \$135.2 million and \$67.5 million, respectively. The three and nine month increase in average interest earning assets was primarily due to growth in net loans of \$135.7 million and \$74.2 million, respectively. The positive effect of interest-earning asset growth on the net interest margin was muted by lower yields due to the continued low interest rate environment. During the three and nine months ended September 30, 2012, average yields on interest-earning assets decreased 40 basis points and 33 basis points, respectively, over the comparable prior-year periods.

Including noninterest bearing deposits, the Company's overall deposit interest cost was 31 basis points and 33 basis points for the three and nine months ended September 30, 2012, down from 40 basis points and 44 basis points during the comparable periods in 2011. Rates on average interest-bearing liabilities for the three and nine months ended

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September 30, 2012 decreased 13 and 16 basis points to 0.86% and 0.88%, respectively, from the comparable prior-year periods, driven by lower rates on NOW and money market deposits and CDs.

On June 7, 2012, the Board of Governors of the Federal Reserve System announced new capital rules incorporating certain Basel III capital standards into U.S. regulation. One specific change is the elimination over time of Trust Preferred securities (TPS) issued by financial institutions as a form of Tier 1 capital. The Company expects that many issuers of TPS will continue to call these instruments. The Company has historically invested in TPS and had TPS holdings of \$76.5 million in its investment portfolio at September 30, 2012, down \$22.5 million due primarily to calls since the beginning of the year. TPS generally have a higher yield than other security types and as the TPS are called, the Company's reinvestment yield on alternative investments may be lower than the yield on the TPS. This may put downward pressure on net interest income and the net interest margin if lower yielding assets are acquired in the place of TPS.

The following table presents noninterest income for the three and nine months ended September 30, 2012 and 2011.

(in thousands)	Three months ended September 30,				Nine months ended September 30,			
	2012	2011	Increase (decrease)		2012	2011	Increase (decrease)	
			Amount	%			Amount	%
<b>NONINTEREST INCOME</b>								
Service charges	\$ 1,218	\$ 1,274	\$ (56)	(4.4)	\$ 3,686	\$ 3,737	\$ (51)	(1.4)
Investment advisory and trust income	1,450	1,291	159	12.3	3,934	4,260	(326)	(7.7)
Insurance income	2,971	2,952	19	0.6	9,810	9,633	177	1.8
Investment banking income	253	205	48	23.4	475	1,806	(1,331)	(73.7)
Other income	1,345	329	1,016	308.8	5,296	3,437	1,859	54.1
<b>Total noninterest income</b>	<b>\$ 7,237</b>	<b>\$ 6,051</b>	<b>\$ 1,186</b>	<b>19.6</b>	<b>\$ 23,201</b>	<b>\$ 22,873</b>	<b>\$ 328</b>	<b>1.4</b>

Noninterest income includes revenues earned from sources other than interest income. These sources include: service charges and fees on deposit accounts; letters of credit and ancillary loan fees; income from investment advisory and trust services; income from life insurance and wealth transfer products; benefits brokerage; property and casualty insurance (P&C); retainer and success fees from investment banking engagements; and increases in the cash surrender value of bank-owned life insurance.

*Service Charges.* Service charges primarily consist of fees earned from our treasury management services. Customers are given the option to pay for these services in cash or by offsetting the fees for these services against an earnings credit that is given for maintaining noninterest-bearing deposits. Service charges were stable during all periods shown in the above table.

*Investment Advisory and Trust Income.* Investment advisory and trust income increased \$0.2 million during the current quarter and decreased \$0.3 million during the nine months ended September 30, 2012 compared to the respective prior-year periods. Fees earned are generally based on a percentage of the assets under management (AUM) and market volatility has a direct impact on earnings. Average AUM during the first nine months of 2012 declined approximately 4% compared to average AUM a year earlier. Discretionary AUM, comprised primarily of equity securities, increased \$49.4 million to \$758.5 million at September 30, 2012 from a year earlier.

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*Insurance Income.* Insurance income is derived from three main areas: wealth transfer, benefits consulting, and P&C. The majority of fees earned on wealth transfer transactions are earned at the inception of the product offering in the form of commissions. Fees on these products are transactional by nature and fee income can fluctuate from period to period based on the volume and size of transactions that have been closed. Revenue from benefits consulting and P&C is a more recurring revenue source as policies and contracts generally renew or rewrite on an annual or more frequent basis. Insurance income was stable for the three and nine months ended September 30, 2012 compared to the same prior-year periods.

For the three and nine months ended on September 30, 2012 and 2011, insurance revenues were earned from the following product lines:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Wealth transfer and executive compensation	17.1%	27.7%	23.8%	24.7%
Benefits consulting	37.2%	31.9%	34.7%	30.2%
Property and casualty	44.0%	38.4%	40.1%	43.2%
Fee income	1.7%	2.0%	1.4%	1.9%
	100.0%	100.0%	100.0%	100.0%

*Investment Banking Income.* Investment banking income includes retainer fees which are recognized over the expected term of the engagement and success fees which are recognized when the transaction is completed and collectability of fees is reasonably assured. Investment banking income is transactional by nature and will fluctuate based on the number

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of clients engaged and transactions successfully closed. Investment banking income for the current quarter was higher than a year earlier on stronger retainer fees. Revenues for the nine months ended September 30, 2012, were \$1.3 million lower compared to the prior-year period as no significant success fees have been earned in 2012. A significant number of deals closed in the fourth quarter of 2011, reducing the pipeline of active deals carried over into 2012.

*Other Income.* Other income is comprised of increases in the cash surrender value of bank-owned life insurance, earnings on equity method investments, swap fees, merchant charges, bankcard fees, wire transfer fees, foreign exchange fees and safe deposit income. Other income for the three and nine months ended September 30, 2012 increased \$1.0 million and \$1.9 million over the respective prior-year periods, driven by gains in the Company's equity method investments and higher net fees from interest rate swaps transactions. Income from both sources can be volatile and dependent on the volume and size of customers entering into interest rate swap transactions or activities in the underlying investment.

## Noninterest Expense

The following table presents noninterest expense for the three and nine months ended September 30, 2012 and 2011.

(in thousands)	Three months ended September 30,				Nine months ended September 30,			
	2012	2011	Increase (decrease)		2012	2011	Increase (decrease)	
			Amount	%			Amount	%
<b>NONINTEREST EXPENSES</b>								
Salaries and employee benefits	\$ 14,791	\$ 14,212	\$ 579	4.1	\$ 45,110	\$ 44,888	\$ 222	0.5
Share-based compensation expense	505	372	133	35.8	1,510	1,137	373	32.8
Occupancy expenses, premises and equipment	3,398	3,358	40	1.2	10,357	10,034	323	3.2
Amortization of intangibles	292	160	132	82.5	611	479	132	27.6
FDIC and other assessments	456	627	(171)	(27.3)	1,337	2,901	(1,564)	(53.9)
Other real estate owned and loan workout costs	477	821	(344)	(41.9)	1,814	2,654	(840)	(31.7)
Net OTTI on securities recognized in earnings	35	136	(101)	(74.3)	297	507	(210)	(41.4)
Loss on securities, other assets and OREO	30	720	(690)	(95.8)	750	2,654	(1,904)	(71.7)
Other operating expenses	3,030	2,824	206	7.3	9,724	8,680	1,044	12.0
<b>Total noninterest expenses</b>	<b>\$ 23,014</b>	<b>\$ 23,230</b>	<b>\$ (216)</b>	<b>(0.9)</b>	<b>\$ 71,510</b>	<b>\$ 73,934</b>	<b>\$ (2,424)</b>	<b>(3.3)</b>

*Salaries and Employee Benefits.* Salaries and employee benefits increased \$0.6 million and \$0.2 million for the three and nine months ended September 30, 2012, respectively, compared to the same periods in 2011. The increase for the current quarter of 2012 is primarily due to higher bonus accruals and higher self-insurance expense. Bonus compensation is based on the Company's overall financial performance as well as performance measures specific to employees and is adjusted throughout the year while insurance benefit expense is affected by benefit claims. The Company had 529 full-time equivalent employees at September 30, 2012, down from 545 a year earlier.

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*Share-based Compensation.* The Company uses share-based compensation to recruit new employees and reward and retain existing employees. Share-based compensation increased during the three and nine months ended September 30, 2012 compared to the prior-year periods due to additional restricted stock issued during the first quarter of 2012. The Company recognizes compensation costs for the grant-date fair value of awards issued to employees and expects to continue using share-based compensation in the future.

*Occupancy Costs.* Occupancy costs consist primarily of rent, depreciation, utilities, property taxes and insurance. Occupancy costs were stable in the current quarter compared to a year earlier. Costs increased \$0.3 million during the nine months ended September 30, 2012, compared to the same period in 2011, largely due to higher software and hardware depreciation and system maintenance contract expenses.

*FDIC and Other Assessments.* FDIC and other assessments consist of premiums paid by FDIC-insured institutions and by Colorado chartered banks. The assessments are based on statutory and risk classification factors. FDIC assessment calculations and base rates changed in the second quarter of 2011, resulting in reduced deposit insurance costs. FDIC and other assessments decreased \$0.2 million and \$1.6 million for the three and nine months ended September 30, 2012, respectively, compared to the prior-year periods.

*OREO and Loan Workout Costs.* Carrying costs and workout expenses of nonperforming loans and OREO decreased \$0.3 million and \$0.8 million during the three and nine months ended September 30, 2012 compared to the respective prior-year periods. These costs are directly correlated to levels of nonperforming assets during these periods and consistent with the continued declines in nonperforming assets. Nonperforming assets have decreased 45% to \$34.3 million at September 30, 2012 from \$62.4 million one year earlier.

*Net OTTI on Securities Recognized in Earnings.* Net OTTI losses on securities represent credit losses recognized on available for sale securities. OTTI recognized during the three and nine months ended September 30, 2012 and 2011 relate solely to private-label MBS that are credit impaired.

*Loss on Securities, Other Assets, and OREO.* Loss on securities, other assets and OREO recognized for the periods presented were comprised of the following:



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(in thousands)	Three months ended September 30,				Nine months ended September 30,			
	2012	2011	Increase (decrease)		2012	2011	Increase (decrease)	
			Amount	%			Amount	%
OREO	\$ 169	\$ 674	\$ (505)	(74.9)	\$ 1,658	\$ 3,232	\$ (1,574)	(48.7)
Investment securities	133	46	87	189.1	(636)	(605)	(31)	5.1
Other	(272)		(272)	(100.0)	(272)	27	(299)	(1,107.4)
	\$ 30	\$ 720	\$ (690)	(95.8)	\$ 750	\$ 2,654	\$ (1,904)	(71.7)

OREO losses recognized during the nine months ended September 30, 2012 are comprised of valuation adjustments of \$1.4 million on OREO currently held and \$0.3 million on OREO sales. Of the \$1.7 million in valuation adjustments recorded, \$0.9 million relates to the Company's largest OREO property located in Colorado.

Gains on investment securities are primarily attributed to TPS and corporate debt calls. Other items are attributed to gains realized in conjunction with the termination of lease agreement related to a previously announced branch closure.

*Other Operating Expenses.* Other operating expenses consist primarily of business development expenses (meals, entertainment and travel), charitable donations, professional services (auditing, legal, marketing and courier), and provision expense for off-balance sheet commitments. Other operating expenses for the three and nine months ended September 30, 2012 increased \$0.2 million and \$1.0 million, respectively, compared to the prior-year period. The increase is attributed to higher marketing expenses and certain banking product service contracts.

## Provision and Allowance for Loan and Credit Losses

The following table presents the provision for loan and credit losses for the nine months ended September 30, 2012 and 2011:

(in thousands)	Three months ended September 30,		Increase / (decrease)	Nine months ended September 30,		Increase / (decrease)
	2012	2011		2012	2011	
Provision for loan losses	\$ (2,506)	\$	\$ (2,506)	\$ (4,396)	\$ 3,622	\$ (8,018)
Provision for credit losses (included in other expenses)						
Total provision for loan and credit losses	\$ (2,506)	\$	\$ (2,506)	\$ (4,396)	\$ 3,622	\$ (8,018)

The provision for loan and credit losses decreased \$2.5 million and \$8.0 million during the three and nine months ended September 30, 2012, respectively, over the comparable prior year periods. This is primarily attributable to an overall improvement in credit quality.

All loans are continually monitored to identify potential problems with repayment and collateral deficiency. At September 30, 2012, the allowance for loan and credit losses decreased to 2.57% of total loans from 3.40% at December 31, 2011, and 3.60% a year earlier primarily due to growth in the loan portfolio coupled with improved asset quality. The ratio of allowance for loan and credit losses to nonperforming loans increased to 225% at September 30, 2012 from 204% at December 31, 2011 and 144% a year earlier. Though management believes the current

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allowance provides adequate coverage of potential problems in the loan portfolio as whole, negative economic trends could adversely affect future earnings and asset quality.

The allowance for loan losses represents management's recognition of the risks of extending credit and its evaluation of the quality of the loan portfolio. The allowance is maintained to provide for probable losses related to specifically identified loans and for losses inherent in the loan portfolio that have been incurred as of the balance sheet date. The allowance is based on various factors affecting the loan portfolio, including a review of problem loans, business conditions, historical loss experience, evaluation of the quality of the underlying collateral, and holding and disposal costs. The allowance is increased by additional charges to operating income and reduced by loans charged off, net of recoveries.

During the three and nine months ended September 30, 2012, the Company had \$2.2 million and \$4.8 million in net charge-offs, respectively. Although the Company continues to record charge-offs, the Company's credit quality outlook remains favorable as reflected by the negative provision expense recorded during 2012.

The allowance for credit losses represents management's recognition of a separate reserve for off-balance sheet loan commitments and letters of credit. While the allowance for loan losses is recorded as a contra-asset to the loan portfolio on the consolidated balance sheet, the allowance for credit losses is recorded in Accrued interest and other liabilities in the accompanying condensed consolidated balance sheet. Although the allowances are presented separately on the balance sheet, any losses incurred from credit losses would be reported as a charge-off in the allowance for loan losses, since any loss would be recorded after the off-balance sheet commitment had been funded. Due to the relationship of these allowances as extensions of credit underwritten through a comprehensive risk analysis, information on both the allowance for loan and credit losses positions is presented in the following table.

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(in thousands)	Nine months ended September 30, 2012		Year ended December 31, 2011		Nine months ended September 30, 2011	
Balance of allowance for loan losses at beginning of period	\$	55,629	\$	65,892	\$	65,892
Charge-offs:						
Commercial		(982)		(4,559)		(3,618)
Real estate mortgage		(2,517)		(7,064)		(2,138)
Land acquisition & development		(3,115)		(1,635)		(1,635)
Real estate construction		(867)		(5,118)		(5,098)
Consumer		(635)		(309)		(184)
Other		(20)		(61)		(61)
Total charge-offs		(8,136)		(18,746)		(12,734)
Recoveries:						
Commercial		1,547		1,377		1,136
Real estate mortgage		514		1,472		1,018
Land acquisition & development		1,248		1,216		603
Real estate construction		3		132		69
Consumer		28		281		86
Other				3		3
Total recoveries		3,340		4,481		2,915
Net charge-offs		(4,796)		(14,265)		(9,819)
Provision for loan losses charged to operations		(4,396)		4,002		3,622
Balance of allowance for loan losses at end of period	\$	46,437	\$	55,629	\$	59,695
Balance of allowance for credit losses at beginning of period	\$	35	\$	61	\$	61
Provision for credit losses charged to operations				(26)		
Balance of allowance for credit losses at end of period	\$	35	\$	35	\$	61
Total provision for loan and credit losses charged to operations	\$	(4,396)	\$	3,976	\$	3,622
Ratio of net charge-offs to average loans		0.28%		0.86%		0.60%
Average loans outstanding during the period	\$	1,713,940	\$	1,651,247	\$	1,650,171

**Nonperforming Assets**

Nonperforming assets consist of nonaccrual loans, past due loans, repossessed assets and OREO. The following table presents information regarding nonperforming assets as of the dates indicated:

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(in thousands)	At September 30, 2012	At December 31, 2011	At September 30, 2011
Nonperforming loans:			
Loans 90 days or more past due and still accruing interest	\$ 1,183	\$ 212	\$
Nonaccrual loans:			
Commercial	2,698	3,105	5,606
Real estate - mortgage	10,440	9,295	18,491
Land acquisition & development	5,021	5,112	6,105
Real estate - construction	647	6,985	8,197
Consumer and other	665	2,527	2,966
Total nonaccrual loans	19,471	27,024	41,365
Total nonperforming loans	20,654	27,236	41,365
OREO and repossessed assets	13,619	18,502	20,986
Total nonperforming assets	\$ 34,273	\$ 45,738	\$ 62,351
Allowance for loan losses	\$ 46,437	\$ 55,629	\$ 59,695
Allowance for credit losses	35	35	61
Allowance for loan and credit losses	\$ 46,472	\$ 55,664	\$ 59,756
Nonperforming assets to total assets	1.34%	1.89%	2.58%
Nonperforming loans to total loans	1.14%	1.66%	2.49%
Nonperforming loans and OREO to total loans and OREO	1.88%	2.76%	3.71%
Allowance for loan and credit losses to total loans (excluding loans held for sale)	2.57%	3.40%	3.60%
Allowance for loan and credit losses to nonperforming loans	225.00%	204.38%	144.46%

Nonperforming assets have decreased steadily since peaking in the fourth quarter of 2009. At September 30, 2012, nonperforming assets decreased \$11.5 million (25%) and \$28.1 million (45%) as compared to December 31, 2011 and September 30, 2011, respectively. Approximately 47% or \$16.0 million of nonperforming assets at September 30, 2012 were concentrated in Colorado, while the remaining 53% or \$18.3 million were in Arizona. Nonperforming loans represent 60% of total nonperforming assets with the remaining 40% comprised of OREO and repossessed assets. Nonperforming loans of \$20.7 million are concentrated primarily within the real estate mortgage (55%), land A&D (24%), and commercial (14%) loan segments. OREO decreased \$4.9 million and \$7.4 million from December 31, 2011 and September 30, 2011, respectively, primarily as a result of the overall improvement in asset quality and OREO sales during 2012. The Company foreclosed on a single OREO property and sold 12 properties in 2012. The Company has dedicated significant resources to the workout and resolution of nonaccrual loans and OREO and continues to closely monitor the financial condition of its clients.

## Segment Results

Certain financial metrics and discussion of the results for the three and nine months ended September 30, 2012 and 2011, of each operating segment, are presented below.

COMMERCIAL BANKING (in thousands, except other information)	Three months ended September 30, 2012				Increase (decrease) %				Nine months ended September 30, 2012				Increase (decrease) %			
	2012	2011	Amount	%	2012	2011	Amount	%	2012	2011	Amount	%	2012	2011	Amount	%
<i>Income Statement</i>																
Net interest income	\$ 24,634	\$ 25,642	\$ (1,008)	(3.9)	\$ 74,290	\$ 76,656	\$ (2,366)	(3.1)								
Provision for loan losses	(2,324)	(2,068)	(256)	(12.4)	(3,528)	(157)	(3,371)	nm								
Noninterest income	2,495	1,653	842	50.9	8,890	7,177	1,713	23.9								
Noninterest expense	7,261	7,403	(142)	(1.9)	24,333	23,027	1,306	5.7								

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Provision for income taxes	8,374	8,149	225	2.8	23,058	22,510	548	2.4
Net income before management fees and overhead	13,818	13,811	7	0.1	39,317	38,453	864	2.2
Management fees and overhead allocations, net of tax	5,704	5,705	(1)	(0.0)	15,799	17,063	(1,264)	(7.4)
Net income	\$ 8,114	\$ 8,106	\$ 8	0.1	\$ 23,518	\$ 21,390	\$ 2,128	9.9
Other information								
Full-time equivalent employees	204.1	207.4			204.4	207.0		
nm=not meaningful								

Earnings for the Commercial Banking segment during the current quarter were in line with 2011 third quarter results while earnings for the nine months ended September 30, 2012, increased \$2.1 million compared to the same period in 2011. Current year to date results were primarily the result of a negative provision for loan losses, an outcome directly related to the Company's early efforts to proactively reserve for problem loans when repayment risks were first identified. Since 2009, the Company has taken deliberate action to reduce high-risk loan concentrations and improve overall asset quality. In addition, the risk profile on loans originated since the downturn is lower than older vintage loans, which has reduced the overall provision requirement. Provision expense has decreased each quarter since peaking in the second quarter of 2009. Offsetting the provision effects were decreases in net interest income for the current quarter and year to date

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periods resulting from lower overall yield on interest-earning assets, down 40 basis points and 33 basis points, respectively. Noninterest income increases for the current quarter and year to date periods relate to interest rate swap fee income and returns on equity method investment. Noninterest expense for the first nine months of 2012 was higher than the prior year period due to salary, bonus and employee benefit cost increases.

INVESTMENT BANKING (in thousands, except other information)	Three months ended September 30, 2012				Three months ended September 30, 2011				Nine months ended September 30, 2012				Nine months ended September 30, 2011			
	2012		2011		Increase (decrease) Amount		%		2012		2011		Increase (decrease) Amount		%	
Income Statement																
Net interest income	\$	1	\$	1	\$		\$	5	\$	6	\$	(1)		(16.7)		
Noninterest income		253		205		48		23.4		475		1,806		(1,331)		(73.7)
Noninterest expense		833		868		(35)		(4.0)		2,527		2,741		(214)		(7.8)
Benefit for income taxes		(266)		(253)		(13)		(5.1)		(829)		(363)		(466)		(128.4)
Net loss before management fees and overhead		(313)		(409)		96		23.5		(1,218)		(566)		(652)		(115.2)
Management fees and overhead allocations, net of tax		33		47		(14)		(29.8)		114		118		(4)		(3.4)
Net loss	\$	(346)	\$	(456)	\$	110	24.1	\$	(1,332)	\$	(684)	\$	(648)		(94.7)	
Other information																
Full-time equivalent employees		19.6		19.9						19.0		19.4				

Net loss for the Investment Banking segment decreased \$0.1 million in the current quarter compared to 2011 and increased \$0.6 million for the nine months ended September 30, 2012 compared to the year-earlier period. No success fees were recorded during 2012 as a significant number of engagements closed in the fourth quarter of 2011.

WEALTH MANAGEMENT (in thousands, except other information)	Three months ended September 30, 2012				Three months ended September 30, 2011				Nine months ended September 30, 2012				Nine months ended September 30, 2011			
	2012		2011		Amount		%		2012		2011		Amount		%	
Income Statement																
Net interest income	\$	(10)	\$	(2)	\$	(8)	(400.0)	\$	(31)	\$	(26)	\$	(5)	(19.2)		
Noninterest income		2,013		2,154		(141)	(6.5)		6,408		6,815		(407)	(6.0)		
Noninterest expense		2,128		2,191		(63)	(2.9)		6,971		6,967		4	0.1		
Benefit for income taxes		(62)		(4)		(58)	nm		(246)		(72)		(174)	(241.7)		
Net loss before management fees and overhead		(63)		(35)		(28)	(80.0)		(348)		(106)		(242)	(228.3)		
Management fees and overhead allocations, net of tax		150		164		(14)	(8.5)		476		472		4	0.8		
Net loss	\$	(213)	\$	(199)	\$	(14)	(7.0)	\$	(824)	\$	(578)	\$	(246)	(42.6)		
Other information																
Full-time equivalent employees		53.0		54.4					53.2		56.1					
nm=not meaningful																

Net loss for the Wealth Management segment increased \$0.3 million for the nine month periods ended September 30, 2012, compared to the year earlier periods driven by lower revenues.

Investment advisory revenues are generally a percentage of assets under management (AUM) and provide a revenue stream that can fluctuate with movement in the equity markets. Discretionary AUM at September 30, 2012 was \$758.5 million, an increase \$49.4 million or 7.0% from a year ago.

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Insurance revenues generated by wealth transfer are transactional by nature, with the majority of revenues earned at the time of the sale. Whole life products generally require large, up-front cash premiums and in recent years revenues have been lower than historical standards due to broader economic uncertainties. For the nine months ended September 30, 2012, the wealth transfer revenues were down approximately 3% compared to the prior-year period.

INSURANCE (in thousands, except other information)	Three months ended September 30				Nine months ended September 30			
	2012	2011	Amount	%	2012	2011	Amount	%
<i>Income Statement</i>								
Net interest income	\$ 2	\$	\$ 2	100.0	\$ 3	\$ (3)	\$ 6	200.0
Noninterest income	2,412	2,089	323	15.5	7,339	7,078	261	3.7
Noninterest expense	2,444	2,181	263	12.1	7,090	6,849	241	3.5
Provision (benefit) for income taxes	(9)	(29)	20	69.0	108	100	8	8.0
Net income before management fees and overhead	(21)	(63)	42	66.7	144	126	18	14.3
Management fees and overhead allocations, net of tax	86	115	(29)	(25.2)	296	288	8	2.8
Net loss	\$ (107)	\$ (178)	\$ 71	39.9	\$ (152)	\$ (162)	\$ 10	6.2
<i>Other information</i>								
Full-time equivalent employees	54.8	55.0			53.9	53.1		

Net loss in the Insurance segment for the three and nine months ended September 30, 2012 was relatively flat compared to the prior-year periods. Revenue in the current quarter increased compared to the prior-year period, driven primarily by growth in P&C income and to a lesser extent continued growth from employee benefits.

The P&C industry's soft premium market conditions that have existed since 2005 appear to be improving as overall premium rates have increased. The segment is focused on following industry developments such as healthcare legislation and its potential impact on its business line and current and prospective clients.

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CORPORATE SUPPORT (in thousands, except other information)	Three months ended September 30, 2012				Three months ended September 30, 2011				Nine months ended September 30, 2012				Nine months ended September 30, 2011				
Income Statement																	
Net interest income	\$	(1,380)	\$	(1,667)	\$	287	17.2	\$	(4,093)	\$	(4,084)	\$	(9)	(0.2)			
Provision for loan losses		(182)		2,068		(2,250)	(108.8)		(868)		3,779		(4,647)	(123.0)			
Noninterest income		64		(50)		114	228.0		89		(3)		92	nm			
Noninterest expense		10,348		10,587		(239)	(2.3)		30,589		34,350		(3,761)	(10.9)			
Benefit for income taxes		(4,410)		(5,511)		1,101	20.0		(12,869)		(15,817)		2,948	18.6			
Net loss before management fees and overhead		(7,072)		(8,861)		1,789	20.2		(20,856)		(26,399)		5,543	21.0			
Management fees and overhead allocations, net of tax		(5,973)		(6,031)		58	1.0		(16,685)		(17,941)		1,256	7.0			
Net loss	\$	(1,099)	\$	(2,830)	\$	1,731	61.2	\$	(4,171)	\$	(8,458)	\$	4,287	50.7			
Other information																	
Full-time equivalent employees		194.2		211.7					197.7		209.9						
nm=not meaningful																	

nm=not meaningful

The Corporate Support and Other segment is composed of activities of the parent company (Parent); non-production, back-office support operations; and eliminating transactions in consolidation. Non-production, back-office operations include human resources, accounting and finance, information technology, and loan and deposit operations. The Company has a process for allocating these support operations back to the production lines based on an internal allocation methodology that is updated annually.

Net loss for the Corporate Support and Other segment decreased \$1.7 million and \$4.3 million for the respective three and nine month periods ended September 30, 2012 and 2011. The primary component of net interest expense for the segment is interest expense related to the Company's long-term.

The provision for loan losses relates to a non-performing loan portfolio the Parent owns. This portfolio has steadily decreased since the 2009 purchase due to loan repayments and collateral sales. In addition, asset quality improvement within the portfolio has contributed to the decline in the provision for loan losses.

Noninterest expense includes salaries and benefits of employees of the Parent and support functions as well as the nonemployee overhead operating costs not directly associated with another segment. Noninterest expense decreases during the three and nine months ended September 30, 2012 compared to prior year periods were primarily attributed to lower bonus compensation expense, loan workout expenses and OREO losses.

## Contractual Obligations and Commitments

Summarized below are the Company's contractual obligations (excluding deposit liabilities) to make future payments at September 30, 2012:

(in thousands)	Within one year	After one but within three years	After three but within five years	After five years	Total
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Repurchase agreements (1)	\$	124,836	\$		\$		\$	124,836
Operating lease obligations		5,538		10,048		7,044		27,654
Long-term debt obligations (2)		26,771		7,955		7,157		154,640
Preferred Stock, Series C dividend (3)		2,868		5,737		58,083		66,688
Supplemental executive retirement plan		4,798						4,798
Total contractual obligations	\$	164,811	\$	23,740	\$	72,284	\$	378,616

(1) Interest on these obligations has been excluded due to the short-term nature of the instruments.

(2) Principal repayment of the junior subordinated debentures is assumed to be at the contractual maturity and interest has been estimated through the applicable dates. Principal repayment of the subordinated notes payable is assumed to be at the first available call date in August 2013. See Note 8 of the notes to the condensed consolidated financial statements for a schedule of specific maturities and possible call dates. Interest on the junior subordinated debentures is calculated at the fixed rate associated with the applicable hedging instrument through the instrument maturity date then at the currently applicable variable rate through contractual maturity and is reported in the due within categories during which the interest expense is expected to be incurred. Included in long-term debt obligations are estimated interest payments related to subordinated debt (junior and unsecured) of \$4.1 million due Within one year , \$8.0 million due After one but within three years , \$7.2 million due After three but within five years and \$40.6 million due After five years. Variable rate interest payments on junior subordinated debentures after maturity of the related fixed interest rate swap hedge are estimates based on current rates and actual payments will differ.

(3) Series C preferred Stock issued to U.S. Department of Treasury in September 2011 includes dividends payable at 5% on \$57.4 million. The preferred shares are shown in the table as being due in the After three but within five years category which assumes the \$57.4 million in preferred stock will be redeemed in the year prior to the contractual dividend rate step up to 9% effective 4.5 years after issuance.

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The contractual amount of the Company's financial instruments with off-balance sheet risk at September 30, 2012, is presented below, classified by the type of commitment and the term within which the commitment expires:

(in thousands)	Within one year	After one but within three years	After three but within five years	After five years	Total
Unfunded loan commitments	\$ 463,302	\$ 74,717	\$ 22,008	\$ 1,303	\$ 561,330
Standby letters of credit	30,724	11,881			42,605
Commercial letters of credit	329				329
Unfunded commitments for unconsolidated investments	6,021				6,021
Company guarantees	1,403				1,403
Total commitments	\$ 501,779	\$ 86,598	\$ 22,008	\$ 1,303	\$ 611,688

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the liquidity, credit enhancement and financing needs of its customers. These financial instruments include legally binding commitments to extend credit and standby letters of credit and involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the consolidated balance sheet. Credit risk is the principal risk associated with these instruments. The contractual amounts of these instruments represent the amount of credit risk should the instruments be fully drawn upon and the customer defaults.

To control the credit risk associated with entering into commitments and issuing letters of credit, the Company uses the same credit quality, collateral policies, and monitoring controls in making commitments and letters of credit as it does with its lending activities. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation.

Legally binding commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit obligate the Company to meet certain financial obligations of its customers if, under the contractual terms of the agreement, the customers are unable to do so. The financial standby letters of credit issued by the Company are irrevocable. Payment is only guaranteed under these letters of credit upon the borrower's failure to perform its obligations to the beneficiary.

Approximately \$42.7 million of total loan commitments at September 30, 2012 represent commitments to extend credit at fixed rates of interest, which exposes the Company to some degree of interest-rate risk.

The Company has also entered into interest-rate swap agreements under which it is required to either receive cash or pay cash to counterparty depending on changes in interest rates. The interest-rate swaps are carried at fair value on the condensed consolidated balance sheets with the fair value representing the net present value of expected future cash receipts or payments based on market interest rates as of the balance sheet date. The fair value of interest-rate swaps recorded on the balance sheet at September 30, 2012 do not represent the actual amounts that will ultimately be received or paid under the contracts since the fair value is based on estimated future interest rates and are therefore excluded from the table above.

## **Liquidity and Capital Resources**

Liquidity refers to the Company's ability to generate adequate amounts of cash to meet financial obligations to its customers and shareholders in order to fund loans, to respond to deposit outflows and to cover operating expenses. Maintaining a level of liquid funds through asset/liability management seeks to ensure that these needs are met at a reasonable cost. Liquidity is essential to compensate for fluctuations in the balance sheet and provide funds for growth and normal operating expenditures. Sources of funds include customer deposits, scheduled amortization of loans, loan prepayments, scheduled maturities of investments and cash flows from mortgage-backed securities. Liquidity needs may also be met by deposit growth, converting assets into cash, raising funds in the brokered CD market or borrowing using lines of credit with correspondent banks, the FHLB or the FRB. Longer-term liquidity needs may be met by selling securities available for sale or raising additional capital.

Liquidity management is the process by which the Company manages the continuing flow of funds necessary to meet its financial commitments on a timely basis and at a reasonable cost. The objective of liquidity management is to ensure the Company has the ability to satisfy the cash flow requirements of depositors and borrowers and to allow us to sustain our operations. These funding commitments include withdrawals by depositors, credit commitments to borrowers, shareholder dividends, debt payments, expenses of its operations and capital expenditures. Liquidity is monitored and closely

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managed by the Company's Asset and Liability Committee (ALCO), a group of senior officers from the lending, deposit gathering, finance and treasury areas. ALCO's primary responsibilities are to ensure the necessary level of funds are available for normal operations as well as maintain a contingency funding policy to ensure that liquidity stress events are quickly identified and management plans are in place to respond. This is accomplished through the use of policies which establish limits and require measurements to monitor liquidity trends, including management reporting that identifies the amounts and costs of all available funding sources.

The Company's current liquidity position is expected to be more than adequate to fund expected asset growth. Historically, our primary source of funds has been customer deposits. Scheduled loan repayments are a relatively stable source of funds, while deposit inflows and unscheduled loan prepayments which are influenced by fluctuations in the general level of interest rates, returns available on other investments, competition, economic conditions, and other factors are less predictable.

Liquidity from asset categories is provided through cash and interest-bearing deposits with other banks, which totaled \$57.2 million at September 30, 2012, compared to \$59.2 million at December 31, 2011. Additional asset liquidity sources include principal and interest payments from securities in the Company's investment portfolio and cash flows from its amortizing loan portfolio. Liability liquidity sources include attracting deposits at competitive rates and maintaining wholesale borrowing (short-term borrowings and brokered CDs) credit relationships.

The Company's loan to core deposit ratio increased to 88.4% at September 30, 2012, from 85.4% at December 31, 2011. The low loan to deposit ratio has allowed the Company to maintain low levels of wholesale borrowings that historically bear a higher cost than core deposits. At September 30, 2012, the Company had zero outstanding wholesale borrowings as compared to \$20.0 million at December 31, 2011. Average wholesale borrowings were \$52.1 million during the nine months ended September 30, 2012, an increase from the 2011 fiscal year average of \$14.1 million.

The Company uses various forms of short-term borrowings for cash management and liquidity purposes, regularly accessing its federal funds and FHLB lines to manage its daily cash position. At September 30, 2012, the Bank has approved federal funds purchase lines with seven correspondent banks with an aggregate credit line of \$165.0 million. The Bank also has a line of credit from the FHLB that is limited by the amount of eligible collateral available to secure it and the Company's investment in FHLB stock. Borrowings under the FHLB line are required to be secured by unpledged securities and qualifying loans. Borrowings may also be used on a longer-term basis to support expanded lending activities and to match the maturity or repricing intervals of assets.

Available funding through correspondent lines and the FHLB at September 30, 2012, totaled \$601.0 million. Available funding is comprised of \$165.0 million through the unsecured federal fund lines and \$436.0 million in secured FHLB borrowing capacity. The Company had \$52.5 million in securities available to be pledged as collateral for additional FHLB borrowings at September 30, 2012. Access to funding through correspondent lines is dependent upon the cash position of the correspondent banks and there may be times when certain lines are not available. In addition, certain lines require a one day rest period after a specified number of consecutive days of accessing the lines. The Company believes it has sufficient borrowing capacity and diversity in correspondent banks to meet its needs.

At the holding company level, our primary sources of funds are dividends paid from the Bank and fee-based subsidiaries, management fees assessed to the Bank and the fee-based business lines, proceeds from the issuance of common stock, and other capital markets activity. The main use of this liquidity is the quarterly payment of dividends on our common and preferred stock, quarterly interest payments on the subordinated debentures and notes payable, payments for mergers and acquisitions activity (including potential earn-out payments), and payments for the salaries and benefits for the employees of the holding company.

The approval of the Colorado State Banking Board is required prior to the declaration of any dividend by the Bank if the total of all dividends declared by the Bank in any calendar year exceeds the total of its net profits for that year combined with the retained net profits for the preceding two years. In addition, the Federal Deposit Insurance Corporation Improvement Act of 1991 provides that the Bank cannot pay a dividend if it will cause the Bank to be undercapitalized. At September 30, 2012, the Bank was not otherwise restricted in its ability to pay dividends to the holding company. The Company's ability to pay dividends on its common stock depends upon the availability of dividends from the Bank, earnings from its fee-based businesses, and upon the Company's compliance with the capital adequacy guidelines of the Federal Reserve Board of Governors. The holding company has a liquidity policy that requires the maintenance of at least 18 months of liquidity on the balance sheet based on projected cash usages, exclusive of dividends from the Bank. At September 30, 2012, the holding company had a liquidity position that exceeds the policy limit and the Company believes it has the ability to continue paying dividends.

At September 30, 2012, shareholders' equity totaled \$251.0 million, a \$30.9 million increase from December 31, 2011. The increase was primarily due to an underwritten public offering of 2,100,000 shares of the Company's common stock at

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a price of \$6.00 per share completed during the first quarter of 2012. The net proceeds to the Company, net of underwriting discounts, commissions and selling costs were \$11.8 million. Also contributing to the increase was a \$1.6 million increase in common surplus relating to stock-based compensation, sales of stock under the ESPP plan and stock exercises; an increase of \$4.6 million in accumulated other comprehensive income associated with changes in the fair value of derivatives and available for sale securities; and net income of \$17.0 million for the nine months ended September 30, 2012. Offsetting these increases were common and preferred dividends of \$4.1 million.

We anticipate that our cash and cash equivalents, expected cash flows from operations together with alternative sources of funding are sufficient to meet our anticipated cash requirements for working capital, loan originations, capital expenditures and other obligations for at least the next 12 months. We continually monitor existing and alternative financing sources to support our capital and liquidity needs, including but not limited to, debt issuance, common stock issuance and deposit funding sources. Based on our current financial condition and our results of operations, we believe the Company will be able to sustain its ability to raise adequate capital through one or more of these financing sources.

We are subject to minimum risk-based capital limitations as set forth by federal banking regulations at both the consolidated Company level and the Bank level. Under the risk-based capital guidelines, different categories of assets, including certain off-balance sheet items, such as loan commitments in excess of one year and letters of credit, are assigned different risk weights, based generally on the perceived credit risk of the asset. These risk weights are multiplied by corresponding asset balances to determine a risk-weighted asset base. For purposes of the risk-based capital guidelines, total capital is defined as the sum of Tier 1 and Tier 2 capital elements, with Tier 2 capital being limited to 100% of Tier 1 capital. Tier 1 capital includes, with certain restrictions, common shareholders' equity, perpetual preferred stock and minority interests in consolidated subsidiaries. Tier 2 capital includes, with certain limitations, perpetual preferred stock not included in Tier 1 capital, certain maturing capital instruments, and the allowance for loan and credit losses. At September 30, 2012, the Bank was well-capitalized with a Tier 1 Capital ratio of 12.4% and Total Capital ratio of 13.7%. The minimum ratios to be considered well-capitalized under the risk-based capital standards are 6% and 10%, respectively. At the holding company level, the Company's Tier 1 Capital ratio at September 30, 2012, was 15.1% and its Total Capital ratio 17.4%. In order to comply with the regulatory capital constraints, the Company and its Board of Directors constantly monitor the capital level and its anticipated needs based on the Company's growth. The Company has identified sources of additional capital that could be used if needed, and monitors the costs and benefits of these sources, which include both the public and private markets.

**Effects of Inflation and Changing Prices**

The primary impact of inflation on our operations is increased operating costs. Unlike most retail or manufacturing companies, virtually all of the assets and liabilities of a financial institution such as the Bank are monetary in nature. As a result, the impact of interest rates on a financial institution's performance is generally greater than the impact 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. Over short periods of time, interest rates may not move in the same direction, or at the same magnitude, as inflation.

**Forward Looking Statements**

This report contains forward-looking statements that describe CoBiz's future plans, strategies and expectations. All forward-looking statements are based on assumptions and involve risks and uncertainties, many of which are beyond our control and which may cause our actual results, performance or achievements to differ materially from the results, performance or achievements contemplated by the forward-looking statements. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include words such as believe, expect, anticipate, intend, plan, estimate or words of similar meaning, or future or conditional verbs such as would, could or may. Forward-looking statements speak only as of the date they are made. Such risks and uncertainties include, among other

things:

- Competitive pressures among depository and other financial institutions nationally and in our market areas may increase significantly.
- Adverse changes in the economy or business conditions, either nationally or in our market areas, could increase credit-related losses and expenses and/or limit growth.
- Increases in defaults by borrowers and other delinquencies could result in increases in our provision for losses on loans and related expenses.
- Our inability to manage growth effectively, including the successful expansion of our customer support, administrative infrastructure and internal management systems, could adversely affect our results of operations and prospects.
- Fluctuations in interest rates and market prices could reduce our net interest margin and asset valuations and increase our expenses.

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- The consequences of continued bank acquisitions and mergers in our market areas, resulting in fewer but much larger and financially stronger competitors, could increase competition for financial services to our detriment.
- Our continued growth will depend in part on our ability to enter new markets successfully and capitalize on other growth opportunities.
- Changes in legislative or regulatory requirements applicable to us and our subsidiaries could increase costs, limit certain operations and adversely affect results of operations.
- Changes in tax requirements, including tax rate changes, new tax laws and revised tax law interpretations may increase our tax expense or adversely affect our customers' businesses.
- The risks identified under "Risk Factors" in Item 1A of our annual report on Form 10-K for the year ended December 31, 2011.

In light of these risks, uncertainties and assumptions, you should not place undue reliance on any forward-looking statements in this report. We undertake no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events or otherwise.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

At September 30, 2012, there have been no material changes in the quantitative and qualitative information about market risk provided pursuant to Item 305 of Regulation S-K as presented in our Form 10-K for the year ended December 31, 2011.

**Item 4. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures.** The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures at September 30, 2012, the end of the period covered by this report ("Evaluation Date"), pursuant to Exchange Act Rule 13a-15(e). Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings.

Disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended (Exchange Act) is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.



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**Changes in Internal Control.** During the quarter that ended on the Evaluation Date, there were no changes in internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### PART II. OTHER INFORMATION

#### Item 6. Exhibits

Exhibits and Index of Exhibits.

10.1 Lease Termination Agreement dated August 16, 2012 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed August 22, 2012).

31.1 Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer.

31.2 Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer.

32.1 Section 1350 Certification of the Chief Executive Officer.

32.2 Section 1350 Certification of the Chief Financial Officer.

101 Pursuant to Rule 405 of Regulation S-T, the following materials from CoBiz Financial Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Statement of Income and Comprehensive Income (Loss), (ii) the Condensed Consolidated Statement of Cash Flows, (iii) the Condensed Consolidated Balance Sheet, and (iv) Notes to the Condensed Consolidated Financial Statements.

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**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**COBIZ FINANCIAL INC.**

Date: October 26, 2012

By: /s/ Steven Bangert  
Steven Bangert  
Chairman and Chief Executive Officer

Date: October 26, 2012

By: /s/ Lyne B. Andrich  
Lyne B. Andrich  
Executive Vice President and Chief  
Financial Officer