BANNER CORP
Form 10-Q
November 09, 2009

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

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED September 30, 2009.

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM __________ to __________ :

Commission File Number 0-26584

BANNER CORPORATION
(Exact name of registrant as specified in its charter)

Washington (State or other jurisdiction of incorporation or organization)	91-1691604 (I.R.S. Employer Identification Number)

10 South First Avenue, Walla Walla, Washington 99362
(Address of principal executive offices and zip code)

Registrant's telephone number, including area code: (509) 527-3636

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 [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ]	Accelerated filer [X]	Non-accelerated filer [ ]	Smaller reporting company [ ]

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

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Title of class:	As of October 31, 2009
Common Stock, $.01 par value per share	20,511,033 shares*

* Includes 240,381 shares held by the Employee Stock Ownership Plan that have not been released, committed to be released, or allocated to participant accounts.

BANNER CORPORATION AND SUBSIDIARIES
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PART I - FINANCIAL INFORMATION

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Unaudited) (In thousands, except shares)
September 30, 2009 and December 31, 2008

ASSETS	September 30 2009	December 31 2008
Cash and due from banks	$ 331,154	$ 102,750
Securities—trading, cost $211,548 and $245,274, respectively	167,944	203,902
Securities—available-for-sale, cost $73,305 and $52,190, respectively	74,527	53,272
Securities—held-to-maturity, fair value $79,266 and $60,530, respectively	76,630	59,794
Federal Home Loan Bank (FHLB) stock	37,371	37,371
Loans receivable:		
Held for sale, fair value $4,835 and $7,540, respectively	4,781	7,413
Held for portfolio	3,891,413	3,953,995
Allowance for loan losses	(95,183)	(75,197)
	3,801,011	3,886,211
Accrued interest receivable	20,912	21,219
Real estate owned, held for sale, net	53,576	21,782
Property and equipment, net	104,469	97,647
Goodwill and other intangibles, net	11,718	13,716
Deferred income tax asset, net	8,516	5,528
Income taxes receivable, net	20,913	9,675
Bank-owned life insurance (BOLI)	54,037	52,680
Other assets	25,230	18,821
	$ 4,788,008	$ 4,584,368
LIABILITIES		
Deposits:		
Non-interest-bearing	$ 546,956	$ 509,105
Interest-bearing transaction and savings accounts	1,305,546	1,137,878
Interest-bearing certificates	2,008,673	2,131,867
	3,861,175	3,778,850
Advances from FHLB at fair value	255,806	111,415
Other borrowings	174,770	145,230
Junior subordinated debentures at fair value (issued in connection with Trust Preferred Securities)	47,859	61,776
Accrued expenses and other liabilities	28,715	40,600
Deferred compensation	12,960	13,149
	4,381,285	4,151,020
COMMITMENTS AND CONTINGENCIES (Note 15)		
STOCKHOLDERS' EQUITY		

Preferred stock - $0.01 par value, 500,000 shares authorized; Series A – liquidation preference		
$1,000 per share, 124,000 shares issued and outstanding	117,034	115,915
Common stock - $0.01 par value per share, 75,000,000 shares authorized, 19,933,943 shares issued:		
19,693,562 shares and 16,911,657 shares outstanding at September 30, 2009 and December 31, 2008, respectively	327,385	316,740
Retained earnings (accumulated deficit)	(36,402)	2,150
Accumulated other comprehensive income:		
Unrealized gain on securities available for sale and/or transferred to held to maturity	703	572
Unearned shares of common stock issued to Employee Stock Ownership Plan (ESOP) trust at cost:		
240,381 restricted shares outstanding at September 30, 2009 and December 31, 2008	(1,987)	(1,987)
Carrying value of shares held in trust for stock related compensation plans	(9,076)	(8,850)
Liability for common stock issued to deferred, stock related, compensation plans	9,066	8,808
	(10)	(42)
	406,723	433,348
	$ 4,788,008	$ 4,584,368

See selected notes to consolidated financial statements

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited) (In thousands except for per share amounts)
For the Quarters and Nine Months Ended September 30, 2009 and 2008

	Quarters Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
INTEREST INCOME:				
Loans receivable	$ 56,175	$ 64,237	$ 168,022	$ 196,537
Mortgage-backed securities	1,422	1,040	4,792	3,280
Other securities and cash equivalents	1,976	2,786	6,248	8,374
	59,573	68,063	179,062	208,191
INTEREST EXPENSE:				
Deposits	20,818	26,818	65,548	84,446
FHLB advances	630	1,160	2,025	4,310
Other borrowings	655	734	1,553	1,874
Junior subordinated debentures	1,118	1,669	3,700	5,399
	23,221	30,381	72,826	96,029
Net interest income before provision for loan losses	36,352	37,682	106,236	112,162
PROVISION FOR LOAN LOSSES	25,000	8,000	92,000	29,500
Net interest income	11,352	29,682	14,236	82,662
OTHER OPERATING INCOME:				
Deposit fees and other service charges	5,705	5,770	16,049	16,277
Mortgage banking operations	2,065	1,500	7,640	4,694
Loan servicing fees	282	480	260	1,296
Miscellaneous	768	286	1,700	980
	8,820	8,036	25,649	23,247
Net change in valuation of financial instruments carried at fair value	4,633	(6,056)	12,429	(4,584)
Total other operating income	13,453	1,980	38,078	18,663
OTHER OPERATING EXPENSES:				
Salary and employee benefits	17,379	18,241	52,508	57,623
Less capitalized loan origination costs	(2,060)	(2,040)	(7,010)	(7,009)
Occupancy and equipment	5,715	5,956	17,697	17,813
Information/computer data services	1,551	1,560	4,684	5,389
Payment and card processing expenses	1,778	1,913	4,786	5,212
Professional services	1,456	1,117	3,833	3,203
Advertising and marketing	1,899	1,572	5,938	4,667
Deposit insurance	2,219	701	7,818	1,661
State/municipal business and use taxes	558	572	1,630	1,712
Real estate owned expenses	2,799	758	5,227	1,592
Miscellaneous	3,335	3,650	10,202	11,067
	36,629	34,000	107,313	102,930
Goodwill write-off	--	--	--	50,000

Total other operating expenses		36,629		34,000		107,313		152,930
Income (loss) before provision for (benefit from) income taxes		(11,824)		(2,338)		(54,999)		(51,605)
PROVISION FOR (BENEFIT FROM) INCOME TAXES		(5,376)		(1,347)		(22,777)		(2,143)
NET INCOME (LOSS)	$	(6,448)	$	(991)	$	(32,222)	$	(49,462)
PREFERRED STOCK DIVIDEND AND DISCOUNT ACCRETION								
Preferred stock dividend	$	1,550	$	--	$	4,650	$	--
Preferred stock discount accretion		373		--		1,119		--
NET INCOME (LOSS) AVAILABLE TO COMMON SHAREHOLDERS	$	(8,371)	$	(991)	$	(37,991)	$	(49,462)
Earnings (loss) per common share (see Note 13):								
Basic	$	(0.44)	$	(0.06)	$	(2.11)	$	(3.09)
Diluted	$	(0.44)	$	(0.06)	$	(2.11)	$	(3.09)
Cumulative dividends declared per common share:	$	0.01	$	0.05	$	0.03	$	0.45

See selected notes to consolidated financial statements

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited) (In thousands)
For the Quarters and Nine Months Ended September 30, 2009 and 2008

	Quarters Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
NET INCOME (LOSS)	$ (6,448)	$ (991)	$ (32,222)	$ (49,462)
OTHER COMPREHENSIVE INCOME (LOSS), NET OF INCOME TAXES:				
Unrealized holding gain (loss) during the period, net of deferred income tax (benefit) of ($121), $0, ($51) and $0, respectively	627	--	89	--
Amortization of unrealized loss on tax exempt securities transferred from available-for-sale to held-to-maturity	14	13	42	41
Other comprehensive income (loss)	641	13	131	41
COMPREHENSIVE INCOME (LOSS)	$ (5,807)	$ (978)	$ (32,091)	$ (49,421)

See selected notes to consolidated financial statements

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited) (In thousands, except per share amounts)
For the Nine Months Ended September 30, 2009 and 2008

	Preferred Stock	Common Stock and Paid in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Unearned Restricted ESOP Shares	Carrying Value, Net of Liability, Of Shares Held in Trust for Stock-Related Compensation Plans	Stockholders' Equity
Balance, January 1, 2009	$ 115,915	$ 316,740	$ 2,150	$ 572	$ (1,987)	$ (42)	$ 433,348
Net income (loss)			(32,222)				(32,222)
Change in valuation of securities—available-for-sale, net of income tax				89			89
Amortization of unrealized loss on tax exempt securities transferred from available-for-sale to held-to-maturity, net of income taxes				42			42
Additional registration costs for issuance of preferred stock		(46)					(46)
Accretion of preferred stock discount	1,119		(1,119)				--
Accrual of dividends on preferred stock			(4,650)				(4,650)
Accrual of dividends on common stock ($.03/share cumulative)			(561)				(561)
Proceeds from issuance of common stock for stockholder reinvestment program, net of registration expenses		10,592					10,592
						32	32

Amortization of compensation related to MRP							
Amortization of compensation related to stock options		99					99
BALANCE, September 30, 2009	$ 117,034	$ 327,385	$ (36,402)	$ 703	$ (1,987)	$ (10)	$ 406,723

See selected notes to consolidated financial statements

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BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Continued)
(Unaudited) (In thousands, except per share amounts)
For the Nine Months Ended September 30, 2009 and 2008

	Preferred Stock	Common Stock and Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned Restricted ESOP Shares	Carrying Value, Net of Liability, Of Shares Held in Trust for Stock-Related Compensation Plans	Stockholders' Equity
Balance, January 1, 2008	$ --	$ 300,486	$ 139,636	$ (176)	$ (1,987)	$ (113)	$ 437,846
Net income (loss)			(49,462)				(49,462)
Cumulative effect of adoption of EITF 06-4 relating to liabilities under split dollar life insurance arrangements			(617)				(617)
Amortization of unrealized loss on tax exempt securities transferred from available-for-sale to held-to-maturity, net of income taxes				41			41
Accrual of dividends on common stock ($.45/share cumulative)			(7,180)				(7,180)
Purchase and retirement of common stock		(14,265)					(14,265)
Proceeds from issuance of common stock for exercise of stock options		594					594
Proceeds from issuance of common stock for stockholder reinvestment program, net of registration expenses		19,303					19,303
		404					404

Net issuance of stock through employer's stock plans, including tax benefits							
Amortization of compensation related to MRP						47	47
Amortization of compensation related to stock options		219					219
BALANCE, September 30, 2008	$ --	$ 306,741	$ 82,377	$ (135)	$ (1,987)	$ (66)	$ 386,930

See selected notes to consolidated financial statements

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (continued)
(Unaudited) (In thousands)
For the Nine Months Ended September 30, 2009 and 2008

	Nine Months Ended September 30	
	2009	2008
COMMON STOCK—SHARES ISSUED AND OUTSTANDING:		
Common stock, shares issued, beginning of period	17,152	16,266
Purchase and retirement of common stock	--	(614)
Issuance of common stock for exercised stock options and/or employee stock plans	--	31
Issuance of common stock for stockholder reinvestment program	2,782	1,297
Net number of shares issued during the period	2,782	714
COMMON SHARES ISSUED AND OUTSTANDING, END OF PERIOD	19,934	16,980
UNEARNED, RESTRICTED ESOP SHARES:		
Number of shares, beginning of period	(240)	(240)
Issuance/adjustment of earned shares	--	--
Number of shares, end of period	(240)	(240)
NET COMMON STOCK—SHARES OUTSTANDING	19,694	16,740

See selected notes to consolidated financial statements

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited) (In thousands)
For the Nine Months Ended September 30, 2009 and 2008

	Nine Months Ended September 30	
	2009	2008
OPERATING ACTIVITIES:		
Net income (loss)	$ (32,222)	$ (49,462)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	7,433	7,857
Deferred income and expense, net of amortization	374	1,421
Amortization of core deposit intangibles	1,998	2,153
Net change in valuation of financial instruments carried at fair value	(12,429)	4,584
Purchases of securities—trading	(69,760)	(94,487)
Principal repayments and maturities of securities—trading	103,383	34,814
Proceeds from sales of securities—trading	--	7,223
Deferred taxes	(3,038)	(9,653)
Equity-based compensation	131	266
Tax benefits realized from equity-based compensation	--	(404)
Increase in cash surrender value of bank-owned life insurance	(1,357)	(1,017)
Gain on sale of loans, excluding capitalized servicing rights	(3,210)	(3,705)
Loss (gain) on disposal of real estate held for sale and property and equipment	631	658
Provision for losses on loans and real estate held for sale	93,579	29,868
Origination of loans held for sale	(481,246)	(285,590)
Proceeds from sales of loans held for sale	483,878	284,101
Goodwill write-off	--	50,000
Net change in:		
Other assets	(14,865)	2,644
Other liabilities	(11,038)	(108)
Net cash provided (used) by operating activities	62,242	(18,837)
INVESTING ACTIVITIES:		
Purchases of securities available for sale	(48,383)	--
Principal repayments and maturities of securities available for sale	20,885	--
Proceeds from sales of securities available for sale	6,458	--
Purchases of securities held to maturity	(17,975)	(2,617)
Principal repayments and maturities of securities held to maturity	1,079	696
Origination of loans, net of principal repayments	(70,652)	(204,521)
Purchases of loans and participating interest in loans	(1,357)	(10,381)
Purchases of property and equipment, net	(14,478)	(7,835)
Proceeds from sale of real estate held for sale, net	29,275	5,442
Cost of acquisitions, net of cash acquired	--	(150)
Other	(345)	(812)
Net cash used by investing activities	(95,493)	(220,178)

FINANCING ACTIVITIES:		
Increase (decrease) in deposits	82,325	170,273
Proceeds from FHLB advances	231,200	162,800
Repayment of FHLB advances	(86,203)	(120,837)
Increase (decrease) in other borrowings, net	29,535	12,772
Cash dividends paid	(5,748)	(9,548)
Repurchases of stock, net of forfeitures	--	(14,265)
Tax benefits realized from equity-based compensation	--	404
Cash proceeds from issuance of stock, net of registration costs	10,546	19,303
Exercise of stock options	--	594
Net cash provided (used) by financing activities	261,655	221,496
NET (DECREASE) INCREASE IN CASH AND DUE FROM BANKS	228,404	(17,519)
CASH AND DUE FROM BANKS, BEGINNING OF PERIOD	102,750	98,430
CASH AND DUE FROM BANKS, END OF PERIOD	$ 331,154	$ 80,911

(Continued on next page)

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(Unaudited) (In thousands)
For the Nine Months Ended September 30, 2009 and 2008

	Nine Months Ended September 30	
	2009	2008
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid in cash	$ 79,518	$ 99,366
Taxes paid (received) in cash	(6,451)	6,827
NON-CASH INVESTING AND FINANCING TRANSACTIONS:		
Loans, net of discounts, specific loss allowances and unearned income, transferred to real estate owned and other repossessed assets	63,141	14,619
Net decrease in accrued dividends payable	(537)	2,368
Change in other assets/liabilities	757	1,718
Adoption of EITF 06-4		
Accrual of liability for split-dollar life insurance	--	617

See selected notes to consolidated financial statements

BANNER CORPORATION AND SUBSIDIARIES
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1: BASIS OF PRESENTATION AND CRITICAL ACCOUNTING POLICIES

Banner Corporation (Banner or the Company) is a bank holding company incorporated in the State of Washington. We are primarily engaged in the business of planning, directing and coordinating the business activities of our wholly owned subsidiaries, Banner Bank and Islanders Bank. Banner Bank is a Washington-chartered commercial bank that conducts business from its main office in Walla Walla, Washington and, as of September 30, 2009, its 85 branch offices and eight loan production offices located in Washington, Oregon and Idaho. Islanders Bank is also a Washington-chartered commercial bank that conducts business from three locations in San Juan County, Washington. Banner Corporation is subject to regulation by the Board of Governors of the Federal Reserve System. Banner Bank and Islanders Bank (the Banks) are subject to regulation by the Washington State Department of Financial Institutions, Division of Banks and the Federal Deposit Insurance Corporation (FDIC).

In the opinion of management, the accompanying consolidated statements of financial condition and related interim consolidated statements of operations, comprehensive income (loss), changes in stockholders' equity and cash flows reflect all adjustments (which include reclassifications and normal recurring adjustments) that are necessary for a fair presentation in conformity with Generally Accepted Accounting Principles (GAAP). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect amounts reported in the financial statements. Various elements of our accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. In particular, management has identified several accounting policies that, because of the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of our financial statements. Those policies relate to (i) the methodology for the recognition of interest income, (ii) determination of the provision and allowance for loan and lease losses, (iii) the valuation of financial assets and liabilities recorded at fair value, (iv) the valuation of intangibles, such as goodwill and core deposit intangibles and mortgage servicing rights and (v) the valuation of real estate held for sale. These policies and the judgments, estimates and assumptions are described in greater detail below in Management's Discussion and Analysis of Financial Condition and Results of Operations (Critical Accounting Policies) and in the Notes to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission (SEC). Management believes that the judgments, estimates and assumptions used in the preparation of our consolidated financial statements are appropriate based on the factual circumstances at the time. However, given the sensitivity of the financial statements to these critical accounting policies, the use of other judgments, estimates and assumptions could result in material differences in our results of operations or financial condition. Further, subsequent changes in economic or market conditions could have a material impact on these estimates and our financial condition and operating results in future periods. There have been no significant changes in our application of accounting policies since December 31, 2008 (for additional information, see Note 3, Accounting Standards Recently Adopted or Issued, of the Selected Notes to Consolidated Financial Statements).

The Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) became effective on July 1, 2009. At that date, the ASC became the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF) and related literature. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under the authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. All other accounting literature is considered non-authoritative. The switch to the ASC affects the way companies refer to GAAP standards in financial statements and accounting policies, but it has not had a material effect on the Company's financial statements.

Certain information and disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC. Certain reclassifications have been made to the 2008 Consolidated Financial Statements and/or schedules to conform to the 2009 presentation. These reclassifications may have affected certain ratios for the prior periods. The effect of these reclassifications is considered immaterial. All significant intercompany transactions and balances have been eliminated.

The information included in this Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the SEC. Interim results are not necessarily indicative of results for a full year.

Subsequent Events: We evaluated subsequent events for reporting and disclosure in these financial statements through November 6, 2009, which is the date this September 30, 2009 Form 10-Q was available to be issued.

Note 2: RECENT DEVELOPMENTS AND SIGNIFICANT EVENTS

FDIC Special Assessment: On May 22, 2009, the FDIC adopted a final rule imposing a five basis point special assessment on each insured depository institution’s total assets minus Tier 1 capital as of June 30, 2009, with the maximum amount of the special assessment for any institution not to exceed ten basis points times the institution’s assessment base for the second quarter 2009 risk-based assessment. The special assessment was collected on September 30, 2009 at the same time the regular quarterly risk based assessment for the second quarter of 2009 was collected. For Banner Corporation, this assessment was $2.1 million, which was recognized in other operating expenses during the quarter ended June 30, 2009. The FDIC Board may vote to impose additional special assessments if the FDIC estimates that the Deposit Insurance Fund reserve ratio will fall to a level that the Board believes would adversely affect public confidence or to a level that will be close to or below zero.

FDIC Proposed Prepayment: On September 29, 2009, the FDIC adopted a Notice of Proposed Rulemaking that would require insured depository institutions to prepay an estimate of their expected quarterly deposit insurance premiums for the fourth quarter of 2009 and for the three years ended December 31, 2010, 2011 and 2012. Insured institutions would be required to deposit funds with the FDIC in the amount of the prepaid assessment on December 30, 2009. The insured institutions would not receive interest on the deposited funds. For purposes of calculating an institution's prepaid assessment amount, for the fourth quarter of 2009 and all of 2010, that institution's assessment rate would be its total base assessment rate in effect on September 30, 2009. That rate would be increased by three basis points for all of 2011 and 2012. Again, for purposes of calculating the prepaid amount, an institution's third quarter 2009 assessment base would be increased quarterly by an estimated five percent annual growth rate through the end of 2012. Each institution would record the entire amount of its prepaid assessment as a prepaid expense (asset) as of December 30, 2009. As of December 31, 2009, and each quarter thereafter, each institution would record an expense (charge to earnings) for its regular quarterly assessment for the quarter and an offsetting credit to the prepaid assessment until the asset is exhausted. Once the asset is exhausted, the institution would record an expense and an accrued expense payable each quarter for its regular assessment, which would be paid in arrears to the FDIC at the end of the following quarter. If the prepaid assessment is not exhausted by December 30, 2014, any remaining amount would be returned to the institution.

FDIC Temporary Liquidity Guarantee Program: Banner Corporation, Banner Bank and Islanders Bank have chosen to participate in the FDIC's Temporary Liquidity Guarantee Program (the "TLGP"), which applies to all U.S. depository institutions insured by the FDIC and all United States bank holding companies, unless they have opted out. Under the TLGP, the FDIC guarantees certain senior unsecured debt of insured institutions and their holding companies, as well as non-interest-bearing transaction account deposits. Under the transaction account guarantee component of the TLGP, all non-interest-bearing and certain interest-bearing transaction accounts maintained at Banner Bank and Islanders Bank are insured in full by the FDIC until June 30, 2010, regardless of the standard maximum deposit insurance amounts. The Banks are required to pay a fee (annualized) on balances of each covered account in excess of $250,000 while the extra deposit insurance is in place. The annualized fee for the transaction account guarantee program is 10 basis points through December 31, 2009 and will be within a range from 15 to 25 basis points from January 1 through June 30, 2010. On March 31, 2009, Banner Bank completed an offering of $50 million of qualifying senior bank notes covered by the TLGP at a fixed rate of 2.625% which mature on March 31, 2012. Under the debt guarantee component of the TLGP, the FDIC will pay the unpaid principal and interest on an FDIC-guaranteed debt instrument upon the uncured failure of the participating entity to make a timely payment of principal or interest. Under the terms of the TLGP, the Bank is not permitted to use the proceeds from the sale of securities guaranteed under the TLGP to prepay any of its other debt that is not guaranteed by the FDIC. Banner Bank is required to pay a 1.00% fee (annualized) on this debt, which will result in a total fee of $1.5 million over three years. None of the senior notes are redeemable prior to maturity.

Participation in the U.S. Treasury's Capital Purchase Program: On November 21, 2008, we received $124 million from the U.S. Treasury Department as part of the Treasury's Capital Purchase Program. We issued $124 million in senior preferred stock, with a related warrant to purchase up to $18.6 million in common stock, to the U.S. Treasury. The warrant provides the Treasury the option to purchase up to 1,707,989 shares of Banner Corporation common stock at a price of $10.89 per share at any time during the next ten years. The preferred stock will pay a 5% dividend for the first five years, after which the rate will increase to 9% if the preferred shares are not redeemed by the Company. The terms and conditions of the transaction and the preferred stock conform to those provided by the U.S. Treasury. A summary of the Capital Purchase Program can be found on the Treasury's web site at www.financialstability.gov/roadtostability/capitalpurchaseprogram.html.

Goodwill write-off: As a result of the significant decline in our stock price and market capitalization over the course of 2008 and in conjunction with similar declines in the value of most financial institutions and the ongoing disruption in related financial markets, we determined it was appropriate to reduce the carrying value of goodwill in our Consolidated Statements of Financial Condition by recording a $50 million write-down in the second quarter of 2008 and, in response to worsening economic indicators and further price declines, an additional $71 million write-down in the fourth quarter of 2008. The total $121 million write-off of goodwill was a non-cash charge that did not affect the Company's or the Banks' liquidity or operations. The adjustment brought our book value and tangible book value more closely in line with each other and more accurately reflected current market conditions. Also, since goodwill is excluded from regulatory capital, the impairment charge (which was not deductible for tax purposes) did not have an adverse effect on the regulatory capital ratios of the Company or either of our subsidiary banks, each of which continues to remain "well capitalized" under the regulatory requirements. (See Note 11 of the Selected Notes to Consolidated Financial Statements for additional information with respect to our valuation of intangible assets.)

Note 3: ACCOUNTING STANDARDS RECENTLY ADOPTED OR ISSUED

Recently Adopted Accounting Standards: In December 2007, FASB revised accounting standards for Business Combinations. The standard, ASC 805, requires the acquiring entity to recognize and measure in its financial statements all the assets acquired, the liabilities assumed, any non-controlling interest in the acquired entity, and the goodwill acquired and establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed. Furthermore, acquisition-related and other costs will now be expensed rather than treated as cost components of the acquisition. ASC 805 also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. The revision to this guidance applies prospectively to business combinations for which the acquisition date occurs on or after January 1, 2009. We do not expect the adoption of these revisions will have a material impact on our consolidated financial statements as related to business combinations consummated prior to January 1, 2009. The adoption of these revisions will increase the costs charged to operations for acquisitions consummated on or after January 1, 2009.

In October 2008, FASB amended accounting standards for Fair Value Measurements and Disclosures. The amended standard, ASC 820, clarifies the application of fair value measurements in a market that is not active. The amendment is intended to address the following application issues: (a) how the reporting entity's own assumptions (that is, expected cash flows and appropriately risk-adjusted discount rates) should be considered when measuring fair value when relevant observable inputs do not exist; (b) how available observable inputs in a market that is not active should be considered when measuring fair value; and (c) how the use of market quotes (for example, broker quotes or pricing services for the same or similar financial assets) should be considered when assessing the relevance of observable and unobservable inputs available to measure fair value. The changes were effective on issuance, including prior periods for which financial statements had not been issued. We adopted the amendment for the quarter ended December 31, 2008 and the effect of adoption on the consolidated financial statements was not material.

In January 2009, FASB amended accounting standards for Investments—Other. The amended standard, ASC 325, addresses certain practices or issues related to the recognition of interest income and impairment on purchased beneficial interests and beneficial interests that continue to be held by a transferor in securitized financial assets, by making its other-than-temporary impairment (“OTTI”) assessment guidance consistent with the accounting standards for Investments—Debt and Equity Securities. The amendment removes the reference to the consideration of a market participant’s estimates of cash flows and instead requires an assessment of whether it is probable, based on current information and events, that the holder of the security will be unable to collect all amounts due according to the contractual terms. If it is probable that there has been an adverse change in estimated cash flows, an OTTI is deemed to exist, and a corresponding loss shall be recognized in earnings equal to the entire difference between the investment’s carrying value and its fair value at the balance sheet date of the reporting period for which the assessment is made. This amendment became effective for interim and annual reporting periods ending after December 15, 2008, and is applied prospectively. The amendment of these standards did not have a material impact on the Company’s consolidated financial statements.

In April 2009, FASB amended accounting standards for Fair Value Measurements and Disclosures. The amended standard, ASC 820, addresses issues related to the determination of fair value when the volume and level of activity for an asset or liability has significantly decreased, and identifying transactions that are not orderly. The revisions affirm the objective that fair value is the price that would be received to sell an asset in an orderly transaction (that is not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions, even if the market is inactive. The amendment provides additional guidance for estimating fair value when the volume and level of activity for the asset or liability have decreased significantly. It also provides guidance on identifying circumstances that indicate a transaction is not orderly. If determined that a quoted price is distressed (not orderly), and thereby not representative of fair value, the entity may need to make adjustments to the quoted price or utilize an alternative valuation technique (e.g., income approach or multiple valuation techniques) to determine fair value. Additionally, an entity must incorporate appropriate risk premium adjustments, reflective of an orderly transaction under current market conditions, due to uncertainty in cash flows. The revised guidance requires disclosures in interim and annual periods regarding the inputs and valuation techniques used to measure fair value and a discussion of changes in valuation techniques and related inputs, if any, during the period. It also requires financial institutions to disclose the fair values of investment securities by major security type. The changes are effective for the interim reporting period ending after June 15, 2009, and are to be applied prospectively. The requirements of these amendments are consistent with the Company’s practice of calculating fair value on the various assets and liabilities it carries at fair value. Therefore, there was no material impact on the fair value measurement of any assets or liabilities in the consolidated financial statements.

In April 2009, FASB revised accounting standards for Investments—Debt and Equity Securities. The standard, ASC 320, changes the OTTI model for debt securities. Under previous guidance, an entity was required to assess whether it has the intent and ability to hold a security to recovery in determining whether an impairment of that security is other-than-temporary. If the impairment was deemed other-than-temporarily impaired, the investment was written-down to fair value through earnings. Under the revised guidance, OTTI is triggered if an entity has the intent to sell the security, it is more likely than not that it will be required to sell the security before recovery, or if the entity does not expect to recover the entire amortized cost basis of the security. If the entity intends to sell the security or it is more likely than not it will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If the entity does not intend to sell the security and it is not likely that the entity will be required to sell the security but the entity does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings as an OTTI. The credit loss is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected of a security. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment loss related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, would be recognized as a charge to other comprehensive income ("OCI"). Impairment losses related to all other factors are to be presented as a separate category within OCI. For investment securities held to maturity, this amount is accreted over the remaining life of the debt security prospectively based on the amount and timing of future estimated cash flows. The accretion of the OTTI amount recorded in OCI will increase the carrying value of the investment and would not affect earnings. If there is an indication of additional credit losses, the security is reevaluated accordingly based on the procedures described above. Upon adoption of the revised guidance, the noncredit portion of previously recognized OTTI is to be reclassified to accumulated OCI by a cumulative-effect adjustment to the opening balance of retained earnings. These revisions became effective in the interim reporting period ending after June 15, 2009. We adopted these revisions for the quarter ended June 30, 2009 and the effect of the adoption on the consolidated financial statements was not material.

In April 2009, FASB revised accounting standards for Financial Instruments. The revised standard, ASC 825, requires fair value disclosures in the notes of an entity's interim financial statements for all financial instruments, whether or not recognized in the statement of financial position. This revision became effective for the interim reporting period ending after June 15, 2009. The adoption of the revised standards and the increased interim financial statement disclosures did not have a material effect on the Company's consolidated financial statements.

In May 2009, FASB amended the accounting standard for Subsequent Events. The updated standard, ASC 855, established general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The revisions should not result in significant changes in the subsequent events that an entity reports, either through recognition or disclosure in its financial statements. It does require disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. This disclosure should alert all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. We adopted the provisions of this guidance for the interim period ended June 30, 2009, and the effect of adoption on the Company's consolidated financial statements was not material.

Recently Issued Accounting Pronouncements: In June 2009, FASB issued an amendment to accounting standards for Accounting for Transfers of Financial Assets. This statement has not yet been codified into the Accounting Standards Codification Hierarchy. The amendment eliminates the concept of a qualifying special-purpose entity, creates more stringent conditions for reporting a transfer of a portion of a financial asset as a sale, clarifies other sale-accounting criteria, and changes the initial measurement of a transferor's interest in transferred financial assets. This statement is effective for annual reporting periods beginning after November 15, 2009, and for interim periods therein. The Company is currently evaluating the impact of the adoption of this amendment.

In June 2009, FASB issued an amendment to accounting standards for Amendments to FASB Interpretation No. 46(R). This statement has not yet been codified into the Accounting Standards Codification Hierarchy. The amendment eliminates previous exceptions to consolidating qualifying special-purpose entities, contains new criteria for determining the primary beneficiary, and increases the frequency of required reassessments to determine whether a company is the primary beneficiary of a variable interest entity. The new guidance also contains a new requirement that any term, transaction, or arrangement that does not have a substantive effect on an entity's status as a variable interest entity, a company's power over a variable interest entity, or a company's obligation to absorb losses or its right to receive benefits of an entity must be disregarded in applying the previous provisions. The elimination of the qualifying special-purpose entity concept and its consolidation exceptions means more entities will be subject to consolidation assessments and reassessments. This statement requires additional disclosures regarding an entity's involvement in a variable interest entity. This statement is effective for annual reporting periods beginning after November 15, 2009, and for interim periods therein. The Company is currently evaluating the impact of the adoption of this amendment.

In June 2009, FASB issued new standards for The Hierarchy of Generally Accepted Accounting Principles. These standards, ASC 105, culminated a multi-year project to replace the previous GAAP hierarchy and established Accounting Standards Codification (the "Codification"). The Codification is not expected to change U.S. GAAP, but combines all authoritative standards into a comprehensive, topically organized online database. Following this guidance, the Financial Accounting Standards Board will not issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates ("ASU") to update the Codification. After the launch of the Codification on July 1, 2009, only one level of authoritative U.S. GAAP for non-governmental entities will exist, other than guidance issued by the SEC. This statement is effective for interim and annual reporting periods ending after September 15, 2009. The adoption of this new standard did not have any impact on the Company's consolidated financial statements and only affects how the Company references authoritative accounting guidance going forward.

In August 2009, FASB issued ASU No. 2009-05, Measuring Liabilities at Fair Value. This update amends ASC 820, Fair Value Measurements and Disclosure, in regards to the fair value measurement of liabilities. FASB ASC 820 clarifies that in circumstances in which a quoted price for an identical liability in an active market is not available, a reporting entity shall utilize one or more of the following techniques: i) the quoted price of the identical liability when traded as an asset, ii) the quoted price for a similar liability or for a similar liability when traded as an asset, or iii) another valuation technique that is consistent with the principles of ASC 820. In all instances a reporting entity shall utilize the approach that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. Also, when measuring the fair value of a liability, a reporting entity shall not include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. This update is effective for the Company in the fourth quarter of 2009. We do not expect the adoption of ASU 2009-05 will have a material impact on the Company's consolidated financial statements.

Note 4: BUSINESS SEGMENTS

The Company is managed by legal entity and not by lines of business. Each of the Banks is a community oriented commercial bank chartered in the State of Washington. The Banks' primary business is that of a traditional banking institution, gathering deposits and originating loans for its portfolio in its respective primary market areas. The Banks offer a wide variety of deposit products to its consumer and commercial customers. Lending activities include the origination of real estate, commercial/agriculture business and consumer loans. Banner Bank is also an active participant in the secondary market, originating residential loans for sale on both a servicing released and servicing retained basis. In addition to interest income on loans and investment securities, the Banks receive other income from deposit service charges, loan servicing fees and from the sale of loans and investments. The performance of the Banks is reviewed by the Company's executive management and Board of Directors on a monthly basis. All of the executive officers of the Company are members of Banner Bank's management team.

Generally accepted accounting principles establish standards to report information about operating segments in annual financial statements and require reporting of selected information about operating segments in interim reports to stockholders. We have determined that the Company's current business and operations consist of a single business segment and have presented our financial statements accordingly.

Note 5: ADDITIONAL INFORMATION REGARDING INTEREST-BEARING DEPOSITS AND SECURITIES

The following table sets forth additional detail on our interest-bearing deposits and securities at the dates indicated (includes securities—trading, available-for-sale and held-to-maturity, all at carrying value) (dollars in thousands):

	September 30 2009	December 31 2008	September 30 2008
Interest-bearing deposits included in cash and due from banks	$ 270,623	$ 12,786	$ 403
Mortgage-backed or related securities			
GNMA	20,130	33,729	9,929
FHLMC	47,596	45,544	36,083
FNMA	40,144	45,491	45,568
Private issuer	7,073	9,537	--
Total mortgage-backed securities	114,943	134,301	91,580
U.S. Agency obligations	79,675	70,389	66,877
Taxable municipal bonds	4,512	4,967	4,978
Corporate bonds	44,515	48,470	74,818
Total other taxable securities	128,702	123,826	146,673
Tax-exempt municipal bonds	74,963	58,607	55,567
Equity securities (excludes FHLB stock)	493	234	578
Total securities	319,101	316,968	294,398
FHLB stock	37,371	37,371	37,371
	$ 627,095	$ 367,125	$ 332,172

The following table provides additional detail on income from deposits and securities for the periods indicated (dollars in thousands):

	Quarters Ended September 30 2009	Quarters Ended September 30 2008	Nine Months Ended September 30 2009	Nine Months Ended September 30 2008
Mortgage-backed securities interest	$ 1,422	$ 1,040	$ 4,792	$ 3,280
Other taxable interest income	1,127	1,899	3,882	5,765
Tax-exempt interest income	850	635	2,370	1,851
Equity securities—dividend / (premium amortization)	(1)	121	(4)	403
FHLB stock dividends	--	131	--	355
	1,976	2,786	6,248	8,374

	$ 3,398	$ 3,826	$ 11,040	$ 11,654

Note 6: FHLB STOCK

At September 30, 2009, the Company carries on its books $37.4 million in Federal Home Loan Bank of Seattle (FHLB) stock, which represents our investment in the stock at its par value. Ownership of this stock allows Banner Bank and Islanders Bank access to funding for liquidity and other borrowing needs. Ownership of FHLB stock is restricted to FHLB member institutions and can only be purchased and redeemed at par. Shares are not publicly traded and do not have a readily determinable fair value. FHLB stock is generally acknowledged to be a long-term investment. Accordingly, when evaluating for impairment, the value is determined based on the ultimate recovery of the par value rather than recognizing temporary declines in value.

As of September 30, 2009, the FHLB was classified as "undercapitalized" by its regulator and therefore did not pay a dividend for the third quarter of 2009 and will not repurchase capital stock or pay a dividend while it is classified as undercapitalized. The FHLB of Seattle reports that it did meet all of its regulatory capital targets for the quarter, including its risk-based capital requirement as of September 30, 2009. The bank reported a risk-based capital surplus of $114.9 million as of September 30, 2009 compared to a risk-based capital deficiency of $159.2 million as of December 31, 2008. However, the FHLB of Seattle's total capital at September 30, 2009 was $927.4 million compared to $1.8 billion at December 31, 2008. The change in the composition of total capital between these two periods was primarily due to additional other-than-temporary impairments of the bank's private-label mortgage-backed securities and the bank's adoption of new accounting rules regarding such securities on January 1, 2009.

Management periodically evaluates FHLB stock for other-than-temporary or permanent impairment. Management's determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on its member institutions or the FHLB itself, and (4) the liquidity position of the FHLB.

Based on the above, the Company has determined there is not an other-than-temporary impairment on the FHLB stock investment as of September 30, 2009.

Note 7: LOANS RECEIVABLE

We originate residential mortgage loans for both portfolio investment and sale in the secondary market. At the time of origination, mortgage loans are designated as held for sale or held for investment. Loans held for sale are stated at lower of cost or estimated fair value determined on an aggregate basis. Net unrealized losses on loans held for sale are recognized through a valuation allowance by charges to income. We also originate construction and land, commercial and multifamily real estate, commercial business, agricultural and consumer loans for portfolio investment. Loans receivable not designated as held for sale are recorded at the principal amount outstanding, net of allowance for loan losses, deferred fees, discounts and premiums. Premiums, discounts and deferred loan fees are amortized to maturity using the level-yield methodology.

Interest is accrued as earned unless management doubts the collectability of the loan or the unpaid interest. Interest accruals are generally discontinued when loans become 90 days past due for scheduled interest payments. All previously accrued but uncollected interest is deducted from interest income upon transfer to nonaccrual status. Future collection of interest is included in interest income based upon an assessment of the likelihood that the loans will be repaid or recovered. A loan may be put on nonaccrual status sooner than this policy would dictate if, in management's judgment, the loan may be uncollectable. Such interest is then recognized as income only if it is ultimately collected.

Our loans receivable, including loans held for sale, at September 30, 2009 and 2008 and December 31, 2008 are summarized as follows (dollars in thousands):

	September 30 2009		December 31 2008		September 30 2008	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Loans (including loans held for sale):						
Commercial real estate						
Owner occupied	$ 481,698	12.4%	$ 459,446	11.6%	$ 448,972	11.2%
Investment properties	585,206	15.0	554,263	14.0	564,947	14.2
Multifamily real estate	152,832	3.9	151,274	3.8	141,787	3.5
Commercial construction	83,937	2.2	104,495	2.6	113,342	2.8
Multifamily construction	62,614	1.6	33,661	0.8	22,236	0.6
One- to four-family construction	277,419	7.1	420,673	10.6	482,443	12.1

Land and land development						
Residential	322,030	8.3	401,129	10.1	417,041	10.4
Commercial	47,182	1.2	62,128	1.6	64,480	1.6
Commercial business	678,187	17.4	679,867	17.2	694,688	17.4
Agricultural business, including secured by farmland	225,603	5.8	204,142	5.2	213,753	5.3
One- to four-family real estate	676,928	17.4	599,169	15.1	561,043	14.0
Consumer	114,354	2.9	115,515	2.9	135,024	3.4
Consumer secured by one- to four- family real estate	188,204	4.8	175,646	4.5	139,423	3.5
Total consumer	302,558	7.7	291,161	7.4	274,447	6.9
Total loans outstanding	3,896,194	100.0%	3,961,408	100.0%	3,999,179	100.0%
Less allowance for loan losses	(95,183)		(75,197)		(58,846)	
Total net loans outstanding at end of period	$ 3,801,011		$ 3,886,211		$ 3,940,333	

Loans are net of unearned, unamortized loan fees or discounts of $9,752,000, $7,105,000, and $7,314,000, respectively, at September 30, 2009, December 31, 2008 and September 30, 2008.

The geographic concentration of our loans at September 30, 2009 was as follows (dollars in thousands):

	Washington	Oregon	Idaho	Other	Total
Commercial real estate					
Owner occupied	$ 380,170	$ 59,793	$ 41,735	$ --	$ 481,698
Investment properties	423,431	107,090	44,243	10,442	585,206
Multifamily real estate	127,882	12,823	8,800	3,327	152,832
Commercial construction	62,827	13,390	7,720	--	83,937
Multifamily construction	33,837	28,777	--	--	62,614
One- to four-family construction	133,319	129,552	14,548	--	277,419
Land and land development					
Residential	149,953	131,034	41,043	--	322,030
Commercial	30,400	12,127	4,655	--	47,182
Commercial business	483,451	94,828	74,621	25,287	678,187
Agricultural business, including secured by farmland	105,119	55,488	64,963	33	225,603
One- to four-family real estate	470,912	169,564	33,205	3,247	676,928
Consumer	82,483	25,573	6,298	--	114,354
Consumer secured by one- to four-family real estate	134,214	40,073	13,416	501	188,204
Total loans outstanding	$ 2,617,998	$ 880,112	$ 355,247	$ 42,837	