BANNER CORP
Form 10-Q
November 05, 2010

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, 2010.

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, 2010
Common Stock, $.01 par value per share	112,060,332 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)
September 30, 2010 and December 31, 2009

ASSETS		September 30 2010		December 31 2009
Cash and due from banks	$	488,123	$	323,005
Securities—trading, cost $133,468 and $192,853, respectively		101,760		147,151
Securities—available-for-sale, cost $151,694 and $95,174, respectively		153,903		95,667
Securities—held-to-maturity, fair value $72,098 and $76,489, respectively		66,929		74,834
Federal Home Loan Bank (FHLB) stock		37,371		37,371
Loans receivable:				
Held for sale, fair value $3,599 and $4,534, respectively		3,545		4,497
Held for portfolio		3,494,557		3,785,624
Allowance for loan losses		(96,435)		(95,269)
		3,401,667		3,694,852
Accrued interest receivable		17,866		18,998
Real estate owned (REO), held for sale, net		107,159		77,743
Property and equipment, net		98,300		103,542
Other intangibles, net		9,210		11,070
Deferred income tax asset, net		--		14,811
Income taxes receivable		12,981		17,436
Bank-owned life insurance (BOLI)		56,141		54,596
Other assets		45,777		51,145
	$	4,597,187	$	4,722,221
LIABILITIES				
Deposits:				
Non-interest-bearing	$	613,313	$	582,480
Interest-bearing transaction and savings accounts		1,459,756		1,341,145
Interest-bearing certificates		1,687,417		1,941,925
		3,760,486		3,865,550
Advances from FHLB at fair value		46,833		189,779
Other borrowings		178,134		176,842
Junior subordinated debentures at fair value (issued in connection with Trust Preferred Securities)		48,394		47,694
Accrued expenses and other liabilities		24,624		24,020
Deferred compensation		13,877		13,208
		4,072,348		4,317,093
COMMITMENTS AND CONTINGENCIES (Note 16)				
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		118,602	117,407
Common stock and paid in capital - $0.01 par value per share, 200,000,000 shares authorized, 111,461,893 shares issued: 111,221,512 shares and 21,299,209 shares outstanding at September 30, 2010 and December 31, 2009, respectively		506,418	331,538
Retained earnings (accumulated deficit)		(99,575)	(42,077)
Accumulated other comprehensive income:			
Unrealized gain on securities available-for-sale and/or transferred to held-to-maturity		1,381	249
Unearned shares of common stock issued to Employee Stock Ownership Plan (ESOP) trust at cost:			
240,381 restricted shares outstanding at September 30, 2010 and December 31, 2009		(1,987)	(1,987)
Carrying value of shares held in trust for stock related compensation plans		(8,724)	(9,045)
Liability for common stock issued to deferred, stock related, compensation plans		8,724	9,043
		--	(2)
		524,839	405,128
	$	4,597,187	$ 4,722,221

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 Nine Months Ended September 30, 2010 and 2009

	Quarters Ended September 30		Nine Months Ended September 30	
	2010	2009	2010	2009
INTEREST INCOME:				
Loans receivable	$51,162	$56,175	$156,394	$168,022
Mortgage-backed securities	972	1,422	3,143	4,792
Other securities and cash equivalents	2,116	1,976	6,317	6,248
	54,250	59,573	165,854	179,062
INTEREST EXPENSE:				
Deposits	12,301	20,818	42,799	65,548
FHLB advances	323	630	1,004	2,025
Other borrowings	604	655	1,864	1,553
Junior subordinated debentures	1,100	1,118	3,174	3,700
	14,328	23,221	48,841	72,826
Net interest income before provision for loan losses	39,922	36,352	117,013	106,236
PROVISION FOR LOAN LOSSES	20,000	25,000	50,000	92,000
Net interest income	19,922	11,352	67,013	14,236
OTHER OPERATING INCOME:				
Deposit fees and other service charges	5,702	5,705	16,494	16,049
Mortgage banking operations	2,519	2,065	4,284	7,640
Loan servicing fees	146	282	774	260
Miscellaneous	919	768	1,788	1,700
	9,286	8,820	23,340	25,649
Other-than-temporary impairment losses	(3,000)	(1,349)	(4,231)	(1,511)
Net change in valuation of financial instruments carried at fair value	1,366	5,982	2,453	13,940
Total other operating income	7,652	13,453	21,562	38,078
OTHER OPERATING EXPENSES:				
Salary and employee benefits	17,093	17,379	50,445	52,508
Less capitalized loan origination costs	(1,731)	(2,060)	(5,076)	(7,010)
Occupancy and equipment	5,546	5,715	16,731	17,697
Information/computer data services	1,501	1,551	4,601	4,684
Payment and card processing expenses	2,018	1,778	5,125	4,786
Professional services	1,500	1,456	4,661	3,833
Advertising and marketing	2,025	1,899	5,717	5,938
Deposit insurance	2,282	2,219	6,623	7,818
State/municipal business and use taxes	630	558	1,643	1,630
REO operations	11,757	2,799	18,981	5,227
Amortization of core deposit intangibles	600	646	1,859	1,997
Miscellaneous	3,107	2,689	8,457	8,205

Total other operating expenses	46,328	36,629	119,767	107,313
Income (loss) before provision for (benefit from) income taxes	(18,754)	(11,824)	(31,192)	(54,999)
PROVISION FOR (BENEFIT FROM) INCOME TAXES	23,988	(5,376)	18,013	(22,777)
NET INCOME (LOSS)	(42,742)	(6,448)	(49,205)	(32,222)
PREFERRED STOCK DIVIDEND AND DISCOUNT ACCRETION				
Preferred stock dividend	1,550	1,550	4,650	4,650
Preferred stock discount accretion	398	373	1,195	1,119
NET INCOME (LOSS) AVAILABLE TO COMMON SHAREHOLDERS	$(44,690)	$(8,371)	$(55,050)	$(37,991)
Earnings (loss) per common share:				
Basic	$(0.40)	$(0.44)	$(1.04)	$(2.11)
Diluted	$(0.40)	$(0.44)	$(1.04)	$(2.11)
Cumulative dividends declared per common share:	$0.01	$0.01	$0.03	$0.03

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, 2010 and 2009

	Quarters Ended September 30		Nine Months Ended September 30	
	2010	2009	2010	2009
NET INCOME (LOSS)	$ (42,742)	$ (6,448)	$ (49,205)	$ (32,222)
OTHER COMPREHENSIVE INCOME (LOSS), NET OF INCOME TAXES:				
Unrealized holding gain (loss) during the period, net of deferred income tax provision (benefit) of ($11), $121, $618 and $51, respectively	(20)	627	1,099	89
Amortization of unrealized loss on tax exempt securities transferred from available-for-sale to held-to-maturity	11	14	33	42
Other comprehensive income (loss)	(9)	641	1,132	131
COMPREHENSIVE INCOME (LOSS)	$ (42,751)	$ (5,807)	$ (48,073)	$ (32,091)

See selected notes to consolidated financial statements

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited) (In thousands)
For the Nine Months Ended September 30, 2010 and 2009

	Preferred Stock	Common Stock and Paid in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income	Unearned Restricted ESOP Shares	Carrying Value, Net of Liability, Of Shares Held in Trust for Stock-Related Compensation Plans	Stockholders' Equity
Balance, January 1, 2010	$ 117,407	$ 331,538	$ (42,077)	$ 249	$ (1,987)	$ (2)	$ 405,128
Net income (loss)			(49,205)				(49,205)
Change in valuation of securities—available-for-sale, net of income tax				1,099			1,099
Amortization of unrealized loss on tax exempt securities transferred from available-for-sale to held-to-maturity, net of income taxes				33			33
Accretion of preferred stock discount	1,195		(1,195)				--
Accrual of dividends on preferred stock			(4,650)				(4,650)
Accrual of dividends on common stock ($.03/share cumulative)			(2,448)				(2,448)
Proceeds from issuance of common stock for stockholder reinvestment program, net of registration expenses		13,198					13,198
Proceeds from issuance of common stock, net of offering costs		161,637					161,637

Amortization of compensation related to MRP						2	2
Amortization of compensation related to stock options		45					45
BALANCE, September 30, 2010	$ 118,602	$ 506,418	$ (99,575)	$ 1,381	$ (1,987)	$ --	$ 524,839

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, 2010 and 2009

	Preferred Stock	Common Stock and Paid in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income	Unearned Restricted ESOP Shares	Carrying Value, Net of Liability, Of Shares Held inTrust 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)
For the Nine Months Ended September 30, 2010 and 2009

	Nine Months Ended September 30 2010	2009
COMMON STOCK—SHARES ISSUED AND OUTSTANDING:		
Common stock, shares issued, beginning of period	21,539	17,152
Purchase and retirement of common stock	--	--
Issuance of common stock for exercised stock options and/or employee stock plans	116	--
Issuance of common stock for stockholder reinvestment program	4,168	2,782
Issuance of common stock	85,639	--
Net number of shares issued during the period	89,923	2,782
COMMON SHARES ISSUED AND OUTSTANDING, END OF PERIOD	111,462	19,934
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	111,222	19,694

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, 2010 and 2009

	Nine Months Ended September 30	
	2010	2009
OPERATING ACTIVITIES:		
Net income (loss)	$(49,205)	$(32,222)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	6,963	7,433
Deferred income and expense, net of amortization	105	374
Amortization of core deposit and other intangibles	1,860	1,998
Other-than-temporary impairment losses	4,231	1,511
Net change in valuation of financial instruments carried at fair value	(2,453)	(13,940)
Deferred taxes	14,193	(3,038)
Equity-based compensation	47	131
Increase in cash surrender value of bank-owned life insurance	(1,545)	(1,357)
Gain on sale of loans, excluding capitalized servicing rights	(2,994)	(3,210)
Loss on disposal of real estate held for sale and property and equipment, net	1,382	631
Provision for losses on loans and real estate held for sale	59,923	93,579
Purchases of securities—trading	(3,266)	(69,760)
Principal repayments and maturities of securities—trading	50,048	103,383
Origination of loans held for sale	(235,084)	(481,246)
Proceeds from sales of loans held for sale	236,036	483,878
Net change in:		
Other assets	10,922	(14,865)
Other liabilities	529	(11,038)
Net cash provided from operating activities	91,692	62,242
INVESTING ACTIVITIES:		
Purchases of securities available-for-sale	(161,516)	(48,383)
Principal repayments and maturities of securities available-for-sale	102,704	20,885
Proceeds from sales of securities available-for-sale	1,965	6,458
Purchases of securities held-to-maturity	(1,158)	(17,975)
Principal repayments and maturities of securities held-to-maturity	6,020	1,079
Principal repayments (originations) of loans, net	174,900	(70,652)
Purchases of loans and participating interest in loans	(286)	(1,357)
Purchases of property and equipment, net	(1,741)	(14,478)
Proceeds from sale of other repossessed assets and REO held for sale, net	30,306	29,275
Other	(108)	(345)
Net cash provided from (used by) investing activities	151,086	(95,493)
FINANCING ACTIVITIES:		
Increase (decrease) in deposits, net	(105,064)	82,325
Proceeds from FHLB advances	--	231,200

Repayment of FHLB advances	(142,504)	(86,203)
Increase in other borrowings, net	1,285	29,535
Cash dividends paid	(6,212)	(5,748)
Cash proceeds from issuance of stock for stockholder reinvestment program	13,198	10,546
Cash proceeds from issuance of stock in secondary offering, net of offering costs	161,637	--
Net cash provided from (used by) financing activities	(77,660)	261,655
NET INCREASE IN CASH AND DUE FROM BANKS	165,118	228,404
CASH AND DUE FROM BANKS, BEGINNING OF PERIOD	323,005	102,750
CASH AND DUE FROM BANKS, END OF PERIOD	$488,123	$331,154

(Continued on next page)

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(Unaudited) (In thousands)
For the Nine Months Ended September 30, 2010 and 2009

	Nine Months Ended September 30	
	2010	2009
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid in cash	$52,132	$79,518
Taxes paid (received) in cash	(561)	(6,451)
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	71,102	63,141
Real estate owned transferred to property and equipment	--	7,030
Net decrease in accrued dividends payable	(886)	(537)
Change in other assets/liabilities	177	757

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, 2010, its 86 branch offices and seven 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 (Washington DFI) and the Federal Deposit Insurance Corporation (FDIC).

In the opinion of management, the accompanying consolidated statements of financial condition and related 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 U.S. Generally Accepted Accounting Principles (GAAP). The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect amounts reported in the financial statements and the disclosure of contingent assets and liabilities as of the date of the statement of financial condition in the accompanying notes. 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, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of the 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 goodwill, 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 the judgments, estimates and assumptions are described in greater detail in 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, 2009 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, because of 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 the Company's financial condition and operating results in future periods.

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 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 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 implementation of 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 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 2009 Consolidated Financial Statements and/or schedules to conform to the 2010 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, 2009 filed with the SEC. Interim results are not necessarily indicative of results for a full year.

Note 2: RECENT DEVELOPMENTS AND SIGNIFICANT EVENTS

Regulatory Actions: On March 23, 2010, Banner Bank entered into a Memorandum of Understanding (MOU) with the FDIC and Washington DFI. The Company also entered into a similar MOU with the Federal Reserve Bank of San Francisco on March 29, 2010. Under its MOU, Banner Bank is required, among other things, to develop and implement plans to reduce commercial real estate concentrations; to improve asset quality and reduce classified assets; to improve profitability; and to increase Tier 1 leverage capital to equal or exceed 10% of average assets. In addition, Banner Bank will not be able to pay cash dividends to Banner Corporation without prior approval from the FDIC and Washington DFI and the Company and Banner Bank must obtain prior regulatory approval before adding any new director or senior executive officer or changing the responsibilities of any current senior executive officer. Further, the Company may not pay any dividends on common or preferred stock, pay interest or principal on the balance of its junior subordinated debentures or repurchase our common stock without the prior written non-objection of the Federal Reserve Bank. See Item 1A, Risk Factors—“We are required to comply with the terms of memoranda of understanding issued by the FDIC and DFI and the Federal Reserve and lack of compliance could result in additional regulatory actions” in our Form 10-Q for the quarter ended June 30, 2010.

Secondary Offering of Common Stock: On June 30, 2010, the Company announced the initial closing of its offering of 75,000,000 shares of its common stock and the sale of an additional 3,500,000 shares pursuant to the partial exercise of the underwriters’ over-allotment option, at a price to the public of $2.00 per share. On July 2, 2010, the Company further announced the completion of this offering as the underwriters exercised their over-allotment option for an additional 7,139,000 shares, at a price to the public of $2.00 per share. Together with the 78,500,000 shares the Company issued on June 30, 2010 (including 3,500,000 shares issued pursuant to the underwriters' initial exercise of their over-allotment option), the Company issued a total of 85,639,000 shares in the offering, resulting in net proceeds, after deducting underwriting discounts and commissions and offering expenses, of approximately $161.6 million. Of that amount, $13.6 million (related to the 7,139,000 shares) was recorded in the Consolidated Statements of Changes in Stockholders' Equity during the quarter ended September 30, 2010, as that portion of the transaction settled after June 30, 2010.

Banner intends to use a significant portion of the net proceeds from the offering to strengthen Banner Bank's regulatory capital ratios in accordance with the MOU and to support managed growth. To that end, at September 30, 2010, the Company had invested a cumulative $110 million as additional paid-in common equity in Banner Bank. As a result, the Tier 1 leverage capital of Banner Bank was 10.77% of average assets on September 30, 2010, unchanged from June 30, 2010, and up from the 9.74% at December 31, 2009. The Company expects to use the remaining net proceeds for general working capital purposes, including additional capital investments in its subsidiary banks if appropriate.

FDIC Prepayment: On November 12, 2009, the FDIC adopted a final rule that required 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 were required to deposit funds with the FDIC in the amount of the prepaid assessment on December 30, 2009. The insured institutions will 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 was its total base assessment rate in effect on September 30, 2009. That rate was then increased by three basis points for all of 2011 and 2012. For purposes of calculating the prepaid amount, an institution's third quarter 2009 assessment base was also assumed to increase quarterly by an estimated five percent annual growth rate through the end of 2012. Each institution was directed to record the entire amount of its prepaid assessment as a prepaid expense (asset) as of December 30, 2009. Thereafter, each institution will 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 will 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 June 30, 2013, any remaining amount will be returned to the institution. For Banner Corporation, the consolidated balance of the prepaid assessment was $23.4 million at September 30, 2010 and is recorded among "other assets" in the Consolidated Statement of Financial Condition.

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 FDIC 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, known as TAGP, 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, 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 was 10 basis points through December 31, 2009 and will be within a range from 15 to 25 basis points from January 1 through December 31, 2010.

Notably, on September 27, 2010, the FDIC announced that it will not continue the TAGP beyond December 31, 2010. However, under the FDIC's proposed rule making of September 27, 2010, separate temporary coverage for non-interest bearing transaction accounts would become effective on December 30, 2010, and terminate on December 31, 2012. Under the proposed rule all funds held in non-interest bearing transaction accounts would be fully insured, without limit. Further, unlike the TAGP, all U.S. depository institutions insured by the FDIC must participate; there is no opt out provision. The FDIC does not plan to charge a separate assessment for the temporary insurance. As proposed, the FDIC will take into account the cost for this additional coverage in determining the amount of the general assessment the FDIC charges insured U.S. depository institutions under its risk-based assessment system

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.

Note 3: ACCOUNTING STANDARDS RECENTLY ADOPTED OR ISSUED

In January 2010, the Board of Governors of the Federal Reserve System issued final risk-based capital rules related to the adoption of FASB ASC Topic 860-10 and FASB ASC Topic 810-10. Banking organizations affected by these recent pronouncements generally will be subject to higher regulatory capital requirements intended to better align risk-based capital levels with the actual risks of certain exposures. The adoption of the new risk-based capital rules in relation to these new pronouncements did not have a material impact on the Company’s consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (Topic 820)—Improving Disclosures about Fair Value Measurements. ASU No. 2010-06 requires:

- fair value disclosures by each class of assets and liabilities (generally a subset within a line item as presented in the statement of financial position) rather than major category,
- for items measured at fair value on a recurring basis, the amounts of significant transfers between Levels 1 and 2, and transfers into and out of Level 3, and the reasons for those transfers, including separate discussion related to the transfers into each level apart from transfers out of each level, and
- gross presentation of the amounts of purchases, sales, issuances, and settlements in the Level 3 recurring measurement reconciliation.

Additionally, the ASU clarifies that a description of the valuation techniques(s) and inputs used to measure fair values is required for both recurring and nonrecurring fair value measurements. Also, if a valuation technique has changed, entities should disclose that change and the reason for the change. Disclosures other than the gross presentation changes in the Level 3 reconciliation are effective for the first reporting period beginning after December 15, 2009. The requirement to present the Level 3 activity of purchases, sales, issuances, and settlements on a gross basis will be effective for fiscal years beginning after December 15, 2010. The sections of this ASU already adopted did not have a material impact on the Company’s consolidated financial statements. The further adoption of the requirement to present the Level 3 reconciliation differently is not expected to have a material effect on the Company’s consolidated financial statements.

In February 2010, FASB issued ASU No. 2010-09, Subsequent Events (Topic 855)—Amendments to Certain Recognition and Disclosure Requirements. ASU No. 2010-09 establishes separate subsequent event recognition criteria and disclosure requirements for SEC filers. SEC filers are defined in this update as entities that are required to file or to furnish their financial statements with either the SEC or another appropriate agency (such as the FDIC or Office of Thrift Supervision) under Section 12(i) of the Securities and Exchange Act of 1934, as amended. Effective with the release date, the financial statements of SEC filers will no longer disclose either the date through which subsequent events were reviewed or that subsequent events were evaluated through the date the financial statements were issued. The requirement to evaluate subsequent events through the date of issuance is still in place; only the disclosure is affected. This ASU also removes the requirement to make those disclosures in financial statements revised for either a correction of an error or a retrospective application of an accounting change. The adoption of this ASU did not have a material impact on the Company’s consolidated financial statements.

In April 2010, FASB issued ASU No. 2010-13, Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades – a consensus of the FASB Emerging Issues Task Force. ASU No. 2010-13 addresses whether an employee stock option should be classified as a liability or as an equity instrument if the exercise price is denominated in the currency in which a substantial portion of the entity’s equity securities trades. That currency may differ from the entity’s functional currency and from the payroll currency of the employee receiving the option. This guidance amends ASC 718, Compensation – Stock Compensation, to clarify that an employee share-based payment award that has an exercise price denominated in the currency of the market in which a substantial portion of the entity’s equity shares trades should not be considered to contain a condition that is not a market, performance, or service condition. The guidance in the ASU is effective for fiscal years, and for interim periods within those fiscal years, beginning on or after December 15, 2010, and did not have a material impact on the Company’s consolidated financial statements.

In April 2010, FASB issued ASU No. 2010-18, Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset—a consensus of the FASB Emerging Issues Task Force. ASU No. 2010-18 clarifies that a creditor should not apply specific guidance in ASC 310, Receivables, 40, Troubled Debt Restructurings by Creditors, to acquired loans accounted for as a pooled asset under ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. However, that guidance in ASC 310-30 continues to apply to acquired loans within the scope of ASC 310-30 that a creditor accounts for individually. This amended guidance is effective for a modification of a loan(s) accounted for within a pool under ASC 310-30 occurring in the first interim or annual period ending on or after July 15, 2010. The amended guidance must be applied prospectively, and early application is permitted. Upon initial application of the amended guidance, an entity may make a one-time election to terminate accounting for loans as a pool under ASC 310-30. An entity may make the election on a pool-by-pool basis. The election does not preclude an entity from applying pool accounting to future acquisitions of loans with credit deterioration. The implementation of this ASU did not have a material impact on the Company's consolidated financial statements.

In July 2010, FASB issued ASU No. 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. ASU No. 2010-20 provides enhanced disclosures related to the credit quality of financing receivables and the allowance for credit losses, and provides that new and existing disclosures should be disaggregated based on how an entity develops its allowance for credit losses and how it manages credit exposures. Under the provisions of this ASU, additional disclosures required for financing receivables include information regarding the aging of past due receivables, credit quality indicators, and modifications of financing receivables. The provisions of ASU No. 2010-20 are effective for periods ending after December 15, 2010, with the exception of the amendments to the rollforward of the allowance for credit losses and the disclosures about modifications which are effective for periods beginning after December 15, 2010. Comparative disclosures are required only for periods ending subsequent to initial adoption. We are currently assessing the effects of adopting the provisions of ASU No. 2010-20 and will provide the required disclosure in our 2010 Annual Report filed on Form 10-K.

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.

GAAP establishes 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 consolidated financial statements accordingly.

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):

	September 30 2010	December 31 2009	September 30 2009
Interest-bearing deposits included in cash and due from banks	$ 441,977	$ 244,641	$ 270,623
Mortgage-backed or related securities			
GNMA	16,105	18,458	20,130
FHLMC	32,160	43,469	47,596
FNMA	35,509	37,549	40,144
Private issuer	3,994	6,465	7,073
Total mortgage-backed securities	87,768	105,941	114,943
U.S. agency obligations	116,188	94,367	79,675
Taxable municipal bonds	2,953	3,717	4,512
Corporate bonds	46,035	43,267	44,515
Total other taxable securities	165,176	141,351	128,702
Tax-exempt municipal bonds	69,504	70,018	74,963
Equity securities (excludes FHLB stock)	144	342	493
Total securities	322,592	317,652	319,101
FHLB stock	37,371	37,371	37,371
	$ 801,940	$ 599,664	$ 627,095

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Securities—Trading: The amortized cost and estimated fair value of securities—trading at September 30, 2010 and December 31, 2009 are summarized as follows (dollars in thousands):

	September 30, 2010			December 31, 2009		
	Amortized Cost	Fair Value	Percent of Total	Amortized Cost	Fair Value	Percent of Total
U.S. Government and agency obligations	$ 4,168	$ 4,480	4.4%	$ 41,178	$ 41,255	28.0%
Municipal bond:						
Taxable	682	716	0.7	1,004	1,034	0.7
Tax exempt	5,755	6,062	6.0	6,065	6,117	4.2
Corporate bonds	63,836	35,095	34.5	76,411	35,017	23.8
Mortgage-backed securities:						
FHLMC	18,792	19,754	19.4	25,030	25,837	17.6
FNMA	33,320	35,509	34.9	36,250	37,549	25.5
Equity securities	6,915	144	0.1	6,915	342	0.2
	$ 133,468	$ 101,760	100.0%	$ 192,853	$ 147,151	100.0%

The amortized cost and estimated fair value of securities—trading at September 30, 2010 and December 31, 2009, 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.

	September 30, 2010		December 31, 2009	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 1,097	$ 1,127	$ 550	$ 565
Due after one year through five years	2,360	2,489	40,232	40,277
Due after five years through ten years	22,436	23,750	21,230	21,641
Due after ten years through twenty years	17,580	18,475	20,931	21,186
Due after twenty years	83,080	55,775	102,995	63,140
	126,553	101,616	185,938	146,809
Equity securities	6,915	144	6,915	342
	$ 133,468	$ 101,760	$ 192,853	$ 147,151

Securities—Available-for-Sale: The amortized cost and estimated fair value of securities available-for-sale at September 30, 2010 and December 31, 2009 are summarized as follows (dollars in thousands):

	September 30, 2010				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Percent of Total
U.S. Government and agency obligations	$111,259	$498	$(49)	$111,708	72.6%
Corporate bonds	9,697	--	(6)	9,691	6.3
Mortgage-backed or related securities:					

FHLMC collateralized mortgage obligations	12,082	323	--	12,405	8.0	
GNMA certificates	14,911	1,194	--	16,105	10.5	
Other collateralized mortgage obligations	3,745	249	--	3,994	2.6	
	$151,694	$2,264	$(55)	$153,903	100.0	%

	December 31, 2009					
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Percent of Total	
U.S. Government and agency obligations	$53,732	$22	$(642)	$53,112	55.5	%
Mortgage-backed or related securities:						
FHLMC collateralized mortgage obligations	17,410	223	--	17,633	18.4	
GNMA certificates	17,741	716	--	18,457	19.3	
Other collateralized mortgage obligations	6,291	174	--	6,465	6.8	
	$					