BANNER CORP
Form 10-K
March 04, 2014

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

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2013
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
Securities registered pursuant to Section 12(b) of the Act:

Common Stock, par value $.01 per share	The NASDAQ Stock Market LLC
(Title of Each Class)	(Name of Each Exchange on Which Registered)

Securities registered pursuant to section 12(g) of the Act:
None.
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act Yes __ No X

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act Yes __No X

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 Web site, 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 if disclosure of delinquent filers pursuant to Item 405 of Regulations S-K is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ____

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 definition 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 Act) Yes ____No X

The aggregate market value of the voting and nonvoting common equity held by nonaffiliates of the registrant based on the closing sales price
of the registrant’s common stock quoted on The NASDAQ Stock Market on June 30, 2013, was:
Common Stock – $645,302,700
(The exclusion from such amount of the market value of the shares owned by any person shall not be deemed an admission by the Registrant
that such person is an affiliate of the Registrant.)
The number of shares outstanding of the registrant’s classes of common stock as of February 28, 2014:
Common Stock, $.01 par value – 19,518,834 shares
Documents Incorporated by Reference
Portions of Proxy Statement for Annual Meeting of Shareholders to be held April 22, 2014 are incorporated by reference into Part III.

BANNER CORPORATION AND SUBSIDIARIES

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Forward-Looking Statements

Certain matters in this Form 10-K constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to our financial condition, liquidity, 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,” “projects,” “outlook” or similar expressions o 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 non-performing assets in our loan portfolio, 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 an informal or formal enforcement action against us or any of the Banks 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 as a result of 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 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, including this report on Form 10-K. 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. All references to "Banner" refer to Banner Corporation and those to "the Banks" refer to its wholly-owned subsidiaries, Banner Bank and Islanders Bank, collectively.

PART 1

Item 1 – Business General

Banner Corporation (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 December 31, 2013, its 85 branch offices and eight loan production offices located in Washington, Oregon and Idaho. Islanders Bank is also a Washington-chartered commercial bank that conducts business from three locations in San Juan County, Washington. Banner Corporation is subject to regulation by the Board of Governors of the Federal Reserve System (the Federal Reserve Board). Banner Bank and Islanders Bank (the Banks) are subject to regulation by the Washington State Department of Financial Institutions, Division of Banks (the DFI) and the Federal Deposit Insurance Corporation (the FDIC). As of December 31, 2013, we had total consolidated assets of $4.4 billion, net loans of $3.3 billion, total deposits of $3.6 billion and total stockholders' equity of $539 million. Our common stock is traded on the NASDAQ Global Select Market under the ticker symbol "BANR."

Banner Bank is a regional bank which offers a wide variety of commercial banking services and financial products to individuals, businesses and public sector entities in its primary market areas. Islanders Bank is a community bank which offers similar banking services to individuals, businesses and public entities located primarily in the San Juan Islands. The Banks' primary business is that of traditional banking institutions, accepting deposits and originating loans in locations surrounding our offices in portions of Washington, Oregon and Idaho. Banner Bank is also an active participant in the secondary market, engaging in mortgage banking operations largely through the origination and sale of one- to four-family residential loans. Lending activities include commercial business and commercial real estate loans, agriculture business loans, construction and land development loans, one- to four-family residential loans and consumer loans. A portion of Banner Bank's construction and mortgage lending activities are conducted through its subsidiary, Community Financial Corporation (CFC), which is located in the Lake Oswego area of Portland, Oregon.

Since becoming a public company in 1995, we have invested significantly in expanding our branch and distribution systems with a primary emphasis on strengthening our market presence in our five primary markets in the Northwest. Those markets include the four largest metropolitan areas in the Northwest: the Puget Sound region of Washington and the greater Portland, Oregon, Boise, Idaho, and Spokane, Washington markets, as well as our historical base in the vibrant agricultural communities in the Columbia Basin region of Washington and Oregon. Our aggressive franchise expansion during this period included the acquisition and consolidation of eight commercial banks, as well as the opening of 28 new branches and relocating 12 others. Since changing our name in 2001, we also have invested heavily in advertising campaigns designed to significantly increase the brand awareness for Banner Bank as well as expanded product offerings. These investments, which have been significant elements in our strategies to grow loans, deposits and customer relationships, have increased our presence within desirable marketplaces and allow us to better serve existing and future customers. This emphasis on growth and development resulted in an elevated level of operating expenses during much of this period; however, we believe that the expanded branch network, a broader product line and heightened brand awareness have created a franchise that we believe is well positioned and is allowing us to successfully execute on our super community bank model. That strategy is focused on delivering customers, including middle market and small businesses, business owners, their families and employees, a compelling value proposition by providing the financial sophistication and breadth of products of a regional bank while retaining the appeal, responsiveness, and superior service level of a community bank.

Despite persistently weak economic conditions and exceptionally low interest rates which have created an unusually challenging banking environment for an extended period, Banner Corporation's successful execution of its strategic turnaround plan and operating initiatives, which resulted in our return to profitability in 2011, continued and strengthened in 2012 and 2013 and delivered noteworthy results as evidenced by our solid profitability for both years. Over this period we achieved substantial progress on our goals to achieve and maintain the Company's moderate risk profile as well as to develop and continue strong earnings momentum going forward. Highlights of this success have included substantial improvement in our asset quality, outstanding client acquisition results and account growth, significantly increased non-interest-bearing deposit balances and strong revenue generation from core operations. As a result, for the year ended December 31, 2013, we had net income available to common shareholders of $46.6 million, or $2.40 per diluted share, and for the year ended December 31, 2012, we had net income available to common shareholders of $64.9 million, or $3.16 per diluted share.

Our return to consistent profitability was punctuated in 2012 by management's decision to reverse the valuation allowance against our deferred tax assets. For the year ended December 31, 2012, the elimination of the deferred tax asset valuation allowance, combined with the Company's pre-tax income, resulted in a net tax benefit of $24.8 million which significantly added to our net income for the year. The decision to reverse the valuation allowance reflected our confidence in the sustainability of our future profitability. Further, as a result of our return to profitability, including the recovery of our deferred tax asset, our improved asset quality and operating trends, strong capital position and our expectation for sustainable profitability for the foreseeable future, we also significantly reduced the credit portion of the discount rate utilized to estimate the fair value of the junior subordinated debentures issued by the Company. As a result, the estimated fair value of our junior subordinated debentures increased by $23.1 million during the year, accounting for most of the $16.5 million net charge before taxes for fair value adjustments for the year ended December 31, 2012. Changes in these two significant accounting estimates, while substantial, represented non-cash valuation adjustments that had no effect on our liquidity or our ability to fund our operations.

Our return to consistent profitability was also highlighted in 2012 by the repurchase and redemption of our Class A Senior Preferred Stock and in 2013 by increases in our quarterly dividends to common shareholders. For the year ended December 31, 2013, dividends to common shareholders totaled $0.54 per share, including $0.12 per share for the first two quarters and $0.15 per share for the third and fourth quarters compared to $0.01 per share for each quarter in the year ended December 31, 2012.

Although economic conditions have improved from the depths of the recession resulting in a material decrease in credit costs in recent periods, the pace of recovery has been modest and uneven and ongoing stress in the economy, reflected in high unemployment, tepid consumer spending, modest loan demand and very low interest rates, will likely continue to create a challenging operating environment going forward. Nonetheless, over the past three years we have significantly improved our risk profile by aggressively managing and reducing our problem assets while meaningfully increasing core deposits and performing loans, which has resulted in lower credit costs and stronger revenues, and which we believe has positioned the Company well to meet this challenging environment.

As a result of substantial reserves already in place as well as declining net charge-offs, we did not record a provision for loan losses in year ended December 31, 2013. By contrast, we recorded a $13.0 million provision for the year ended December 31, 2012 and $35.0 million for the year ended December 31, 2011. The decrease in loan loss provisioning compared to the earlier years reflects our significant progress in reducing the levels of delinquencies, non-performing loans and net charge-offs, particularly for loans for the construction of one- to four-family homes and for acquisition and development of land for residential properties. As a result of our focused efforts, non-performing loans decreased by 28% to $24.8 million at December 31, 2013, compared to $34.4 million a year earlier. The allowance for loan losses at December 31, 2013 was $75.0 million, representing 2.19% of total loans outstanding and 303% of non-performing loans. (See Note 6, Loans Receivable and the Allowance for Loan Losses, as well as “Asset Quality” below in this Form 10-K.)

Aside from the level of loan loss provision, our operating results depend primarily on our net interest income, which is the difference between interest income on interest-earning assets, consisting of loans and investment securities, and interest expense on interest-bearing liabilities, composed primarily of customer deposits and borrowings. Net interest income is primarily a function of our interest rate spread, which is the difference between the yield earned on interest-earning assets and the rate paid on interest-bearing liabilities, as well as a function of the average balances of interest-earning assets and interest-bearing liabilities. Our net interest income before provision for loan losses decreased modestly to $166.7 million for the year ended December 31, 2013, compared to $167.6 million for the year earlier. During the same period, our interest rate spread decreased to 4.08% from 4.13%. These decreases in net interest income and net interest spread reflect declining yields on performing loans and securities, which were only partially offset by continuing reductions in deposit and other funding costs. Pressure on our net interest margin in the exceptionally low market interest rate environment that the Federal Reserve has maintained for an extended period following the recessionary period of 2008 and 2009 is a particularly challenging issue for banks, which appears likely to persist in the foreseeable future.

Our net income also is affected by the level of our other operating income, including deposit fees and service charges, loan origination and servicing fees, and gains and losses on the sale of loans and securities, as well as our non-interest operating expenses and income tax provisions. In addition, our net income is affected by the net change in the value of certain financial instruments carried at fair value, in certain periods by other-than-temporary impairment (OTTI) charges or recoveries and in the current period by a termination fee related to the cancellation of the proposed acquisition of Home Federal Bancorp, Inc. (See Note 22 of the Notes to the Consolidated Financial Statements.) For the year ended December 31, 2013, we recorded a net charge of $2.3 million for fair value adjustments, which was offset by $1.0 million in gains on the sale of securities, $409,000 in OTTI recoveries and the $3.0 million acquisition termination fee. In comparison, we recorded a net fair value loss of $16.5 million (primarily related to the estimated fair value of our junior subordinated debentures) and an OTTI loss of $409,000 for the year ended December 31, 2012, which were only minimally offset by $51,000 in gains on the sale of securities.

Our total other operating income, which includes the gain on sale of securities, OTTI losses and recoveries, changes in the value of financial instruments carried at fair value and, for 2013, the acquisition termination fee, was $43.3 million for the year ended December 31, 2013, compared to $26.9 million for the year ended December 31, 2012. As a result, our total revenues (net interest income before the provision for loan losses plus other operating income) for 2013 increased to $210.1 million, compared to $194.6 million for 2012. However, our total revenues, excluding the gain on sale of securities, OTTI and fair value adjustments and the acquisition termination fee, which we believe is more indicative of our core operations, were $208.0 million for the year ended December 31, 2013, compared to $ 211.4 million for the year ended December 31, 2012, as the modest decrease in net interest income and a more significant decline in mortgage banking revenues more than offset a meaningful increase in deposit fees and service charges.

Our other operating expenses decreased slightly to $141.0 million for the year ended December 31, 2013, compared to $141.5 million for the year ended December 31, 2012, largely as a result of decreased costs related to real estate owned and FDIC deposit insurance, which were partially offset by increased compensation and payment and card processing expenses.

Other operating income, revenues and other earnings information excluding fair value adjustments, OTTI losses or recoveries, gains or losses on sale of securities and other one-time transactions are financial measures not made in conformity with U.S. generally acceptable accounting principles (GAAP). Management has presented these non-GAAP financial measures in this discussion and analysis because it believes that they provide useful and comparative information to assess trends in our core operations. However, these non-GAAP financial measures are supplemental and are not a substitute for any analysis based on GAAP. Where applicable, we have also presented comparable earnings information using GAAP financial measures. For a reconciliation of these non-GAAP financial measures, see the tables that set forth reconciliations of non-GAAP financial measures located in Item 7, "Management's Discussions and Analysis of Financial Condition—Executive Overview." Because not all companies use the same calculations, our presentation may not be comparable to other similarly titled measures as calculated by other companies. See Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” for more detailed information about our financial performance, critical accounting policies and reconciliations of these non-GAAP financial measures.

Recent Developments and Significant Events

Proposed Acquisition of Six Sterling Savings Bank Branches

On February 19, 2014, the Company announced that Banner Bank had entered into an agreement for the acquisition of six branches in Oregon from Sterling Savings Bank. The purchase of the branches is subject to consummation of the previously announced merger between Sterling Financial Corporation, the parent of Sterling Savings Bank, and Umpqua Holdings Corporation, regulatory approval and the satisfaction of customary closing conditions and is expected to be completed in the second quarter of 2014.

Canceled Acquisition of Home Federal Bancorp, Inc.

On September 24, 2013, the Company and Home Federal Bancorp, Inc. (NASDAQ: HOME), announced the signing of a definitive Agreement and Plan of Merger (Agreement). The Agreement provided a thirty-day period during which the board of directors of Home Federal Bancorp, Inc. could evaluate purchase offers from other institutions. On October 16, 2013, Home Federal Bancorp, Inc.'s board declared that it had received a superior proposal from Cascade Bancorp. Under the terms of the Agreement, Banner's board of directors had the right but elected not to match Cascade's offer. Consequently, on October 23, 2013, Banner announced that the Agreement between it and Home Federal Bancorp, Inc. had been terminated. In connection with the termination of the Agreement, Home Federal Bancorp, Inc. paid a termination fee of $3.0 million to Banner.

Income Tax Reporting and Accounting:

Amended Federal Income Tax Returns: The Company has years 2010 - 2012 open for tax examination under the statute of limitation provisions of the Internal Revenue Code of 1986 (Code). Tax years 2006 - 2009 are not open for assessment of additional tax, but remain open for adjustment to the amount of Net Operating Losses (NOLs), credit, and other carryforwards utilized in open years or to be utilized in the future. The Company filed amended federal income tax returns for tax years 2008 and 2009 to claim additional bad debt deductions, which resulted in additional NOLs for tax years 2008 and 2009. The Company also filed amended federal income tax returns for tax years 2005 - 2006 and a tentative refund claim for tax year 2007 to carryback the NOLs and general business credits from 2008 and 2009 to those earlier years. Review of the amended returns for all years was completed by the Internal Revenue Service (IRS) and the Company signed a closing agreement with the IRS related to refund claims of $9.8 million, primarily related to tax year 2006. As of December 31, 2013, the Company had recorded a tax receivable of $9.8 million with an offsetting adjustment to its deferred tax assets. Additionally, the Company recorded an estimated amount for interest on the tax receivable of $450,000 in 2013, which was recorded in miscellaneous income.

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 2010, the Company evaluated its net deferred tax asset and determined it was prudent to establish a full valuation allowance against the net asset. While the full valuation allowance remained in effect, the Company did not recognize any tax expense or benefit in its Consolidated Statements of Operations. During 2012, management analyzed the Company’s performance and trends since December 31, 2010, focusing on trends in asset quality, loan loss provisioning, capital position, net interest margin, core operating income and net income and the likelihood of continued profitability. Based on this analysis, management determined that a full valuation allowance was no longer appropriate and reversed all of the valuation allowance during the year ending December 31, 2012. The ultimate 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. See Note 13 of the Notes to the Consolidated Financial Statements for more information.

Stockholder Equity Transactions:

Preferred Stock: On March 29, 2012, the Company's $124 million of Series A Preferred Stock with a liquidation value of $1,000 per share, originally issued to the U.S. Treasury (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. During the year ended December 31, 2012, the Company repurchased or redeemed all of its Series A Preferred Stock. The related warrants to purchase up to $18.6 million in Banner common stock (243,998 shares) were sold by the Treasury at public auction in June 2013. That sale did not change the Company's capital position and did not have any impact on the financial accounting and reporting for these securities.

Restricted Stock Grants: Under the 2012 Restricted Stock Plan, which was approved on April 24, 2012, the Company is 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 Corporation and its affiliates. Shares granted under the Plan have a minimum vesting period of three years. The Plan will continue in effect for a term of ten years, after which no further awards may be granted. Vesting requirements may include time-based conditions, performance-based conditions, or market-based conditions. The 2012 Restricted Stock Plan was amended on April 23, 2013 to provide for the ability to grant (1) cash-denominated incentive-based awards payable in cash or common stock, including those that are eligible to qualify as qualified performance-based compensation for the purposes of Section 162(m) of the Code and (2) restricted stock awards that qualify as qualified performance-based compensation for the purposes of Section 162(m) of the Code. As of December 31, 2013, the Company had granted 189,426 shares of restricted stock from the 2012 Restricted Stock Plan, of which 31,178 shares had vested and 158,248 shares remain unvested.

Lending Activities

General: All of our lending activities are conducted through Banner Bank, its subsidiary, Community Financial Corporation, and Islanders Bank. We offer a wide range of loan products to meet the demands of our customers and our loan portfolio is very diversified by product type, borrower and geographic location within our market area. We originate loans for our own loan portfolio and for sale in the secondary market. Management's strategy has been to maintain a well diversified portfolio with a significant percentage of assets in the loan portfolio having more frequent interest rate repricing terms or shorter maturities than traditional long-term fixed-rate mortgage loans. As part of this effort, we have developed a variety of floating or adjustable interest rate products that correlate more closely with our cost of funds, particularly loans for commercial business and real estate, agricultural business, and construction and development purposes. However, in response to customer demand, we continue to originate fixed-rate loans, including fixed interest rate mortgage loans with terms of up to 30 years. The relative amount of fixed-rate loans and adjustable-rate loans that can be originated at any time is largely determined by the demand for each in a competitive environment.

Historically, our lending activities have been primarily directed toward the origination of real estate and commercial loans. Prior to 2008, real estate lending activities were significantly focused on residential construction and land development and first mortgages on owner-occupied, one- to four-family residential properties; however, over the subsequent five years our origination of construction and land development loans declined materially and the proportion of the portfolio invested in these types of loans has declined substantially. Beginning in 2011 and continuing into 2012 and 2013, we experienced more demand for one- to four-family construction loans and outstanding balances have increased modestly. Our residential mortgage loan originations also decreased during the earlier years of this cycle, although less significantly than the decline in construction and land development lending as exceptionally low interest rates supported demand for loans to refinance existing debt as well as loans to finance home purchases. Refinancing activity was particularly significant during 2012 and the first half of 2013, resulting in a meaningful increase in residential mortgage originations compared to earlier years; however, refinancing declined in the last two quarters of 2013 as a result of the increase in long-term mortgage interest rates. Despite the recent increase in these loan originations, our outstanding balances for residential mortgages have continued to decline, as most of the new originations have been sold in the secondary market while existing residential loans have been repaying at an accelerated pace. Our real estate lending activities also include the origination of multifamily and commercial real estate loans. While reduced from periods prior to the economic slowdown, our level of activity and investment in these types of loans has been slowly increasing in recent periods. Our commercial business lending is directed toward meeting the credit and related deposit needs of various small to medium-sized business and agribusiness borrowers operating in our primary market areas. Reflecting the slowly recovering economy, in recent periods demand for these types of commercial business loans has slowly increased and total outstanding balances have modestly increased. Our consumer lending activity is primarily directed at meeting demand from our existing deposit customers and, while we have increased our emphasis on consumer lending in recent years, demand for consumer loans also has been modest during this period of economic weakness as we believe many consumers have been focused on reducing their personal debt. At December 31, 2013, our net loan portfolio totaled $3.343 billion compared to $3.158 billion at December 31, 2012.

For additional information concerning our loan portfolio, see Item 7, "Management's Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2013 and 2012—Loans and Lending" including Tables 7 and 8, which sets forth the composition and geographic concentration of our loan portfolio, and Tables 9 and 10, which contain information regarding the loans maturing in our portfolio.

One- to Four-Family Residential Real Estate Lending: At both Banner Bank and Islanders Bank, we originate loans secured by first mortgages on one- to four-family residences in the Northwest communities where we have offices. While we offer a wide range of products, we have not engaged in any sub-prime lending programs, which we define as loans to borrowers with poor credit histories or undocumented repayment capabilities and with excessive reliance on the collateral as the source of repayment. However, in recent years we have experienced a modest increase in delinquencies on our residential loans as a result of a decline in home prices compared to earlier periods and despite more recent improvement in housing markets. At December 31, 2013, $529 million, or 16% of our loan portfolio, consisted of permanent loans on one- to four-family residences.

We offer fixed- and adjustable-rate mortgages (ARMs) at rates and terms competitive with market conditions, primarily with the intent of selling these loans into the secondary market. Fixed-rate loans generally are offered on a fully amortizing basis for terms ranging from 10 to 30 years at interest rates and fees that reflect current secondary market pricing. Most ARM products offered adjust annually after an initial period ranging from one to five years, subject to a limitation on the annual change of 1.0% to 2.0% and a lifetime limitation of 5.0% to 6.0%. For a small portion of the portfolio, where the initial period exceeds one year, the first rate change may exceed the annual limitation on subsequent rate changes. Our ARM products most frequently adjust based upon the average yield on Treasury securities adjusted to a constant maturity of one year or certain London Interbank Offered Rate (LIBOR) indices plus a margin or spread above the index. ARM loans held in our portfolio may allow for interest-only payments for an initial period up to five years but do not provide for negative amortization of principal and carry no prepayment restrictions. The retention of ARM loans in our loan portfolio can help reduce our exposure to changes in interest rates. However, borrower demand for ARM loans versus fixed-rate mortgage loans is a function of the level of interest rates, the expectations of changes in the level of interest rates and the difference between the initial interest rates and fees charged for each type of loan. In recent years, borrower demand for ARM loans has been limited and we have chosen not to aggressively pursue ARM loans by offering minimally profitable, deeply discounted teaser rates or option-payment ARM products. As a result, ARM loans have represented only a small portion of our loans originated during this period and of our portfolio.

Our residential loans are generally underwritten and documented in accordance with the guidelines established by the Federal Home Loan Mortgage Corporation (Freddie Mac or FHLMC) and the Federal National Mortgage Association (Fannie Mae or FNMA). Government insured loans are underwritten and documented in accordance with the guidelines established by the Department of Housing and Urban Development (HUD) and the Veterans Administration (VA). In the loan approval process, we assess the borrower's ability to repay the loan, the adequacy of the proposed security, the employment stability of the borrower and the creditworthiness of the borrower. For ARM loans, our standard practice provides for underwriting based upon fully indexed interest rates and payments. Generally, we will lend up to 97% of the lesser of the appraised value or purchase price of the property on conventional loans, although higher loan-to-value ratios are available on certain government insured programs. We require private mortgage insurance on conventional residential loans with a loan-to-value ratio at origination exceeding 80%. For the past five years, particularly in 2009 and 2010, a number of exceptions to these general underwriting guidelines were granted in connection with the sale or refinance of properties, particularly new construction, for which we were already providing financing. These exceptions most commonly relate to loan-to-value and mortgage insurance requirements and not to credit underwriting or loan documentation standards. Such exceptions, while infrequent in recent periods, will likely continue in the near term to facilitate troubled loan resolution and may result in loans having performance characteristics different from the rest of our one- to four-family loan portfolio.

Through our mortgage banking activities, we sell residential loans on either a servicing-retained or servicing-released basis. In recent years, we have generally sold a significant portion of our conventional residential mortgage originations and nearly all of our government insured loans in the secondary market.

Construction and Land Lending: Historically, we have invested a significant portion of our loan portfolio in residential construction and land loans to professional home builders and developers; however, as housing markets weakened the amount of this investment was substantially reduced from 2009 through 2011. More recently, in response to improvement in certain sub-markets, our construction and development lending increased in 2012 and 2013 and made a meaningful contribution to increased revenues and profitability in those years. To a lesser extent, we also originate construction loans for commercial and multifamily real estate. Although well diversified with respect to sub-markets, price ranges and borrowers, our construction and land loans are significantly concentrated in the greater Puget Sound region of Washington State and the Portland, Oregon market area. At December 31, 2013, construction and land loans totaled $351 million, or 10% of total loans of the Company, consisting of $201 million of one- to four-family construction loans, $76 million of residential land or land development loans, $64 million of commercial and multifamily real estate construction loans and $10 million of commercial land or land development loans.

Construction and land lending affords us the opportunity to achieve higher interest rates and fees with shorter terms to maturity than are usually available on other types of lending. Construction and land lending, however, involves a higher degree of risk than other lending opportunities because of the inherent difficulty in estimating both a property's value at completion of the project and the estimated cost of the project. If the estimate of construction cost proves to be inaccurate, we may be required to advance funds beyond the amount originally committed to permit completion of the project. If the estimate of value upon completion proves to be inaccurate, we may be confronted at, or prior to, the maturity of the loan with a project the value of which is insufficient to assure full repayment. Disagreements between borrowers and builders and the failure of builders to pay subcontractors may also jeopardize projects. Loans to builders to construct homes for which no purchaser has been identified carry additional risk because the payoff for the loan is dependent on the builder's ability to sell the property before the construction loan is due. We attempt to address these risks by adhering to strict underwriting policies, disbursement procedures and monitoring practices.

Construction loans made by us include those with a sales contract or permanent loan in place for the finished homes and those for which purchasers for the finished homes may be identified either during or following the construction period. We actively monitor the number of unsold homes in our construction loan portfolio and local housing markets to attempt to maintain an appropriate balance between home sales and new loan originations. The maximum number of speculative loans (loans that are not pre-sold) approved for each builder is based on a combination of factors, including the financial capacity of the builder, the market demand for the finished product and the ratio of sold to unsold inventory the builder maintains. We have attempted to diversify the risk associated with speculative construction lending by doing business with a large number of small and mid-sized builders spread over a relatively large geographic region with numerous sub-markets within our three-state service area.

Loans for the construction of one- to four-family residences are generally made for a term of twelve to eighteen months. Our loan policies include maximum loan-to-value ratios of up to 80% for speculative loans. Individual speculative loan requests are supported by an independent appraisal of the property, a set of plans, a cost breakdown and a completed specifications form. Underwriting is focused on the borrowers' financial strength, credit history and demonstrated ability to produce a quality product and effectively market and manage their operations. All speculative construction loans must be approved by senior loan officers.

Historically, we have also made land loans to developers, builders and individuals to finance the acquisition and/or development of improved lots or unimproved land, although over the past five years we have only originated a limited amount of this type of loan. In making land loans, we follow underwriting policies and disbursement and monitoring procedures similar to those for construction loans. The initial term on land loans is typically one to three years with interest only payments, payable monthly, and provisions for principal reduction as lots are sold and released from the lien of the mortgage.

We regularly monitor the construction and land loan portfolios and the economic conditions and housing inventory in each of our markets and increase or decrease this type of lending as we observe market conditions change. Housing markets in most areas of the Pacific Northwest significantly deteriorated beginning in 2008 and our origination of new construction loans declined sharply as a result; however, our level of construction lending has increased in the past three years as many sub-markets have improved. We believe that the underwriting policies and internal monitoring systems we have in place have helped to mitigate some of the risks inherent in construction and land lending; however, weak housing market conditions nonetheless resulted in material delinquencies and charge-offs in our construction and land loan portfolios prior to

2012. Reducing the amount of non-performing construction and land development loans and related real estate acquired through foreclosure was one of the most critical issues that we needed to resolve to return to acceptable levels of profitability and we have made substantial progress during the past four years in this regard, as reflected in the decline in non-performing construction and land loans to 5% of non-performing loans at December 31, 2013 from 50% of non-performing loans at December 31, 2010. (See “Asset Quality” below and Item 7, “Management's Discussion and Analysis of Financial Condition and Results of Operations-Asset Quality.”)

Commercial and Multifamily Real Estate Lending: We originate loans secured by multifamily and commercial real estate including, as noted above, loans for construction of multifamily and commercial real estate projects. Commercial real estate loans are made for both owner-occupied and investor properties. At December 31, 2013, our loan portfolio included $137 million in multifamily and $1.195 billion in commercial real estate loans, including $503 million in owner-occupied commercial real estate loans and $692 million in non-owner-occupied commercial real estate loans, which in aggregate comprised 35% of our total loans. Multifamily and commercial real estate lending affords us an opportunity to receive interest at rates higher than those generally available from one- to four-family residential lending. However, loans secured by multifamily and commercial properties are generally greater in amount, more difficult to evaluate and monitor and, therefore, potentially riskier than one- to four-family residential mortgage loans. Because payments on loans secured by multifamily and commercial properties are often dependent on the successful operation and management of the properties, repayment of these loans may be affected by adverse conditions in the real estate market or the economy. In addition, many of our commercial and multifamily real estate loans are not fully amortizing and contain large balloon payments upon maturity. Such balloon payments may require the borrower to either sell or refinance the underlying property in order to make the payment, which may increase the risk of default or non-payment. In originating multifamily and commercial real estate loans, we consider the location, marketability and overall attractiveness of the properties. Our underwriting guidelines for multifamily and commercial real estate loans require an appraisal from a qualified independent appraiser and an economic analysis of each property with regard to the annual revenue and expenses, debt service coverage and fair value to determine the maximum loan amount. In the approval process we assess the borrowers’ willingness and ability to manage the property and repay the loan and the adequacy of the collateral in relation to the loan amount.

Multifamily and commercial real estate loans originated by us are both fixed- and adjustable-rate loans generally with intermediate terms of five to ten years. Most of our multifamily and commercial real estate loans are linked to various Federal Home Loan Bank (FHLB) advance rates, certain prime rates or other market rate indices. Rates on these adjustable-rate loans generally adjust with a frequency of one to five years after an initial fixed-rate period ranging from one to ten years. Our commercial real estate portfolio consists of loans on a variety of property types with no large concentrations by property type, location or borrower. At December 31, 2013, the average size of our commercial real estate loans was $676,000 and the largest commercial real estate loan in our portfolio was approximately $17 million.

Commercial Business Lending: We are active in small- to medium-sized business lending and are engaged to a lesser extent in agricultural lending primarily by providing crop production loans. Our commercial bankers are focused on local markets and devote a great deal of effort to developing customer relationships and providing these types of borrowers with a full array of products and services delivered in a thorough and responsive manner. While also strengthening our commitment to small business lending, in recent years we have added experienced officers and staff focused on corporate lending opportunities for borrowers with credit needs generally in a $3 million to $15 million range. In addition to providing earning assets, this type of lending has helped us increase our deposit base. In recent years, our commercial business lending has also included participation in certain national syndicated loans, including shared national credits. Expanding commercial lending and related commercial banking services is currently an area of significant focus, including recent additions to staffing in the areas of business development, credit administration, Small Business Administration (SBA) lending, and loan and deposit operations.

Commercial business loans may entail greater risk than other types of loans. Commercial business loans may be unsecured or secured by special purpose or rapidly depreciating assets, such as equipment, inventory and receivables, which may not provide an adequate source of repayment on defaulted loans. In addition, commercial business loans are dependent on the borrower’s continuing financial strength and management ability, as well as market conditions for various products, services and commodities. For these reasons, commercial business loans generally provide higher yields or related revenue opportunities than many other types of loans but also require more administrative and management attention. Loan terms, including the fixed or adjustable interest rate, the loan maturity and the collateral considerations, vary significantly and are negotiated on an individual loan basis.

We underwrite our commercial business loans on the basis of the borrower’s cash flow and ability to service the debt from earnings rather than on the basis of the underlying collateral value. We seek to structure these loans so that they have more than one source of repayment. The borrower is required to provide us with sufficient information to allow us to make a prudent lending determination. In most instances, this information consists of at least three years of financial statements, tax returns, a statement of projected cash flows, current financial information on any guarantor and information about the collateral. Loans to closely held businesses typically require personal guarantees by the principals. Our commercial business loan portfolio is geographically dispersed across the market areas serviced by our branch network and there are no significant concentrations by industry or products.

Our commercial business loans may be structured as term loans or as lines of credit. Commercial business term loans are generally made to finance the purchase of fixed assets and have maturities of five years or less. Commercial business lines of credit are typically made for the purpose of providing working capital and are usually approved with a term of one year. Adjustable- or floating-rate loans are primarily tied to various prime rate or LIBOR indices. At December 31, 2013, commercial business loans totaled $682 million, or 20% of our total loans, including $121 million of shared national credits.

Agricultural Lending: Agriculture is a major industry in many parts of our service areas. While agricultural loans are not a large part of our portfolio, we intend to continue to make agricultural loans to borrowers with a strong capital base, sufficient management depth, proven ability to operate through agricultural cycles, reliable cash flows and adequate financial reporting. Payments on agricultural loans depend, to a large degree, on the results of operations of the related farm entity. The repayment is also subject to other economic and weather conditions as well as market prices for agricultural products, which can be highly volatile. At December 31, 2013, agricultural business loans, including collateral secured loans to purchase farm land and equipment, totaled $228 million, or 7% of our loan portfolio.

Agricultural operating loans generally are made as a percentage of the borrower's anticipated income to support budgeted operating expenses. These loans are secured by a blanket lien on all crops, livestock, equipment, accounts and products and proceeds thereof. In the case of crops, consideration is given to projected yields and prices from each commodity. The interest rate is normally floating based on the prime rate or a LIBOR index plus a negotiated margin. Because these loans are made to finance a farm or ranch's annual operations, they are usually written on a one-year review and renewable basis. The renewal is dependent upon the prior year's performance and the forthcoming year's projections as well as the overall financial strength of the borrower. We carefully monitor these loans and related variance reports on income and expenses compared to budget estimates. To meet the seasonal operating needs of a farm, borrowers may qualify for single payment notes, revolving lines of credit and/or non-revolving lines of credit.

In underwriting agricultural operating loans, we consider the cash flow of the borrower based upon the expected operating results as well as the value of collateral used to secure the loans. Collateral generally consists of cash crops produced by the farm, such as milk, grains, fruit, grass seed, peas, sugar beets, mint, onions, potatoes, corn and alfalfa or livestock. In addition to considering cash flow and obtaining a blanket security interest in the farm's cash crop, we may also collateralize an operating loan with the farm's operating equipment, breeding stock, real estate and federal agricultural program payments to the borrower.

We also originate loans to finance the purchase of farm equipment. Loans to purchase farm equipment are made for terms of up to seven years. On occasion, we also originate agricultural real estate loans secured primarily by first liens on farmland and improvements thereon located in our market areas, although generally only to service the needs of our existing customers. Loans are written in amounts ranging from 50% to 75% of the tax assessed or appraised value of the property for terms of five to 20 years. These loans generally have interest rates that adjust at least every five years based upon a Treasury index or FHLB advance rate plus a negotiated margin. Fixed-rate loans are granted on terms usually not to exceed five years. In originating agricultural real estate loans, we consider the debt service coverage of the borrower's cash flow, the appraised value of the underlying property, the experience and knowledge of the borrower, and the borrower's past performance with us and/or the market area. These loans normally are not made to start-up businesses and are reserved for existing customers with substantial equity and a proven history.

Among the more common risks to agricultural lending can be weather conditions and disease. These risks may be mitigated through multi-peril crop insurance. Commodity prices also present a risk, which may be reduced by the use of set price contracts. Normally, required beginning and projected operating margins provide for reasonable reserves to offset unexpected yield and price deficiencies. In addition to these risks, we also consider management succession, life insurance and business continuation plans when evaluating agricultural loans.

Consumer and Other Lending: We originate a variety of consumer loans, including home equity lines of credit, automobile, boat and recreational vehicle loans and loans secured by deposit accounts. While consumer lending has traditionally been a small part of our business, with loans made primarily to accommodate our existing customer base, it has received consistent emphasis in recent years. Part of this emphasis includes a Banner Bank-funded credit card program. Similar to other consumer loan programs, we focus this credit card program on our existing customer base to add to the depth of our customer relationships. In addition to earning balances, credit card accounts produce non-interest revenues through interchange fees and other activity-based revenues. Our underwriting of consumer loans is focused on the borrower's credit history and ability to repay the debt as evidenced by documented sources of income. At December 31, 2013, we had $295 million, or 9% of our loans receivable, in consumer related loans, including $173 million, or 5% of our loans receivable, in consumer loans secured by one- to four-family residences.

Similar to commercial business loans, our other consumer loans often entail greater risk than residential mortgage loans. Home equity lines of credit generally entail greater risk than do one- to four-family residential mortgage loans where we are in the first lien position. For those home equity lines secured by a second mortgage, it is unlikely that we will be successful in recovering all or a portion of our loan proceeds in the event of default unless we are prepared to repay the first mortgage loan and such repayment and the costs associated with a foreclosure are justified by the value of the property. In the case of consumer loans which are unsecured or secured by rapidly depreciating assets such as automobiles, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The remaining deficiency often does not warrant further substantial collection efforts against the borrower. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans. These loans may also give rise to claims and defenses by a consumer loan borrower against an assignee of such loans such as us, and a borrower may be able to assert against the assignee claims and defenses that it has against the seller of the underlying collateral.

Loan Solicitation and Processing: We originate real estate loans in our market areas by direct solicitation of real estate brokers, builders, depositors, walk-in customers and visitors to our Internet website. Loan applications are taken by our mortgage loan officers or through our Internet website and are processed in branch or regional locations. Most underwriting and loan administration functions for our real estate loans are performed by loan personnel at central locations. We do not make loans originated by independent third-party loan brokers or any similar wholesale loan origination channels.

Our commercial bankers solicit commercial and agricultural business loans through call programs focused on local businesses and farmers. While commercial bankers are delegated reasonable commitment authority based upon their qualifications, credit decisions on significant commercial and agricultural loans are made by senior loan officers or in certain instances by the Board of Directors of Banner Bank and Islanders Bank.

We originate consumer loans through various marketing efforts directed primarily toward our existing deposit and loan customers. Consumer loan applications are primarily underwritten and documented by centralized administrative personnel.

Loan Originations, Sales and Purchases

While we originate a variety of loans, our ability to originate each type of loan is dependent upon the relative customer demand and competition in each market we serve. For the years ended December 31, 2013, 2012 and 2011, we originated loans, net of repayments, including our participation in syndicated loans, of $579 million, $448 million, and $247 million, respectively. The increase in net originations for 2013 and 2012 reflects a significant increase in production of one- to four-family residential loans, as well as increased new commercial business and agricultural business loans and commercial real estate loans.

We sell many of our newly originated one- to four-family residential mortgage loans to secondary market purchasers as part of our interest rate risk management strategy. Originations of one- to four-family residential loans for sale decreased to $430 million for the year ended December 31, 2013 from $504 million during 2012, reflecting reduced refinancing activity. Proceeds from sales of loans for the years ended December 31, 2013, 2012 and 2011, totaled $445 million, $505 million, and $282 million, respectively. Sales of loans generally are beneficial to us because these sales may generate income at the time of sale, provide funds for additional lending and other investments, increase liquidity or reduce interest rate risk. We sell loans on both a servicing-retained and a servicing-released basis. All loans are sold without recourse. The decision to hold or sell loans is based on asset liability management goals, strategies and policies and on market conditions. See “Loan Servicing.” At December 31, 2013, we had $3 million in loans held for sale.

We periodically purchase whole loans and loan participation interests or participate in syndicates originating new loans primarily during periods of reduced loan demand in our primary market area and at times to support our Community Reinvestment Act lending activities. Any such purchases are made generally consistent with our underwriting standards; however, the loans may be located outside of our normal lending area. During the years ended December 31, 2013, 2012 and 2011, we purchased $49 million, $18 million and $28 million, respectively, of loans and loan participation interests.

Loan Servicing

We receive fees from a variety of institutional owners in return for performing the traditional services of collecting individual payments and managing portfolios of sold loans. At December 31, 2013, we were servicing $1.216 billion of loans for others. Loan servicing includes processing payments, accounting for loan funds and collecting and paying real estate taxes, hazard insurance and other loan-related items such as private mortgage insurance. In addition to earning fee income, we retain certain amounts in escrow for the benefit of the lender for which we incur no interest expense but are able to invest the funds into earning assets. At December 31, 2013, we held $5.7 million in escrow for our portfolio of loans serviced for others. The loan servicing portfolio at December 31, 2013 was composed of $757 million of Freddie Mac residential mortgage loans, $342 million of Fannie Mae residential mortgage loans and $117 million of both residential and non-residential mortgage loans serviced for a variety of private investors. The portfolio included loans secured by property located primarily in the states of Washington, Oregon and Idaho. For the year ended December 31, 2013, we recognized $1.8 million in income from loan servicing in our results of operations, which was net of $2.4 million of servicing rights amortization and included a $1.3 million reversal of a valuation adjustment to mortgage servicing rights.

Mortgage Servicing Rights: We record mortgage servicing rights (MSRs) with respect to loans we originate and sell in the secondary market on a servicing-retained basis. The value of MSRs is capitalized and amortized in proportion to, and over the period of, the estimated future net servicing income. For the years ended December 31, 2013, 2012 and 2011, we capitalized $2.9 million, $3.7 million, and $1.9 million, respectively, of MSRs relating to loans sold with servicing retained. No MSRs were purchased in those periods. Amortization of MSRs for the years ended December 31, 2013, 2012 and 2011, was $2.4 million, $2.6 million, and $1.8 million, respectively. Management periodically evaluates the estimates and assumptions used to determine the carrying values of MSRs and the amortization of MSRs. MSRs generally are adversely affected by higher levels of current or anticipated prepayments resulting from decreasing interest rates. These carrying values are adjusted when the valuation indicates the carrying value is impaired. During 2013, we recorded $1.3 million in income from the reversal of a valuation allowance that had previously been recognized against our MSRs. At December 31, 2013, our MSRs were carried at a value of $8.1 million, net of amortization.

Asset Quality

Classified Assets: State and federal regulations require that the Banks review and classify their problem assets on a regular basis. In addition, in connection with examinations of insured institutions, state and federal examiners have authority to identify problem assets and, if appropriate, require them to be classified. Historically, we have not had any meaningful differences of opinion with the examiners with respect to asset classification. Banner Bank's Credit Policy Division reviews detailed information with respect to the composition and performance of the loan portfolios, including information on risk concentrations, delinquencies and classified assets for both Banner Bank and Islanders Bank. The Credit Policy Division approves all recommendations for new classified loans or, in the case of smaller-balance homogeneous loans including residential real estate and consumer loans, it has approved policies governing such classifications, or changes in classifications, and develops and monitors action plans to resolve the problems associated with the assets. The Credit Policy Division also approves recommendations for establishing the appropriate level of the allowance for loan losses. Significant problem loans are transferred to Banner Bank's Special Assets Department for resolution or collection activities. The Banks' and Banner Corporation's Boards of Directors are given a detailed report on classified assets and asset quality at least quarterly. For additional information regarding asset quality and non-performing loans, see Item 7, "Management's Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2013 and 2012—Asset Quality," and Tables 15, 16 and 17 contained therein.

Allowance for Loan Losses: In originating loans, we recognize that losses will be experienced and that the risk of loss will vary with, among other things, the type of loan being made, the creditworthiness of the borrower over the term of the loan, general economic conditions and, in the case of a secured loan, the quality of the security for the loan. As a result, we maintain an allowance for loan losses consistent with GAAP guidelines. We increase our allowance for loan losses by charging provisions for possible loan losses against our income. The allowance for losses on loans is maintained at a level which, in management's judgment, is sufficient to provide for probable losses based on evaluating known and inherent risks in the loan portfolio and upon continuing analysis of the factors underlying the quality of the loan portfolio. At December 31, 2013, we had an allowance for loan losses of $75 million, which represented 2.19% of loans and 303% of non-performing loans compared to 2.39% and 225%, respectively, at December 31, 2012. For additional information concerning our allowance for loan losses, see Item 7, "Management's Discussion and Analysis of Financial Condition—Comparison of Results of Operations for the Years Ended December 31, 2013 and 2012—Provision and Allowance for Loan Losses," and Tables 21 and 22 contained therein.

Real Estate Owned: Real estate owned (REO) is property acquired by foreclosure or receiving a deed in lieu of foreclosure, and is recorded at the lower of the estimated fair value of the property, less expected selling costs, or the carrying amount of the defaulted loan. Development and improvement costs relating to the property are capitalized to the extent they add value to the property. The carrying value of the property is periodically evaluated by management and, if necessary, allowances are established to reduce the carrying value to net realizable value. Gains or losses at the time the property is sold are credited or charged to operations in the period in which they are realized. The amounts we will ultimately recover from REO may differ substantially from the carrying value of the assets because of market factors beyond our control or because of changes in our strategies for recovering the investment. If the book value of the REO is determined to be in excess of the fair market value, a valuation allowance is recognized against earnings. At December 31, 2013, we had REO of $4 million, compared to $16 million at December 31, 2012. Valuation allowances recognized during 2013 were $785,000 and for 2012 and 2011 were $5.2 million and $15.1 million, respectively. For additional information on REO, see Item 7, "Management's Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2013 and 2012—Asset Quality" and Table 18 contained therein and Note 7 of the Notes to the Consolidated Financial Statements.

Investment Activities

Investment Securities

Under Washington state law, banks are permitted to invest in various types of marketable securities. Authorized securities include but are not limited to Treasury obligations, securities of various federal agencies (including government-sponsored enterprises), mortgage-backed and asset-backed securities, certain certificates of deposit of insured banks and savings institutions, bankers' acceptances, repurchase agreements, federal funds, commercial paper, corporate debt and equity securities and obligations of states and their political subdivisions. Our investment policies are designed to provide and maintain adequate liquidity and to generate favorable rates of return without incurring undue interest rate or credit risk. Our policies generally limit investments to U.S. Government and agency (including government-sponsored entities) securities, municipal bonds, certificates of deposit, corporate debt obligations and mortgage-backed securities. Investment in mortgage-backed securities may include those issued or guaranteed by

Freddie Mac, Fannie Mae, Government National Mortgage Association (Ginnie Mae or GNMA) and privately-issued mortgage-backed securities that have an AA credit rating or higher at the time of purchase, as well as collateralized mortgage obligations (CMOs). A high credit rating indicates only that the rating agency believes there is a low risk of loss or default. To the best of our knowledge, we do not have any investments in mortgage-backed securities, collateralized debt obligations or structured investment vehicles that have a material exposure to sub-prime mortgages. However, we do have investments in single-issuer trust preferred securities and collateralized debt obligations secured by pooled trust preferred securities that have been materially adversely impacted by concerns related to the banking and insurance industries as well as payment deferrals and defaults by certain issuers. Further, all of our investment securities, including those that have high credit ratings, are subject to market risk in so far as a change in market rates of interest or other conditions may cause a change in an investment's earnings performance and/or market value.

At December 31, 2013, our consolidated investment portfolio totaled $635 million and consisted principally of U.S. Government agency obligations, mortgage-backed securities, municipal bonds, corporate debt obligations, and asset-backed securities. From time to time, investment levels may be increased or decreased depending upon yields available on investment alternatives and management's projections as to the demand for funds to be used in loan originations, deposits and other activities. During the year ended December 31, 2013, holdings of mortgage-backed securities increased $45 million to $351 million, while Treasury and agency obligations decreased $37 million to $61 million, corporate securities including equities decreased $5 million to $44 million, municipal bonds increased $19 million to $154 million, and investments in asset-backed securities decreased $18 million to $25 million.

For detailed information on our investment securities, see Item 7, "Management's Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2013 and 2012—Investments," and Tables 1 to 6 contained therein.

Derivatives

Off-Balance-Sheet Derivatives: The Company, through its Banner Bank subsidiary, is party to various derivative instruments that are used for asset and liability management and customer financing needs. Derivative instruments are contracts between two or more parties that have a notional amount and an underlying variable, require no net investment and allow for the net settlement of positions. The notional amount serves as the basis for the payment provision of the contract and takes the form of units, such as shares or dollars. The underlying variable represents a specified interest rate, index, or other component. The interaction between the notional amount and the underlying variable determines the number of units to be exchanged between the parties and influences the market value of the derivative contract. We obtain dealer quotations to value our derivative contracts.

Our predominant derivative and hedging activities involve interest rate swaps related to certain term loans and forward sales contracts associated with mortgage banking activities. Generally, these instruments help us manage exposure to market risk and meet customer financing needs. Market risk represents the possibility that economic value or net interest income will be adversely affected by fluctuations in external factors such as market-driven interest rates and prices or other economic factors.

Derivatives Designated in Hedge Relationships

Our fixed rate loans result in exposure to losses in value or net interest income as interest rates change. The risk management objective for hedging fixed rate loans is to effectively convert the fixed rate received to a floating rate. We have hedged our exposure to changes in the fair value of certain fixed rate loans through the use of interest rate swaps. For a qualifying fair value hedge, changes in the value of the derivatives are recognized in current period earnings along with the corresponding changes in the fair value of the designated hedged item attributable to the risk being hedged.

In a program brought to Banner Bank through its merger with F&M Bank in 2007, customers received fixed interest rate commercial loans and F&M Bank subsequently hedged those fixed rate loans by entering into interest rate swaps with a dealer counterparty. We receive fixed rate payments from the customers on the loans and make similar fixed rate payments to the dealer counterparty on the swaps in exchange for variable rate payments based on the one-month LIBOR index. These interest rate swaps are designated as fair value hedges. Through application of the “short cut method of accounting,” there is an assumption that the hedges are effective. We discontinued originating interest rate swaps under this program in 2008.

Derivatives Not Designated in Hedge Relationships

Interest Rate Swaps. Banner Bank has been using an interest rate swap program for commercial loan customers, termed the Back-to-Back Program, since 2010. In the Back-to-Back Program, we provide the client with a variable rate loan and enter into an interest rate swap in which the client receives a variable rate payment in exchange for a fixed rate payment. We offset its risk exposure by entering into an offsetting interest rate swap with a dealer counterparty for the same notional amount and length of term as the client interest rate swap providing the dealer counterparty with a fixed rate payment in exchange for a variable rate payment. There are also a few interest rate swaps from prior to 2009 that were not designated in hedge relationships that are included in these totals. These swaps do not qualify as designated hedges; therefore, each swap is accounted for as a free standing derivative.

Mortgage Banking. In the normal course of business, we sell originated mortgage loans into the secondary mortgage loan markets. During the period of loan origination and prior to the sale of the loans in the secondary market, we have exposure to movements in interest rates associated with written rate lock commitments with potential borrowers to originate loans that are intended to be sold and for closed loans that are awaiting sale and delivery into the secondary market.

Written loan commitments that relate to the origination of mortgage loans that will be held for resale are considered free-standing derivatives and do not qualify for hedge accounting. Written loan commitments generally have a term of up to 60 days before the closing of the loan. The loan commitment does not bind the potential borrower to enter into the loan, nor does it guarantee that we will approve the potential borrower for the loan. Therefore, when determining fair value, we make estimates of expected “fallout” (loan commitments not expected to close), using models which consider cumulative historical fallout rates, current market interest rates and other factors.

Written loan commitments in which the borrower has locked in an interest rate results in market risk to us to the extent market interest rates change from the rate quoted to the borrower. We economically hedge the risk of changing interest rates associated with our interest rate lock commitments by entering into forward sales contracts.

Mortgage loans which are held for sale are subject to changes in fair value due to fluctuations in interest rates from the loan's closing date through the date of sale of the loans into the secondary market. Typically, the fair value of these loans declines when interest rates increase and rises when interest rates decrease. To mitigate this risk, we enter into forward sales contracts on a significant portion of these loans to provide an economic hedge against those changes in fair value. Mortgage loans held for sale and the forward sales contracts are recorded at fair value with ineffective changes in value recorded in current earnings as loan sales income.

We are exposed to credit-related losses in the event of nonperformance by the counterparty to these agreements. Credit risk of the financial contract is controlled through the credit approval, limits, and monitoring procedures and we do not expect the counterparties to fail their obligations.

In connection with the interest rate swaps between Banner Bank and the dealer counterparties, the agreements contain a provision where if Banner Bank fails to maintain its status as a well/adequately capitalized institution, then the counterparty could terminate the derivative positions and we would be required to settle its obligations. Similarly, we could be required to settle our obligations under certain of these agreements if specific regulatory events occur, such as a publicly issued prompt corrective action directive, cease and desist order, or a capital maintenance agreement that required Banner Bank to maintain a specific capital level. If we had breached any of these provisions at December 31, 2013 or 2012, we could have been required to settle our obligations under the agreements at the termination value. As of December 31, 2013 and 2012, the termination value of derivatives in a net liability position related to these agreements was $2.7 million and $8.4 million, respectively. We generally post collateral against derivative liabilities in the form of government agency-issued bonds, mortgage-backed securities, or commercial mortgage-backed securities. Collateral posted against derivative liabilities was $8.9 million and $12.5 million as of December 31, 2013 and 2012, respectively. Derivative assets and liabilities are recorded at fair value on the balance sheet and do not take into account the effects of master netting agreements. Master netting agreements allow us to settle all derivative contracts held with a single counterparty on a net basis and to offset net derivative positions with related collateral where applicable.

Deposit Activities and Other Sources of Funds

General: Deposits, FHLB advances (or other borrowings) and loan repayments are our major sources of funds for lending and other investment purposes. Scheduled loan repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are influenced by general economic, interest rate and money market conditions and may vary significantly. Borrowings may be used on a short-term basis to compensate for reductions in the availability of funds from other sources. Borrowings may also be used on a longer-term basis for general business purposes, including funding loans and investments.

We compete with other financial institutions and financial intermediaries in attracting deposits. There is strong competition for transaction balances and savings deposits from commercial banks, credit unions and non-bank corporations, such as securities brokerage companies, mutual funds and other diversified companies, some of which have nationwide networks of offices. Much of the focus of our branch expansion, relocations and renovation and advertising and marketing campaigns has been directed toward attracting additional deposit customer relationships and balances. In addition, our electronic banking activities including debit card and automated teller machine (ATM) programs, on-line Internet banking services and, most recently, customer remote deposit and mobile banking capabilities are all directed at providing products and services that enhance customer relationships and result in growing deposit balances. Growing core deposits (transaction and savings accounts) is a fundamental element of our business strategy. Core deposits increased to 76% of total deposits at December 31, 2013 compared to 71% a year earlier and 64% two years ago.

Deposit Accounts: We generally attract deposits from within our primary market areas by offering a broad selection of deposit instruments, including demand checking accounts, interest-bearing checking accounts, money market deposit accounts, regular savings accounts, certificates of deposit, cash management services and retirement savings plans. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit and the interest rate, among other factors. In determining the terms of deposit accounts, we consider current market interest rates, profitability to us, matching deposit and loan products and customer preferences and concerns. At December 31, 2013, we had $3.618 billion of deposits, including $2.745 billion of transaction and savings accounts and $873 million in time deposits. For additional information concerning our deposit accounts, see Item 7, “Management’s Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2013 and 2012—Deposit Accounts.” See also Table 11 contained therein, which sets forth the balances of deposits in the various types of accounts, and Table 12, which sets forth the amount of our certificates of deposit greater than $100,000 by time remaining until maturity as of December 31, 2013. In addition, see Note 9 of the Notes to the Consolidated Financial Statements.

Borrowings: While deposits are the primary source of funds for our lending and investment activities and for general business purposes, we also use borrowings to supplement our supply of lendable funds, to meet deposit withdrawal requirements and to more efficiently leverage our capital position. The FHLB-Seattle serves as our primary borrowing source, although in recent years we have significantly reduced our use of FHLB advances. The FHLB-Seattle provides credit for member financial institutions such as Banner Bank and Islanders Bank. As members, the Banks are required to own capital stock in the FHLB-Seattle and are authorized to apply for advances on the security of that stock and certain of their mortgage loans and securities provided certain credit worthiness standards have been met. Limitations on the amount of advances are based on the financial condition of the member institution, the adequacy of collateral pledged to secure the credit, and FHLB stock ownership requirements. At December 31, 2013, we had $27 million of borrowings from the FHLB-Seattle. At that date, Banner Bank had been authorized by the FHLB-Seattle to borrow up to $767 million under a blanket floating lien security agreement, while Islanders Bank was approved to borrow up to $26 million under a similar agreement. The Federal Reserve Bank also serves as an important source of borrowing capacity. The Federal Reserve Bank provides credit based upon acceptable loan collateral, which includes certain loan types not eligible for pledging to the FHLB-Seattle. At December 31, 2013, based upon our available unencumbered collateral, Banner Bank was eligible to borrow $564 million from the Federal Reserve Bank, although at that date we had no funds borrowed under this arrangement. Although eligible to participate, Islanders Bank has not applied for approval to borrow from the Federal Reserve Bank. For additional information concerning our borrowings, see Item 7, “Management’s Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2013 and 2012—Borrowings,” Table 14 contained therein, and Notes 10 and 11 of the Notes to the Consolidated Financial Statements.

We issue retail repurchase agreements, generally due within 90 days, as an additional source of funds, primarily in connection with cash management services provided to our larger deposit customers. At December 31, 2013, we had issued retail repurchase agreements totaling $83 million, which were secured by a pledge of certain U.S. Government and agency notes and mortgage-backed securities with a market value of $100 million. We also may borrow funds through the use of secured wholesale repurchase agreements with securities brokers; however, during the three years ended December 31, 2013, we did not have any wholesale repurchase borrowings.

We have also issued $120 million of junior subordinated debentures in connection with the sale of trust preferred securities (TPS). The TPS were issued from 2002 through 2007 by special purpose business trusts formed by Banner Corporation and were sold in private offerings to pooled investment vehicles. The junior subordinated debentures associated with the TPS have been recorded as liabilities and are reported at fair value on our Consolidated Statements of Financial Condition. All of the debentures issued to the Trusts, measured at their fair value, less the common stock of the Trusts, qualified as Tier I capital as of December 31, 2013, under guidance issued by the Board of Governors of the Federal Reserve System. We invested substantially all of the proceeds from the issuance of the TPS as additional paid in capital at Banner Bank. For additional information about deposits and other sources of funds, see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources," and Notes 9, 10, 11 and 12 of the Notes to the Consolidated Financial Statements.

Personnel

As of December 31, 2013, we had 1,029 full-time and 102 part-time employees. Banner Corporation has no employees except for those who are also employees of Banner Bank, its subsidiaries, and Islanders Bank. The employees are not represented by a collective bargaining unit. We believe our relationship with our employees is good.

Taxation
Federal Taxation

General: For tax reporting purposes, we report our income on a calendar year basis using the accrual method of accounting on a consolidated basis. We are subject to federal income taxation in the same manner as other corporations with some exceptions, including particularly the reserve for bad debts. Reference is made to Note 13 of the Notes to the Consolidated Financial Statements for additional information concerning the income taxes payable by us.

State Taxation

Washington Taxation: We are subject to a Business and Occupation (B&O) tax which is imposed under Washington law at the current rate of 1.50% of gross receipts. On April 12, 2010, the Washington State Legislature temporarily increased the rate to 1.80% for the period May 1, 2010 through June 30, 2013. Interest received on loans secured by mortgages or deeds of trust on residential properties, residential mortgage-backed securities, and certain U.S. Government and agency securities is not subject to this tax. Our B&O tax expense was $1.9 million, $2.3 million, and $2.2 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Oregon and Idaho Taxation: Corporations with nexus in the states of Oregon and Idaho are subject to a corporate level income tax. Our operations in those states resulted in corporate income taxes paid of approximately $761,000, $540,000, and $30,000 for the years ended December 31, 2013, 2012 and 2011, respectively. As our operations in these states increase, the state income tax provision will have an increasing effect on our effective tax rate and results of operations.

Competition

We encounter significant competition both in attracting deposits and in originating loans. Our most direct competition for deposits comes from other commercial and savings banks, savings associations and credit unions with offices in our market areas. We also experience competition from securities firms, insurance companies, money market and mutual funds, and other investment vehicles. We expect continued strong competition from such financial institutions and investment vehicles in the foreseeable future, including competition from on-line Internet banking competitors. Our ability to attract and retain deposits depends on our ability to provide transaction services and investment opportunities that satisfy the requirements of depositors. We compete for deposits by offering a variety of accounts and financial services, including robust electronic banking capabilities, with competitive rates and terms, at convenient locations and business hours, and delivered with a high level of personal service and expertise.

Competition for loans comes principally from other commercial banks, loan brokers, mortgage banking companies, savings banks and credit unions and for agricultural loans from the Farm Credit Administration. The competition for loans is intense as a result of the large number of institutions competing in our market areas. We compete for loans primarily by offering competitive rates and fees and providing timely decisions and excellent service to borrowers.

Regulation
Banner Bank and Islanders Bank

General: As state-chartered, federally insured commercial banks, Banner Bank and Islanders Bank (the Banks) are subject to extensive regulation and must comply with various statutory and regulatory requirements, including prescribed minimum capital standards. The Banks are regularly examined by the FDIC and state banking regulators and file periodic reports concerning their activities and financial condition with these banking regulators. The Banks' relationship with depositors and borrowers also is regulated to a great extent by both federal and state law, especially in such matters as the ownership of deposit accounts and the form and content of mortgage and other loan documents.

Federal and state banking laws and regulations govern all areas of the operation of the Banks, including reserves, loans, investments, deposits, capital, issuance of securities, payment of dividends and establishment of branches. Federal and state bank regulatory agencies also have the general authority to limit the dividends paid by insured banks and bank holding companies if such payments should be deemed to constitute an unsafe and unsound practice. The respective primary federal regulators of Banner Corporation, Banner Bank and Islanders Bank have authority to impose penalties, initiate civil and administrative actions and take other steps intended to prevent banks from engaging in unsafe or unsound practices.

State Regulation and Supervision: As a Washington state-chartered commercial bank with branches in the States of Washington, Oregon and Idaho, Banner Bank is subject to the applicable provisions of Washington, Oregon and Idaho law and regulations. State law and regulations govern Banner Bank's ability to take deposits and pay interest thereon, to make loans on or invest in residential and other real estate, to make consumer loans, to invest in securities, to offer various banking services to its customers and to establish branch offices. In a similar fashion, Washington State laws and regulations for state-chartered commercial banks also apply to Islanders Bank.

Deposit Insurance: The Deposit Insurance Fund (“DIF”) of the FDIC insures deposit accounts of the Banks up to $250,000 per separately insured depositor. As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of, and to require reporting by, FDIC-insured institutions. Banner Bank's and Islanders Bank's deposit insurance premiums expense for the year ended December 31, 2013, were $2.2 million and $151,000, respectively.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) requires the FDIC's deposit insurance assessments to be based on assets instead of deposits. The FDIC has issued rules which specify that the assessment base for a bank is equal to its total average consolidated assets less average tangible capital. The FDIC assessment rates range from approximately five basis points to 35 basis points, depending on applicable adjustments for unsecured debt issued by an institution and brokered deposits (and to further adjustment for institutions that hold unsecured debt of other FDIC-insured institutions), until such time as the FDIC's reserve ratio equals 1.15%. Once the FDIC's reserve ratio reaches 1.15% and the reserve ratio for the immediately prior assessment period is less than 2.0%, the applicable assessment rates may range from three basis points to 30 basis points (subject to adjustments as described above). If the reserve ratio for the prior assessment period is equal to, or greater than 2.0% and less than 2.5%, the assessment rates may range from two basis points to 28 basis points and if the reserve ratio for the prior assessment period is greater than 2.5%, the assessment rates may range from one basis point to 25 basis points (in each case subject to adjustments as described above). No institution may pay a dividend if it is in default on its federal deposit insurance assessment.

The FDIC conducts examinations of and requires reporting by state non-member banks, such as the Banks. The FDIC also may prohibit any insured institution from engaging in any activity determined by regulation or order to pose a serious risk to the deposit insurance fund.

The FDIC may terminate the deposit insurance of any insured depository institution if it determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by an agreement with the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as determined by the FDIC. Management is not aware of any existing circumstances which would result in termination of the deposit insurance of either Banner Bank or Islanders Bank.

Prompt Corrective Action: Federal statutes establish a supervisory framework based on five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. An institution's category depends upon where its capital levels are in relation to relevant capital measures, which include a risk-based capital measure, a leverage ratio capital measure and certain other factors. The federal banking agencies have adopted regulations that implement this statutory framework. Under these regulations, an institution is treated as well capitalized if its ratio of total capital to risk-weighted assets is 10% or more, its ratio of core capital to risk-weighted assets is 6% or more, its ratio of core capital to total assets (leverage ratio) is 5% or more, and it is not subject to any federal supervisory order or directive to meet a specific capital level. In order to be adequately capitalized, an institution must have a total risk-based capital ratio of not less than 8%, a core capital to risk-weighted assets ratio of not less than 4%, and a leverage ratio of not less than 4%. An institution that is not well capitalized is subject to certain restrictions on brokered deposits, including restrictions on the rates it can offer on its deposits generally. Any institution which is neither well capitalized nor adequately capitalized is considered undercapitalized.

Undercapitalized institutions are subject to certain prompt corrective action requirements, regulatory controls and restrictions which become more extensive as an institution becomes more severely undercapitalized. Failure by either Banner Bank and Islanders Bank to comply with applicable capital requirements would, if unremedied, result in progressively more severe restrictions on its activities and lead to enforcement actions, including, but not limited to, the issuance of a capital directive to ensure the maintenance of required capital levels and, ultimately, the appointment of the FDIC as receiver or conservator. Banking regulators will take prompt corrective action with respect to depository institutions that do not meet minimum capital requirements. Additionally, approval of any regulatory application filed for their review may be dependent on compliance with capital requirements.

At December 31, 2013, both Banner Bank and Islanders Bank were categorized as “well capitalized” under the prompt corrective action regulations of the FDIC. For additional information, see Note 18 of the Notes to Consolidated Financial Statements.

Standards for Safety and Soundness: The federal banking regulatory agencies have prescribed, by regulation, guidelines for all insured depository institutions relating to internal controls, information systems and internal audit systems; loan documentation; credit underwriting; interest rate risk exposure; asset growth; asset quality; earnings; and compensation, fees and benefits. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. Each insured depository institution must implement a comprehensive written information security program that includes administrative, technical, and physical safeguards appropriate to the institution's size and complexity and the nature and scope of its activities. The information security program must be designed to ensure the security and confidentiality of customer information, protect against any unanticipated threats or hazards to the security or integrity of such information, protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer, and ensure the proper disposal of customer and consumer information. Each insured depository institution must also develop and implement a risk-based response program to address incidents of unauthorized access to customer information in customer information systems. If the FDIC determines that an institution fails to meet any of these guidelines, it may require an institution to submit to the FDIC an acceptable plan to achieve compliance.

Capital Requirements: Federally insured financial institutions, such as Banner Bank and Islanders Bank, are required to maintain a minimum level of regulatory capital. On July 2, 2013, the Federal Reserve approved a final rule ("Final Rule") to establish a new comprehensive regulatory capital framework for all U.S. financial institutions and their holding companies. On July 9, 2013, the Final Rule was approved as an interim final rule by the FDIC. The Final Rule implements the "Basel III" regulatory capital reforms and changes required by the Dodd-Frank Act, which is discussed below in the section entitled "New Capital Rules." The following is a discussion of the capital requirements the Banks were subject to as of December 31, 2013.

FDIC regulations recognize two types, or tiers, of capital: core (Tier 1) capital and supplementary (Tier 2) capital. Tier 1 capital generally includes common stockholders' equity, qualifying restricted core capital elements (other than cumulative perpetual preferred stock), less deductions for disallowed intangibles and disallowed deferred tax assets. Tier 2 capital, which recognizes up to 100% of Tier 1 capital for risk-based capital purposes includes such items as qualifying general loan loss reserves (up to 1.25% of risk-weighted assets), qualified subordinated debt, redeemable preferred stock, other restricted core capital elements, cumulative perpetual preferred stock, and net unrealized holding gains on equity securities (subject to certain limitations); provided, however, the amount of term subordinated debt and intermediate term preferred stock that may be included in Tier 2 capital for risk-based capital purposes is limited to 50% of Tier 1 capital.

The FDIC currently measures an institution's capital using a leverage limit together with certain risk-based ratios. The FDIC's minimum leverage capital requirement specifies a minimum ratio of Tier 1 capital to average total assets. Most banks are required to maintain a minimum leverage ratio of at least 3% to 4% of total assets. At December 31, 2013, Banner Bank and Islanders Bank had Tier 1 leverage capital ratios of 12.65% and 13.60%, respectively. The FDIC retains the right to require an institution to maintain a higher capital level based on an institution's particular risk profile.

FDIC regulations also establish a measure of capital adequacy based on ratios of qualifying capital to risk-weighted assets. Assets are placed in one of four categories and given a percentage weight based on the relative risk of the category. In addition, certain off-balance-sheet items are converted to balance-sheet credit equivalent amounts, and each amount is then assigned to one of the four categories. Under the guidelines, the ratio of total capital (Tier 1 capital plus Tier 2 capital) to risk-weighted assets must be at least 8%, and the ratio of Tier 1 capital to risk-weighted assets must be at least 4%. In evaluating the adequacy of a bank's capital, the FDIC may also consider other factors that may affect the bank's financial condition. Such factors may include interest rate risk exposure, liquidity, funding and market risks, the quality and level of earnings, concentration of credit risk, risks arising from nontraditional activities, loan and investment quality, the effectiveness of loan and investment policies, and management's ability to monitor and control financial operating risks. At December 31, 2013, Banner Bank and Islanders Bank had Tier 1 risk-based capital ratios of 14.49% and 17.48%, respectively, and total risk-based capital ratios of 15.75% and 18.73%, respectively.

FDIC capital requirements are designated as the minimum acceptable standards for banks whose overall financial condition is fundamentally sound, which are well-managed and have no material or significant financial weaknesses. The FDIC capital regulations state that, where the FDIC determines that the financial history or condition, including off-balance-sheet risk, managerial resources and/or the future earnings prospects of a bank are not adequate and/or a bank has a significant volume of assets classified substandard, doubtful or loss or otherwise criticized, the FDIC may determine that the minimum adequate amount of capital for the bank is greater than the minimum standards established in the regulation.

We believe that, under the current regulations, Banner Bank and Islanders Bank exceed their minimum capital requirements. However, events beyond the control of the Banks, such as weak or depressed economic conditions in areas where they have most of their loans, could adversely affect future earnings and, consequently, the ability of the Banks to meet their capital requirements. For additional information concerning Banner Bank's and Islanders Bank's capital, see Note 18 of the Notes to the Consolidated Financial Statements.

New Capital Rules. The Final Rules approved by the Federal Reserve and subsequently approved as an interim final rule by the FDIC substantially amend the regulatory risk-based capital rules applicable to Banner Corporation and the Banks.

Effective in 2015 (with some changes generally transitioned into full effectiveness over two to four years), the Banks will be subject to new capital requirements adopted by the FDIC. These new requirements create a new required ratio for common equity Tier 1 (“CET1”) capital, increase the leverage and Tier 1 capital ratios, change the risk-weights of certain assets for purposes of the risk-based capital ratios, create an additional capital conservation buffer over the required capital ratios and change what qualifies as capital for purposes of meeting these various capital requirements. Beginning in 2016, failure to maintain the required capital conservation buffer will limit the ability of the Banks to pay dividends, repurchase shares or pay discretionary bonuses.

When these new requirements become effective in 2015, the Banks’ leverage ratio of 4% of adjusted total assets and total capital ratio of 8% of risk-weighted assets will remain the same; however, the Tier 1 capital ratio requirement will increase from 4.0% to 6.5% of risk-weighted assets.

In addition, the Banks will have to meet the new CET1 capital ratio of 4.5% of risk-weighted assets, with CET1 consisting of qualifying Tier 1 capital less all capital components that are not considered common equity.

For all of these capital requirements, there are a number of changes in what constitutes regulatory capital, some of which are subject to a two-year transition period. These changes include the phasing-out of certain instruments as qualifying capital. The Banks do not have any of these instruments. Under the new requirements for total capital, Tier 2 capital is no longer limited to the amount of Tier 1 capital included in total capital.

Mortgage servicing rights, certain deferred tax assets and investments in unconsolidated subsidiaries over designated percentages of common stock will be deducted from capital, subject to a two-year transition period. In addition, Tier 1 capital will include accumulated other comprehensive income, which includes all unrealized gains and losses on available-for-sale debt and equity securities, subject to a two-year transition period. Because of their asset size, the Banks have the one-time option of deciding in the first quarter of 2015 whether to permanently opt out of the inclusion of accumulated other comprehensive income in their capital calculations. The Banks are considering whether to take advantage of this opt-out to reduce the impact of market volatility on its regulatory capital levels.

The new requirements also include changes in the risk-weights of assets to better reflect credit risk and other risk exposures. These include a 150% risk weight (up from 100%) for certain high volatility commercial real estate acquisitions, development and construction loans and for non-residential mortgage loans that are 90 days past due or otherwise in nonaccrual status; a 20% (up from 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable; a 250% risk weight (up from 100%) for mortgage servicing and deferred tax assets that are not deducted from capital; and increased risk-weights (0% to 600%) for equity exposures.

The application of these more stringent capital requirements could, among other things, result in lower returns on invested capital, over time require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Implementation of changes to asset risk weightings for risk-based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in management modifying its business strategy and could limit our ability to make distributions, including paying out dividends or buying back shares. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. Any additional changes in our regulation and oversight, in the form of new laws, rules and regulations could make compliance more difficult or expensive or otherwise materially adversely affect our business, financial condition or prospects.

Commercial Real Estate Lending Concentrations: The federal banking agencies have issued guidance on sound risk management practices for concentrations in commercial real estate lending. The particular focus is on exposure to commercial real estate loans that are dependent on the cash flow from the real estate held as collateral and that are likely to be sensitive to conditions in the commercial real estate market (as opposed to real estate collateral held as a secondary source of repayment or as an abundance of caution). The purpose of the guidance is not to limit a bank's commercial real estate lending but to guide banks in developing risk management practices and capital levels commensurate with the level and nature of real estate concentrations. The guidance directs the FDIC and other bank regulatory agencies to focus their supervisory resources on institutions that may have significant commercial real estate loan concentration risk. A bank that has experienced rapid growth in commercial real estate lending, has notable exposure to a specific type of commercial real estate loan, or is approaching or exceeding the following supervisory criteria may be identified for further supervisory analysis with respect to real estate concentration risk:

- Total reported loans for construction, land development and other land represent 100% or more of the bank's capital; or

• Total commercial real estate loans (as defined in the guidance) represent 300% or more of the bank's total capital or the outstanding balance of the bank's commercial real estate loan portfolio has increased 50% or more during the prior 36 months.

The guidance provides that the strength of an institution's lending and risk management practices with respect to such concentrations will be taken into account in supervisory guidance on evaluation of capital adequacy. As of December 31, 2013, Banner Bank's and Islanders Bank's aggregate loans for construction, land development and land loans were 114% and 48% of total capital, respectively. In addition, at December 31, 2013, Banner Bank's and Islanders Bank's loans on commercial real estate were 265% and 192% of total capital, respectively.

Activities and Investments of Insured State-Chartered Financial Institutions: Federal law generally limits the activities and equity investments of FDIC insured, state-chartered banks to those that are permissible for national banks. An insured state bank is not prohibited from, among other things, (1) acquiring or retaining a majority interest in a subsidiary, (2) investing as a limited partner in a partnership the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such limited partnership investments may not exceed 2% of the bank's total assets, (3) acquiring up to 10% of the voting stock of a company that solely provides or re-insures directors', trustees' and officers' liability insurance coverage or bankers' blanket bond group insurance coverage for insured depository institutions, and (4) acquiring or retaining the voting shares of a depository institution if certain requirements are met.

Washington State has enacted a law regarding financial institution parity. Primarily, the law affords Washington-chartered commercial banks the same powers as Washington-chartered savings banks. In order for a bank to exercise these powers, it must provide 30 days notice to the Director of the Washington Department of Financial Institutions and the Director must authorize the requested activity. In addition, the law provides that Washington-chartered commercial banks may exercise any of the powers that the Federal Reserve has determined to be closely related to the business of banking and the powers of national banks, subject to the approval of the Director in certain situations. The law also provides that Washington-chartered savings banks may exercise any of the powers of Washington-chartered commercial banks, national banks and federally-chartered savings banks, subject to the approval of the Director in certain situations. Finally, the law provides additional flexibility for Washington-chartered commercial and savings banks with respect to interest rates on loans and other extensions of credit. Specifically, they may charge the maximum interest rate allowable for loans and other extensions of credit by federally-chartered financial institutions to Washington residents.

Environmental Issues Associated With Real Estate Lending: The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) is a federal statute that generally imposes strict liability on all prior and present “owners and operators” of sites containing hazardous waste. However, Congress asked to protect secured creditors by providing that the term “owner and operator” excludes a person whose ownership is limited to protecting its security interest in the site. Since the enactment of the CERCLA, this “secured creditor exemption” has been the subject of judicial interpretations which have left open the possibility that lenders could be liable for cleanup costs on contaminated property that they hold as collateral for a loan. To the extent that legal uncertainty exists in this area, all creditors, including Banner Bank and Islanders Bank, that have made loans secured by properties with potential hazardous waste contamination (such as petroleum contamination) could be subject to liability for cleanup costs, which costs often substantially exceed the value of the collateral property.

Federal Reserve System: The Federal Reserve Board requires that all depository institutions maintain reserves on transaction accounts or non-personal time deposits. These reserves may be in the form of cash or non-interest-bearing deposits with the regional Federal Reserve Bank. Interest-bearing checking accounts and other types of accounts that permit payments or transfers to third parties fall within the definition of transaction accounts and are subject to Regulation D reserve requirements, as are any non-personal time deposits at a bank. At December 31, 2013, the Banks' deposits with the Federal Reserve Bank and vault cash exceeded their reserve requirements.

Affiliate Transactions: Banner Corporation, Banner Bank and Islanders Bank are separate and distinct legal entities. Federal laws strictly limit the ability of banks to engage in certain transactions with their affiliates, including their bank holding companies. Transactions deemed to be a “covered transaction” under Section 23A of the Federal Reserve Act and between a subsidiary bank and its parent company or any non-bank subsidiary of the bank holding company are limited to 10% of the subsidiary bank's capital and surplus and, with respect to the parent company and all such non-bank subsidiaries, to an aggregate of 20% of the subsidiary bank's capital and surplus. Further, covered transactions that are loans and extensions of credit generally are required to be secured by eligible collateral in specified amounts. Federal law also requires that covered transactions and certain other transactions listed in Section 23B of the Federal Reserve Act between a bank and its affiliates be on terms as favorable to the bank as transactions with non-affiliates.

Community Reinvestment Act: Banner Bank and Islanders Bank are subject to the provisions of the Community Reinvestment Act of 1977 (CRA), which requires the appropriate federal bank regulatory agency to assess a bank's performance under the CRA in meeting the credit needs of the community serviced by the bank, including low and moderate income neighborhoods. The regulatory agency's assessment of the bank's record is made available to the public. Further, a bank's CRA performance rating must be considered in connection with a bank's application to, among other things, to establish a new branch office that will accept deposits, relocate an existing office or merge or consolidate with, or acquire the assets or assume the liabilities of, a federally regulated financial institution. Both Banner Bank and Islanders Bank received a “satisfactory” rating during their most recent CRA examinations.

Dividends: The amount of dividends payable by the Banks to the Company will depend upon their earnings and capital position, and is limited by federal and state laws, regulations and policies. Federal law further provides that no insured depository institution may make any capital distribution (which includes a cash dividend) if, after making the distribution, the institution would be “undercapitalized,” as defined in the prompt corrective action regulations. Moreover, the federal bank regulatory agencies also have the general authority to limit the dividends paid by insured banks if such payments should be deemed to constitute an unsafe and unsound practice.

Privacy Standards: The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 (GLBA) modernized the financial services industry by establishing a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms and other financial service providers. Banner Bank and Islanders Bank are subject to FDIC regulations implementing the privacy protection provisions of the GLBA. These regulations require the Banks to disclose their privacy policy, including informing consumers of their information sharing practices and informing consumers of their rights to opt out of certain practices.

Anti-Money Laundering and Customer Identification: In response to the terrorist events of September 11, 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA Patriot Act) was signed into law on October 26, 2001. The USA Patriot Act gives the federal government new powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing, and broadened anti-money laundering requirements. Bank regulators are directed to consider a holding company's effectiveness in combating money laundering when ruling on Bank Holding Company Act and Bank Merger Act applications. Banner Bank's and Islanders Bank's policies and procedures comply with the requirements of the USA Patriot Act.

Other Consumer Protection Laws and Regulations: The Dodd-Frank Act established the Consumer Financial Protection Bureau (CFPB) and empowered it to exercise broad regulatory, supervisory and enforcement authority with respect to both new and existing consumer financial protection laws. The Banks are subject to consumer protection regulations issued by the CFPB, but as financial institutions with assets of less than $10 billion, the Banks are generally subject to supervision and enforcement by the FDIC and the Washington Department of Financial Institutions (DFI) with respect to our compliance with consumer financial protection laws and CFPB regulations.

The Banks are subject to a broad array of federal and state consumer protection laws and regulations that govern almost every aspect of its business relationships with consumers. While the list set forth below is not exhaustive, these include the Truth-in-Lending Act, the Truth in

Savings Act, the Electronic Fund Transfers Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Home Mortgage Disclosure Act, the Fair Credit Reporting Act, the Right to Financial Privacy Act, the Home Ownership and Equity Protection Act, the Fair Credit Billing Act, the Homeowners Protection Act, the Check Clearing for the 21st Century Act, laws governing flood insurance, laws governing consumer protections in connection with the sale of insurance, federal and state laws prohibiting unfair and deceptive business practices, and various regulations that implement some or all of the foregoing. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans, collecting loans, and providing other services. Failure to comply with these laws and regulations can subject the Banks to various penalties, including but not limited to, enforcement actions, injunctions, fines, civil liability, criminal penalties, punitive damages, and the loss of certain contractual rights.

Banner Corporation

General: Banner Corporation, as sole shareholder of Banner Bank and Islanders Bank, is a bank holding company registered with the Federal Reserve. Bank holding companies are subject to comprehensive regulation by the Federal Reserve under the Bank Holding Company Act of 1956, as amended, or the BHCA, and the regulations of the Federal Reserve. We are required to file quarterly reports with the Federal Reserve and provide additional information as the Federal Reserve may require. The Federal Reserve may examine us, and any of our subsidiaries, and charge us for the cost of the examination. The Federal Reserve also has extensive enforcement authority over bank holding companies, including, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders and to require that a holding company divest subsidiaries (including its bank subsidiaries). In general, enforcement actions may be initiated for violations of law and regulations and unsafe or unsound practices. Banner Corporation is also required to file certain reports with, and otherwise comply with the rules and regulations of the Securities and Exchange Commission.

The Bank Holding Company Act: Under the BHCA, we are supervised by the Federal Reserve. The Federal Reserve has a policy that a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, the Dodd-Frank Act and earlier Federal Reserve policy provide that a bank holding company should serve as a source of strength to its subsidiary banks by having the ability to provide financial assistance to its subsidiary banks during periods of financial distress to the banks. A bank holding company's failure to meet its obligation to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve to be an unsafe and unsound banking practice or a violation of the Federal Reserve's regulations or both. The Dodd-Frank Act requires new regulations to be promulgated concerning the source of strength. Banner Corporation and any subsidiaries that it may control are considered “affiliates” within the meaning of the Federal Reserve Act, and transactions between Banner Bank and affiliates are subject to numerous restrictions. With some exceptions, Banner Corporation, and its subsidiaries, are prohibited from tying the provision of various services, such as extensions of credit, to other services offered by Banner Corporation, or by its affiliates.

Acquisitions: The BHCA prohibits a bank holding company, with certain exceptions, from acquiring ownership or control of more than 5% of the voting shares of any company that is not a bank or bank holding company and from engaging in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. Under the BHCA, the Federal Reserve may approve the ownership of shares by a bank holding company in any company, the activities of which the Federal Reserve has determined to be so closely related to the business of banking or managing or controlling banks as to be a proper incident thereto. These activities include: operating a savings institution, mortgage company, finance company, credit card company or factoring company; performing certain data processing operations; providing certain investment and financial advice; underwriting and acting as an insurance agent for certain types of credit-related insurance; leasing property on a full-payout, non-operating basis;

selling money orders, travelers' checks and U.S. Savings Bonds; real estate and personal property appraising; providing tax planning and preparation services; and, subject to certain limitations, providing securities brokerage services for customers.

Federal Securities Laws: Banner Corporation's common stock is registered with the Securities and Exchange Commission under Section 12(b) of the Securities Exchange Act of 1934, as amended. We are subject to information, proxy solicitation, insider trading restrictions and other requirements under the Securities Exchange Act of 1934 (the Exchange Act).

The Dodd-Frank Act. On July 21, 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank-Act imposes new restrictions and an expanded framework of regulatory oversight for financial institutions, including depository institutions and implements new capital regulations that Banner Corporation and the Banks will become subject to and that are discussed above under the section entitled "Banner Bank and Islanders Bank—Capital Requirements—New Capital Rules."

In addition, among other changes, the Dodd-Frank Act requires public companies, like Banner Corporation, to (i) provide their shareholders with a non-binding vote (a) at least once every three years on the compensation paid to executive officers and (b) at least once every six years on whether they should have a "say on pay" vote every one, two or three years; (ii) have a separate, non-binding shareholder vote regarding golden parachutes for named executive officers when a shareholder vote takes place on mergers, acquisitions, dispositions or other transactions that would trigger the parachute payments; (iii) provide disclosure in annual proxy materials concerning the relationship between the executive compensation paid and the financial performance of the issuer; and (iv) amend Item 402 of Regulation S-K to require companies to disclose the ratio of the Chief Executive Officer's annual total compensation to the median annual total compensation of all other employees. For certain of these changes, the implementing regulations have not been promulgated, so the full impact of the Dodd-Frank Act on public companies cannot be determined at this time.

Sarbanes-Oxley Act of 2002: The Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act was signed into law on July 30, 2002 in response to public concerns regarding corporate accountability in connection with several accounting scandals. The stated goals of the Sarbanes-Oxley Act are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The Sarbanes-Oxley Act generally applies to all companies, such as Banner Corporation, that file or are required to file periodic reports with the Securities and Exchange Commission (SEC), under the Exchange Act.

The Sarbanes-Oxley Act includes very specific additional disclosure requirements and corporate governance rules and requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules and mandates further studies of certain issues by the SEC and the Comptroller General. Our policies and procedures have been updated to comply with the requirements of the Sarbanes-Oxley Act.

Interstate Banking and Branching: The Federal Reserve must approve an application of a bank holding company to acquire control of, or acquire all or substantially all of the assets of, a bank located in a state other than the holding company's home state, without regard to whether the transaction is prohibited by the laws of any state. The Federal Reserve may not approve the acquisition of a bank that has not been in existence for the minimum time period (not exceeding five years) specified by the statutory law of the host state. Nor may the Federal Reserve approve an application if the applicant (and its depository institution affiliates) controls or would control more than 10% of the insured deposits in the United States or 30% or more of the deposits in the target bank's home state or in any state in which the target bank maintains a branch. Federal law does not affect the authority of states to limit the percentage of total insured deposits in the state which may be held or controlled by a bank holding company to the extent such limitation does not discriminate against out-of-state banks or bank holding companies. Individual states may also waive the 30% state-wide concentration limit contained in the federal law.

The federal banking agencies are authorized to approve interstate merger transactions without regard to whether the transaction is prohibited by the law of any state, unless the home state of one of the banks adopted a law prior to June 1, 1997 which applies equally to all out-of-state banks and expressly prohibits merger transactions involving out-of-state banks. Interstate acquisitions of branches will be permitted only if the law of the state in which the branch is located permits such acquisitions. Interstate mergers and branch acquisitions will also be subject to the nationwide and statewide insured deposit concentration amounts described above. Under the Dodd-Frank Act, the federal banking agencies may generally approve interstate de novo branching.

Dividends: The Federal Reserve has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses its view that although there are no specific regulations restricting dividend payments by bank holding companies other than state corporate laws, a bank holding company must maintain an adequate capital position and generally should not pay cash dividends unless the company's net income for the past year is sufficient to fully fund the cash dividends and that the prospective rate of earnings appears consistent with the company's capital needs, asset quality, and overall financial condition. The Federal Reserve policy statement also indicates that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends.

Capital Requirements: The Federal Reserve has established capital adequacy guidelines for bank holding companies that generally parallel the capital requirements of the FDIC for the Banks, although the Federal Reserve regulations provide for the inclusion of certain trust preferred securities for up to 25% of Tier 1 capital in determining compliance with the guidelines. The Federal Reserve regulations provide that capital standards will be applied on a consolidated basis in the case of a bank holding company with $500 million or more in total consolidated assets. The guidelines require that a company's total risk-based capital must equal 8% of risk-weighted assets and one half of the 8% (4%) must consist of Tier 1 (core) capital. As of December 31, 2013, Banner Corporation's total risk-based capital was 16.99% of risk-weighted assets and its Tier 1 (core) capital was 15.73% of risk-weighted assets. In July 2013, the Federal Reserve and the FDIC approved a new rule that will substantially amend the regulatory risk-based capital rules to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. For a discussion of the new capital rules, see the section above entitled "Banner Bank and Islanders Bank—Capital Requirements—New Capital Rules."

Stock Repurchases: A bank holding company, except for certain "well-capitalized" and highly rated bank holding companies, is required to give the Federal Reserve prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding twelve months, is equal to 10% or more of its consolidated net worth. The Federal Reserve may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe or unsound practice or would violate any law, regulation, Federal Reserve order or any condition imposed by, or written agreement with, the Federal Reserve. During the year ended December 31, 2013, the only Banner Corporation shares we repurchased were 12,185 shares surrendered by employees to satisfy tax withholding obligations upon the vesting of restricted stock grants.

Management Personnel
Executive Officers

The following table sets forth information with respect to the executive officers of Banner Corporation and Banner Bank as of December 31, 2013:

Name	Age	Position with Banner Corporation	Position with Banner Bank
Mark J. Grescovich	49	President, Chief Executive Officer, Director	President, Chief Executive Officer, Director
Lloyd W. Baker	65	Executive Vice President, Chief Financial Officer	Executive Vice President, Chief Financial Officer
Cynthia D. Purcell	56		Executive Vice President, Retail Banking and Administration
Richard B. Barton	70		Executive Vice President, Chief Lending Officer
Steven W. Rust	66		Executive Vice President, Chief Information Officer
Douglas M. Bennett	61		Executive Vice President, Real Estate Lending Operations
Tyrone J. Bliss	56		Executive Vice President, Risk Management and Compliance Officer
Gary W. Wagers	53		Executive Vice President, Retail Products and Services
James T. Reed, Jr.	51		Senior Vice President, Commercial Banking
M. Kirk Quillin	51		Senior Vice President, Commercial Banking

Biographical Information

Set forth below is certain information regarding the executive officers of Banner Corporation and Banner Bank. There are no family relationships among or between the directors or executive officers.

Mark J. Grescovich is President and Chief Executive Officer, and a director, of Banner Corporation and Banner Bank. Mr. Grescovich joined the Bank in April 2010 and became Chief Executive Officer in August 2010 following an extensive banking career specializing in finance, credit administration and risk management. Prior to joining the Bank, Mr. Grescovich was the Executive Vice President and Chief Corporate Banking Officer for Akron, Ohio-based FirstMerit Corporation and FirstMerit Bank N.A., a commercial bank with $14.5 billion in assets and over 200 branch offices in three states. He assumed the role and responsibility for FirstMerit's commercial and regional line of business in 2007, having served since 1994 in various commercial and corporate banking positions, including that of Chief Credit Officer. Prior to joining FirstMerit, Mr. Grescovich was a Managing Partner in corporate finance with Sequoia Financial Group, Inc. of Akron, Ohio and a commercial and corporate lending officer and credit analyst with Society National Bank of Cleveland, Ohio.

Lloyd W. Baker joined First Savings Bank of Washington (now Banner Bank) in 1995 as Asset/Liability Manager, has been a member of the executive management committee since 1998 and has served as the Chief Financial Officer of Banner Corporation and Banner Bank since 2000. His banking career began in 1973.

Cynthia D. Purcell was formerly the Chief Financial Officer of Inland Empire Bank (now Banner Bank), which she joined in 1981, and has served in her current position as Executive Vice President since 2000. Ms. Purcell is responsible for Retail Banking and Administration.

Richard B. Barton joined Banner Bank in 2002 as Chief Credit Officer. Mr. Barton's banking career began in 1972 with Seafirst Bank and Bank of America, where he served in a variety of commercial lending and credit risk management positions. In his last positions at Bank of America before joining Banner Bank, he served as the senior real estate risk management executive for the Pacific Northwest and as the credit risk management executive for the west coast home builder division. Mr. Barton was named Chief Lending Officer in 2008.

Steven W. Rust joined Banner Bank in October 2005. Mr. Rust has over 35 years of relevant industry experience prior to joining Banner Bank and was founder and President of InfoSoft Technology, through which he worked for nine years as a technology consultant and interim Chief

Information Officer for banks and insurance companies. He worked 19 years with US Bank/West One Bancorp as Senior Vice President & Manager of Information Systems.

Douglas M. Bennett, who joined First Federal Savings and Loan (now Banner Bank) in 1974, has over 37 years of experience in real estate lending. He has served as a member of Banner Bank's executive management committee since 2004.

Tyrone J. Bliss joined Banner Bank in 2002. Mr. Bliss is a Certified Regulatory Compliance Manager with more than 35 years of commercial banking experience. Prior to joining Banner Bank, his career included senior risk management and compliance positions with Bank of America's Consumer Finance Group, Barnett Banks, Inc., and Florida-based community banks.

Gary W. Wagers joined Banner Bank as Senior Vice President, Consumer Lending Administration in 2002 and was named to his current position in Retail Products and Services in January 2008. Mr. Wagers began his banking career in 1982 at Idaho First National Bank. Prior to joining Banner Bank, his career included senior management positions in retail lending and branch banking operations with West One Bank and US Bank.

James T. Reed, Jr. joined Towne Bank (now Banner Bank) as a Vice President and Commercial Branch Manager in July 1995 and was named to his current position as the West Region Commercial Banking Executive in July 2012. He is responsible for Commercial Banking in Western Washington and Western Oregon as well as Specialty Banking. Mr. Reed began his banking career with Rainier Bank which later became Security Pacific Bank and later still West One Bank. He earned a Bachelor of Arts in Interdisciplinary Arts and Sciences from the University of Washington, and earned certificates from Pacific Coast Banking School, Northwest Intermediate Banking School and Northwest Intermediate Commercial Lending School. Currently, Mr. Reed sits on the University of Washington Bothell Advisory Board and the University of Washington Foundation Board.

M. Kirk Quillin joined Banner Bank's commercial banking group in 2002 as a Senior Vice President and commercial loan manager and was named to his current position as the East Region Commercial Banking Executive in July 2012. He is responsible for commercial and specialty banking for all locations in Eastern Washington, Eastern Oregon and Idaho. Mr. Quillin began his career in the banking industry in 1984 with Idaho First National Bank, which is now U.S. Bank. His career also included management positions in commercial lending with Washington Mutual. He earned a B.S. in Finance and Economics from Boise State University and was certified by the Pacific Coast Banking School and Northwest Intermediate Commercial Lending School.

Corporate Information

Our principal executive offices are located at 10 South First Avenue, Walla Walla, Washington 99362. Our telephone number is (509) 527-3636. We maintain a website with the address www.bannerbank.com. The information contained on our website is not included as a part of, or incorporated by reference into, this Annual Report on Form 10-K. Other than an investor's own Internet access charges, we make available free of charge through our website our Annual Report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we have electronically filed such material with, or furnished such material to, the Securities and Exchange Commission.

Item 1A – Risk Factors

An investment in our common stock is subject to risks inherent in our business. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included in this report. In addition to the risks and uncertainties described below, other risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition, capital levels, cash flows, liquidity, results of operations and prospects. The market price of our common stock could decline significantly due to any of these identified or other risks, and you could lose some or all of your investment. The risks discussed below also include forward-looking statements, and our actual results may differ substantially from those discussed in these forward-looking statements. This report is qualified in its entirety by these risk factors.

Risks Factors Related to Our Business

Our business may be adversely affected by downturns in the national economy and the regional economies on which we depend.

Our operations are significantly affected by national and regional economic conditions. Weakness in the national economy or the economies of the markets in which we operate could have a material adverse effect on our financial condition, results of operations and prospects. Most of our loans are to businesses and individuals in the states of Washington, Oregon and Idaho. All of our branches and most of our deposit customers are also located in these three states. Beginning in 2008, Washington, Oregon and Idaho experienced significant home price declines, increased foreclosures and high unemployment rates, and each state continues to face fiscal challenges, which may have adverse long term effects on economic conditions in those states. While those negative trends have slowed and we have seen improvement in our Northwest markets, new economic challenges in any of our markets could have a material adverse effect on our financial condition and results of operations. As a result of the high concentration of our customer base in the Puget Sound area of Washington State, the deterioration of businesses in the Puget Sound area, or one or more businesses with a large employee base in that area, could have a material adverse effect on our business, financial condition, liquidity, results of operations and prospects. In addition, weakness in the global economy has adversely affected many businesses operating in our markets that are dependent upon international trade.

A deterioration in economic conditions or a prolonged delay in economic recovery in the market areas we serve, in particular the Puget Sound area of Washington State, the Portland, Oregon metropolitan area, Spokane, Washington, Boise, Idaho and the agricultural regions of the Columbia Basin, could result in the following consequences, any of which could have a material adverse effect on our business, financial condition, liquidity and results of operations:

- demand for our products and services may decline;
- loan delinquencies, problem assets and foreclosures may increase;
- collateral for loans, especially real estate, may decline in value, in turn reducing customers' borrowing power, reducing the value of assets and collateral associated with existing loans;
- the net worth and liquidity of loan guarantors may decline, impairing their ability to honor commitments to us; and
- the amount of our low-cost or non-interest-bearing deposits may decrease.

A return of recessionary conditions could result in increases in our level of non-performing loans and/or reduce demand for our products and services, which could have adverse effect on our results of operations.

The ongoing debate in Congress regarding the national debt ceiling and federal budget deficit and concerns over the United States' credit rating (which was downgraded by Standard & Poor's), the European sovereign debt crisis, the overall weakness in the economy and continued high unemployment in the United States, among other economic indicators, have contributed to increased volatility in the capital markets and diminished expectations for the economy.

A return of recessionary conditions and/or continued negative developments in the domestic and international credit markets may significantly affect the markets in which we do business, the value of our loans and investments, and our ongoing operations, costs and profitability. Further, declines in real estate values and sales volumes and continued high unemployment levels may result in higher than expected loan delinquencies and a decline in demand for our products and services. These negative events may cause us to incur losses and may adversely affect our capital, liquidity, and financial condition.
Furthermore, the Board of Governors of the Federal Reserve System, in an attempt to help the overall economy, has, among other things, kept interest rates low through its targeted federal funds rate and the purchase of U.S. Treasury and mortgage-backed securities. If the Federal Reserve Board increases the federal funds rate or more rapidly curtails purchases of mortgage-backed securities, market interest rates would likely rise, which may negatively affect the housing markets and the U.S. economic recovery. In addition, deflationary pressures, while possibly lowering our operating costs, could have a significant negative effect on our borrowers, especially our business borrowers, and the values of underlying collateral securing loans, which could negatively affect our financial performance.

Declines in property value have increased the loan-to-value ratios on a significant portion of our residential mortgage loan portfolio, which exposes us to greater risk of loss.

Many of our residential mortgage loans are secured by liens on mortgage properties in which the borrowers have little or no equity because either we originated the loan with a relatively high combined loan-to-value ratio or because of the decline in home values in our market areas. Residential loans with high combined loan-to-value ratios will be more sensitive to declining property values than those with lower combined loan-to-value ratios and therefore may experience a higher incidence of default and severity of losses. In addition, if the borrowers sell their homes, such borrowers may be unable to repay their loans in full from the sale proceeds. As a result, these loans may experience higher rates of delinquencies, defaults and losses.

Our loan portfolio includes loans with a higher risk of loss.

We originate construction and land loans, commercial and multifamily mortgage loans, commercial business loans, agricultural mortgage loans and agricultural loans, and consumer loans, primarily within our market areas. We had $2.89 billion outstanding in these types of higher risk loans at December 31, 2013 compared to $2.65 billion at December 31, 2012. These loans typically present different risks to us for a number of reasons, including those discussed below:

- Construction and Land Loans. At December 31, 2013, construction and land loans were $351 million or 10% of our total loan portfolio. This type of lending contains the inherent difficulty in estimating both a property's value at completion of the project and the estimated cost (including interest) of the project. If the estimate of construction cost proves to be inaccurate, we may be required to advance funds beyond the amount originally committed to permit completion of the project. If the estimate of value upon completion proves to be inaccurate, we may be confronted at, or prior to, the maturity of the loan with a project the value of which is insufficient to assure full repayment. In addition, speculative construction loans to a builder are often associated with homes that are not pre-sold, and thus pose a greater potential risk to us than construction loans to individuals on their personal residences. Loans on land under development or held for future construction also pose additional risk because of the lack of income being produced by the property and the potential illiquid nature of the collateral. These risks can be significantly impacted by supply and demand conditions. As a result, this type of lending often involves the disbursement of substantial funds with repayment dependent on the success of the ultimate project and the ability of the borrower to sell the property, rather than the ability of the borrower or guarantor to independently repay principal and interest. While our origination of these types of loans has decreased significantly from earlier periods, as a result of the recent improvement in real estate values in certain of our market areas, this category of lending increased by $35 million or 11% in 2013. At December 31, 2013, construction and land loans that were non-performing were $1 million, or 5% of our total non-performing loans.

- Commercial and Multifamily Real Estate Loans. At December 31, 2013, commercial and multifamily real estate loans were $1.332 billion, or 39% of our total loan portfolio. These loans typically involve higher principal amounts than other types of loans and some of our commercial borrowers have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan. Repayment of these loans is dependent upon income being generated from the property securing the loan in amounts sufficient to cover operating expenses and debt service, which may be adversely affected by changes in the economy or local market conditions. In addition, many of our commercial and multifamily real estate loans are not fully amortizing and contain large balloon payments upon maturity. Such balloon payments may require the borrower to either sell or refinance the underlying property in order to make the payment, which may increase the risk of default or non-payment. This risk was exacerbated in the recent recession and could remain an elevated risk in the current slow recovery economic environment. At December 31, 2013, commercial and multifamily real estate loans that were non-performing were $6 million, or 25% of our total non-performing loans.

- Commercial Business Loans. At December 31, 2013, commercial business loans were $682 million, or 20% of our total loan portfolio. Our commercial loans are primarily made based on the cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The borrowers' cash flow may prove to be unpredictable, and collateral securing these loans may fluctuate in value. Most often, this collateral is accounts receivable, inventory, equipment or real estate. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. Other collateral securing loans may depreciate over time, may be difficult to appraise, may be illiquid and may fluctuate in value based on the success of the business. At December 31, 2013, commercial business loans that were non-performing were $723,000, or 3% of our total non-performing loans.

- Agricultural Loans. At December 31, 2013, agricultural loans were $228 million, or 7% of our total loan portfolio. Repayment is dependent upon the successful operation of the business, which is greatly dependent on many things outside the control of either us or the borrowers. These factors include weather, commodity prices, and interest rates among others. Collateral securing these loans may be difficult to evaluate, manage or liquidate and may not provide an adequate source of repayment. At December 31, 2013, there were $105,000 of agricultural loans that were non-performing.

- Consumer Loans. At December 31, 2013, consumer loans were $295 million, or 9% of our total loan portfolio. Consumer loans (such as personal lines of credit) are collateralized, if at all, with assets that may not provide an adequate source of payment of the loan due to depreciation, damage, or loss. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on these loans. At December 31, 2013, consumer loans that were non-performing were $1 million, or 5% of our total non-performing loans.

Our allowance for loan losses may prove to be insufficient to absorb losses in our loan portfolio which would cause our results of operations, liquidity and financial condition to be adversely affected.

Lending money is a substantial part of our business and each loan carries a certain risk that it will not be repaid in accordance with its terms or that any underlying collateral will not be sufficient to assure repayment. This risk is affected by, among other things:

- cash flow of the borrower and/or the project being financed;
- in the case of a collateralized loan, the changes and uncertainties as to the future value of the collateral;
- the duration of the loan;
- the character and creditworthiness of a particular borrower; and
- changes in economic and industry conditions.

We maintain an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense, which we believe is appropriate to provide for probable losses in our loan portfolio. The amount of this allowance is determined by our management through periodic reviews and consideration of several factors, including, but not limited to:

- our general reserve, based on our historical default and loss experience, certain macroeconomic factors, and management's expectations of future events;
- our specific reserve, based on our evaluation of non-performing loans and their underlying collateral; and
- an unallocated reserve to provide for other credit losses inherent in our portfolio that may not have been contemplated in the other loss factors.

The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we review our loans and loss and delinquency experience, and evaluate economic conditions and make significant estimates of current credit risks and future trends, all of which may undergo material changes. If our estimates are incorrect, the allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in the need for additions to our allowance through an increase in the provision for loan losses. Deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in the allowance for loan losses. In addition, bank regulatory agencies periodically review our allowance for loan losses and may require an increase in the provision for possible loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for loan losses, we will need additional provisions to increase the allowance for loan losses. Any increases in the provision for loan losses will result in a decrease in net income and may have a material adverse effect on our financial condition, results of operations and capital.

Our growth or future losses may require us to raise additional capital in the future, but that capital may not be available when it is needed or the cost of that capital may be very high.

We are required by federal regulatory authorities to maintain adequate levels of capital to support our operations. We may at some point, however, need to raise additional capital to support continued growth or be required by our regulators to increase our capital resources. Any capital we obtain may result in the dilution of the interests of existing holders of our common stock. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial condition and performance. Accordingly, we cannot make assurances that we will be able to raise additional capital if needed on terms that are acceptable to us, or at all. If we cannot raise additional capital when needed, our ability to further expand our operations could be materially impaired and our financial condition and liquidity could be materially and adversely affected. In addition, if we are unable to raise additional capital when required by our bank regulators, we may be subject to adverse regulatory action.

If our investments in real estate are not properly valued or sufficiently reserved to cover actual losses, or if we are required to increase our valuation reserves, our earnings could be reduced.

We obtain updated valuations in the form of appraisals and broker price opinions when a loan has been foreclosed and the property taken in as REO and at certain other times during the assets holding period. Our net book value (NBV) in the loan at the time of foreclosure and thereafter is compared to the updated market value of the foreclosed property less estimated selling costs (fair value). A charge-off is recorded for any excess in the asset's NBV over its fair value. If our valuation process is incorrect, or if property values decline, the fair value of the investments in real estate may not be sufficient to recover our carrying value in such assets, resulting in the need for additional write-downs. Significant write-downs to our investments in real estate could have a material adverse effect on our financial condition, liquidity and results of operations.

In addition, bank regulators periodically review our REO and may require us to recognize further write-downs. Any increase in our write-downs, as required by the bank regulators, may have a material adverse effect on our financial condition, liquidity and results of operations.

Our securities portfolio may be negatively impacted by fluctuations in market value and interest rates.

Our securities portfolio may be impacted by fluctuations in market value, potentially reducing accumulated other comprehensive income and/or earnings. Fluctuations in market value may be caused by changes in market interest rates, lower market prices for securities and limited investor demand. Our securities portfolio is evaluated for other-than-temporary impairment. If this evaluation shows impairment to the actual or projected cash flows associated with one or more securities, a potential loss to earnings may occur. Changes in interest rates can also have an adverse effect on our financial condition, as our available-for-sale securities are reported at their estimated fair value, and therefore are impacted by fluctuations in interest rates. We increase or decrease our shareholders' equity by the amount of change in the estimated fair value of the available-for-sale securities, net of taxes. There can be no assurance that the declines in market value will not result in other-than-temporary impairments of these assets, which would lead to accounting charges that could have a material adverse effect on our net income and capital levels.

An increase in interest rates, change in the programs offered by secondary market purchasers or our ability to qualify for their programs may reduce our mortgage banking revenues, which would negatively impact our non-interest income.

Our mortgage banking operations provide a significant portion of our non-interest income. We generate mortgage revenues primarily from gains on the sale of single-family mortgage loans pursuant to programs currently offered by Fannie Mae, Freddie Mac, Ginnie Mae and non-GSE investors. These entities account for a substantial portion of the secondary market in residential mortgage loans. Any future changes in these programs, our eligibility to participate in such programs, the criteria for loans to be accepted or laws that significantly affect the activity of such entities could, in turn, materially adversely affect our results of operations. Mortgage banking is generally considered a volatile source of income because it depends largely on the level of loan volume which, in turn, depends largely on prevailing market interest rates. In a rising or higher interest rate environment, our originations of mortgage loans may decrease, resulting in fewer loans that are available to be sold to investors. This would result in a decrease in mortgage banking revenues and a corresponding decrease in non-interest income. In addition, our results of operations are affected by the amount of non-interest expense associated with mortgage banking activities, such as salaries and employee benefits, occupancy, equipment and data processing expense and other operating costs. During periods of reduced loan demand, our results of operations may be adversely affected to the extent that we are unable to reduce expenses commensurate with the decline in loan originations. In addition, although we sell loans into the secondary market without recourse, we are required to give customary representations and warranties about the loans to the buyers. If we breach those representations and warranties, the buyers may require us to repurchase the loans and we may incur a loss on the repurchase.

Our results of operations, liquidity and cash flows are subject to interest rate risk.

Our earnings and cash flows are largely dependent upon our net interest income. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Federal Reserve. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and investments and the amount of interest we pay on deposits and borrowings, but these changes could also affect (i) our ability to originate loans and obtain deposits, (ii) the fair value of our financial assets and liabilities and (iii) the average duration of our mortgage-backed securities portfolio and other interest-earning assets. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, our net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings. In addition, a substantial amount of our loans have adjustable interest rates. As a result, these loans may experience a higher rate of default in a rising interest rate environment. Further, a significant portion of our adjustable rate loans have interest rate floors below which the loan’s contractual interest rate may not adjust. Approximately 68% of our loan portfolio was comprised of adjustable or floating-rate loans at December 31, 2013, and approximately $1.6 billion, or 68%, of those loans contained interest rate floors, below which the loans’ contractual interest rate may not adjust.   At December 31, 2013, the weighted average floor interest rate of these loans was 4.85%. At that date, approximately $1.4 billion, or 87%, of these loans were at their floor interest rate. The inability of our loans to adjust downward can contribute to increased income in periods of declining interest rates, although this result is subject to the risks that borrowers may refinance these loans during periods of declining interest rates. Also, when loans are at their floors, there is a further risk that our interest income may not increase as rapidly as our cost of funds during periods of increasing interest rates which could have a material adverse effect on our results of operations.

Any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on our financial condition, liquidity and results of operations. Further, a prolonged period of exceptionally low market interest rates, such as we are currently experiencing and the Board of Governors of the Federal Reserve System has indicated it intends to maintain, limits our ability to lower our interest expense, while the average yield on our interest-earning assets may continue to decrease as our loans reprice or are originated at these low market rates. Accordingly, our net interest income may continue to decrease, which may have an adverse affect on our profitability. Also, our interest rate risk modeling techniques and assumptions likely may not fully predict or capture the impact of actual interest rate changes on our balance sheet or projected operating results.

If our investment in the Federal Home Loan Bank of Seattle becomes impaired, our earnings and shareholders' equity could decrease.

At December 31, 2013, the Company had recorded $35.4 million in FHLB stock, compared to $36.7 million at December 31, 2012. The Banks' investments in FHLB stock are generally viewed as a long-term investment and are carried at par value ($100 per share), which reasonably approximates its fair value. 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. 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.

The Seattle FHLB announced that it had a risk-based capital deficiency under the regulations of the Federal Housing Finance Agency (the FHFA), its primary regulator, as of December 31, 2008, and that it would suspend future dividends and the repurchase and redemption of outstanding common stock. The FHLB of Seattle announced September 7, 2012 that the FHFA now considers the FHLB of Seattle to be adequately capitalized.

Dividends on, or repurchases of, the FHLB of Seattle stock continue to require consent of the FHFA. The FHFA subsequently approved the repurchase of portions of FHLB of Seattle stock, and as of December 31, 2013, the FHLB had repurchased $1.315 million of the Banks' stock. During the years ended December 31, 2012 and 2011, the Banks did not receive any dividend income on FHLB stock. The FHLB announced in July 2013 that, based on its second quarter 2013 financial results, their Board of Directors had declared a $0.025 per share cash dividend. For the year ended December 31, 2013, the Banks received $18,000 in dividends on FHLB stock. Based on the above, the Company has determined there is not any impairment on the FHLB stock investment as of December 31, 2013. Deterioration in the FHLB’s financial position may, however, result in future impairment in the value of those securities. The Company will continue to monitor the financial condition of the FHLB as it relates to, among other things, the recoverability of the Banks' investments.

Changes in laws and regulations and the cost of regulatory compliance with new laws and regulations may adversely affect our operations, increase our costs of operations and decrease our efficiency.
The financial services industry is extensively regulated. Federal and state banking regulations are designed primarily to protect the deposit insurance funds and consumers. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of an institution, the classification of assets by the institution and the adequacy of an institution's allowance for loan losses. The significant federal and state banking regulations that affect us are described in this report under the heading “Item 1. Business-Regulation.” These regulations, along with the currently existing tax, accounting, securities, insurance, and monetary laws, regulations, rules, standards, policies, and interpretations control the methods by which financial institutions conduct business, implement strategic initiatives and tax compliance, and govern financial reporting and disclosures. These laws, regulations, rules, standards, policies, and interpretations are constantly evolving and may change significantly over time. Such changes could subject us to additional costs, limit the types of financial services and products we may offer, restrict mergers and acquisitions, investments, access to capital, the location of banking offices, and/or increase the ability of non-banks to offer competing financial services and products, among other things. Further, changes in accounting standards can be both difficult to predict and involve judgment and discretion in their interpretation by us and our independent accounting firms. These changes could materially impact, potentially even retroactively, how we report our financial condition and results of our operations as could our interpretation of those changes.

The Dodd-Frank Act created a new Consumer Financial Protection Bureau (“CFPB”) with broad powers to supervise and enforce consumer protection laws. The CFPB has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The CFPB has examination and enforcement authority over all banks with more than $10 billion in assets. Banks with $10 billion or less in assets will continue to be examined for compliance with the consumer laws and regulations of the CFPB by their primary bank regulators. The Dodd-Frank Act also weakens the federal preemption rules that have been applicable for national banks and federal savings associations, and gives state attorneys general the ability to enforce federal consumer protection laws. The Company does not currently have assets in excess of $10 billion, but it may at some point in the future.

In 2013, the CFPB issued several final regulations and changes to certain consumer protections under existing laws. These final rules, most of the provisions of which (including the qualified mortgage rule) became effective January 10, 2014, generally prohibit creditors from extending mortgage loans without regard for the consumer’s ability to repay and add restrictions and requirements to mortgage origination and servicing practices. In addition, these rules limit prepayment penalties and require the creditor to retain evidence of compliance with the ability-to-repay requirement for three years. Compliance with these rules will likely increase our overall regulatory compliance costs and may require changes to our underwriting practices with respect to mortgage loans. Moreover, these rules may adversely affect the volume of mortgage loans that we underwrite and may subject us to increased potential liabilities related to such residential loan origination activities.

The Dodd-Frank Act requires minimum leverage (Tier 1) and risk-based capital requirements for savings and loan holding companies and bank holding companies that are no less stringent than those applicable to banks, which will limit our ability to borrow at the holding company level and invest the proceeds from such borrowings as capital in the Bank, and will exclude certain instruments that previously have been eligible for inclusion by bank holding companies as Tier 1 capital.

The Dodd-Frank Act also broadens the base for FDIC deposit insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution, rather than deposits. The Dodd-Frank Act also permanently increases the maximum amount of deposit insurance for banks, savings institutions, and credit unions to $250,000 per depositor, retroactive to January 1, 2008. The legislation also increases the required minimum reserve ratio for the DIF, from 1.15% to 1.35% of insured deposits, and directs the FDIC to offset the effects of increased assessments on depository institutions with less than $10 billion in assets.

Effective December 10, 2013, pursuant to the Dodd-Frank Act, federal banking and securities regulators issued final rules to implement Section 619 of the Dodd-Frank Act (the Volcker Rule). Generally, subject to a transition period and certain exceptions, the Volcker Rule restricts insured depository institutions and their affiliated companies from engaging in short-term proprietary trading of certain securities, investing in funds with collateral comprised of less than 100% loans that are not registered with the Securities and Exchange Commission ("SEC") and from engaging in hedging activities that do not hedge a specific identified risk. After the transition period, the Volcker Rule prohibitions and restrictions will apply to banking entities unless an exception applies. We are analyzing the impact of the Volcker Rule on our investment portfolio and possible changes to our investment strategies, which could negatively affect our earnings.

The full impact of the Dodd-Frank Act on our business will not be known until all of the regulations implementing the statute are adopted and implemented. As a result, we cannot at this time predict the extent to which the Dodd-Frank Act will impact our business, operations or financial condition. However, compliance with these new laws and regulations may require us to make changes to our business and operations and will likely result in additional costs and divert management's time from other business activities, any of which may adversely impact our results of operations, liquidity or financial condition.

Any other additional changes in our regulation and oversight, whether in the form of new laws, rules or regulations, could likewise make compliance more difficult or expensive or otherwise materially adversely affect our business, financial condition or prospects.

The short-term and long-term impact of the changing regulatory capital requirements and anticipated new capital rules is uncertain.

On July 9, 2013, the FDIC and the other federal bank regulatory agencies issued a final rule that will revise their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. The final rule applies to all depository institutions, top-tier bank holding companies with total consolidated assets of $500 million or more and top-tier savings and loan holding companies. Among other things, the rule establishes a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), increases the minimum Tier 1 capital to risk-based assets requirement (from 4.0% to 6.0% of risk-weighted assets) and assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The final rule also requires unrealized gains and losses on certain "available-for-sale" securities holdings to be included for purposes of calculating regulatory capital requirements unless a one-time opt-in or opt-out is exercised. The rule limits a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The final rule becomes effective for Banner Bank on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective.

The application of these more stringent capital requirements could, among other things, result in lower returns on invested capital, require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. Implementation of changes to asset risk weightings for risk-based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in management modifying its business strategy, and could limit our ability to make distributions, including paying out dividends or buying back shares. Specifically, beginning in 2016, Banner Bank's ability to pay dividends will be limited if does not have the capital conservation buffer required by the new capital rules, which may limit our ability to pay dividends to stockholders. See "Regulation and Supervision—Federal Banking Regulation—New Capital Rule."

Non-compliance with the USA PATRIOT Act, Bank Secrecy Act, or other laws and regulations could result in fines or sanctions.

The USA PATRIOT and Bank Secrecy Acts require financial institutions to develop programs to prevent financial institutions from being used for money laundering and terrorist activities. If such activities are detected, financial institutions are obligated to file suspicious activity reports with the U.S. Treasury's Office of Financial Crimes Enforcement Network. These rules require financial institutions to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts. Failure to comply with these regulations could result in fines or sanctions. Recently several banking institutions have received large fines for non-compliance with these laws and regulations. While we have developed policies and procedures designed to assist in compliance with these laws and regulations, no assurance can be given that these policies and procedures will be effective in preventing violations of these laws and regulations.

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition.

Liquidity is essential to our business and the inability to obtain adequate funding may negatively affect growth and, consequently, our earnings capability and capital levels. An inability to raise funds through deposits, borrowings, the sale of loans or investment securities and other sources could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities on terms which are acceptable to us could be impaired by factors that affect us specifically or the financial services industry or economy in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity as a result of a downturn in the Washington, Oregon or Idaho markets in which our loans are concentrated, negative operating results, or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry and the continued uncertainty in credit markets. In particular, our liquidity position could be significantly constrained if we are unable to access funds from the Federal Home Loan Bank of Seattle, the Federal Reserve Bank of San Francisco (FRBSF) or other wholesale funding sources or if adequate financing is not available at acceptable interest rates. Finally, if we are required to rely more heavily on more expensive funding sources, our revenues may not increase proportionately to cover our costs. In this case, our results of operations and financial condition would be negatively affected. Additionally, collateralized public funds are bank deposits of state and local municipalities. These deposits are required to be secured by certain investment grade securities to ensure repayment, which on the one hand tends to reduce our contingent liquidity risk by making these funds somewhat less credit sensitive, but on the other hand reduces standby liquidity by restricting the potential liquidity of the pledged collateral. Although these funds historically have been a relatively stable source of funds for us, availability depends on the individual municipality's fiscal policies and cash flow needs. In addition, changes in recent years in the collateralization requirements and other provisions of the Washington and Oregon public funds deposit programs have changed the economic benefit associated with accepting public funds deposits.

Legal and regulatory proceedings and related matters could adversely affect us or the financial services industry in general.

We, and other participants in the financial services industry upon whom we rely to operate, have been and may in the future become involved in legal and regulatory proceedings. Most of the proceedings we consider to be in the normal course of our business or typical for the industry; however, it is inherently difficult to assess the outcome of these matters and there can be no assurance that anyone in particular, including us, will prevail in any proceeding or litigation. There could be substantial cost and management diversion in such litigation and proceedings, and any adverse determination could have a materially adverse effect on our business, brand or image, or our financial condition and results of our operations.

We are dependent on key personnel and the loss of one or more of those key personnel may materially and adversely affect our prospects.

Competition for qualified employees and personnel in the banking industry is intense and there are a limited number of qualified persons with knowledge of, and experience in, the community banking industry where the Banks conduct their business. The process of recruiting personnel with the combination of skills and attributes required to carry out our strategies is often lengthy.   Our success depends to a significant degree upon our ability to attract and retain qualified management, loan origination, finance, administrative, marketing and technical personnel and upon the continued contributions of our management and personnel. In particular, our success has been and continues to be highly dependent upon the abilities of key executives, including our President, and certain other employees. In addition, our success has been and continues to be highly dependent upon the services of our directors, many of whom are at or nearing retirement age, and we may not be able to identify and attract suitable candidates to replace such directors.

We operate in a highly competitive industry and market areas.

The Banks face substantial competition in all phases of their operations from a variety of different competitors. Our future growth and success will depend on our ability to compete effectively in this highly competitive environment. To date, the Banks have been competitive by focusing on their business lines in their market areas and emphasizing the high level of service and responsiveness desired by their customers. We compete for loans, deposits and other financial services with other commercial banks, thrifts, credit unions, brokerage houses, mutual funds, insurance companies and specialized finance companies. Many of our competitors offer products and services which we do not offer, and many have substantially greater resources and lending limits, name recognition and market presence that benefit them in attracting business. In addition, larger competitors may be able to price loans and deposits more aggressively than the Banks do, and newer competitors may also be more aggressive in terms of pricing loan and deposit products than we are in order to obtain a share of the market. Some of the financial institutions and financial services organizations with which we compete are not subject to the same degree of regulation as is imposed on bank holding companies, federally insured state-chartered banks and national banks and federal savings banks. As a result, these non-bank competitors have certain advantages over us in accessing funding and in providing various services.

Our ability to compete successfully depends on a number of factors including the following:

- the ability to develop, maintain and build upon long-term customer relationships based on top-quality service, high ethical standards and safe, sound assets;
- the ability to expand our market position;
- the scope, relevance and pricing of products and services offered to meet customer needs and demands;
- the rate at which we introduce new products and services relative to our competitors;

- customer satisfaction with our level of service; and
- industry and general economic trends.

Failure to perform in any of these areas could significantly weaken our competitive position, which could adversely affect our growth and profitability, which, in turn, could have a material adverse effect on our financial condition, liquidity and results of operations.

Our business may be adversely affected by an increasing prevalence of fraud and other financial crimes.

Our loans to businesses and individuals and our deposit relationships and related transactions are subject to exposure to the risk of loss due to fraud and other financial crimes. Nationally, reported incidents of fraud and other financial crimes have increased. We have also experienced losses due to apparent fraud and other financial crimes. While we have policies and procedures designed to prevent such losses, there can be no assurance that such losses will not occur.

Managing reputational risk is important to attracting and maintaining customers, investors and employees.

Threats to our reputation can come from many sources, including adverse sentiment about financial institutions generally, unethical practices, employee misconduct, failure to deliver minimum standards of service or quality, compliance deficiencies, and questionable or fraudulent activities of our customers. We have policies and procedures in place to protect our reputation and promote ethical conduct, but these policies and procedures may not be fully effective. Negative publicity regarding our business, employees, or customers, with or without merit, may result in the loss of customers, investors and employees, costly litigation, a decline in revenues and increased governmental regulation.

We are subject to certain risks in connection with our use of technology.

Our security measures may not be sufficient to mitigate the risk of a cyber attack. Communications and information systems are essential to the conduct of our business, as we use such systems to manage our customer relationships, our general ledger and virtually all other aspects of our business. Our operations rely on the secure processing, storage, and transmission of confidential and other information in our computer systems and networks. Although we take protective measures and endeavor to modify them as circumstances warrant, the security of our computer systems, software, and networks may be vulnerable to breaches, unauthorized access, misuse, computer viruses, or other malicious code and cyber attacks that could have a security impact. If one or more of these events occur, this could jeopardize our or our customers' confidential and other information processed and stored in, and transmitted through, our computer systems and networks, or otherwise cause interruptions or malfunctions in our operations or the operations of our customers or counterparties. We may be required to expend significant additional resources to modify our protective measures or to investigate and remediate vulnerabilities or other exposures, and we may be subject to litigation and financial losses that are either not insured against or not fully covered through any insurance maintained by us. We could also suffer significant reputational damage.

Security breaches in our Internet banking activities could further expose us to possible liability and damage our reputation. Any compromise of our security also could deter customers from using our Internet banking services that involve the transmission of confidential information. We rely on standard Internet security systems to provide the security and authentication necessary to effect secure transmission of data. These precautions may not protect our systems from compromises or breaches of our security measures, which could result in significant legal liability and significant damage to our reputation and our business.

Our security measures may not protect us from systems failures or interruptions. While we have established policies and procedures to prevent or limit the impact of systems failures and interruptions, there can be no assurance that such events will not occur or that they will be adequately addressed if they do. In addition, we outsource certain aspects of our data processing and other operational functions to certain third-party providers. If our third-party providers encounter difficulties, or if we have difficulty in communicating with them, our ability to adequately process and account for transactions could be affected, and our business operations could be adversely impacted. Threats to information security also exist in the processing of customer information through various other vendors and their personnel.

The occurrence of any failures or interruptions may require us to identify alternative sources of such services, and we cannot assure you that we could negotiate terms that are as favorable to us, or could obtain services with similar functionality as found in our existing systems without the need to expend substantial resources, if at all. Further, the occurrence of any systems failure or interruption could damage our reputation and result in a loss of customers and business, could subject us to additional regulatory scrutiny, or could expose us to legal liability. Any of these occurrences could have a material adverse effect on our financial condition and results of operations.

Item 1B – Unresolved Staff Comments

None.

Item 2 – Properties

Banner Corporation maintains its administrative offices and main branch office, which is owned by us, in Walla Walla, Washington. In total, as of December 31, 2013, we have 88 branch offices located in Washington, Oregon and Idaho. Eighty-five branches are Banner Bank branches and three of those 88 are Islanders Bank branches. Sixty-four branches are located in Washington, fifteen in Oregon and nine in Idaho. Of those offices, approximately half are owned and the other half are leased facilities. We also have eight leased locations for loan production offices spread throughout the same three-state area. The lease terms for our branch and loan production offices are not individually material. Lease expirations range from one to 25 years. Administrative support offices are primarily in Washington, where we have eight facilities, of which we own four and lease four. Additionally, we have one leased administrative support office in Idaho and own one located in Oregon. In the opinion of management, all properties are adequately covered by insurance, are in a good state of repair and are appropriately designed for their present and future use.

Item 3 – Legal Proceedings

In the normal course of business, we have various legal proceedings and other contingent matters outstanding. These proceedings and the associated legal claims are often contested and the outcome of individual matters is not always predictable. These claims and counter-claims typically arise during the course of collection efforts on problem loans or with respect to action to enforce liens on properties in which we hold a security interest. We are not a party to any pending legal proceedings that we believe would have a material adverse effect on our financial condition or operations.

Item 4 – Mine Safety Disclosures

Not applicable.

PART II

Item 5 – Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Price Range of Common Stock and Dividend Information

Our common stock is traded on the NASDAQ Global Select Market under the symbol "BANR." Shareholders of record as of December 31, 2013 totaled 1,627 based upon securities position listings furnished to us by our transfer agent. This total does not reflect the number of persons or entities who hold stock in nominee or "street" name through various brokerage firms. The following tables show the reported high and low sale prices of our common stock for the periods presented as well as the cash dividends declared per share of common stock for each of those periods.

Year Ended December 31, 2013	High	Low	Cash Dividend Declared
First quarter	$32.03	$29.14	$0.12
Second quarter	34.30	29.33	0.12
Third quarter	38.44	33.78	0.15
Fourth quarter	45.15	35.62	0.15

Year Ended December 31, 2012	High	Low	Cash Dividend Declared
First quarter	$22.97	$17.13	$0.01
Second quarter	22.80	18.05	0.01
Third quarter	27.41	20.04	0.01
Fourth quarter	31.32	26.49	0.01

The timing and amount of cash dividends paid on our common stock depends on our earnings, capital requirements, financial condition and other relevant factors and is subject to the discretion of our board of directors. After consideration of these factors, beginning in the third quarter of 2008, we reduced our dividend payout to preserve our capital and further reduced our dividend in the first quarter of 2009. Our aggregate dividend payments were also reduced by our one-for-seven reverse stock split effective June 1, 2011. As a result of improved earnings, levels of capital, asset quality and financial condition, beginning in the first quarter of 2013 we increased the dividend and further increased it in the third quarter of 2013. There can be no assurance that we will pay dividends on our common stock in the future.

Our ability to pay dividends on our common stock depends primarily on dividends we receive from Banner Bank and Islanders Bank. Under federal regulations, the dollar amount of dividends the Banks may pay depends upon their capital position and recent net income. Generally, if a bank satisfies its regulatory capital requirements, it may make dividend payments up to the limits prescribed under state law and FDIC regulations. In addition, an institution that has converted to a stock form of ownership may not declare or pay a dividend on, or repurchase any of, its common stock if the effect thereof would cause the regulatory capital of the institution to be reduced below the amount required for the liquidation account which was established in connection with the conversion. Banner Bank, our primary subsidiary, converted to a stock form of ownership and is therefore subject to the limitation described in the preceding sentence. In addition, under Washington law, no bank may declare or pay any dividend in an amount greater than its retained earnings without the prior approval of the Washington DFI. The Washington DFI also has the power to require any bank to suspend the payment of any and all dividends.

Further, under Washington law, Banner Corporation is prohibited from paying a dividend if, after making such dividend payment, it would be unable to pay its debts as they become due in the usual course of business, or if its total liabilities, plus the amount that would be needed, in the event Banner Corporation were to be dissolved at the time of the dividend payment, to satisfy preferential rights on dissolution of holders of preferred stock ranking senior in right of payment to the capital stock on which the applicable distribution is to be made, exceed our total assets.

In addition to the foregoing regulatory considerations, there are numerous governmental requirements and regulations that affect our business activities. A change in applicable statutes, regulations or regulatory policy may have a material effect on our business and on our ability to pay dividends on our common stock.

Payments of the distributions on our trust preferred securities (TPS) from the special purpose subsidiary trusts we sponsored are fully and unconditionally guaranteed by us. The junior subordinated debentures that we have issued to our subsidiary trusts are ranked senior to our shares of common stock. We must make required payments on the junior subordinated debentures before any dividends can be paid on our TPS and our common stock and, in the event of our bankruptcy, dissolution or liquidation, the interest and principal obligations under the junior subordinated debentures must be satisfied before any distributions can be made on our common stock. We may defer the payment of interest on each of the junior subordinated debentures for a period not to exceed 20 consecutive quarters, provided that the deferral period does not extend beyond the stated maturity. During such deferral period, distributions on the corresponding TPSs will also be deferred and we may not pay cash dividends to the holders of shares of our common stock. At December 31, 2013, we are current on all interest payments.

Issuer Purchases of Equity Securities

During the year ended December 31, 2013, the only Banner Corporation shares we repurchased were 12,185 shares surrendered by employees to satisfy tax withholding obligations upon the vesting of restricted stock grants.

Equity Compensation Plan Information

The equity compensation plan information presented under Part III, Item 12 of this report is incorporated herein by reference.

Performance Graph. The following graph compares the cumulative total shareholder return on Banner Corporation common stock with the cumulative total return on the NASDAQ (U.S. Stock) Index, a peer group of the SNL $1 Billion to $5 Billion Asset Bank Index and a peer group of the SNL NASDAQ Bank Index. Total return assumes the reinvestment of all dividends.

	Period Ended					
Index	12/31/08	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13
Banner Corporation	100.00	28.75	25.27	26.95	48.39	71.65
NASDAQ Composite	100.00	145.36	171.74	170.38	200.63	281.22
SNL Bank $1B-$5B	100.00	71.68	81.25	74.10	91.37	132.87
SNL Bank NASDAQ	100.00	81.12	95.71	84.92	101.22	145.48

*Assumes $100 invested in Banner Corporation common stock and each index at the close of business on December 31, 2008 and that all dividends were reinvested. Information for the graph was provided by SNL Financial L.C. © 2014.

Item 6 – Selected Financial Data

The following condensed consolidated statements of financial condition and operations and selected performance ratios as of December 31, 2013, 2012, 2011, 2010, and 2009 and for the years then ended have been derived from our audited consolidated financial statements. Certain information for prior years has been restated in accordance with the U.S. Securities and Exchange Commission Staff Accounting Bulletin No. 108 which addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements.

The information below is qualified in its entirety by the detailed information included elsewhere herein and should be read along with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Item 8, Financial Statement and Supplementary Data."

FINANCIAL CONDITION DATA:

	December 31				
(In thousands)	2013	2012	2011	2010	2009
Total assets	$4,388,166	$4,265,564	$4,257,312	$4,406,082	$4,722,221
Cash and securities [(1)]	772,614	811,902	754,396	729,345	640,657
Loans receivable, net	3,343,455	3,158,223	3,213,426	3,305,716	3,694,852
Deposits	3,617,926	3,557,804	3,475,654	3,591,198	3,865,550
Borrowings	184,234	160,000	212,649	267,761	414,315
Common stockholders' equity	538,972	506,919	411,748	392,472	287,721
Total stockholders' equity	538,972	506,919	532,450	511,472	405,128
Shares outstanding	19,544	19,455	17,553	16,165	3,077
Shares outstanding excluding unearned, restricted shares held in ESOP	19,509	19,421	17,519	16,130	3,042

OPERATING DATA:

	For the Year Ended December 31				
(In thousands)	2013	2012	2011	2010	2009
Interest income	$179,712	$187,162	$197,563	$218,082	$237,370
Interest expense	12,996	19,514	32,992	60,312	92,797
Net interest income before provision for loan losses	166,716	167,648	164,571	157,770	144,573
Provision for loan losses	—	13,000	35,000	70,000	109,000
Net interest income	166,716	154,648	129,571	87,770	35,573
Deposit fees and other service charges	26,581	25,266	22,962	22,009	21,394
Mortgage banking operations revenue	11,170	13,812	6,146	6,370	8,893
Other-than-temporary impairment recoveries (losses)	409	(409)	3,000	(4,231)	(1,511)
Net change in valuation of financial instruments carried at fair value	(2,278)	(16,515)	(624)	1,747	12,529
All other operating income	7,460	4,748	2,506	3,253	2,385
Total other operating income	43,342	26,902	33,990	29,148	43,690
REO operations expense (recoveries), net	(689)	3,354	22,262	26,025	7,147
All other operating expenses	141,664	138,099	135,842	134,776	134,933
Total other operating expense	140,975	141,453	158,104	160,801	142,080
Income (loss) before provision for income tax expense (benefit)	69,083	40,097	5,457	(43,883)	(62,817)

Provision for income tax expense (benefit)	22,528	(24,785)	—	18,013	(27,053)
Net income (loss)	$46,555	$64,882	$5,457	$(61,896)	$(35,764)

(footnotes follow)

PER COMMON SHARE DATA:

	At or For the Years Ended December 31				
	2013	2012	2011	2010	2009
Net income (loss):					
Basic	$2.40	$3.17	$(0.15)	$(7.21)	$(16.31)
Diluted	2.40	3.16	(0.15)	(7.21)	(16.31)
Common stockholders' equity per share (2)(9)	27.63	26.10	23.50	24.33	94.58
Common stockholders' tangible equity per share (2)(9)	27.50	25.88	23.14	23.80	90.94
Cash dividends	0.54	0.04	0.10	0.28	0.28
Dividend payout ratio (basic)	22.50%	1.26%	(66.67)%	(3.88)%	(1.72)%
Dividend payout ratio (diluted)	22.50%	1.27%	(66.67)%	(3.88)%	(1.72)%

OTHER DATA:

	As of December 31				
	2013	2012	2011	2010	2009
Full time equivalent employees	1,084	1,074	1,078	1,060	1,060
Number of branches	88	88	89	89	89

KEY FINANCIAL RATIOS:

	At or For the Years Ended December 31				
	2013	2012	2011	2010	2009
Performance Ratios:					
Return on average assets [3]	1.09 %	1.54 %	0.13 %	(1.36)%	(0.78)%
Return on average common equity [4]	8.85	14.03	1.37	(17.19)	(11.69)
Average common equity to average assets	12.36	10.96	9.31	7.90	6.71
Interest rate spread [5]	4.08	4.13	3.99	3.61	3.23
Net interest margin [6]	4.11	4.17	4.05	3.67	3.33
Non-interest income to average assets	1.02	0.64	0.79	0.64	0.96
Non-interest expense to average assets	3.31	3.35	3.69	3.53	3.12
Efficiency ratio [7]	67.11	72.71	79.62	86.03	75.47
Average interest-earning assets to interest-bearing liabilities	108.3	109.11	106.90	104.32	104.55
Selected Financial Ratios:					
Allowance for loan losses as a percent of total loans at end of period	2.19	2.39	2.52	2.86	2.51
Net charge-offs as a percent of average outstanding loans during the period	0.30	0.57	1.50	1.88	2.28
Non-performing assets as a percent of total assets	0.66	1.18	2.79	5.77	6.27
Allowance for loan losses as a percent of non-performing loans [8]	302.77	225.33	110.09	64.30	44.55
Common stockholders' tangible equity to tangible assets [9]	12.23	11.80	9.54	8.73	5.87
Consolidated Capital Ratios:					
Total capital to risk-weighted assets	16.99	16.96	18.07	16.92	12.73
Tier 1 capital to risk-weighted assets	15.73	15.70	16.80	15.65	11.47
Tier 1 leverage capital to average assets	13.64	12.74	13.44	12.24	9.62

(1) Includes securities available-for-sale and held-to-maturity.

(2) Calculated using shares outstanding excluding unearned restricted shares held in ESOP and adjusted for 1-for-7 reverse stock split.

(3) Net income divided by average assets.

(4) Net income divided by average common equity.

(5) Difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.

(6) Net interest income before provision for loan losses as a percent of average interest-earning assets.

(7) Other operating expenses divided by the total of net interest income before loan losses and other operating income (non-interest income).

(8) Non-performing loans consist of nonaccrual and 90 days past due loans.

(9) Common stockholders' tangible equity per share and the ratio of tangible common stockholders' equity to tangible assets are non-GAAP financial measures. We calculate tangible common equity by excluding the balance of goodwill, other intangible assets and preferred equity from stockholders' equity. We calculate tangible assets by excluding the balance of goodwill and other intangible assets from total assets. We believe that this is consistent with the treatment by our bank regulatory agencies, which exclude goodwill and other intangible assets from the calculation of risk-based capital ratios. In addition, excluding preferred equity, the level of which may vary from company to company, allows investors to more easily compare our capital adequacy to other companies in the industry that also use this measure. Management believes that these non-GAAP financial measures provide information to investors that is useful in understanding the basis of our capital position. However, these

non-GAAP financial measures are supplemental and are not a substitute for any analysis based on GAAP. Because not all companies use the same calculation of tangible common equity and tangible assets, this presentation may not be comparable to other similarly titled measures as calculated by other companies. For a reconciliation of these non–GAAP measures, see Item 7, "Management's Discussion and Analysis of Financial Condition—Executive Overview."

Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's discussion and analysis of results of operations is intended to assist in understanding our financial condition and results of operations. The information contained in this section should be read in conjunction with the Consolidated Financial Statements and accompanying Notes to the Consolidated Financial Statements of this Form 10-K.

Executive Overview

We are a bank holding company incorporated in the State of Washington and own two subsidiary banks, 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 December 31, 2013, its 85 branch offices and eight loan production offices located in Washington, Oregon and Idaho. Islanders Bank is also a Washington-chartered commercial bank and conducts its business from three locations in San Juan County, Washington. As of December 31, 2013, we had total consolidated assets of $4.4 billion, net loans of $3.3 billion, total deposits of $3.6 billion and total stockholders' equity of $539 million.

Banner Bank is a regional bank which offers a wide variety of commercial banking services and financial products to individuals, businesses and public sector entities in its primary market areas. Islanders Bank is a community bank which offers similar banking services to individuals, businesses and public entities located in the San Juan Islands. The Banks' primary business is that of traditional banking institutions, accepting deposits and originating loans in locations surrounding their offices in portions of Washington, Oregon and Idaho. Banner Bank is also an active participant in the secondary market, engaging in mortgage banking operations largely through the origination and sale of one- to four-family residential loans. Lending activities include commercial business and commercial real estate loans, agriculture business loans, construction and land development loans, one- to four-family residential loans and consumer loans.

Banner Corporation's successful execution of its strategic plan and operating initiatives continued in 2013, as evidenced by our solid operating results and profitability. Highlights for the year included further improvement in our asset quality, strong deposit growth, solid revenues from core operations and additional client acquisition. Additionally, the quarterly cash dividend was increased to $0.12 per share in the first two quarters of the year and to $0.15 per share in the last two quarters of the year, reflecting the strong performance and our expectation of continued success and sustained profitability.

Despite persistently weak economic conditions and exceptionally low interest rates which have created an unusually challenging banking environment for an extended period, the Company experienced marked improvement and consistent profitability in 2012 which continued in 2013. For the year ended December 31, 2013, our net income to common shareholders was $46.6 million or $2.40 per diluted share, compared to net income to common shareholders of $59.1 million, or $3.16 per diluted share for the year ended December 31, 2012. Although there continue to be indications that economic conditions are improving from the recessionary downturn, the pace of recovery has been modest and uneven and ongoing stress in the economy will likely continue to be challenging going forward. As a result, our future operating results and financial performance will be significantly affected by the course of the recovery. However, over the past three years we have significantly improved our risk profile by aggressively managing and reducing our problem assets, which has resulted in lower credit costs and stronger revenues, and which we believe has positioned the Company well to meet this challenging environment.

Our return to consistent profitability was punctuated in the second quarter of 2012 by management's decision to reverse the valuation allowance against our deferred tax assets. This decision resulted in a substantial tax benefit for the full year 2012, and resulted in a significant reduction in our tax expense for the year ended December 31, 2012.

The decision to reverse the valuation allowance reflected our confidence in the sustainability of our future profitability. Further, as a result of our return to profitability, including the reversal of our deferred tax asset, our improved asset quality and operating trends, strong capital position and our expectation for sustainable profitability for the foreseeable future, we also significantly reduced the credit risk component associated with the estimated fair value of the junior subordinated debentures issued by the Company. Changes in these two significant accounting estimates, while substantial, represent non-cash valuation adjustments that had no effect on our liquidity or our ability to fund our operations.

As a result of substantial reserves already in place representing 2.19% of total loans outstanding at December 31, 2013, as well as declining net charge-offs, Banner did not record a provision for loan losses in year ended December 31, 2013. By contrast, we recorded a $13.0 million provision for the year ended December 31, 2012 and $35 million for the year ended December 31, 2011. The decrease in loan loss provisioning from a year earlier reflects significant progress in reducing the levels of delinquencies, non-performing loans and net charge-offs, particularly for loans for the construction of one- to four-family homes and for acquisition and development of land for residential properties. The allowance for loan losses at December 31, 2013 was $75.0 million, representing 303% of non-performing loans. Non-performing loans decreased by 28% to $24.8 million at December 31, 2013, compared to $34.4 million a year earlier. (See Note 7 of the Notes to the Consolidated Financial Statements, Loans Receivable and the Allowance for Loan Losses, as well as “Asset Quality” below in this Form 10-K.)

Aside from the level of loan loss provision, our operating results depend primarily on our net interest income, which is the difference between interest income on interest-earning assets, consisting of loans and investment securities, and interest expense on interest-bearing liabilities, composed primarily of customer deposits and borrowings. Net interest income is primarily a function of our interest rate spread, which is the difference between the yield earned on interest-earning assets and the rate paid on interest-bearing liabilities, as well as a function of the average balances of interest-earning assets and interest-bearing liabilities. Our net interest income before provision for loan losses decreased modestly to $166.7 million for the year ended December 31, 2013, compared to $167.6 million for the year earlier. During the same period, our net interest spread decreased to 4.08% from 4.13%. These decreases in net interest income and net interest spread reflect declining yields on performing loans and securities, partially offset by continuing reductions in deposit and other funding costs.

Our net income also is affected by the level of our other operating income, including deposit fees and service charges, loan origination and servicing fees, and gains and losses on the sale of loans and securities, as well as our non-interest operating expenses and income tax provisions. In addition, our net income is affected by the net change in the value of certain financial instruments carried at fair value, in certain periods by other-than-temporary impairment (OTTI) charges or recoveries and in the current period by a $3.0 million termination fee related to the termination of the proposed acquisition of Home Federal Bancorp, Inc. (See Note 22 of the Notes to the Consolidated Financial Statements.) For the year ended December 31, 2013, we recorded a net charge of $2.3 million for fair value adjustments, which was offset by $1.0 million in gains on the sale of securities, $409,000 in OTTI recoveries and the $3.0 million acquisition termination fee. In comparison, we recorded a net fair value loss of $16.5 million (primarily related to the estimated fair value of our junior subordinated debentures) and an OTTI loss of $409,000 for the year ended December 31, 2012, which were partially offset by $51,000 in gains on the sale of securities.

Our total other operating income, which includes the gain on sale of securities, OTTI recovery, changes in the value of financial instruments carried at fair value and, for 2013, including the acquisition termination fee was $43.3 million for the year ended December 31, 2013, compared to $26.9 million for the year ended December 31, 2012. However, other operating income excluding the gain on sale of securities, OTTI adjustments, changes in the value of financial instruments and the acquisition termination fee, which we believe is more indicative of our core operations, decreased 5.8% to $41.2 million for the year ended December 31, 2013 compared to $43.8 million for the same period a year earlier, as decreased mortgage banking revenues were only partially offset by increased deposit fees and service charges.

Our total revenues (net interest income before the provision for loan losses plus total other operating income) for the year ended December 31, 2013 increased $15.5 million, or 8%, to $210.1 million, compared to $194.6 million for the same period a year earlier, largely as a result of the much smaller net fair value loss in 2013 as well as the acquisition termination fee and gains on the sale of securities. Our total revenues from core operations, which excludes gains on sale of securities, OTTI and fair value adjustments and the termination fee, decreased by $3.5 million, or 2%, to $208.0 million for the year ended December 31, 2013, compared to $211.4 million for the same period a year earlier, as increased deposit fees and service charges were not sufficient to fully offset decreases in net interest income and mortgage banking revenues.

For the year ended December 31, 2013, other operating expenses decreased minimally to $141.0 million, compared to $141.5 million for the year ended December 31, 2012, largely as a result of decreased costs related to REO operations and FDIC deposit insurance, which were generally offset by increased compensation and payment and card processing expenses, as well as approximately $550,000 of expenses related to the proposed acquisition of Home Federal Bancorp, Inc.

Other operating income, revenues and other earnings information excluding fair value adjustments, OTTI losses or recoveries, gains or losses on sale of securities and other one-time transactions, and common stockholders' tangible equity per share and the ratio of tangible common stockholders' equity to tangible assets referred to in footnote (9) to Item 6 - Selected Financial Data above, are non-GAAP financial measures. Management has presented these non-GAAP financial measures in this report because it believes that they provide useful and comparative information to assess trends in our core operations and in understanding our capital position. However, these non-GAAP financial measures are supplemental and are not a substitute for any analysis based on GAAP. Where applicable, we have also presented comparable earnings information using GAAP financial measures. For a reconciliation of these non-GAAP financial measures, see the tables below. Because not all companies use the same calculations, our presentation may not be comparable to other similarly titled measures as calculated by other companies. See "Comparison of Results of Operations for the Years Ended December 31, 2013 and 2012" for more detailed information about our financial performance.

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The following tables set forth reconciliations of non-GAAP financial measures discussed in this report (dollars in thousands):

	For the Years Ended December 31		
	2013	2012	2011
Total other operating income	$43,342	$26,902	$33,990
Exclude gain on sale of securities	(1,022)	(51)	5
Exclude other-than-temporary impairment losses (recoveries)	(409)	409	(3,000)
Exclude change in valuation of financial instruments carried at fair value	2,278	16,515	624
Exclude one-time termination fee	(2,954)	—	—
Total other operating income, excluding fair value adjustments, OTTI, gain on sale of securities and one-time fees	$41,235	$43,775	$31,619
Net interest income before provision for loan losses	$166,716	$167,648	$164,571
Total other operating income	43,342	26,902	33,990
Total revenue	210,058	194,550	198,561
Exclude gain on sale of securities	(1,022)	(51)	5
Exclude other-than-temporary impairment losses (recoveries)	(409)	409	(3,000)
Exclude change in valuation of financial instruments carried at fair value	2,278	16,515	624
Exclude one-time termination fee	(2,954)	—	—
Total revenue, excluding fair value adjustments, OTTI, gain on sale of securities and one-time fees	$207,951	$211,423	$196,190
Income before provision for taxes	$69,083	$40,097	$5,457
Exclude gain on sale of securities	(1,022)	(51)	5
Exclude other-than-temporary impairment losses (recoveries)	(409)	409	(3,000)
Exclude change in valuation of financial instruments carried at fair value	2,278	16,515	624
Exclude one-time termination fee	(2,954)	—	—
Income before provision for taxes, excluding fair value adjustments, OTTI, gain on sale of securities and one-time fees	$66,976	$56,970	$3,086
Net income	$46,555	$64,882	$5,457
Exclude gain on sale of securities	(1,022)	(51)	5
Exclude other-than-temporary impairment losses (recoveries)	(409)	409	(3,000)
Exclude change in valuation of financial instruments carried at fair value	2,278	16,515	624
Exclude one-time termination fee	(2,954)	—	—
Exclude related tax expense (benefit)	759	(6,074)	854
Total earnings, excluding fair value adjustments, OTTI, gain on sale of securities and one-time fees, net of related tax effects	$45,207	$75,681	$3,940

	December 31		
	2013	2012	2011
Stockholders’ equity	$538,972	$506,919	$532,450
Other intangible assets, net	2,449	4,230	6,331
Tangible equity	536,523	502,689	526,119
Preferred equity	—	—	120,702
Tangible common stockholders’ equity	$536,523	$502,689	$405,417
Total assets	$4,388,166	$4,265,564	$4,257,312
Other intangible assets, net	2,449	4,230	6,331
Tangible assets	$4,385,717	$4,261,334	$4,250,981
Tangible common stockholders’ equity to tangible assets	12.23 %	11.80 %	9.54 %
Common stockholders' tangible equity per share	$27.50	$25.88	$23.14

We offer a wide range of loan products to meet the demands of our customers. Our lending activities are primarily directed toward the origination of real estate and commercial loans. Prior to 2008, real estate lending activities were significantly focused on residential construction and first mortgages on owner-occupied, one- to four-family residential properties; however, over the subsequent three years our origination of construction and land development loans declined materially and the proportion of the portfolio invested in these types of loans declined substantially. Beginning in 2011 and continuing since then, we have experienced increased demand for one- to four-family construction loans and, while outstanding balances have increased only modestly, originations have increased significantly in 2012 and 2013. One- to four-family construction loans increased $57 million to $201 million at December 31, 2013, compared to $144 million at December 31, 2011. Our residential mortgage loan originations also decreased during the earlier years of this cycle, although less significantly than the decline in construction and land development lending as exceptionally low interest rates supported demand for loans to refinance existing debt as well as loans to finance home purchases. Refinancing activity was particularly significant in 2012 and in the in the first six months of 2013, leading to meaningful increases in residential mortgage originations during these periods; however, the rise in mortgage interest rates that began in the second quarter slowed origination activity in the last two quarters of 2013 and may result in lower refinancing activity in the future. Despite significant loan originations, in 2012 and 2013 our outstanding balances for residential mortgages have continued to decline, as most of the new originations have been sold in the secondary market while existing residential loans have been repaying at an accelerated pace. However, as a result of these originations and loan sales, our portfolio of loans serviced for others has increased to $1.216 billion at December 31, 2013. Our real estate lending activities also include the origination of multifamily and commercial real estate loans including construction and development loans for these types of properties. While our level of activity and investment in these types of loans has been relatively stable for many years, we have experienced an increase in new originations in recent periods. Our commercial business lending is directed toward meeting the credit and related deposit needs of various small- to medium-sized business and agribusiness borrowers operating in our primary market areas. Reflecting the slowly recovering economy, demand for these types of commercial business loans has been modest although our production levels have increased in recent periods. Commercial and agricultural business loans increased $62 million to $910 million at December 31, 2013, compared to $848 million at December 31, 2012. Our consumer loan activity is primarily directed at meeting demand from our existing deposit customers and, while we have increased our emphasis on consumer lending in recent years, demand for consumer loans also has been modest during this period of economic weakness as we believe many consumers have been focused on reducing their personal debt. At December 31, 2013, our net loan portfolio totaled $3.343 billion compared to $3.158 billion at December 31, 2012.

Deposits, customer retail repurchase agreements and loan repayments are the major sources of our funds for lending and other investment purposes. We compete with other financial institutions and financial intermediaries in attracting deposits and we generally attract deposits within our primary market areas. Much of the focus of our earlier branch expansion and current marketing efforts has been directed toward attracting additional deposit customer relationships and balances. This effort has been particularly focused on increasing transaction and savings accounts and for the past three years we have been very successful in increasing these core deposit balances. The long-term success of our deposit gathering activities is reflected not only in the growth of deposit balances, but also in increases in the level of deposit fees, service charges and other payment processing revenues compared to periods prior to that expansion.

Total deposits were $3.618 billion at December 31, 2013 compared to $3.558 billion a year earlier. Non-interest-bearing account balances increased 14% to $1.115 billion at December 31, 2013, compared to $981 million a year ago. Interest-bearing transaction and savings accounts totaled $1.630 billion at December 31, 2013, compared to $1.547 billion a year ago, while certificates of deposit further decreased to $873 million compared to $1.029 billion a year earlier. Non-certificate core deposits represented 76% of total deposits at December 31, 2013, compared to 71% of total deposits a year ago and 64% two years earlier.

Critical Accounting Policies

In the opinion of management, the accompanying Consolidated Statements of Financial Condition and related Consolidated Statements of Operations, Comprehensive Income, Changes in Stockholders' Equity and Cash Flows reflect all adjustments (which include reclassification and normal recurring adjustments) that are necessary for a fair presentation in conformity with U.S. Generally Accepted Accounting Principles (GAAP). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect amounts reported in the financial statements.

Various elements of our accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. In particular, management has identified several accounting policies that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of our 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 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 below. Management believes 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 our results of operations or financial condition. Further, subsequent changes in economic or market conditions could have a material impact on these estimates and our financial condition and operating results in future periods. There have been no significant changes in our application of accounting policies since December 31, 2012. For additional information concerning critical accounting policies, see Notes 1, 6, 13, 21 and 22 of the Notes to the Consolidated Financial Statements and the following:

Interest Income: (Notes 1 and 6) Interest on loans and securities is accrued as earned unless management doubts the collectability of the asset or the unpaid interest. Interest accruals on loans are generally discontinued when loans become 90 days past due for payment of interest and the loans are then placed on nonaccrual status. All previously accrued but uncollected interest is deducted from interest income upon transfer to nonaccrual status. For any future payments collected, interest income is recognized only upon management's assessment that there is a strong likelihood that the full amount of a loan 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 amounts owed, principal or interest, may be uncollectable. While less common, similar interest reversal and nonaccrual treatment is applied to investment securities if their ultimate collectability becomes questionable.

Provision and Allowance for Loan Losses: (Notes 1 and 6) The provision for loan losses reflects the amount required to maintain the allowance for losses at an appropriate level based upon management's evaluation of the adequacy of general and specific loss reserves. We maintain an allowance for loan losses consistent in all material respects with the GAAP guidelines outlined in ASC 450, Contingencies. We have established systematic methodologies for the determination of the adequacy of our allowance for loan losses. The methodologies are set forth in a formal policy and take into consideration the need for an overall general valuation allowance as well as specific allowances that are tied to individual problem loans. We increase our allowance for loan losses by charging provisions for probable loan losses against our income and value impaired loans consistent with the accounting guidelines outlined in ASC 310, Receivables.

The allowance for losses on loans is maintained at a level sufficient to provide for probable losses based on evaluating known and inherent risks in the loan portfolio and upon our continuing analysis of the factors underlying the quality of the loan portfolio. These factors include, among others, changes in the size and composition of the loan portfolio, delinquency rates, actual loan loss experience, current and anticipated economic conditions, detailed analysis of individual loans for which full collectability may not be assured, and determination of the existence and realizable value of the collateral and guarantees securing the loans. Realized losses related to specific assets are applied as a reduction of the carrying value of the assets and charged immediately against the allowance for loan loss reserve. Recoveries on previously charged off loans are credited to the allowance. The reserve is based upon factors and trends identified by us at the time financial statements are prepared. Although we use the best information available, future adjustments to the allowance may be necessary due to economic, operating, regulatory and other conditions beyond our control. The adequacy of general and specific reserves is based on our continuing evaluation of the pertinent factors underlying the quality of the loan portfolio as well as individual review of certain large balance loans. Loans are considered impaired when, based on current information and events, we determine that it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors involved in determining impairment include, but are not limited to, the financial condition of the borrower, the value of the underlying collateral and the current status of the economy. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of collateral if the loan is collateral dependent. Subsequent changes in the value of impaired loans are included within the provision for loan losses in the same manner in which impairment initially was recognized or as a reduction in the provision that would otherwise be reported. Large groups of smaller-balance homogeneous loans are collectively evaluated for impairment. Loans that are collectively evaluated for impairment include residential real estate and consumer loans and, as appropriate, smaller balance non-homogeneous loans. Larger balance non-homogeneous residential construction and land, commercial real estate, commercial business loans and unsecured loans are individually evaluated for impairment.

Our methodology for assessing the appropriateness of the allowance consists of several key elements, which include specific allowances, an allocated formula allowance and an unallocated allowance. Losses on specific loans are provided for when the losses are probable and estimable. General loan loss reserves are established to provide for inherent loan portfolio risks not specifically provided for. The level of general reserves is based on analysis of potential exposures existing in our loan portfolio including evaluation of historical trends, current market conditions and other relevant factors identified by us at the time the financial statements are prepared. The formula allowance is calculated by applying loss factors to outstanding loans, excluding those loans that are subject to individual analysis for specific allowances. Loss factors are based on our historical loss experience adjusted for significant environmental considerations, including the experience of other banking organizations, which in our judgment affect the collectability of the portfolio as of the evaluation date. The unallocated allowance is based upon our evaluation of various factors that are not directly measured in the determination of the formula and specific allowances. This methodology may result in losses or recoveries differing significantly from those provided in the Consolidated Financial Statements.

While we believe the estimates and assumptions used in our determination of the adequacy of the allowance are reasonable, there can be no assurance that such estimates and assumptions will not be proven incorrect in the future, or that the actual amount of future provisions will not exceed the amount of past provisions or that any increased provisions that may be required will not adversely impact our financial condition and results of operations. In addition, the determination of the amount of the Banks' allowance for loan losses is subject to review by bank regulators as part of the routine examination process, which may result in the adjustment of reserves based upon their judgment of information available to them at the time of their examination.

Fair Value Accounting and Measurement: (Notes 1 and 22) We use fair value measurements to record fair value adjustments to certain financial assets and liabilities and to determine fair value disclosures. We include in the Notes to the Consolidated Financial Statements information about the extent to which fair value is used to measure financial assets and liabilities, the valuation methodologies used and the impact on our results of operations and financial condition. Additionally, for financial instruments not recorded at fair value we disclose, where appropriate, our estimate of their fair value. For more information regarding fair value accounting, please refer to Note 22 in the Notes to the Consolidated Financial Statements.

Other Intangible Assets: (Notes 1 and 21) Other intangible assets consists primarily of core deposit intangibles (CDI), which are amounts recorded in business combinations or deposit purchase transactions related to the value of transaction-related deposits and the value of the customer relationships associated with the deposits. Core deposit intangibles are being amortized on an accelerated basis over a weighted average estimated useful life of eight years. These assets are reviewed at least annually for events or circumstances that could impact their recoverability. These events could include loss of the underlying core deposits, increased competition or adverse changes in the economy. To the extent other identifiable intangible assets are deemed unrecoverable, impairment losses are recorded in other non-interest expense to reduce the carrying amount of the assets.

Mortgage Servicing Rights: Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of loans. Generally, purchased servicing rights are capitalized at the cost to acquire the rights. For sales of mortgage loans, the value of the servicing right is estimated and capitalized. Fair value is based on market prices for comparable mortgage servicing contracts. Capitalized servicing rights are reported in other assets and are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

Real Estate Held for Sale: (Notes 1 and 7) Property acquired by foreclosure or deed in lieu of foreclosure is recorded at the lower of the estimated fair value of the property, less expected selling costs, or the carrying value of the defaulted loan. Development and improvement costs relating to the property may be capitalized, while other holding costs are expensed. The carrying value of the property is periodically evaluated by management and, if necessary, allowances are established to reduce the carrying value to net realizable value. Gains or losses at the time the property is sold are charged or credited to operations in the period in which they are realized. The amounts the Banks will ultimately recover from real estate held for sale may differ substantially from the carrying value of the assets because of market factors beyond the Banks' control or because of changes in the Banks' strategies for recovering the investment.

Income Taxes and Deferred Taxes: (Note 13) 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 (ASC 740), a valuation allowance is required to be recognized if it is "more likely than not" that all or a portion of our deferred tax assets will not be realized.

Accounting Standards Recently Adopted or Issued

Offsetting Assets and Liabilities

In December 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) No. 2011-11, Disclosures About Offsetting Assets and Liabilities. The new disclosure requirements mandate that entities disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial condition as well as instruments and transactions subject to an agreement similar to a master netting arrangement. ASU No. 2011-11 also requires disclosure of collateral received and posted in connection with master netting agreements or similar arrangements.

In January 2013, FASB issued ASU No. 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. The provisions of ASU No. 2013-01 limit the scope of the new balance sheet offsetting disclosures to the following financial instruments, to the extent they are offset in the financial statements or subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in the statement of financial position: (1) derivative financial instruments; (2) repurchase agreements and reverse repurchase agreements; and (3) securities borrowing and securities lending transactions.

The Company adopted the provisions of ASU No. 2011-11 and ASU No. 2013-01 effective January 1, 2013. As the provisions of ASU No. 2011-11 and ASU No. 2013-01 only impact disclosure requirements related to the offsetting of assets and liabilities and information instruments and transactions eligible for offset in the statement of financial condition, the adoption had no impact on the Company's consolidated statements of operations and financial condition.

Reclassifications Out of Accumulated Other Comprehensive Income

In February 2013, FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. ASU No. 2013-02 does not amend any existing requirements for reporting net income or other comprehensive income in the financial statements. ASU No. 2013-02 requires an entity to disaggregate the total change of each component of other comprehensive income (e.g., unrealized gains or losses on available-for-sale investment securities) and separately present reclassification adjustments and current period other comprehensive income. The provisions of ASU No. 2013-02 also require that entities present, either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source (e.g., unrealized gains or losses on available-for-sale investment securities). The Company adopted the provisions of ASU No. 2013-02 effective January 1, 2013. The adoption of this guidance did not have a material effect on the Company's consolidated financial statements.

Unrecognized Tax Benefits

In July 2013, FASB issued ASU No. 2013-11, Presentation of an Unrecognized Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. This ASU requires an unrecognized tax benefit to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. An exception exists to the extent that a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax of the applicable jurisdiction does not require the entity to use, and entity does not intend to use, the deferred tax asset for such a purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. ASU No. 2013-11 is effective for fiscal years and interim periods beginning after December 15, 2013 and is not expected to have a material impact on the Company's consolidated financial statements.

Investing in Qualified Affordable Housing Projects

In January 2014, FASB issued ASU No. 2014-01, Accounting for Investments in Qualified Affordable Housing Projects. The objective of this Update is to provide guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit. The amendments in this Update modify the conditions that a reporting entity must meet to be eligible to use a method other than the equity or cost methods to account for qualified affordable housing project investments. If the modified conditions are met, the amendments permit an entity to amortize the initial cost of the investment in proportion to the amount of tax credits and other tax benefits received and recognize the net investment performance in the income statement as a component of income tax expense (benefit). Additionally, the amendments introduce new recurring disclosures about all investments in qualified affordable housing projects irrespective of the method used to account for the investments. The amendments in this Update should be applied retrospectively to all periods presented. ASU No. 2014-01 is effective beginning after December 15, 2014 and is not expected to have a material impact on the Company's consolidated financial statements.

Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure

In January 2014, FASB issued ASU No. 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. The amendments in this Update clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. ASU No. 2014-04 is effective for fiscal years and interim periods beginning after December 15, 2014 and is not expected to have a material impact on the Company's consolidated financial statements.

Comparison of Financial Condition at December 31, 2013 and 2012

General. Total assets increased $122 million, or 3%, to $4.388 billion at December 31, 2013, compared to $4.266 billion at December 31, 2012. Net loans receivable (gross loans less deferred fees and discounts, and allowance for loan losses) increased $185 million, or 6%, to $3.343 billion at December 31, 2013, from $3.158 billion at December 31, 2012. The increase in net loans included increases of $122 million in commercial real estate loans, $64 million in commercial business loans, $40 million in one- to four-family construction loans, $30 million in multifamily construction loans, and $4 million in consumer loans, partially offset by decreases of $52 million in one- to four-family real estate loans, $18 million in commercial construction loans, $5 million in land and land development loans, $2 million in agricultural business loans, and $351,000 in multifamily loans.

The decrease in one- to four-family real estate was largely the result of accelerated prepayments in the current low interest rate environment. The increase in commercial real estate loans included $109 million for investment properties and $13 million for owner-occupied properties.

The increase in commercial business loans is an encouraging sign of economic activity; however, credit line utilizations remained at relatively low levels. The increase in construction and development loans was particularly helpful to the net interest margin as interest rates, loan fees and the velocity of turnover in this lending activity are generally higher than for most other categories of loans. The net increase in net loans receivable was positively impacted by a reduction of $3 million in the allowance for loan losses due to net charge-offs. There was no provision for loan losses during the year ended December 31, 2013. While demand for consumer loans remained weak and utilization of existing credit lines for consumer and commercial borrowers was low, our production of new commercial real estate and commercial loans was again encouraging.

Securities increased to $635 million at December 31, 2013, from $631 million at December 31, 2012, while the aggregate total of securities and interest-bearing deposits decreased $43 million, or 6%, to $703 million at December 31, 2013, compared to $746 million a year earlier. The change in the mix of interest-bearing deposits and securities holdings compared to a year ago reflects both an increase in our overall securities holdings and a modest extension of the expected duration of our securities holdings designed to increase the aggregate portfolio yield relative to interest-bearing deposits. The securities purchased in recent periods were primarily short- to intermediate-term U.S. Government Agency notes and mortgage-backed securities and, to a lesser extent, intermediate-term taxable and tax-exempt municipal securities. Securities acquired during the year generally have expected weighted average lives ranging from six months to six years, although some have long-term maturities of 10-20 years. The average effective duration of Banner's securities portfolio was approximately 3.4 years at December 31, 2013. At December 31, 2013, the fair value of our trading securities was $13 million less than their amortized cost. The reduction reflected in the fair value of these securities compared to their amortized cost primarily was centered in single-issuer trust preferred securities and collateralized debt obligations secured by pools of trust preferred securities issued by bank holding companies and insurance companies, partially offset by modest gains in all other trading securities. (See Note 4 of the Notes to the Consolidated Financial Statements.) Our available-for-sale portfolio decreased $3 million during the year, as purchases of primarily mortgage-backed or related securities and municipal bonds were exceeded by net repayments, sales and maturities of other securities. Periodically, we also acquire securities (primarily municipal bonds) which are designated as held-to-maturity and this portfolio increased by $16 million from the prior year-end balances.

REO decreased another $12 million, to $4 million at December 31, 2013 compared to $16 million at December 31, 2012 and $43 million at December 31, 2011, continuing the improving trend with respect to these non-earning assets. The December 31, 2013 total included $2 million in land or land development projects and $2 million in single-family homes and related residential construction. During the year ended December 31, 2013, we transferred $3 million of loans into REO, capitalized additional investments of $348,000 in acquired properties, disposed of approximately $17 million of properties and recognized $2 million of gains in current earnings, net of valuation adjustments, for REO properties sold. (See “Asset Quality” discussion below.)

Deposits increased $60 million, or 2%, to $3.618 billion at December 31, 2013, from $3.558 billion at December 31, 2012. Non-interest-bearing deposits increased by $134 million, or 14%, to $1.115 billion from $981 million, and interest-bearing transaction and savings accounts increased by $83 million, or 5%, to $1.630 billion at December 31, 2013 from $1.547 billion at December 31, 2012. Offsetting these increases, certificates of deposit decreased $157 million, or 15%, to $873 million at December 31, 2013 from $1.029 billion at December 31, 2012. The growth in non-interest-bearing deposits and other transaction and savings accounts was particularly notable and significantly contributed to our net interest margin and deposit fee revenues. A portion of the decrease in certificates of deposit was in brokered certificates which decreased $11 million from the prior year-end balance; however, much of the decrease reflects management’s pricing decisions designed to allow maturing higher priced retail certificates to migrate off the balance sheet or into core deposits.

FHLB advances increased $17 million, to $27 million at December 31, 2013 from $10 million at December 31, 2012. The new FHLB advances were all very short-term maturities with correspondingly low interest rates. Other borrowings, consisting of retail repurchase agreements primarily related to customer cash management accounts, increased $6 million to $83 million at December 31, 2013, compared to $77 million at December 31, 2012. No additional junior subordinated debentures were issued or matured during the year; however, the estimated fair value of these instruments increased $1 million to $74 million at December 31, 2013 from $73 million a year ago, primarily as a result of the impact of the passage of time on the years to maturity in the net present value calculation used to estimate fair value of these financial instruments. For more information, see Notes 10, 11 and 12 of the Notes to the Consolidated Financial Statements.

Total stockholders' equity increased $32 million, or 6%, to $539 million at December 31, 2013 compared to $507 million at December 31, 2012, primarily due to retained earnings from operations reduced by payment of dividends to common shareholders and a $5 million reduction as a result of changes in other comprehensive income net of income taxes. During the year ended December 31, 2013, we issued 100,989 additional shares of common stock for $1 million primarily related to our restricted stock plans and 12,185 shares were surrendered by employees to satisfy tax withholding obligations upon the vesting of restricted stock grants. Tangible common stockholders' equity, which excludes intangible assets, also increased $34 million to $537 million, or 12.23% of tangible assets at December 31, 2013, compared to $503 million, or 11.80% at December 31, 2012, reflecting the net additions to equity and the reduction through amortization in core deposit intangibles. During the year ended December 31, 2013, the only Banner Corporation shares we repurchased were 12,185 shares surrendered by employees to satisfy tax withholding obligations upon the vesting of restricted stock grants.

Investments: At December 31, 2013, our consolidated investment portfolio totaled $635 million and consisted principally of U.S. Government and agency obligations, mortgage-backed and mortgage-related securities, municipal bonds, corporate debt obligations, and asset-backed securities. From time to time, our investment levels may be increased or decreased depending upon yields available on investment alternatives and management's projections as to the demand for funds to be used in our loan origination, deposit and other activities. During the year ended December 31, 2013, our aggregate investment in securities increased $4 million. Holdings of mortgage-backed securities increased $45 million and municipal bonds increased $19 million. Partially offsetting these increases was a net decrease in U.S. Government and agency obligations of $37 million, a net decrease in asset-backed securities of $18 million, and a net decrease in corporate bonds of $5 million.

U.S. Government and Agency Obligations: Our portfolio of U.S. Government and agency obligations had a carrying value of $61 million ($62 million at amortized cost, with a fair value adjustment of $1 million) at December 31, 2013, a weighted average contractual maturity of 3.7 years and a weighted average coupon rate of 1.41%. Most of the U.S. Government and agency obligations we own include call features which allow the issuing agency the right to call the securities at various dates prior to the final maturity. Certain agency obligations also include step-up provisions which provide for periodic increases in the coupon rate if the call options are not exercised.

Mortgage-Backed Obligations: At December 31, 2013, our mortgage-backed and mortgage-related securities had a carrying value of $351 million ($353 million at amortized cost, with a fair value adjustment of $2 million). The weighted average coupon rate of these securities was 2.59% and the weighted average contractual maturity was 8.1 years, although we receive principal payments on these securities each period resulting in a much shorter expected average life. As of December 31, 2013, 99% of the mortgage-backed and mortgage-related securities pay interest at a fixed rate and 1% pay at an adjustable-interest rate. We do not believe that any of our mortgage-backed obligations had a meaningful exposure to sub-prime mortgages.

Municipal Bonds: The carrying value of our tax-exempt bonds at December 31, 2013 was $120 million (also with an amortized cost of $120 million), and was comprised of general obligation bonds (i.e., backed by the general credit of the issuer) and revenue bonds (i.e., backed by revenues from the specific project being financed) issued by cities and counties and various housing authorities, and hospital, school, water and sanitation districts located in the states of Washington, Oregon and Idaho, our primary service area. We also had taxable bonds in our municipal bond portfolio, which at December 31, 2013 had a carrying value of $34 million (also $34 million at amortized cost). Many of our qualifying municipal bonds are not rated by a nationally recognized credit rating agency due to the smaller size of the total issuance and a portion of these bonds have been acquired through direct private placement by the issuers. We have not experienced any defaults or payment deferrals on our municipal bonds. At December 31, 2013, our municipal bond portfolio, including taxable and tax-exempt, had a weighted average maturity of approximately 9.4 years and a weighted average coupon rate of 3.92%.

Corporate Bonds: Our corporate bond portfolio, which had a carrying value of $44 million ($58 million at amortized cost, with a fair value adjustment of $14 million) at December 31, 2013, was comprised principally of long-term adjustable-rate capital securities issued by financial institutions, including single issuers trust preferred securities and collateralized debt obligations secured by pools of trust preferred securities issued by bank holding companies and insurance companies. The market for these capital securities deteriorated significantly in 2008 and 2009 and in our opinion is still not currently functioning in a meaningful manner. As a result, the fair value estimates for many of these securities are more subjective than in periods before 2008 when they were acquired. Nonetheless, it is apparent that the values have declined appreciably since purchase, which is reflected in our financial statements and results of operations, although values have recently improved and we had a $1.0 million recovery during the year ended December 31, 2013 on certain collateralized debt obligations that had previously been written off. (See “Critical Accounting Policies” above and Note 22 of the Notes to the Consolidated Financial Statements.) At December 31, 2013, the portfolio had a weighted average maturity of 19.0 years and a weighted average coupon rate of 2.14%.

Asset-Backed Securities: At December 31, 2013, our asset-backed securities portfolio had a carrying value of $25 million ($26 million at amortized cost, with a fair value adjustment of $1 million), and was comprised of securitized pools of student loans issued or guaranteed by the Student Loan Marketing Association (SLMA) and credit card receivables. The weighted average coupon rate of these securities was 1.87% and the weighted average contractual maturity was 9.1 years. Approximately 62% of these securities have adjustable interest rates tied to three-month LIBOR while the remaining securities have fixed interest rates.

The following tables set forth certain information regarding carrying values and percentage of total carrying values of our portfolio of securities—trading and securities—available-for-sale, both carried at estimated fair market value, and securities—held-to-maturity, carried at amortized cost as of December 31, 2013, 2012 and 2011 (dollars in thousands):

Table 1: Securities—Trading

	As of December 31,								
	2013			2012			2011		
	Carrying Value	Percent of Total		Carrying Value	Percent of Total		Carrying Value	Percent of Total	
U.S. Government and agency obligations	$1,481	2.4	%	$1,637	2.3	%	$2,635	3.3	%
Municipal bonds:									
Taxable	—	—		—	—		420	0.5	
Tax exempt	5,023	8.0		5,684	8.0		5,542	6.9	
Total municipal bonds	5,023	8.0		5,684	8.0		5,962	7.4	
Corporate bonds	35,140	56.2		35,741	50.2		35,055	43.4	
Mortgage-backed or related securities:									
1-4 residential agency guaranteed	11,230	18.0		17,911	25.1		26,654	33.0	
Multifamily, agency guaranteed	9,530	15.3		10,196	14.3		10,019	12.4	
Total mortgage-backed or related securities	20,760	33.3		28,107	39.4		36,673	45.4	
Equity securities	68	0.1		63	0.1		402	0.5	
Total securities—trading	$62,472	100.0	%	$71,232	100.0	%	$80,727	100.0	%

Table 2: Securities—Available-for-Sale

	As of December 31,								
	2013			2012			2011		
	Carrying Value	Percent of Total		Carrying Value	Percent of Total		Carrying Value	Percent of Total	
U.S. Government and agency obligations	$58,660	12.5	%	$96,980	20.5	%	$338,971	72.8	%
Municipal bonds:									
Taxable	23,664	5.0		21,153	4.5		10,581	2.3	
Tax exempt	29,191	6.2		23,785	5.0		16,729	3.6	
Total municipal bonds	52,855	11.2		44,938	9.5		27,310	5.9	
Corporate bonds	6,964	1.5		10,729	2.3		6,260	1.3	
Mortgage-backed or related securities:									
1-4 residential agency guaranteed	46,887	10.0		87,859	18.6		70,500	15.1	
1-4 residential other	1,051	0.2		1,299	0.3		1,835	0.4	
Multifamily agency guaranteed	268,438	57.1		177,940	37.6		20,919	4.5	
Multifamily other	10,234	2.2		10,659	2.2		—	—	
Total mortgage-backed or related securities	326,610	69.5		277,757	58.7		93,254	20.0	
Asset-backed securities:									
SLMA	15,681	3.3		32,474	6.9		—	—	
Other asset-backed securities	9,510	2.0		10,042	2.1		—	—	

Total asset-backed securities	25,191	5.3		42,516	9.0		—	—	
Total securities—available-for-sale	$470,280	100.0	%	$472,920	100.0	%	$465,795	100.0	%

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Table 3: Securities—Held-to-Maturity

	As of December 31,								
	2013			2012			2011		
	Carrying Value	Percent of Total		Carrying Value	Percent of Total		Carrying Value	Percent of Total	
U.S. Government and agency obligations	$1,186	1.1	%	$—	—	%	$—	—	%
Municipal bonds:									
Taxable	10,552	10.3		10,326	11.9		7,496	9.9	
Tax exempt	85,374	83.3		74,076	85.7		66,692	88.4	
Total municipal bonds	95,926	93.6		84,402	97.6		74,188	98.3	
Corporate bonds	2,050	2.0		2,050	2.4		1,250	1.7	
Mortgage-backed or related securities:									
Multifamily, agency guaranteed	3,351	3.3		—	—		—	—	
Total mortgage-backed or related securities	3,351	3.3		—	—		—	—	
Total securities—held-to-maturity	$102,513	100.0	%	$86,452	100.0	%	$75,438	100.0	%
Estimated market value	$103,610			$92,458			$80,107		

The following table shows the maturity or period to repricing of our consolidated portfolio of securities—trading at fair value as of December 31, 2013 (dollars in thousands):

Table 4: Securities–Trading Maturity/Repricing and Rates

	Securities—Trading at December 31, 2013											
	One Year or Less		After One to Five Years		After Five to Ten Years		After Ten to Twenty Years		After Twenty Years		Total	
	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield
U.S. Government and agency obligations:												
Fixed-rate	$—	— %	$—	— %	$1,481	5.29%	$—	— %	$—	— %	$1,481	5.29%
	—	—	—	—	1,481	5.29	—	—	—	—	1,481	5.29
Municipal bonds:												
Fixed-rate tax exempt [(1)]	263	4.25	4,760	5.12	—	—	—	—	—	—	5,023	5.08
	263	—	4,760	5.12	—	—	—	—	—	—	5,023	5.08
Corporate bonds:												
Adjustable-rate	35,140	2.38	—	—	—	—	—	—	—	—	35,140	2.38
	35,140	2.38	—	—	—	—	—	—	—	—	35,140	2.38
Mortgage-backed or related securities:												
Fixed-rate	—	—	2,537	5.47	12,091	4.65	2,883	4.98	343	5.31	17,854	4.83
Adjustable-rate	2,906	2.39	—	—	—	—	—	—	—	—	2,906	2.39
	2,906	2.39	2,537	5.47	12,091	4.65	2,883	4.98	343	5.31	20,760	4.48
Equity securities	68	—	—	—	—	—	—	—	—	—	68	—
Total securities—trading—carrying value	$38,377	2.39	$7,297	5.24	$13,572	4.72	$2,883	4.98	$343	5.31	$62,472	3.15
Total securities—trading—amortized cost	$52,526		$7,056		$12,602		$2,656		$310		$75,150	

(1) Yields on tax-exempt municipal bonds are not calculated as tax equivalent.

The following table shows the maturity or period to repricing of our consolidated portfolio of securities—available-for-sale at fair value as of December 31, 2013 (dollars in thousands):

Table 5: Securities–Available-for-Sale Maturity/Repricing and Rates

	Securities—Available-for-Sale at December 31, 2013										
	One Year or Less		After One to Five Years		After Five to Ten Years		After Ten to Twenty Years		After Twenty Years		Tot
	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Car Val
U.S. Government and agency obligations:											
Fixed-rate	$14,140	1.62%	$41,573	0.80%	$702	1.00%	$533	1.47%	$—	— %	$56
Adjustable-rate	1,712	0.51	—	—	—	—	—	—	—	—	1,71
	15,852	1.50	41,573	0.80	702	1.00	533	1.47	—	—	58,6
Municipal bonds:											
Fixed rate taxable	3,595	0.94	19,614	1.29	—	—	455	2.20	—	—	23,6
Fixed rate tax exempt (1)	5,518	1.34	20,271	1.11	1,939	1.78	1,463	2.67	—	—	29,1
	9,113	1.18	39,885	1.20	1,939	1.78	1,918	2.56	—	—	52,8
Corporate bonds:											
Fixed-rate	2,003	1.76	—	—	—	—	—	—	—	—	2,00
Adjustable-rate	4,961	1.04	—	—	—	—	—	—	—	—	4,96
	6,964	1.25	—	—	—	—	—	—	—	—	6,96
Mortgage-backed or related securities:											
Fixed-rate	—	—	238,031	1.13	23,278	2.32	12,683	1.42	52,618	2.53	326
	—	—	238,031	1.13	23,278	2.32	12,683	1.42	52,618	2.53	326
Asset-backed securities:											
Fixed-rate	—	—	—	—	9,510	1.65	—	—	—	—	9,51
Adjustable-rate	15,681	1.31	—	—	—	—	—	—	—	—	15,6
	15,681	1.31	—	—	9,510	1.65	—	—	—	—	25,1
Total securities—available-for-sale—carrying value	$47,610	1.34	$319,489	1.09	$35,429	2.08	$15,134	1.58	$52,618	2.53	$47
Total securities—available-for sale amortized cost	$47,387		$322,493		$36,217		$15,535		$53,328		$47

(1) Yields on tax-exempt municipal bonds are not calculated as tax equivalent.

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The following table shows the maturity or period to repricing of our consolidated portfolio of securities held-to-maturity as of December 31, 2013 (dollars in thousands):

Table 6: Securities–Held-to-Maturity Maturity/Repricing and Rates

	Securities—Held-to-Maturity at December 31, 2013											
	One Year or Less		After One to Five Years		After Five to Ten Years		After Ten to Twenty Years		After Twenty Years		Total	
	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weig Aver Yiel
U.S. Government and agency obligations:												
Fixed-rate	$—	— %	$—	— %	$—	— %	$1,186	1.20%	$—	— %	$1,186	1.20
	—	—	—	—	—	—	1,186	1.20	—	—	1,186	1.20
Municipal bonds:												
Fixed rate taxable	—	—	4,040	4.06	3,058	4.30	3,454	4.26	—	—	10,552	4.20
Fixed rate tax exempt [(1)]	770	3.83	6,294	3.20	10,489	2.64	55,004	4.17	12,817	3.36	85,374	3.78
	770	3.83	10,334	3.53	13,547	3.02	58,458	4.17	12,817	3.36	95,926	3.83
Corporate bonds:												
Fixed-rate	500	3.00	500	3.00	1,050	3.52	—	—	—	—	2,050	3.27
	500	3.00	500	3.00	1,050	3.52	—	—	—	—	2,050	3.27
Mortgage-backed or related securities:												
Fixed-rate	—	—	—	—	3,351	2.58	—	—	—	—	3,351	2.58
	—	—	—	—	3,351	2.58	—	—	—	—	3,351	2.58
Total securities held-to-maturity—carrying value	$1,270	3.50	$10,834	3.51	$17,948	2.97	$59,644	4.11	$12,817	3.36	$102,513	3.75
Total securities held-to-maturity—estimated market value	$1,281		$11,206		$17,908		$60,791		$12,424		$103,610	

(1) Yields on tax-exempt municipal bonds are not calculated as tax equivalent.

Loans and Lending. Our loan portfolio increased $183 million, or 6%, during the year ended December 31, 2013, compared to a decrease of $61 million, or 2%, during the year ended December 31, 2012. While we originate a variety of loans, our ability to originate each type of loan is dependent upon the relative customer demand and competition in each market we serve. Reflecting the recession in 2008 and 2009 and subsequent modest pace of recovery, loan demand, other than for lower rate refinancing of real estate loans, has been weak for most of the past six years as consumers and businesses have been cautious in their use of credit. However, we have implemented strategies designed to capture more market share and achieve increases in targeted loans and our loan originations increased meaningfully in 2012 and 2013. Nonetheless, looking forward, new loan originations and portfolio balances will continue to be significantly affected by the course of the recovery from the current sluggish economic environment. For the years ended December 31, 2013, 2012 and 2011, we originated loans, net of repayments and charge-offs, of $579 million, $448 million and $247 million, respectively. The level of net originations during all three years was significantly impacted by a substantial amount of loan repayments and charge-offs. We generally sell a significant portion of our newly originated one- to four-family residential mortgage loans to secondary market purchasers. Proceeds from sales of loans for the years ended December 31, 2013, 2012 and 2011 totaled $445 million, $505 million and $282 million, respectively. See "Loan Servicing Portfolio" below. Loans held for sale decreased to $3 million at December 31, 2013, compared to $12 million at December 31, 2012.

At various times, we also purchase whole loans and participation interests in loans. During the years ended December 31, 2013, 2012 and 2011, we purchased $49 million, $18 million and $28 million, respectively, of loans and loan participation interests.

One- to Four-Family Residential Real Estate Lending: At December 31, 2013, $529 million, or 16%, of our loan portfolio, consisted of permanent loans on one- to four-family residences. We are active originators of one- to four-family residential loans in most communities where we have established offices in Washington, Oregon and Idaho. Our originations of one- to four-family residential loans were particularly strong in 2012 and the first half of 2013; however, since most of these new loans were sold in the secondary market and principal repayments on existing loans were substantial, we had a $52 million decrease in the balance of loans on one- to four-family residences compared to the prior year. Our one- to four-family loan originations totaled $511 million for the year ended December 31, 2013, compared to $538 million and $358 million for the years ended December 31, 2012 and 2011, respectively.

Construction and Land Lending: Historically, we invested a significant proportion of our loan portfolio in residential construction loans, as well as land loans and loans for the construction of commercial and multifamily real estate. However, as housing markets weakened in 2008, we significantly reduced our origination of new construction and land development loans. The slower pace of originations coupled with repayments as a result of home sales and restructuring opportunities as well as charge-off and foreclosure actions caused our portfolio of one- to four-family construction loans to decrease substantially through 2011. Reversing this trend during the year ended December 31, 2012, one- to four-family construction loans increased by $17 million in 2012 and by an additional $40 million during 2013 to total $201 million at December 31, 2013. By contrast, land development loans (both residential and commercial) decreased by $5 million during the year ended December 31 2013, to $86 million at December 31, 2013. Although significantly below our production levels prior to the beginning of the housing downturn, our construction loan originations have increased for each of the past three years as builders have adjusted to new price levels and certain sub-markets have become very active. Our construction and land development loan originations totaled $681 million for the year ended December 31, 2013, compared to $492 million for the year ended December 31, 2012, and $376 million for the year ended December 31, 2011. At December 31, 2013, construction and land loans totaled $351 million (including $201 million of one- to four-family construction loans, $76 million of residential land or land development loans, $64 million of commercial and multifamily real estate construction loans and $10 million of commercial land or land development loans), or 10% of total loans, compared to $305 million, or 9%, at December 31, 2012. The geographic distribution of our construction and land development loans is approximately

36% in the greater Puget Sound market and 42% in the greater Portland, Oregon market, with the remaining 22% in the various eastern Washington, eastern Oregon and western Idaho markets we serve. While delinquencies and defaults in residential construction and land development loans had a material adverse effect on our results of operations for much of the economic cycle from 2008 through 2011, at December 31, 2013 only $1 million of these loans were non-performing. For the years ended December 31, 2013 and 2012, performing construction loans made a very important contribution to our net interest income and profitability.

Commercial and Multifamily Real Estate Lending: We also originate loans secured by multifamily and commercial real estate. Multifamily and commercial real estate loans originated by us are both fixed- and adjustable-rate loans generally with intermediate terms of five to ten years. Our commercial real estate portfolio consists of loans on a variety of property types with no significant concentrations by property type, borrowers or locations. We experienced reasonably strong demand for both multifamily and commercial real estate loans in 2013, and total balances in these categories increased $122 million or 11% from the prior year end. At December 31, 2013, our loan portfolio included $1.195 billion of commercial real estate loans, or 35% of the total loan portfolio. Our portfolio of multifamily loans was much smaller, at $137 million, or 4% of total loans.

Commercial Business Lending: We are active in small- to medium-sized business lending. In addition to providing earning assets, this type of lending has helped increase our deposit base. Reflecting the relatively weak economic environment, demand for new loans remained modest and line utilizations continued to be low in 2013; however, our production levels for targeted loans were encouraging and resulted in a $64 million, or 10%, increase in commercial business loan balances for the year. At December 31, 2013, commercial business loans totaled $682 million, or 20% of total loans, compared to $618 million, or 19%, at December 31, 2012.

Agricultural Lending: Agriculture is a major industry in many Washington, Oregon and Idaho locations in our service area. While agricultural loans are not a large part of our portfolio, we routinely make agricultural loans to borrowers with a strong capital base, sufficient management depth, proven ability to operate through agricultural cycles, reliable cash flows and adequate financial reporting. Payments on agricultural loans depend, to a large degree, on the results of operation of the related farm entity. The repayment is also subject to other economic and weather conditions as well as market prices for agricultural products, which can be highly volatile at times. Generally, in recent years, weather conditions, production levels and market prices have been good for most of our agricultural borrowers. Our 2013 production levels for agricultural loans were consistent with recent years and at December 31, 2013, agricultural loans totaled $228 million, or 7% of the loan portfolio, compared to $230 million, or 7%, at December 31, 2012.

Consumer and Other Lending: We originate a variety of consumer loans, including home equity lines of credit, automobile, recreational vehicle and boat loans, credit cards and loans secured by deposit accounts. Consumer lending has traditionally been a modest part of our business with loans made primarily to accommodate our existing customer base. In recent years, including 2013, demand for consumer loans has been restrained; however, outstanding balances have increased modestly despite mortgage refinancing activity that has resulted in repayments on home equity lines of credit. The modest increase in 2012 and 2013 was due principally to the purchase during the fourth quarter of 2012 of approximately $13 million of consumer loans originated by another northwest financial institution that are secured by recreational boats, and in 2013 the purchase of an additional $9 million of similar boat loans from that lender. To date the performance of these purchased loans has been in accordance with our expectations as the amount of non-performing boat loans is insignificant. At December 31, 2013, our consumer loans were $4 million greater compared with the prior year. At December 31, 2013, we had $295 million, or 9% of our loan portfolio, in consumer loans, compared to $291 million, or 9%, at December 31, 2012. As of December 31, 2013, 59% of our consumer loans were secured by one- to four-family real estate, including home equity lines of credit. Credit card balances totaled $22 million at December 31, 2013 compared to $21 million a year earlier.

Loan Servicing Portfolio: At December 31, 2013, we were servicing $1.216 billion of loans for others and held $5.7 million in escrow for our portfolio of loans serviced for others. The loan servicing portfolio at December 31, 2013 was composed of $757 million of Freddie Mac residential mortgage loans, $342 million of Fannie Mae residential mortgage loans and $117 million of both residential and non-residential mortgage loans serviced for a variety of private investors. The portfolio included loans secured by property located primarily in the states of Washington, Oregon and Idaho. For the year ended December 31, 2013, we recognized $1.8 million of loan servicing fees in our results of operations, which were net of $2.4 million of amortization for mortgage servicing rights (MSRs) and included $1.3 million in impairment charge reversals for a valuation adjustment to MSRs.

Mortgage Servicing Rights: For the years ended December 31, 2013, 2012 and 2011, we capitalized $2.9 million, $3.7 million, and $1.9 million, respectively, of MSRs relating to loans sold with servicing retained. No MSRs were purchased in those periods. Amortization of MSRs for the years ended December 31, 2013, 2012 and 2011 was $2.4 million, $2.6 million, and $1.8 million, respectively. Management periodically evaluates the estimates and assumptions used to determine the carrying values of MSRs and the amortization of MSRs. During 2013, we recorded $1.3 million in income from the reversal of the valuation allowance that had previously been recognized against our MSRs. At December 31, 2013, our MSRs were carried at a value of $8.1 million, net of amortization, compared to $6.2 million at December 31, 2012.

Table 7: Loan Portfolio Analysis

The following table sets forth the composition of the Company's loan portfolio, including loans held for sale, by type of loan as of the dates indicated (dollars in thousands):

	December 31									
	2013		2012		2011		2010		2009	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percen of Tot
Commercial real estate										
Owner-occupied	$502,601	14.7 %	$489,581	15.1 %	$469,806	14.2 %	$515,093	15.1 %	$509,464	13.4
Investment properties	692,457	20.2	583,641	18.0	621,622	18.9	550,610	16.2	573,495	15.1
Multifamily real estate	137,153	4.0	137,504	4.3	139,710	4.2	134,634	4.0	153,497	4.1
Commercial construction	12,168	0.4	30,229	0.9	42,391	1.3	62,707	1.8	80,236	2.1
Multifamily construction	52,081	1.5	22,581	0.7	19,436	0.6	27,394	0.8	57,422	1.5
One- to four-family construction	200,864	5.9	160,815	5.0	144,177	4.4	153,383	4.5	239,135	6.3
Land and land development										
Residential	75,695	2.2	77,010	2.4	97,491	3.0	167,764	4.9	284,331	7.5
Commercial	10,450	0.3	13,982	0.4	15,197	0.5	32,386	1.0	43,743	1.2
Commercial business	682,169	20.0	618,049	19.1	601,440	18.2	585,457	17.2	637,823	16.8
Agricultural business, including secured by farmland	228,291	6.7	230,031	7.1	218,171	6.6	204,968	6.0	205,307	5.4
One- to four-family real estate	529,494	15.5	581,670	18.0	642,501	19.5	682,924	20.1	703,277	18.6
Consumer secured by one- to four-family real estate	173,188	5.1	170,123	5.3	181,049	5.5	186,036	5.5	191,454	5.1
Consumer—other	121,834	3.5	120,498	3.7	103,347	3.1	99,761	2.9	110,937	2.9
Total loans outstanding	3,418,445	100.0%	3,235,714	100.0%	3,296,338	100.0%	3,403,117	100.0%	3,790,121	100.0
Less allowance for loan losses	(74,990)		(77,491)		(82,912)		(97,401)		(95,269)	
Net loans	$3,343,455		$3,158,223		$3,213,426		$3,305,716		$3,694,852	

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Table 8: Loans by Geographic Concentration

The following table sets forth the Company's loans by geographic concentration at December 31, 2013 (dollars in thousands):

	Washington	Oregon	Idaho	Other	Total
Commercial real estate					
Owner-occupied	$379,666	$56,054	$58,279	$8,602	$502,601
Investment properties	487,775	101,326	60,216	43,140	692,457
Multifamily real estate	108,121	19,108	9,765	159	137,153
Commercial construction	11,335	703	130	—	12,168
Multifamily construction	37,979	14,102	—	—	52,081
One- to four-family construction	109,026	90,186	1,652	—	200,864
Land and land development					
Residential	42,364	32,046	1,285	—	75,695
Commercial	5,156	3,364	1,930	—	10,450
Commercial business	405,275	85,676	68,853	122,365	682,169
Agricultural business, including secured by farmland	118,569	59,020	50,702	—	228,291
One-to four-family real estate	333,147	171,950	21,807	2,590	529,494
Consumer secured by one- to four-family real estate	113,710	45,917	12,864	697	173,188
Consumer—other	83,724	32,322	5,742	46	121,834
Total loans outstanding	$2,235,847	$711,774	$293,225	$177,599	$3,418,445
Percent of total loans	65.4 %	20.8 %	8.6 %	5.2 %	100.0 %

The following table sets forth certain information at December 31, 2013 regarding the dollar amount of loans maturing in our portfolio based on their contractual terms to maturity, but does not include scheduled payments or potential prepayments. Demand loans, loans having no stated schedule of repayments and no stated maturity, and overdrafts are reported as due in one year or less. Loan balances are net of unamortized premiums and discounts, include loans held for sale and exclude the allowance for loan losses (in thousands):

Table 9: Loans by Maturity

	Maturing in One Year or Less	Maturing After One to Three Years	Maturing After Three to Five Years	Maturing After Five to Ten Years	Maturing After Ten Years	Total
Commercial real estate						
Owner-occupied	$16,788	$36,866	$84,926	$282,688	$81,333	$502,601
Investment properties	50,850	62,470	126,743	389,218	63,176	692,457
Multifamily real estate	8,045	14,251	7,992	69,521	37,344	137,153
Commercial construction	11,529	639	—	—	—	12,168
Multifamily construction	23,563	28,518	—	—	—	52,081
One- to four-family construction	167,133	10,534	269	167	22,761	200,864
Land and land development						
Residential	45,884	29,199	441	—	171	75,695
Commercial	3,805	2,687	2,909	507	542	10,450
Commercial business	326,041	100,171	118,451	110,266	27,240	682,169
Agricultural business, including secured by farmland	108,338	19,787	28,708	63,766	7,692	228,291

One- to four-family real estate	17,939	22,667	10,788	26,665	451,435	529,494
Consumer secured by one- to four-family real estate	2,461	1,694	2,144	15,260	151,629	173,188
Consumer—other	11,551	10,744	13,371	32,042	54,126	121,834
Total loans	$793,927	$340,227	$396,742	$990,100	$897,449	$3,418,445

Contractual maturities of loans do not necessarily reflect the actual life of such assets. The average life of loans typically is substantially less than their contractual maturities because of principal repayments and prepayments. In addition, due-on-sale clauses on certain mortgage loans generally give us the right to declare loans immediately due and payable in the event that the borrower sells the real property subject to the mortgage and the loan is not repaid. The average life of mortgage loans tends to increase; however, when current mortgage loan market rates are substantially higher than rates on existing mortgage loans and, conversely, decreases when rates on existing mortgage loans are substantially higher than current mortgage loan market rates.

The following table sets forth the dollar amount of all loans maturing after December 31, 2014 which have fixed interest rates and floating or adjustable interest rates (in thousands):

Table 10: Loans Maturing after One Year

	Fixed Rates	Floating or Adjustable Rates	Total
Commercial real estate			
Owner-occupied	$64,433	$421,380	$485,813
Investment properties	158,349	483,258	641,607
Multifamily real estate	44,899	84,209	129,108
Commercial construction	—	639	639
Multifamily construction	3,898	24,620	28,518
One- to four-family construction	4,821	28,910	33,731
Land and land development			
Residential	4,548	25,262	29,810
Commercial	773	5,872	6,645
Commercial business	185,210	170,918	356,128
Agricultural business, including secured by farmland	47,435	72,519	119,954
One- to four-family real estate	370,089	141,466	511,555
Consumer secured by one- to four-family real estate	10,706	160,021	170,727
Consumer—other	84,312	25,971	110,283
Total loans maturing after one year	$979,473	$1,645,045	$2,624,518

Deposits: We made further progress in 2013 implementing our strategies to strengthen our franchise by remixing our deposits away from high cost certificates of deposit and emphasizing core deposit activity in non-interest-bearing and other transaction and savings accounts. Increasing core deposits (transaction and savings accounts) is a fundamental element of our business strategy. This strategy continues to improve our cost of funds and increase the opportunity for deposit fee revenues, while stabilizing our funding base. Total deposits increased $60 million, to $3.618 billion at December 31, 2013 from $3.558 billion at December 31, 2012, non-interest-bearing deposits increased by $134 million, or 14%, to $1.115 billion at year end from $981 million at December 31, 2012, and interest-bearing transaction and savings accounts increased by $83 million, or 5%, to $1.630 billion at December 31, 2013 compared to $1.547 billion a year earlier. This core deposit growth augmented similarly strong results in 2012 and coupled with significantly better pricing was primarily responsible for the reduced deposit costs and strong net interest margin we experienced in 2013. Offsetting these increases, certificates of deposit decreased $157 million, or 15%, to $873 million at December 31, 2013 from $1.029 billion at December 31, 2012. A portion of the decrease in certificates of deposit was in brokered certificates, which decreased $11 million from the prior year-end balances; however, much of the decrease reflects a reduction in retail certificates as a result of management’s pricing decisions designed to allow maturing higher priced certificates to migrate off the balance sheet or into core deposit accounts.

The following table sets forth the balances of deposits in the various types of accounts offered by the Banks at the dates indicated (dollars in thousands):

Table 11: Deposits

	December 31							
	2013			2012			2011	
	Amount	Percent of Total	Increase (Decrease)	Amount	Percent of Total	Increase (Decrease)	Amount	Percent of Total
Non-interest-bearing checking	$1,115,346	30.8 %	$134,106	$981,240	27.6 %	$203,677	$777,563	22.4 %
Interest-bearing checking	422,910	11.7	12,594	410,316	11.5	47,774	362,542	10.4
Regular savings	798,764	22.1	70,807	727,957	20.5	58,361	669,596	19.3
Money market	408,211	11.3	(787)	408,998	11.5	(6,458)	415,456	11.9
Total transaction and savings accounts	2,745,231	75.9	216,720	2,528,511	71.1	303,354	2,225,157	64.0
Certificates maturing:								
Within one year	660,394	18.2	(99,232)	759,626	21.3	(212,689)	972,315	28.0
After one year, but within two years	117,789	3.3	(35,582)	153,371	4.3	(15,982)	169,353	4.9
After two years, but within five years	90,880	2.5	(21,892)	112,772	3.2	7,169	105,603	3.0
After five years	3,632	0.1	108	3,524	0.1	298	3,226	0.1
Total certificate accounts	872,695	24.1	(156,598)	1,029,293	28.9	(221,204)	1,250,497	36.0
Total Deposits	$3,617,926	100.0 %	$60,122	$3,557,804	100.0 %	$82,150	$3,475,654	100.0 %

Included in Total Deposits:								
Public transaction accounts	$87,521	2.4 %	$7,566	$79,955	2.2 %	$7,891	$72,064	2.1 %
Public interest-bearing certificates	51,465	1.4	(9,053)	60,518	1.7	(6,594)	67,112	1.9
Total public deposits	$138,986	3.8 %	$(1,487)	$140,473	3.9 %	$1,297	$139,176	4.0 %
Total brokered deposits	$4,291	0.1 %	$(11,411)	$15,702	0.4 %	$(33,492)	$49,194	1.4 %

The following table indicates the amount of the Banks’ certificates of deposit with balances equal to or greater than $100,000 by time remaining until maturity as of December 31, 2013 (in thousands):

Table 12: Maturity Period—$100,000 or greater CDs

	Certificates of Deposit $100,000 or Greater
Maturing in three months or less	$129,238
Maturing after three months through six months	82,766
Maturing after six months through twelve months	155,529
Maturing after twelve months	118,417
Total	$485,950

Table 13: Geographic Concentration of Deposits

The following table provides additional detail on geographic concentrations of our deposits at December 31, 2013 (in thousands):

	Washington	Oregon	Idaho	Total
Total deposits	$2,743,230	$626,959	$247,737	$3,617,926
Percent of total deposits	75.9 %	17.3 %	6.8 %	100.0 %

Borrowings: The FHLB-Seattle serves as our primary borrowing source. To access funds, we are required to own a sufficient level of capital stock in the FHLB-Seattle and may apply for advances on the security of such stock and certain of our mortgage loans and securities provided that certain creditworthiness standards have been met. At December 31, 2013, we had $27 million of borrowings from the FHLB-Seattle (at fair value) at a weighted average rate of 0.27%, an increase of $17 million compared to a year earlier. Also at December 31, 2013, we had an investment of $35 million in FHLB-Seattle capital stock. At that date, Banner Bank was authorized by the FHLB-Seattle to borrow up to $767 million under a blanket floating lien security agreement, while Islanders Bank was approved to borrow up to $26 million under a similar agreement.

Table 14: FHLB Advances Outstanding

The following table provides additional detail on our FHLB advances as of December 31, 2013 and 2012 (dollars in thousands):

	December 31 2013		2012	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate
Maturing in one year or less	$27,000	0.23 %	$10,000	2.38 %
Maturing after one year through three years	—	—	—	—
Maturing after three years through five years	—	—	—	—
Maturing after five years	203	5.94	210	5.94
Total FHLB advances, at par	27,203	0.27	10,210	2.45
Fair value adjustment	47		94	
Total FHLB advances, carried at fair value	$27,250		$10,304	

At certain times the Federal Reserve Bank has also served as an important source of borrowings. The Federal Reserve Bank provides credit based upon acceptable loan collateral, which includes certain loan types not eligible for pledging to the FHLB-Seattle. At December 31, 2013, based upon our available unencumbered collateral, Banner Bank was eligible to borrow $564 million from the Federal Reserve Bank; however, at that date we had no funds borrowed under this arrangement.

We also issue retail repurchase agreements to customers that are primarily related to customer cash management accounts and in the past have borrowed funds through the use of secured wholesale repurchase agreements with securities brokers. In each case, the repurchase agreements are generally due within 90 days. At December 31, 2013, retail repurchase agreements totaling $83 million, with a weighted average rate of 0.20%, were secured by a pledge of certain mortgage-backed securities and agency securities. Retail repurchase agreement balances, which are primarily associated with sweep account arrangements, increased $6 million, or 8%, from the 2012 year-end balance. We had no outstanding borrowings under wholesale repurchase agreements at December 31, 2013 or 2012.

We have issued an aggregate of $120 million, net of repayments, of trust preferred securities (TPS) since 2002. The junior subordinated debentures associated with the TPS have been recorded as liabilities on our Consolidated Statements of Financial Condition, although portions of the TPS qualify as Tier 1 or Tier II capital for regulatory capital purposes. The junior subordinated debentures are carried at fair value on our Consolidated Statements of Financial Condition and have an estimated fair value of $74 million at December 31, 2013. At December 31, 2013, the TPS had a weighted average rate of 2.33%. See Notes 1 and 12 of the Notes to the Consolidated Financial Statements for additional information with respect to the TPS.

Asset Quality: Achieving and maintaining a moderate risk profile by aggressively managing troubled assets has been and will continue to be a primary focus for us. As a result, our non-performing assets declined substantially in 2012 and decreased further in 2013. All of our key credit quality metrics have improved compared to a year ago, and as a result our credit costs have been significantly reduced. In addition, our reserve levels are substantial and, as a result of our impairment analysis and charge-off actions, reflect current appraisals and valuation estimates as well as recent regulatory examination results. While our non-performing assets and credit costs have been materially reduced, we continue to be actively engaged with our borrowers in resolving remaining problem assets and with the effective management of real estate owned as a result of foreclosures.

Non-performing assets decreased to $29 million, or 0.66% of total assets, at December 31, 2013, from $50 million, or 1.18% of total assets, at December 31, 2012, and $119 million, or 2.79% of total assets, at December 31, 2011. Construction and land development loans, including related REO, represented approximately 12% of our non-performing assets at December 31, 2013. Reflecting lingering weakness in the economy and property values which now have generally stabilized but are lower than when many of the related loans were originated, we continued to maintain a substantial allowance for loan losses at year end even though non-performing loans declined. At December 31, 2013, our allowance for loan losses was $75 million, or 2.19% of total loans and 303% of non-performing loans, compared to $77 million, or 2.39% of total loans and 225% of non-performing loans at December 31, 2012. Included in our allowance at December 31, 2013 was an unallocated portion of $7 million, which is based upon our evaluation of various factors that are not directly measured in the determination of the formula and specific allowances. We continue to believe our level of non-performing loans and assets, which declined significantly during the past two years, is manageable and we believe that we have sufficient capital and human resources to manage the collection of our non-performing assets in an orderly fashion.

The primary components of the $29 million in non-performing assets are $22 million in nonaccrual loans and $4 million in REO and other repossessed assets. The geographic distribution of non-performing assets included approximately $12 million, or 41%, in the Puget Sound region, $8 million, or 27%, in the greater Portland market area, $1 million, or 5%, in the greater Boise market area, and $8 million, or 27%, in other areas of Washington, Oregon and Idaho.

Loans are reported as restructured when we grant concessions to a borrower experiencing financial difficulties that we would not otherwise consider. As a result of these concessions, restructured loans or TDRs are impaired as the Banks will not collect all amounts due, both principal and interest, in accordance with the terms of the original loan agreement. If any restructured loan becomes delinquent or other matters call into question the borrower's ability to repay full interest and principal in accordance with the restructured terms, the restructured loan(s) would be reclassified as nonaccrual. At December 31, 2013, we had $47 million of restructured loans currently performing under their restructured terms.

The following table sets forth information with respect to our non-performing assets and restructured loans, at the dates indicated (dollars in thousands):

Table 15: Non-Performing Assets

	December 31				
	2013	2012	2011	2010	2009
Nonaccrual loans: [1]					
Secured by real estate:					
Commercial	$6,287	$6,579	$9,226	$24,727	$7,300
Multifamily	—	—	362	1,889	383
Construction/land	1,193	3,672	27,731	75,734	159,264
One- to four-family	12,532	12,964	17,408	16,869	14,614
Commercial business	723	4,750	13,460	21,100	21,640
Agricultural business, including secured by farmland	—	—	1,896	5,853	6,277
Consumer	1,173	3,396	2,905	2,332	3,923
	21,908	31,361	72,988	148,504	213,401
Loans more than 90 days delinquent, still on accrual:					
Secured by real estate:					
One- to four-family	2,611	2,877	2,147	2,955	358
Commercial business	—	—	4	—	—
Agricultural business, including secured by farmland	105	—	—	—	—
Consumer	144	152	173	30	91
	2,860	3,029	2,324	2,985	449
Total non-performing loans	24,768	34,390	75,312	151,489	213,850
Securities on nonaccrual	—	—	500	1,896	4,232
REO assets held for sale, net [2]	4,044	15,778	42,965	100,872	77,743
Other repossessed assets held for sale, net	115	75	74	73	59
Total non-performing assets	$28,927	$50,243	$118,851	$254,330	$295,884
Total non-performing loans to net loans before allowance for loan losses	0.72 %	1.06 %	2.28 %	4.45 %	5.64 %
Total non-performing loans to total assets	0.56 %	0.81 %	1.77 %	3.44 %	4.53 %
Total non-performing assets to total assets	0.66 %	1.18 %	2.79 %	5.77 %	6.27 %
Restructured loans [3]	$47,428	$57,462	$54,533	$60,115	$43,683
Loans 30-89 days past due and on accrual	$8,784	$11,685	$9,962	$28,847	$34,156

(1) Includes $5.7 million of non-accrual restructured loans. For the year ended December 31, 2013, $381,000 in interest income would have been recorded had nonaccrual loans been current, and no interest income on these loans was included in net income for this period.

(2) Real estate acquired by us as a result of foreclosure or by deed-in-lieu of foreclosure is classified as real estate held for sale until it is sold. When property is acquired, it is recorded at the lower of the estimated fair value of the property, less expected selling costs, or the carrying value of the defaulted loan. Subsequent to foreclosure, the property is carried at the lower of the foreclosed amount or net realizable value. Upon receipt of a new appraisal and market analysis, the carrying value is written down through the establishment of a specific reserve to the anticipated sales price, less selling and holding costs.

(3) These loans are performing under their restructured terms.

In addition to the non-performing loans noted in Table 15, as of December 31, 2013, we had classified loans with an aggregate outstanding balance of $88 million that are not on nonaccrual status, with respect to which known information concerning possible credit problems with the borrowers or the cash flows of the properties securing the respective loans has caused management to be concerned about the ability of the borrowers to comply with present loan repayment terms. This may result in the future inclusion of such loans in the nonaccrual loan category.

The following table provides additional detail and geographic concentration of non-performing assets at December 31, 2013 (dollars in thousands):

Table 16: Non-Performing Assets by Geographic Concentration

	Washington	Oregon	Idaho	Total
Secured by real estate:				
Commercial	$6,239	$—	$48	$6,287
Construction and land				
One- to four-family construction	—	269	—	269
Residential land acquisition & development	—	750	—	750
Residential land improved lots	—	174	—	174
Total construction and land	—	1,193	—	1,193
One- to four-family	9,466	5,066	611	15,143
Commercial business	663	60	—	723
Agricultural business, including secured by farmland	105	—	—	105
Consumer	1,021	40	256	1,317
Total non-performing loans	17,494	6,359	915	24,768
REO and repossessed assets	2,026	1,628	505	4,159
Total non-performing assets at end of the period	$19,520	$7,987	$1,420	$28,927
Percent of non-performing assets	67.5 %	27.6 %	4.9 %	100.0 %

Table 17: Non-Performing Loan Summary

Within our non-performing loans, we have a total of two nonaccrual lending relationships, each with aggregate loan exposures in excess of $1 million that collectively comprise $3.4 million, or 13.6% of our total non-performing loans as of December 31, 2013, and the single largest relationship totaled $1.8 million at that date. The most significant of our non-performing loan exposures at December 31, 2013 are included in the following table (dollars in thousands):

Amount	Percent of Total Non-Performing Loans	Collateral Securing the Indebtedness	Geographic Location
$1,572	6.3 %	Commercial building	Central Washington
1,820	7.3	Commercial building	Greater Spokane, WA area
21,376	86.4	Relationships under $1 million; various collateral	Sum of 125 loans spread throughout the franchise
$24,768	100.0 %	Total non-performing loans	

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Table 18: Real Estate Owned Summary

At December 31, 2013, we had $4.0 million of REO, the most significant component of which is a subdivision in the greater Portland, Oregon area consisting of 13 residential buildable lots and 33.2 acres of undeveloped land with a book value of $940,000. All other REO holdings have individual book values of less than $500,000. The table below summarizes our REO by geographic location and property type (dollars in thousands):

Amount	Percent of Total REO		REO Description	Geographic Location
$1,623	40.1	%	Three single family residences 11 residential buildable lots 33 acres undeveloped land	Greater Portland, OR area
1,094	27.1		Four acres undeveloped buildable land Two single family residences One residential lot Two parcels of undeveloped residential land Two acres of buildable residential land One single family condominium unit	Greater Seattle-Puget Sound area
788	19.5		One single family residence under construction Three residential lots 13 acres of undeveloped land One parcel of bare land	Other Washington locations
505	12.5		Two single family residences One residential lot One commercial office building	Greater Boise, ID area
34	0.8		One single family residence	Greater Spokane, WA area
$4,044	100.0	%		

Comparison of Results of Operations for the Years Ended December 31, 2013 and 2012

Following three difficult years and despite a still challenging economy, Banner Corporation returned to profitability in 2011 and achieved significantly increased profitability in 2012 and 2013. For the year ended December 31, 2013, we had net income and net income available to common shareholders of $46.6 million, or $2.40 per diluted share. This compares to net income of $64.9 million, which, after providing for the preferred stock dividend of $4.9 million, the related discount accretion of $3.3 million, and including a $2.5 million gain on repurchase and retirement of preferred stock, resulted in net income to common shareholders of $59.1 million, or $3.16 per diluted share, for the year ended December 31, 2012. While our return to profitability has largely resulted from a material decrease in credit costs, particularly our provision for loan losses, it also reflects strong revenue generation from our core operations. The decrease in credit costs reflects a significantly reduced level of non-performing assets while the improvement in net revenues has been driven largely by increased deposit fees and other service charges fueled by growth in core deposits and a significant increase in revenues from mortgage banking, notwithstanding a decrease in 2013 compared to 2012, as well as solid net interest income as a result of lower funding costs and reduced non-performing assets. In addition, deposit insurance expenses decreased due to improvements in our asset quality and earnings performance. Despite these positive trends, the current year results reflect the difficult operating environment presented by continued very low market interest rates and slow economic growth, which resulted in a decline in our net interest margin, and modest loan demand as well as reduced mortgage banking revenues as refinancing activity moderated. The results for the year ended December 31, 2013 also include a $22.5 million provision for income taxes while the results for 2012 included a $24.8 million net benefit from income taxes as a result of reversing the valuation allowance for our deferred tax assets during the year.

Aside from credit costs, our operating results depend largely on our net interest income which, as explained below, decreased by $932,000 to $166.7 million, primarily because of a significant reduction in loan yields and despite an increase in average interest-earning assets and further reductions in deposit and funding costs. Our operating results for the year ended December 31, 2013 also reflected a significant increase in other operating income, which was particularly influenced by a termination fee of $3.0 million related to a proposed acquisition, $1.0 million in gains on the sale of securities and a reduction of $14.2 million in net charges as a result of changes in the valuation of financial instruments carried at fair value. Excluding fair value and OTTI adjustments, the acquisition termination fee and gains on sale of securities, our other operating income decreased by $2.5 million to $41.2 million for the year ended December 31, 2013 compared to $43.8 million the preceding year, primarily as a result of a $2.6 million decrease in mortgage banking revenue. Other operating expenses decreased modestly to $141.0 million for the year ended December 31, 2013 compared with $141.5 million for the year ended December 31, 2012.

Net Interest Income. Net interest income before provision for loan losses decreased by $932,000, or 0.6%, to $166.7 million for the year ended December 31, 2013, compared to $167.6 million one year earlier, primarily as a result of a decrease in the net interest margin and despite a modest increase in average interest-earning assets. The net interest margin of 4.11% for the year ended December 31, 2013 decreased six basis points from the prior year, largely as a result of continuing exceptionally low market interest rates on asset yields. Nonaccruing loans reduced the margin by just one basis point during the year ended December 31, 2013, compared to a margin reduction of eight basis points in the year ended December 31, 2012. Reflecting the low interest rate environment, the yield on interesting-earning assets for the year ended December 31, 2013 decreased by 23 basis points compared to the prior year. Funding costs were also significantly lower, although not enough to offset the decline in asset yields, as the cost of interest-bearing liabilities decreased by 18 basis points compared to the prior year. As a result, the net interest spread decreased to 4.08% for the year ended December 31, 2013 compared to 4.13% for the prior year and was only partially offset by the 1% increase in average interest-earning assets.

Interest Income. Interest income for the year ended December 31, 2013 was $179.7 million, compared to $187.2 million for the prior year, a decrease of $7.5 million, or 4%. The decrease in interest income occurred as a result of a decline in the yield on interest-earning assets, which was only partially offset by an increase in average balances. The average balance of interest-earning assets was $4.053 billion for the year ended December 31, 2013, an increase of $33 million, or 1%, compared to $4.020 billion one year earlier. The yield on average interest-earning assets decreased 23 basis points to 4.43% for the year ended December 31, 2013, compared to 4.66% one year earlier. The decrease in the yield on earning assets reflects the continuing erosion of yields as loans and investments mature or prepay and are replaced by lower yielding assets in the current low interest rate environment. The continuing pressure from lower market interest rates was particularly evident as our loan yields decreased 31 basis points to 5.10% for the year ended December 31, 2013 compared to 5.41% in the preceding year. We believe that loan yields will likely continue to decline in the current interest rate environment as new origination activity will reflect market rates that are below the average portfolio yield and opportunities to further reduce the impact of non-performing loans have diminished. Average loans receivable for the year ended December 31, 2013 increased $52 million, or 2%, to $3.276 billion, compared to $3.224 billion for the prior year. Interest income on loans decreased by $7.1 million, or 4%, to $167.2 million for the current year from $174.3 million for the year ended December 31, 2012, reflecting the impact of the 31 basis point decrease in the average yield on loans, partially offset by the $52 million increase in average loan balances.

The combined average balance of mortgage-backed securities, investment securities, daily interest-bearing deposits and FHLB stock decreased to $777 million for the year ended December 31, 2013 (excluding the effect of fair value adjustments), compared to $796 million for the year ended December 31, 2012 and the interest and dividend income from those investments decreased by $332,000 compared to the prior year. The average yield on the combined portfolio was 1.61% for the year ended December 31, 2012, unchanged from the prior year. The adverse impact of lower market rates on the combined yield on these investments was offset by changes in the mix to include lower balances of daily interest-bearing deposits and more securities.

Interest Expense. Interest expense for the year ended December 31, 2013 was $13.0 million, compared to $19.5 million for the prior year, a decrease of $6.5 million, or 33%. The decrease in interest expense occurred as a result of an 18 basis point decrease in the average cost of all interest-bearing liabilities to 0.35% for the year ended December 31, 2013, from 0.53% one year earlier, partially offset by a $59 million, or 2%, increase in average interest-bearing liabilities. This increase in average interest-bearing balances reflects increases in transaction and savings accounts and advances from the FHLB, offset by a continued decline in certificates of deposits. The growth in non-interest-bearing deposits and other transaction and savings accounts during the past three years has significantly contributed to our reduced funding costs.

Deposit interest expense decreased $5.4 million, or 36%, to $9.7 million for the year ended December 31, 2013 compared to $15.1 million for the prior year as a result of a 16 basis point decrease in the cost of deposits, partially offset by a $68 million, or 2%, increase in the average balance of deposits. Average deposit balances increased to $3.515 billion for the year ended December 31, 2013, from $3.448 billion for the year ended December 31, 2012, while the average rate paid on deposit balances decreased to 0.28% in the current year from 0.44% for the prior year. Deposit costs are significantly affected by changes in the level of market interest rates; however, changes in the average rate paid for interest-bearing deposits frequently tend to lag changes in market interest rates as evidenced by the continuing decline in our deposit costs despite relatively stable short-term market interest rates over the past twelve months.

While we do not anticipate further reductions in market interest rates, we do expect additional modest declines in deposit costs over the near term as maturities of certificates of deposit will present further repricing opportunities and competitive pricing should remain restrained in response to modest loan demand in the current economic environment. Further, continuing changes in our deposit mix, especially growth in lower cost transaction and savings accounts, in particular non-interest-bearing deposits, have meaningfully contributed to the decrease in our funding costs compared to earlier periods, and should also result in lower deposit costs going forward. However, it is clear that the pace of decline in deposit costs compared to prior periods has slowed and that the opportunity for future reductions is limited.

Average FHLB advances (excluding the effect of fair value adjustments) increased to $18.9 million for the year ended December 31, 2013, compared to $10.2 million for the prior year, while the average rate paid on FHLB advances for the year ended December 31, 2013 decreased to 0.52% from 2.49% for the year ended December 31, 2012. Average FHLB advances increased as a result of certain cash management activities at Banner Bank, while the cost of the advances declined as a result of the maturity of a higher rate fixed-term advance in February 2013. The decline in average rate paid on FHLB advances was responsible for the $155,000 decrease in the related interest expense to $99,000 for the year ended December 31, 2013, from $254,000 in the prior year, despite the increase in the average balance outstanding for the year.

Other borrowings consist of retail repurchase agreements with customers secured by certain investment securities and, prior to March 31, 2012, $50 million of senior bank notes issued under the Temporary Liquidity Guarantee Program (TLGP). The average balance for other borrowings decreased $17 million to $85 million during the current year from $102 million one year earlier, while the average rate on other borrowings decreased to 0.23% from 0.74% a year earlier. As a result, interest expense for other borrowing decreased to $192,000 for the year ended December 31, 2013, compared to $758,000 for the year ended December 31, 2012. The senior bank notes had a fixed rate of 2.625%, plus a 1.00% guarantee fee, and matured on March 31, 2012.

Junior subordinated debentures which were issued in connection with trust preferred securities had an average balance of $124 million (excluding the effect of fair value adjustments) for both the years ended December 31, 2013 and 2012. During 2013, the average rate decreased to 2.40% compared to 2.74% for 2012. Generally, the junior subordinated debentures are adjustable-rate instruments with repricing frequencies of three months based upon the three-month LIBOR index; however, one $25 million issue of junior subordinated debentures had a fixed rate of 6.56%

for an initial five-year period which expired on February 29, 2012. Subsequent to that date, the interest rate on that debenture resets every three months at a rate of three-month LIBOR plus 1.62%. The change in the rate on that debenture, coupled with a modestly lower level of LIBOR, resulted in the lower cost of the junior subordinated debentures for the year ended December 31, 2013 compared to the prior year.

Table 19, Analysis of Net Interest Spread, presents, for the periods indicated, our condensed average balance sheet information, together with interest income and yields earned on average interest-earning assets and interest expense and rates paid on average interest-bearing liabilities. Average balances are computed using daily average balances. (See the footnotes to the tables for more information on average balances.)

The following table provides an analysis of our net interest spread for the last three years (dollars in thousands):

Table 19: Analysis of Net Interest Spread

	Year Ended December 31, 2013			Year Ended December 31, 2012			Year Ended December 31, 2011		
	Average Balance	Interest and Dividends	Yield/ Cost (4)	Average Balance	Interest and Dividends	Yield/ Cost (4)	Average Balance	Interest and Dividends	Yield/ Cost (4)
Interest-earning assets:									
Mortgage loans	$2,388,222	$124,859	5.23 %	$2,380,308	$131,523	5.53 %	$2,464,462	$139,102	5.64 %
Commercial/agricultural loans	783,076	35,622	4.55	751,486	36,836	4.90	744,439	39,127	5.26
Consumer and other loans	104,469	6,724	6.44	91,983	5,963	6.48	88,749	6,128	6.90
Total loans (1)	3,275,767	167,205	5.10	3,223,777	174,322	5.41	3,297,650	184,357	5.59
Mortgage-backed securities	335,680	5,168	1.54	188,806	4,176	2.21	87,463	3,455	3.95
Other securities	320,283	7,107	2.22	431,580	8,328	1.93	423,612	9,245	2.18
Interest-bearing deposits with banks	85,178	214	0.25	138,179	336	0.24	219,025	506	0.23
FHLB stock	36,154	18	0.05	37,263	—	—	37,371	—	—
Total investment securities	777,295	12,507	1.61	795,828	12,840	1.61	767,471	13,206	1.72
Total interest-earning assets	4,053,062	179,712	4.43	4,019,605	187,162	4.66	4,065,121	197,563	4.86
Non-interest-earning assets	204,077			199,561			215,646		
Total assets	$4,257,139			$4,219,166			$4,280,767		
Interest-bearing liabilities:									
Savings accounts	$763,318	1,572	0.21	$682,173	1,825	0.27	$648,262	3,119	0.48
Checking and interest-bearing checking accounts (2)	1,398,876	380	0.03	1,203,991	491	0.04	1,035,100	811	0.08
Money market accounts	410,031	950	0.23	411,453	1,319	0.32	437,561	2,469	0.56
Certificates of deposit	943,268	6,835	0.72	1,150,288	11,472	1.00	1,389,351	19,765	1.42
Total deposits	3,515,493	9,737	0.28	3,447,905	15,107	0.44	3,510,274	26,164	0.75
Other interest-bearing liabilities:									
FHLB advances	18,935	99	0.52	10,215	254	2.49	14,699	370	2.52
Other borrowings	84,961	192	0.23	102,193	758	0.74	154,140	2,265	1.47
Junior subordinated debentures	123,716	2,968	2.40	123,716	3,395	2.74	123,716	4,193	3.39
Total borrowings	227,612	3,259	1.43	236,124	4,407	1.87	292,555	6,828	2.33
Total interest-bearing liabilities	3,743,105	12,996	0.35	3,684,029	19,514	0.53	3,802,829	32,992	0.87
Non-interest-bearing liabilities (3)	(11,970)			(22,757)			(40,266)		
Total liabilities	3,731,135			3,661,272			3,762,563		
Stockholders' equity	526,004			557,894			518,204		

Total liabilities and stockholders' equity	$4,257,139			$4,219,166			$4,280,767		
Net interest income/rate spread		$166,716	4.08 %		$167,648	4.13 %		$164,571	3.99 %
Net interest margin			4.11 %			4.17 %			4.05 %
Ratio of average interest-earning assets to average interest-bearing liabilities			108.28 %			109.11 %			106.90 %

(footnotes follow)

(1) Average balances include loans accounted for on a nonaccrual basis and loans 90 days or more past due. Amortization of net deferred loan fees/costs is included with interest on loans.
(2) Average balances include non-interest-bearing deposits.
(3) Average non-interest-bearing liabilities include fair value adjustments related to FHLB advances and junior subordinated debentures.
(4) Yields and costs have not been adjusted for the effect of tax-exempt interest.

The following table sets forth the effects of changing rates and volumes on our net interest income during the periods shown (in thousands). Information is provided with respect to (i) effects on interest income attributable to changes in volume (changes in volume multiplied by prior rate) and (ii) effects on interest income attributable to changes in rate (changes in rate multiplied by prior volume). Effects on interest income attributable to changes in rate and volume (changes in rate multiplied by changes in volume) have been allocated between changes in rate and changes in volume (in thousands):

Table 20: Rate/Volume Analysis

	Year Ended December 31, 2013 Compared to Year Ended December 31, 2012 Increase (Decrease) in Income/Expense Due to			Year Ended December 31, 2012 Compared to Year Ended December 31, 2011 Increase (Decrease) in Income/Expense Due to		
	Rate	Volume	Net	Rate	Volume	Net
Interest-earning assets:						
Mortgage loans	$(7,100)	$436	$(6,664)	$(2,891)	$(4,688)	$(7,579)
Commercial/agricultural loans	(2,721)	1,507	(1,214)	(2,658)	367	(2,291)
Consumer and other loans	(43)	804	761	(383)	218	(165)
Total loans [1]	(9,864)	2,747	(7,117)	(5,932)	(4,103)	(10,035)
Mortgage-backed securities	(1,547)	2,539	992	(2,005)	2,726	721
Other securities	1,131	(2,352)	(1,221)	(1,088)	171	(917)
Interest-bearing deposits with banks	11	(133)	(122)	26	(196)	(170)
FHLB stock	19	(1)	18	—	—	—
Total investment securities	(386)	53	(333)	(3,067)	2,701	(366)
Total net change in interest income on interest-earning assets	(10,250)	2,800	(7,450)	(8,999)	(1,402)	(10,401)
Interest-bearing liabilities:						
Deposits [2]	(3,795)	(1,575)	(5,370)	(8,159)	(2,898)	(11,057)
FHLB advances						