BANNER CORP
Form 10-Q
August 09, 2012

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, 2012.

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	91-1691604
(State or other jurisdiction of incorporation or organization)	(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 [x] 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, 2012
Common Stock, $.01 par value per share	19,223,271 shares*

* Includes 34,340 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

Item 1 - Financial Statements. The Consolidated Financial Statements of Banner Corporation and Subsidiaries filed as a part of the report are as follows:

Special Note Regarding Forward-Looking Statements

Certain matters in this report on Form 10-Q contain certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 concerning our future operations. These statements relate to our financial condition, results of operations, plans, objectives, future performance or business. Forward-looking statements are not statements of historical fact, are based on certain assumptions and are generally identified by use of the words “believes,” “expects,” “anticipates,” “estimates,” “forecasts,” “intends,” “plans,” “targets,” “potentially,” “probal “outlook” or similar expressions or future or conditional verbs such as “may,” “will,” “should,” “would” a “could.” Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, assumptions and statements about future economic performance and projections of financial items. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from the results anticipated or implied by our forward-looking statements, including, but not limited to: the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and changes in our allowance for loan losses and provision for loan losses that may be impacted by deterioration in the housing and commercial real estate markets and may lead to increased losses and nonperforming assets, and may result in our allowance for loan losses not being adequate to cover actual losses and require us to materially increase our reserves; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates and the relative differences between short and long-term interest rates, loan and deposit interest rates, our net interest margin and funding sources; fluctuations in the demand for loans, the number of unsold homes, land and other properties and fluctuations in real estate values in our market areas; secondary market conditions for loans and our ability to sell loans in the secondary market; results of examinations of us by the Board of Governors of the Federal Reserve System (the Federal Reserve Board) and of our bank subsidiaries by the Federal Deposit Insurance Corporation (the FDIC), the Washington State Department of Financial Institutions, Division of Banks (the Washington DFI) or other regulatory authorities, including the possibility that any such regulatory authority may, among other things, institute a formal or informal enforcement action against us or any of our bank subsidiaries which could require us to increase our reserve for loan losses, write-down assets, change our regulatory capital position or affect our ability to borrow funds, or maintain or increase deposits, or impose additional requirements and restrictions on us, any of which could adversely affect our liquidity and earnings; legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, or the interpretation of regulatory capital or other rules; the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the implementing regulations; our ability to attract and retain deposits; further increases in premiums for deposit insurance; our ability to control operating costs and expenses; the use of estimates in determining fair value of certain of our assets and liabilities, which estimates may prove to be incorrect and result in significant changes in valuation; difficulties in reducing risk associated with the loans on our balance sheet; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our work force and potential associated charges; the failure or security breach of computer systems on which we depend; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; our ability to implement our business strategies; our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we may acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto; our ability to manage loan delinquency rates; increased competitive pressures among financial services companies; changes in consumer spending, borrowing and savings habits; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; our ability to pay dividends on our common and preferred stock and interest or principal payments on our junior subordinated debentures; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; the economic impact of war or any terrorist activities; other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services; and other risks detailed from time to time in our filings with the Securities and Exchange Commission. Any forward-looking statements are based upon management's beliefs and assumptions at the time they are made. We do not undertake and specifically disclaim any obligation to update any forward-looking statements included in this report or the reasons why actual results could differ from those contained in such statements whether as a result of new information, future events or otherwise. These risks could cause our actual results to differ materially from those expressed in any forward-looking statements by, or on behalf of, us. In light of these risks, uncertainties and assumptions, the forward-looking statements discussed in this report might not occur, and you should not put undue reliance on any forward-looking statements.

As used throughout this report, the terms "we," "our," "us," or the "Company" refer to Banner Corporation and its consolidated subsidiaries, unless the context otherwise requires.

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Unaudited) (In thousands, except shares)
June 30, 2012 and December 31, 2011

ASSETS	June 30 2012	December 31 2011
Cash and due from banks	$ 189,176	$ 132,436
Securities—trading, amortized cost $106,220 and $112,663, respectively	77,368	80,727
Securities—available-for-sale, amortized cost $433,051 and $462,579, respectively	436,130	465,795
Securities—held-to-maturity, fair value $89,153 and $80,107, respectively	83,312	75,438
Federal Home Loan Bank stock	37,371	37,371
Loans receivable:		
Held for sale	6,752	3,007
Held for portfolio	3,205,505	3,293,331
Allowance for loan losses	(80,221)	(82,912)
	3,132,036	3,213,426
Accrued interest receivable	14,656	15,570
Real estate owned, held for sale, net	25,816	42,965
Property and equipment, net	90,228	91,435
Intangible assets, net	5,252	6,331
Bank-owned life insurance (BOLI)	59,800	58,563
Deferred tax assets, net	31,572	--
Other assets	38,710	37,255
	$ 4,221,427	$ 4,257,312
LIABILITIES		
Deposits:		
Non-interest-bearing	$ 804,562	$ 777,563
Interest-bearing transaction and savings accounts	1,449,890	1,447,594
Interest-bearing certificates	1,171,297	1,250,497
	3,425,749	3,475,654
Advances from FHLB at fair value	10,423	10,533
Other borrowings	90,030	152,128
Junior subordinated debentures at fair value (issued in connection with Trust Preferred Securities)	70,553	49,988
Accrued expenses and other liabilities	23,564	23,253
Deferred compensation	13,916	13,306
	3,634,235	3,724,862
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	121,610	120,702
Common stock and paid in capital - $0.01 par value per share, 50,000,000 shares authorized, 18,804,819 shares issued: 18,770,479 shares and 17,519,132 shares outstanding at June 30, 2012 and December 31, 2011, respectively	554,866	531,149
Accumulated deficit	(89,266)	(119,465)
Accumulated other comprehensive income	1,969	2,051
Unearned shares of common stock issued to Employee Stock Ownership Plan (ESOP) trust at cost		
34,340 restricted shares outstanding at June 30, 2012 and December 31, 2011	(1,987)	(1,987)
	587,192	532,450
	$ 4,221,427	$ 4,257,312

See Selected Notes to the 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 Three and Six Months Ended June 30, 2012 and 2011

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
INTEREST INCOME:				
Loans receivable	$44,040	$46,846	$88,028	$93,601
Mortgage-backed securities	995	859	1,922	1,734
Securities and cash equivalents	2,230	2,183	4,513	4,216
	47,265	49,888	94,463	99,551
INTEREST EXPENSE:				
Deposits	4,035	7,014	8,483	14,826
FHLB advances	64	64	127	242
Other borrowings	74	568	623	1,147
Junior subordinated debentures	802	1,041	1,814	2,079
	4,975	8,687	11,047	18,294
Net interest income before provision for loan losses	42,290	41,201	83,416	81,257
PROVISION FOR LOAN LOSSES	4,000	8,000	9,000	25,000
Net interest income	38,290	33,201	74,416	56,257
OTHER OPERATING INCOME:				
Deposit fees and other service charges	6,283	5,693	12,152	10,972
Mortgage banking operations	2,855	855	5,504	1,817
Loan servicing fees, net of amortization and impairment	343	397	560	653
Miscellaneous	485	369	1,036	862
	9,966	7,314	19,252	14,304
Gain on sale of securities	29	--	29	--
Net change in valuation of financial instruments carried at fair value	(19,059)	1,939	(17,374)	2,195
Total other operating income (loss)	(9,064)	9,253	1,907	16,499
OTHER OPERATING EXPENSES:				
Salary and employee benefits	19,390	18,288	38,900	35,543
Less capitalized loan origination costs	(2,747)	(1,948)	(4,997)	(3,668)
Occupancy and equipment	5,204	5,436	10,681	10,830
Information/computer data services	1,746	1,521	3,261	3,088
Payment and card processing expenses	2,116	1,939	4,006	3,586
Professional services	1,224	1,185	2,568	2,857
Advertising and marketing	1,650	1,903	3,716	3,643
Deposit insurance	816	1,389	2,179	3,358
State/municipal business and use taxes	565	544	1,133	1,038
REO operations	1,969	6,568	4,567	11,199
Amortization of core deposit intangibles	525	570	1,079	1,167

Miscellaneous	3,208	2,860	6,486	5,758
Total other operating expenses	35,666	40,255	73,579	78,399
Income (loss) before provision for income taxes	(6,440)	2,199	2,744	(5,643)
PROVISION FOR (BENEFIT FROM) INCOME TAXES	(31,830)	--	(31,830)	--
NET INCOME (LOSS)	25,390	2,199	34,574	(5,643)
PREFERRED STOCK DIVIDEND AND DISCOUNT ACCRETION				
Preferred stock dividend	1,550	1,550	3,100	3,100
Preferred stock discount accretion	454	425	908	851
NET INCOME (LOSS) AVAILABLE TO COMMON SHAREHOLDERS	$23,386	$224	$30,566	$(9,594)
Earnings (loss) per common share:				
Basic	$1.27	$0.01	$1.69	$(0.58)
Diluted	$1.27	$0.01	$1.69	$(0.58)
Cumulative dividends declared per common share:	$0.01	$0.01	$0.02	$0.08

See Selected Notes to the Consolidated Financial Statements

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited) (In thousands)
For the Three and Six Months Ended June 30, 2012 and 2011

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
NET INCOME (LOSS)	$25,390	$2,199	$34,574	$(5,643)
OTHER COMPREHENSIVE INCOME (LOSS), NET OF INCOME TAXES:				
Unrealized holding gain (loss) during the period, net of deferred income tax provision (benefit) of ($29), $0, ($49) and $0, respectively	(52)	1,970	(87)	1,289
Amortization of unrealized gain (loss) on tax exempt securities transferred from available-for-sale to held-to-maturity	3	4	5	9
Other comprehensive income (loss)	(49)	1,974	(82)	1,298
COMPREHENSIVE INCOME (LOSS)	$25,341	$4,173	$34,492	$(4,345)

See Selected Notes to the Consolidated Financial Statements

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited) (In thousands, except for shares)
For the Six Months Ended June 30, 2012

	Preferred Stock		Common Stock and Paid in Capital		(Accumulated Deficit)	Accumulated Other Comprehensive Income	Stockholders' Equity
	Shares	Amount	Shares	Amount			
Balance, January 1, 2012	124,000	$ 120,702	17,519,132	$ 529,162	$ (119,465)	$ 2,051	$ 532,450
Net income (loss)					34,574		34,574
Change in valuation of securities—available-for-sale, net of income tax						(87)	(87)
Amortization of unrealized loss on tax exempt securities transferred from available-for-sale to held-to-maturity, net of income tax						5	5
Accretion of preferred stock discount		908			(908)		--
Accrual of dividends on preferred stock					(3,100)		(3,100)
Accrual of dividends on common stock ($.02/share cumulative)					(367)		(367)
Proceeds from issuance of common stock for stockholder reinvestment program			1,236,812	23,610			23,610
Amortization of compensation related to restricted stock grant			14,535	100			100
Amortization of compensation related to stock options				7			7

BALANCE, June 30, 2012	124,000	$	121,610	18,770,479	$	552,879	$	(89,266)	$	1,969	$	587,192

See Selected Notes to the Consolidated Financial Statements

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited) (In thousands, except for shares)
For the Year Ended December 31, 2011

	Preferred Stock		Common Stock and Paid in Capital			Accumulated Other	
	Shares	Amount	Shares	Amount	(Accumulated Deficit)	Comprehensive Income	Stockholders' Equity
Balance, January 1, 2011	124,000	$ 119,000	16,130,441	$ 507,470	$ (115,348)	$ 350	$ 511,472
Net income (loss)					5,457		5,457
Change in valuation of securities—available-for-sale, net of income tax						1,685	1,685
Amortization of unrealized loss on tax exempt securities transferred from available-for-sale to held-to-maturity, net of income tax						16	16
Accretion of preferred stock discount		1,701			(1,701)		--
Accrual of dividends on preferred stock					(6,200)		(6,200)
Accrual of dividends on common stock ($.10/share cumulative)					(1,673)		(1,673)
Proceeds from issuance of common stock for stockholder reinvestment program			1,372,625	21,556			21,556
Amortization of compensation related to restricted stock grant			16,066	111			111
Amortization of compensation related to stock options				25			25

Other			1								1
BALANCE, December 31, 2011	124,000	$	120,702	17,519,132	$	529,162	$	(119,465)	$	2,051	$ 532,450

See Selected Notes to the Consolidated Financial Statements

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited) (In thousands)
For the Six Months Ended June 30, 2012 and 2011

	Six Months Ended June 30 2012	Six Months Ended June 30 2011
OPERATING ACTIVITIES:		
Net income (loss)	$34,574	$(5,643)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	2,384	4,358
Deferred income and expense, net of amortization	1,273	860
Amortization of core deposit intangibles	1,079	1,167
Net change in valuation of financial instruments carried at fair value	17,374	(2,195)
Principal repayments and maturities of securities—trading	6,520	7,600
Deferred taxes	(31,572)	--
Equity-based compensation	107	60
Increase in cash surrender value of bank-owned life insurance	(917)	(925)
Gain on sale of loans, excluding capitalized servicing rights	(3,651)	(1,164)
(Gain) loss on disposal of real estate held for sale and property and equipment	(688)	521
Provision for losses on loans and real estate held for sale	12,197	32,838
Origination of loans held for sale	(243,516)	(114,706)
Proceeds from sales of loans held for sale	243,422	116,291
Net change in:		
Other assets	127	16,368
Other liabilities	855	(827)
Net cash provided from operating activities	39,568	54,603
INVESTING ACTIVITIES:		
Purchases of available-for-sale securities	(186,650)	(174,739)
Principal repayments and maturities of available-for-sale securities	202,693	88,031
Proceeds from sales of securities available-for-sale	11,751	--
Purchases of securities held-to-maturity	(10,224)	(7,488)
Principal repayments and maturities of securities held-to-maturity	2,287	2,964
Principal repayments of loans, net of originations	72,176	39,025
Purchases of loans and participating interest in loans	(4,735)	(97)
Purchases of property and equipment	(1,184)	(1,413)
Proceeds from sale of real estate held for sale, net	23,229	48,264
Other	(320)	(106)
Net cash provided from (used by) investing activities	109,023	(5,559)
FINANCING ACTIVITIES:		
Decrease in deposits, net	(49,905)	(124,798)
Repayment of FHLB advances	(3)	(32,802)
Decrease in other borrowings, net	(62,098)	(39,528)

Cash dividends paid	(3,456)	(5,389)
Cash proceeds from issuance of stock for stockholder reinvestment plan	23,611	8,265
Net cash used by financing activities	(91,851)	(194,252)
NET INCREASE (DECREASE) IN CASH AND DUE FROM BANKS	56,740	(145,208)
CASH AND DUE FROM BANKS, BEGINNING OF PERIOD	132,436	361,652
CASH AND DUE FROM BANKS, END OF PERIOD	$189,176	$216,444

(Continued on next page)

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(Unaudited) (In thousands)
For the Six Months Ended June 30, 2012 and 2011

	Six Months Ended June 30	
	2012	2011
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid in cash	$11,799	$19,575
Taxes received in cash	--	(13,058)
Taxes paid in cash	800	--
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	8,521	26,917

See Selected Notes to the Consolidated Financial Statements

BANNER CORPORATION AND SUBSIDIARIES
SELECTED NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1: BASIS OF PRESENTATION AND CRITICAL ACCOUNTING POLICIES

The accompanying unaudited consolidated financial statements include the accounts of Banner Corporation (the Company or Banner), a bank holding company incorporated in the State of Washington and its wholly-owned subsidiaries, Banner Bank and Islanders Bank (the Banks).

These unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the Securities and Exchange Commission (SEC). In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the financial position and results of operations for the periods presented have been included. 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 2011 Consolidated Financial Statements and/or schedules to conform to the 2012 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 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 the Company's 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, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of Banner's financial statements. These 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, including other-than-temporary impairment (OTTI) losses, (iv) the valuation of intangibles, such as core deposit intangibles and mortgage servicing rights, (v) the valuation of real estate held for sale and (vi) the valuation of or recognition of deferred tax assets and liabilities. These policies and judgments, estimates and assumptions are described in greater detail in subsequent notes to the Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations (Critical Accounting Policies) in our Annual Report on Form 10-K for the year ended December 31, 2011 filed with the Securities and Exchange Commission (SEC). Management believes that the judgments, estimates and assumptions used in the preparation of the 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 the Company's results of operations or financial condition. Further, subsequent changes in economic or market conditions could have a material impact on these estimates and the Company's financial condition and operating results in future periods.

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, 2011 filed with the SEC (2011 Form 10-K). Interim results are not necessarily indicative of results for a full year.

Note 2: RECENT DEVELOPMENTS AND SIGNIFICANT EVENTS

Regulatory Actions: On March 19, 2012, the Memorandum of Understanding (MOU) by and between Banner Bank and the FDIC and Washington State Department of Financial Institutions, Division of Banks (originally effective

March 29, 2010) was terminated. On April 10, 2012, a similar MOU by and between the Company and the Federal Reserve Bank of San Francisco (originally effective March 23, 2010) was also terminated.

Income Tax Reporting and Accounting:

Amended Federal Income Tax Returns: On October 25, 2011, the Company filed amended federal income tax returns for tax years 2005, 2006, 2008 and 2009. The amended tax returns, which are under review by the Internal Revenue Service (IRS), could significantly affect the timing for recognition of credit losses within previously filed income tax returns and, if approved, would result in the refund of up to $13.6 million of previously paid taxes from the utilization of net operating loss carryback claims into prior tax years. The outcome of the IRS review is inherently uncertain, and since there can be no assurance of approval of some or all of the tax carryback claims, no asset has been recognized to reflect the possible results of these amendments as of June 30, 2012, because of this uncertainty. Accordingly, the Company does not anticipate recognizing any tax benefit until the results of the IRS review have been determined.

Deferred Tax Asset Valuation Allowance: The Company and its wholly-owned subsidiaries file consolidated U.S. federal income tax returns, as well as state income tax returns in Oregon and Idaho. Income taxes are accounted for using the asset and liability method. Under this method a deferred tax asset or liability is determined based on the enacted tax rates which are expected to be in effect when the differences between the financial statement carrying amounts and tax basis of existing assets and liabilities are expected to be reported in the Company's income tax returns. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. Under GAAP, a valuation allowance is required to be recognized if it is "more likely than not" that all or a portion of Banner's deferred tax assets will not be realized. During the quarter ended September 30, 2010, the Company evaluated its net deferred tax asset and determined it was prudent to establish a full valuation allowance against the net asset. At each subsequent quarter-end, the Company has re-analyzed that position and the Company continued to maintain a full valuation allowance through March 31, 2012. During the quarter ended June 30, 2012, management analyzed the Company's performance and trends over the previous five quarters, focusing strongly on trends in asset quality, loan loss provisioning, capital position, net interest margin, core operating income and net income. Based on this analysis, management determined that a full valuation allowance was no longer appropriate and reversed nearly all of the valuation allowance. The Company anticipates utilizing the remaining $7.0 million in valuation allowance to offset its projected tax expense in the third and fourth quarters of 2012. The ultimate utilization of the remaining valuation allowance and realization of deferred tax assets is dependent upon the existence, or generation, of taxable income in the periods when those temporary differences and net operating loss and credit carryforwards are deductible. Management considers the scheduled reversal of deferred tax assets and liabilities, taxes paid in carryback years, projected future taxable income, available tax planning strategies, and other factors in making its assessment to reverse the deferred tax valuation allowance. As a result, the valuation allowance decreased to $7.0 million at June 30, 2012 from $38.2 million at December 31, 2011. See Note 12 of the Selected Notes to the Consolidated Financial Statements for more information.

Stockholder Equity Transactions:

Restricted Stock Grants: On April 24, 2012, shareholders approved the Banner Corporation 2012 Restricted Stock Plan (the Plan). Under the Plan, the Company was authorized to issue up to 300,000 shares of its common stock to provide a means for attracting and retaining highly skilled officers of Banner and its affiliates. Shares granted under the Plan have a minimum vesting period of three years. The Plan shall continue in effect for a term of ten years, after which no further awards may be granted. Concurrent with the approval of the Plan was the approval of a grant of $300,000 of restricted stock to Mark J. Grescovich, President and Chief Executive Officer of Banner Corporation and Banner Bank. In June 2012, the Board of Directors approved grants of 76,500 restricted shares to certain other officers of the Company, to be effective July 2, 2012, that will vest in one-third increments over a three-year period.

Participation in the U.S. Treasury's Capital Purchase Program: On March 29, 2012, the Company's $124 million of senior preferred stock, originally issued to the U.S. Treasury as part of its Capital Purchase Program, was sold by the Treasury as part of its efforts to manage and recover its investments under the Troubled Asset Relief Program (TARP). While the sale of these preferred shares to new owners did not result in any proceeds to the Company and does not change the Company's capital position or accounting for these securities, it does eliminate restrictions put in place by the Treasury on TARP recipients. The Treasury retained its related warrants to purchase up to $18.6 million in common stock.

Note 3: ACCOUNTING STANDARDS RECENTLY ADOPTED

In April 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-03, Reconsideration of Effective Control for Repurchase Agreements. This guidance was effective for the first interim or annual period beginning on or after December 15, 2011. The guidance was applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. The amendments remove the transferor's ability criterion from the consideration of effective control for repurchase and other agreements that both entitle and obligate the transferor to repurchase or redeem financial assets before their maturity. The adoption of this guidance did not have a material effect on the Company's Consolidated Financial Statements.

In May 2011, FASB issued ASU No. 2011-04, Fair Value Measurement - Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs. ASU 2011-04 amends Topic 820, Fair Value Measurements and Disclosures, to converge the fair value measurement guidance in U.S. generally accepted accounting principles and International Financial Reporting Standards. ASU 2011-04 clarifies the application of existing fair value measurement requirements, changes certain principles in Topic 820 and requires additional fair value disclosures. ASU 2011-04 became effective for the first interim or annual period beginning on or after December 15, 2011 and did not have a significant impact on the Company's Consolidated Financial Statements.

In June 2011, FASB issued ASU No. 2011-05, Presentation of Comprehensive Income. The amendments in this ASU were effective for fiscal years and interim periods within those years beginning after December 15, 2011 and were to be applied retrospectively. The FASB decided to eliminate the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, the amendments require the consecutive presentation of the statement of net income and other comprehensive income and require the presentation of reclassification adjustments on the face of the financial statements from other comprehensive income to net income. See also ASU No. 2011-12. The adoption of this guidance did not have a material effect on the Company's Consolidated Financial Statements.

In December 2011, FASB issued ASU No. 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU No. 2011-05. This ASU was made to allow FASB time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. While FASB is considering the operational concerns about the presentation requirements for reclassification adjustments, and the needs of financial statement users for additional information about reclassification adjustments, entities should continue to report reclassification out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU 2011-05. The amendments in this ASU were effective at the same time as the amendments in ASU 2011-05 so that entities will not be required to comply with the presentation requirements effective at the same time as the amendments in ASU 2011-05 that this ASU is deferring. The amendments in this ASU were effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance did not have a material effect 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 portfolio in its respective primary market areas. The Banks offer a wide variety of deposit products to their 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: INTEREST-BEARING DEPOSITS AND SECURITIES

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

	June 30 2012	December 31 2011	June 30 2011
Interest-bearing deposits included in cash and due from banks	$132,536	$69,758	$168,198
U.S. Government and agency obligations	229,669	341,606	216,761
Municipal bonds:			
Taxable	19,225	18,497	14,486
Tax exempt	102,139	88,963	83,315
Total municipal bonds	121,364	107,460	97,801
Corporate bonds	42,923	42,565	59,788
Mortgage-backed or related securities:			
Ginnie Mae (GNMA)	16,736	19,572	21,818
Freddie Mac (FHLMC)	62,782	42,001	25,941
Fannie Mae (FNMA)	88,610	66,519	27,362
Private issuer	1,780	1,835	3,108
Total mortgage-backed or related securities	169,908	129,927	78,229
Asset-backed securities:			
Student Loan Marketing Association (SLMA)	32,492	--	--
Equity securities (excludes FHLB stock)	454	402	646

Total securities	596,810	621,960	453,225
FHLB stock	37,371	37,371	37,371
	$766,717	$729,089	$658,794

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Securities—Trading: The amortized cost and estimated fair value of securities—trading at June 30, 2012 and December 31, 2011 are summarized as follows (dollars in thousands):

	June 30, 2012			December 31, 2011		
	Amortized Cost	Fair Value	Percent of Total	Amortized Cost	Fair Value	Percent of Total
U.S. Government and agency obligations	$1,400	$1,645	2.1 %	$2,401	$2,635	3.3 %
Municipal bonds:						
Taxable	85	92	0.1	391	420	0.5
Tax exempt	5,437	5,509	7.1	5,431	5,542	6.9
Total municipal bonds	5,522	5,601	7.2	5,822	5,962	7.4
Corporate bonds	62,948	37,605	48.6	63,502	35,055	43.4
Mortgage-backed or related securities:						
FHLMC	8,509	9,132	11.8	10,535	11,246	13.9
FNMA	20,927	22,931	29.7	23,489	25,427	31.5
Total mortgage-backed or related securities	29,436	32,063	41.5	34,024	36,673	45.4
Equity securities	6,914	454	0.6	6,914	402	0.5
	$106,220	$77,368	100.0 %	$112,663	$80,727	100.0 %

There were no sales of securities—trading during the six months ended June 30, 2012 or 2011. The Company did not recognize any OTTI charges on securities—trading during the six months ended June 30, 2012 or 2011. At June 30, 2012, there were no securities—trading in a nonaccrual status. At June 30, 2011, there was one single-issuer trust preferred security that was on nonaccrual; however, subsequently, deferred and current payments have been received, removing the security from nonaccrual status.

The amortized cost and estimated fair value of securities—trading at June 30, 2012 and December 31, 2011, by contractual maturity, are shown below (in thousands). Expected maturities will differ from contractual maturities because some securities may be called or prepaid with or without call or prepayment penalties.

	June 30, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$--	$--	$1,000	$1,009
Due after one year through five years	1,544	1,619	1,545	1,626
Due after five years through ten years	4,093	4,091	4,087	4,123
Due after ten years through twenty years	6,717	6,728	6,544	6,184
Due after twenty years	57,516	32,413	58,549	30,710
	69,870	44,851	71,725	43,652

Mortgage-backed securities	29,436	32,063	34,024	36,673
Equity securities	6,914	454	6,914	402
	$106,220	$77,368	$112,663	$80,727

Securities—Available-for-Sale: The amortized cost and estimated fair value of securities—available-for-sale at June 30, 2012 and December 31, 2011 are summarized as follows (dollars in thousands):

	June 30, 2012				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Percent of Total
U.S. Government and agency obligations	$227,344	$700	$(20)	$228,024	52.3 %
Municipal bonds:					
Taxable	12,587	257	(2)	12,842	2.9
Tax exempt	20,646	225	(11)	20,860	4.8
Total municipal bonds	33,233	482	(13)	33,702	7.7
Corporate bonds	4,032	36	--	4,068	0.9
Mortgage-backed or related securities:					
FHLMC	53,656	169	(175)	53,650	12.3
FNMA	64,986	748	(56)	65,678	15.1
GNMA	15,476	1,260	--	16,736	3.8
Other	1,672	108	--	1,780	0.4
Total mortgage-backed or related securities	135,790	2,285	(231)	137,844	31.6
Asset-backed securities:					
SLMA	32,652	--	(160)	32,492	7.5
	$433,051	$3,503	$(424)	$436,130	100.0 %

	December 31, 2011				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Percent of Total
U.S. Government and agency obligations	$338,165	$862	$(56)	$338,971	72.8 %
Municipal bonds:					
Taxable	10,358	225	(2)	10,581	2.3
Tax exempt	16,535	210	(16)	16,729	3.6
Total municipal bonds	26,893	435	(18)	27,310	5.9
Corporate bonds	6,240	20	--	6,260	1.3
Mortgage-backed or related securities:					
FHLMC	30,504	284	(33		