BANNER CORP
Form 10-Q
August 07, 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 June 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 July 31, 2009
Common Stock, $.01 par value per share	18,942,263 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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BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Unaudited) (In thousands, except shares)
June 30, 2009 and December 31, 2008

ASSETS	June 30 2009	December 31 2008
Cash and due from banks	$ 84,258	$ 102,750
Securities—trading, cost $213,762 and $245,274, respectively	167,476	203,902
Securities—available-for-sale, cost $50,506 and $52,190, respectively	50,980	53,272
Securities—held-to-maturity, fair value $77,478 and $60,530, respectively	77,321	59,794
Federal Home Loan Bank (FHLB) stock	37,371	37,371
Loans receivable:		
Held for sale, fair value $8,480 and $7,540, respectively	8,377	7,413
Held for portfolio	3,904,704	3,953,995
Allowance for loan losses	(90,694)	(75,197)
	3,822,387	3,886,211
Accrued interest receivable	18,892	21,219
Real estate owned, held for sale, net	56,967	21,782
Property and equipment, net	103,709	97,647
Goodwill and other intangibles, net	12,365	13,716
Deferred income tax asset, net	8,942	5,528
Income taxes receivable, net	15,212	9,675
Bank-owned life insurance (BOLI)	53,341	52,680
Other assets	23,321	18,821
	$ 4,532,542	$ 4,584,368
LIABILITIES		
Deposits:		
Non-interest-bearing	$ 508,284	$ 509,105
Interest-bearing transaction and savings accounts	1,131,093	1,137,878
Interest-bearing certificates	2,110,466	2,131,867
	3,749,843	3,778,850
Advances from FHLB at fair value	115,946	111,415
Other borrowings	158,249	145,230
Junior subordinated debentures at fair value (issued in connection with Trust Preferred Securities)	49,563	61,776
Accrued expenses and other liabilities	36,652	40,600
Deferred compensation	12,815	13,149
	4,123,068	4,151,020
COMMITMENTS AND CONTINGENCIES (Note 13)		
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	116,661	115,915
Common stock - $0.01 par value per share, 25,000,000 shares authorized, 18,426,458 shares issued:		
18,186,077 shares and 16,911,657 shares outstanding at June 30, 2009 and December 31, 2008, respectively	322,582	316,740
Retained earnings (accumulated deficit)	(27,826)	2,150
Accumulated other comprehensive income (loss):		
Unrealized gain on securities available for sale and/or transferred to held to maturity	62	572
Unearned shares of common stock issued to Employee Stock Ownership Plan (ESOP) trust at cost:		
240,381 restricted shares outstanding at June 30, 2009 and December 31, 2008	(1,987)	(1,987)
Carrying value of shares held in trust for stock related compensation plans	(8,838)	(8,850)
Liability for common stock issued to deferred, stock related, compensation plans	8,820	8,808
	(18)	(42)
	409,474	433,348
	$ 4,532,542	$ 4,584,368

See selected notes to consolidated financial statements

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

	Quarters Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
INTEREST INCOME:				
Loans receivable	$ 55,500	$ 64,174	$ 111,847	$ 132,300
Mortgage-backed securities	1,569	1,087	3,370	2,240
Securities and cash equivalents	2,089	2,861	4,272	5,588
	59,158	68,122	119,489	140,128
INTEREST EXPENSE:				
Deposits	21,638	27,565	44,730	57,628
FHLB advances	675	1,301	1,395	3,150
Other borrowings	671	530	898	1,140
Junior subordinated debentures	1,249	1,666	2,582	3,730
	24,233	31,062	49,605	65,648
Net interest income before provision for loan losses	34,925	37,060	69,884	74,480
PROVISION FOR LOAN LOSSES	45,000	15,000	67,000	21,500
Net interest income (loss)	(10,075)	22,060	2,884	52,980
OTHER OPERATING INCOME:				
Deposit fees and other service charges	5,408	5,494	10,344	10,507
Mortgage banking operations	2,860	1,579	5,575	3,194
Loan servicing fees	248	467	(22)	816
Miscellaneous	412	363	932	694
	8,928	7,903	16,829	15,211
Net change in valuation of financial instruments carried at fair value	11,049	649	7,796	1,472
Total other operating income	19,977	8,552	24,625	16,683
OTHER OPERATING EXPENSES:				
Salary and employee benefits	17,528	19,744	35,129	39,382
Less capitalized loan origination costs	(2,834)	(2,728)	(4,950)	(4,969)
Occupancy and equipment	5,928	5,989	11,982	11,857
Information/computer data services	1,599	1,840	3,133	3,829
Payment and card processing expenses	1,555	1,768	3,008	3,299
Professional services	1,183	1,331	2,377	2,086
Advertising and marketing	2,207	1,677	4,039	3,095
Deposit insurance	4,102	633	5,599	960
State/municipal business and use taxes	532	576	1,072	1,140
Real estate owned expenses	1,805	678	2,428	834
Miscellaneous	3,286	3,714	6,867	7,417
	36,891	35,222	70,684	68,930
Goodwill write-off	--	50,000	--	50,000
Total other operating expenses	36,891	85,222	70,684	118,930

Income (loss) before provision for (benefit from) income taxes	(26,989)	(54,610)	(43,175)	(49,267)
PROVISION FOR (BENEFIT FROM) INCOME TAXES	(10,478)	(2,305)	(17,401)	(796)
NET INCOME (LOSS)	$ (16,511)	$ (52,305)	$ (25,774)	$ (48,471)
PREFERRED STOCK DIVIDEND AND DISCOUNT ACCRETION				
Preferred stock dividend	$ 1,550	$ --	$ 3,100	$ --
Preferred stock discount accretion	373	--	746	--
NET INCOME (LOSS) AVAILABLE TO COMMON SHAREHOLDERS	$ (18,434)	$ (52,305)	$ (29,620)	$ (48,471)
Earnings (loss) per common share (see Note 11):				
Basic	$ (1.04)	$ (3.31)	$ (1.70)	$ (3.06)
Diluted	$ (1.04)	$ (3.31)	$ (1.70)	$ (3.06)
Cumulative dividends declared per common share:	$ 0.01	$ 0.20	$ 0.02	$ 0.40

See selected notes to consolidated financial statements

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

	Quarters Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
NET INCOME (LOSS)	$ (16,511)	$ (52,305)	$ (25,774)	$ (48,471)
OTHER COMPREHENSIVE INCOME (LOSS), NET OF INCOME TAXES:				
Unrealized holding gain (loss) during the period, net of deferred income tax (benefit) of $220, $0, $70 and $0, respectively	(802)	--	(538)	--
Amortization of unrealized loss on tax exempt securities transferred from available-for-sale to held-to-maturity	14	14	28	28
Other comprehensive income (loss)	(788)	14	(510)	28
COMPREHENSIVE INCOME (LOSS)	$ (17,299)	$ (52,291)	$ (26,284)	$ (48,443)

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 Six Months Ended June 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)			(25,774)				(25,774)
Change in valuation of securities—available-for-sale, net of income tax				(538)			(538)
Amortization of unrealized loss on tax exempt securities transferred from available-for-sale to held-to-maturity, net of income taxes				28			28
Additional registration costs for issuance of preferred stock		(46)					(46)
Accretion of preferred stock discount	746		(746)				--
Accrual of dividends on preferred stock			(3,100)				(3,100)
Accrual of dividends on common stock ($.02/share cumulative)			(356)				(356)
Proceeds from issuance of common stock for stockholder reinvestment program, net of registration expenses		5,814					5,814
Amortization of compensation related to MRP						24	24

Amortization of compensation related to stock options		74					74
BALANCE, June 30, 2009	$ 116,661	$ 322,582	$ (27,826)	$ 62	$ (1,987)	$ (18)	$ 409,474

See selected notes to consolidated financial statements

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Continued)
(Unaudited) (In thousands, except per share amounts)
For the Six Months Ended June 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)			(48,471)				(48,471)
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				28			28
Accrual of dividends on common stock ($.40/share cumulative)			(6,344)				(6,344)
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		12,425					12,425
Net issuance of stock through employer's stock		4					4

plans, including tax benefits							
Amortization of compensation related to MRP						32	32
Forfeiture of MRP stock							
Amortization of compensation related to stock options		181					181
BALANCE, June 30, 2008	$ --	$ 299,425	$ 84,204	$ (148)	$ (1,987)	$ (81)	$ 381,413

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)
For the Six Months Ended June 30, 2009 and 2008

	Six Months Ended June 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	1,274	622
Net number of shares issued during the period	1,274	39
COMMON SHARES ISSUED AND OUTSTANDING, END OF PERIOD	18,426	16,305
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	18,186	16,065

See selected notes to consolidated financial statements

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

	Six Months Ended June 30	
	2009	2008
OPERATING ACTIVITIES:		
Net income (loss)	$ (25,774)	$ (48,471)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	4,998	5,198
Deferred income and expense, net of amortization	(749)	(652)
Amortization of core deposit intangibles	1,351	1,462
Net change in valuation of financial instruments carried at fair value	(7,796)	(1,472)
Purchases of securities—trading	(64,761)	(74,600)
Principal repayments and maturities of securities—trading	96,104	26,201
Proceeds from sales of securities—trading	--	2,598
Deferred taxes	(3,343)	(4,593)
Equity-based compensation	98	213
Tax benefits realized from equity-based compensation	--	(4)
Increase in cash surrender value of bank-owned life insurance	(661)	(730)
Gain on sale of loans, excluding capitalized servicing rights	(2,294)	(2,550)
Loss (gain) on disposal of real estate held for sale and property and equipment	607	136
Provision for losses on loans and real estate held for sale	67,113	21,868
Origination of loans held for sale	(345,007)	(196,850)
Proceeds from sales of loans held for sale	344,043	194,629
Goodwill write-off	--	50,000
Net change in:		
Other assets	(5,855)	384
Other liabilities	(3,565)	(9,790)
Net cash provided (used) by operating activities	54,509	(37,023)
INVESTING ACTIVITIES:		
Purchases of securities available for sale	(18,672)	--
Principal repayments and maturities of securities available for sale	13,992	--
Proceeds from sales of securities available for sale	6,459	--
Purchases of securities held to maturity	(17,975)	(2,617)
Principal repayments and maturities of securities held to maturity	408	487
Origination of loans, net of principal repayments	(52,937)	(169,448)
Purchases of loans and participating interest in loans	(27)	(8,825)
Purchases of property and equipment, net	(11,445)	(5,144)
Proceeds from sale of real estate held for sale, net	16,663	1,331
Cost of acquisitions, net of cash acquired	--	(150)
Other	(225)	(671)
Net cash used by investing activities	(63,759)	(185,037)

FINANCING ACTIVITIES:		
Increase (decrease) in deposits	(29,007)	136,160
Proceeds from FHLB advances	91,200	102,800
Repayment of FHLB advances	(86,203)	(87,837)
Increase (decrease) in other borrowings, net	13,016	72,468
Cash dividends paid	(4,016)	(6,336)
Repurchases of stock, net of forfeitures	--	(14,265)
Tax benefits realized from equity-based compensation	--	4
Cash proceeds from issuance of stock, net of registration costs	5,768	12,425
Exercise of stock options	--	594
Net cash provided (used) by financing activities	(9,242)	216,013
NET (DECREASE) INCREASE IN CASH AND DUE FROM BANKS	(18,492)	(6,047)
CASH AND DUE FROM BANKS, BEGINNING OF PERIOD	102,750	98,430
CASH AND DUE FROM BANKS, END OF PERIOD	$ 84,258	$ 92,383

(Continued on next page)

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

	Six Months Ended June 30	
	2009	2008
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid in cash	$ 49,668	$ 67,780
Taxes paid in cash	(6,377)	5,916
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	52,160	11,232
Net decrease in accrued dividends payable	(560)	8
Change in other assets/liabilities	169	967
Adoption of EITF 06-4		
Accrual of liability for split-dollar life insurance	--	617

See selected notes to consolidated financial statements

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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 June 30, 2009, its 84 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).

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 August 7, 2009, which is the dare this June 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 will be collected on September 30, 2009 at the same time the regular quarterly risk based assessment for the second quarter of 2009 is 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 has indicated an additional special assessment of up to five basis points later in 2009 is probable, but the amount is uncertain. The FDIC Board may vote to impose such an additional special assessment 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 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 December 31, 2013, regardless of the standard maximum deposit insurance amounts. The Banks are required to pay a 10 basis point fee (annualized) on balances of each covered account in excess of $250,000 while the extra deposit insurance is in place. 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. Subject to FDIC approval, we have remaining capacity under the TLGP to issue approximately $30 million of additional guaranteed notes. 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. The additional capital enhances our capacity to support the communities we serve through expanded lending activities and economic development. This capital also creates additional flexibility in considering strategic opportunities that may be available to us as the financial services industry continues to consolidate.

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 10 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: On April 9, 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSB) Financial Accounting Standard (FAS) 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. FSP FAS 157-4 provides guidance to help an entity determine whether the market for an asset is not active and when a price for a transaction is not distressed. In this two-step model, an entity must first determine whether there are factors present that indicate that the market for the asset is not active at the measurement date. Second, an entity must evaluate whether a quoted price is representative of a transaction that is not orderly. If determined that a quoted price is distressed (not orderly), and thereby not representative of fair value under SFAS 157, the entity must 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. This FSP is effective for interim reporting periods ending after June 15, 2009. We adopted FSP FAS 157-4 for the quarter ended June 30, 2009 and the effect of the adoption on the consolidated financial statements was not material.

On April 9, 2009, FASB issued FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments ("OTTI"), that 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 new 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 that 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 before recovering its cost basis, only the portion of the impairment loss representing credit losses would be recognized in earnings as an OTTI. The remaining impairment loss would be recognized as a charge to other comprehensive income ("OCI"). The FSP also results in a new category within OCI for the portion of the OTTI that is unrelated to credit losses for securities held to maturity. The impairment recognized in OCI would be amortized over the remaining life of the debt security prospectively based on the amount and timing of future estimated cash flows, unless there is an indication of additional credit losses. The amortization of the OTTI amount recorded in OCI will increase the carrying value of the investment, and would not affect earnings. Upon adoption of the FSP, the noncredit portion of previously recognized OTTI shall be reclassified to accumulated OCI by a cumulative-effect adjustment to the opening balance of retained earnings. This FSP is effective for interim reporting periods ended after June 15, 2009. We adopted FSP FAS 115-2 and FAS 124-2 for the quarter ended June 30, 2009 and the effect of the adoption on the consolidated financial statements was not material.

On April 9, 2009, FASB issued FSP FAS 107-1 and Accounting Principles Board Opinion (APB) 28-1, Interim Disclosures about Fair Value of Financial Instruments. This FSP requires SFAS 107, Disclosures about Fair Value of Financial Instruments, 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 FSP is effective for interim reporting periods ending after June 15, 2009. We adopted FSP 107-1 and APB 28-1 for the quarter ended June 30, 2009 and the effect of the adoption on the consolidated financial statements was not material.

On January 12, 2009, FASB issued FSP Emerging Issues Task Force (EITF) 99-20-1, Amendments to the Impairment Guidance of EITF Issue No. 99-20. FSP EITF 99-20-1 addresses certain practical issues in EITF No. 99-20, 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 assessment guidance consistent with Statement of Financial Accounting Standard (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities. FSP EITF 99-20-1 removes the reference to the consideration of a market participant's estimates of cash flows in EITF 99-20, 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 other-than-temporary impairment 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 FSP is effective for interim and annual reporting periods ending after December 15, 2008, and shall be applied prospectively. We adopted FSP 99-20-1 for the quarter ended March 31, 2009 and the effect of the adoption on our consolidated financial statements was not material.

In October 2008, the FASB issued FSP No. FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP 157-3). FSP 157-3 clarifies the application of FAS 157 in a market that is not active. The FSP 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. FSP 157-3 was effective on issuance, including prior periods for which financial statements had not been issued. We adopted FSP 157-3 for the quarter ended December 31, 2008 and the effect of adoption on the consolidated financial statements was not material.

Recently Issued Accounting Pronouncements: In June 2009, the FASB issued FAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162 (FAS 168), which pertains to the authority of United States generally accepted accounting standards. With the issuance of FAS 168, the FASB Accounting Standards Codification (Codification) will become the source of authoritative U.S. generally accepted accounting principles recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this Statement, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other non-grandfathered, non-SEC accounting literature not included in the Codification will become non-authoritative. FAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. We plan to adopt FAS 168 in the third quarter; however, we do not expect the adoption to have a material effect on the results of operations or consolidated financial statements of the Company.

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. The Company has determined that its current business and operations consist of a single business segment.

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):

	June 30 2009	December 31 2008	June 30 2008
Interest-bearing deposits included in Cash and due from banks	$ 16,919	$ 12,786	$ 430
Mortgage-backed or related securities			
GNMA	21,186	33,729	--
FHLMC	53,153	45,544	37,986
FNMA	43,501	45,491	51,450
Private issuer	7,641	9,537	--
Total mortgage-backed securities	125,481	134,301	89,436
U.S. Agency obligations	46,704	70,389	61,922
Taxable municipal bonds	4,608	4,967	5,087
Corporate bonds	43,065	48,470	75,120
Total other taxable securities	94,377	123,826	142,129
Tax-exempt municipal bonds	75,573	58,607	55,883
Equity securities (excludes FHLB stock)	346	234	6,834
Total securities	295,777	316,968	294,282
FHLB stock	37,371	37,371	37,371
	$ 350,067	$ 367,125	$ 332,083

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

	Quarters Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Mortgage-backed securities interest	$ 1,569	$ 1,087	$ 3,370	$ 2,240
Other taxable interest income	1,276	1,950	2,756	3,866
Tax-exempt interest income	814	633	1,518	1,216
Equity securities—dividend / (premium amortization)	(1)	147	(2)	282
FHLB stock dividends	--	131	--	224
	2,089	2,861	4,272	5,588
	$ 3,658	$ 3,948	$ 7,642	$ 7,828

Note 6: 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 June 30, 2009 and 2008 and December 31, 2008 are summarized as follows (dollars in thousands):

	June 30 2009		December 31 2008		June 30 2008	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Loans (including loans held for sale):						
Commercial real estate	$ 1,049,921	26.8%	$ 1,013,709	25.6%	$ 983,732	24.8%
Multifamily real estate	150,168	3.8	151,274	3.8	145,016	3.6
Commercial construction	90,762	2.3	104,495	2.6	103,009	2.6
Multifamily construction	56,968	1.5	33,661	0.8	17,681	0.4
One- to four-family construction	337,368	8.6	420,673	10.6	540,718	13.6
Land and land development	403,697	10.3	486,130	12.3	494,944	12.5
Commercial business	678,273	17.3	679,867	17.2	709,109	17.8
Agricultural business, including secured by farmland	215,339	5.5	204,142	5.2	212,397	5.3
One- to four-family real estate	653,513	16.7	599,169	15.1	511,611	12.9
Consumer	91,173	2.4	92,642	2.4	97,473	2.5
Consumer secured by one- to four-family real estate	185,899	4.8	175,646	4.4	157,609	4.0
Total consumer	277,072	7.2	268,288	6.8	255,082	6.5
Total loans outstanding	3,913,081	100.0%	3,961,408	100.0%	3,973,299	100.0%
Less allowance for loan losses	(90,694)		(75,197)		(58,570)	
Total net loans outstanding at end of period	$ 3,822,387		$ 3,886,211		$ 3,914,729	

Loans are net of unearned, unamortized loan fees or discounts of $7,991,000, $7,105,000, and $7,253,000, respectively, at June 30, 2009, December 31, 2008 and June 30, 2008.

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

	Washington	Oregon	Idaho	Other	Total
Commercial real estate	$ 785,186	$ 172,632	$ 81,478	$ 10,625	$ 1,049,921
Multifamily real estate	125,599	12,405	8,813	3,351	150,168
Commercial construction	65,357	15,171	10,234	--	90,762

Multifamily construction	31,431	25,537	--	--	56,968
One- to four-family construction	166,637	151,704	19,027	--	337,368
Land and land development	195,192	155,902	52,603	--	403,697
Commercial business	496,605	93,752	70,818	17,098	678,273
Agricultural business, including secured by farmland	101,717	48,807	64,815	--	215,339
One- to four-family real estate	486,614	131,853	31,766	3,280	653,513
Consumer	63,283	23,663	4,227	--	91,173
Consumer secured by one- to four-family real estate	134,094	37,996	13,308	501	185,899
Total loans outstanding	$ 2,651,715	$ 869,422	$ 357,089	$ 34,855	$ 3,913,081
Percent of total loans	67.8%	22.2%	9.1%	0.9%	100.0 %

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The geographic concentration of our land and land development loans at June 30, 2009 was as follows (dollars in thousands):

	Washington	Oregon	Idaho	Total
Residential				
Acquisition and development	$ 94,895	$ 102,198	$ 22,088	$ 219,181
Improved lots	48,448	30,581	4,107	83,136
Unimproved land	25,523	10,988	21,167	57,678
Commercial and industrial				
Acquisition and development	4,013	--	197	4,210
Improved land	11,366	10,652	398	22,416
Unimproved land	10,947	1,483	4,646	17,076
Total land and land development loans outstanding	$ 195,192	$ 155,902	$ 52,603	$ 403,697
Percent of total land and land development loans	48.4 %	38.6 %	13.0 %	100.0 %

As noted in the tables above, substantially all of our loans are to borrowers in the states of Washington, Oregon and Idaho. Accordingly, their ultimate collectability is particularly susceptible to, among other things, changes in market and economic conditions within these states.

The amount of impaired loans, net of any charge-offs recorded as a result of specific impairment analysis, and the related allocated reserve for loan losses were as follows (dollars in thousands):

	June 30, 2009		December 31, 2008	
	Loan amount	Allocated reserves	Loan amount	Allocated reserves
Impaired loans:				
Non-accrual	$ 223,444	$ 19,303	$ 186,978	$ 13,053
Accrual	56,655	821	23,635	1,195
	$ 280,099	$ 20,124	$ 210,613	$ 14,248

The Company originates both adjustable- and fixed-rate loans. The maturity and repricing composition of those loans, less undisbursed amounts and deferred fees, were as follows (dollars in thousands):

	June 30 2009	December 31 2008	June 30 2008
Fixed-rate (term to maturity):			
Due in one year or less	$ 155,756	$ 130,958	$ 88,318
Due after one year through three years	204,129	206,455	184,977
Due after three years through five years	221,595	246,897	208,773
Due after five years through ten years	165,129	157,621	230,831
Due after ten years	497,054	425,213	420,040
	$ 1,243,663	$ 1,167,144	$ 1,132,939
Adjustable-rate (term to rate adjustment):			
Due in one year or less	$ 1,802,578	$ 1,912,755	$ 1,921,983
Due after one year through three years	375,608	402,482	394,703
Due after three years through five years	454,586	440,555	359,500
Due after five years through ten years	36,646	38,472	164,174

		2,669,418		2,794,264		2,840,360
	$	3,913,081	$	3,961,408	$	3,973,299

The adjustable-rate loans may have interest rate adjustment limitations and are generally indexed to various Prime or LIBOR rates, or One to Five Year Constant Maturity Treasury Indices or FHLB borrowing rates. Future market factors may affect the correlation of the interest rate adjustment with the rates the Banks pay on the short-term deposits that primarily have been utilized to fund these loans.

Note 7: ALLOWANCE FOR LOAN LOSSES

The following is a schedule of our allocation of the allowance for loan losses at the dates indicated (dollars in thousands):

	June 30 2009	December 31 2008	June 30 2008
Specific or allocated loss allowances:			
Commercial real estate	$ 5,333	$ 4,199	$ 4,518
Multifamily real estate	83	87	524
Construction and land	55,585	38,253	19,991
One- to four-family real estate	1,333	752	2,322
Commercial business	19,474	16,533	21,494
Agricultural business, including secured by farmland	1,323	530	1,634
Consumer	1,540	1,730	2,583
Total allocated	84,671	62,084	53,066
Estimated allowance for undisbursed commitments	1,976	1,108	543
Unallocated	4,047	12,005	4,961
Total allowance for loan losses	$ 90,694	$ 75,197	$ 58,570
Allowance for loan losses as a percentage of total loans outstanding	2.32%	1.90%	1.47%
Allowance for loan losses as a percentage of non-performing loans	40%	40%	65%

An analysis of the changes in our allowance for loan losses is as follows (dollars in thousands):

	Quarters Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
Balance, beginning of the period	$ 79,724	$ 50,446	$ 75,197	$ 45,827
Provision for loan losses	45,000	15,000	67,000	21,500
Recoveries of loans previously charged off:				
Commercial real estate	--	--	--	--
Multifamily real estate	--	--	--	--
Construction and land	266	9	318	9
One- to four-family real estate	89	40	91	40
Commercial business	249	174	319	260
Agricultural business, including secured by farmland	22	5	22	8
Consumer	32	27	63	82

	658	255	813	399
Loans charged off:				
Commercial real estate	--	(7)	--	(7)
Multifamily real estate	--	--	--	--
Construction and land	(27,290)	(5,081)	(39,707)	(6,049)
One- to four-family real estate	(1,181)	(119)	(2,272)	(191)
Commercial business	(2,438)	(1,770)	(6,232)	(2,550)
Agricultural business, including secured by farmland	(3,186)	--	(3,186)	--
Consumer	(593)	(154)	(919)	(359)
	(34,688)	(7,131)	(52,316)	(9,156)
Net (charge-offs) recoveries	(34,030)	(6,876)	(51,503)	(8,757)
Balance, end of the period	$ 90,694	$ 58,570	$ 90,694	$ 58,570
Net loan charge-offs to average outstanding loans during the period	0.87%	0.18%	1.31%	0.23%

Note 8: GOODWILL AND OTHER INTANGIBLE ASSETS AND MORTGAGE SERVICING RIGHTS

Goodwill and Other Intangible Assets: Goodwill and other intangible assets consists primarily of goodwill, which represents the excess of the purchase price over the fair value of net assets acquired in a business combination accounted for under the purchase method, and core deposit intangibles (CDI), which are amounts recorded in business combinations or deposit purchase transactions related to the value of transaction-related deposits and the value of the customer relationships associated with the deposits.

We account for goodwill and other intangible assets in accordance with SFAS No. 142, Goodwill and Other Intangible Assets. Goodwill is not amortized but is reviewed annually for impairment. During 2008, we engaged an independent valuation consultant to review goodwill for impairment and, as a result of the significant decline in the Company’s 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 wrote off all previously recognized goodwill. We amortize core deposit intangibles over their estimated useful life and review them at least annually for events or circumstances that could impact their recoverability. The core deposit intangible assets shown in the table below represent the value ascribed to the long-term deposit relationships acquired in three separate bank acquisitions during 2007. These intangible assets are being amortized using an accelerated method over an estimated useful life of eight years. The core deposit intangible assets are not estimated to have a significant residual value. Other intangible assets are amortized over their useful lives and are also reviewed for impairment.

The following table summarizes the changes in the Company’s goodwill and other intangibles for the six months ended June 30, 2008 and 2009 (dollars in thousands):

	Goodwill	Core Deposit Intangibles	Other	Total
Balance, December 31, 2007	$ 121,108	$ 16,529	$ 17	$ 137,654
Adjustments related to 2007 acquisitions	12	--	--&#16	