BANNER CORP
Form 10-Q
November 06, 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 September 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 (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 [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.

Accelerated filer [x] Non-accelerated filer [ ]

Large 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, 2012
Common Stock, $.01 par value per share	19,454,965 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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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,” “probably,” “outlook” or similar expressions or future or conditional verbs such as “may,” “will,” “should,” “would” and “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 including changes related to Basel III; the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the implementing regulations; our ability to attract and retain deposits; 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)
September 30, 2012 and December 31, 2011

	September 30 2012	December 31 2011
ASSETS		
Cash and due from banks	$203,756	$132,436
Securities—trading, amortized cost $92,017 and $112,663, respectively	72,593	80,727
Securities—available-for-sale, amortized cost $456,228 and $462,579, respectively	459,958	465,795
Securities—held-to-maturity, fair value $95,176 and $80,107, respectively	88,626	75,438
Federal Home Loan Bank stock	37,038	37,371
Loans receivable:		
Held for sale	6,898	3,007
Held for portfolio	3,206,625	3,293,331
Allowance for loan losses	(78,783)	(82,912)
	3,134,740	3,213,426
Accrued interest receivable	16,118	15,570
Real estate owned, held for sale, net	20,356	42,965
Property and equipment, net	89,202	91,435
Intangible assets, net	4,740	6,331
Bank-owned life insurance (BOLI)	60,395	58,563
Deferred tax assets, net	41,474	—
Other assets	39,668	37,255
	$4,268,664	$4,257,312
LIABILITIES		
Deposits:		
Non-interest-bearing	$918,962	$777,563
Interest-bearing transaction and savings accounts	1,480,234	1,447,594
Interest-bearing certificates	1,087,176	1,250,497
	3,486,372	3,475,654
Advances from FHLB at fair value	10,367	10,533
Other borrowings	82,275	152,128
Junior subordinated debentures at fair value (issued in connection with Trust Preferred Securities)	73,071	49,988
Accrued expenses and other liabilities	36,109	23,253
Deferred compensation	14,375	13,306
	3,702,569	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, 73,416 and 124,000 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively	72,242	120,702
Common stock and paid in capital - $0.01 par value per share, 50,000,000 shares authorized, 19,454,879 shares issued: 19,420,539 shares and 17,519,132 shares outstanding at September 30, 2012 and December 31, 2011, respectively	567,659	531,149
Accumulated deficit	(74,212)	(119,465)
Accumulated other comprehensive income	2,393	2,051
Unearned shares of common stock issued to Employee Stock Ownership Plan (ESOP) trust at cost 34,340 restricted shares outstanding at September 30, 2012 and December	(1,987)	(1,987)

31, 2011		
	566,095	532,450
	$4,268,664	$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 Nine Months Ended September 30, 2012 and 2011

	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
INTEREST INCOME:				
Loans receivable	$43,953	$45,641	$131,981	$139,242
Mortgage-backed securities	1,089	799	3,011	2,533
Securities and cash equivalents	2,132	3,121	6,645	7,337
	47,174	49,561	141,637	149,112
INTEREST EXPENSE:				
Deposits	3,536	6,169	12,019	20,995
FHLB advances	64	64	191	306
Other borrowings	71	559	694	1,706
Junior subordinated debentures	805	1,041	2,619	3,120
	4,476	7,833	15,523	26,127
Net interest income before provision for loan losses	42,698	41,728	126,114	122,985
PROVISION FOR LOAN LOSSES	3,000	5,000	12,000	30,000
Net interest income	39,698	36,728	114,114	92,985
OTHER OPERATING INCOME:				
Deposit fees and other service charges	6,681	6,096	18,833	17,068
Mortgage banking operations	3,397	1,401	8,901	3,218
Loan servicing fees, net of amortization and impairment	377	289	937	942
Miscellaneous	1,146	586	2,182	1,448
	11,601	8,372	30,853	22,676
Gain on sale of securities	19	—	48	—
Other-than-temporary impairment recovery (loss)	(409)	3,000	(409)	3,000
Net change in valuation of financial instruments carried at fair value	473	(1,032)	(16,901)	1,163
Total other operating income	11,684	10,340	13,591	26,839
OTHER OPERATING EXPENSES:				
Salary and employee benefits	19,614	18,226	58,514	53,769
Less capitalized loan origination costs	(2,655)	(1,929)	(7,652)	(5,597)
Occupancy and equipment	5,811	5,352	16,492	16,182
Information/computer data services	1,807	1,547	5,068	4,635
Payment and card processing expenses	2,335	2,132	6,341	5,718
Professional services	993	1,950	3,561	4,807
Advertising and marketing	1,897	1,602	5,613	5,245
Deposit insurance	791	1,299	2,970	4,657
State/municipal business and use taxes	582	553	1,715	1,591
REO operations	(1,304)	6,698	3,263	17,897
Amortization of core deposit intangibles	508	554	1,583	1,721
Miscellaneous	2,976	3,054	9,466	8,812
Total other operating expenses	33,355	41,038	106,934	119,437
Income before provision for income taxes	18,027	6,030	20,771	387
PROVISION FOR (BENEFIT FROM) INCOME TAXES	2,407	—	(29,423)	—

NET INCOME	15,620	6,030	50,194	387
PREFERRED STOCK DIVIDEND, DISCOUNT ACCRETION AND GAINS				
Preferred stock dividend	1,227	1,550	4,327	4,650
Preferred stock discount accretion	1,216	425	2,124	1,276
Gain on repurchase and retirement of preferred stock	(2,070)	—	(2,070)	—
NET INCOME (LOSS) AVAILABLE TO COMMON SHAREHOLDERS	$15,247	$4,055	$45,813	$(5,539)
Earnings (loss) per common share:				
Basic	$0.80	$0.24	$2.49	$(0.33)
Diluted	$0.79	$0.24	$2.48	$(0.33)
Cumulative dividends declared per common share:	$0.01	$0.01	$0.03	$0.09

See Selected Notes to the Consolidated Financial Statements

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
NET INCOME	$15,620	$6,030	$50,194	$387
OTHER COMPREHENSIVE INCOME, NET OF INCOME TAXES:				
Unrealized holding gain during the period, net of deferred income tax provision of $228, $0, $179 and $0, respectively	422	651	335	1,940
Amortization of unrealized gain on tax exempt securities transferred from available-for-sale to held-to-maturity	2	3	7	12
Other comprehensive income	424	654	342	1,952
COMPREHENSIVE INCOME	$16,044	$6,684	$50,536	$2,339

See Selected Notes to the Consolidated Financial Statements

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BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited) (In thousands, except for shares)
For the Nine Months Ended September 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	$532,450
Net income					50,194		50,194
Change in valuation of securities—available-for-sale, net of income tax						335	335
Amortization of unrealized loss on tax exempt securities transferred from available-for-sale to held-to-maturity, net of income tax						7	7
Accretion of preferred stock discount		2,124			(2,124)		—
Accrual of dividends on preferred stock					(4,327)		(4,327)
Repurchase of preferred stock	(50,584)	(50,584)			2,070		(48,514)
Accrual of dividends on common stock ($.03/share cumulative)					(560)		(560)
Proceeds from issuance of common stock for stockholder reinvestment program			1,814,234	36,314			36,314
Amortization of compensation related to restricted stock grant			87,173	189			189
Amortization of compensation related to stock options				7			7
BALANCE, September 30, 2012	73,416	$72,242	19,420,539	$565,672	$ (74,212)	$ 2,393	$566,095

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 Deficit)	Accumulated Other Comprehensive Income	Stockholders' Equity
	Shares	Amount	Shares	Amount			
Balance, January 1, 2011	124,000	$119,000	16,130,441	$507,470	$ (115,348)	$ 350	$511,472
Net income					5,457		5,457
Change in valuation of securities—available-for-sale, net of income tax						1,685	1,685
Amortization of unrealized loss on tax exempt securities transferred from available-for-sale to held-to-maturity, net of income tax						16	16
Accretion of preferred stock discount		1,701			(1,701)		—
Accrual of dividends on preferred stock					(6,200)		(6,200)
Accrual of dividends on common stock ($.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

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

	Nine Months Ended September 30 2012	2011
OPERATING ACTIVITIES:		
Net income	$50,194	$387
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	6,048	6,509
Deferred income and expense, net of amortization	1,871	1,207
Amortization of core deposit intangibles	1,583	1,721
Other-than-temporary impairment (recovery) or loss	409	(3,000)
Net change in valuation of financial instruments carried at fair value	16,901	(1,163)
Purchases of securities-trading	(2,161)	—
Proceeds from sales of securities-trading	2,170	—
Principal repayments and maturities of securities—trading	13,838	11,305
Increase in deferred taxes	(41,474)	—
Increase in current taxes payable	10,177	—
Equity-based compensation	195	91
Increase in cash surrender value of bank-owned life insurance	(1,489)	(1,405)
Gain on sale of loans, net of capitalized servicing rights	(6,117)	(1,992)
(Gain) loss on disposal of real estate held for sale and property and equipment	(3,645)	1,254
Provision for losses on loans and real estate held for sale	16,451	42,407
Origination of loans held for sale	(369,251)	(186,341)
Proceeds from sales of loans held for sale	371,477	187,830
Net change in:		
Other assets	(2,000)	16,308
Other liabilities	3,678	(677)
Net cash provided from operating activities	68,855	74,441
INVESTING ACTIVITIES:		
Purchases of available-for-sale securities	(299,985)	(420,910)
Principal repayments and maturities of available-for-sale securities	290,440	224,716
Proceeds from sales of securities available-for-sale	13,282	13,179
Purchases of securities held-to-maturity	(16,115)	(11,303)
Principal repayments and maturities of securities held-to-maturity	2,800	7,066
Principal repayments of loans, net of originations	63,755	92,156
Purchases of loans and participating interest in loans	(4,863)	(620)
Purchases of property and equipment	(3,823)	(2,486)
Proceeds from sale of real estate held for sale, net	33,516	66,653
Other	(8)	(169)
Net cash provided from (used by) investing activities	78,999	(31,718)
FINANCING ACTIVITIES:		
Increase (decrease) in deposits, net	10,718	(53,764)
Repayment of FHLB advances	(4)	(32,804)
Decrease in other borrowings, net	(69,853)	(36,109)
Cash dividends paid	(5,195)	(7,107)

Cash proceeds from issuance of stock for stockholder reinvestment plan	36,314	13,736
Repurchase of preferred stock	(48,514)	—
Net cash used by financing activities	(76,534)	(116,048)
NET INCREASE (DECREASE) IN CASH AND DUE FROM BANKS	71,320	(73,325)
CASH AND DUE FROM BANKS, BEGINNING OF PERIOD	132,436	361,652
CASH AND DUE FROM BANKS, END OF PERIOD	$203,756	$288,327

(Continued on next page)

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

	Nine Months Ended September 30	
	2012	2011
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid in cash	$16,585	$28,231
Taxes paid (received) in cash	2,579	(13,048)
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	11,632	45,880

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 September 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 utilized $4.0 million of the remaining $7.0 million in valuation allowance to offset a portion of its tax expense in the third quarter of 2012 and anticipates utilizing the remaining $3.0 million to offset tax expense in the fourth quarter 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 $3.0 million at September 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 (14,535 restricted shares) that will vest in one-third increments over a three-year period to Mark J. Grescovich, President and Chief Executive Officer of Banner Corporation and Banner Bank. Subsequent to that initial issuance from this new plan was the issuance of 77,500 additional shares to certain other officers of the Company. All of these shares also vest in one-third annual increments over the subsequent three-year period following the grant.

Preferred Stock: On March 29, 2012, the Company's $124 million of senior preferred stock with a liquidation value of $1,000 per share, 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 did not change the Company's capital position or accounting for these securities, it did 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 Banner common stock. During the third quarter of 2012, the Company repurchased 50,584 shares or 41% of its preferred stock in private transactions for $48.5 million at an average price of $959 per share. As a result, the Company realized gains of $2.1 million on the repurchases, which was partially offset by accelerated amortization of a portion of the initial discount recorded at the issuance of the preferred shares. In addition, the accrual of the quarterly dividend was reduced by the retirement of the repurchased shares.

Note 3: ACCOUNTING STANDARDS RECENTLY ADOPTED

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):

	September 30 2012	December 31 2011	September 30 2011
Interest-bearing deposits included in cash and due from banks	$143,251	$69,758	$234,824
U.S. Government and agency obligations	159,885	341,606	292,012
Municipal bonds:			
Taxable	26,742	18,497	15,220
Tax exempt	106,171	88,963	92,432
Total municipal bonds	132,913	107,460	107,652
Corporate bonds	40,505	42,565	52,238
Mortgage-backed or related securities:			
Fannie Mae (FNMA)	158,334	66,519	47,177
Freddie Mac (FHLMC)	65,661	42,001	25,350
Ginnie Mae (GNMA)	29,665	19,572	20,815
Private issuer	1,412	1,835	2,589
Total mortgage-backed or related securities	255,072	129,927	95,931
Asset-backed securities:			
Student Loan Marketing Association (SLMA)	32,752	—	—
Equity securities (excludes FHLB stock)	50	402	545
Total securities	621,177	621,960	548,378
FHLB stock	37,038	37,371	37,371
	$801,466	$729,089	$820,573

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

	September 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	$1,380	$1,642	2.3	%	$2,401	$2,635	3.3	%
Municipal bonds:								
Taxable	—	—	—		391	420	0.5	
Tax exempt	5,439	5,535	7.6		5,431	5,542	6.9	
Total municipal bonds	5,439	5,535	7.6		5,822	5,962	7.4	
Corporate bonds	57,820	35,180	48.4		63,502	35,055	43.4	
Mortgage-backed or related securities:								
FNMA	19,383	21,543	29.7		23,489	25,427	31.5	
FHLMC	7,981	8,643	11.9		10,535	11,246	13.9	
Total mortgage-backed or related securities	27,364	30,186	41.6		34,024	36,673	45.4	
Equity securities	14	50	0.1		6,914	402	0.5	
	$92,017	$72,593	100.0	%	$112,663	$80,727	100.0	%

There were three sales of securities—trading totaling $2.2 million with a resulting gain of $10,000 during the nine months ended September 30, 2012. There were no sales of securities—trading during the nine months ended September 30, 2011. The Company recognized $409,000 in OTTI charges on securities—trading related to certain equity securities issued by government sponsored entities during the nine months ended September 30, 2012 and no OTTI charges during the nine months ended September 30, 2011. At September 30, 2012, there were no securities—trading in a nonaccrual status. At September 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 September 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.

	September 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	1,543	1,614	1,545	1,626
Due after five years through ten years	4,076	4,101	4,087	4,123
Due after ten years through twenty years	1,626	1,645	6,544	6,184
Due after twenty years	57,394	34,997	58,549	30,710
	64,639	42,357	71,725	43,652
Mortgage-backed securities	27,364	30,186	34,024	36,673
Equity securities	14	50	6,914	402
	$92,017	$72,593	$112,663	$80,727

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

	September 30, 2012				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Percent of Total
U.S. Government and agency obligations	$157,662	$584	$(4)	$158,242	34.4 %
Municipal bonds:					
Taxable	15,940	268	(41)	16,167	3.5
Tax exempt	23,571	269	(4)	23,836	5.2
Total municipal bonds	39,511	537	(45)	40,003	8.7
Corporate bonds	4,027	48	—	4,075	0.9
Mortgage-backed or related securities:					
FNMA	135,929	1,276	(414)	136,791	29.7
FHLMC	56,631	476	(89)	57,018	12.4
GNMA	28,533	1,211	(79)	29,665	6.5
Private issuer	1,329	83	—	1,412	0.3
Total mortgage-backed or related securities	222,422	3,046	(582)	224,886	48.9
Asset-backed securities:					
SLMA	32,606	194	(48)	32,752	7.1
	$456,228	$4,409	$(679)	$459,958	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)	30,755	6.6
FNMA	40,897	310	(115)	41,092	8.8
GNMA	18,145	1,427	—	19,572	4.2
Private issuer	1,735	100	—	1,835	0.4
Total mortgage-backed or related securities	91,281	2,121	(148)	93,254	20.0
	$462,579	$3,438	$(222)	$465,795	100.0 %

At September 30, 2012 and December 31, 2011, an aging of unrealized losses and fair value of related securities—available-for-sale was as follows (in thousands):

	September 30, 2012					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government and agency obligations	$11,054	$(4)	$—	$—	$11,054	$(4)
Municipal bonds:						
Taxable	5,224	(41)	—	—	5,224	(41)
Tax exempt	2,519	(4)	—	—	2,519	(4)
Total municipal bonds	7,743	(45)	—	—	7,743	(45)
Mortgage-backed or related securities:						
FNMA	48,467	(414)	—	—	48,467	(414)
FHLMC	17,239	(89)	—	—	17,239	(89)
GNMA	9,417	(79)	—	—	9,417	(79)
Total mortgage-backed or related securities	75,123	(582)	—	—	75,123	(582)
Asset-backed securities:						
SLMA	5,013	(48)	—	—	5,013	(48)
	$98,933	$(679)	$—	$—	$98,933	$(679)

	December 31, 2011					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government and agency obligations	$74,326	$(56)	$—	$—	$74,326	$(56)
Municipal bonds:						
Taxable	3,599	(2)	—	—	3,599	(2)
Tax exempt	4,075	(16)	—	—	4,075	(16)
Total municipal bonds	7,674	(18)	—	—	7,674	(18)
Mortgage-backed or related securities:						
FNMA	27,332	(115)	—	—	27,332	(115)
FHLMC	6,556	(33)	—	—	6,556	(33)
Total mortgage-backed or related securities	33,888	(148)	—	—	33,888	(148)
	$115,888	$(222)	$—	$—	$115,888	$(222)

Proceeds from the sale of three securities—available-for-sale during the nine months ended September 30, 2012 were $13.3 million with a resulting gain of $38,000 compared to proceeds of $13.2 million from the sale of three securities with no resulting gain or loss during the nine months ended September 30, 2011. At September 30, 2012, there were 23 securities—available for sale with unrealized losses, compared to 26 securities at December 31, 2011. Management does not believe that any individual unrealized loss as of September 30, 2012 represents OTTI. The decline in fair market values of these securities was generally due to changes in interest rates and changes in market-desired spreads subsequent to their purchase.

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The amortized cost and estimated fair value of securities—available-for-sale at September 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.

	September 30, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$17,266	$17,301	$19,520	$19,602
Due after one year through five years	157,169	158,130	312,862	313,930
Due after five years through ten years	37,693	37,776	38,916	39,009
Due after ten years through twenty years	21,678	21,865	—	—
Due after twenty years	—	—	—	—
	233,806	235,072	371,298	372,541
Mortgage-backed securities	222,422	224,886	91,281	93,254
	$456,228	$459,958	$462,579	$465,795

Securities—Held-to-Maturity: The amortized cost and estimated fair value of securities—held-to-maturity at September 30, 2012 and December 31, 2011 are summarized as follows (dollars in thousands):

	September 30, 2012				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Percent of Total
Municipal bonds:					
Taxable	$10,575	$462	$(91)	$10,946	11.5 %
Tax exempt	76,801	6,179	—	82,980	87.2
Total municipal bonds	87,376	6,641	(91)	93,926	98.7
Corporate bonds	1,250	—	—	1,250	1.3
	$88,626	$6,641	$(91)	$95,176	100.0 %

	December 31, 2011				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Percent of Total
Municipal bonds:					
Taxable	$7,496	$390	$—	$7,886	9.8 %
Tax exempt	66,692	4,281	—	70,973	88.6
Total municipal bonds	74,188	4,671	—	78,859	98.4
Corporate bonds	1,250	—	(2)	1,248	1.6
	$75,438	$4,671	$(2)	$80,107	100.0 %

At September 30, 2012 and December 31, 2011, an age analysis of unrealized losses and fair value of related securities—held-to-maturity was as follows (in thousands):

	September 30, 2012					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Municipal bonds:						
Taxable	$4,238	$(91)	$—	$—	$4,238	$(91)
	$4,238	$(91)	$—	$—	$4,238	$(91)

	December 31, 2011					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate bonds	$—	—	$498	$(2)	$498	$(2)
	$—	—	$498	$(2)	$498	$(2)

There were no sales of securities—held-to-maturity during the nine months ended September 30, 2012 and 2011. The Company recognized no OTTI charges on securities—held-to-maturity during the nine months ended September 30, 2012. During the same period in 2011, we did recognize $3.0 million from the recovery of one security—held-to-maturity which had previously been charged off as OTTI in the previous year; however, there were no other OTTI charges for the nine months ended September 30, 2011. As of September 30, 2012, there were no securities—held-to-maturity in a nonaccrual status. There were two securities—held-to-maturity with unrealized losses at September 30, 2012 and December 31, 2011, respectively. Management does not believe that any individual unrealized loss as of September 30, 2012 represents OTTI. The decline in fair market value of these securities was generally due to changes in interest rates and changes in market-desired spreads subsequent to their purchase.

The amortized cost and estimated fair value of securities—held-to-maturity at September 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.

	September 30, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$4,152	$4,164	$2,707	$2,768
Due after one year through five years	14,539	15,332	14,420	15,150
Due after five years through ten years	11,395	11,823	9,726	10,254
Due after ten years through twenty years	56,248	61,334	46,741	49,936
Due after twenty years	2,292	2,523	1,844	1,999
	$88,626	$95,176	$75,438	$80,107

Pledged Securities: The following table presents, as of September 30, 2012, investment securities which were pledged to secure borrowings, public deposits or other obligations as permitted or required by law (in thousands):

	Amortized Cost	Fair Value
Purpose or beneficiary:		
State and local governments public deposits	$92,740	$99,358
Interest rate swap counterparties	10,841	11,025
Retail repurchase agreements	101,315	104,036
Other	5,976	6,149
Total pledged securities	$210,872	$220,568

Note 6: FHLB STOCK

The Banks' investments in Federal Home Loan Bank of Seattle stock are carried at par value ($100 per share), which reasonably approximates its fair value. As members of the FHLB system, the Banks are required to maintain a minimum level of investment in FHLB stock based on specific percentages of their outstanding FHLB advances. For the three and nine months ended September 30, 2012 and 2011, the Banks did not receive any dividend income on FHLB stock. At September 30, 2012 and December 31, 2011, respectively, the Company had recorded $37.0 million and $37.4 million in FHLB stock. This stock is generally viewed as a long-term investment and is carried at par. It does not have a readily determinable fair value. Ownership of FHLB stock is restricted to the FHLB and member institutions and can only be purchased and redeemed at par.

Management periodically evaluates FHLB stock for impairment. Management's determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB. The FHLB has communicated that it believes the calculation of risk-based capital under the current rules of the FHFA significantly overstates the market risk of the FHLB's private-label mortgage-backed securities in the current market environment and that it has enough capital to cover the risks reflected in its balance sheet. As a result, as of September 30, 2012, the Company has not recorded an impairment on its investment in FHLB stock. However, deterioration in the FHLB's financial position could result in impairment in the value of those securities. In addition, on October 25, 2010, the FHLB of Seattle received a Consent Order from the FHFA. The FHLB of Seattle reported, in its earnings release for the quarter ended June 30, 2012, that it continues to address the requirements of the Consent Agreement and that, as of June 30, 2012, it met all minimum financial metrics required under the Consent Agreement. Further, the FHLB of Seattle announced September 7, 2012 that the FHFA now considers the FHLB of Seattle to be adequately capitalized. Any dividends on, or repurchases of, the FHLB of Seattle stock continue to require consent of the FHFA. The FHFA recently approved the FHLB of Seattle repurchase of a portion of its stock and $333,000 of FHLB of Seattle stock was purchased from Banner Bank on September 24, 2012. The Company will continue to monitor the financial condition of the FHLB of Seattle as it relates to, among other things, the recoverability of Banner's investment.

Note 7: LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES

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 the lower of cost or estimated market value determined on an aggregate basis. Net unrealized losses on loans held for sale are recognized through a valuation allowance by charges to income. The Banks also originate construction, land and land development, commercial and multifamily real estate, commercial business, agricultural business 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.

Loans receivable, including loans held for sale, at September 30, 2012, December 31, 2011 and September 30, 2011 are summarized as follows (dollars in thousands):

	September 30, 2012			December 31, 2011			September 30, 2011		
	Amount	Percent of Total		Amount	Percent of Total		Amount	Percent of Total	
Commercial real estate									
Owner-occupied	$477,871	14.9	%	$469,806	14.2	%	$474,863	14.7	%
Investment properties	604,265	18.8		621,622	18.9		586,652	18.2	
Multifamily real estate	138,716	4.3		139,710	4.2		134,146	4.2	
Commercial construction	28,598	0.9		42,391	1.3		38,124	1.2	
Multifamily construction	14,502	0.5		19,436	0.6		16,335	0.5	
One- to four-family construction	163,521	5.1		144,177	4.4		145,776	4.5	
Land and land development									
Residential	79,932	2.5		97,491	3.0		96,875	3.0	
Commercial	14,242	0.4		15,197	0.5		19,173	0.6	
Commercial business	603,606	18.8		601,440	18.2		580,876	18.0	
Agricultural business, including secured by farmland	219,084	6.8		218,171	6.6		211,571	6.6	
One- to four-family real estate	594,413	18.5		642,501	19.5		639,909	19.8	
Consumer	103,393	3.2		103,347	3.1		98,794	3.1	
Consumer secured by one- to four-family	171,380	5.3		181,049	5.5		182,152	5.6	
Total consumer	274,773	8.5		284,396	8.6		280,946	8.7	
Total loans outstanding	3,213,523	100.0	%	3,296,338	100.0	%	3,225,246	100.0	%
Less allowance for loan losses	(78,783	)		(82,912	)		(86,128	)	
Net loans	$3,134,740			$3,213,426			$3,139,118		

Loan amounts are net of unearned, unamortized loan fees (and costs) of $9 million, as of September 30, 2012, and $10 million as of December 31, 2011 and September 30, 2011.

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The Company's loans by geographic concentration at September 30, 2012 were as follows (dollars in thousands):

	Washington	Oregon	Idaho	Other	Total
Commercial real estate					
Owner-occupied	$360,406	$53,929	$58,799	$4,737	$477,871
Investment properties	471,723	81,874	44,187	6,481	604,265
Multifamily real estate	117,769	13,190	7,436	321	138,716
Commercial construction	20,030	4,998	2,159	1,411	28,598
Multifamily construction	9,498	5,004	—	—	14,502
One- to four-family construction	88,350	73,375	1,796	—	163,521
Land and land development					
Residential	39,181	38,781	1,970	—	79,932
Commercial	9,205	3,107	1,930	—	14,242
Commercial business	387,598	75,609	59,461	80,938	603,606
Agricultural business, including secured by farmland	109,099	45,418	64,567	—	219,084
One- to four-family real estate	365,510	201,898	24,542	2,463	594,413
Consumer	66,837	31,154	5,402	—	103,393
Consumer secured by one- to four-family	116,127	43,054	11,668	531	171,380
Total consumer	182,964	74,208	17,070	531	274,773
Total loans	$2,161,333	$671,391	$283,917	$96,882	$3,213,523
Percent of total loans	67.3 %	20.9 %	8.8 %	3.0 %	100.0 %

The geographic concentrations of the Company's land and land development loans by state at September 30, 2012 were as follows (dollars in thousands):

	Washington	Oregon	Idaho	Total
Residential:				
Acquisition and development	$6,229	$15,820	$1,710	$23,759
Improved land and lots	22,727	20,273	260	43,260
Unimproved land	10,225	2,688	—	12,913
Commercial:				
Acquisition and development	1,370	—	484	1,854
Improved land and lots	3,470	138	558	4,166
Unimproved land	4,365	2,969	888	8,222
Total land and land development loans	$48,386	$41,888	$3,900	$94,174
Percent of land and land development loans	51.4 %	44.5 %	4.1 %	100.0 %

The Company originates both adjustable- and fixed-rate loans. The maturity and repricing composition of those loans, less undisbursed amounts and deferred fees, at September 30, 2012, December 31, 2011 and September 30, 2011 were as follows (in thousands):

	September 30, 2012	December 31, 2011	September 30, 2011
Fixed-rate (term to maturity):			
Due in one year or less	$185,379	$216,782	$194,153
Due after one year through three years	168,307	250,715	237,087
Due after three years through five years	168,348	182,647	170,747
Due after five years through ten years	165,973	157,559	162,461
Due after ten years	456,758	502,196	494,989
Total fixed-rate loans	1,144,765	1,309,899	1,259,437
Adjustable-rate (term to rate adjustment):			
Due in one year or less	1,283,783	1,200,182	1,172,572
Due after one year through three years	291,778	425,309	431,373
Due after three years through five years	441,773	336,382	336,984
Due after five years through ten years	45,951	23,618	23,932
Due after ten years	5,473	948	948
Total adjustable-rate loans	2,068,758	1,986,439	1,965,809
Total loans	$3,213,523	$3,296,338	$3,225,246

The adjustable-rate loans have interest rate adjustment limitations and are generally indexed to various prime (The Wall Street Journal) or LIBOR rates, One to Five Year Constant Maturity Treasury Indices or FHLB advance 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 were primarily utilized to fund these loans.

Impaired Loans and the Allowance for Loan Losses. A loan is considered impaired when, based on current information and circumstances, the Company determines it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan agreement, including scheduled interest payments. Impaired loans are comprised of loans on nonaccrual, TDRs that are performing under their restructured terms, and loans that are 90 days or more past due, but are still on accrual.

The amount of impaired loans and the related allocated reserve for loan losses as of September 30, 2012 and December 31, 2011 were as follows (in thousands):

	September 30, 2012		December 31, 2011	
	Loan Amount	Allocated Reserves	Loan Amount	Allocated Reserves
Impaired loans:				
Nonaccrual loans				
Commercial real estate				
Owner-occupied	$2,895	$111	$4,306	$281
Investment properties	2,679	62	4,920	626
Multifamily real estate	—	—	362	11
Commercial construction	—	—	949	—
One- to four-family construction	3,271	40	6,622	1,921
Land and land development				
Residential	3,840	519	19,060	1,485
Commercial	340	9	1,100	45
Commercial business	6,158	220	13,460	1,871
Agricultural business/farmland	645	66	1,896	629
One- to four-family residential	14,234	571	17,408	243
Consumer	1,168	13	1,115	62
Consumer secured by one- to four-family	1,403	25	1,790	23
Total consumer	2,571	38	2,905	85
Total nonaccrual loans	$36,633	$1,636	$72,988	$7,197
Past due and still accruing	2,078	3	2,324	19
TDRs on accrual status	62,438	6,523	54,533	3,100
Total impaired loans	$101,149	$8,162	$129,845	$10,316

As of September 30, 2012, the Company had additional commitments to advance funds up to an amount of $2.6 million related to TDRs.

The following tables provide additional information on impaired loans with and without specific allowance reserves as of September 30, 2012 and December 31, 2011 (in thousands):

	At or For the Nine Months Ended September 30, 2012				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Without a specific allowance reserve [1]					
Commercial real estate					
Owner-occupied	$2,186	$2,437	$134	$2,355	$—
Investment properties	649	886	96	769	—
Multifamily real estate	2,134	2,134	433	2,137	—
One- to four-family construction	5,816	5,878	516	5,066	118
Land and land development					
Residential	2,383	2,994	467	3,094	15
Commercial	46	46	9	46	—
Commercial business	3,728	3,924	810	3,810	1
Agricultural business/farmland	645	1,328	66	923	—
One- to four-family residential	22,220	23,585	201	22,530	17
Consumer	953	1,053	13	1,048	—
Consumer secured by one- to four-family	1,642	2,061	54	1,773	12
	42,402	46,326	2,799	43,551	163
With a specific allowance reserve [2]					
Commercial real estate					
Owner-occupied	$2,481	$2,481	$4	$2,500	$—
Investment properties	9,386	10,372	951	9,642	—
Multifamily real estate	5,000	5,000	1,414	5,000	—
One- to-four family construction	6,384	6,460	667	5,181	131
Land and land development					
Residential	7,342	11,535	772	7,894	—
Commercial	294	454	—	383	—
Commercial business	6,115	7,447	383	7,683	—
One- to four-family residential	20,719	21,277	1,139	19,970	38
Consumer	727	743	33	743	—
Consumer secured by one- to four-family	299	398	—	294	—
	58,747	66,167	5,363	59,290	169
Total					
Commercial real estate					
Owner-occupied	$4,667	$4,918	$138	$4,855	$—
Investment properties	10,035	11,258	1,047	10,411	—
Multifamily real estate	7,134	7,134	1,847	7,137	—
One- to four-family construction	12,200	12,338	1,183	10,247	249
Land and land development					
Residential	9,725	14,529	1,239	10,988	15
Commercial	340	500	9	429	—
Commercial business	9,843	11,371	1,193	11,493	1
Agricultural business/farmland	645	1,328	66	923	—
One- to four-family residential	42,939	44,862	1,340	42,500	55
Consumer	1,680	1,796	46	1,791	—
Consumer secured by one- to four-family	1,941	2,459	54	2,067	12

$101,149	$112,493	$8,162	$102,841	$332

	At or For the Year Ended December 31, 2011				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Without a specific allowance reserve (1)					
Commercial real estate					
Owner-occupied	$852	$853	$78	$874	$—
Investment properties	1,576	1,618	261	1,728	9
Multifamily real estate	452	452	6	456	32
One- to four-family construction	5,429	5,488	437	5,580	242
Land and land development					
Residential	4,064	4,679	1,176	4,524	99
Commercial	645	645	45	616	—
Commercial business	5,173	5,535	932	5,587	81
Agricultural business/farmland	412	632	37	529	—
One- to four-family residential	27,529	28,121	277	27,933	919
Consumer	559	666	5	624	7
Consumer secured by one- to four-family	1,707	2,162	29	2,042	22
	48,398	50,851	3,283	50,493	1,411
With a specific allowance reserve (2)					
Commercial real estate					
Owner-occupied	$3,643	$4,013	$207	$3,901	$13
Investment properties	11,750	14,200	1,485	13,471	424
Multifamily real estate	1,997	1,997	11	1,967	82
Commercial construction	949	1,493	—	1,465	—
One- to-four family construction	9,556	9,821	1,998	9,185	277
Land and land development					
Residential	20,331	34,068	616	36,747	220
Commercial	454	454	—	454	—
Commercial business	12,889	13,333	1,404	13,721	144
Agricultural business/farmland	1,483	1,671	592	1,855	—
One- to four-family residential	16,877	18,301	658	17,555	469
Consumer	915	915	62	881	18
Consumer secured by one- to four-family	603	630	—	585	—
	81,447	100,896	7,033	101,787	1,647
Total					
Commercial real estate					
Owner-occupied	$4,495	$4,866	$285	$4,775	$13
Investment properties	13,326	15,818	1,746	15,199	433
Multifamily real estate	2,449	2,449	17	2,423	114
Commercial construction	949	1,493	—	1,465	—
One- to four-family construction	14,985	15,309	2,435	14,765	519
Land and land development					
Residential	24,395	38,747	1,792	41,271	319
Commercial	1,099	1,099	45	1,070	—
Commercial business	18,062	18,868	2,336	19,308	225
Agricultural business/farmland	1,895	2,303	629	2,384	—
One- to four-family residential	44,406	46,422	935	45,488	1,388
Consumer	1,474	1,581	67	1,505	25

Consumer secured by one- to four-family	2,310	2,792	29	2,627	22
	$129,845	$151,747	$10,316	$152,280	$3,058

(Footnotes on following page)

Footnotes for Tables of Impaired Loans with and without Specific Allowance Reserves

(1) Loans without a specific allowance reserve have not been individually evaluated for impairment, but have been included in pools of homogeneous loans for evaluation of related allowance reserves.

(2) Loans with a specific allowance reserve have been individually evaluated for impairment using either a discounted cash flow analysis or, for collateral dependent loans, current appraisals to establish realizable value. These analyses may identify a specific impairment amount needed or may conclude that no reserve is needed. Any specific impairment that is identified is included in the category's Related Allowance column.

Troubled Debt Restructures. Some of the Company's loans are reported as troubled debt restructurings (TDRs). Loans are reported as TDRs when the bank grants a concession(s) to a borrower experiencing financial difficulties that it would not otherwise consider. Examples of such concessions include forgiveness of principal or accrued interest, extending the maturity date(s) or providing a lower interest rate than would be normally available for a transaction of similar risk. As a result of these concessions, restructured loans are impaired as the bank will not collect all amounts due, both principal and interest, in accordance with the terms of the original loan agreement. Loans identified as TDRs are accounted for in accordance with the Banks' impaired loan accounting policies.

The following tables present TDRs at September 30, 2012 and December 31, 2011 (in thousands):

	September 30, 2012		
	Accrual Status	Nonaccrual Status	Total Modifications
Commercial real estate			
Owner-occupied	$1,772	$1,111	$2,883
Investment properties	7,357	1,448	8,805
Multifamily real estate	7,134	—	7,134
One-to-four family construction	8,929	2,518	11,447
Land and land development			
Residential	5,884	210	6,094
Commercial	—	—	—
Commercial business	3,669	274	3,943
One- to four-family residential	26,668	2,911	29,579
Consumer	491	398	889
Consumer secured by one-to-four family	534	502	1,036
Total consumer	1,025	900	1,925
	$62,438	$9,372	$71,810

	December 31, 2011		
	Accrual Status	Nonaccrual Status	Total Modifications
Commercial real estate			
Owner-occupied	$—	$142	$142
Investment properties	7,751	1,822	9,573
Multifamily real estate	2,088	—	2,088
One-to-four family construction	8,362	271	8,633
Land and land development			
Residential	5,334	557	5,891
Commercial	—	949	949
Commercial business	4,401	—	4,401
One- to four-family residential	23,291	3,086	26,377
Consumer	2,935	3,974	6,909
Consumer secured by one-to-four family	371	549	920
Total consumer	3,306	4,523	7,829
	$54,533	$11,350	$65,883

Loans may be restructured or modified for multiple reasons and the types of restructures that occur can include modifications of: interest rates, payment amount, maturity date, or provide for periods of reduced payments or forgiveness of portions of interest or principal due. Our TDRs have generally not involved forgiveness of amounts due, but almost always include a modification of multiple factors; the most common combination including interest rate, payment amount and maturity date.

The following tables present new TDRs that occurred during the three and nine months ended September 30, 2012 and 2011 (dollars in thousands):

	Three Months Ended September 30, 2012			Nine Months Ended September 30, 2012		
	Number of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment	Number of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
Recorded Investment (1) (2)						
Commercial real estate						
Owner occupied	1	$946	$946	1	$946	$946
Investment properties	3	2,784	2,784	6	3,708	3,708
Multifamily real estate	—	—	—	2	5,054	5,054
One-to-four family construction	11	1,711	1,711	19	4,504	4,504
Land and land development-residential	—	—	—	6	2,059	2,059
Commercial business	3	94	94	9	1,309	1,309
One- to four-family residential	1	153	153	18	9,182	9,182
Consumer	—	—	—	4	371	371
	19	$5,688	$5,688	65	$27,133	$27,133

	Three Months Ended September 30, 2011			Nine Months Ended September 30, 2011		
	Number of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment	Number of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
Recorded Investment (1) (2)						
Commercial real estate						
Owner-occupied	—	$—	$—	1	$189	$189
Investment properties	—	—	—	3	1,976	1,976
Multifamily real estate	1	455	455	3	2,452	2,452
One-to-four family construction	5	1,566	1,566	8	3,848	3,848
Land and land development - residential	3	681	681	3	681	681
Commercial business	2	855	645	3	905	695
One- to four-family residential	—	—	—	4	1,097	1,097
Consumer	—	—	—	3	136	136
	11	$3,557	$3,347	28	$11,284	$11,074

(1) Since most loans were already considered classified and/or on nonaccrual status prior to restructuring, the modifications did not have a material effect on the Company’s determination of the allowance for loan losses.

(2) The majority of these modifications do not fit into one separate type, such as rate, term, amount, interest-only or payment, but instead are a combination of multiple types of modifications; therefore, they are disclosed in aggregate.

The following table presents TDRs which incurred a payment default within twelve months of the restructure date during the three and nine-month periods ended September 30, 2012 and 2011 (in thousands). A default on a TDR results in either a transfer to nonaccrual status or a partial charge-off:

	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Commercial real estate-owner occupied	$—	$—	$1,358	$—
Land and land development - residential	—	2,227	—	2,227
One- to four-family residential	—	—	559	873
Total	$—	$2,227	$1,917	$3,100

Credit Quality Indicators: To appropriately and effectively manage the ongoing credit quality of the Company's loan portfolio, management has implemented a risk-rating or loan grading system for its loans. The system is a tool to evaluate portfolio asset quality throughout each applicable loan's life as an asset of the Company. Generally, loans and leases are risk rated on an aggregate borrower/relationship basis with individual loans sharing similar ratings. There are some instances when specific situations relating to individual loans will provide the basis for different risk ratings within the aggregate relationship. Loans are graded on a scale of 1 to 9. A description of the general characteristics of these categories is shown below:

Overall Risk Rating Definitions: Risk-ratings contain both qualitative and quantitative measurements and take into account the financial strength of a borrower and the structure of the loan or lease. Consequently, the definitions are to be applied in the context of each lending transaction and judgment must also be used to determine the appropriate risk rating, as it is not unusual for a loan or lease to exhibit characteristics of more than one risk-rating category. Consideration for the final rating is centered in the borrower's ability to repay, in a timely fashion, both principal and interest. There were no material changes in the risk-rating or loan grading system in the nine months ended September 30, 2012.

Risk Rating 1: Exceptional
A credit supported by exceptional financial strength, stability, and liquidity. The risk rating of 1 is reserved for the Company's top quality loans, generally reserved for investment grade credits underwritten to the standards of institutional credit providers.

Risk Rating 2: Excellent
A credit supported by excellent financial strength, stability and liquidity. The risk rating of 2 is reserved for very strong and highly stable customers with ready access to alternative financing sources.

Risk Rating 3: Strong
A credit supported by good overall financial strength and stability. Collateral margins are strong; cash flow is stable although susceptible to cyclical market changes.

Risk Rating 4: Acceptable
A credit supported by the borrower's adequate financial strength and stability. Assets and cash flow are reasonably sound and provide for orderly debt reduction. Access to alternative financing sources will be more difficult to obtain.

Risk Rating 5: Watch
A credit with the characteristics of an acceptable credit which requires, however, more than the normal level of supervision and warrants formal quarterly management reporting. Credits in this category are not yet criticized or classified, but due to adverse events or aspects of underwriting require closer than normal supervision. Generally, credits should be watch credits in most cases for six months or less as the impact of stress factors are analyzed.

Risk Rating 6: Special Mention
A credit with potential weaknesses that deserves management's close attention is risk rated a 6. If left uncorrected, these potential weaknesses will result in deterioration in the capacity to repay debt. A key distinction between Special Mention and Substandard is that in a Special Mention credit, there are identified weaknesses that pose potential risk(s) to the repayment sources, versus well defined weaknesses that pose risk(s) to the repayment sources. Assets in this category are expected to be in this category no more than 9-12 months as the potential weaknesses in the credit are resolved.

Risk Rating 7: Substandard

A credit with well defined weaknesses that jeopardize the ability to repay in full is risk rated a 7. These credits are inadequately protected by either the sound net worth and payment capacity of the borrower or the value of pledged collateral. These are credits with a distinct possibility of loss. Loans headed for foreclosure and/or legal action due to deterioration are rated 7 or worse.

Risk Rating 8: Doubtful
A credit with an extremely high probability of loss is risk rated 8. These credits have all the same critical weaknesses that are found in a substandard loan; however, the weaknesses are elevated to the point that based upon current information, collection or liquidation in full is improbable. While some loss on doubtful credits is expected, pending events may strengthen a credit making the amount and timing of any loss indeterminable. In these situations taking the loss is inappropriate until it is clear that the pending event has failed to strengthen the credit and improve the capacity to repay debt.

Risk Rating 9: Loss
A credit that is considered to be currently uncollectible or of such little value that it is no longer a viable Bank asset is risk rated 9. Losses should be taken in the accounting period in which the credit is determined to be uncollectible. Taking a loss does not mean that a credit has absolutely no recovery or salvage value but, rather, it is not practical or desirable to defer writing off the credit, even though partial recovery may occur in the future.

The following table shows the Company's portfolio of risk-rated loans and non-risk-rated loans by grade or other characteristics as of September 30, 2012 and December 31, 2011 (in thousands):

	September 30, 2012							
	Commercial Real Estate	Multifamily Real Estate	Construction and Land	Commercial Business	Agricultural Business	One- to Four-Family Residential	Consumer	Total Loans
Risk-rated loans:								
Pass (Risk Ratings 1-5) (1)	$1,018,552	$131,782	$263,281	$560,320	$217,084	$ 571,146	$268,463	$3,030,628
Special mention	19,223	—	3,267	13,482	331	440	151	36,894
Substandard	44,361	6,934	34,189	29,804	1,669	22,827	6,159	145,943
Doubtful	—	—	58	—	—	—	—	58
Loss	—	—	—	—	—	—	—	—
Total loans	$1,082,136	$138,716	$300,795	$603,606	$219,084	$ 594,413	$274,773	$3,213,523
Performing loans	$1,076,562	$138,716	$293,345	$597,433	$218,438	$ 578,142	$272,176	$3,174,812
Non-performing loans	5,574	—	7,450	6,173	646	16,271	2,597	38,711
Total loans	$1,082,136	$138,716	$300,795	$603,606	$219,084	$ 594,413	$274,773	$3,213,523

	December 31, 2011							
	Commercial Real Estate	Multifamily Real Estate	Construction and Land	Commercial Business	Agricultural Business	One- to Four-Family Residential	Consumer	Total Loans
Risk-rated loans:								
Pass (Risk Ratings 1-5) (1)	$1,003,990	$132,108	$257,685	$542,625	$213,512	$ 607,793	$276,642	$3,034,355
Special mention	29,751	5,000	3,359	13,447	923	772	402	53,654
Substandard	57,687	2,602	57,648	45,032	3,736	33,936	7,352	207,993
Doubtful	—	—	—	336	—	—	—	336
Loss	—	—	—	—	—	—	—	—
Total loans	$1,091,428	$139,710	$318,692	$601,440	$218,171	$ 642,501	$284,396	$3,296,338
Performing loans	$1,082,202	$139,348	$290,961	$587,976	$216,275	$ 622,946	$281,318	$3,221,026
Non-performing loans (2)	9,226	362	27,731	13,464	1,896			