Banner Corporation

2009 Annual Report

Fellow Shareholders,

This last year has been an extraordinary and difficult year for commercial banks nationally but even more challenging for Pacific Northwest banks, including Banner.

The U.S. economy continued its downturn through the first three quarters of 2009, led by a dramatic slowdown in sales and values of one-to-four family residential construction assets, especially in the Pacific Northwest. The declines were particularly evident in related residential land and lots. Banks, such as Banner Bank, that have a large commitment to financing this industry universally experienced declines in asset values, increases in foreclosures of builder properties, pressure on net interest margins, large increases in provisions for loan losses and related reserves along with increases in collection expenses.

The economy began to stabilize in the fourth quarter which slowed down the growth of delinquent loans and also slowed down declines in property values. It also provided a basis for improved volumes of new home sales. These economic factors led to improvement in Banner's operating performance in the fourth quarter. Banner had an improved net interest margin, lower operating expenses and a stabilization of problem assets.

This stabilization led to a lower provision for loan losses and a significant reduction in 2009 of our portfolio of loans to the residential construction industry. Since the high point in June 2007, this loan concentration has been reduced by more than 50% and now is at approximately 16% of total loans outstanding.

We are encouraged by these trends in the fourth quarter and believe our current commitment to lending to the residential construction industry is at an appropriate concentration level. We expect our net interest margin to continue to improve somewhat in 2010 as compared to 2009 and, if the economic trends continue to improve, our provision for loan losses will be reduced in 2010. These factors should lead to a return to profitability for Banner in 2010.

2009 did bring some good changes to our balance sheet and we remain very well capitalized. We reduced our loan to deposit ratio to below 100% on the way to our long-range goal of 95%. We significantly grew our core deposits while reducing deposits we hold from public entities due to changes in the economics of holding such public entity deposits. We also minimized our level of brokered deposits while at the same time significantly increasing our level of on-balance-sheet liquidity. All of this deposit activity improved our funding mix and reduced our cost of funds.

In line with projections from last year, we did open four new branches in 2009—in downtown Spokane, downtown Everett and the Fairhaven area of Bellingham, Washington, and in downtown Lake Oswego, Oregon. We do not have any plans to open any new branches in 2010 as we view that as inappropriate until we return solidly to profitability.

As we approach our shareholder meeting in April, 2010, I am reminded that meeting will mark the end of director service of Wilber Pribilsky as he reaches mandatory retirement age for our directors. He has served as a director for 23 years, including several years recently as the Board's lead director. We will miss his knowledge and commitment to Banner but remain grateful for his exemplary service to our company.

As I stated last year, we are disappointed in our overall performance in 2009, but recognize the tremendous effort of our staff during the year and their commitment to make Banner better in 2010 and beyond.

Finally, thank you to our Shareholders and customers for continued support during these tumultuous times and rest assured we are committed to better performance in 2010.

D. Michael Jones
President & Chief Executive Officer
Banner Corporation & Banner Bank

10 S. First Avenue
P.O. Box 907
Walla Walla, WA 99362-0265

March 29, 2010

Dear Shareholder:

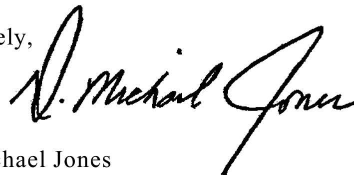
You are cordially invited to attend the annual meeting of shareholders of Banner Corporation. The meeting will be held at the Marcus Whitman Hotel at 6 W. Rose Street, Walla Walla, Washington, on Tuesday, April 27, 2010, at 10:00 a.m., local time.

The Notice of Annual Meeting of Shareholders and Proxy Statement describe the formal business to be transacted at the meeting. During the meeting, we will also report on our operations. Directors and officers of Banner Corporation, as well as a representative of Moss Adams LLP, our independent auditor, will be present to respond to appropriate questions of shareholders.

It is important that your shares are represented at this meeting, whether or not you attend the meeting in person and regardless of the number of shares you own. To make sure your shares are represented, we urge you to promptly vote. You may vote your shares via the Internet or a toll-free telephone number, or by completing and mailing the enclosed proxy card. If you attend the meeting, you may vote in person even if you have previously submitted your proxy.

We look forward to seeing you at the meeting.

Sincerely,



D. Michael Jones
President and Chief Executive Officer

BANNER CORPORATION
10 S. FIRST AVENUE
WALLA WALLA, WASHINGTON 99362
(509) 527-3636

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS
TO BE HELD ON APRIL 27, 2010

Notice is hereby given that the 2010 annual meeting of shareholders of Banner Corporation will be held at the Marcus Whitman Hotel at 6 W. Rose Street, Walla Walla, Washington, on Tuesday, April 27, 2010, at 10:00 a.m., local time, for the purpose of considering and acting upon the following:

Proposal 1. To elect four directors to each serve for a three-year term.

Proposal 2. To provide advisory approval of the compensation of our named executive officers.

Proposal 3. To ratify the Audit Committee's selection of Moss Adams LLP as our independent auditor for 2010.

Proposal 4. To amend the Articles of Incorporation to increase the authorized number of shares of common stock from 75,000,000 to 200,000,000 shares.

We will also consider and act upon such other matters as may properly come before the meeting or any adjournments or postponements thereof. As of the date of this notice, we are not aware of any other business to come before the annual meeting.

The Board of Directors has fixed the close of business on March 1, 2010 as the record date for the annual meeting. This means that shareholders of record at the close of business on that date are entitled to receive notice of and to vote at the meeting and any adjournment thereof. **To ensure that your shares are represented at the meeting, please take the time to vote by submitting your vote via the Internet or telephone, or by signing, dating and mailing the enclosed proxy card which is solicited on behalf of the Board of Directors. The proxy will not be used if you attend and vote at the annual meeting in person. Regardless of the number of shares you own, your vote is very important. Please act today.**

BY ORDER OF THE BOARD OF DIRECTORS

ALBERT H. MARSHALL
SECRETARY

Walla Walla, Washington
March 29, 2010

IMPORTANT: Voting promptly will save us the expense of further requests for proxies in order to ensure a quorum. A proxy card and self-addressed envelope are enclosed for your convenience. No postage is required if mailed in the United States.

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PROXY STATEMENT
OF
BANNER CORPORATION
10 S. FIRST AVENUE
WALLA WALLA, WASHINGTON 99362
(509) 527-3636

ANNUAL MEETING OF SHAREHOLDERS
APRIL 27, 2010

The Board of Directors of Banner Corporation is using this Proxy Statement to solicit proxies from our shareholders for use at the 2010 annual meeting of shareholders. We are first mailing this Proxy Statement and the form of proxy to our shareholders on or about March 29, 2010.

The information provided in this Proxy Statement relates to Banner Corporation and its wholly-owned subsidiaries, Banner Bank and Islanders Bank. Banner Corporation may also be referred to as "Banner" and Banner Bank and Islanders Bank may also be referred to as the "Banks." References to "we," "us" and "our" refer to Banner and, as the context requires, the Banks.

INFORMATION ABOUT THE ANNUAL MEETING

Time and Place of the Annual Meeting

Our annual meeting will be held as follows:

Date: Tuesday, April 27, 2010
Time: 10:00 a.m., local time
Place: Marcus Whitman Hotel located at 6 W. Rose Street, Walla Walla, Washington

Matters to Be Considered at the Annual Meeting

At the meeting, you will be asked to consider and vote upon the following proposals:

Proposal 1. To elect four directors to each serve for a three-year term

Proposal 2. To provide advisory approval of the compensation of our named executive officers

Proposal 3. To ratify the Audit Committee's selection of Moss Adams LLP as our independent auditor for 2010.

Proposal 4. To amend the Articles of Incorporation to increase the authorized number of shares of common stock from 75,000,000 to 200,000,000 shares.

We also will transact any other business that may properly come before the annual meeting. As of the date of this Proxy Statement, we are not aware of any other business to be presented for consideration at the annual meeting other than the matters described in this Proxy Statement.

Who is Entitled to Vote?

We have fixed the close of business on March 1, 2010 as the record date for shareholders entitled to notice of and to vote at our annual meeting. Only holders of record of Banner's common stock on that date are entitled to notice of and to vote at the annual meeting. You are entitled to one vote for each share of Banner common stock you own. On March 1, 2010, there were 22,509,931 shares of Banner common stock outstanding and entitled to vote at the annual meeting.

How Do I Vote at the Annual Meeting?

Proxies are solicited to provide all shareholders of record on the voting record date an opportunity to vote on matters scheduled for the annual meeting and described in these materials. You are a shareholder of record if your shares of Banner common stock are held in your name. If you are a beneficial owner of Banner common stock held by a broker, bank or other nominee (i.e., in "street name"), please see the instructions in the following question.

Shares of Banner common stock can only be voted if the shareholder is present in person or by proxy at the annual meeting. To ensure your representation at the annual meeting, we recommend you vote by proxy even if you plan to attend the annual meeting. You can always change your vote at the meeting if you are a shareholder of record.

This year, shareholders may vote by proxy via the Internet or a toll-free telephone number, or by mailing a proxy card. Instructions for voting are found on the proxy card. Shares of Banner common stock represented by properly executed proxies will be voted by the individuals named on the proxy card in accordance with the shareholder's instructions. Where properly executed proxies are returned to us with no specific instruction as how to vote at the annual meeting, the persons named in the proxy will vote the shares "FOR" election of each of our director nominees, "FOR" approval of the compensation of our named executive officers, "FOR" ratification of the selection of Moss Adams LLP as our independent auditor and "FOR" the amendment of the Articles of Incorporation to increase the authorized number of shares of common stock. If any other matters are properly presented at the annual meeting for action, the persons named in the enclosed proxy and acting thereunder will have the discretion to vote on these matters in accordance with their best judgment. We do not currently expect that any other matters will be properly presented for action at the annual meeting.

You may receive more than one proxy card depending on how your shares are held. For example, you may hold some of your shares individually, some jointly with your spouse and some in trust for your children. In this case, you will receive three separate proxy cards to vote.

What if My Shares Are Held in Street Name?

If you are the beneficial owner of shares held in "street name" by a broker, your broker, as the record holder of the shares, is required to vote the shares in accordance with your instructions. If you do not give instructions to your broker, your broker may nevertheless vote the shares with respect to discretionary items, but will not be permitted to vote your shares with respect to non-discretionary items, pursuant to current industry practice. In the case of non-discretionary items, the shares not voted will be treated as "broker non-votes." The proposal to elect directors is considered a non-discretionary item under the rules governing brokers that are members of the New York Stock Exchange; therefore, you must provide instructions to your broker in order to have your shares voted in the election of directors.

If your shares are held in street name, you will need proof of ownership to be admitted to the annual meeting. A recent brokerage statement or letter from the record holder of your shares are examples of proof of ownership. If you want to vote your shares of common stock held in street name in person at the annual meeting, you will have to get a written proxy in your name from the broker, bank or other nominee who holds your shares.

How Will My Shares of Common Stock Held in the Employee Stock Ownership Plan Be Voted?

If a shareholder is a participant in the Banner Corporation Employee Stock Ownership Plan ("ESOP"), the proxy card represents a voting instruction to the trustees of the ESOP as to the number of shares in the participant's plan account. Each participant in the ESOP may instruct the trustees how to vote the shares of common stock allocated to the participant's plan account. The instructions are confidential and will not be disclosed to Banner. If an ESOP participant properly executes the proxy card, the ESOP trustee will vote the participant's shares in accordance with the participant's instructions. Unallocated shares of common stock held by the ESOP and allocated shares for which no voting instructions are received or for which proper voting instructions are not received will be voted by the trustees in the same proportion as shares for which the trustees have received voting instructions. The trustees of the ESOP are Directors Adams, Budke, Casper, Epstein, Klaue, Kravas, Lane, Layman, Mitchell, Orrico, Pribilsky and Smith.

How Many Shares Must Be Present to Hold the Meeting?

A quorum must be present at the meeting for any business to be conducted. The presence at the meeting, in person or by proxy, of at least a majority of the shares of Banner common stock entitled to vote at the annual meeting as of the record date will constitute a quorum. Proxies received but marked as abstentions or broker non-votes will be included in the calculation of the number of shares considered to be present at the meeting.

What if a Quorum Is Not Present at the Meeting?

If a quorum is not present at the scheduled time of the meeting, a majority of the shareholders present or represented by proxy may adjourn the meeting until a quorum is present. The time and place of the adjourned meeting will be announced at the time the adjournment is taken, and no other notice will be given unless the meeting is adjourned for 120 days or more. An adjournment will have no effect on the business that may be conducted at the meeting.

Vote Required to Approve Proposal 1: Election of Directors

Directors are elected by a plurality of the votes cast, in person or by proxy, at the annual meeting by holders of Banner common stock. Accordingly, the four nominees for election as directors who receive the highest number of votes actually cast will be elected. Pursuant to our Articles of Incorporation, shareholders are not permitted to cumulate their votes for the election of directors. Votes may be cast for or withheld from each nominee. Votes that are withheld and broker non-votes will have no effect on the outcome of the election because the four nominees receiving the greatest number of votes will be elected. **Our Board of Directors unanimously recommends that you vote "FOR" the election of each of our director nominees.**

Vote Required to Approve Proposal 2: Advisory Approval of Executive Compensation

The advisory vote to approve the compensation of our named executive officers requires the affirmative vote of a majority of the outstanding shares present in person or by proxy at the annual meeting. Abstentions will have the same effect as a vote against the proposal. **Our Board of Directors unanimously recommends that you vote "FOR" approval of the compensation of our named executive officers.**

Vote Required to Approve Proposal 3: Ratification of the Selection of the Independent Auditor

Ratification of the selection of Moss Adams LLP as our independent auditor for the fiscal year ending December 31, 2010 requires the affirmative vote of a majority of the outstanding shares present in person or by proxy at the annual meeting. Abstentions will have the same effect as a vote against the proposal. **Our Board of Directors unanimously recommends that you vote "FOR" the ratification of the selection of the independent auditor.**

Vote Required to Approve Proposal 4: Proposed Amendment to the Articles of Incorporation to Increase the Authorized Number of Shares of Common Stock

The approval of the proposed Amendment to the Articles of Incorporation to increase the authorized number of shares of common stock requires the affirmative vote of a majority of the outstanding shares entitled to vote at the annual meeting. Abstentions will have the same effect as a vote against the proposal. **Our Board of Directors unanimously recommends that you vote "FOR" the amendment to the Articles of Incorporation to increase the authorized number of shares of common stock.**

Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting of Shareholders to Be Held on April 27, 2010

Our Proxy Statement and 2009 Annual Report to Shareholders are available at www.bannerbank.com/proxymaterials. The following materials are available for review: Proxy Statement; proxy card; and 2009 Annual Report to Shareholders. Directions to attend the annual meeting, where you may vote in person, can be found online at http://www.marcuswhitmanhotel.com/index.cfm?page=nav7&psub=4.

May I Revoke My Proxy?

You may revoke your proxy before it is voted by:

- submitting a new proxy with a later date;
- notifying the Secretary of Banner in writing before the annual meeting that you have revoked your proxy; or
- voting in person at the annual meeting.

If you plan to attend the annual meeting and wish to vote in person, we will give you a ballot at the annual meeting. However, if your shares are held in "street name," you must bring a validly executed proxy from the nominee indicating that you have the right to vote your shares.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth, as of March 1, 2010, the voting record date, information regarding share ownership of:

- those persons or entities (or groups of affiliated person or entities) known by management to beneficially own more than five percent of Banner's common stock other than directors and executive officers;
- each director and director nominee of Banner;
- each executive officer named in the Summary Compensation Table appearing under "Executive Compensation" below (known as "named executive officers"); and
- all current directors and executive officers of Banner and Banner Bank as a group.

Persons and groups who beneficially own in excess of five percent of Banner's common stock are required to file with the Securities and Exchange Commission ("SEC"), and provide a copy to us, reports disclosing their ownership under the Securities Exchange Act of 1934. To our knowledge, no other person or entity, other than those set forth below, beneficially owned more than five percent of the outstanding shares of Banner's common stock as of the close of business on the voting record date.

Beneficial ownership is determined in accordance with the rules and regulations of the SEC. In accordance with Rule 13d-3 of the Securities Exchange Act, a person is deemed to be the beneficial owner of any shares of common stock if he or she has voting and/or investment power with respect to those shares. Therefore, the table below includes shares owned by spouses, other immediate family members in trust, shares held in retirement accounts or funds for the benefit of the named individuals, and other forms of ownership, over which shares the persons named in the table may possess voting and/or investment power. In addition, in computing the number of shares beneficially owned by a person and the percentage ownership of that person, shares of common stock subject to outstanding options that are currently exercisable or exercisable within 60 days after the voting record date are included in the number of shares beneficially owned by the person and are deemed outstanding for the purpose of calculating the person's percentage ownership. These shares, however, are not deemed outstanding for the purpose of computing the percentage ownership of any other person.

As of the voting record date, there were 22,509,931 shares of Banner common stock outstanding.

Name	*Number of Shares Beneficially Owned (1)*	*Percent of Shares Outstanding*
Beneficial Owners of More Than 5%		
Banner Corporation Employee Stock Ownership Plan Trust 10 S. First Avenue Walla Walla, Washington 99362	1,291,553 (2)	5.74
Dimensional Fund Advisors LP Palisades West, Building One, 6300 Bee Cave Road Austin, Texas 78746	1,433,488 (3)	6.37
Directors		
Robert D. Adams	103,750 (4)	*
Gordon E. Budke	23,887	*
David B. Casper	58,237 (5)	*
Edward L. Epstein	21,554	*
Jesse G. Foster	60,403 (6)	*
David A. Klaue	919,048 (7)	4.08
Constance H. Kravas	39,040 (8)	*
Robert J. Lane	10,000 (9)	*
John R. Layman	145,882 (10)	*
Dean W. Mitchell	87,957 (11)	*
Brent A. Orrico	186,406 (12)	*
Wilber Pribilsky	124,034 (13)	*
Gary Sirmon	209,454 (14)	*
Michael M. Smith	117,844 (15)	*
Named Executive Officers		
D. Michael Jones**	83,000 (16)	*
Lloyd W. Baker	57,250 (17)	*
Richard B. Barton	27,208	*
Cynthia D. Purcell	28,086	*
Paul E. Folz	30,903 (18)	*
All Executive Officers and Directors as a Group (23 persons)	2,412,417	10.72

* Less than 1% of shares outstanding.

** Mr. Jones is also a director of Banner.

(1) Shares held in accounts under the ESOP and shares of restricted stock granted under the Banner Corporation Management Recognition and Development Plan, as to which the holders have voting power but not investment power, are included as follows: Ms. Kravas, 605 shares; Mr. Sirmon, 13,409 shares; Mr. Jones, 4,041 shares; Mr. Baker, 11,675 shares; Mr. Barton, 3,708 shares; Ms. Purcell, 7,370 shares; Mr. Folz, 3,690 shares; and all executive officers and directors as a group, 67,222 shares. The amounts shown also include the following number of shares which the indicated individuals have the right to acquire within 60 days of the voting record date through the exercise of stock options granted pursuant to Banner's stock option plans: Mr. Adams, 2,000; Mr. Budke, 18,150; Mr. Casper, 2,000; Mr. Epstein, 18,150; Mr. Foster, 1,800; Ms. Kravas, 18,150; Mr. Klaue, 7,000; Mr. Lane, 7,000; Mr. Layman, 7,000; Mr. Mitchell, 2,000; Mr. Pribilsky, 2,000; Mr. Smith, 18,150; Mr. Baker, 16,600; Mr. Barton, 21,000; Ms. Purcell, 16,600; Mr. Folz, 21,000; and all executive officers and directors as a group, 200,600.

(2) As of the voting record date, 1,051,172 shares have been allocated to participants' accounts, excluding allocations to individuals who no longer participate in the ESOP.

(3) Based on a Schedule 13G/A dated February 10, 2010 filed by Dimensional Fund Advisors LP ("Dimensional"), a registered investment adviser, which reports sole voting power over 1,397,788 shares and sole dispositive power over 1,433,488 shares. Dimensional furnishes investment advice to four investment companies registered under the Investment Company Act of 1940, and serves as investment manager to certain other commingled group trusts and separate accounts (collectively, the "Funds"). In its role as investment advisor or manager, Dimensional possesses investment and/or voting power over the shares that are owned by the Funds, and may be deemed to be the beneficial owner of the shares held by the Funds. However, all shares are owned by the Funds and Dimensional disclaims beneficial ownership of these shares.

(Footnotes continue on following page)

(4) Includes 13,270 shares owned by a trust directed by Mr. Adams.
(5) Includes 4,475 shares held jointly with his wife.
(6) Includes 25,517 shares owned solely by his wife.
(7) Includes 600,798 shares owned by companies controlled by Mr. Klaue.
(8) Includes 1,112 shares held jointly with her husband.
(9) Includes 3,000 shares held jointly with his wife.
(10) Includes 50,000 shares which have been pledged.
(11) Includes 35,512 shares held jointly with his wife.
(12) Includes 42,964 shares owned by companies controlled by Mr. Orrico and 93,527 shares owned by trusts directed by Mr. Orrico.
(13) Includes 52,929 shares held jointly with his wife.
(14) Includes 90,302 shares owned by companies controlled by Mr. Sirmon.
(15) Includes 10,200 shares held jointly with his wife, 16,000 shares owned solely by his wife and 50,000 shares owned by a company controlled by Mr. Smith.
(16) Includes 1,000 shares held as custodian for minors.
(17) Includes 847 shares owned solely by his wife.
(18) Includes 2,800 shares held jointly with his wife.

PROPOSAL 1 – ELECTION OF DIRECTORS

Our Board of Directors currently consists of 15 members and is divided into three classes. One-third of the directors are elected annually to serve for a three-year period or until their respective successors are elected and qualified. However, Wilber E. Pribilsky has reached our mandatory retirement age and will retire effective as of the annual meeting. At that time, the Board will reduce its size from 15 to 14 members. The table below sets forth information regarding each director of Banner and each nominee for director. The Corporate Governance/Nominating Committee of the Board of Directors selects nominees for election as directors. All of our nominees currently serve as Banner directors. Each nominee has consented to being named in this Proxy Statement and has agreed to serve if elected. If a nominee is unable to stand for election, the Board of Directors may either reduce the number of directors to be elected or select a substitute nominee. If a substitute nominee is selected, the proxy holders will vote your shares for the substitute nominee, unless you have withheld authority. At this time, we are not aware of any reason why a nominee might be unable to serve if elected.

The Board of Directors recommends a vote "FOR" the election of Robert D. Adams, Edward L. Epstein, Robert J. Lane and Gary Sirmon.

Name	*Age as of December 31, 2009*	*Year First Elected or Appointed Director (1)*	*Term to Expire*
	BOARD NOMINEES		
Robert D. Adams	68	1984	2013 (2)
Edward L. Epstein	73	2003	2013 (2)
Robert J. Lane	64	2007	2013 (2)
Gary Sirmon	66	1983	2013 (2)
	DIRECTORS CONTINUING IN OFFICE		
Jesse G. Foster	71	1996	2011
D. Michael Jones	67	2002	2011
David A. Klaue	56	2007	2011
Dean W. Mitchell	75	1979	2011
Brent A. Orrico	60	1999	2011
Gordon E. Budke	68	2002	2012
David B. Casper	73	1976	2012
Constance H. Kravas	63	2004	2012
John R. Layman	51	2007	2012
Michael M. Smith	55	2003	2012

(Footnotes appear on following page)

(1) Includes prior service on the Board of Directors of Banner Bank for all directors who have served since 1995 or earlier.
(2) Assuming re-election.

Information Regarding Nominees for Election. Set forth below is the present principal occupation and other business experience during the last five years of each nominee for election, as well as a brief discussion of the particular experience, qualifications, attributes and skills that led the Board to conclude that the nominee should serve as a director of Banner.

Robert D. Adams recently sold his business interests as a partner in and the President and Chief Executive Officer of Carroll Adams Tractor Co., which sold and rented farm, industrial and consumer equipment and with which he was affiliated for 36 years. Through his career, Mr. Adams developed expertise in management, risk assessment, and agricultural and commercial building construction.

Edward L. Epstein retired in 2008 as a partner in the Portland, Oregon, law firm of Stoel Rives LLP, which he joined 1962. Mr. Epstein is a corporate lawyer who focused on mergers and acquisitions, federal income taxation of corporations, advice to boards of directors and corporate governance matters. He co-chaired the firm's mergers and acquisitions practice group for a number of years, and gave advice to businesses of all sizes, including those in the banking and financial services sector.

Robert J. Lane is a retired banking executive who spent his 29-year banking career with Seattle First National Bank, Idaho First National Bank, West One Bancorp and U.S. Bancorp. Mr. Lane's banking career afforded him the opportunity to gain expertise in management, credit-related production, corporate and commercial banking, and commercial real estate. He is President of Lane Farms, Inc. of La Grande, Oregon and has other real estate and investment interests.

Gary Sirmon is Chairman of the Board and a director of Banner and Banner Bank. He joined Banner Bank in 1980 as an Executive Vice President and served as its Chief Executive Officer from 1982 until February 2002. Mr. Sirmon's extensive career in banking has given him expertise in management, strategic planning, risk management, and mergers and acquisitions.

Information Regarding Incumbent Directors. Set forth below is the present principal occupation and other business experience during the last five years of each director continuing in office, as well as a brief discussion of the particular experience, qualifications, attributes and skills that led the Board to conclude that the director should serve on Banner's Board of Directors.

Jesse G. Foster is Vice Chairman of the Board and a director of Banner and Banner Bank. Mr. Foster retired as an officer of Banner as of the end of 2003 and now serves as a consultant to Banner Bank. He was formerly the Chief Executive Officer, President and a Director of Inland Empire Bank, which he joined in 1962. Mr. Foster's banking career gave him expertise in all areas of banking.

D. Michael Jones is the President and Chief Executive Officer, and a director, of Banner and Banner Bank. He joined Banner Bank in 2002 following an extensive career in banking, finance and accounting. Mr. Jones is a Certified Public Accountant (Inactive) and served as President and Chief Executive Officer from 1996 to 2001 for Source Capital Corporation, a lending company in Spokane, Washington. From 1987 to 1995, Mr. Jones served as President of West One Bancorp, a large regional banking franchise based in Boise, Idaho. Mr. Jones' banking career has given him expertise in all areas of banking.

David A. Klaue served as Chairman of the Board of Directors of F&M Bank until its acquisition by Banner Bank in May 2007. He is Chairman of the Board of Empire Lumber Co., a diversified wood products manufacturer with operations in Washington, Idaho and Montana; Felts Field Aviation, an air transportation company; Park Ranch Land & Cattle Co., a cow/calf, feeder and hay producer; and Empire Investments, a real estate investment company, companies with which he has been affiliated for over 30 years. He is a managing member in various other real estate investment, equipment and sales companies. Mr. Klaue's career has afforded him expertise in business, agricultural and real estate management.

Dean W. Mitchell retired as Owner and Manager of Tri-Cities Communications, Inc., which operated KONA AM and FM radio stations, with which he was affiliated for 45 years. Mr. Mitchell's career gave him experience in preparing budgets and financial statements, as well as employee compensation. He has also gained a wealth of experience from serving as a director of Banner for 32 years.

Brent A. Orrico is President of FAO Corporation, an asset management company, and is a principal of B & O Financial Management Company, with which he has been affiliated for 15 years. Mr. Orrico has 30 years' experience in banking and finance-related business activities, including having served as an executive officer at a major financial institution and being a founding member of two community banks. Mr. Orrico also serves as a director of Islanders Bank.

Gordon E. Budke is President of Budke Consulting, PLLC, which specializes in general business assistance to small and growing companies. A Certified Public Accountant with over 34 years' experience in public accounting, Mr. Budke retired as a partner from Coopers & Lybrand (now PricewaterhouseCoopers) in October 1997. His qualification as an audit committee financial expert was the primary reason for his nomination to the Board. Mr. Budke also serves on the Board of Directors of Yokes Foods, Inc.

David B. Casper is President of David Casper Ranch, Inc., a farming operation he has owned since 1973. Mr. Casper has expertise in the area of agricultural lending and has gained a wealth of experience in his 34 years as a director of Banner.

Constance H. Kravas is the University of Washington's Vice President for Development and Alumni Relations and also serves as the President of University of Washington Foundation. Prior to joining the University of Washington in 2001, she served as Vice Chancellor for University Advancement at the University of California, Riverside, and as Vice President for Advancement of Washington State University and President of the Washington State University Foundation. Ms. Kravas has over 30 years' experience in leadership and management positions for not-for-profit boards.

John R. Layman served as co-Vice Chairman of the Board of Directors of F&M Bank until its acquisition by Banner Bank in May 2007. He is managing partner of Layman, Layman & Robinson, PLLP, with which he has been associated since 1983. His areas of practice include real estate development, commercial litigation, personal injury and product liability. He also has experience in corporate duties, securities litigation, fiduciary obligations and reporting requirements.

Michael M. Smith has managed a family-owned farming and orchard operation, B.T. Loftus Ranches, Inc., in Washington's Yakima valley since 1974. He is also a founder, director and former president of Yakima Chief, Inc., an international hops sales organization. Mr. Smith's career has afforded him experience in managing financial and operational aspects of agricultural companies.

MEETINGS AND COMMITTEES OF THE BOARD OF DIRECTORS

Board of Directors

The Board of Directors conducts its business through Board meetings and through its committees. During the year ended December 31, 2009, the Board of Directors held 14 meetings. No director attended fewer than 75% of the total meetings of the Board and committees on which such person served during this period.

Committees and Committee Charters

The Board of Directors has standing Executive, Audit, Compensation and Corporate Governance/Nominating Committees. The Board has adopted written charters for the Audit, Compensation and Corporate Governance/ Nominating Committees and although copies of these charters are not available on our website, they must be attached to the annual meeting proxy statement at least once every three years or when the charter has been materially amended. The Audit and Compensation Committee charters are attached to this Proxy Statement as Appendix A and Appendix B, respectively, and the Corporate Governance/Nominating Committee charter was attached to the Proxy Statement for the 2009 annual meeting.

Executive Committee

The Executive Committee, consisting of Directors Orrico (Chairman), Budke, Foster, Jones, Mitchell and Sirmon, acts for the Board of Directors when formal Board action is required between regular meetings. The Committee has the authority to exercise all powers of the full Board of Directors, except that it does not have the power to, among other things, declare dividends, authorize the issuance of stock, amend the Bylaws or approve any agreement of merger or consolidation other than mergers with Banner subsidiaries. The Executive Committee met twice during the year ended December 31, 2009.

Audit Committee

The Audit Committee, consisting of Directors Budke (Chairman), Adams, Layman and Smith, oversees management's fulfillment of its financial reporting responsibilities and maintenance of an appropriate internal control system. It also has the sole authority to appoint or replace our independent auditor and oversees the activities of our internal audit functions. The Audit Committee believes it has fulfilled its responsibilities under its charter. The Committee met 15 times during the year ended December 31, 2009.

Each member of the Audit Committee is "independent," in accordance with the requirements for companies quoted on Nasdaq. In addition, the Board of Directors has determined that Mr. Adams and Mr. Budke meet the definition of "audit committee financial expert," as defined by the SEC.

Compensation Committee

The Compensation Committee, which consists of Directors Mitchell (Chairman), Casper, Klaue and Lane, sets salary policies and levels for senior management and oversees all of our salary and incentive compensation programs. The Committee believes it has fulfilled its responsibilities under its charter. The Compensation Committee met six times during the year ended December 31, 2009.

Each member of the Compensation Committee is "independent," in accordance with the requirements for companies quoted on Nasdaq. The Committee meets, outside of the presence of Mr. Jones, to discuss his compensation and make its recommendation to the full Board, which then votes on his compensation. Mr. Jones makes recommendations to the Compensation Committee regarding the compensation of all other executive officers. The Committee considers the recommendations of Mr. Jones and makes its recommendation to the full Board, which then votes on executive compensation.

Corporate Governance/Nominating Committee

The Corporate Governance/Nominating Committee, consisting of Directors Orrico (Chairman), Epstein, Kravas and Pribilsky, assures that we maintain the highest standards and best practices in all critical areas relating to the management of the business of Banner. The Committee also selects nominees for the election of directors and develops a list of nominees for board vacancies. The Corporate Governance/Nominating Committee believes it has fulfilled its responsibilities under its charter. Each member of the Committee is "independent," in accordance with the requirements for companies quoted on Nasdaq. The Committee met three times during the year ended December 31, 2009.

The Corporate Governance/Nominating Committee met on January 26, 2010 to nominate directors for election at the annual meeting. Only those nominations made by the Committee or properly presented by shareholders will be voted upon at the annual meeting. In its deliberations for selecting candidates for nominees as director, the Committee considers the candidate's level of success and respect in the candidate's field, as well as the candidate's independence, communication skills, education, character and community involvement. The Committee also considers the candidate's knowledge of the banking business and whether the candidate would provide for adequate representation of our market area. Any nominee for director made by the Committee must be highly qualified with regard to some or all these attributes. The Committee does not specifically consider diversity in identifying nominees for director; however, the Committee believes that the judicious application of the criteria described above provide Banner with a well-rounded and effective Board with a diverse range of experience and perspectives.

In searching for qualified director candidates to fill vacancies in the Board, the Committee solicits its current Board of Directors for names of potentially qualified candidates. Additionally, the Committee may request that members of the Board of Directors pursue their own business contacts for the names of potentially qualified candidates. The Committee would then consider the potential pool of director candidates, select the candidate the Committee believes best meets the then-current needs of the Board, and conduct a thorough investigation of the proposed candidate's background to ensure there is no past history that would cause the candidate not to be qualified to serve as a Banner director. The Committee will consider director candidates recommended by our shareholders. If a shareholder submits a proposed nominee, the Committee would consider the proposed nominee, along with any other proposed nominees recommended by members of the Board of Directors, in the same manner in which the Committee would evaluate its nominees for director. For a description of the proper procedure for shareholder nominations, see "Shareholder Proposals" in this Proxy Statement.

Leadership Structure

The positions of Chairman of the Board and of President and Chief Executive Officer are held by two persons. This has been the case since 1995, when Banner was formed to become the holding company for Banner Bank. The Board believes this structure is appropriate for Banner because it provides the Board with capable leadership and independence from management. It also allows the President and Chief Executive Officer to focus on the day-to-day business of managing Banner, while the Chairman leads the Board.

Board Involvement in Risk Management Process

The Board of Directors recognizes that effective risk management requires a high level of cooperation between the Board and senior management. Nonetheless, the Board has established and maintains its independence in overseeing the conduct of Banner, including the risk management process. The Board's leadership structure takes into account its risk administration function by the conduct of its business through Board meetings and through its committees, in particular the Corporate Governance/Nominating and Audit Committees, as well as by the separation of the positions of Chairman of the Board and of President and Chief Executive Officer as described above.

Directors keep themselves informed of the activities and condition of Banner and of the risk environment in which it operates by regularly attending Board and assigned Committee meetings, and by review of meeting materials, auditor's findings and recommendations, and supervisory communications. Directors stay abreast of general industry trends and any statutory and regulatory developments pertinent to Banner and the Banks by periodic briefings by senior management, counsel, auditors or other consultants, and by more formal director education. The Corporate Governance/ Nominating Committee monitors and evaluates director training and information resources.

The Board oversees the conduct of Banner's business and administers the risk management function by:

- selecting, evaluating, and retaining competent senior management;
- establishing, with senior management, Banner's long- and short-term business objectives, and adopting operating policies to achieve these objectives in a legal and sound manner;
- monitoring operations to ensure that they are controlled adequately and are in compliance with laws and policies;
- overseeing Banner's business performance; and
- ensuring that the Banks help to meet our communities' credit needs.

These responsibilities are governed by a complex framework of federal and state law and regulation as well as regulatory guidelines applicable to the operation of Banner and the Banks.

The Board ensures that all significant risk taking activities are covered by written policies that are communicated to appropriate employees. Specific policies cover material credit, market, liquidity, operational, legal and reputation risks. The policies are formulated to further Banner's business plan in a manner consistent with safe and sound practices. The Board ensures that all such policies are monitored by senior management to make certain that they conform with changes in laws and regulations, economic conditions, and Banner's and the Banks' circumstances. The policies are implemented by senior management who develop and maintain procedures, including a system of internal

controls, designed to foster sound practices, to comply with laws and regulations, and to protect Banner against external crimes and internal fraud and abuse.

The Board's policies also establish mechanisms for providing the Board with the information needed to monitor Banner's operations. This includes senior management reports to the Board. These reports present information in a form meaningful to members of the Board, who recognize that the level of detail and frequency of individual senior management reports will vary with the nature of the risk under consideration and Banner's and the Banks' unique circumstances.

The Board has also established a mechanism for independent third party review and testing of compliance with policies and procedures, applicable laws and regulations, and the accuracy of information provided by senior management. This is accomplished, for example, by an internal auditor reporting directly to the Audit Committee. In addition, an annual external audit is performed. The Audit Committee reviews the auditors' findings with senior management and monitors senior management's efforts to resolve any identified issues and recommendations. The Audit Committee provides regular reports of its activities to the Board.

The Board also reviews reports of inspection and examination or other supervisory activity, and any other material correspondence received from Banner's regulators. Findings and recommendations, if any, are carefully reviewed, and progress in addressing such matters is routinely monitored.

Corporate Governance

We are committed to establishing and maintaining high standards of corporate governance. The Corporate Governance/Nominating Committee is responsible for initiatives to comply with the provisions contained in the Sarbanes-Oxley Act of 2002, the rules and regulations of the SEC adopted thereunder, and Nasdaq rules governing corporate governance. The Committee will continue to evaluate and improve our corporate governance principles and policies as necessary and as required.

Code of Ethics. On June 19, 2003, the Board of Directors adopted the Officer and Director Code of Ethics. The Code is applicable to each of our directors and officers, including the principal executive officer and senior financial officers, and requires individuals to maintain the highest standards of professional conduct. A copy of the Code of Ethics was filed as an exhibit to Banner's Annual Report on Form 10-K for the year ended December 31, 2004.

Communications with Shareholders. The Board of Directors maintains a process for shareholders to communicate with the Board. Shareholders wishing to communicate with the Board of Directors should send any communication to the Secretary, Banner Corporation, 10 S. First Avenue, Walla Walla, Washington 99362. Any communication must state the number of shares beneficially owned by the shareholder making the communication. The Secretary will forward such communication to the full Board of Directors or to any individual director or directors to whom the communication is directed unless the communication is unduly hostile, threatening, illegal or similarly inappropriate, in which case the Secretary has the authority to discard the communication or take appropriate legal action.

Annual Meeting Attendance by Directors. We do not have a policy regarding Board member attendance at annual meetings of shareholders. All directors attended last year's annual meeting of shareholders.

Related Party Transactions. We have a number of written policies governing transactions with related parties. These policies are intended to ensure that all transactions entered into with related parties are in the best interests of Banner and its shareholders. As a general rule, transactions with directors and officers, and their related interests are prohibited. An exception applies to normal banking relationships.

Our Code of Ethics provides that where an officer or director finds that any financial or business relationship with customers, consultants, or vendors may impair, or appear to impair, the independence of business judgment on behalf of Banner, that person must (1) disclose fully to a supervisor, the Chief Executive Officer or to the Board of Directors the existence and nature of the conflict and (2) remove and insulate himself/herself from all decision-making and action related to that financial or business activity of Banner. Each year, our directors and officers complete a conflict of interest questionnaire to ensure that no conflicts, or potential conflicts, of interest are overlooked.

The Banks have followed a policy of granting loans to our employees, officers and directors, which fully complies with all applicable federal regulations. All outstanding loans to our directors and executive officers: (1) were made in the ordinary course of business; (2) were made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with persons not related to the Banks; and (3) did not involve more than the normal risk of collectibility or present other unfavorable features when made. Loans made to executive officers and directors are granted pursuant to the normal underwriting procedures of the Banks. Loans made to a director or executive officer in an amount that, when aggregated with the amount of all other loans to that person and his or her related interests, are in excess of the greater of $25,000 or 5% of the institution's capital and surplus (up to a maximum of $500,000) must be approved in advance by a majority of the disinterested members of the Board of Directors. All lines of credit to insiders that, combined with other loans, do not exceed $500,000 for directors and their related interests or $100,000 for executive officers and that do not fall within the exceptions to Regulation O of the Board of Governors of the Federal Reserve System must be approved by the Board of Directors at least annually. All loan approval and review procedures are governed by written policies.

In addition, each director and executive officer completes a form annually to identify all related interests. Deposit and loan accounts of directors, executive officers and related interests are then coded with special markers so that developments can be tracked. Our Regulation O officer, a compliance specialist, monitors developments monthly and completes a quarterly report of Regulation O compliance which is submitted to the Board of Directors.

Director Independence. Our common stock is listed on The Nasdaq Global Select Market. In accordance with Nasdaq rules, at least a majority of our directors must be independent directors. The Board has determined that 13 of our 15 directors are "independent," as defined by Nasdaq. Robert D. Adams, Gordon E. Budke, David B. Casper, Edward L. Epstein, David A. Klaue, Constance H. Kravas, Robert J. Lane, John R. Layman, Dean W. Mitchell, Brent A. Orrico, Wilber E. Pribilsky, Gary Sirmon and Michael M. Smith are independent.

DIRECTORS' COMPENSATION

Director Compensation Table

The following table shows the compensation paid to our non-employee directors for 2009. Directors who are employees of Banner or the Banks are not compensated for their services as directors; accordingly, compensation information for D. Michael Jones, who is our President and Chief Executive Officer, is included in the section entitled "Executive Compensation." We do not offer any non-equity incentive plan compensation to directors and the directors did not receive any stock or option awards in 2009; therefore, these columns have been omitted from the table below.

Name	*Fees Earned or Paid in Cash ($)(1)*	*Change in Pension Value and Non-qualified Deferred Compensation Earnings ($)*	*All Other Compensation ($)(2)*	*Total ($)*
Robert D. Adams	48,000	--	--	48,000
Gordon E. Budke	70,000	--	242	70,242
David B. Casper	38,000	--	--	38,000
Edward L. Epstein	39,000 (3)	--	36	39,036
Jesse G. Foster	3,000 (4)	(5)	196,529 (6)	199,529
David A. Klaue	36,000	--	--	36,000
Constance H. Kravas	36,000	--	85	36,085
Robert J. Lane	38,250	--	--	38,250
John R. Layman	47,000	--	--	47,000
Dean W. Mitchell	41,250	--	--	41,250
Brent A. Orrico	56,750 (7)	--	--	56,750
Wilber E. Pribilsky	36,000	--	--	36,000
Gary Sirmon	58,000 (3)	(8)	138,363 (9)	196,363
Michael M. Smith	47,000	--	36	47,036

(Footnotes appear on following page)

(1) The following directors deferred all or a portion of their fees into Banner common stock or life insurance, pursuant to the deferred fee agreements described below: Adams, Casper, Klaue, Kravas, Layman, Mitchell, Orrico and Smith.
(2) Unless otherwise noted, consists of dividends received on restricted stock.
(3) Includes $3,000 in fees for attending meetings of the Board of Directors of Community Financial Corporation, a subsidiary of Banner Bank.
(4) Pursuant to the terms of his consulting agreement (described below), Mr. Foster does not receive an annual retainer and does not earn fees for attending Board or committee meetings of Banner or Banner Bank. He only receives meeting fees for attending meetings of the Board of Directors of Community Financial Corporation.
(5) The present value of Mr. Foster's supplemental retirement benefits decreased by $44,405 in 2009.
(6) Mr. Foster received $120,000 pursuant to his consulting agreement and $72,000 pursuant to his supplemental retirement agreement (each as described below), as well as an aggregate of $4,529 for a car allowance, country club dues and life insurance premiums paid.
(7) Includes $18,000 in fees for attending meetings of the Board of Directors of Islanders Bank.
(8) The present value of Mr. Sirmon's supplemental retirement benefits and salary continuation plan decreased by $47,612 in 2009.
(9) Mr. Sirmon received $77,062 pursuant to his salary continuation agreement and $57,604 pursuant to his supplemental retirement agreement (each as described below), as well as an aggregate of $3,697 for life and health insurance premiums.

During the year ended December 31, 2009, non-employee directors of Banner received an annual retainer of $33,000 and a fee of $1,000 per committee meeting attended. The Chairman of the Board receives an additional $20,000 annual retainer, the Chairman of the Audit Committee receives an additional $20,000 annual retainer and the Chairmen of the Compensation Committee and the Corporate Governance/Nominating Committee receive an additional $250 per committee meeting attended. Non-employee directors who serve on the Board of Community Financial Corporation, a subsidiary of Banner Bank, receive $500 for each meeting attended. Non-employee directors who serve on the Board of Islanders Bank receive an annual retainer of $17,400 and $300 per committee meeting attended. Officers of Banner or its subsidiaries who are also directors do not receive any fee or remuneration for services as members of the Board of Directors or any Board committees. The Board of Directors typically determines whether to adjust the annual retainer and meeting fees of directors in April of each year and from time to time requests recommendations from the Compensation Committee.

In order to encourage the retention of qualified directors, we have entered into deferred fee agreements whereby directors may defer all or a portion of their regular fees until retirement. Each director may direct the investment of the deferred fees toward the purchase of life insurance, Banner common stock, mutual fund-style investments or a stable value account. We have established grantor trusts to hold the common stock and mutual fund-style investments. The assets of the trusts are considered part of our general assets and the directors have the status of unsecured creditors of Banner with respect to the trust assets. The deferred fee agreements provide pre-retirement death and disability benefits in an amount equal to the value of the director's account balance upon the occurrence of either event. At retirement, a director may elect to receive the balance of his or her account in a lump sum or in annual installments over a period not exceeding the life expectancy of the director and the director's beneficiary. In connection with its acquisitions, Banner also assumed liability for certain deferred compensation plans for the acquired institutions' directors. At December 31, 2009, our estimated deferred compensation liability accrual with respect to non-employee directors under these agreements was $3.2 million.

Banner Bank entered into a salary continuation agreement in October 1993 with Mr. Gary Sirmon, a director and former Chairman, President and Chief Executive Officer of Banner and Banner Bank, to ensure his continued service through retirement. Mr. Sirmon retired on July 16, 2005 and will receive monthly payments over a minimum of a 180-month period following retirement. The annual payment for Mr. Sirmon under this agreement is $77,062, or approximately $6,422 per month.

Banner Bank also is party to an agreement with Mr. Sirmon to provide him with supplemental retirement benefits. Banner Bank has purchased life insurance to recover these benefits and the benefits payable under the salary continuation agreement upon Mr. Sirmon's death. The agreement provides that, following Mr. Sirmon's retirement at or after attaining age 62 (which occurred on July 16, 2005) and for a minimum of a 180-month period thereafter, Banner Bank will pay him (or his beneficiary) an annual benefit based on his level of pre-retirement compensation and other retirement benefits. The annual payment for Mr. Sirmon under this agreement is $57,604, or approximately $4,800 per month.

Banner Bank entered into a consulting agreement with Mr. Jesse G. Foster, a director and former executive officer of Banner, in December 2003. The agreement, which is on a month-to-month basis and may be terminated by

either party upon 30 days' notice, provided for compensation of $10,000 per month. Effective January 1, 2010, the compensation was reduced to $8,000 per month to reflect a reduction in his consulting engagement and effective March 1, 2010, the compensation was further reduced to $5,000 per month. The monthly compensation includes any Board or committee fees payable to Mr. Foster.

Banner Bank also is party to an agreement with Mr. Foster to provide him with supplemental retirement benefits. Banner Bank has purchased life insurance to recover the benefits payable under this agreement upon Mr. Foster's death. The agreement provides that, following Mr. Foster's retirement at or after attaining age 62 and for a 12-year period thereafter, Banner Bank will pay him (or his beneficiary) an annual benefit equal to 40% of his average annual salary during the three years preceding his retirement. The agreement also restricts Mr. Foster's ability to compete with Banner Bank within a 50-mile radius of the former Banner Bank of Oregon's main and branch office locations for a one-year period following his termination of employment. Mr. Foster retired as an executive officer effective as of December 31, 2003 and is receiving payments of $6,000 per month under this agreement.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

The Compensation Committee of the Banner Board of Directors is responsible for setting the policies and compensation levels for Banner directors, officers and employees, while the Compensation Committee of the Banner Bank Board of Directors is responsible for setting the policies and compensation levels for Banner Bank directors, officers and employees. Banner Bank is the primary subsidiary of Banner. Each Committee is responsible for evaluating the performance of its Chief Executive Officer while the Chief Executive Officer evaluates the performance of other senior officers and makes recommendations to the appropriate Committee regarding compensation levels.

The Compensation Committee continually reviews executive compensation. The recent economic downturn has impacted and will continue to impact our compensation for the foreseeable future. In particular, we did not pay any bonuses to the named executive officers for 2008 and 2009 and do not anticipate paying any bonuses to the named executive officers for 2010. On November 21, 2008, Banner received $124 million from the U.S. Department of the Treasury as part of the Capital Purchase Program. The additional capital is intended to enhance our capacity to support the communities we serve through expanded lending activities and economic development. Participation in this program will affect executive compensation, as described below.

Impact of American Recovery and Reinvestment Act of 2009 on Executive Compensation. Effective November 21, 2008, Banner completed the sale to the U.S. Department of the Treasury of 124,000 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock"), with a related warrant to purchase 1,707,989 shares of Banner's common stock (the "Treasury Warrant"). The issuance was the result of the Treasury's approval of Banner's application to participate in the Treasury's Capital Purchase Program, which was established by Treasury pursuant to the authority granted by the Emergency Economic Stabilization Act of 2008 (the "EESA"). Banner was required to make certain changes to its executive compensation arrangements as necessary to comply with the provisions of the EESA. Effective February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 ("ARRA"). The ARRA amends the provisions of the EESA that are applicable to Troubled Asset Relief Program ("TARP") recipients, such as Banner. Accordingly, Banner is now subject to additional limitations on executive compensation, including a provision for recovery of bonus, retention awards, or incentive compensation paid based on earnings, revenue, gains or other criteria later found to be materially inaccurate, a prohibition on making golden parachute payments, a prohibition on paying or accruing any bonus, retention award or incentive compensation (except for certain grants of long-term restricted stock), and providing tax gross-ups. These restrictions and prohibitions apply to various Banner officers, as discussed in greater detail herein.

Objectives and Overview of the Compensation Program. Our executive compensation policies are designed to establish an appropriate relationship between executive pay and the annual and long-term performance of Banner and Banner Bank, to reflect the attainment of short- and long-term financial performance goals, to enhance our ability to attract and retain qualified executive officers, and to align to the greatest extent possible the interests of management and shareholders. The principles underlying the executive compensation policies include the following:

- to attract and retain key executives who are vital to our long-term success and are of the highest caliber;
- to provide levels of compensation competitive with those offered throughout the financial industry and consistent with our level of performance;
- to motivate executives to enhance long-term shareholder value by granting awards tied to the value of our common stock; and
- to integrate the compensation program with our annual and long-term strategic planning and performance measurement processes.

The Committees consider a variety of subjective and objective factors in determining the compensation package for individual executives including: (1) the performance of Banner and Banner Bank as a whole with emphasis on annual performance factors and long-term objectives; (2) the responsibilities assigned to each executive; and (3) the performance of each executive of assigned responsibilities as measured by the progress of Banner and Banner Bank during the year.

Compensation Consultant. In late 2008, the Banner Compensation Committee engaged Swanson Watts LLC to assist the Committee with its periodic review of Banner's executive pay practices by performing a total compensation benchmarking analysis. In particular, Swanson Watts reviewed and analyzed the current executive compensation and benefit practices for the named executive officers, comparing these practices to those of Banner's peer group. The peer group consists of 16 financial institutions ranging in total assets from $1 billion to $12 billion and headquartered in Washington, Oregon, Montana and California. Swanson Watts presented data in two groupings: (1) the subset of nine Northwest financial institutions Banner has historically monitored, and (2) all 16 financial institutions, including seven California institutions that are similar in asset size to Banner. Banner has historically monitored the following nine financial institutions:

AmericanWest Bancorporation	Glacier Bancorp, Inc.
Cascade Bancorp	Sterling Financial Corp.
Columbia Bancorp	Umpqua Holdings Corporation
Columbia Banking System	West Coast Bancorp
Frontier Financial Corporation	

Banner monitored this peer group because management believes these institutions represent Banner's most direct competitors in the markets it serves, in terms of services offered as well as competition for employees. Swanson Watts added the following California financial institutions to its analysis:

CVB Financial Corp	PFF Bancorp, Inc.
First Community Bancorp	SVB Financial Group
Hanmi Financial Corp	Westamerica Bancorporation
Imperial Capital Bancorp, Inc.	

These institutions were added to provide better comparative data for financial institutions similar to Banner in terms of asset size. Swanson Watts presented the results of its benchmarking analysis to the Compensation Committee in February 2009. The Committee considered the results of the analysis in determining whether any changes to executive compensation were necessary; however, as a result of restrictions on executive compensation as a result of Banner's participation in the Treasury's Capital Purchase Program, the Committee made no changes based on the analysis presented by Swanson Watts.

Compensation Program Elements. The Compensation Committees focus primarily on the following five components in forming the total compensation package for our named executive officers:

- base salary;
- incentive compensation;
- deferred compensation;

- long-term incentive compensation; and
- participation in a supplemental executive retirement program.

The current compensation plans involve a combination of salary, deferred compensation, phantom stock awards to reward long-term performance and a supplemental executive retirement program to ensure the continued service of executive officers. During the year ended December 31, 2009, there were no at-risk incentives to reward short-term performance and none are contemplated for 2010 as a result of Banner's participation in the Treasury's Capital Purchase Program.

Base Salary. The salary levels of executive officers are designed to be competitive within the banking and financial services industries. In addition to the benchmarking analysis described above, the Compensation Committees evaluate current salary levels by surveying similar institutions in Washington, Oregon, the Northwest and the United States. The Committees' peer group analyses focus on asset size, nature of ownership, type of operation and other common factors. Specifically, the Committees annually review the Northwest Financial Industry Salary Survey prepared by Milliman (actuaries and consultants) in association with the Washington Bankers Association, the Washington Financial League and the Oregon Bankers Association, covering 98 Northwest financial organizations in Washington, Oregon and Idaho, the American Bankers Association 2009 Compensation and Benefits Survey, which covers 407 responding financial institutions, the Moss Adams 2009 Bankers' Compensation Survey, covering 65 respondents, and the Compensation Data 2009 Banking and Finance West survey published by Compdata Surveys, covering 85 banking and finance companies in the western United States.

The Compensation Committees take a number of factors into account when setting the base salaries of the named executive officers. These factors include peer data provided by compensation consultants and the Committees' review of compensation surveys, the officer's level of experience, the responsibilities assigned to the officer and the officer's performance during the previous year.

Incentive Compensation Program. Historically, a short-term incentive plan had been in effect for the officers of Banner Bank which was designed to compensate for performance. The plan was designed to provide for incentive compensation with established targets of 35% of salary for the Chief Executive Officer, 30% of salary for executive vice presidents and 18% to 25% of salary for certain other officers. In certain circumstances, incentive compensation was payable at higher levels based on exceptional performance. In making awards under this plan, the Compensation Committee, the President and Chief Executive Officer or executive officers, as appropriate, reviewed quantifiable data related to specific shared corporate goals and individual performance goals. Individual performance goals varied significantly depending primarily on the assigned responsibilities of each officer and may have included such items as business unit performance measures, staff management, project completion, or individual loan or deposit production totals. However, as a result of the economic environment and Banner's anticipated operating results, no awards were contemplated or paid for the year ended December 31, 2009. In addition, Banner's participation in the Treasury's Capital Purchase Program currently prohibits it from paying or accruing any bonus, retention award or incentive compensation to its five most highly compensated employees; therefore, Mr. Jones, Ms. Purcell and three employees who are not named executive officers were not eligible to receive incentive awards for the year ended December 31, 2009. This prohibition will be effective for as long as the 124,000 shares of Banner's Series A Preferred Stock sold to the Treasury remain outstanding. Future incentive awards for eligible executive vice presidents and certain other officers under a short-term incentive plan, such as that described above, will depend upon Banner's operating results, among other factors.

Deferred Compensation. In 2004, we adopted deferred compensation plans which allow executive officers of Banner to defer all or part of their cash compensation or non-qualified stock options until retirement. Each executive officer may direct the investment of the deferred compensation toward the purchase of life insurance, Banner common stock, mutual fund-style investments or a stable value account. We established grantor trusts to hold the common stock and mutual fund-style investments. The assets of the trusts are considered part of our general assets and the executive officers have the status of unsecured creditors of Banner with respect to the trust assets. The deferred compensation agreements provide pre-retirement death and disability benefits in an amount based on the value of the executive officer's account balance upon the occurrence of either event. At retirement, an executive officer may elect to receive the balance of his account in a lump sum or in annual installments over a period not exceeding the life expectancy of the executive

officer and his beneficiary. At December 31, 2009, our estimated deferred compensation liability accrual with respect to executive officers under these agreements was $760,000.

Section 401(a)(17) of the Internal Revenue Code limits the amount of compensation that is considered for purposes of determining the maximum contribution to Banner Bank's tax-qualified profit sharing plan by eligible employees. For 2009, this limit was $245,000 and remains the same for 2010. In previous years, we have credited executive officers whose total compensation exceeds this amount with additional deferred compensation to restore amounts that could not be contributed to the profit sharing plan as a result of the Section 401(a)(17) limitation. However, for 2009 we did not provide any such credits to our executive officers.

Long-Term Incentive Compensation. Our shareholders approved the 2001 Stock Option Plan, under which officers may receive grants of stock options. Shareholders also approved the 1996 Management Recognition and Development Plan, the 1996 Stock Option Plan and the 1998 Stock Option Plan, under which grants of stock options and awards of restricted shares are outstanding, but no further grants or awards may be made. We believe that stock ownership by our officers is a significant factor in aligning the interests of the officers with those of shareholders. Stock options and stock awards under these plans are allocated based upon the officers' level of responsibility and expected contributions to Banner and Banner Bank as judged by the Compensation Committee or the Board of Directors. The Compensation Committee considers a number of factors in granting equity awards. These factors differ from year to year, but generally include a review of trends in making awards by Banner's peer group and the Committee's view on what is necessary for retention, as well as the potential recipient's other compensation and value to Banner. The Compensation Committee does not place any specific weight on any of the factors it considers. As a result of the limited number of stock options available for granting purposes, no stock options were granted in 2009.

Stock ownership is enhanced through participation in our ESOP, under which eligible employees receive an allocation of Banner stock based on a percentage of eligible wages. We also provide a 401(k) profit sharing plan. The Board of Directors has appointed an administrative committee of Banner Bank officers to administer the ESOP and the 401(k) plan, and the named executive officers participate in both of these plans. On an annual basis, the Board of Directors establishes the level of employer contributions to the ESOP and the 401(k) plan, which applies to all eligible participants including the named executive officers. In 2008, we contributed two percent of eligible wages into the ESOP on behalf of each eligible participant, and we matched the first four percent of participants' contributions into the 401(k) plan each payroll period. In 2009, we matched the first four percent of participants' contributions into the 401(k) plan for the month of January but did not contribute to either the ESOP or 401(k) plan thereafter because the Board of Directors considered it prudent to reduce employee benefit costs as an expense saving measure duing a year of reduced profitability.

On June 13, 2006, the Board of Directors adopted the Banner Corporation Long-Term Incentive Plan, in accordance with the recommendations made by Banner's Compensation Committee. The plan is an account-based type of benefit, the value of which is directly related to changes in the value of Banner common stock, commonly known as a "phantom stock plan." The primary objective of the plan is to encourage retention and reward performance by allowing executives who remain with Banner or Banner Bank for a five-year period of time to share in increases in the value of Banner's common stock. Although the plan benefits are tied to the increase in value of Banner stock during the vesting period, the plan benefit is paid in cash rather than Banner stock, hence the term "phantom stock." The plan was amended on May 5, 2008 to eliminate the 25% cap on the amount of any annual increase in the value of an award, to clarify certain provisions and to allow for the repricing of existing and future awards.

Within 30 days after a grant of phantom stock, the participant must elect how and when plan benefits will be paid. One election relates to the timing of when the benefit will be paid: upon separation from service; at a specific time; or upon completion of 60 months of continuous service. If no election is made, payment will be made upon the participant's separation from service. In the case of certain key employees, payment may be delayed for six months in order to comply with Section 409A of the Internal Revenue Code. The other election relates to the form of payment, with the choices being a lump sum or monthly installments over 120 months. If no election is made, distribution will be in the form of a lump sum. With respect to monthly installments, there will be no change in a monthly installment amount based on changes in the value of Banner stock or dividends. Instead, the value of the long-term incentive benefit will be adjusted annually to reflect Banner Bank's average earning assets rate for the preceding year. The initial awards under this program were made in July 2006. Subsequent awards are granted at the discretion of the Compensation Committee as it deems appropriate. In 2009, only non-employee directors and non-executive officers received awards

under the Long-Term Incentive Plan. Banner's participation in the Treasury's Capital Purchase Program currently prohibits it from paying or accruing any bonus, retention award or incentive compensation, which includes a grant of phantom stock, to its five most highly compensated employees; therefore, Mr. Jones, Ms. Purcell and three employees who are not named executive officers were not eligible to receive phantom stock awards for the year ended December 31, 2009. This prohibition will be effective for as long as the 124,000 shares of Banner's Series A Preferred Stock sold to the Treasury remain outstanding.

Supplemental Executive Retirement Program. We have adopted a supplemental executive retirement program ("SERP") for each of the named executive officers. The SERP is intended to encourage retention by ensuring that the named executive officers reach a targeted retirement income, recognizing their value to Banner and rewarding them for their long-term service commitments. At termination of employment at or after retirement age and achievement of a service requirement, the executive's annual benefit under the SERP, which may be reduced by certain other retirement benefits, would be computed as a percentage of the executive's final average compensation (as defined in the plan) and the executive's annual years of service (called the "supplemental benefit"). The executives are eligible for a reduced benefit upon early retirement if they meet the years of service requirements in their individual agreements; however, no benefit payment will begin before retirement age. The SERP also provides for payments in the event of an executive's disability or death, or termination in the event of a change in control, all as discussed in further detail below, under "Potential Payments Upon Termination or Change in Control." Executives' receipt of payments under the SERP are subject to confidentiality and non-competition provisions. The executive officers have the status of unsecured creditors of Banner Bank with respect to the benefits accrued under the SERP.

Allocation of Compensation. We do not have any specific policies regarding allocation of total compensation between short-term and long-term elements, or cash and non-cash elements. For 2009, the composition of total compensation for our named executive officers was as follows:

Type of Compensation	*Percentage of Total Compensation*
Base salary	73%
Deferred compensation and long-term incentive compensation	0
Supplemental executive retirement program	24
All other compensation	3

Compensation Committee Report

The Compensation Committee of Banner's Board of Directors has submitted the following report for inclusion in this Proxy Statement:

The Compensation Committee has reviewed and approved the Compensation Discussion and Analysis contained in this proxy statement with management. Based on the Committee's discussion with management, the Compensation Committee recommended that the Board of Directors approve and include the Compensation Discussion and Analysis in this proxy statement.

The Compensation Committee certifies that:

(1) It has reviewed with senior risk officers the senior executive officer (SEO) compensation plans and has made all reasonable efforts to ensure that these plans do not encourage SEOs to take unnecessary and excessive risks that threaten the value of Banner;

(2) It has reviewed with senior risk officers the employee compensation plans and has made all reasonable efforts to limit any unnecessary risks these plans pose to Banner; and

(3) It has reviewed the employee compensation plans to eliminate any features of these plans that would encourage the manipulation of reported earnings of Banner to enhance the compensation of any employee.

In October 2009, the Banner Compensation Committee met with the Senior Risk Management Officer to discuss, evaluate and review our senior executive officer compensation plans and employee compensation plans and the risks, if any, these plans pose to Banner as required by our participation in the Treasury's Capital Purchase Program. They met to determine whether any features in senior executive officer compensation plans could lead those officers to take unnecessary and excessive risks that would threaten the value of Banner, and whether any features in employee compensation plans unnecessarily expose Banner to risks, including any features of senior executive officer or employee compensation plans that would encourage behavior focused on short-term results rather than long-term value creation. They also met to discuss, evaluate and review the terms of employee compensation plans for the purpose of determining whether they contain any feature that could encourage the manipulation of the reported earnings of Banner to enhance the compensation of an employee.

The Compensation Committee and Senior Risk Management Officer concluded that our senior executive officer compensation plans do not encourage the senior executive officers to take unnecessary and excessive risks that would threaten the value of Banner; that senior executive officer or employee compensation plans do not unnecessarily expose Banner to risks or contain any features that would encourage senior executive officer or employee behavior focused on short-term results rather than long-term value creation; and that employee compensation plans do not contain any feature that could encourage the manipulation of the reported earnings of Banner to enhance the compensation of an employee.

In reaching these conclusions, the Compensation Committee and Senior Risk Management Officer considered elements of Banner's Strategic Plan, including keys to success, financial measures and other goals; Banner's unique and material risks, including long-term and short-term risks, and the key features of senior executive officer and employee compensation plans. They also considered information from the Swanson Watts LLC total compensation benchmarking analysis noted above.

During 2009, senior executive officer compensation predominately consisted of base salary, deferred compensation and the SERP. The Committee and the Senior Risk Management Officer noted that combined senior executive officer base salaries appeared reasonably balanced as a percentage of total compensation and that the level of combined senior executive officer base salaries appeared similar to peers and are therefore risk neutral with only a slight bias towards risk taking to enhance short-term earnings. Although long-term incentive compensation was not a significant component of compensation in 2009, they noted that long-term incentive compensation requires participants to remain in the active employment of Banner for an extended period of time (typically five years or more of vesting) to obtain the full benefit of the plan. In addition, the value of long-term incentives are predominantly, if not wholly, dependent on the value of Banner's common stock; therefore, these incentives serve to promote long-term value creation by each participant.

The Committee and the Senior Risk Management Officer noted that senior executive officers may elect to participate in deferred compensation plans as described elsewhere in this Proxy Statement and that they may direct the investment of deferred compensation toward the purchase of Banner common stock. Risks associated with this feature of the plan are mitigated by several features of the plan, including: required advance selection of the form and timing of plan distributions; waiting periods in the event of making a change in desired distributions; and the inability of a senior executive officer to accelerate plan payments. Further, Banner establishes grantor trusts to hold the investments associated with senior executive officer deferred compensation elections. This means that senior executive officers have the status of unsecured creditors of Banner with respect to trust assets; therefore, participation in the deferred compensation plan creates a bias towards long-term value creation and the financial strength of Banner.

The SERP component of senior executive officer compensation also appears to create a bias towards long-term value creation because each participant is an unsecured creditor of Banner. While a SERP participant's benefits are tied, in part, to the value of Banner common stock because of the offset for tax-qualified benefits which includes the ESOP, the risks associated with this feature of the plan are mitigated by several provisions of the plan, including restrictions on changing the form of benefit and prohibitions on accelerating benefits.

The Compensation Committee and Senior Risk Management Officer further observed that Banner's internal controls over financial reporting and disclosures which provide for an audited review of assets, liabilities, capital, revenues and expenses as well as the financial reports released to regulators, shareholders and the public provide for an extensive array of preventive and detective controls that individually and collectively serve to discourage and deter any senior executive officer or employee from contemplating or taking any action to manipulate reported earnings. The

Compensation Committee and Senior Risk Management Officer further concluded that senior executive officer compensation plans reflect the need for Banner to remain a competitive enterprise, to retain and recruit talented employees who will contribute to Banner's future success, and ultimately to repay TARP Capital Purchase Program obligations.

The foregoing report is provided by the following directors, who constitute the Committee:

The Compensation Committee

Dean W. Mitchell, Chair
David B. Casper
David A. Klaue
Robert J. Lane

This report shall not be deemed to be incorporated by reference by any general statement incorporating by reference this Proxy Statement into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, and shall not otherwise be deemed filed under such acts.

Summary Compensation Table

The following table presents information regarding compensation for our named executive officers: (1) D. Michael Jones, our Chief Executive Officer; (2) Lloyd W. Baker, our Chief Financial Officer; and (3) our three other most highly compensated executive officers, who are Richard B. Barton, Cynthia D. Purcell and Paul E. Folz. No executive officer of Islanders Bank or Community Financial Corporation is an executive officer of Banner. The named executive officers did not receive any option awards or non-equity incentive plan compensation; therefore, these columns have been omitted from the table below.

Name and Principal Position	*Year*	*Salary ($)*	*Bonus ($)*	*Stock Awards ($)(1)*	*Change in Pension Value and Non-qualified Deferred Compensation Earnings ($)(2)*	*All Other Compen-sation ($)(3)*	*Total ($)*
D. Michael Jones	2009	425,000	--	--	2,516 (4)	9,754	437,270
President and	2008	425,000	--	--	81,488 (4)	27,461	533,949
Chief Executive Officer	2007	415,000	175,000	--	286,502 (4)	49,562	926,064
Lloyd W. Baker	2009	250,000	--	--	180,550 (5)	10,090	440,640
Executive Vice President,	2008	220,000	--	14,400	211,068 (5)	24,488	469,956
Chief Financial Officer	2007	202,167	65,000	--	172,912 (5)	27,958	468,037
Richard B. Barton	2009	254,000	--	--	103,812 (6)	20,168	377,980
Executive Vice President,	2008	236,250	--	10,800	173,760 (6)	35,531	456,341
Senior Credit Officer	2007	222,500	55,000	--	186 (6)	37,271	314,957
Cynthia D. Purcell	2009	270,000	--	--	101,815 (7)	6,536	378,351
Executive Vice President,	2008	257,650	--	14,400	220,176 (7)	21,444	513,670
Chief Operating Officer	2007	239,792	70,000	--	103,429 (7)	26,593	439,814
Paul E. Folz	2009	260,000	--	--	101,779 (8)	8,921	370,700
Executive Vice President,	2008	257,500	--	10,800	168,982 (8)	21,626	458,908
Community Banking	2007	239,792	65,000	--	480 (8)	26,484	331,756

(1) Represents the aggregate grant date fair value of awards, computed in accordance with Financial Accounting Standards Board Accounting Standards Codification Topic 718, "Compensation – Stock Compensation" ("FASB ASC Topic 718"). For a discussion of valuation assumptions, see Note 19 of the Notes to Consolidated Financial Statements in Banner's Annual Report on Form 10-K for the year ended December 31, 2009.
(2) See Pension Benefits below for a detailed discussion of the assumptions used to calculate the Change in Pension Value.
(3) Includes 401(k) plan contributions, dividends on unvested restricted stock, life insurance premiums, club dues and company car allowance.

(Footnotes continue on following page)

(4) For 2009, represents above-market earnings on deferred compensation. For 2008, consists of an increase in the value of Mr. Jones's SERP of $76,449 and above-market earnings on deferred compensation of $5,039. For 2007, consists of an increase in the value of Mr. Jones's SERP of $278,664 and above-market earnings on deferred compensation of $7,838.
(5) Represents an increase in the value of Mr. Baker's SERP.
(6) Consists of the following increases in the value of Mr. Barton's SERP: $103,753 for 2009 and $173,639 for 2008; and the following amounts of above-market earnings on deferred compensation: $59 for 2009 and $121 for 2008. For 2007, represents above-market earnings on deferred compensation.
(7) Represents an increase in the value of Ms. Purcell's SERP.
(8) Consists of the following increases in the value of Mr. Folz's SERP: $101,595 for 2009 and $168,667 for 2008; and the following amounts of above-market earnings on deferred compensation: $184 for 2009 and $315 for 2008. For 2007, represents above-market earnings on deferred compensation.

Employment Agreements. We entered into employment agreements with Mr. Jones on February 11, 2002, Mr. Baker on July 1, 1998, Ms. Purcell on March 3, 2001 and Messrs. Barton and Folz on June 3, 2002. The agreements provide that each executive's base salary is subject to annual review. The base salaries for 2010 for Mr. Jones, Mr. Baker, Mr. Barton, Ms. Purcell and Mr. Folz are $425,000, $250,000, $254,000, $285,000 and $260,000, respectively. In addition to base salary, the agreements provide for the executive's participation in the employee benefit plans and other fringe benefits applicable to executive personnel. The initial three-year term of each agreement may be extended annually for an additional year at the discretion of the Board of Directors of Banner Bank. The agreements were extended on the following dates: Messrs. Barton and Folz, June 1, 2009, Mr. Baker, July 1, 2009, Mr. Jones, February 11, 2010 and Ms. Purcell, March 1, 2010. The agreements provide that compensation may be paid in the event of disability, death, involuntary termination or a change in control, as described below under "Potential Payments Upon Termination or Change in Control."

Outstanding Equity Awards

The following information with respect to outstanding stock and option awards as of December 31, 2009 is presented for the named executive officers.

	Option Awards (1)					*Stock Awards (2)*	
Name	*Grant Date (1)*	*Number of Securities Underlying Unexercised Options (#) Exercisable*	*Number of Securities Underlying Unexercised Options (#) Unexercisable*	*Option Exercise Price ($)*	*Option Expira-tion Date*	*Number of Shares or Units of Stock That Have Not Vested (#)*	*Market Value of Shares or Units of Stock That Have Not Vested ($)*
D. Michael Jones	--	--	--	--	--	--	--
Lloyd W. Baker	11/21/00	4,800	--	13.09	11/21/10		
	12/19/01	4,800	--	16.43	12/19/11		
	03/25/03	5,000	--	15.67	03/25/13		
	12/16/04	2,000	--	31.71	12/16/14		
						8,250 (3)	8,500
Richard B. Barton	06/03/02	14,000	--	22.05	06/03/12		
	03/25/03	5,000	--	15.67	03/25/13		
	12/16/04	2,000	--	31.71	12/16/14		
						7,250 (4)	8,160
Cynthia D. Purcell	11/21/00	4,800	--	13.09	11/21/10		
	12/19/01	4,800	--	16.43	12/19/11		
	03/25/03	5,000	--	15.67	03/25/13		
	12/16/04	2,000	--	31.71	12/16/14		
						8,250 (3)	8,500
Paul E. Folz	06/03/02	14,000	--	22.05	06/03/12		
	03/25/03	5,000	--	15.67	03/25/13		
	12/16/04	2,000	--	31.71	12/16/14		
						7,250 (4)	8,160

(1) Option grants vest pro rata over a five-year period from the grant date, with the first 20% vesting one year after the grant date.
(2) Represents phantom stock awards. Phantom stock awards vest after five years of service from the date of grant.
(3) Consists of the following awards of phantom stock: 4,250 shares on July 1, 2006 and 4,000 shares on May 5, 2008.
(4) Consists of the following awards of phantom stock: 4,250 shares on July 1, 2006 and 3,000 shares on May 5, 2008.

Option Exercises and Stock Vested

The following table shows the value realized upon vesting of stock awards for our named executive officers in 2009. The named executive officers did not exercise any stock options in 2009.

	Stock Awards	
Name	*Number of Shares Acquired on Vesting (#)*	*Value Realized on Vesting ($)*
D. Michael Jones	--	--
Lloyd W. Baker	100	247
Richard B. Barton	100	247
Cynthia D. Purcell	100	247
Paul E. Folz	100	247

Pension Benefits

The following information is presented with respect to the nature and value of pension benefits for the named executive officers at December 31, 2009.

Name	*Plan Name*	*Number of Years Credited Service (#)*	*Present Value of Accumulated Benefit ($)(1)*	*Payments During Last Fiscal Year ($)*
D. Michael Jones	Supplemental Executive Retirement Program	7(2)	1,210,627	--
Lloyd W. Baker	Supplemental Executive Retirement Program	15	1,269,640	--
Richard B. Barton	Supplemental Executive Retirement Program	3	277,412	--
Cynthia D. Purcell	Supplemental Executive Retirement Program	25	920,250	--
Paul E. Folz	Supplemental Executive Retirement Program	3	270,262	--

(1) Amounts shown assume normal retirement age as defined in individual agreements, except for Mr. Jones who has reached retirement age and is assumed for present value calculation purposes to retire on December 31, 2009, and an assumed life of 82 years for the recipient and recipient's spouse, with the projected cash flows discounted at six and one-half percent to calculate the resulting present value.
(2) As of December 31, 2008, Mr. Jones agreed to limit his years of service to seven years.

Supplemental Executive Retirement Program. We have adopted a SERP for each of the named executive officers. Banner Bank has purchased life insurance on each of the executives in an amount sufficient to recover the benefits payable under the SERP, payable upon their deaths. The SERP provides for payments in the event of retirement, early retirement, disability, involuntary termination following a change in control and death. These payments are discussed in further detail below, under "Potential Payments Upon Termination or Change in Control."

Nonqualified Deferred Compensation

The following information is presented with respect to plans that provide for the deferral of compensation on a basis that is not tax-qualified in which the named executive officers participated in 2009.

Name	*Executive Contributions in Last FY ($)*	*Registrant Contributions in Last FY ($)*	*Aggregate Earnings in Last FY ($)(1)*	*Aggregate Withdrawals/ Distributions ($)*	*Aggregate Balance at FYE ($)(2)*
D. Michael Jones	--	--	(3,060)	--	646,101
Lloyd W. Baker	--	--	(21,086)	--	9,457
Richard B. Barton	--	--	837	--	16,331
Cynthia D. Purcell	--	--	1,870	--	8,032
Paul E. Folz	--	--	(6,229)	--	51,355

(Footnotes appear on following page)

(1) The following amounts, constituting above-market earnings, were reported as compensation in 2009 in the Summary Compensation Table: for Mr. Jones, $2,516; for Mr. Barton, $59; and for Mr. Folz, $184.
(2) Of these amounts, the following amounts were previously reported as compensation to the officers in the Summary Compensation Table: for Mr. Jones, $64,634; for Mr. Baker, $4,310; for Mr. Barton, $5,150; for Ms. Purcell, $4,772; and for Mr. Folz, $7,811.

Potential Payments Upon Termination or Change in Control

We have entered into agreements with the named executive officers that provide for potential payments upon disability, termination, early retirement, normal retirement and death. In addition, our equity plans also provide for potential payments upon termination. The following table shows, as of December 31, 2009, the value of potential payments and benefits following a termination of employment under a variety of scenarios. However, as a result of Banner's participation in the Treasury's Capital Purchase Program, it is currently prohibited from making a golden parachute payment to a named executive officer or any of the next five most highly compensated employees. For purposes of this restriction, a golden parachute payment means any payment for the departure from a TARP recipient for any reason, or any payment due to a change in control of the TARP recipient, except for payments for services performed or benefits accrued. Excluded from the restriction are payments made in the event of an employee's death or disability. The affected executives signed compensation modification agreements to comply with the restriction against making golden parachute payments. Accordingly, except for payments for services performed or benefits accrued, our named executive officers are not currently eligible to receive any payments upon termination without just cause or in connection with a change in control pursuant to their employment agreements or supplemental executive retirement program but they, or their beneficiaries, remain eligible to receive payments upon a termination due to death or disability. The prohibition against golden parachute payments will be effective for as long as the 124,000 shares of Banner's Series A Preferred Stock sold to the Treasury remain outstanding.

	Death ($)	*Disability ($)*	*Involuntary Termination ($)*	*Involuntary Termination Following Change in Control ($)*	*Early Retirement ($)*	*Normal Retirement ($)*
D. Michael Jones						
Employment Agreement	--	--	885,417(1)	2,119,492(1)	--	--
SERP	67,025(2)	134,050(2)	134,050(2)	134,050(2)	134,050(2)	134,050(2)
Equity Plans	--	--	--	--	--	--
Lloyd W. Baker						
Employment Agreement	--	166,667(2)	625,000(1)	762,707(1)	--	--
SERP	60,163(2)	120,325(2)	120,325(3)	120,325(3)	120,325(3)	120,325(2)
Equity Plans	--	--	--	8,500(1)	--	8,500
Richard B. Barton						
Employment Agreement	--	169,333(2)	613,833(1)	878,577(1)	--	--
SERP	17,052(2)	34,103(2)	34,103(4)	34,103(4)	34,103(4)	34,103(2)
Equity Plans	--	--	--	8,160(1)	--	8,160
Cynthia D. Purcell						
Employment Agreement	--	190,000(2)	617,500(1)	819,720(1)	--	--
SERP	76,860(2)	153,719(2)	94,222(3)	94,222(3)	94,222(3)	153,719(2)
Equity Plans	--	--	--	8,500(1)	--	8,500
Paul E. Folz						
Employment Agreement	--	173,000(2)	628,333(1)	839,560(1)	--	--
SERP	17,546(2)	35,092(2)	35,092(3)	35,092(3)	35,092(3)	35,092(2)
Equity Plans	--	--	--	8,160(1)	--	8,160

(1) Payment is prohibited as a result of Banner's participation in the Treasury's Capital Purchase Program.
(2) Indicates annual payments.
(3) Indicates annual payments (which may not begin before age 62).
(4) Indicates annual payments (which may not begin before age 68).

Employment Agreements. The employment agreements with Messrs. Baker, Barton and Folz and Ms. Purcell provide for payments in the event of death, disability or termination. The employment agreement with Mr. Jones provides for payments in the event of death or termination. In the event of an executive's death during the term of his employment agreement, we will pay to his estate the compensation due through the last day of the calendar month in which his death occurred.

The employment agreements with Messrs. Baker, Barton and Folz and Ms. Purcell provide that if the executive becomes disabled or incapacitated to the extent that he or she is unable to perform the duties of his or her position, he or she shall receive short-term disability benefits equal to 100% of his or her monthly compensation beginning on the 15th day of disability and continuing until the 180th day of disability and long-term disability benefits equal to 66 2/3% of monthly salary beginning on the 181st day of disability and continuing until he or she attains age 65. These benefits will be reduced by the amount of any benefits payable to the executive under any other disability program of Banner Bank. The Bank currently provides disability benefits with certain limitations to all full time employees. In addition, during any period of disability, the executive and his or her dependents shall, to the greatest extent possible, continue to be covered under all executive benefits plans of Banner Bank, including without limitation, its retirement plans, life insurance plan and health insurance plans, as if actively employed by Banner Bank. If the executive is disabled for a continuous period exceeding six calendar months, Banner Bank may, at it election, terminate the employment agreement.

The employment of the executives is terminable at any time for just cause as defined in the agreements. In addition, the employment of the executive may be terminated without just cause, in which case the agreement provides that he or she would continue to receive base salary over the remaining term. As described previously, as a result of Banner's participation in the Treasury's Capital Purchase Program, it is currently prohibited from a making a payment upon termination without just cause to a named executive officer.

The employment agreements also provide for benefits in the event of the executives' termination in connection with a change in control. If, after a change in control, we terminate an executive's employment or otherwise change the circumstances in which he or she is employed, or cause a reduction in responsibilities or authority or compensation or other benefits provided under the employment agreement without consent, the agreements provide that we must pay to the executive and provide him or her, or the his or her beneficiaries, dependents and estate, with the following: (1) 2.99 times the executive's base amount (as defined in Section 280G of the Internal Revenue Code of 1986); and (2) during the period of 36 calendar months beginning with the event of termination, continued coverage under all Banner employee benefit plans as if the executive were still employed during that period under the employment agreement. The employment agreements limit these payments and do not allow payments of amounts in excess of the limits imposed by Section 280G of the Internal Revenue Code. As described previously, as a result of Banner's participation in the Treasury's Capital Purchase Program, it is currently prohibited from making a payment in connection with a change in control to a named executive officer.

Supplemental Executive Retirement Program. We have adopted a supplemental executive retirement program ("SERP") for each of the named executive officers. At termination of employment at or after attaining age 62 (age 65 for Mr. Jones and age 68 for Mr. Barton) and having achieved a service requirement, the executive's annual benefit under the SERP would be computed as the product of 3% (4% for Messrs. Barton and Folz) of the executive's final average compensation (defined as the three calendar years of the executive's annual cash compensation, including bonuses, which produce the highest average within the executive's final eight (five in the case of Mr. Jones) full calendar years of employment) and the executive's annual years of service (subsequent to January 1, 2007 for Messrs. Barton and Folz) (called the "supplemental benefit"). However, the supplemental benefit would be limited such that the sum of (1) amounts payable from the executive's other retirement benefits from Banner and Banner Bank and (2) the supplemental benefit may not exceed 60% of final average compensation (for Messrs. Barton and Folz, the supplemental benefit may not exceed the product of 3% times his total years of service and his final average compensation). Payment of the supplemental benefit begins on the first day of the month next following the executive's retirement date and continues monthly for the executive's life, unless the executive is a specified employee (as defined in Section 416(i) of the Internal Revenue Code), in which case payment begins on the first day of the month following the six-month anniversary of the executive's termination of employment. The executives are eligible for a reduced benefit upon retirement prior to age 62 (age 68 for Mr. Barton) if they meet the years of service requirements in their individual agreements; however, no benefit payment will begin before age 62 (age 68 for Mr. Barton) and payments will be subject to the delayed distribution requirements if the executive is a specified employee.

In the event of the executive's termination of employment prior to his or her retirement date by reason of disability (or in the case of Mr. Jones, for good reason), the agreements provide that the executive or the executive's surviving spouse shall receive the supplemental benefit described above as if the executive's retirement date had occurred on the date immediately preceding termination of employment. "Good reason" is defined as having occurred when: (1) the executive is assigned duties which are largely inferior to his duties immediately prior to a change of control; (2) the executive's incentive and benefit plans, programs or arrangements are terminated, or the executive's participation is reduced to such an extent as to materially reduce their aggregate value; or (3) the executive is required to relocate his principal business office or his principal place of residence outside of the area consisting of a 35-mile radius from the current main office and any branch of Banner Bank, or the executive is assigned duties that would reasonably require such a relocation. As described previously, as a result of Banner's participation in the Treasury's Capital Purchase Program, it is currently prohibited from making a payment to Mr. Jones upon a termination for good reason.

In the event of the executive's death, the executive's surviving spouse shall receive a spouse's supplemental benefit. If the death occurs following the executive's retirement date, the surviving spouse shall be entitled to a spouse's supplemental benefit, payable for life, equal to 50% of the monthly amount of the supplemental benefit payable to the executive prior to his or her death. If the death occurs while the executive is actively employed by Banner or any of its affiliates, the surviving spouse shall receive a spouse's supplement benefit equal to 50% of the amount the executive would have received as a supplemental benefit if the executive's retirement date had occurred on the date immediately preceding the executive's death.

With respect to each of the named executive officers other than Mr. Jones, the agreement provides that in the event of the executive's involuntary termination of employment on or after the effective date of a change in control, the date of termination shall be treated as the executive's retirement date and he or she shall be entitled to receive a supplemental benefit. If the executive had reached his or her retirement date, the supplemental benefit would be calculated as described above for normal retirement and if the executive had not reached his or her retirement date but had satisfied the years of service requirement, the supplemental benefit would be calculated as described above for early retirement. No benefit payment will begin before age 62 (age 68 for Mr. Barton) and payments will be subject to the delayed distribution requirements if the executive is a specified employee. As described previously, as a result of Banner's participation in the Treasury's Capital Purchase Program, it is currently prohibited from making a payment in connection with a change in control to a named executive officer.

In the event of Mr. Jones's involuntary termination of employment or termination for good reason on or after the effective date of a change in control, his agreement provides that the date of termination shall be his retirement date and he shall be entitled to receive a supplemental benefit calculated for normal retirement. Within 90 days prior to the effective date of the change in control, the agreement provides that Mr. Jones may elect to have the supplemental benefit payable (1) monthly for life, beginning either on the first day of the month next following his retirement date or if he is a specified employee, the first day of the month following the six-month anniversary of his termination of employment, or (2) beginning on a date specified by Mr. Jones. As described previously, as a result of Banner's participation in the Treasury's Capital Purchase Program, it is currently prohibited from making a payment in connection with a change in control to a named executive officer.

The supplemental benefit shall cease to be paid to the executive (and rights to the spouse's supplemental benefit shall terminate) if the executive (1) discloses material confidential information or trade secrets concerning Banner Bank or any of its subsidiaries without its consent or (2) engages in any activity that is materially damaging to the Bank including engaging in competitive employment during the three-year period beginning on the executive's retirement date (or in the case of Messrs. Barton and Folz, during the two-year period beginning on the date of his involuntary termination of employment on or after the effective date of a change of control.

Equity Plans. Our 2001 Stock Option Plan and Long-Term Incentive Plan provide for accelerated vesting of awards in the event of a change in control. If a change in control occurs: (1) all options granted and not fully exercisable will become exercisable in full; and (2) awards of phantom stock will vest fully and be payable within 60 days. In addition, if a tender offer or exchange offer for Banner's shares commences, options granted under the 2001 Stock Option Plan and not fully exercisable will become exercisable in full. The Long-Term Incentive Plan also provides that a participant who (1) has attained age 65, (2) voluntarily terminates employment with Banner and its affiliates, (3) is not vested at the time of the termination of employment and (4) enters into a non-competition agreement for a period equal to the greater of two years from the participant's separation from service or the period of time necessary for the participant to fully vest in his

or her benefit, shall have continuous service credited on his or her behalf for vesting purposes for a period equal to the term of the non-competition agreement. As described previously, as a result of Banner's participation in the Treasury's Capital Purchase Program, it is currently prohibited from making golden parachute payments to the named executive officers and this includes accelerating equity awards.

Compensation Committee Interlocks and Insider Participation

The members of the Compensation Committee are Dean W. Mitchell, David B. Casper, David A. Klaue and Robert J. Lane. No members of the Compensation Committee were officers or employees of Banner or any of its subsidiaries during the year ended December 31, 2009, nor were they formerly Banner officers or had any relationships otherwise requiring disclosure.

PROPOSAL 2 – ADVISORY VOTE ON EXECUTIVE COMPENSATION

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009 ("ARRA") into law. For financial institutions that have received or will receive financial assistance under the troubled asset relief program ("TARP") or related programs, such as Banner, the ARRA significantly rewrites the original executive compensation and corporate governance provisions of Section 111 of the Emergency Economic Stabilization Act of 2008. Notably, the ARRA requires that TARP recipients permit shareholders to vote to approve executive compensation. This proposal, commonly known as a "say on pay" proposal gives shareholders the opportunity to endorse or not endorse the compensation of our named executive officers. The proposal will be presented at the annual meeting in the form of the following resolution:

> RESOLVED, that the shareholders approve the compensation of Banner Corporation's named executive officers, as disclosed in the Compensation Discussion and Analysis, the compensation tables and related material in the Proxy Statement for the 2010 annual meeting of shareholders.

As provided under the ARRA, this vote will not be binding on our Board of Directors and may not be construed as overruling a decision by the Board. The Compensation Committee and the Board may, however, take into account the outcome of the vote when considering future executive compensation arrangements.

Our executive compensation policies are designed to establish an appropriate relationship between executive pay and the annual and long-term performance of Banner and Banner Bank, to reflect the attainment of short- and long-term financial performance goals, to enhance our ability to attract and retain qualified executive officers, and to align to the greatest extent possible the interests of management and shareholders. Our Board of Directors believes that our compensation policies and procedures achieve these objectives. **The Board of Directors unanimously recommends that you vote "FOR" approval of the compensation of our named executive officers.**

AUDIT COMMITTEE MATTERS

Audit Committee Charter. The Audit Committee operates pursuant to a charter approved by our Board of Directors. The Audit Committee reports to the Board of Directors and is responsible for overseeing and monitoring our financial accounting and reporting, system of internal controls established by management and audit process. The charter sets out the responsibilities, authority and specific duties of the Audit Committee. The charter specifies, among other things, the structure and membership requirements of the Audit Committee, as well as the relationship of the Audit Committee to our independent auditor, the internal audit department and management.

Report of the Audit Committee. The Audit Committee reports as follows with respect to Banner's audited financial statements for the year ended December 31, 2009:

- The Audit Committee has completed its review and discussion of the 2009 audited financial statements with management;
- The Audit Committee has discussed with the independent auditor (Moss Adams LLP) the matters required to be discussed by Statement on Auditing Standards No. 61, *Communication with Audit*

Committees, as amended, as adopted by the Public Company Accounting Oversight Board in Rule 3200T;

- The Audit Committee has received written disclosures and the letter from the independent auditor required by applicable requirements of the Public Company Accounting Oversight Board regarding the independent auditor's communications with the Audit Committee concerning independence, and has discussed with the independent auditor the independent auditor's independence; and
- The Audit Committee has, based on its review and discussions with management of the 2009 audited financial statements and discussions with the independent auditors, recommended to the Board of Directors that Banner's audited financial statements for the year ended December 31, 2009 be included in its Annual Report on Form 10-K.

The foregoing report is provided by the following directors, who constitute the Audit Committee:

Audit Committee

Gordon E. Budke, Chairman
Robert D. Adams
John R. Layman
Michael M. Smith

This report shall not be deemed to be incorporated by reference by any general statement incorporating by reference this Proxy Statement into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, and shall not otherwise be deemed filed under such acts.

PROPOSAL 3 – RATIFICATION OF SELECTION OF INDEPENDENT AUDITOR

The Audit Committee of the Board of Directors has selected Moss Adams LLP as our independent auditor for the year ending December 31, 2010 and that selection is being submitted to shareholders for ratification. Although ratification is not required by our Bylaws or otherwise, the Board is submitting the selection of Moss Adams LLP to our shareholder for ratification as a matter of good corporate practice. If the selection is not ratified, the Audit Committee will consider whether it is appropriate to select another registered public accounting firm. Even if the selection is ratified, the Audit Committee in its discretion may select a different registered public accounting firm at any time during the year if it determines that such a change would be in the best interests of Banner and our shareholders. Moss Adams LLP served as our independent auditor for the year ended December 31, 2009 and a representative of the firm will be present at the annual meeting to respond to shareholders' questions and will have the opportunity to make a statement if he or she so desires.

The Board of Directors unanimously recommends that you vote "FOR" the ratification of the appointment of Moss Adams LLP as our independent auditor.

The following table sets forth the aggregate fees billed, or expected to be billed, to us by Moss Adams LLP for professional services rendered for the fiscal years ended December 31, 2009 and 2008.

	Year Ended December 31,	
	2009	*2008*
Audit Fees (1)	$646,499	$635,451
Audit-Related Fees	--	--
Tax Fees	--	11,950
All Other Fees	--	--

(1) Fees for 2009 include estimated amounts to be billed.

The Audit Committee will establish general guidelines for the permissible scope and nature of any permitted non-audit services to be provided by the independent auditor in connection with the Committee's annual review of its charter. Pre-approval may be granted by action of the full Audit Committee or by delegated authority to one or more members of the Audit Committee. If this authority is delegated, all approved non-audit services will be presented to the Audit Committee at its next meeting. In considering non-audit services, the Audit Committee or its delegate will consider various factors, including but not limited to, whether it would be beneficial to have the service provided by the independent auditors and whether the service could compromise the independence of the independent auditors. For the year ended December 31, 2009, the Audit Committee approved all of the services provided by Moss Adams LLP that were designated as audit-related fees, tax fees and all other fees as set forth in the table above.

The Audit Committee of the Board of Directors determined that all of the services performed by Moss Adams LLP in fiscal year 2009 were not incompatible with Moss Adams LLP maintaining its independence.

PROPOSAL 4 – AMENDMENT OF THE ARTICLES OF INCORPORATION TO INCREASE THE NUMBER OF AUTHORIZED SHARES OF COMMON STOCK

On February 23, 2010, our Board of Directors unanimously adopted a resolution recommending that Banner's Articles of Incorporation be amended to increase the number of authorized shares of common stock, having a par value of $.01 per share, from 75,000,000 shares to 200,000,000 shares (the "Common Stock Amendment"). The Board of Directors further directed that the Common Stock Amendment be submitted for consideration by shareholders at the annual meeting. If the Common Stock Amendment is approved by shareholders, Banner will execute and submit to the Washington Secretary of State for filing Articles of Amendment of the Articles of Incorporation providing for the Common Stock Amendment. The Common Stock Amendment will become effective at the close of business on the date the Articles of Amendment are accepted for filing by the Washington Secretary of State.

As of the voting record date for the annual meeting, there were 22,509,931 shares of common stock issued and outstanding and another 2,203,367 shares of common stock were reserved for issuance upon exercise of options previously granted from Banner's stock option plans or issuable under other outstanding stock awards and the Treasury Warrant.

The Board of Directors believes that it is in Banner's best interest to increase the number of authorized but unissued shares of common stock in order to meet Banner's possible future business and financing needs as they arise. During 2009 we sought to raise capital and are continuing to evaluate opportunities that may be available to increase Banner's capital position. In connection with our evaluation, we have had preliminary discussions with our investment bankers but have not determined the specific method or methods by which we will raise capital, the amounts we will raise or the exact timing of an offering. Our Board of Directors believes that the availability of these additional shares will provide Banner with the capability and flexibility to increase our capital through the issuance of common stock for a variety of purposes that the Board of Directors may deem advisable in the future. These purposes could include, among other things, increasing the capital position of our subsidiary banks; issuing stock for possible acquisition transactions; repaying funds received by Banner through the Treasury's Capital Purchase Program should we elect to do so in the future; or for other corporate and business purposes. The additional common shares authorized would be identical in all respects to Banner's currently authorized shares of common stock. Banner's Articles of Incorporation provide that shareholders shall not have preemptive rights for its capital stock. The determination by our Board of Directors and Banner's management that the authorized common stock should be increased took into account the historical and anticipated issuance patterns of Banner, the potential issuance of stock splits or dividends in the future based on market conditions and the use of authorized shares for our Dividend Reinvestment and Direct Stock Purchase and Sale Plan or other additional financing or expansion may be appropriate to enhance shareholder value.

The proposed increase in the number of authorized shares of common stock would give our Board of Directors authority to issue additional shares of common stock from time to time without delay or further action by the shareholders except as may be required by applicable law or the rules of Nasdaq. Subject to its fiduciary duties to shareholders, the Board of Directors would have the authority to issue additional shares in transactions that might discourage, delay or prevent an unsolicited acquisition of control of Banner or make such an unsolicited acquisition of control of Banner more difficult or expensive; however, the Board of Directors has no plans to utilize the authorized shares in that manner and is not aware of any effort by any third parties to acquire control of Banner.

The issuance of additional shares of common stock for any of the corporate purposes listed above could have a dilutive effect on earnings per share and the book or market value of our outstanding common stock, depending on the circumstances, and could dilute a shareholder's percentage voting power in Banner. Holders of our common stock are not entitled to preemptive rights or other protections against dilution. Our Board of Directors intends to take these factors into

account before authorizing any new issuance of shares. As noted above, we may repurchase our Series A Preferred Stock and the related Treasury Warrant issued under the Capital Purchase Program with the proceeds from any sale of these additional shares of common stock. If we elect to repurchase the Series A Preferred Stock and the Treasury Warrant, the Treasury Warrant will be repurchased at fair market value. Accordingly, the repurchase of these securities may be at an amount more than our carrying value and, as such, may negatively impact our net income available to shareholders and our earnings per share.

In the event shareholders approve the Common Stock Amendment, Article IV of Banner's Articles of Incorporation will be amended to increase the number of shares of common stock which Banner is authorized to issue from 75,000,000 to 200,000,000. The par value of the common stock will remain at one cent ($.01) per share. Upon effectiveness of the Amendment, the first sentence of Article IV of Banner's Articles of Incorporation will read as follows:

> ***ARTICLE IV.*** ***Capital Stock***. The total number of shares of all classes of capital stock which the corporation has authority to issue is 200,500,000, of which 200,000,000 shall be common stock of par value of $0.01 per share, and of which 500,000 shall be serial preferred stock of par value $0.01 per share.

The remaining text of Article VI of Banner's Articles of Incorporation would remain unchanged.

Approval of the Common Stock Amendment will require the affirmative vote of a majority of the outstanding shares entitled to vote thereon. Proxies received in response to the Board of Directors' solicitation will be voted "FOR" approval of the Common Stock Amendment if no specific instructions are included thereon for this Proposal 4.

The Board of Directors recommends a vote "FOR" the amendment of the Articles of Incorporation to increase the number of authorized shares of common stock.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires our executive officers and directors, and persons who own more than 10% of any registered class of Banner's equity securities, to file reports of ownership and changes in ownership with the SEC. Executive officers, directors and greater than 10% shareholders are required by regulation to furnish us with copies of all Section 16(a) forms they file. Based solely on our review of the copies of such forms we have received and written representations provided to us by these persons, we believe that during the year ended December 31, 2009, all filing requirements applicable to our reporting officers, directors and greater than 10% shareholders were properly and timely complied with, except for Mr. Foster, who filed a late Form 5 covering two transactions.

MISCELLANEOUS

The Board of Directors is not aware of any business to come before the annual meeting other than those matters described in this Proxy Statement. However, if any other matters should properly come before the meeting, it is intended that proxies in the accompanying form will be voted in respect thereof in accordance with the judgment of the person or persons voting the proxies.

We will bear the cost of solicitation of proxies, and will reimburse brokerage firms and other custodians, nominees and fiduciaries for reasonable expenses incurred by them in sending proxy materials to the beneficial owners of Banner's common stock. In addition to solicitations via the Internet and by mail, our directors, officers and regular employees may solicit proxies personally or by telecopier or telephone without additional compensation.

Banner's 2009 Annual Report to Shareholders, including financial statements, has been mailed to all shareholders of record as of the close of business on March 1, 2010. Any shareholder who has not received a copy of the Annual Report may obtain a copy by writing to us or by accessing our proxy materials online at www.bannerbank.com/proxymaterials. The Annual Report is not to be treated as part of the proxy solicitation material or having been incorporated herein by reference.

A copy of Banner's Annual Report on Form 10-K for the year ended December 31, 2009, as filed with the SEC, will be furnished without charge to shareholders of record as of March 1, 2010 upon written request to Albert H. Marshall, Secretary, Banner Corporation, 10 S. First Avenue, Post Office Box 907, Walla Walla, Washington 99362.

SHAREHOLDER PROPOSALS

Proposals of shareholders intended to be presented at our annual meeting to be held in 2011 must be received by us no later than November 30, 2010 to be considered for inclusion in the proxy materials and form of proxy relating to that meeting. Any such proposals shall be subject to the requirements of the proxy rules adopted under the Securities Exchange Act.

In addition, our Articles of Incorporation provide that in order for business to be brought before the annual meeting, a shareholder must deliver notice to the Secretary not less than 30 nor more than 60 days prior to the date of the annual meeting; provided that if less than 31 days' notice of the annual meeting is given to shareholders, such notice must be delivered not later than the close of the tenth day following the day on which notice of the annual meeting was mailed to shareholders. The notice must state the shareholder's name, address and number of shares of Banner common stock held, and briefly discuss the business to be brought before the annual meeting, the reasons for conducting such business at the annual meeting and any interest of the shareholder in the proposal.

Our Articles of Incorporation provide that if a shareholder intends to nominate a candidate for election as a director, the shareholder must deliver written notice of his or her intention to our Secretary not less than 30 days nor more than 60 days prior to the date of the annual meeting of shareholders; provided, however, that if less than 31 days' notice of the annual meeting is given to shareholders, such written notice must be delivered to our Secretary not later than the close of the tenth day following the day on which notice of the annual meeting was mailed to shareholders. The notice must set forth (1) the name, age, business address and, if known, residence address of each nominee for election as a director, (2) the principal occupation or employment of each nominee, (3) the number of shares of Banner common stock which are beneficially owned by each such nominee, (4) such other information as would be required to be included pursuant to the Securities Exchange Act in a proxy statement soliciting proxies for the election of the proposed nominee, including, without limitation, such person's written consent to being named in the proxy statement as a nominee and to serving as a director, if elected, and (5) as to the shareholder giving such notice (a) his or her name and address as they appear on our books and (b) the class and number of Banner shares which are beneficially owned by such shareholder.

BY ORDER OF THE BOARD OF DIRECTORS

ALBERT H. MARSHALL
SECRETARY

Walla Walla, Washington
March 29, 2010

<u>Appendix A</u>

BANNER CORPORATION
AUDIT COMMITTEE CHARTER

I. Purpose

The primary function of the Audit Committee ("Audit Committee" or "Committee") is to assist the Board of Directors ("Board") in fulfilling its oversight responsibilities by reviewing the quality and integrity of financial reports and other financial information provided by Banner Corporation ("Corporation"); the Corporation's systems of internal controls regarding finance, accounting, legal compliance and ethics that management and the Board have established; and the Corporation's auditing, accounting and financial reporting processes generally. Consistent with the function, the Audit Committee should encourage continuous improvement of, and should foster adherence to, the Corporation's policies, procedures and practices at all levels. The Audit Committee's primary duties and responsibilities are to:

1. Serve as an independent and objective party to monitor the Corporation's financial reporting process and internal control system.

2. Review and appraise the audit efforts of the Corporation's independent accountants and internal auditing department.

3. Provide an open avenue of communication among the independent accountants, financial and senior management, the internal auditing department and the Board of Directors.

The Audit Committee will primarily fulfill these responsibilities by carrying out the activities enumerated in Section IV of this charter.

II. Composition

The Audit Committee shall be comprised of three or more directors as determined by the Board, each of whom shall be independent directors, and free from any relationships that, in the opinion of the Board, would interfere with the exercise of his or her independent judgment, as a member of the Committee. All members of the Committee shall have a working familiarity with basic finance and accounting practices. Member independence, experience and financial expertise will be in conformance with rules established by the SEC, NASD, FDIC, and the AICPA. The members of the Committee shall be elected by the Board at the annual organizational meeting of the Board and shall serve until their successors shall be duly elected and qualified. Unless a Chair is selected by the full Board, the members of the Committee may designate a Chair by majority vote of the full Committee membership.

III. Meetings

The Committee shall meet at least four times annually, or more frequently as circumstances dictate. As part of its job to foster open communication, the Committee should meet at least annually with management, the Internal Audit Officer and the independent accountants in separate executive session to discuss any matters that the Committee or each of these groups believes should be discussed privately. In addition, the Committee or at least its Chair should meet with the independent accountants and management quarterly to review the Corporation's financial statements consistent with IV.4 below.

IV. Responsibilities and Duties

To fulfill its responsibilities and duties, the Audit Committee shall:

<u>Documents/Reports Review</u>

1. Review and update this Charter periodically, at least annually, as conditions dictate.
2. Review the Corporation's annual financial statements and any submitted to the public, including any certification, report, opinion, or review rendered by the independent accountants.

3. Review the regular internal reports prepared by the internal auditing department and management's response.
4. Review with financial management and the independent accountants the financial statements, including disclosures made in Management's Discussion and Analysis of Financial Condition and Results of Operations, in the Corporation's reports on Forms 10-Q and 10-K and annual reports to shareholders prior to its filing or prior to the release of earnings. The Committee shall recommend to the Board whether or not the audited financial statements should be included in the Corporation's 10-K.
5. Review disclosures made by the Corporation's chief executive officer and chief financial officer regarding compliance with their certification obligations as required under the Sarbanes-Oxley Act of 2002 and the rules promulgated thereunder, including the Corporation's disclosure controls and procedures and internal controls for financial reporting and evaluations thereof.

Independent Accountants

6. Be directly responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged for the purpose of preparing or issuing an audit report of performing other audit, review or attest services for the Corporation, and each such registered accounting firm shall report directly to the Audit Committee.
7. Approve all audit engagement fees and terms and all non-audit engagements with the independent accountants. The Committee may delegate authority to pre-approve non-audit services to one or more members of the Committee. If this authority is delegated, all approved non-audit services will be presented to the Committee at its next scheduled meeting.
8. Ensure receipt from the independent accountants of a formal written statement delineating all relationships between the accountants and the Corporation, consistent with Independence Standards Board Standard 1. On an annual basis, the Committee should review and discuss with the accountants any such relationships to determine the accountants' independence and objectivity. The Committee should take, or recommend to the Board that it take appropriate action to oversee the independence of the accountants.
9. Ensure the independent accountants' ultimate accountability to the Board and the Committee, as representatives of the shareholders, receiving direct reports from the accountants.
10. Periodically consult with the independent accountants out of the presence of management about internal controls and the completeness and accuracy of the organization's financial statements.
11. Discuss with the independent auditors all matters required by Statement of Auditing Standards No. 61 relating to the conduct of the audit.
12. Ensure that the lead audit partner of the independent accountants and the audit partner responsible for reviewing the audit are rotated at least every five years, and that all other audit partners are rotated at least every seven years.

Financial Reporting Processes

13. In consultation with the independent accountants and the internal auditors, review the integrity of the organization's financial reporting processes, both internal and external.
14. Consider the independent accountants' judgments about the quality and appropriateness of the Corporation's accounting principles as applied in its financial reporting.
15. Consider and approve, if appropriate, major changes to the Corporation's auditing and accounting principles and practices as suggested by the independent accountant's, management, or the internal auditing department.

Process Improvements

16. Establish regular and separate systems of reporting to the Audit Committee by each of management, the independent accountants and the internal auditors regarding any significant judgments made in management's preparation of the financial statements and the view of each as to appropriateness of such judgments.
17. Establish procedures that allow employees of the Corporation or any of its subsidiaries to submit confidential and anonymous concerns regarding questionable accounting or auditing matters.

18. Establish procedures for the receipt, retention and treatment of complaints received by the Corporation regarding accounting, internal accounting controls or auditing matters.
19. Following completion of the annual audit, review separately, as needed, with each of management, the independent accountants and the internal auditing department any significant difficulties encountered during the course of the audit, including any restrictions on the scope of work or access to required information.
20. Review (and in the case of the independent accountants, settle) any disagreement among management and the independent accountants or the internal auditing department in connection with the preparation of the financial statements.
21. Review with the independent accountants, the internal auditing department and management the adequacy and effectiveness of the accounting and financial controls of the Corporation and elicit any recommendations for the improvement of such internal control procedures or particular areas where new or more detailed controls or procedures are desirable.
22. Review with the independent accountants, the internal auditing department and management the extent to which changes or improvements in financial or accounting practices, as approved by the Audit Committee, have been implemented.

Compliance

23. Review the Corporation's financial statements, reports and other information disseminated to the public. Assess compliance with legal requirements and engage outside consultants or counsel, when necessary.
24. Review activities, organizational structure, and qualifications of the internal audit department.
25. Review, with the organization's counsel, legal compliance matters including corporate securities trading policies.
26. Review, with the organization's counsel, any legal matter that could have a significant impact on the organization's public financial statements.
27. On an ongoing basis, review all related party transactions for potential conflict of interest situations. Approve related party transactions when warranted.
28. Perform any other activities consistent with this Charter, the Corporation's By-laws and governing law, as the Committee or Board deems necessary or appropriate.

Reporting

29. Prepare an audit committee report for inclusion in the Corporation's annual proxy statement, consulting with the Corporation's legal counsel, if necessary.

Miscellaneous

30. Determine the appropriate funding for payment of (i) compensation to the independent accountants, (ii) compensation to any advisers employed by the Committee and (iii) ordinary administrative expenses of the Audit Committee that are necessary or appropriate in carrying out its duties.
31. Discuss with management any second opinions sought from an accounting firm other than the Corporation's independent accountants, including the substance and reasons for seeking any such opinion.
32. Review the internal audit function of the Corporation, including the independence, competence, staffing, adequacy and authority of the internal auditing department, the reporting relationships among the internal auditing department, financial management and the Audit Committee, the internal audit reporting obligations, the proposed internal audit plans for the coming year, and the coordination of such plans with the independent accountants.
33. Review findings from completed internal audits and progress reports on the proposed internal audit plan, together with explanations for any deviations from the original plan.
34. Review the appointment, reassignment or dismissal of the director of the internal audit.
35. Review at least annually the material exceptions noted in the reports to the Audit Committee by the internal auditors and the independent accountants, and the progress made in responding to the exceptions.

36. Inquire of management and the independent auditors about significant risks or exposures, review the Corporation's policies for risk assessment and risk management, and assess the steps management has taken to control such risk to the Corporation.
37. Review the Corporation's policies and procedures for regular review of the expense accounts of the Corporation's executive management.
38. Review with management and legal counsel the Corporation's system for assessing whether the Corporation's financial statements, reports and other financial information required to be disseminated to the public and filed with governmental organizations satisfy the requirements of the SEC and NASD.
39. Discuss with management and the independent accountants any correspondence with regulators or governmental agencies and any employee complaints or published reports, which raise material issues regarding the Corporation's financial statements or accounting policies.
40. Discuss with the Corporation's legal counsel any regulatory matters that may have a material impact on the Corporation's financial statements or its compliance and reporting policies.
41. At its discretion, request that management, the independent accountants or the internal auditors undertake special projects or investigations which the Audit Committee deems necessary to fulfill its responsibilities.

V. Limitations of Audit Committee's Roles

While the Committee has the responsibilities and powers set forth in this Audit Committee Charter, it is not the duty of the Committee to prepare financial statements, plan or conduct audits or to determine that the Corporation's financial statements and disclosures are complete and accurate and are in accordance with generally accepted accounting principles and applicable rules and regulations. These are the responsibilities of management and the independent accountants.

Appendix B

COMPENSATION COMMITTEE CHARTER FOR THE COMPENSATION COMMITTEE OF BANNER CORPORATION AND THE COMPENSATION COMMITTEE OF BANNER BANK

I. Purpose

The primary function of the Compensation Committee of Banner Corporation ("Corporation Compensation Committee") and the Compensation Committee of Banner Bank ("Bank Compensation Committee," and together with the Corporation Compensation Committee, the "Committees") is to work together to coordinate the compensation paid to the directors, officers and employees of both Banner Corporation ("Corporation") and Banner Bank ("Bank"). In achieving this goal, the Committees shall operate separately but shall coordinate their efforts in order to achieve a coordinated policy. The Corporation Compensation Committee shall set the policies and compensation levels for directors, officers and employees of the Corporation, while the Bank Compensation Committee shall set the policies and compensation levels for directors, officers and employees of the Bank. The Committees shall coordinate their efforts to ensure that compensation policies are administered fairly and consistently.

II. Composition

The Committees shall each be comprised of three or more directors as determined by the Board of Directors of the Corporation or the Bank, as appropriate. Each member shall be an independent director of the respective entity, who is free from any relationships that, in the opinion of the relevant Board, would interfere with the exercise of his or her independent judgment as a member of the Committee. Member independence will be in conformity with rules established by the Securities and Exchange Commission and the National Association of Securities Dealers. The members of the Committees shall be elected by the Board of Directors of the Corporation or the Bank, as appropriate, at the annual organizational meeting of the relevant Board and shall serve until their successors are duly elected and qualified. Unless a Chair is selected by the relevant Board, the members of each Committee may designate a Chair by majority vote of the full Committee membership.

III. Meetings

The Committees shall each meet at least annually, or more frequently as circumstances dictate. As part of the job to set executive compensation levels, each Committee should meet at least annually with the appropriate Chief Executive Officer in order to discuss the Chief Executive Officer's evaluation of the senior officers and recommendations for compensation levels. In addition to the separate meetings of the Corporation Compensation Committee and the Bank Compensation Committee, the Committees shall meet together at least annually, or more frequently as circumstances dictate, to ensure that compensation policies for the Corporation and the Bank are administered consistently.

IV. Responsibilities and Duties

To fulfill its responsibilities and duties, each Committee shall (with the understanding that the Corporation Compensation Committee shall take all action with respect to the Corporation and the Bank Compensation Committee shall take all action with respect to the Bank):

Compensation Policies

1. Develop guidelines and policies for director compensation, coordinating actions between the Corporation Compensation Committee and the Bank Compensation Committee.
2. Develop guidelines and policies for executive compensation, coordinating actions between the Corporation Compensation Committee and the Bank Compensation Committee.
3. Make regular reports to the appropriate Board of Directors.

4. At least annually, review the compensation policies to ensure that they are effective in meeting goals for compensation and make new recommendations, as needed.
5. Review and approve the list of a peer group of companies to which the Corporation and the Bank shall compare themselves for compensation purposes.
6. If necessary, engage independent consultants and outside counsel to provide comparative information regarding compensation and benefits, and advice on issues involving laws and regulations governing compensation.
7. Review and approve other large compensation expense categories such as employee benefit plans.
8. At least annually, review and update (if necessary) this Charter, as conditions dictate.

Compensation

9. Review director compensation levels and recommend, as necessary, changes in the compensation levels, with equity ownership in the Corporation encouraged.
10. Receive and review an annual report from the Chief Executive Officer which includes the performance assessment for all senior officers and recommendations for compensation levels, and which also includes salary recommendations for all employees.
11. Set compensation for all senior officers, other than the Chief Executive Officer, based on the recommendations of the Chief Executive Officer.
12. On an annual basis, review and approve goals and objectives relevant to compensation of the Chief Executive Officer, evaluate the Chief Executive Officer’s performance in light of those goals and objectives, and determine the Chief Executive Officer’s compensation based on this evaluation.
13. For the senior officers, annually review and approve (i) employment agreements, severance agreements and change in control agreements or provisions, in each case, when and if appropriate, and (ii) any special or supplemental benefits.
14. Adopt, administer, approve and ratify awards under incentive compensation and stock plans, including amendments to the awards made under any such plans, and review and monitor awards under such plans.

Succession Planning

15. In conjunction with the Corporate Governance/Nominating Committee, recommend to the appropriate Board of Directors a policy on succession planning for the Chief Executive Officer.

Reporting

16. Prepare a report on executive compensation for inclusion in the Corporation’s annual proxy statement, consulting with the Corporation’s legal counsel, if necessary.

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The following table shows the maturity or period to repricing of our consolidated portfolio of securities held to maturity (dollars in thousands):

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

	Securities—Held to Maturity at December 31, 2009											
	One Year or Less		Over One to Five Years		Over Five to Ten Years		Over Ten to Twenty Years		Over 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	Weighte d Average Yield	Carrying Value	Weighted Average Yield (1)
Municipal bonds:												
Taxable	$ 208	5.48 %	$ 1,421	5.75 %	$ --	-- %	$ --	-- %	$ 1,054	5.73 %	$ 2,683	5.72 %
Tax exempt	3,848	6.25	11,285	6.05	11,334	6.01	35,352	7.14	2,082	8.55	63,901	6.74
	4,056	6.21	12,706	6.02	11,334	6.01	35,352	7.14	3,136	7.60	66,584	6.70
Corporate bonds:												
Fixed-rate	--	--	750	2.67	500	3.00	4,000	9.88	3,000	11.00	8,250	9.21
Total securities held to maturity—carrying value	$ 4,056	6.21	$ 13,456	5.83	$ 11,834	5.88	$ 39,352	7.42	$ 6,136	9.26	$ 74,834	6.98
Total securities held to maturity—estimated market value	$ 4,091		$ 14,041		$ 12,419		$ 40,076		$ 5,862		$ 76,489	

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

Loans/Lending: Our net loan portfolio decreased $191 million, or 5%, during the year ended December 31, 2009, compared to an increase of $122 million, or 3% during the year ended December 31, 2008 and an increase of $833 million, or 28%, ($597 million was added through acquisitions), in the year ended December 31, 2007. 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 current recession, loan demand has been weak for most of the past two years as consumers and businesses have been cautious in their use of credit. In addition, in response to weak housing markets we significantly curtailed the origination of new residential construction and land development loans. As a result, our loan growth slowed significantly in 2008 and, as noted above, loan portfolio balances declined in 2009. Looking forward, new loan originations and portfolio balances will be significantly affected by the course of the recovery from the current economic recession. For the years ended December 31, 2009, 2008 and 2007, we originated, net of repayments, $582 million, $562 million and $607 million of loans, respectively.

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, 2009, 2008 and 2007 totaled $563 million, $366 million and $393 million, respectively. We sell loans on both a servicing-retained and a servicing-released basis. See *"Loan Servicing Portfolio"* below. The decision to hold or sell loans is based on asset/liability management goals and policies and market conditions. Loans held for sale decreased to $4 million at December 31, 2009, compared to $7 million at December 31, 2008.

At various times, we also purchase whole loans and participation interests in loans. During the years ended December 31, 2009, 2008 and 2007, we purchased $1 million, $13 million and $23 million, respectively, of loans and loan participation interests.

One- to Four-Family Residential Real Estate Lending: At December 31, 2009, $703 million, or 18.6% 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 communities where we have established offices in Washington, Oregon and Idaho. Despite slowing economic activity, continued in-migration and the unprecedented low mortgage interest rate environment in 2009 supported demand for residential loans. In addition, in the spring of the year we instituted an aggressive advertising and mortgage financial campaign called the Great Northwest Home Rush designed to promote the sale of newly constructed homes that we had previously financed. In working with the home builders and their realtors, the campaign included a significant commitment to advertising and marketing as well as attractive loan rates and terms, and resulted in a substantial amount of home sales and new loan originations. The combined effects of these factors allowed us to originate a total of $732 million of one- to four-family residential loans for the year ended December 31, 2009. The loan sales noted above, coupled with principal repayments, offset much of the increase from current year origination activity; however, in 2009 we had a $104 million increase in the balance of loans on one- to four-family residences compared to the prior year.

Construction and Land Lending: A significant proportion of our loan portfolio consists of residential construction loans to professional home builders, as well as land loans and loans for the construction of commercial and multifamily real estate. As home sales slowed in the second half of 2007 and the housing market weakened even further in 2008 and into 2009, we significantly reduced our origination of new construction and land development loans. Improving home sales in the second half of 2009 and restructuring opportunities were sufficient to reduce our portfolio of one- to-four-family construction loans by $182 million compared to the prior year-end and by $415 million compared to their peak quarter-end balance at June 30, 2007. Likewise, land development loans decreased $135 million to $328 million at December 31, 2009; however, a meaningful portion of the decline in land development loans resulted from transfers to real estate owned and charge-offs. We continue to believe that land and land development loans represent the most significant source of risk in our loan portfolio. At December 31, 2009, construction and land loans totaled $705 million (including $284 million of residential land or land development loans, $138 million of commercial and multifamily real estate construction loans and $44 million of commercial land or land development loans), or 18.6% of total loans, compared to $1.022 billion, or 25.7%, at December 31, 2008. Construction and land development loan originations totaled $190 million for the year ended December 31, 2009, a 45% decrease compared to $345 million for the year ended December 31, 2008. The geographic distribution of our construction and land development loans is approximately 32% in the greater Puget Sound market, 38% in the greater Portland, Oregon market, and 7% in the greater Boise, Idaho market, with the remaining 23% distributed in various eastern Washington, eastern Oregon, and northern Idaho markets we serve. Increased delinquencies and defaults in residential construction and land development loans had a material adverse effect on our results of operations for 2008 and 2009 and at December 31, 2009, 76% of our non-performing assets resulted from construction and land development lending. See "Asset Quality."

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 reasonable demand for both multifamily and commercial real estate loans in 2009, although multifamily loan growth was relatively modest. At December 31, 2009, our loan portfolio included $153 million in multifamily and $1.083 billion in commercial real estate loans. Multifamily and commercial real estate loans comprised 32.5% of total loans at December 31, 2009, compared to 29.4% a year earlier, while combined growth for these loan types was $71 million for the year.

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 the deposit base. Unfortunately, as economic activity remained slow in the current year, demand for commercial business loans was restrained, resulting in a decrease of $42 million, or 6% for the year. At December 31, 2009, commercial business loans totaled $638 million, or 16.8% of total loans, compared to $680 million, or 17.2%, at December 31, 2008. 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.

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 2009, weather conditions,

production levels and market prices were good for most of our agricultural borrowers except for dairy products where excess supply and weak demand put strain on certain dairy operations. Generally, agricultural loan balances have a seasonal pattern and for the year the peak quarter-end balance was $226 million, or 5.8% of the loan portfolio on September 30, 2009. At December 31, 2009, agricultural loans totaled $205 million, or 5.4% of the loan portfolio, compared to $204 million, or 5.2%, at December 31, 2008.

Consumer and Other Lending: We originate a variety of consumer loans, including home equity lines of credit, automobile loans and loans secured by deposit accounts and, although the balances are not currently significant, in 2006 we reintroduced credit card lending to our consumer loan products. 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 renewed emphasis in recent years. This increased effort along with the impact of the 2007 acquisitions has allowed non-real estate-related consumer loans to increase meaningfully despite continuing high levels of prepayments. At December 31, 2009, we had $111 million, or 2.9% of our loans receivable, in non-real estate-secured consumer loans, a slight decrease compared to December 31, 2008. In addition, consumer loans secured by one- to four-family real estate, including home equity lines of credit, increased by $16 million to $191 million, or 5.1% of total loans, at December 31, 2009, compared to $176 million, or 4.5%, at December 31, 2008. While consumer loans remain a relatively small portion of the loan portfolio, aggregate growth was 4% in 2009 and we anticipate increased consumer loan activity in future periods as our branch network and retail customer base continue to grow.

Loan Servicing Portfolio: At December 31, 2009, we were servicing $679 million of loans for others, compared to $446 million at December 31, 2008. The loan servicing portfolio at December 31, 2009 included $388 million of Freddie Mac mortgage loans, $109 million of Fannie Mae mortgage loans and $182 million of loans serviced for a variety of private investors. The portfolio included loans secured by property located primarily in the states of Washington and Oregon. For the year ended December 31, 2009, $93,000 of loan servicing fees, net of $2.1 million of servicing rights amortization and a valuation adjustment of $800,000, was recognized in operations. For the prior year, net loan servicing fees were $1.7 million. The decreased servicing income for the current year primarily reflects an elevated level of loan prepayments resulting in accelerated amortization of mortgage servicing rights as well as an $800,000 impairment charge to adjust the carrying value our 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, 2009, 2008 and 2007, we capitalized $5.0 million, $1.6 million and $781,000, respectively, of MSRs relating to loans sold with servicing retained. Amortization of MSRs for the years ended December 31, 2009, 2008 and 2007, was $2.1 million, $902,000 and $658,000, respectively. Management periodically evaluates the estimates and assumptions used to determine the carrying values of MSRs and the amortization of MSRs. These carrying values are adjusted when the valuation indicates the carrying value is impaired. For the year ended December 31, 2009, we recorded a valuation adjustment of $800,000. MSRs generally are adversely affected by current and anticipated prepayments resulting from decreasing interest rates; however, in the current year MSR values were also adversely impacted by the effect of distressed sellers on market prices. At December 31, 2009 and 2008, MSRs were carried at a value, net of amortization, of $5.7 and $3.6 million, respectively.

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									
	2009		2008		2007		2006		2005	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Loans :										
Commercial real estate	$ 1,082,959	28.5%	$ 1,013,709	25.6%	$ 882,523	23.2%	$ 596,488	20.1%	$ 555,889	22.8%
Multifamily real estate	153,497	4.1	151,274	3.8	165,886	4.4	147,311	5.0	144,512	5.9
Commercial construction	80,236	2.1	104,495	2.6	74,123	1.9	98,224	3.3	51,931	2.1
Multifamily construction	57,422	1.5	33,661	0.8	35,318	0.9	39,908	1.3	62,624	2.6
One- to four-family construction	239,135	6.3	420,673	10.6	613,779	16.1	570,501	19.2	348,661	14.3
Land and land development	328,074	8.7	463,257	11.7	478,957	12.6	391,275	13.2	221,756	9.2
Commercial business	637,823	16.8	679,867	17.2	696,350	18.3	467,745	15.8	442,232	18.1
Agricultural business, including secured by farmland	205,307	5.4	204,142	5.2	186,305	4.9	163,518	5.5	147,562	6.0
One- to four-family real estate	703,277	18.6	599,169	15.1	445,222	11.7	361,625	12.2	365,903	15.0
Consumer	110,937	2.9	115,515	2.9	112,188	2.9	62,216	2.1	49,253	2.0
Consumer secured by one- to four-family real estate	191,454	5.1	175,646	4.5	118,966	3.1	67,179	2.3	49,408	2.0
Total consumer	302,391	8.0	291,161	7.4	231,154	6.0	129,395	4.4	98,661	4.0
Total loans	3,790,121	100.0%	3,961,408	100.0%	3,809,617	100.0%	2,965,990	100.0%	2,439,731	100.0%
Less allowance for loan losses	(95,269)		(75,197)		(45,827)		(35,535)		(30,898)	
Total net loans at end of period:	$ 3,694,852		$ 3,886,211		$ 3,763,790		$ 2,930,455		$ 2,408,833	

The following table sets forth the Company's loans by geographic concentration at December 31, 2009 (dollars in thousands):

	Washington	Oregon	Idaho	Other	Total
Loans:					
Commercial real estate owner-occupied	$ 401,392	$ 61,821	$ 46,251	$ --	$ 509,464
Commercial real estate non-owner-occupied	413,570	105,956	43,684	10,285	573,495
Multifamily real estate	127,748	13,672	8,776	3,301	153,497
Commercial construction	57,493	13,625	9,118	--	80,236
Multifamily construction	29,956	27,466	--	--	57,422
One- to four-family construction	107,067	120,395	11,673	--	239,135
Land and land development	169,669	125,067	33,338	--	328,074
Commercial business	451,531	92,289	70,803	23,200	637,823
Agricultural business, including secured by farmland	94,452	50,419	60,436	--	205,307
One-to four-family real estate	485,185	185,573	30,064	2,455	703,277
Consumer	216,315	65,564	20,011	501	302,391
Total loans outstanding	$ 2,554,378	$ 861,847	$ 334,154	$ 39,742	$ 3,790,121
Percent of total loans	67.4 %	22.7 %	8.8 %	1.1 %	100.0 %

The following table sets forth certain information at December 31, 2009 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 loans in progress (undisbursed loan proceeds), unamortized premiums and discounts, include loans held for sale and exclude the allowance for loan losses (dollars in thousands):

Table 8: Loan Maturity

	Maturing Within One Year	Maturing After 1 to 3 Years	Maturing After 3 to 5 Years	Maturing After 5 to 10 Years	Maturing After 10 Years	Total
Loans:						
Commercial real estate owner-occupied	$ 19,516	$ 31,559	$ 65,087	$ 314,674	$ 78,628	$ 509,464
Commercial real estate non-owner-occupied	40,160	41,781	169,254	275,163	47,137	573,495
Multifamily real estate	8,143	20,740	27,208	54,638	42,768	153,497
Commercial construction	77,836	484	--	--	1,916	80,236
Multifamily construction	57,422	--	--	--	--	57,422
One- to –four-family construction	202,142	31,669	1,987	770	2,567	239,135
Residential land development and acquisition	222,569	51,383	2,775	648	6,956	284,331
Commercial land development and acquisition	34,176	4,798	738	2,884	1,147	43,743
Commercial business	319,326	101,236	121,721	82,430	13,110	637,823
Agricultural business, including secured by farmland	112,967	21,217	18,639	48,571	3,913	205,307
One- to four-family real estate	11,678	48,104	28,088	21,551	593,856	703,277
Consumer	15,604	20,157	16,823	12,770	45,583	110,937
Consumer secured by one- to four-family real estate	7,088	6,972	6,703	7,158	163,533	191,454
Total consumer	22,692	27,129	23,526	19,928	209,116	302,391
Total loans	$ 1,128,627	$ 380,100	$ 459,023	$ 821,257	$ 1,001,114	$ 3,790,121

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 due after December 31, 2009 which have fixed interest rates and floating or adjustable interest rates (dollars in thousands):

Table 8(a): Loans Maturing after One Year

	Fixed Rates	Floating or Adjustable Rates	Total
Loans:			
Commercial real estate owner-occupied	$ 80,958	$ 408,990	$ 489,948
Commercial real estate non-owner-occupied	147,792	385,543	533,335
Multifamily real estate	47,335	98,019	145,354
Commercial construction	--	2,400	2,400
Multifamily construction	--	--	--
One- to –four family construction	20,240	16,753	36,993
Residential land development and acquisition	18,040	43,722	61,762
Commercial land development and acquisition	2,202	7,365	9,567
Commercial business	145,524	172,973	318,497
Agricultural business, including secured by farmland	28,203	64,137	92,340
One- to- four-family real estate	543,508	148,091	691,599
Consumer	82,043	13,290	95,333
Consumer secured by one- to- four-family real estate	15,683	168,683	184,366
Total consumer	97,726	181,973	279,699
Total	$ 1,131,528	$ 1,529,966	$ 2,661,494

Deposit Accounts: Our retail deposit franchise had a very strong year with total retail deposits growing by $363 million for the year ended December 31, 2009, which more than offset planned reductions of $173 million in public funds deposits and $103 million in brokered deposits. Deposits generally are attracted from within our primary market areas through the offering of a broad selection of deposit instruments, including demand checking accounts, NOW 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. At December 31, 2009, we had $3.866 billion of deposits, with 50%, or $1.924 billion, in transaction and savings accounts and 50%, or $1.942 billion, in time deposits, of which $1.594 billion had remaining maturities of one year or less. Total deposits increased by $87 million, or 2%, for the year ended December 31, 2009. This includes non-interest-bearing transaction accounts, which increased by 14%, or $73 million, over the same time period. As illustrated in the following table, we have added significantly to total transaction accounts (demand, NOW, savings and money market accounts) since 2007. In the year ended December 31, 2009, total transaction accounts increased by $277 million, or 17%, as customer relationships increased and customers' average account balances increased as they repositioned balances to obtain additional insurance coverage. By contrast, certificates of deposit decreased $190 million, or 9%, during 2009 as the reduction in public funds and brokered deposits exceeded retail certificate of deposit growth. Further, although not included in deposit balances, in 2009 we had a decrease of $21 million, or 14%, in retail repurchase agreements, which are customer funds that are primarily associated with sweep account arrangements tied to transaction accounts. While use of these cash management services has the effect of reducing transaction account balances, it contributes to increased deposit fee revenues. Deposit balances at December 31, 2009 included $166 million of public funds owned by various counties, municipalities and other public entities predominantly located in Washington, Oregon and Idaho, compared to $339 million at December 31, 2008. Brokered deposits totaled $165 million, or 4.3% of total deposits, at December 31, 2009, compared to $268 million, or 7.1% of total deposits, at December 31, 2008. Growing deposits in general and transaction accounts in particular is a core element of our business plan and is a primary focus of our recent and ongoing branch expansion, relocation and renovation activities.

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 9: Deposits

	At December 31							
	2009			2008			2007	
	Amount	Percent of Total	Increase (Decrease)	Amount	Percent of Total	Increase (Decrease)	Amount	Percent of Total
Demand and NOW checking	$ 942,736	24.4 %	$ 54,679	$ 888,057	23.5 %	$ (26,830)	$ 914,887	25.3 %
Regular savings	538,765	13.9	63,880	474,885	12.6	(134,188)	609,073	16.8
Money market	442,124	11.4	158,083	284,041	7.5	35,638	248,403	6.9
Certificates which mature:								
Within 1 year	1,593,575	41.3	50,650	1,542,925	40.8	(67,322)	1,610,247	44.5
After 1 year, but within 2 years	248,065	6.4	(173,645)	421,710	11.2	268,006	153,704	4.2
After 2 years, but within 5 years	96,528	2.5	(66,431)	162,959	4.3	86,469	76,490	2.1
After 5 years	3,757	0.1	(516)	4,273	0.1	(3,516)	7,789	0.2
Total	$ 3,865,550	100.0 %	$ 86,700	$ 3,778,850	100.0 %	$ 158,257	$ 3,620,593	100.0 %
Included in Total Deposits:								
Public transaction accounts	$ 78,202	2.0 %	$ (39,200)	$ 117,402	3.1 %	$ 8,256	$ 109,146	3.0 %
Public interest-bearing certificates	88,186	2.3	(133,729)	221,915	5.9	(3,096)	225,011	6.2
Total public deposits	$ 166,388	4.3	$ (172,929)	$ 339,317	9.0	$ 5,160	$ 334,157	9.2
Total brokered deposits	$ 165,016	4.3 %	$ (103,442)	$ 268,458	7.1 %	$ 211,009	$ 57,449	1.6 %

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, 2009 (in thousands):

Table 10: Maturity Period—$100,000 or greater CDs

	Certificates of Deposit $100,000 or Greater
Due in three months or less	$ 203,204
Due after three months through six months	132,976
Due after six months through twelve months	539,543
Due after twelve months	158,917
Total	$ 1,034,640

The following table provides additional detail on geographic concentrations of our deposits at December 31, 2009 (in thousands):

Table 11: Geographic Concentration of Deposits	Washington	Oregon	Idaho	Total
	$ 2,979,985	$ 611,180	$ 274,385	$ 3,865,550

Borrowings: The FHLB-Seattle serves as our primary borrowing source. To access funds, we are required to own 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, 2009, we had $189 million of borrowings from the FHLB-Seattle at a weighted average rate of 1.18%, an increase of $79 million compared to a year earlier. Also at December 31, 2009, we had an investment of $37 million in FHLB-Seattle capital stock. At that date, Banner Bank was authorized by the FHLB-Seattle to borrow up to $1.020 billion under a blanket floating lien security agreement, while Islanders Bank was approved to borrow up to $43 million under a similar agreement.

Table 12: FHLB Advances Outstanding at December 31, 2009
(dollars in thousands)

	Adjustable-rate advances		Fixed-rate advances		Total advances	
	Rate*	Amount	Rate*	Amount	Rate*	Amount
Due in one year or less	0.50 %	$ 132,500	3.25 %	$ 13,000	3.28 %	$ 145,500
Due after one year through two years			2.73	32,800	2.73	32,800
Due after three years through four years			2.38	10,000	2.38	10,000
Due after five years			5.94	228	5.94	228
Total FHLB advances, at par			2.80 %	$ 56,028	1.18 %	188,528
Fair value adjustment						1,251
Total FHLB advances, carried at fair value						$ 189,779

*Weighted average interest rate

The Federal Reserve Bank of San Francisco (FRBSF) has also served as an important source of borrowings. The FRBSF provides credit based upon acceptable loan collateral, which includes certain loan types not eligible for pledging to the FHLB-Seattle. At December 31, 2009, based upon our available unencumbered collateral, Banner Bank was eligible to borrow $373 million from the FRBSF; however, at that date we had no funds borrowed under this arrangement.

In March 2009, we completed an offering of $50 million of senior bank notes under the FDIC Temporary Liquidity Guarantee Program (TLGP) at a fixed rate of 2.625%. The notes mature on March 31, 2012 and prepayment is not an option. At December 31, 2009, the balance of the senior bank notes remained $50 million. No notes were outstanding under the TLGP at December 31, 2008.

We also issue retail repurchase agreements to customers 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, 2009, retail repurchase agreements totaling $124 million, with a weighted average rate of 0.49%, were secured by a pledge of certain mortgage-backed securities and agency securities with a market value of $147 million. Retail repurchase agreement balances, which are primarily associated with sweep account arrangements, decreased by $21 million during 2009, partially as a result of decreased use of our cash management services by commercial deposit customers, but largely as certain customers transferred balances into fully insured transaction accounts under the FDIC Temporary Liquidity Guarantee Program (TLGP). We had no outstanding borrowings under wholesale repurchase agreements or our commercial bank credit lines at December 31, 2009 or 2008.

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 statement 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 in our Consolidated Statements of Financial Condition and have an estimated fair value of $48 million at December 31, 2009. At December 31, 2009, the TPS had a weighted average rate of 3.34%. See Notes 1 and 15 of the Notes to the Consolidated Financial Statements for additional information with respect to the TPS.

Asset Quality: Over the past two years as housing markets have continued to weaken in many of our primary service areas, we have experienced significantly increasing delinquencies and non-performing assets, primarily in our construction and land development loan portfolios. Beginning in the third quarter of 2008 and continuing into the early months of 2009, home and lot sales activity was exceptionally slow, causing stress on builders' and developers' cash flows and their ability to service debt, which is reflected in our increased non-performing asset totals. Further, property values generally declined during this period, reducing the value of the collateral securing loans. In addition, other non-housing-related segments of the loan portfolio are showing some signs of stress and increasing levels of non-performing loans as the effects of the recessionary economy are becoming more evident. As a result, for the years ended December 31, 2009 and 2008, our provision for loan losses was significantly higher than historical levels and our normal expectations. This higher level of delinquencies and non-accruals also had a material adverse effect on operating income as a result of foregone interest revenues and increased loan collection costs. Although our future results will depend on the course of recovery from the current economic recession, home sales improved in the spring and summer months of 2009 and we are actively engaged with our borrowers in resolving problem loans. While property values have continued to decline in most markets, 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.

Non-performing assets increased to $296 million, or 6.27% of total assets, at December 31, 2009, from $209 million, or 4.56% of total assets, at December 31, 2008. Slow sales and excess inventory in most housing markets have been the primary cause of the increase in delinquencies and foreclosures of construction and land development loans, which, including related real estate owned, represented approximately 76% of our non-performing assets at December 31, 2009. As a result of this softness in the housing market, property values, particularly values for residential land and building lots, declined throughout the year ended December 31, 2009. Reflecting these value declines, we further increased our allowance for loan losses even though total loans outstanding declined. While less significant, other non-housing-related segments of the loan portfolio also experienced increased non-performing loans as a result of deteriorating economic conditions and we increased the allocated allowance for those portions of our portfolio as well. At December 31, 2009, our allowance for loan losses was $95.3 million, or 2.51% of total

loans and 45% of non-performing loans, compared to $75.2 million, or 1.90% of total loans and 40% of non-performing loans at December 31, 2008. We continue to believe our level of non-performing loans and assets, while increased, is manageable, and we believe that we have sufficient capital and human resources to manage the collection of our one- to four-family residential construction and related land loan portfolios and other non-performing assets in an orderly fashion. However, our operating results will continue to be adversely impacted until we are able to significantly reduce the level of our non-performing assets.

While non-performing assets are geographically disbursed, they are concentrated largely in land and land development loans. The primary components of the $296 million in non-performing assets are $213 million in nonaccrual loans, including $159 million of construction and land development loans, and $78 million in real estate owned (REO) and other repossessed assets. The geographic distribution of non-performing construction, land and land development loans and related real estate owned included approximately $92 million, or 41%, in the Puget Sound region, $76 million, or 34%, in the greater Portland market area, $25 million, or 11%, in the greater Boise market area, $17 million, or 8%, in Central Oregon, and $13 million, or 6%, in other areas of Washington.

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 are impaired as the Bank will not collect all amounts due, both principal and interest, in accordance with the terms of the original loan agreement. 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 non-accrual.

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

Table 13: Non-Performing Assets

	At December 31				
	2009	2008	2007	2006	2005
Nonaccrual loans: (1)					
Secured by real estate:					
Commercial	$ 7,300	$ 12,879	$ 1,357	$ 4,215	$ 1,363
Multifamily	383	--	1,222	792	--
Construction/land	159,264	154,823	33,432	2,056	479
One- to four-family	14,614	8,649	3,371	1,198	1,137
Commercial business	21,640	8,617	2,250	4,498	2,543
Agricultural business	6,277	1,880	436	703	4,598
Consumer	3,923	130	--	1	229
	213,401	186,978	42,068	13,463	10,349
Loans more than 90 days delinquent, still on accrual:					
Secured by real estate:					
Commercial	--	--	--	--	--
Multifamily	--	--	--	--	--
Construction/land	--	--	--	--	--
One- to four-family	358	124	221	593	104
Commercial business	--	--	--	--	--
Agricultural business	--	--	--	--	--
Consumer	91	243	94	--	--
	449	367	315	593	104
Total non-performing loans	213,850	187,345	42,383	14,056	10,453
Securities on non-accrual	4,232	--	--	--	--
Real estate owned/repossessed assets held for sale (2)	77,802	21,886	1,885	918	506
Total non-performing assets	$ 295,884	$ 209,231	$ 44,268	$ 14,974	$ 10,959
Restructured loans (3)	$ 43,683	$ 23,635	$ 2,750	$ --	$ --
Total non-performing loans to net loans before allowance for loan losses	5.64%	4.73%	1.11%	0.47%	0.43%
Total non-performing loans to total assets	4.53%	4.09%	0.94%	0.40%	0.34%
Total non-performing assets to total assets	6.27%	4.56%	0.99%	0.43%	0.36%

(1) For the year ended December 31, 2009, $17.7 million 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 its cost (the unpaid principal balance of the related loan plus foreclosure costs) or net realizable value. 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. At December 31, 2009, we had $77.7 million of real estate owned.

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

In addition to the non-performing loans noted in Table 13, as of December 31, 2009, we had classified loans with an aggregate outstanding balance of $204 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, 2009 (in thousands):

Table 13(a): Non-performing assets	Washington	Oregon	Idaho	Other	Total
Secured by real estate:					
Commercial	$ 6,095	$ 716	$ 489	$ --	$ 7,300
Multifamily	383	--	--	--	383
Construction and land					
One- to four-family construction	21,819	24,760	6,810	--	53,389
Commercial construction	1,561	--	--	--	1,561
Residential land acquisition & development	16,775	25,920	3,987	--	46,682
Residential land improved lots	10,743	8,287	588	--	19,618
Residential land unimproved	22,414	241	321	--	22,976
Commercial land acquisition & development	--	--	--	--	--
Commercial land improved	--	10,656	--	--	10,656
Commercial land unimproved	4,382	--	--	--	4,382
Total construction and land	$ 77,694	$ 69,864	$ 11,706	$ --	$ 159,264
One- to four-family	$ 8,666	$ 5,548	$ 758	$ --	$ 14,972
Commercial business	14,825	633	1,195	4,987	21,640
Agricultural business, including secured by farmland	365	214	5,698	--	6,277
Consumer	3,029	372	183	430	4,014
Total non-performing loans	$ 111,057	$ 77,347	$ 20,029	$ 5,417	$ 213,850
Securities on non-accrual	$ 3,000	$ --	$ --	$ 1,232	$ 4,232
Real estate owned (REO) and repossessed assets	44,330	17,909	15,563	--	77,802
Total non-performing assets at end of the period	$ 158,387	$ 95,256	$ 35,592	$ 6,649	$ 295,884

Within our non-performing loans, we have a total of 15 nonaccrual lending relationships, each with aggregate loan exposures in excess of $3 million that collectively comprise $102 million, or 48% of our total non-performing loans as of December 31, 2009, and the single largest relationship is slightly more than $18 million.

Table 13(b): Non-Performing loan summary

The most significant of our non-performing loan exposures are included in the following table:

In thousands	Percent of total non-performing loans	Collateral securing the indebtedness	Geographic location
$ 18,457	8.6 %	86 residential lots Three completed homes	Greater Seattle-Puget Sound
11,758	5.5	166 residential lots Eight completed homes 100 unit multi-family site	Greater Portland, OR area
10,065	4.7	13 acres with three developed commercial lots	Central Oregon
9,926	4.7	105 residential lots	Greater Seattle-Puget Sound
6,486	3.0	14 residential lots Seven completed homes 3.7 acres land	Greater Portland, OR area
6,460	3.0	89 residential lots Five completed homes	Central Oregon
6,069	2.8	Land approved for 58 lots and two existing homes	Greater Seattle-Puget Sound
5,990	2.8	40 residential lots Three completed new home	Greater Portland, OR area
4,987	2.3	Inventory, equipment, accounts receivable	Helena, MT
4,627	2.2	Dairy cows and farm equipment	Greater Boise area
4,076	1.9	Approximately seven acres commercial land	Greater Seattle-Puget Sound
3,450	1.6	Three residential lots Two completed homes	Greater Spokane, WA
3,387	1.6	10 residential lots 15 completed homes	Boise/Southern Idaho
3,329	1.6	Four residential lots Five completed homes	Greater Portland, OR area
3,200	1.5	Promissory note secured by a 250 unit multi-family complex	Houston, TX
111,583	52.2	Various collateral; relationships under $3 million	Various (mostly in WA, OR, ID)
$ 213,850	100.0 %	Total non-performing loans	

At December 31, 2009, we had $77.8 million of real estate owned and other repossessed assets, the most significant component of which is an unfinished subdivision in the greater Seattle metropolitan area with 167 platted lots and a book value of $14.3 million. The second largest holding is a mixed use three-story office/retail commercial property in the greater Seattle area with a book value of $6.8 million. The third and fourth largest REO holdings are unfinished residential subdivisions: one with 41 lots and a book value of $4.0 million in the Greater Portland area and the other with 66 lots and a book value of $3.5 million in the Salem, Oregon area.

Table 13(c): Real estate owned summary

The table below summarizes our real estate owned by geographic location and property type:

In thousands	Percent of total REO and repossessed assets	Geographic location	REO description
$ 34,939	44.9 %	Greater Seattle-Puget Sound area	18 completed homes One home under construction Mixed-use three-story retail/commercial property 15 residential lots Two land development projects: 168 SFD lots 22 acres of land One agricultural property with a SFD
21,340	27.4	Greater Portland, Oregon area	11 completed homes Two townhomes 12 townhome lots 146 residential lots One land development project: 20 SFD lots Two undeveloped parcels of land
16,976	21.8	Greater Boise, Idaho area	Six completed four-plexes 15 completed homes 155 plus residential lots Five land development projects Four commercial lots Two acres land Three agricultural parcels
2,307	3.0	Greater Spokane, Washington area	Three completed homes One home under construction Two mini-storage sites Land for 81 entitles lots
2,240	2.9	Other Washington locations	Two completed homes One home under construction 27 residential lots Five acres of land
$ 77,802	100.0 %		

Comparison of Results of Operations for the Years Ended December 31, 2009 and 2008

Reflecting the current recession, ongoing strains in the financial and housing markets, and further deterioration of property values for the year ended December 31, 2009, we had a net loss of $35.8 million which, after providing for the preferred stock dividend of $6.2 million and related discount accretion of $1.5 million, resulted in a net loss to common shareholders of $43.5 million, or ($2.33) per diluted share. This loss compares to a net loss to common shareholders of $128.8 million, or ($7.94) per diluted share, for the year ended December 31, 2008, which included the preferred dividend and discount accretion only in the fourth quarter. The results for the year ended December 31, 2008 also included a $121.1 million non-cash, non-tax deductible impairment charge for the write-off of goodwill.

The net loss for the current year reflects a much higher level of loan loss provisioning than the prior year, as well as a significant contraction in our net interest margin as asset yields have declined sharply over the past two years in response to the Federal Reserve's monetary policy actions and as a result of increased levels of nonaccrual loans and other non-performing assets. As more fully explained below, our provision for loan losses was $109.0 million for the year ended December 31, 2009, compared to $62.5 million for the prior year. The increased provision for losses in the current periods primarily reflects an increase in 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 provision and net charge-offs in the current year were significantly influenced by declines in the appraised value of residential land and developed building lots.

Our operating results for the year ended December 31, 2009 also included an increase in other operating income, which was particularly influenced by a $11.0 million ($7.1 million after tax) net gain as a result of changes in the valuation of financial instruments carried at fair value compared to $9.2 million ($5.9 million after tax) net loss for the prior year. Excluding these fair value adjustments, other operating income increased to $32.7 million for the year compared to $30.5 million in 2008, primarily as a result of increased gain on the sale of loans from mortgage banking operations. Other operating expenses of $142.1 million for the year ended December 31, 2009 decreased from $260.0 million for the prior year, which is primarily reflective of the goodwill impairment charge of $121.1 million in last year's results. Excluding the goodwill impairment charge, other operating expenses increased $3.2 million year over year as reduced costs for compensation, occupancy, information/computer data services, and payment processing activities were more than offset by significantly increased deposit insurance charges as well as costs related to real estate owned and higher professional services and advertising expenditures.

Compared to levels a year ago, total assets increased 3% to $4.722 billion at December 31, 2009, net loans decreased 5% to $3.695 billion, and deposits increased 2% to $3.866 billion, while borrowings, including customer sweep accounts (retail repurchase agreements) and junior subordinated debentures, increased $96 million, or 30%, to $414 million. The average balance of interest-earning assets was $4.348 billion for the year ended December 31, 2009, an increase of $67 million, or 2%, compared to $4.281 billion one year earlier.

Net Interest Income. Net interest income before provision for loan losses decreased by $3.2 million, or 2%, to $144.6 million for the year ended December 31, 2009, compared to $147.8 million one year earlier, primarily as a result of the decrease in the net interest margin and despite a modest increase in average interest-earning assets. The net interest margin of 3.33% for the year ended December 31, 2009 declined 12 basis points from the prior year, largely as a result of the effect of much lower short-term interest rates on earning asset yields, particularly floating- and adjustable-rate loan yields. This decline in interest rates was further compounded by the adverse effect of an increase in the level of nonaccrual loans and other non-performing assets. Nonaccruing loans reduced the margin by 41 basis points in the year ended December 31, 2009 compared to a 21 basis point reduction for the prior year. In addition, the mix of earning assets changed to include fewer loans and more securities and interest-bearing deposits, particularly in the second half of 2009 as our on-balance-sheet liquidity increased. This change in the mix in the very low interest rate environment had a further adverse effect on earning asset yields. Funding costs were also significantly lower; however, deposit costs, particularly during the first half of 2009, were adversely impacted by competitive pressures that became severe in late 2008 as a result of the effect of the stress in financial and housing markets on many competing financial institutions. As a result, average funding costs for the year did not decline quite as rapidly or as much as asset yields decreased. Reflecting generally lower market interest rates as well as changes in asset mix and a higher level of nonaccrual loans, the yield on earning assets for the year ended December 31, 2009 decreased by 92 basis points compared to the prior year, while funding costs for the same period decreased by only 79 basis points compared to a year earlier. As a result, the net interest spread compressed to 3.23% for the year compared to 3.36% for the prior year and more than offset the 2% growth in average interest-earning assets. However, it is important to note that by comparison to the first two quarters of the year, net interest income and the net interest margin improved meaningfully in the second half of 2009 as rapidly declining interest expense on deposits contributed to significantly lower funding costs and that the trend of lower funding costs accelerated in the final quarter of 2009.

Interest Income. Interest income for the year ended December 31, 2009 was $237.4 million, compared to $273.2 million for the prior year, a decrease of $35.8 million, or 13%. The decrease in interest income occurred despite a $67 million increase in the average balance of interest earning assets, as the growth was more than offset by the 92 basis point decrease in the average yield on those assets. The yield on average interest-earning assets decreased to 5.46% for the year ended December 31, 2009, compared to 6.38% one year earlier. The decrease in the yield on earning assets reflects the significant changes in Federal Reserve monetary policy actions beginning in September 2007 and accelerating throughout 2008 designed to aggressively lower short-term interest rates and to maintain these very low interest rates throughout 2009. As a result of these policy actions, bank prime rates, which had averaged 5.08% for the year ended December 31, 2008, declined by 183 basis points to average 3.25% for the year ended December 31, 2009. Average loans receivable for the year ended December 31, 2009 decreased $34 million, or 1%, to $3.901 billion, compared to $3.935 billion for the prior year. However, interest income on loans decreased by $34.2 million, or 13%, to $223.0 million for the year from $257.2 million for the year ended December 31, 2008, reflecting the impact of the 82 basis point decrease in the average yield on loans, along with the $34 million decrease in average loan balances. The decrease in average loan yields reflects the lower average level of market interest rates in the current year, particularly short-term interest rates including the prime rate and LIBOR indices which affect the yield on large portions of our construction, land development, commercial and agricultural loans. The decrease in average loan yields also reflects the adverse effect of increased loan delinquencies as well as changes in the mix of the loan portfolio and slower turn-over in the construction and land development portfolio which resulted in less recognition of deferred loan fee income. The average yield on loans was 5.72% for the year ended December 31, 2009, compared to 6.54% one year earlier.

The combined average balance of mortgage-backed securities, investment securities, daily interest-bearing deposits and FHLB stock increased by $102 million (excluding the effect of fair value adjustments) for the year ended December 31, 2009, while the interest and dividend income from those investments decreased by $1.6 million compared to the prior year. The effect of the increased average balance was more than offset as the average yield on the securities portfolio and cash equivalents decreased to 3.20% for the year ended December 31, 2009, from 4.61% one year earlier. The 141 basis point decrease in the yield on the securities portfolio is a reflection of the current lower rate environment as well as change in the mix of those assets, particularly the increase in daily interest-bearing deposits, and elimination of the dividend on FHLB stock. In response to the ongoing turmoil in the credit and mortgage markets and the effect on the market value of certain of its mortgage assets, the FHLB of Seattle suspended its dividend indefinitely in the fourth quarter of 2008 until its earnings and capital position have adequately improved. By contrast, dividend income received from our investment in FHLB stock for the year ended December 31, 2008 was $355,000.

Interest Expense. Interest expense for the year ended December 31, 2009 was $92.8 million, compared to $125.3 million for the prior year, a decrease of $32.5 million, or 26%. The decrease in interest expense occurred as a result of a 79 basis point decrease in the average cost of all interest-bearing liabilities to 2.23% for the year ended December 31, 2009, from 3.02% one year earlier, somewhat offset by an $11 million increase in average interest-bearing liabilities. The small increase in interest-bearing balances reflects modest net deposit growth during the year generally offset by an aggregate similar decrease in total borrowings. The effect of lower average market rates for the year on the cost of these funds was partially mitigated by deposit pricing characteristics noted below.

Deposit interest expense decreased $27.1 million, or 25%, to $83.2 million for the year ended December 31, 2009 compared to $110.3 million for the prior year as a result of a 75 basis point decrease in the cost of interest-bearing deposits and despite a modest increase in the average balance of deposits. Average deposit balances increased $36 million, to $3.758 billion for the year ended December 31, 2009, from $3.722 billion for the year ended December 31, 2008, while the average rate paid on deposit balances decreased from 2.96% a year ago to 2.21% for the current 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 tend to be less severe and to lag changes in market interest rates. In addition, non-interest-bearing deposits dampen the effect of changes in market rates on our aggregate cost of deposits. This lower degree of volatility and lag effect for deposit pricing have been evident in the decrease in deposit costs as the Federal Reserve pursued policies first to aggressively lower short-term interest rates by 500 basis points from September 18, 2007 to December 31, 2008 and more recently to maintain the very low level of interest rates for the year ended December 31, 2009. Furthermore, competitive pricing pressure for interest-bearing deposits was quite intense for certain periods during the past twelve months, as many financial institutions experienced increased liquidity concerns in the deteriorating economic conditions. Nonetheless,

we did experience significantly declining deposit costs during 2009, with the trend of lower deposit costs accelerating in the second half of the year. While we do not anticipate further reductions in market interest rates, we do expect additional declines in deposit costs over the near term as account maturities will present further repricing opportunities and competitive pricing has become more rational in response to modest loan demand in the current economic environment.

Average FHLB advances (excluding the effect of fair value adjustments) decreased to $102 million for the year ended December 31, 2009, compared to $188 million one year earlier. The average rate paid on FHLB advances for the year ended December 31, 2009 decreased to 2.57%, a decrease of 31 basis points compared to the prior year, and was augmented by the $86 million decrease in average FHLB borrowings, resulting in a $2.8 million decrease in the related interest expense. The lower average rate for FHLB advances reflects an increase in the amount of lower cost overnight funding as well as the maturity of certain fixed-rate advances. Other borrowings consist of retail repurchase agreements with customers, secured by certain investment securities, the senior bank notes issued under the TLGP, as well as overnight federal funds borrowings from the Federal Reserve Bank of San Francisco and correspondent banks. The average balance for other borrowings, consisting of $125 million in customer retail repurchase agreements, $38 million of senior bank notes, and $12 million of federal funds purchased, was $175 million for the year ended December 31, 2009, an increase of $61 million over the prior year. The related interest expense for other borrowings decreased by $66,000, to $2.2 million for the year ended December 31, 2009, from $2.3 million one year earlier, as the increase in the average balance was more than offset by the lower market interest rates. The average rate paid on other borrowings was 1.26% for the year ended December 31, 2009, compared to 1.99% one year earlier. Repurchase agreements and federal funds borrowings generally have relatively short terms and therefore reprice to current market levels more quickly than deposits, which generally lag current market rates. The senior bank notes which were issued on March 31, 2009, have a fixed rate of 2.625% and fixed maturity with a 27 month remaining term to maturity at 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) and an average cost of 3.84% for the year ended December 31, 2009. Junior subordinated debentures outstanding in the prior year had the same average balance of $124 million (excluding the effect of fair value adjustments) but with a higher average rate of 5.94%. Generally, the junior subordinated debentures are adjustable-rate instruments with repricing frequencies of three months based upon the three-month LIBOR index. The lower average cost of the junior subordinated debentures in the current quarter reflects the impact of lower short-term market interest rates.

Provision and Allowance for Loan Losses. During the year ended December 31, 2009, the provision for loan losses was $109.0 million, compared to $62.5 million for the year ended December 31, 2008. As discussed in the Summary of Critical Accounting Policies section above and in Note 1 of the Selected Notes to Consolidated Financial Statements, the provision and allowance for loan losses is one of the most critical accounting estimates included in our Consolidated Financial Statements. Throughout 2009, the provision for loan losses was the most important factor contributing to our disappointing operating results. 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, trends in delinquencies and net charge-offs and current economic conditions. We believe that the allowance for loan losses as of December 31, 2009 was adequate to absorb the probable losses inherent in the loan portfolio at that date and that the estimates and assumptions used in our determination of the adequacy of the allowance are reasonable.

While the provision for loan losses was significantly greater in the year ended December 31, 2009 than in the prior year, it was meaningfully less in the second half of the year than in the first half as the pace of net charge-offs and problem loan identification moderated as the year progressed. The provision for loan losses for the year ended December 31, 2009 continued to primarily reflect material levels of delinquent and non-performing construction, land and land development loans for one- to four-family properties and additional declines in property values. It also reflects our concerns that the significant number of distressed sellers and lender foreclosures may further disrupt certain housing markets and adversely affect home prices and the demand for building lots. These concerns heightened during the second half of 2008 and remained elevated in the current year as additional evidence of price declines for certain housing and related lot and land markets became more apparent. This was particularly the case in certain areas of the Puget Sound and Portland regions where a significant portion of our construction and development loans are located. Aside from housing-related construction and development loans, non-performing loans generally reflect unique operating difficulties for the individual borrower; however, the weak pace of general economic activity has also become a significant contributing factor. We recorded net charge-offs of $89 million for the year ended December 31, 2009, compared to $33 million for the prior year, and non-performing loans increased by $27 million during the year to $214 million at December 31, 2009, compared to $187 million at December, 31, 2008. A comparison of the allowance for loan losses at December 31, 2009 and 2008 reflects an increase of $20 million, or 27%, to $95 million at December 31, 2009, from $75 million at December 31, 2008. Similarly, the allowance for loan losses as a percentage of total loans (loans receivable excluding allowance for losses) increased to 2.51% at December 31, 2009, compared to 1.90% at December 31, 2008. Likewise the allowance as a percentage of non-performing loans increased to 45% at December 31, 2009, compared to 40% a year earlier, and more of the non-performing loan balances have been reduced to expected recovery values as a result of specific impairment analysis and related charge-offs.

As of December 31, 2009, we had identified $262 million of impaired loans, including $44 million of restructured loans which are currently performing under their restructured terms. Of those impaired loans, $109 million have no allowances for credit losses as their estimated collateral value is equal to or exceeds their carrying costs, which in some cases is net of substantial write-offs. The remaining $153 million have related allowances for credit losses totaling $22 million. Impaired loans with related allowances for credit losses that have been individually evaluated for reserve needs totaled $84 million and accounted for $16 million of the allowances for impaired loans at December 31, 2009. Also, at December 31, 2009, impaired loans with related allowances for credit losses that are collectively evaluated as homogeneous pools totaled $69 million and accounted for $6 million of the total allowance related to impaired loans.

We believe that the allowance for loan losses as of December 31, 2009 was adequate to absorb the known and inherent risks of loss in the loan portfolio at that date. 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 allowance for loan losses is subject to

review by bank regulators as part of the routine examination process, which may result in the establishment of additional reserves based upon their judgment of information available to them at the time of their examination.

The following table sets forth an analysis of our allowance for loan losses for the periods indicated (dollars in thousands):

Table 14: Changes in Allowance for Loan Losses

	Years Ended December 31				
	2009	2008	2007	2006	2005
Balance, beginning of period	$ 75,197	$ 45,827	$ 35,535	$ 30,898	$ 29,610
Allowances added through business combinations		--	7,276	--	--
Provision	109,000	62,500	5,900	5,500	4,903
Recoveries of loans previously charged off:					
Commercial real estate	--	1,530	--	75	187
Multifamily real estate	--	--	--	--	6
Construction and land	715	192	62	507	259
One- to four-family real estate	138	45	338	77	--
Commercial business	545	471	678	1,112	713
Agricultural business, including secured by farmland	38	1,048	275	72	70
Consumer	275	185	138	55	91
	1,711	3,471	1,491	1,898	1,326
Loans charged off:					
Commercial real estate	(1)	(7)	--	--	(521)
Multifamily real estate	--	--	--	--	(8)
Construction and land	(64,456)	(27,020)	(1,344)	--	(218)
One- to four-family real estate	(8,795)	(934)	(385)	(62)	(135)
Commercial business	(11,541)	(7,323)	(1,081)	(1,632)	(1,692)
Agricultural business, including secured by farmland	(3,877)	(60)	(650)	(759)	(1,886)
Consumer	(1,969)	(1,257)	(915)	(308)	(481)
	(90,639)	(36,601)	(4,375)	(2,761)	(4,941)
Net charge-offs	(88,928)	(33,130)	(2,884)	(863)	(3,615)
Balance, end of period	$ 95,269	$ 75,197	$ 45,827	$ 35,535	$ 30,898
Allowance for loan losses as a percent of total loans	2.51 %	1.90 %	1.20 %	1.20 %	1.27 %
Net loan charge-offs as a percent of average outstanding loans during the period	2.28 %	0.84 %	0.08 %	0.03 %	0.16 %
Allowance for loan losses as a percent of non-performing loans	45 %	40 %	108 %	253 %	296 %

The following table sets forth the breakdown of the allowance for loan losses by loan category at the dates indicated (dollars in thousands):

Table 15: Allocation of Allowance for Loan Losses

	At December 31									
	2009		2008		2007		2006		2005	
	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans
Specific or allocated loss allowances (1):										
Commercial real estate	$ 8,278	28.5 %	$ 4,199	25.6 %	$ 3,771	23.2 %	$ 5,129	20.1 %	$ 4,566	22.8 %
Multifamily real estate	90	4.1	87	3.8	934	4.4	886	5.0	839	5.9
Construction and land	45,209	18.6	38,253	26.3	7,569	32.0	11,717	37.4	7,223	28.4
One- to four-family real estate	2,912	18.6	752	15.1	1,987	14.8	1,420	14.5	860	17.0
Commercial business	22,054	16.8	16,533	17.2	19,026	18.3	10,513	15.8	9,741	18.1
Agricultural business, including secured by farmland	919	5.4	530	5.2	1,419	4.9	2,417	5.5	3,502	6.0
Consumer	1,809	8.0	1,730	6.8	3,468	2.4	903	1.7	561	1.8
Estimated allowance for undisbursed commitments	1,594	N/A	1,108	N/A	330	N/A	513	N/A	156	N/A
Unallocated (1)	12,404	N/A	12,005	N/A	7,323	N/A	2,037	N/A	3,450	N/A
Total allowance for loan losses	$ 95,269	100.0 %	$ 75,197	100.0 %	$ 45,827	100.0 %	$ 35,535	100.0 %	$ 30,898	100.0 %

(1) We establish specific loss allowances when individual loans are identified that present a possibility of loss (i.e., that full collectibility is not reasonably assured). The remainder of the allocated and unallocated allowance for loan losses is established for the purpose of providing for estimated losses which are inherent in the loan portfolio.

Other Operating Income. Other operating income, which includes changes in the valuation of financial instruments carried at fair value as well as non-interest revenues from core operations, was $43.7 million for the year ended December 31, 2009, compared to $39.6 million for the prior year. Excluding the fair value adjustments, other operating income from core operations increased by $2.2 million, or 7%, to $32.7 million for the year ended December 31, 2009 compared to $30.5 million for the prior year, primarily as a result of increased mortgage banking activity. While the pace of mortgage banking activity moderated in the final quarter, for the year it was strong and, as a result, gain on sale of loans increased by $2.8 million to $8.9 million for the year ended December 31, 2009, compared to $6.0 million in the prior year. Loan sales for the year ended December 31, 2009 totaled $563 million, compared to $366 million for the year ended December 31, 2008. By contrast, reflecting accelerated amortization due to early loan payoffs as well as $800,000 of MSR impairment charges, servicing fees decreased by $1.6 million compared to a year earlier. The slower pace of economic activity adversely affected our payment processing revenues in both years as activity levels for deposit customers, cardholders and merchants remained subdued. Primarily reflecting this slow-down in customer transaction volumes, income from deposit fees and other service charges decreased by $146,000, or approximately 1%, to $21.4 million for the year ended December 31, 2009, compared to $21.5 million for the prior year, despite growth in our account base. For the year ended December 31, 2009, we recorded a net gain of $11.0 million for the change in valuation of financial instruments carried at fair value, compared to a net gain of $9.2 million for the year ended December 31, 2008. The fair value adjustments in both years primarily reflect changes in the valuation of the junior subordinated debentures we have issued, which resulted in a large gain, partially offset by reductions in the values of the trust preferred securities which we own, including collateralized debt obligations secured by pools of trust preferred securities, and in 2008 by the write down of Fannie Mae and Freddie Mac equity securities. As discussed more thoroughly in Note 25 of the Selected Notes to the Consolidated Financial Statements, the valuation of these financial instruments has become very difficult and more subjective in recent periods as current and reliable observable transaction data does not exist.

Other Operating Expenses. Other operating expenses for the year ended December 31, 2009 totaled $142.1 million compared to $260.0 million, including the $121.1 million goodwill impairment charge in 2008. Excluding the goodwill impairment charge for the year ended December 31, 2008, other operating expenses for the year ended December 31, 2009 increased by $3.2 million, or 2%, compared to the prior year. The current year's expenses reflect significantly higher deposit insurance expense, elevated costs associated with problem loan collection activities including charges related to real estate owned, and increased advertising, generally offset by reductions in compensation, occupancy costs and payment and card processing expenses. As a result, other operating expenses as a percentage of average assets was 3.12% for the year ended December 31, 2009, compared to 5.65% (3.02% excluding goodwill impairment) one year earlier. Salary and employee benefits decreased $7.4 million to $68.7 million for the year ended December 31, 2009 from $76.1 million for the year ended December 31, 2008, reflecting reduced staffing levels as well as the elimination of certain incentive accruals and reductions in the level of employer paid retirement contributions. Likewise, occupancy costs decreased $614,000 to $23.4 million for the year ended December 31, 2009 compared to $24.0 million one year ago as we continued to achieve additional operating efficiencies in this important area following the successful integration of the 2007 acquisitions. The current year's operating expenses also included $6.4 million for payment and card processing services, which was a decrease of $597,000 compared to the year ended December 31, 2008, largely as a result of lower activity levels. By contrast, the cost of FDIC insurance increased $6.0 million, or 150%, to $10.0 million for the year ended December 31, 2009 compared to $4.0 million for the year ended December 31, 2008, reflecting increased assessment rates and incremental charges for certain deposits in excess of $250,000 as well as a special assessment of $2.0 million collected in June 2009. Advertising and marketing expenditures increased by $963,000, or 14%, to $7.6 million for the year ended December 31, 2009, compared to $6.7 million in the prior year, primarily as a result of a number of targeted deposit acquisition campaigns and costs associated with our Great Northwest Home Rush program. Additionally, expenses related to real estate owned, including losses on sales and valuation adjustments, increased $4.9 million to $7.1 million for the year ended December 31, 2009, compared to $2.3 million for the prior year.

Income Taxes. Our normal, expected statutory income tax rate is 36.4%, representing a blend of the statutory federal income tax rate of 35.0% and apportioned effects of the Oregon and Idaho income tax rates of 6.6% and 7.6%, respectively. Our effective tax rates for the years ended December 31, 2009 and 2008 were 43.1% and 5.2%, respectively, in each case reflecting a tax benefit rather than a tax expense. In both years the effective tax rate reflects the recording of tax credits related to certain Community Reinvestment Act (CRA) investments combined with the tax benefits of tax exempt income from municipal securities and bank-owned life insurance policies. The impact of those tax credits and tax exempt income, combined with a taxable loss in the current year, results in an effective tax rate that is somewhat higher than the expected statutory rate. By contrast, the lower effective tax rate for the year ended December 31, 2008 reflects the effect of the goodwill write-off, which was a non-deductible expense for tax purposes and significantly reduced the otherwise expected tax benefit of the before-tax book loss.

Comparison of Results of Operations for the Years Ended December 31, 2008 and 2007

General. For the year ended December 31, 2008, we had a net loss to common shareholders of $128.0 million, or $(7.94) per share (diluted), compared to net income of $36.9 million, or $2.49 per share (diluted), for the year ended December 31, 2007. The net loss for the year reflected material increases in our provision for loan losses as well as a significant decline in our net interest margin, which more than offset the favorable effects of continued growth of loans and deposits, as well as changes in the mix of assets and liabilities. Results for 2008 were also adversely affected by a $121.1 million non-cash impairment charge to eliminate the carrying value of goodwill. Our provision for loan losses was $62.5 million for the year ended December 31, 2008 compared to $5.9 million for the prior year. The increase in the provision for loan losses during 2008 primarily reflected an increase in delinquent and non-performing construction, land and land development loans for one- to four-family properties and our concerns that the increasing number of distressed sellers and lender foreclosures could further disrupt certain housing markets and adversely affect home prices and the demand for building lots. These trends became more apparent as the year progressed, particularly in the Puget Sound region which had previously shown fewer signs of stress.

Our operating results for the year ended December 31, 2008, also included an increase in other operating income, particularly deposit fees and service charges as a result of the increase in our deposit customer base and related payment processing activities. Other operating expenses for the year increased substantially compared to the prior year. The increase was predominantly due to the write-off of $121.1 million of goodwill. The increased expense was also representative of a full year's effect of the 2007 acquisitions and various new branches, as well as substantially increased deposit insurance and collection and legal costs. Over the twenty-four month period, through acquisitions and de novo operations we

added 28 new branches to improve and expand our franchise, impacting both revenues and expenses. Further, our operating results for the year ended December 31, 2008 included a $9.2 million ($5.9 million after tax) net gain as a result of changes in the valuation of financial instruments carried at fair value, compared to a $11.6 million ($7.4 million after tax) gain for the prior year. The fair value adjustment for 2008 primarily reflected changes in the valuation of trust preferred securities and junior subordinated debentures, both owned and issued by the Company, and the reduction in fair value of our investment in Fannie Mae and Freddie Mac equity securities. Excluding the net fair value adjustments and goodwill write-off, the net loss from core operations was $12.7 million for the year ended December 31, 2008, compared to net income of $29.5 million for the year ended December 31, 2007.

Net Interest Income. Net interest income before provision for loan losses decreased to $147.8 million for the year ended December 31, 2008, compared to $149.8 million for the prior year, primarily as a result of the decrease in the net interest margin as discussed below and despite the $534 million, or 14%, growth in average interest-earning assets compared to the prior year. The average balance of interest-earning assets was $4.281 billion for the year ended December 31, 2008, compared to $3.747 billion for the prior year. The net interest margin of 3.45% for the year ended December 31, 2008 declined 54 basis points from the prior year, largely as a result of the effect of rapidly declining short-term interest rates on earning asset yields, particularly floating- and adjustable-rate loan yields. By comparison to the prior year, this decline was compounded by the adverse effect of a large increase in the level of non-accrual loans and other non-performing assets. While funding costs were also significantly lower, the more immediate impact of lower market rates on a substantial portion of our loan portfolio resulted in compression of our net interest margin and more than offset benefits from loan and deposit growth. Reflecting generally lower market interest rates as well as changes in asset mix and a higher level of non-accrual loans, the yield on earning assets for the year ended December 31, 2008 decreased by 150 basis points compared to the prior year, while funding costs for the same period decreased by only 101 basis points.

Interest Income. Interest income for the year ended December 31, 2008 was $273.2 million, compared to $295.5 million for the prior year, a decrease of $22.3 million, or 8%. The decrease in interest income occurred despite a $534 million increase in the average balance of interest earning assets, as the growth was more than offset by the decrease in the average yield on those assets. The yield on average interest-earning assets decreased to 6.38% for the year ended December 31, 2008, compared to 7.89% in the prior year. The decrease in the yield on earning assets reflects the significant changes in Federal Reserve policy actions beginning in September 2007 designed to aggressively lower short-term interest rates. As a result of those policy actions, bank prime rates, which had averaged 8.05% for the year ended December 31, 2007, declined by 297 basis points to average 5.08% for the year ended December 31, 2008. The prime rate ended the year at 3.25%, and this change placed further downward pressure on loan yields in 2009. Average loans receivable for the year ended December 31, 2008 increased by $498 million, or 15%, to $3.935 billion, compared to $3.437 billion for the prior year ended December 31, 2007. Interest income on loans for the year decreased by $24.1 million, or 9%, to $257.2 million from $281.3 million for the prior year, reflecting the impact of the 164 basis point decrease in the average yield on loans, which was partially offset by the increase in average loan balances. The decrease in average loan yields reflects the lower average level of market interest rates in 2008, following the Federal Reserve's actions to lower those rates, particularly short-term interest rates including the prime rate and LIBOR indices which affect the yield on large portions of our construction, land development, commercial and agricultural loans. The decrease in average loan yields also reflects changes in the mix of the loan portfolio and slower turn-over in the construction and land development portfolio which resulted in less recognition of deferred loan fee income, as well as the adverse effect of increased loan delinquencies. The average yield on loans was 6.54% for the year ended December 31, 2008, compared to 8.18% in the prior year.

The combined average balance of mortgage-backed securities, investment securities, daily interest-bearing deposits and FHLB stock increased by $36 million, excluding the effect of fair value adjustments for the year ended December 31, 2008, and the interest and dividend income from those investments increased by $1.8 million compared to the prior year. The effect of the increased average balance was somewhat enhanced as the average yield on the securities portfolio and cash equivalents increased slightly to 4.61% for the year ended December 31, 2008, from 4.57% in the prior year. The four basis point increase in the yield of the securities portfolio is a reflection of a change in the mix of those assets. Also, while not particularly significant in amount, we received $355,000 in dividend income on our FHLB of Seattle stock for the year ended December 31, 2008, an increase of $133,000 compared to the prior year. However, in response to the ongoing turmoil in the credit and mortgage markets and the effect on the market value of certain of its mortgage assets, the FHLB of Seattle suspended its dividend indefinitely in the fourth quarter of 2008.

Interest Expense. Interest expense for the year ended December 31, 2008 was $125.3 million, compared to $145.7 million for the comparable period in 2007, a decrease of $20.3 million, or 14%. The decrease in interest expense occurred as a result of a 101 basis point decrease in the average cost of all interest-bearing liabilities to 3.02% for the year ended December 31, 2008, from 4.03% for the prior year, and despite a $528 million increase in average interest-bearing liabilities. The increase in interest-bearing balances reflects a $390 million increase in average deposits, including growth due to our acquisitions, along with a $100 million increase, excluding the effect of fair value adjustments in average FHLB advances. The average balances for junior subordinated debentures (excluding the effect of fair value adjustments) and other borrowings also increased by $38 million compared to a year ago. The effect of lower average market rates for the year on the cost of these funds was partially mitigated by deposit pricing characteristics noted below and by changes in the mix of deposits.

Deposit interest expense decreased $19.1 million, or 15%, to $110.3 million for the year ended December 31, 2008 compared to $129.4 million for the prior year as a result of a 92 basis point decrease in the cost of interest-bearing deposits and despite the significant deposit growth during 2008. Reflecting the acquisitions, branch expansion and other growth initiatives, average deposit balances increased $390 million, or 12%, to $3.722 billion for the year ended December 31, 2008, from $3.332 billion for the year ended December 31, 2007, while the average rate paid on deposit balances decreased from 3.88% a year ago to 2.96% for the year ended December 31, 2008. 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 tend to be less severe and to lag changes in market interest rates. In addition, non-interest-bearing deposits dampen the effect of changes in market rates on our cost of deposits. This lower degree of volatility and lag effect for deposit pricing was evident in the relatively modest decrease in deposit costs as the Federal Reserve moved aggressively to lower short-term interest rates by 500 basis points from September 18, 2007 to December 31, 2008.

Average FHLB advances (excluding the effect of fair value adjustments) increased to $188 million for the year ended December 31, 2008, compared to $88 million one year earlier. While the average rate paid on FHLB advances for the year ended December 31, 2008 decreased to

2.88%, a decrease of 186 basis points compared to the prior year, the $100 million increase in average FHLB borrowings resulted in a $1.2 million increase in the related interest expense. 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) and an average cost of 5.94% for the year ended December 31, 2008. Junior subordinated debentures outstanding in the prior year had an average balance of $117 million with a higher average rate of 7.61%. Generally, the junior subordinated debentures are adjustable-rate instruments with repricing frequencies of three months. The lower average cost of the junior subordinated debentures in 2008 reflected lower short-term market interest rates, as well as a lower spread on the most recently issued debentures and the early redemption of a higher costing tranche of debentures. Effective April 22, 2007, we exercised the early redemption provision with respect to approximately $26 million of the junior subordinated debentures which had a spread of 3.70% to six-month LIBOR and an average cost of 9.09% during the six months preceding redemption. We replaced the redeemed debentures with a new $26 million tranche of junior subordinated debentures issued on July 31, 2007 with an initial rate of 6.74% and a repricing spread of 1.38% to three-month LIBOR. Other borrowings consist of retail repurchase agreements with customers, wholesale repurchase agreements with investment banking firms secured by certain investment securities as well as overnight federal funds borrowings from the FRBSF and correspondent banks. The average balance for other borrowings, consisting of $101 million in customer retail repurchase agreements and $13 million of Fed Funds, was $114 million for the year ended December 31, 2008, an increase of $31 million over the prior year. The related interest expense for other borrowings decreased by $943,000, to $2.3 million from $3.2 million for the respective periods, again reflecting significantly lower market interest rates. The average rate paid on other borrowings was 1.99% for the year ended December 31, 2008, compared to 3.88% in the prior year. Other borrowings generally have relatively short terms and therefore reprice to current market levels more quickly than deposits, which generally lag current market rates, although, similar to deposits, customer retail repurchase agreements have a lower degree of volatility than most market rates.

Provision and Allowance for Loan Losses. During the year ended December 31, 2008, the provision for loan losses was $62.5 million compared to $5.9 million for the prior year. For 2008, the provision for loan losses was the most important factor contributing to our disappointing core operating results.

The significantly greater provision for loan losses for the year ended December 31, 2008 primarily reflected the substantial increase in delinquent and non-performing construction, land and land development loans for one- to four-family properties and our concerns that the increasing number of distressed sellers and lender foreclosures could further disrupt certain housing markets and adversely affect home prices and the demand for building lots. In particular, the increased provision for loan losses reflected our concern that higher levels of delinquencies and loan loss provisioning recently announced by a number of lenders in our markets could lead to significant additional discounting of property values in efforts to expedite problem loan resolutions. These concerns heightened during the second half of the year as evidence of over-supply and price declines for certain housing and related lot and land markets became more apparent. This was particularly the case in certain outlying areas of the Puget Sound and Portland regions, which had previously demonstrated fewer signs of stress than some of the other markets that we serve. Aside from housing-related construction and development loans, non-performing loans generally reflect unique operating difficulties for the individual borrower; however, as the year progressed the deteriorating pace of economic activity became a more significant contributing factor. We recorded net charge-offs of $33.1 million for the year ended December 31, 2008, compared to $2.9 million for the prior year, and non-performing loans increased to $187 million at December 31, 2008, compared to $42 million at December 31, 2007. A comparison of the allowance for loan losses at December 31, 2008 and 2007 shows an increase of $29 million, to $75 million at December 31, 2008, from $46 million at December 31, 2007. The allowance for loan losses as a percentage of total loans (loans receivable excluding allowance for losses) increased to 1.90% at December 31, 2008, compared to 1.20% at December 31, 2007. The allowance as a percentage of non-performing loans decreased to 40% at December 31, 2008, compared to 108% a year earlier.

As of December 31, 2008, we had identified $211 million of impaired loans. Of those impaired loans, $92 million had related allowances for credit losses totaling $14 million. The remaining $119 million in impaired loans had no allowances for credit losses as their estimated collateral value was equal to or exceeded their carrying costs. Impaired loans with related allowances for credit losses that were individually evaluated for reserve needs totaled $53 million and accounted for $11 million of the allowances for impaired loans. Impaired loans with related allowances for credit losses that were collectively evaluated as homogeneous pools totaled $38 million and accounted for $4 million of the total allowance related to impaired loans.

Other Operating Income. Other operating income was $39.6 million for the year ended December 31, 2008, compared to $38.4 million for the prior year. Deposit fees and other service charge income increased by $5.0 million, or 30%, to $21.5 million for the year ended December 31, 2008, compared to $16.6 million for the prior year, significantly influenced by the increase in deposit balances from our acquisitions, yet also reflecting internally generated growth in customer transaction accounts and increased merchant credit card services. Changes in certain pricing schedules and interchange fees also contributed to the increased fee income. While deposit fees exhibited solid growth for the full year, the slowing economy did adversely affect our payment processing revenues beginning particularly in the late summer, as activity levels for deposit customers, cardholders and merchants clearly declined compared to earlier in the year and compared to the prior year. Loan servicing fees also increased by $61,000, or 4%, to $1.7 million for the year ended December 31, 2008, compared to $1.6 million for the prior year. Reflecting decreased mortgage banking activity, gain on sale of loans decreased by $225,000 to $6.0 million for the year ended December 31, 2008, compared to $6.3 million for the prior year. Loan sales for the year ended December 31, 2008 totaled $366 million, compared to $393 million for the prior year. Gain on sale of loans for 2008 included $267,000 of fees on $30 million of loans which were brokered and are not reflected in the volume of loans sold. By comparison, in the year ended December 31, 2007, gain on sale of loans included $945,000 of fees on $109 million of brokered loans. For the years ended December 31, 2008 and 2007, other income also included net gains of $9.2 million and $11.6 million, respectively, for the change in valuation of financial instruments carried at fair value. The fair value adjustments in both years primarily reflected changes in the valuation of the junior subordinated debentures we have issued, which resulted in a large gain, partially offset by reductions in the values of the trust preferred securities, including collateralized debt obligations secured by pools of trust preferred securities, and Fannie Mae and Freddie Mac equity securities which we own.

Other Operating Expenses. Other operating expenses increased $132.5 million, or 104%, to $260.0 million, for the year ended December 31, 2008, from $127.5 million for the prior year. The write-off of $121.1 million of goodwill accounted for 91% of the increase. The remaining $11.4 million increase was primarily a result of the recent bank acquisitions and branch expansion evidenced by the increase in compensation,

occupancy and miscellaneous expenses as locations, staffing and the volume of activity have expanded. In 2008, management became keenly focused on expense discipline and we began to experience much of the anticipated efficiencies following the prior year's acquisitions. However, the expected improvement was significantly offset by increased FDIC deposit insurance expense and higher loan collection costs as a result of increased delinquencies. The cost of FDIC insurance increased $3.6 million from the previous year. We also incurred $2.3 million of costs in connection with operating expenses and valuation adjustments for REO and other repossessed assets, an increase of $2.1 million in comparison with the prior year. Besides the effect of our three bank acquisitions in 2007, the expenses for 2008 included operating costs associated with the opening of two new branch offices in 2008 in Portland, Oregon, and Bellevue, Washington, and ten branches at various times during 2007. Primarily reflecting these additions, occupancy costs increased by $3.1 million, or 15%, compared to the prior year. Direct expenses associated with payment and card processing services increased by $1.6 million as a result of growth in these fee generating activities, largely reflecting growth in the account base. Operating expenses for 2008 also included $2.8 million for amortization of the core deposit intangibles recorded in connection with three acquisitions, which was an increase of $947,000 compared to the year ended December 31, 2007. While we continued our strong commitment to advertising and marketing expenditures, marketing and advertising costs decreased $1.6 million, or 20%, to $6.7 million for the year ended December 31, 2008, compared to $8.3 million in the prior year. Other operating expenses as a percentage of average assets were 5.65% (3.02% excluding the goodwill write-off) for the year ended December 31, 2008, compared to 3.15% for the prior year, reflecting the increased expenses noted above.

Income Taxes. Our normal, expected statutory income tax rate is 36.4%, representing a blend of the statutory federal income tax rate of 35.0% and apportioned effects of the Oregon and Idaho income tax rates of 6.6% and 7.6%, respectively. Our effective tax rates for the years ended December 31, 2008 and 2007 were 5.2% and 32.6%, respectively. The effective tax rate in 2007 reflects the recording of tax credits related to certain Community Reinvestment Act (CRA) investments combined with the tax benefits of tax exempt income from municipal securities and bank-owned life insurance policies. The effective tax rate in 2008 reflects the previously mentioned tax credits and tax exempt income combined with relatively modest amounts of taxable income and the significant effect of the goodwill write-off which was a non-deductible expense for tax purposes.

Table 16, *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 footnotes.)

Table 16: Analysis of Net Interest Spread (dollars in thousands)

	Year Ended December 31, 2009			Year Ended December 31, 2008			Year Ended December 31, 2007		
	Average Balance	Interest & Dividends	Yield/ Cost (3)	Average Balance	Interest & Dividends	Yield/ Cost (3)	Average Balance	Interest & Dividends	Yield/ Cost (3)
Interest-earning assets:									
Mortgage loans	$ 2,893,706	$ 165,289	5.71 %	$ 2,904,350	$ 192,135	6.62 %	$ 2,617,889	$ 214,832	8.21 %
Commercial/agricultural loans	913,059	51,048	5.59	934,564	58,169	6.22	742,915	61,018	8.21
Consumer and other loans	93,804	6,698	7.14	96,125	6,907	7.19	76,455	5,473	7.16
Total loans (1)	3,900,569	223,035	5.72	3,935,039	257,211	6.54	3,437,259	281,323	8.18
Mortgage-backed securities	125,852	6,057	4.81	97,586	4,639	4.75	125,396	5,832	4.65
Securities and deposits	284,163	8,278	2.91	210,869	10,953	5.19	147,633	8,120	5.50
FHLB stock dividends (reversal)	37,371	--	--	37,372	355	0.95	36,831	222	0.60
Total investment securities	447,386	14,335	3.20	345,827	15,947	4.61	309,860	14,174	4.57
Total interest-earning assets	4,347,955	237,370	5.46	4,280,866	273,158	6.38	3,747,119	295,497	7.89
Non-interest-earning assets	212,126			325,235			297,353		
Total assets	$ 4,560,081			$ 4,606,101			$ 4,044,472		
Interest-bearing liabilities:									
Savings accounts	$ 503,893	7,958	1.58 %	$ 552,762	14,459	2.62 %	$ 523,278	21,448	4.10 %
Checking and NOW accounts (2)	845,355	2,466	0.29	874,199	5,796	0.66	801,981	10,995	1.37
Money market accounts	360,401	5,890	1.63	230,248	4,566	1.98	245,932	9,268	3.77
Certificates of deposit	2,048,507	66,897	3.27	2,064,803	85,493	4.14	1,760,907	87,709	4.98
Total deposits	3,758,156	83,211	2.21	3,722,012	110,314	2.96	3,332,098	129,420	3.88
Other interest-bearing liabilities:									
FHLB advances	102,210	2,627	2.57	187,920	5,407	2.88	87,957	4,168	4.74
Other borrowings	174,670	2,205	1.26	114,077	2,271	1.99	82,796	3,214	3.88
Junior subordinated debentures	123,716	4,754	3.84	123,716	7,353	5.94	116,725	8,888	7.61
Total borrowings	400,596	9,586	2.39	425,713	15,031	3.53	287,478	16,270	5.66
Total interest-bearing liabilities	4,158,752	92,797	2.23	4,147,725	125,345	3.02	3,619,576	145,690	4.03
Non-interest-bearing liabilities	(21,122)			30,335			58,371		
Total liabilities	4,137,630			4,178,060			3,677,947		
Stockholders' equity	422,451			428,041			366,525		
Total liabilities and stockholders' equity	$ 4,560,081			$ 4,606,101			$ 4,044,072		
Net interest income/rate spread		$ 144,573	3.23 %		$ 147,813	3.36 %		$ 149,807	3.86 %
Net interest margin			3.33 %			3.45 %			4.00 %
Ratio of average interest-earning assets to average interest-bearing liabilities			104.55 %			103.21 %			103.52 %

(footnotes follow tables)

Table 16: Analysis of Net Interest Spread (dollars in thousands) (continued)

	Year Ended December 31, 2006			Year Ended December 31, 2005		
	Average Balance	Interest & Dividends	Yield/ Cost (3)	Average Balance	Interest & Dividends	Yield/ Cost (3)
Interest-earning assets:						
Mortgage loans	$ 2,109,162	$ 172,908	8.20 %	$ 1,664,918	$ 122,198	7.34 %
Commercial/agricultural loans	610,954	51,104	8.36	567,556	40,154	7.07
Consumer and other loans	47,469	3,649	7.69	40,202	3,046	7.58
Total loans (1)	2,767,585	227,661	8.23	2,272,676	165,398	7.28
Mortgage-backed securities	169,047	7,860	4.65	296,419	13,336	4.50
Securities and deposits	137,543	7,462	5.43	263,789	11,455	4.34
FHLB stock	35,844	36	0.10	35,809	(29)	(0.08)
Total investment securities	342,434	15,358	4.48	596,017	24,762	4.15
Total interest-earning assets	3,110,019	243,019	7.81	2,868,693	190,160	6.63
Non-interest-earning assets	191,579			180,339		
Total assets	$ 3,301,598			$ 3,049,032		
Interest-bearing liabilities:						
Savings accounts	$ 243,275	9,188	3.78	$ 159,842	3,474	2.17
Checking and NOW accounts (2)	604,275	7,594	1.26	542,613	4,118	0.76
Money market accounts	283,814	10,891	3.84	300,059	7,524	2.51
Certificates of deposit	1,404,790	62,314	4.44	1,119,702	37,137	3.32
Total deposits	2,536,154	89,987	3.55	2,122,216	52,253	2.46
Other interest-bearing liabilities:						
FHLB advances	295,228	14,354	4.86	522,624	21,906	4.19
Other borrowings	94,613	3,744	3.96	68,339	1,765	2.58
Junior subordinated debentures	99,143	8,029	8.10	81,207	5,453	6.71
Total borrowings	488,984	26,127	5.34	672,170	29,124	4.33
Total interest-bearing liabilities	3,025,138	116,114	3.84	2,794,386	81,377	2.91
Non-interest-bearing liabilities	39,103			34,065		
Total liabilities	3,064,241			2,827,542		
Stockholders' equity	237,357			220,581		
Total liabilities and stockholders' equity	$ 3,301,598			$ 3,049,032		
Net interest income/rate spread		$ 126,905	3.97 %		$ 108,783	3.72 %
Net interest margin			4.08 %			3.79 %
Ratio of average interest-earning assets to average interest-bearing liabilities			102.81 %			102.66 %

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 and origination costs is included with interest on loans.
2) Average balances include non-interest-bearing deposits.
3) Yields and costs have not been adjusted for the effect of tax-exempt interest.

Table 17, Rate/Volume Analysis, sets forth the effects of changing rates and volumes on our net interest income. 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.

Table 17: Rate/Volume Analysis (dollars in thousands)

	Year Ended December 31, 2009 Compared to Year Ended December 31, 2008 Increase (Decrease) Due to			Year Ended December 31, 2008 Compared to Year Ended December 31, 2007 Increase (Decrease) Due to			Year Ended December 31, 2007 Compared to Year Ended December 31, 2006 Increase (Decrease) Due to		
	Rate	Volume	Net	Rate	Volume	Net	Rate	Volume	Net
Interest-earning assets:									
Mortgage loans	$ (26,149)	$ (697)	$ (26,846)	$ (44,558)	$ 21,861	$ (22,697)	$ 211	$ 41,713	$ 41,924
Commercial/agricultural loans	(5,802)	(1,319)	(7,121)	(16,624)	13,775	(2,849)	(931)	10,845	9,914
Consumer and other loans	(47)	(162)	(209)	23	1,411	1,434	(268)	2,092	1,824
Total loans (1)	(31,998)	(2,178)	(34,176)	(61,159)	37,047	(24,112)	(988)	54,650	53,662
Mortgage-backed securities	60	1,358	1,418	123	(1,316)	(1,193)	--	(2,028)	(2,028)
Securities and deposits	(5,741)	3,066	(2,675)	(480)	3,313	2,833	98	560	658
FHLB stock	(355)	--	(355)	130	3	133	185	1	186
Total investment securities	(6,036)	4,424	(1,612)	(227)	2,000	1,773	283	(1,467)	(1,184)
Total net change in interest income on interest-earning assets	(38,034)	2,246	(35,788)	(61,386)	39,047	(22,339)	(705)	53,183	52,478
Interest-bearing liabilities:									
Deposits (2)	(28,163)	1,060	(27,103)	(33,052)	13,946	(19,106)	9,011	30,422	39,433
FHLB advances	(531)	(2,249)	(2,780)	(2,114)	3,353	1,239	(346)	(9,840)	(10,186)
Junior subordinated debentures	(2,599)	--	(2,599)	(2,042)	507	(1,535)	(506)	1,365	859
Other borrowings	(2,573)	2,507	(66)	(3,382)	2,439	(943)	(203)	(327)	(530)
Total borrowings	(5,703)	258	(5,445)	(7,538)	6,299	(1,239)	(1,055)	(8,802)	(9,857)
Total net change in interest expense on interest-bearing liabilities	(33,866)	1,318	(32,548)	(40,590)	20,245	(20,345)	7,956	21,620	29,576
Net change in net interest income	$ (4,168)	$ 928	$ (3,240)	$ (20,796)	$ 18,802	$ (1,994)	$ (8,661)	$ 31,563	$ 22,902

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 and origination costs is included with interest on loans.
2) Average balances include non-interest-bearing deposits.

Market Risk and Asset/Liability Management

Our financial condition and operations are influenced significantly by general economic conditions, including the absolute level of interest rates as well as changes in interest rates and the slope of the yield curve. Our profitability is dependent to a large extent on our net interest income, which is the difference between the interest received from our interest-earning assets and the interest expense incurred on our interest-bearing liabilities.

Our activities, like all financial institutions, inherently involve the assumption of interest rate risk. Interest rate risk is the risk that changes in market interest rates will have an adverse impact on the institution's earnings and underlying economic value. Interest rate risk is determined by the maturity and repricing characteristics of an institution's assets, liabilities and off-balance-sheet contracts. Interest rate risk is measured by the variability of financial performance and economic value resulting from changes in interest rates. Interest rate risk is the primary market risk affecting our financial performance.

The greatest source of interest rate risk to us results from the mismatch of maturities or repricing intervals for rate sensitive assets, liabilities and off-balance-sheet contracts. This mismatch or gap is generally characterized by a substantially shorter maturity structure for interest-bearing liabilities than interest-earning assets, although our floating-rate assets tend to be more immediately responsive to changes in market rates than most funding deposit liabilities. Additional interest rate risk results from mismatched repricing indices and formulae (basis risk and yield curve risk), and product caps and floors and early repayment or withdrawal provisions (option risk), which may be contractual or market driven, that are generally more favorable to customers than to us. An exception to this generalization is the beneficial effect of interest rate floors on a portion of our floating-rate loans, which help us maintain higher loan yields in periods when market interest rates decline significantly. However, in a declining interest rate environment, as loans with floors are repaid they generally are replaced with new loans which have lower interest rate floors. Further, many of the floating-rate loans with interest rate floors are in portions of the portfolio currently experiencing higher levels of delinquencies, which tends to mitigate the beneficial effect of the floors. As of December 31, 2009, our loans with interest rate floors totaled approximately $1.7 billion and had a weighted average floor rate of 5.73%. An additional consideration is the lagging and somewhat inelastic pricing adjustments for interest rates on certain deposit products as market interest rates change. These deposit pricing characteristics are particularly relevant to the administered rates paid on certain checking, savings and money market accounts and contributed to the narrowing of our net interest margin following the Federal Reserve's actions to lower market interest rates beginning in late 2007 and accelerating in 2008, as asset yields declined while the reduction in deposit costs lagged. Further, deposit costs have not declined as much as other short-term market interest rates as credit concerns and liquidity issues for certain large financial institutions, particularly in the summer and fall of 2008, created heightened competitive pricing pressures. Fortunately, these competitive pressures have decreased over recent quarters and deposit costs have declined sharply over the same period. As previously noted, our net interest margin has also been adversely affected by an increase in loan delinquencies as well as changes in the portfolio mix as construction and development lending has slowed.

The principal objectives of asset/liability management are: to evaluate the interest rate risk exposure; to determine the level of risk appropriate given our operating environment, business plan strategies, performance objectives, capital and liquidity constraints, and asset and liability allocation alternatives; and to manage our interest rate risk consistent with regulatory guidelines and policies approved by the Board of Directors. Through such management, we seek to reduce the vulnerability of our earnings and capital position to changes in the level of interest rates. Our actions in this regard are taken under the guidance of the Asset/Liability Management Committee, which is comprised of members of our senior management. The Committee closely monitors our interest sensitivity exposure, asset and liability allocation decisions, liquidity and capital positions, and local and national economic conditions and attempts to structure the loan and investment portfolios and funding sources to maximize earnings within acceptable risk tolerances.

Sensitivity Analysis

Our primary monitoring tool for assessing interest rate risk is asset/liability simulation modeling, which is designed to capture the dynamics of balance sheet, interest rate and spread movements and to quantify variations in net interest income resulting from those movements under different rate environments. The sensitivity of net interest income to changes in the modeled interest rate environments provides a measurement of interest rate risk. We also utilize economic value analysis, which addresses changes in estimated net economic value of equity arising from changes in the level of interest rates. The net economic value of equity is estimated by separately valuing our assets and liabilities under varying interest rate environments. The extent to which assets gain or lose value in relation to the gains or losses of liability values under the various interest rate assumptions determines the sensitivity of net economic value to changes in interest rates and provides an additional measure of interest rate risk.

The interest rate sensitivity analysis performed by us incorporates beginning-of-the-period rate, balance and maturity data, using various levels of aggregation of that data, as well as certain assumptions concerning the maturity, repricing, amortization and prepayment characteristics of loans and other interest-earning assets and the repricing and withdrawal of deposits and other interest-bearing liabilities into an asset/liability computer simulation model. We update and prepare simulation modeling at least quarterly for review by senior management and the directors. We believe the data and assumptions are realistic representations of our portfolio and possible outcomes under the various interest rate scenarios. Nonetheless, the interest rate sensitivity of our net interest income and net economic value of equity could vary substantially if different assumptions were used or if actual experience differs from the assumptions used.

Tables 18 and 18(a), *Interest Rate Risk Indicators,* set forth as of December 31, 2009 and 2008, the estimated changes in our net interest income over a one-year time horizon and the estimated changes in economic value of equity based on the indicated interest rate environments.

Table 18: Interest Rate Risk Indicators (dollars in thousands)

	As of December 31, 2009			
	Estimated Increase (Decrease) in			
Change (in Basis Points) in Interest Rates (1)	Net Interest Income Next 12 Months		Economic Value of Equity	
+400	$ 1,057	0.7 %	$ (159,608)	(33.6)%
+300	1,738	1.1	(125,568)	(26.4)
+200	1,970	1.2	(79,883)	(16.8)
+100	1,681	1.1	(33,542)	(7.1)
0	0	0.0	0	0.0
-25	(510)	(0.3)	(264)	(0.1)
-50	(843)	(0.5)	9,574	2.0

Table 18(a): Interest Rate Risk Indicators (dollars in thousands)

	As of December 31, 2008			
	Estimated Increase (Decrease) in			
Change (in Basis Points) in Interest Rates (1)	Net Interest Income Next 12 Months		Economic Value of Equity	
+400	$ 12,203	7.9 %	$ (180,488)	(36.8)%
+300	7,690	5.0	(139,414)	(28.5)
+200	2,263	1.5	(98,285)	(20.1)
+100	132	0.1	(54,122)	(11.0)
0	0	0.0	0	0.0
-25	(809)	(0.5)	13,235	2.7
-50	(1,408)	(0.9)	38,246	7.8

(1) Assumes an instantaneous and sustained uniform change in market interest rates at all maturities.

Another although less reliable monitoring tool for assessing interest rate risk is “gap analysis.” The matching of the repricing characteristics of assets and liabilities may be analyzed by examining the extent to which assets and liabilities are “interest sensitive” and by monitoring an institution’s interest sensitivity “gap.” An asset or liability is said to be interest sensitive within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets anticipated, based upon certain assumptions, to mature or reprice within a specific time period and the amount of interest-bearing liabilities anticipated to mature or reprice, based upon certain assumptions, within that same time period. A gap is considered positive when the amount of interest-sensitive assets exceeds the amount of interest-sensitive liabilities. A gap is considered negative when the amount of interest-sensitive liabilities exceeds the amount of interest-sensitive assets. Generally, during a period of rising rates, a negative gap would tend to adversely affect net interest income while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income while a positive gap would tend to adversely affect net interest income.

Certain shortcomings are inherent in gap analysis. For example, although certain assets and liabilities may have similar maturities or periods of repricing, they may react in different degrees to changes in market rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as ARM loans, have features that restrict changes in interest rates on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, prepayment and early withdrawal levels would likely deviate significantly from those assumed in calculating the table. Finally, the ability of some borrowers to service their debt may decrease in the event of a severe change in market rates.

Tables 19 and 19(a), *Interest Sensitivity Gap,* present our interest sensitivity gap between interest-earning assets and interest-bearing liabilities at December 31, 2009 and 2008. The tables set forth the amounts of interest-earning assets and interest-bearing liabilities which are anticipated by us, based upon certain assumptions, to reprice or mature in each of the future periods shown. At December 31, 2009, total interest-bearing liabilities maturing or repricing within one year exceeded total interest-earning assets maturing or repricing in the same time period by $32.8 million, representing a negative one-year cumulative gap to total assets ratio of (0.70)%.

Management is aware of the sources of interest rate risk and in its opinion actively monitors and manages it to the extent possible. The interest rate risk indicators and interest sensitivity gaps as of December 31, 2009 and 2008 are within our internal policy guidelines and management considers that our current level of interest rate risk is reasonable.

Table 19: Interest Sensitivity Gap as of December 31, 2009

	Within 6 Months	After 6 Months Within 1 Year	After 1 Year Within 3 Years	After 3 Years Within 5 Years	After 5 Years Within 10 Years	Over 10 Years	Total
				(dollars in thousands)			
Interest-earning assets: (1)							
Construction loans	$ 379,415	$ 32,684	$ 24,570	$ 2,197	$ --	$ 67	$ 438,933
Fixed-rate mortgage loans	130,057	79,265	267,880	205,617	179,460	75,909	938,188
Adjustable-rate mortgage loans	550,326	145,422	411,333	221,223	12,297	--	1,340,601
Fixed-rate mortgage-backed securities	10,782	9,518	28,102	16,923	17,468	4,870	87,663
Adjustable-rate mortgage-backed securities	1,734	2,670	4,155	6,456	--	--	15,015
Fixed-rate commercial/agricultural loans	67,803	32,354	78,039	25,846	7,358	887	212,287
Adjustable-rate commercial/agricultural loans	533,481	15,072	43,958	14,623	245	--	607,379
Consumer and other loans	161,665	11,050	35,042	30,280	22,075	901	261,013
Investment securities and interest-earning deposits	377,483	26,625	30,535	16,166	32,474	63,807	547,090
Total rate sensitive assets	$ 2,212,746	$ 354,660	$ 923,614	$ 539,331	$ 271,377	$ 146,441	$ 4,448,169
Interest-bearing liabilities: (2)							
Regular savings and NOW accounts	150,973	132,008	308,020	308,020	--	--	899,021
Money market deposit accounts	221,062	132,637	88,425	--	--	--	442,124
Certificates of deposit	668,266	924,781	311,643	33,478	3,708	50	1,941,926
FHLB advances	142,728	3,000	32,800	10,000	--	--	188,528
Other borrowings	2,512	--	50,000	--	--	--	52,512
Trust preferred securities	97,942	--	25,774	--	--	--	123,716
Retail repurchase agreements	124,330	--	--	--	--	--	124,330
Total rate sensitive liabilities	$ 1,407,813	$ 1,192,426	$ 816,662	$ 351,498	$ 3,708	$ 50	$ 3,772,157
Excess (deficiency) of interest-sensitive assets over interest-sensitive liabilities	$ 804,933	$ (837,766)	$ 106,952	$ 187,833	$ 267,669	$ 146,391	$ 676,012
Cumulative excess (deficiency) of interest-sensitive assets	$ 804,933	$ (32,833)	$ 74,119	$ 261,952	$ 529,621	$ 676,012	$ 676,012
Cumulative ratio of interest-earning assets to interest-bearing liabilities	157.18 %	98.74 %	102.17 %	106.95 %	114.04 %	117.92 %	117.92 %
Interest sensitivity gap to total assets	17.05 %	(17.74)%	2.26 %	3.98 %	5.67 %	3.10 %	14.32 %
Ratio of cumulative gap to total assets	17.05 %	(0.70)%	1.57 %	5.55 %	11.22 %	14.32 %	14.32 %

(footnotes follow Table 19(a))

Table 19(a): Interest Sensitivity Gap as of December 31, 2008

	Within 6 Months	After 6 Months Within 1 Year	After 1 Year Within 3 Years	After 3 Years Within 5 Years	After 5 Years Within 10 Years	Over 10 Years	Total
	(dollars in thousands)						
Interest-earning assets: (1)							
Construction loans	$ 631,125	$ 17,519	$ 30,966	$ 1,419	$ 38	$ --	$ 681,067
Fixed-rate mortgage loans	91,959	82,860	242,943	174,270	153,198	55,900	801,130
Adjustable-rate mortgage loans	591,333	148,180	393,414	202,618	5,861	--	1,341,406
Fixed-rate mortgage-backed securities	16,378	14,147	38,101	19,778	17,229	3,752	109,385
Adjustable-rate mortgage-backed securities	4,036	3,321	9,201	6,043	--	--	22,601
Fixed-rate commercial/agricultural loans	48,525	45,925	90,181	33,864	7,664	495	226,654
Adjustable-rate commercial/agricultural loans	590,877	11,063	41,509	19,040	463	--	662,952
Consumer and other loans	134,017	11,391	30,466	45,893	17,157	10,602	249,526
Investment securities and interest-earning deposits	153,683	7,861	12,915	11,950	26,666	57,458	270,533
Total rate sensitive assets	$ 2,261,933	$ 342,267	$ 889,696	$ 514,875	$ 228,276	$ 128,207	$ 4,365,254
Interest-bearing liabilities: (2)							
Regular savings and NOW accounts	214,593	112,807	263,219	263,219	--	--	853,838
Money market deposit accounts	142,021	85,212	56,808	--	--	--	284,041
Certificates of deposit	852,313	671,023	562,322	41,934	4,273	--	2,131,865
FHLB advances	53,233	10,000	35,800	10,000	--	--	109,033
Other borrowings	--	--	--	--	--	--	--
Trust preferred securities	97,942	--	25,774	--	--	--	123,716
Retail repurchase agreements	145,081	--	--	150	--	--	145,231
Total rate sensitive liabilities	$ 1,505,183	$ 879,042	$ 943,923	$ 315,303	$ 4,273	$ --	$ 3,647,724
Excess (deficiency) of interest-sensitive assets over interest-sensitive liabilities	$ 756,750	$ (536,775)	$ (54,227)	$ 199,572	$ 224,003	$ 128,207	$ 717,530
Cumulative excess (deficiency) of interest-sensitive assets	$ 756,750	$ 219,975	$ 165,748	$ 365,320	$ 589,323	$ 717,530	$ 717,530
Cumulative ratio of interest-earning assets to interest-bearing liabilities	150.28 %	109.23 %	104.98 %	110.03 %	116.16 %	119.67 %	119.67 %
Interest sensitivity gap to total assets	16.23 %	(11.51)%	(1.16)%	4.28 %	4.80 %	2.75 %	15.39 %
Ratio of cumulative gap to total assets	16.23 %	4.72 %	3.55 %	7.83 %	12.64 %	15.39 %	15.39 %

(footnotes follow table)

Footnotes for Tables 19 and 19(a): Interest Sensitivity Gap

(1) Adjustable-rate assets are included in the period in which interest rates are next scheduled to adjust rather than in the period in which they are due to mature, and fixed-rate assets are included in the period in which they are scheduled to be repaid based upon scheduled amortization, in each case adjusted to take into account estimated prepayments. Mortgage loans and other loans are not reduced for allowances for loan losses and non-performing loans. Mortgage loans, mortgage-backed securities, other loans and investment securities are not adjusted for deferred fees and unamortized acquisition premiums and discounts.

(2) Adjustable-rate liabilities are included in the period in which interest rates are next scheduled to adjust rather than in the period they are due to mature. Although regular savings, demand, NOW, and money market deposit accounts are subject to immediate withdrawal, based on historical experience management considers a substantial amount of such accounts to be core deposits having significantly longer maturities. For the purpose of the gap analysis, these accounts have been assigned decay rates to reflect their longer effective maturities. If all of these accounts had been assumed to be short-term, the one-year cumulative gap of interest-sensitive assets would have been $(737.3) million, or (15.6%) of total assets at December 31, 2009, and $(363.3) million, or (7.8%), at December 31, 2008. Interest-bearing liabilities for this table exclude certain non-interest-bearing deposits that are included in the average balance calculations reflected in Table 16, *Analysis of Net Interest Spread*.

Liquidity and Capital Resources

Our primary sources of funds are deposits, borrowings, proceeds from loan principal and interest payments and sales of loans, and the maturity of and interest income on mortgage-backed and investment securities. While maturities and scheduled amortization of loans and mortgage-backed securities are a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by market interest rates, economic conditions and competition.

Our primary investing activity is the origination and purchase of loans. During the years ended December 31, 2009, 2008 and 2007, we purchased loans of $1 million, $13 million and $23 million, respectively, while loan originations, net of repayments, totaled $582 million, $562 million and $607 million, respectively. This activity was funded primarily by principal repayments on loans and securities, sales of loans, and deposit growth. During the years ended December 31, 2009, 2008 and 2007, we sold $563 million, $366 million and $393 million, respectively, of loans. Net deposit growth was $87 million, $158 million and $826 million for the years ended December 31, 2009, 2008 and 2007, respectively, with $560 million of the 2007 growth coming from acquisitions. The increase in deposits in the current year occurred despite the runoff of $173 million in public funds in response to changes in the collateralization requirements under the Washington and Oregon State public deposit protection regulations. In addition to reducing our collateral requirements, allowing those deposits to run off also reduced our exposure to future shared-risk assessments under those regulations. Deposit activity for the year ended December 31, 2009 also included a net decrease of $103 million of brokered deposits. Deposit activity in 2008 included net increases of $211 million and $5 million of brokered deposits and public funds, respectively. Brokered deposits and public funds are generally more price sensitive than retail deposits and our use of those deposits varies significantly based upon our liquidity management strategies at any point in time. FHLB advances (excluding fair value adjustments) increased $79 million for the year ended December 31, 2009 and decreased $58 million and $46 million for the years ended December 31, 2008 and 2007, respectively. Other borrowings, including the $50 million of senior bank notes issued under the FDIC Temporary Liquidity Guarantee Program (TLGP), increased $32 million for the year ended December 31, 2009. Excluding fair value adjustments, our junior subordinated debentures were unchanged for the year ended December 31, 2009 while they increased $54 million for the year ended December 31, 2008 and decreased $33 million for the year ended December 31, 2007. In the year ended December 31, 2008, we also received $124 million when we issued senior preferred stock to the U.S. Treasury through its Capital Purchase Program.

We must maintain an adequate level of liquidity to ensure the availability of sufficient funds to accommodate deposit withdrawals, to support loan growth, to satisfy financial commitments and to take advantage of investment opportunities. During the years ended December 31, 2009, 2008 and 2007, we used our sources of funds primarily to fund loan commitments, purchase securities, add to our short-term liquidity position and pay maturing savings certificates and deposit withdrawals. In 2007 we also used approximately $33 million to fund the cash portion of the purchase price and acquisition costs of our three acquisitions. At December 31, 2009, we had outstanding loan commitments totaling $777 million, including undisbursed loans in process and unused credit lines totaling $760 million. While reflecting growth in the loan portfolio and lending activities, this level of commitments is proportionally consistent with our historical experience and does not represent a departure from normal operations. We generally maintain sufficient cash and readily marketable securities to meet short-term liquidity needs; however, our primary liquidity management practice is to increase or decrease short-term borrowings, including FHLB advances and FRBSF borrowings. We maintain credit facilities with the FHLB-Seattle, which at December 31, 2009 provide for advances that in the aggregate may equal the lesser of 35% of Banner Bank's assets or adjusted qualifying collateral, up to a total possible credit line of $1.020 billion, and 25% of Islanders Bank's assets or adjusted qualifying collateral, up to a total possible credit line of $43 million. Advances under these credit facilities totaled $189 million, or 4% of our assets at December 31, 2009. In addition, Banner Bank has been approved for participation in the Federal Reserve Bank of San Francisco's Borrower-In-Custody (BIC) program. Under this program we can borrow up to 65% of eligible loans not already pledged for other borrowings, which we currently estimate would provide additional borrowing capacity of $373 million. We utilized this facility on a limited basis during 2009; however, we had no funds borrowed from the Federal Reserve Bank at December 31, 2009.

At December 31, 2009, certificates of deposit amounted to $1.942 billion, or 50% of our total deposits, including $1.594 billion which were scheduled to mature within one year. While no assurance can be given as to future periods, historically, we have been able to retain a significant amount of our deposits as they mature. Management believes it has adequate resources and funding potential to meet our foreseeable liquidity requirements.

Capital Requirements

Banner Corporation is a bank holding company registered with the Federal Reserve. Bank holding companies are subject to capital adequacy requirements of the Federal Reserve under the Bank Holding Company Act of 1956, as amended (BHCA), and the regulations of the Federal Reserve. Banner Bank and Islanders Bank, as state-chartered, federally insured commercial banks, are subject to the capital requirements established by the FDIC.

The capital adequacy requirements are quantitative measures established by regulation that require Banner Corporation and the Banks to maintain minimum amounts and ratios of capital. The Federal Reserve requires Banner Corporation to maintain capital adequacy that generally parallels the FDIC requirements. The FDIC requires the Banks to maintain minimum ratios of Tier 1 total capital to risk-weighted assets as well as Tier 1 leverage capital to average assets. At December 31, 2009, Banner Corporation and the Banks each exceeded all current regulatory capital requirements. (See Item 1, "Business–Regulation," and Note 21 of the Notes to the Consolidated Financial Statements for additional information regarding Banner Corporation's and Banner Bank's regulatory capital requirements.)

Table 18, *Regulatory Capital Ratios,* shows the regulatory capital ratios of Banner Corporation and its subsidiaries, Banner Bank and Islanders Bank, as of December 31, 2009, and minimum regulatory requirements for the Banks to be categorized as "well-capitalized."

Table 20: Regulatory Capital Ratios

Capital Ratios	Banner Corporation	Banner Bank	Islanders Bank	"Well-capitalized" Minimum Ratio
Total capital to risk-weighted assets	12.73 %	12.95 %	13.17 %	10.00 %
Tier 1 capital to risk-weighted assets	11.47	11.69	12.18	6.00
Tier 1 leverage capital to average assets	9.62	9.74	11.58	5.00

Effect of Inflation and Changing Prices

The Consolidated Financial Statements and related financial data presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America, which require the measurement of financial position and operating results in terms of historical dollars, without considering the changes in relative purchasing power of money over time due to inflation. The primary effect of inflation on our operations is reflected in increased operating costs. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant effect on a financial institution's performance than do general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Contractual Obligations at December 31, 2009

(dollars in thousands)	Total	Due In One Year Or Less	Due In One to Three Years	Due In Three To Five Years	Due In More Than Five Years
Advances from Federal Home Loan Bank	$ 188,528	$ 145,500	$ 32,800	$ 10,000	$ 228
Junior subordinated debentures	123,716	--	--	--	123,716
Other borrowings (retail repurchase agreements)	124,330	124,330	--	--	--
Other borrowings	52,512	2,535	49,977	--	--
Operating lease obligations	39,112	6,693	10,988	8,464	12,967
Purchase obligation	2,041	766	1,275	--	--
Construction-related obligations	--	--	--	--	--
Total	$ 530,239	$ 279,824	$ 95,040	$ 18,464	$ 136,911

At December 31, 2009, we had commitments to extend credit of $777 million. In addition, we have contracts with various vendors to provide services, including information processing, for periods generally ranging from one to five years, for which our financial obligations are dependent upon acceptable performance by the vendor. For additional information regarding future financial commitments, this discussion should be read in conjunction with our Consolidated Financial Statements and related notes included elsewhere in this filing, including Note 31: "Financial Instruments with Off-Balance-Sheet Risk."

ITEM 7A – Quantitative and Qualitative Disclosures about Market Risk

See pages 69-73 of Management's Discussion and Analysis of Financial Condition and Results of Operations.

ITEM 8 – Financial Statements and Supplementary Data

For financial statements, see index on page 80.

ITEM 9 – Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

ITEM 9A – Controls and Procedures

The management of Banner Corporation is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Securities Exchange Act of 1934 (Exchange Act). A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that its objectives are met. Also, because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. As a result of these inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Further, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

(a) *Evaluation of Disclosure Controls and Procedures:* An evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) was carried out under the supervision and with the participation of our Chief Executive Officer, Chief Financial Officer and several other members of our senior management as of the end of the period covered by this report. Based on their evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2009, our disclosure controls and procedures were effective in ensuring that the information required to be disclosed by us in the reports it files or submits under the Exchange Act is (i) accumulated and communicated to our management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

(b) *Changes in Internal Controls Over Financial Reporting:* In the quarter ended December 31, 2009, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management's Annual Report on Internal Control over Financial Reporting: Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we included a report of management's assessment of the design and effectiveness of its internal controls as part of this Annual Report on Form 10-K for the year ended December 31, 2009.

ITEM 9B – Other Information

None.

PART III

ITEM 10 – Directors, Executive Officers and Corporate Governance

The information required by this item contained under the section captioned "Proposal – Election of Directors," "Meetings and Committees of the Board of Directors" and "Shareholder Proposals" in the Proxy Statement for the Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission no later than 120 days after the end of our fiscal year, is incorporated herein by reference.

Information regarding the executive officers of the Registrant is provided herein in Part I, Item 1 hereof.

The information regarding our Audit Committee and Financial Expert included under the sections captioned "Meetings and Committees of the Board of Directors" and "Audit Committee Matters" in the Proxy Statement for the Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission no later than 120 days after the end of our fiscal year, is incorporated herein by reference.

Reference is made to the cover page of this Annual Report and the section captioned "Section 16(a) Beneficial Ownership Reporting Compliance" of the Proxy Statement for the Annual Meeting of the Stockholders, which will be filed with the Securities and Exchange Commission no later than 120 days after the end of our fiscal year, regarding compliance with Section 16(a) of the Securities Exchange Act of 1934.

Code of Ethics

The Board of Directors adopted a Code of Business Conduct and Ethics for our officers (including its senior financial officers), directors, and employees. The Code of Business Conduct and Ethics requires our officers, directors, and employees to maintain the highest standards of professional conduct. A copy of the Code of Business Conduct and Ethics was filed as an exhibit to our Annual Report on Form 10-K for the year ended December 31, 2004.

Whistleblower Program and Protections

We subscribe to the Ethicspoint reporting system and encourage employees, customers, and vendors to call the Ethicspoint hotline at 1-866-ETHICSP (384-4277) or visit its website at www.Ethicspoint.com to report any concerns regarding financial statement disclosures, accounting, internal controls, or auditing matters. We will not retaliate against any of our officers or employees who raise legitimate concerns or questions about an ethics matter or a suspected accounting, internal control, financial reporting, or auditing discrepancy or otherwise assists in investigations regarding conduct that the employee reasonably believes to be a violation of Federal Securities Laws or any rule or regulation of the Securities Exchange Commission, Federal Securities Laws relating to fraud against shareholders or violations of applicable banking laws. Non-retaliation against employees is fundamental to our Code of Ethics and there are strong legal protections for those who, in good faith, raise an ethical concern or a complaint about their employer.

ITEM 11 – Executive Compensation

Information required by this item regarding management compensation and employment contracts, director compensation, and Compensation Committee interlocks and insider participation in compensation decisions is incorporated by reference to the sections captioned "Executive Compensation," "Directors' Compensation," and "Compensation Committee Matters," respectively, in the Proxy Statement for the Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission no later than 120 days after the end of our fiscal year.

ITEM 12 – Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following table summarizes share and exercise price information about our equity compensation plans as of December 31, 2009.

Plan Category:	**(a)** Number of securities to be issued upon exercise of outstanding options, warrants and rights	**(b)** Weighted average exercise price of outstanding options, warrants and rights	**(c)** Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)
Equity compensation plans approved by security holders:	495,378	$ 22.34	none
Equity compensation plans not approved by security holders:	none	n/a	none
Total	495,378		none

(a) Security Ownership of Certain Beneficial Owners

Information required by this item is incorporated herein by reference to the section captioned "Security Ownership of Certain Beneficial Owners and Management" in the Proxy Statement for the Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission no later than 120 days after the end of our fiscal year.

(b) Security Ownership of Management

Information required by this item is incorporated herein by reference to the section captioned "Security Ownership of Certain Beneficial Owners and Management" in the Proxy Statement for the Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission no later than 120 days after the end of our fiscal year.

(c) Changes in Control

We are not aware of any arrangements, including any pledge by any person of our securities, the operation of which may at a subsequent date result in a change in control of Banner Corporation.

ITEM 13 – Certain Relationships and Related Transactions, and Director Independence

The information required by this item contained under the sections captioned "Related Party Transactions" and "Director Independence" in the Proxy Statement for the Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission no later than 120 days after the end of our fiscal year, is incorporated herein by reference.

ITEM 14 – Principal Accounting Fees and Services

The information required by this item contained under the section captioned "Independent Auditors" in the Proxy Statement for the Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission no later than 120 days after the end of our fiscal year, is incorporated herein by reference.

PART IV

ITEM 15 – Exhibits and Financial Statement Schedules

(a) (1) Financial Statements

See Index to Consolidated Financial Statements on page 80.

(2) Financial Statement Schedules

All financial statement schedules are omitted because they are not applicable or not required, or because the required information is included in the Consolidated Financial Statements or the Notes thereto or in Part 1, Item 1.

(3) Exhibits

See Index of Exhibits on page 140.

(b) Exhibits

See Index of Exhibits on page 140.

Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Banner Corporation

Date: March 16, 2010

/s/ D. Michael Jones
D. Michael Jones
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ D. Michael Jones
D. Michael Jones
President and Chief Executive Officer; Director
(Principal Executive Officer)

Date: March 16, 2010

/s/ Lloyd W. Baker
Lloyd W. Baker
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: March 16, 2010

/s/ David Casper
David Casper
Director

Date: March 16, 2010

/s/ Robert D. Adams
Robert D. Adams
Director

Date: March 16, 2010

/s/ Edward L. Epstein
Edward L. Epstein
Director

Date: March 16, 2010

/s/Jesse G. Foster
Jesse G. Foster
Director

Date: March 16, 2010

/s/ Gary Sirmon
Gary Sirmon
Chairman of the Board

Date: March 16, 2010

/s/ Dean W. Mitchell
Dean W. Mitchell
Director

Date: March 16, 2010

/s/ Brent A. Orrico
Brent A. Orrico
Director

Date: March 16, 2010

/s/Wilber Pribilsky
Wilber Pribilsky
Director

Date: March 16, 2010

/s/ Michael M. Smith
Michael M. Smith
Director

Date: March 16, 2010

/s/Gordon E. Budke
Gordon E. Budke
Director

Date: March 16, 2010

/s/ Constance H. Kravas
Constance H. Kravas
Director

Date: March 16, 2010

/s/ David A Klaue
David A. Klaue
Director

Date: March 16, 2010

/s/ Robert J. Lane
Robert J. Lane
Director

Date: March 16, 2010

/s/ John R. Layman
John R. Layman
Director

Date: March 16, 2010

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BANNER CORPORATION AND SUBSIDIARIES
(Item 8 and Item 15(a)(1))

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March 16, 2010

Report of Management

To the Stockholders:

The management of Banner Corporation (the Company) is responsible for the preparation, integrity, and fair presentation of its published financial statements and all other information presented in this annual report. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and, as such, include amounts based on informed judgments and estimates made by management. In the opinion of management, the financial statements and other information herein present fairly the financial condition and operations of the Company at the dates indicated in conformity with accounting principles generally accepted in the United States of America.

Management is responsible for establishing and maintaining an effective system of internal control over financial reporting. The internal control system is augmented by written policies and procedures and by audits performed by an internal audit staff (assisted in certain instances by contracted external audit resources other than the independent registered public accounting firm), which reports to the Audit Committee of the Board of Directors. Internal auditors monitor the operation of the internal and external control system and report findings to management and the Audit Committee. When appropriate, corrective actions are taken to address identified control deficiencies and other opportunities for improving the system. The Audit Committee provides oversight to the financial reporting process. There are inherent limitations in the effectiveness of any system of internal control, including the possibility of human error and circumvention or overriding of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of an internal control system may vary over time.

The Audit Committee of the Board of Directors is comprised entirely of outside directors who are independent of the Company's management. The Audit Committee is responsible for the selection of the independent auditors. It meets periodically with management, the independent auditors and the internal auditors to ensure that they are carrying out their responsibilities. The Committee is also responsible for performing an oversight role by reviewing and monitoring the financial, accounting, and auditing procedures of the Company in addition to reviewing the Company's financial reports. The independent auditors and the internal auditors have full and free access to the Audit Committee, with or without the presence of management, to discuss the adequacy of the internal control structure for financial reporting and any other matters which they believe should be brought to the attention of the Committee.

D. Michael Jones, Chief Executive Officer
Lloyd W. Baker, Chief Financial Officer

Management Report on Internal Control over Financial Reporting

March 16, 2010

The management of Banner Corporation is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f).

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. All internal control systems, no matter how well designed, have inherent limitations, including the possibility of human error and the circumvention of overriding controls. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. Also, projection of any evaluation of effectiveness to future periods is subject to risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management with the participation of the Chief Executive Officer and Chief Financial Officer assessed the effectiveness of Banner Corporation's internal control over financial reporting as of December 31, 2009. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control – Integrated Framework.*

Based on its assessment, Management concluded that Banner Corporation maintained effective internal control over financial reporting as of December 31, 2009.

The Company's registered public accounting firm has audited the Company's consolidated financial statements and the effectiveness of our internal control over financial reporting as of and for the year ended December 31, 2009 that are included in this annual report and issued their Report of Independent Registered Public Accounting Firm, appearing under Item 8. The attestation report expresses an unqualified opinion on the effectiveness of the Company's internal controls over financial reporting as of December 31, 2009.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Banner Corporation and Subsidiaries
Walla Walla, Washington

We have audited the accompanying consolidated statements of financial condition of Banner Corporation and subsidiaries (the Company) as of December 31, 2009 and 2008, and the related consolidated statements of income, comprehensive income (loss), changes in stockholders' equity, and cash flows for the each of the years in the three-year period ended December 31, 2009. We also have audited the Company's internal control over financial reporting as of December 31, 2009, based on criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control - Integrated Framework*. The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also include performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Banner Corporation and subsidiaries, as of December 31, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, Banner Corporation and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control - Integrated Framework*.

/s/Moss Adams LLP

Moss Adams LLP
Portland, Oregon
March 16, 2010

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(in thousands, except shares)
December 31, 2009 and 2008

ASSETS	**2009**	2008
Cash and due from banks	$ 323,005	$ 102,750
Securities—trading, cost $192,853and $245,274, respectively	147,151	203,902
Securities—available-for-sale, cost $95,174 and $52,190, respectively	95,667	53,272
Securities—held-to-maturity, fair value $76,489 and $60,530, respectively	74,834	59,794
Federal Home Loan Bank stock	37,371	37,371
Loans receivable:		
Held for sale, fair value $4,534 and $7,540, respectively	4,497	7,413
Held for portfolio	3,785,624	3,953,995
Allowance for loan losses	(95,269)	(75,197)
	3,694,852	3,886,211
Accrued interest receivable	18,998	21,219
Real estate owned, held for sale, net	77,743	21,782
Property and equipment, net	103,542	97,647
Goodwill and other intangibles, net	11,070	13,716
Deferred income tax asset, net	14,811	5,528
Income taxes receivable, net	17,436	9,675
Bank-owned life insurance (BOLI)	54,596	52,680
Other assets	51,145	18,821
	$ 4,722,221	$ 4,584,368
LIABILITIES		
Deposits:		
Non-interest-bearing	$ 582,480	$ 509,105
Interest-bearing transactions and savings accounts	1,341,145	1,137,878
Interest-bearing certificates	1,941,925	2,131,867
	3,865,550	3,778,850
Advances from FHLB at fair value	189,779	111,415
Other borrowings	176,842	145,230
Junior subordinated debentures at fair value (issued in connection with Trust Preferred Securities)	47,694	61,776
Accrued expenses and other liabilities	24,020	40,600
Deferred compensation	13,208	13,149
	4,317,093	4,151,020
COMMITMENTS AND CONTINGENCIES (Notes 22 and 31)		
STOCKHOLDERS' EQUITY		
Preferred stock - $0.01 par value, 500,000 shares authorized; Series A – liquidation preference $1,000 per share, 124,000 shares issued and outstanding	117,407	115,915
Common stock and paid in capital - $0.01 par value per share, 75,000,000 shares authorized, 21,539,590 shares issued: 21,299,209 shares and 16,911,657 shares outstanding at December 31, 2009 and 2008, respectively	331,538	316,740
Retained earnings (accumulated deficit)	(42,077)	2,150
Accumulated other comprehensive income (loss):		
Unrealized gain (loss) on securities available for sale and/or transferred to held to maturity	249	572
Unearned shares of common stock issued to Employee Stock Ownership Plan (ESOP) trust at cost: 240,381 and 240,381 restricted shares outstanding at December 31, 2009 and 2008, respectively	(1,987)	(1,987)
Carrying value of shares held in trust for stock related compensation plans	(9,045)	(8,850)
Liability for common stock issued to deferred, stock related, compensation plans	9,043	8,808
	(2)	(42)
	405,128	433,348
	$ 4,722,221	$ 4,584,368

See notes to consolidated financial statements

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands except for per share data)
For the Years Ended December 31, 2009, 2008 and 2007

	2009	2008	2007
INTEREST INCOME:			
Loans receivable	$ 223,035	$ 257,211	$ 281,323
Mortgage-backed securities	6,057	4,639	5,832
Securities and cash equivalents	8,278	11,308	8,342
	237,370	273,158	295,497
INTEREST EXPENSE:			
Deposits	83,211	110,314	129,420
FHLB advances	2,627	5,407	4,168
Other borrowings	2,205	2,271	3,214
Junior subordinated debentures	4,754	7,353	8,888
	92,797	125,345	145,690
Net interest income before provision for loan losses	144,573	147,813	149,807
PROVISION FOR LOAN LOSSES	109,000	62,500	5,900
Net interest income	35,573	85,313	143,907
OTHER OPERATING INCOME:			
Deposit fees and other service charges	21,394	21,540	16,573
Mortgage banking operations	8,893	6,045	6,270
Loan servicing fees, net of amortization and impairment	93	1,703	1,642
Miscellaneous	2,292	1,185	2,336
	32,672	30,473	26,821
Net change in valuation of financial instruments carried at fair value	11,018	9,156	11,574
Total other operating income	43,690	39,629	38,395
OTHER OPERATING EXPENSES:			
Salary and employee benefits	68,674	76,104	75,975
Less capitalized loan origination costs	(8,863)	(8,739)	(10,683)
Occupancy and equipment	23,396	24,010	20,953
Information/computer data services	6,264	6,698	7,297
Payment and card processing expenses	6,396	6,993	5,415
Professional services	6,084	4,378	3,207
Advertising and marketing	7,639	6,676	8,310
Deposit Insurance	9,968	3,969	373
State/municipal business and use taxes	2,154	2,257	1,993
REO operations	7,147	2,283	189
Amortization of core deposit intangibles	2,645	2,828	1,881
Miscellaneous	10,576	11,442	12,579
	142,080	138,899	127,489
Goodwill write-off	--	121,121	--
Total other operating expenses	142,080	260,020	127,489
Income (loss) before provision for (benefit from) income taxes	(62,817)	(135,078)	54,813
PROVISION FOR (BENEFIT FROM) INCOME TAXES	(27,053)	(7,085)	17,890
NET INCOME (LOSS)	$ (35,764)	$ (127,993)	$ 36,923
PREFERRED STOCK DIVIDEND AND DISCOUNT ACCRETION			
Preferred stock dividend	$ 6,200	$ 689	$ --
Preferred stock discount accretion	1,492	161	--
NET INCOME (LOSS) AVAILABLE TO COMMON SHAREHOLDERS	$ (43,456)	$ (128,843)	$ 36,923
Earnings (loss) per common share (see Note 28)			
Basic	$ (2.33)	$ (7.94)	$ 2.53
Diluted	$ (2.33)	$ (7.94)	$ 2.49
Cumulative dividends declared per common share	$ 0.04	$ 0.50	$ 0.77

See notes to consolidated financial statements

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in thousands)
For the Years Ended December 31, 2009, 2008 and 2007

	2009	2008	2007
NET INCOME (LOSS)	$ (43,456)	$ (128,843)	$ 36,923
OTHER COMPREHENSIVE INCOME (LOSS), NET OF INCOME TAXES:			
Unrealized holding gain (loss) during the period, net of deferred income tax (benefit) of ($212), $390 and $0	(377)	692	--
Amortization of unrealized gain on tax exempt securities transferred from available-for-sale to held-to-maturity	54	56	53
Other comprehensive income (loss)	(323)	748	53
COMPREHENSIVE INCOME (LOSS)	$ (43,779)	$ (128,095)	$ 36,976

See notes to consolidated financial statements

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(in thousands)
For the Years Ended December 31, 2009, 2008 and 2007

	Common Stock and Paid in Capital	Preferred Stock	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Unearned Restricted ESOP Shares	Carrying Value, Net of Liability, Of Shares Held in Trust for Stock-Related Compensation Plans	Stockholders' Equity
Balance, January 1, 2009	$ 316,740	$ 115,915	$ 2,150	$ 572	$ (1,987)	$ (42)	$ 433,348
Net income (loss)			(35,764)				(35,764)
Change in valuation of securities—available-for-sale, net of income tax				(377)			(377)
Amortization of unrealized loss on tax exempt securities transferred from available-for-sale to held-to-maturity, net of income taxes				54			54
Additional registration costs for issuance of preferred stock	(47)						(47)
Accretion of preferred stock discount		1,492	(1,492)				--
Accrual of dividends on preferred stock			(6,200)				(6,200)
Accrual of dividends on common stock ($.04/share cumulative)			(771)				(771)
Proceeds from issuance of common stock for stockholder reinvestment program, net of registration expenses	14,723						14,723
Amortization of compensation related to MRP						40	40
Amortization of compensation related to stock options	122						122
BALANCE, December 31, 2009	$ 331,538	$ 117,407	$ (42,077)	$ 249	$ (1,987)	$ (2)	$ 405,128

Continued

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(in thousands)
For the Years Ended December 31, 2009, 2008 and 2007

	Common Stock and Paid in Capital	Preferred Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned Restricted ESOP Shares	Carrying Value, Net of Liability, Of Shares Held in Trust for Stock-Related Compensation Plans	Stockholders' Equity
Balance, January 1, 2008	$ 300,486	$ --	$ 139,636	$ (176)	$ (1,987)	$ (113)	$ 437,846
Net income (loss)			(127,993)				(127,993)
Cumulative effect of adoption of accounting principles related to liabilities under split dollar life insurance arrangements			(617)				(617)
Change in valuation of securities—available-for-sale, net of income tax				692			692
Amortization of unrealized loss on tax exempt securities transferred from available-for-sale to held-to-maturity, net of income taxes				56			56
Issuance of preferred stock with attached common stock warrant	8,246	115,754					124,000
Accretion of preferred stock discount		161	(161)				--
Accrual of dividends on preferred stock			(689)				(689)
Accrual of dividends on common stock ($.50/share cumulative)			(8,026)				(8,026)
Purchase and retirement of common stock	(14,266)						(14,266)
Proceeds from issuance of common stock for exercise of stock options	594						594
Proceeds from issuance of common stock for stockholder reinvestment program, net of registration expenses	21,021						21,021
Net issuance of stock through employer's stock plans, including tax benefit	400						400
Amortization of compensation related to MRP						65	65
Forfeiture of MRP stock	(6)					6	--
Amortization of compensation related to stock options	265						265
BALANCE, December 31, 2008	$ 316,740	$ 115,915	$ 2,150	$ 572	$ (1,987)	$ (42)	$ 433,348

Continued

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(in thousands)
For the Years Ended December 31, 2009, 2008 and 2007

	Common Stock and Paid in Capital	Preferred Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned Restricted ESOP Shares	Carrying Value, Net of Liability, Of Shares Held in Trust for Stock-Related Compensation Plans	Stockholders' Equity
Balance, January 1, 2007	$ 137,981	$ --	$ 117,754	$ (2,852)	$ (1,987)	$ (289)	$ 250,607
Net income			36,923				36,923
Cumulative effect of early adoption of accounting principles for Fair Value accounting			(3,520)	2,623			(897)
Amortization of unrealized loss on tax exempt securities transferred from available-for-sale to held-to-maturity, net of income taxes				53			53
Accrual of dividends on common stock ($.77/share cumulative)			(11,521)				(11,521)
Purchase and retirement of common stock	(2,099)						(2,099)
Proceeds from issuance of common stock for exercise of stock options	1,715						1,715
Proceeds from issuance of common stock for stockholder reinvestment program	37,579						37,579
Net issuance of stock through employer's stock plans, including tax benefit	58						58
Acquisitions:							
Shares issued to the shareholders of F&M Bank ("F&M")	77,993						77,993
Shares issued to the shareholders of San Juan Financial Holding Company ("SJFHC")	35,134						35,134
Shares issued to the shareholders of NCW Community Bank ("NCW")	11,773						11,773
Amortization of compensation related to MRP						159	159
Forfeiture of MRP stock	(17)					17	--
Amortization of compensation related to stock options	369						369
BALANCE, December 31, 2007	$ 300,486	$ --	$ 139,636	$ (176)	$ (1,987)	$ (113)	$ 437,846

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(continued) (in thousands)
For the years Ended December 31, 2009, 2008 and 2007

	2009	2008	2007
COMMON STOCK—SHARES ISSUED AND OUTSTANDING			
Common stock, shares issued, beginning of period	17,152	16,266	12,314
Purchase and retirement of common stock	--	(614)	(69)
Issuance of common stock for bank acquisitions	--	--	2,932
Issuance of common stock for exercised stock options and/or employee stock plans	--	31	93
Issuance of common stock for stockholder reinvestment program	4,387	1,469	996
Net number of shares issued during the period	4,387	886	3,952
COMMON SHARES ISSUED AND OUTSTANDING, END OF PERIOD	21,539	17,152	16,266
UNEARNED, RESTRICTED ESOP SHARES:			
Number of shares, beginning of period	(240)	(240)	(240)
Issuance/adjustment of earned shares	--	--	--
Number of shares, end of period	(240)	(240)	(240)
NET COMMON STOCK—SHARES OUTSTANDING	21,299	16,912	16,026

See notes to consolidated financial statements

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
For the Years Ended December 31, 2009, 2008 and 2007

	2009	2008	2007
OPERATING ACTIVITIES:			
Net income (loss)	$ (35,764)	$ (127,993)	$ 36,923
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation	9,777	10,525	8,233
Deferred income and expense, net of amortization	2,411	(1,318)	(3,240)
Amortization of core deposit intangibles	2,645	2,828	1,881
Loss (gain) on sale of securities	(140)	(9)	1,504
Net change in valuation of financial instruments carried at fair value	(10,878)	(9,147)	(13,078)
Purchases of securities—trading	(69,760)	(142,859)	(53,300)
Principal repayments and maturities of securities—trading	122,056	84,529	35,268
Proceeds from sales of securities—trading	6,458	17,255	76,462
Deferred taxes	(9,070)	(8,513)	4,922
Equity-based compensation	162	330	528
Tax benefits realized from equity-based compensation	--	(400)	(58)
Increase in cash surrender value of bank-owned life insurance	(1,916)	(1,197)	(1,979)
Gain on sale of loans, excluding capitalized servicing rights	(3,884)	(4,397)	(5,489)
Loss (gain) on disposal of real estate held for sale and property and equipment	766	450	(244)
Provision for losses on loans and real estate held for sale	110,643	63,323	5,900
Origination of loans held for sale	(559,792)	(369,219)	(392,170)
Proceeds from sales of loans held for sale	562,708	366,402	392,654
Goodwill write-off	--	121,121	--
Net change in:			
Other assets	(36,008)	(469)	(303)
Other liabilities	(15,305)	(4,134)	(3,441)
Net cash (used) provided by operating activities	75,109	(2,892)	90,973
INVESTING ACTIVITIES:			
Purchases of available for sale securities	(77,390)	(52,592)	--
Principal repayments and maturities of available for sale securities	27,922	407	--
Purchases of securities held to maturity	(17,975)	(7,981)	(6,707)
Principal repayments and maturities of securities held to maturity	2,856	1,640	980
Origination of loans, net of principal repayments	(21,645)	(191,404)	(215,173)
Purchases of loans and participating interest in loans	(1,376)	(13,086)	(23,137)
Purchases of property and equipment, net	(8,865)	(10,194)	(27,396)
Proceeds from sale of real estate held for sale, net	37,081	6,403	3,245
Cost of acquisitions, net of cash acquired	--	(150)	(10,603)
Other	(440)	(919)	(299)
Net cash used by investing activities	(59,832)	(267,876)	(279,090)
FINANCING ACTIVITIES			
Increase in deposits	86,700	158,257	266,159
Proceeds from FHLB advances	238,700	132,800	266,335
Repayment of FHLB advances	(159,205)	(190,838)	(312,418)
Increase (decrease) in wholesale repurchase agreement borrowings, net	--	--	(26,359)
Increase (decrease) in other borrowings, net	31,605	53,506	(6,316)
Proceeds from issuance of preferred stock with common stock warrant	(47)	124,000	--
Proceeds from issuance of junior subordinated debentures	--	--	25,774
Investment in trust securities related to junior subordinated debentures	--	--	(774)
Repayment of trust securities	--	--	(25,774)
Cash dividends paid	(7,498)	(10,386)	(10,599)
Repurchases of stock, net of forfeitures	--	(14,266)	(2,099)
Tax benefits realized from equity-based compensation	--	400	58
Cash proceeds from issuance of stock, net of registration costs	14,723	21,021	37,460
Exercise of stock options	--	594	1,715
Net cash provided by financing activities	204,978	275,088	213,162
NET INCREASE (DECREASE) IN CASH AND DUE FROM BANKS	220,255	4,320	25,045
CASH AND DUE FROM BANKS, BEGINNING OF YEAR	102,750	98,430	73,385
CASH AND DUE FROM BANKS, END OF YEAR	$ 323,005	$ 102,750	$ 98,430

(Continued on next page)

BANNER CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2009, 2008 and 2007
(in thousands)
(continued from prior page)

	2009	2008	2007
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Interest paid in cash	$ 100,464	$ 126,356	$ 142,912
Taxes paid (received) in cash	(8,173)	9,182	14,174
NON-CASH INVESTING AND FINANCING TRANSACTIONS:			
Loans, net of discounts, specific loss allowances and unearned income transferred to real estate owned and other repossessed assets	102,213	27,558	4,258
Real estate owned transferred to property and equipment	7,030	--	--
Net change in accrued dividends payable	527	1,671	922
Stock issued to/forfeited from MRP	--	6	--
Securities available-for-sale transferred to trading	--	--	226,153
Change in other assets/liabilities	924	1,471	1,705
Acquisitions:			
Cash paid out in acquisitions	--	--	33,161
Fair value of assets acquired	--	--	791,714
Liabilities assumed in acquisitions	--	--	633,614
Stock based consideration issued for acquisitions	--	--	125,020
Effects of adoption of new accounting pronouncements:			
Accrual of liability for split-dollar life insurance	--	617	--
FHLB advances adjustment to fair value	--	--	678
Junior subordinated debentures, including unamortized origination costs adjustment to fair value	--	--	2,079
Deferred tax asset related to fair value adjustments	--	--	504

See notes to consolidated financial statements

Note 1: BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business: Banner Corporation (Banner or the Company) is a bank holding company incorporated in the State of Washington. The Company is primarily engaged in the business of planning, directing and coordinating the business activities of two wholly owned subsidiaries, Banner Bank and, subsequent to May 1, 2007, Islanders Bank, as explained below. Banner Bank is a Washington-chartered commercial bank that conducts business from its main office in Walla Walla, Washington and, as of December 31, 2009, its 86 branch offices and seven loan production offices located in Washington, Oregon and Idaho. Islanders Bank is also a Washington-chartered commercial bank that conducts business from three locations in San Juan County, Washington. Banner Corporation is subject to regulation by the Board of Governors of the Federal Reserve System. Banner Bank and Islanders Bank (the Banks) are subject to regulation by the Washington State Department of Financial Institutions, Division of Banks and the Federal Deposit Insurance Corporation (FDIC). The consolidated financial statements and results of operation presented in this report on Form 10-K include financial information for Islanders Bank and two other acquisitions, F&M Bank, Spokane, Washington, and NCW Community Bank, Wenatchee, Washington, which were merged into Banner Bank in 2007. (See Note 4 of the Selected Notes to Consolidated Financial Statements for additional information with respect to these acquisitions.)

The Company's operating results depend primarily on its 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, Federal Home Loan Bank (FHLB) advances, other borrowings and junior subordinated debentures. In 2008 and 2009, the Company's net income was significantly impacted by unprecedented high levels of provisions for loan losses and the net change in the value of financial instruments carried at fair value. In addition, the 2008 results were also impacted by a substantial goodwill impairment charge.

Principles of Consolidation: The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All material intercompany transactions, profits and balances have been eliminated.

Subsequent Events: The Company has evaluated events and transactions for potential recognition or disclosure through March 16, 2010, the day the financial statements were issued.

Use of Estimates: In the opinion of management, the accompanying consolidated statements of financial condition and related consolidated statements of operations, comprehensive income (loss), changes in stockholders' equity and cash flows reflect all adjustments (which include reclassifications and normal recurring adjustments) that are necessary for a fair presentation in conformity with U.S. Generally Accepted Accounting Principles (GAAP). The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect amounts reported in the financial statements and the disclosure of contingent assets and liabilities as of the date of the statement of financial condition in the accompanying notes. Various elements of our accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. In particular, management has identified several accounting policies that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of the financial statements. These policies relate to (i) the methodology for the recognition of interest income, (ii) determination of the provision and allowance for loan and lease losses, (iii) the valuation of financial assets and liabilities recorded at fair value, (iv) the valuation of intangibles, such as goodwill, core deposit intangibles and mortgage servicing rights, (v) the valuation of real estate held for sale and (vi) deferred tax assets and liabilities. These policies and the judgments, estimates and assumptions are described in greater detail in Management's Discussion and Analysis of Financial Condition and Results of Operations (Critical Accounting Policies) in this Annual Report on Form 10-K for the year ended December 31, 2009 filed with the Securities and Exchange Commission (SEC). Management believes that the judgments, estimates and assumptions used in the preparation of our consolidated financial statements are appropriate based on the factual circumstances at the time. However, because of the sensitivity of the financial statements to these critical accounting policies, the use of other judgments, estimates and assumptions could result in material differences in our results of operations or financial condition. Further, subsequent changes in economic or market conditions could have a material impact on these estimates and the Company's financial condition and operating results in future periods.

The Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) became effective on July 1, 2009. At that date, the ASC became the source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF) and related literature. Rules and interpretive releases of the SEC under the authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. All other accounting literature is considered non-authoritative. The implementation of the ASC affects the way companies refer to GAAP standards in financial statements and accounting policies, but it has not had a material effect on the Company's Consolidated Financial Statements.

Securities: Securities are classified as held to maturity when the Company has the ability and positive intent to hold them to maturity. Securities classified as available for sale are available for future liquidity requirements and may be sold prior to maturity. Securities classified as trading are also available for future liquidity requirements and may be sold prior to maturity. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Securities classified as held-to-maturity are carried at cost, adjusted for amortization of premiums and accretion of discounts to maturity and, if appropriate, any other-than-temporary impairment losses. Securities classified as available-for-sale are recorded at fair value. Unrealized gains and losses on securities classified as available for sale are excluded from earnings and are reported net of tax as accumulated other comprehensive income, a component of stockholders' equity, until realized. Securities classified as trading are also recorded at fair value. Unrealized holding gains and losses on securities classified as trading are included in earnings. (See Note 25 for a more complete discussion of accounting for the fair value of financial instruments.) Declines in the fair value of securities classified as held to maturity or available for sale below their cost that are deemed to be other-than-temporary are recognized in earnings as realized losses. Realized gains and losses on sale are computed on the specific identification method and are included in operations on the trade date sold.

Prior to the second quarter of 2009, the Company would assess an other-than-temporary impairment (OTTI) or permanent impairment based on the nature of the decline and whether the Company has the ability and intent to hold the investments until a market price recovery. If the Company determined a security to be other-than-temporarily or permanently impaired, the full amount of the impairment would be recognized through earnings in its entirety. New guidance related to the recognition and presentation of OTTI for debt securities became effective in the second quarter of 2009. Rather than asserting whether a Company has the ability and intent to hold an investment until a market price recovery, a Company must consider whether it intends to sell a security or if it is likely that it would be required to sell the security before recovery of the amortized cost basis of the investment which may not be until maturity. For debt securities, if we intend to sell the security or it is likely that we will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If we do not intend to sell the security and it is not likely that we will be required to sell the security but we do not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income (OCI). Impairment losses related to all other factors are presented as separate categories within OCI. For investment securities held to maturity, this amount is accreted over the remaining life of the debt security prospectively based on the amount and timing of future estimated cash flows. The accretion of the amount recorded in OCI increases the carrying value of the investment and does not affect earnings. If there is an indication of additional credit losses, the security is re-evaluated according to the procedures described above.

Investment in FHLB Stock: The Banks' investments in Federal Home Loan Bank stock are carried at par value ($100 per share), which reasonably approximates its fair value. As members of the FHLB system, the Banks are required to maintain a minimum level of investment in FHLB stock based on specific percentages of its outstanding FHLB advances. For the year ended December 31, 2009, the Banks did not receive any dividend income on FHLB stock. The Banks received dividend income on FHLB stock totaling $355,000 and $222,000 for the years ended December 31, 2008 and 2007, respectively. In the fourth quarter of 2008, due to a weakened capital position and financial performance stemming from the turmoil in the capital and mortgage markets, the FHLB of Seattle suspended dividend payment on all classes of stock.

At December 31, 2009, the Company had recorded $37.4 million in FHLB stock. This represents no change from December 31, 2008. This stock is generally viewed as a long-term investment and is carried at par. It does not have a readily determinable fair value. Ownership of FHLB stock is restricted to the FHLB and member institutions and can only be purchased and redeemed at par. Although as of September 30, 2009, the FHLB of Seattle met all of its regulatory requirements (including the risk-based capital requirement), on November 6, 2009, the Finance Agency reaffirmed the FHLB of Seattle capital classification as undercapitalized. The Finance Agency also indicated that it would not change the capital classification to adequately capitalized until the Finance Agency believes the FHLB of Seattle has demonstrated sustained performance in line with an approved capital restoration plan.

Management periodically evaluates FHLB stock for other-than-temporary or permanent impairment. Management's determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB. As of December 31, 2009, management has concluded that our investment in FHLB stock is not impaired.

Loans Receivable: The Banks originate residential mortgage loans for both portfolio investment and sale in the secondary market. At the time of origination, mortgage loans are designated as held for sale or held for investment. Loans held for sale are stated at lower of cost or estimated fair value determined on an aggregate basis. Net unrealized losses on loans held for sale are recognized through a valuation allowance by charges to income. The Banks also originate construction and land development, commercial and multifamily real estate, commercial business, agricultural and consumer loans for portfolio investment. Loans receivable not designated as held for sale are recorded at the principal amount outstanding, net of allowance for loan losses, deferred fees, discounts and premiums. Premiums, discounts and deferred loan fees are amortized to maturity using the level-yield methodology.

Interest Income: 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 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: 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 generally accepted accounting principles 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 estimated 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 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 we identify 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, including changes in the size and composition of the loan portfolio, delinquency rates, actual loan loss experience and current economic conditions, as well as individual review of certain large balance loans. 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. 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.

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 that, 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 financial statements.

Loans are reported as restructured when the Bank grants a concession(s) to a borrower experiencing financial difficulties that it would not otherwise consider. Examples of such concessions include forgiveness of principal or accrued interest, extending the maturity date(s) or providing a lower interest rate than would be normally available for a transaction of similar risk. As a result of these concessions, restructured loans are impaired as the Bank will not collect all amounts due, both principal and interest, in accordance with the terms of the original loan agreement. Impairment reserves on non-collateral dependent restructured loans are measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan's carrying value. These impairment reserves are recognized as a specific component to be provided for in the allowance for loan and lease losses.

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.

Loan Origination and Commitment Fees: Loan origination fees, net of certain specifically defined direct loan origination costs, are deferred and recognized as an adjustment of the loans' interest yield using the level-yield method over the contractual term of each loan adjusted for actual loan prepayment experience. Net deferred fees or costs related to loans held for sale are recognized in income at the time the loans are sold. Loan commitment fees are deferred until the expiration of the commitment period unless management believes there is a remote likelihood that the underlying commitment will be exercised, in which case the fees are amortized to fee income using the straight-line method over the commitment period. If a loan commitment is exercised, the deferred commitment fee is accounted for in the same manner as a loan origination fee. Deferred commitment fees associated with expired commitments are recognized as fee income.

Real Estate Held for Sale: Property acquired by foreclosure or deed in lieu of foreclosure is recorded at the lower of estimated fair value, less cost to sell, or the carrying value of the defaulted loan. Development and improvement costs relating to the property are capitalized while direct 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.

Property and Equipment: The provision for depreciation is based upon the straight-line method applied to individual assets and groups of assets acquired in the same year at rates adequate to charge off the related costs over their estimated useful lives:

Buildings and leased improvements	10-30 years
Furniture and equipment	3-10 years

Routine maintenance, repairs and replacement costs are expensed as incurred. Expenditures which significantly increase values or extend useful lives are capitalized. The Company reviews buildings, leasehold improvements and equipment for impairment whenever events or changes in circumstances indicate that the undiscounted cash flows for the property are less than its carrying value. If identified, an impairment loss is recognized through a charge to earnings based on the fair value of the property.

Goodwill and Other Intangible Assets: Goodwill and other intangible assets consists primarily of goodwill, which represents the excess of the purchase price over the fair value of net assets acquired in a business combination accounted for under the purchase method, and core deposit intangibles (CDI), which are amounts recorded in business combinations or deposit purchase transactions related to the value of transaction-related deposits and the value of the customer relationships associated with the deposits. Prior to December 31, 2008, the largest component of our intangible assets was goodwill which arose from business combinations completed in previous periods. However, for the year ended December 31, 2008, we recorded $121.1 million of impairment charges, which eliminated all of the goodwill previously carried in our Consolidated Statements of Financial Condition. The other major component of our intangible assets is core deposit intangibles, which is the value ascribed to the long-term deposit relationships arising from acquisitions. 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.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, balance outstanding, loan type, age and remaining term, and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the Company later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal or a fixed amount per loan and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income.

Derivative Instruments: Derivatives include "off-balance-sheet" financial products, the value of which is dependent on the value of underlying financial assets, such as stock, bonds, foreign currency, or a reference rate or index. Such derivatives include "forwards," "futures," "options" or "swaps." The Company and the Banks generally have not invested in "off-balance-sheet" derivative instruments, although investment policies authorize such investments. However, as a result of the acquisition of F&M, the Company became a party to approximately $23.0 million ($20.4 million as of December 31, 2009) in notional amounts of interest rate swaps. These swaps serve as hedges to an equal amount of fixed rate loans which include market value prepayment penalties that mirror the provision of the specifically matched interest rate swaps. The fair value adjustments for these swaps and the related loans are reflected in other assets or other liabilities as appropriate, and in the carrying value of the hedged loans. Further, as a part of mortgage banking activities, the Company issues "rate lock" commitments to borrowers and obtain offsetting "best efforts" delivery commitments from purchasers of loans. While not providing any trading or net settlement mechanisms, these off-balance-sheet commitments do have many of the prescribed characteristics of derivatives. On December 31, 2009, the Company and the Banks had no other investment-related off-balance-sheet derivatives.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Banks, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Banks do not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Advertising Expenses: Advertising costs are expensed as incurred. Costs related to production of advertising are considered incurred when the advertising is first used.

Income Taxes: The Company files a consolidated income tax return including all of its wholly owned subsidiaries on a calendar year basis. 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 will be in effect when the differences between the financial statement carrying amounts and tax bases 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 of change.

The Company adopted the revised provisions of FASB ASC 740, *Income Taxes*, ("ASC 740"), relating to the accounting for uncertainty in income taxes on January 1, 2007. Upon the implementation of the revised provisions, the Company recognized no material adjustment in the form of a liability for unrecognized tax benefits. The Company periodically reviews its income tax positions based on tax laws and regulations and financial reporting considerations, and records adjustments as appropriate. This review takes into consideration the status of current taxing authorities' examinations of the Company's tax returns, recent positions taken by the taxing authorities on similar transactions, if any, and the overall tax environment.

Employee Stock Ownership Plan: The Company loaned the Employees Stock Ownership Plan (ESOP) the funds necessary to fund the purchase of 8% of the Company's initial public offering of common stock. The loan to the ESOP is repaid principally from the Company's contribution to the ESOP, and the collateral for the loan is the Company's common stock purchased by the ESOP. Annually, in consultation with the Company's directors, the ESOP's trustees determine if the contribution will be used to make a payment on the loan or purchase shares in the open market. When the contribution is used to repay debt, shares are released from collateral based on the proportion of debt service paid in the year and allocated to participants' accounts. When shares are released from collateral, compensation expense is recorded equal to the average current market price of the shares, and the shares become outstanding for earnings-per-share calculations. When the contribution is used to purchase shares in the open market, compensation expense is recorded in the amount of the contribution. Stock and cash dividends on allocated

shares are recorded as a reduction of retained earnings and paid or distributed directly to participants' accounts. Dividends on unallocated shares are used to fund a portion of the Company's contribution to the ESOP (see additional discussion in Note 18).

Equity-Based Compensation: At December 31, 2009, the Company had the following stock-based employee/director compensation plans: a stock grant plan (the 1996 Management Recognition and Development Plan), three stock option plans (the 1996 Stock Option Plan, the 1998 Stock Option Plan and the 2001 Stock Option Plan) and the Banner Corporation Long-Term Incentive Plan. These plans are described more fully in Note 19.

The 1996 Management Recognition and Development Plan (MRP), a restricted stock grant plan, values shares awarded at their fair value, which is their intrinsic value on the date of the award grant. The expense of the award grants are accrued ratably over the five-year vesting period from the date of each award.

Stock Option Plans: The Company has adopted the fair value recognition provisions of FASB ASC 718, *Stock Compensation,* using the modified-prospective-transition method. Under that method, compensation costs recognized include: (a) compensation costs for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant-date fair value and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value. This method requires the cash flows resulting from the tax benefits of tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows (see Note 19).

The Banner Corporation Long-Term Incentive Plan was initiated in June 2006. The Plan is an account-based type of benefit, the value of which is directly related to changes in the value of the Company's common stock (the excess of the fair market value of a share of the Company's common stock on the date of vesting over the fair market value of such share on the date granted) plus dividends declared on the Company's common stock and changes in Banner Bank's average earnings rate. Awards granted through the plan are considered stock appreciation rights (SARs) and are included in deferred compensation. The Company remeasures the fair value of a SAR each reporting period until the award is settled and compensation expense is recognized each reporting period for changes in the SAR's fair value and vesting.

Wholesale Repurchase Agreements: The Company periodically enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Company transfers legal control over the assets but still retains effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, repurchase agreements are accounted for as financing arrangements and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Consolidated Statements of Financial Condition while the dollar amount of securities underlying the agreements remains in the respective asset accounts. Those securities are disclosed as encumbered.

Comprehensive Income: Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. In addition, certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the Statement of Financial Condition, and such items, along with net income, are components of comprehensive income which is reported in the Consolidated Statements of Comprehensive Income.

Average Balances: Average balances are obtained from the best available daily, weekly or monthly data, which the Company's management believes approximate the average balances calculated on a daily basis.

Reclassification: Certain reclassifications have been made to the prior years' consolidated financial statements and/or schedules to conform to the current year's presentation. These reclassifications may have affected certain ratios for the prior periods. These reclassifications had no effect on retained earnings or net income as previously presented and the effect of these reclassifications is considered immaterial.

Note 2: RECENT DEVELOPMENTS AND SIGNIFICANT EVENTS

Regulatory Actions: In light of the current challenging operating environment, along with our elevated level of non-performing assets, delinquencies, and adversely classified assets and our recent operating results, we expect Banner Bank to shortly enter into a Memorandum of Understanding or MOU with the FDIC and Washington DFI. We expect that, under the MOU, Banner Bank will be required, among other things, to develop and implement plans to reduce commercial real estate concentrations; to improve asset quality and reduce classified assets; to improve profitability; and to increase Tier 1 leverage capital to equal or exceed 10% of average assets. In addition, we expect that Banner Bank will not be able to pay cash dividends to Banner Corporation without prior approval from the FDIC and Washington DFI. See Item 1A, Risk Factors—"We are subject to various regulatory requirements, expect to be subject to a memorandum of understanding and may be subject to future additional regulatory restrictions and enforcement actions."

We also expect that the Company will enter into a similar MOU with the Federal Reserve Bank of San Francisco. In addition, the Company and Banner Bank must obtain prior regulatory approval before adding any new director or senior executive officer or changing the responsibilities of any current senior executive officer. Further, the Company may not pay any dividends on common or preferred stock, pay interest or principal on the balance of its junior subordinated debentures or repurchase our common stock without the prior written non-objection of the Federal Reserve Bank.

FDIC Prepayment: On November 12, 2009, the FDIC adopted a final rule that required insured depository institutions to prepay an estimate of their expected quarterly deposit insurance premiums for the fourth quarter of 2009 and for the three years ended December 31, 2010, 2011 and 2012. Insured institutions were required to deposit funds with the FDIC in the amount of the prepaid assessment on December 30, 2009. The insured institutions will not receive interest on the deposited funds. For purposes of calculating an institution's prepaid assessment amount, for the fourth quarter of 2009 and all of 2010, that institution's assessment rate was its total base assessment rate in effect on September 30, 2009. That rate was then increased by three basis points for all of 2011 and 2012. Again, for purposes of calculating the prepaid amount, an institution's third quarter 2009 assessment base was assumed to increase quarterly by an estimated five percent annual growth rate through the

end of 2012. Each institution was directed to record the entire amount of its prepaid assessment as a prepaid expense (asset) as of December 30, 2009. Thereafter, each institution will record an expense (charge to earnings) for its regular quarterly assessment for the quarter and an offsetting credit to the prepaid assessment until the asset is exhausted. Once the asset is exhausted, the institution will record an expense and an accrued expense payable each quarter for its regular assessment, which would be paid in arrears to the FDIC at the end of the following quarter. If the prepaid assessment is not exhausted by June 30, 2013, any remaining amount will be returned to the institution. The balance of the prepaid assessment was $29.5 million at December 31, 2009.

FDIC Special Assessment: On May 22, 2009, the FDIC adopted a final rule imposing a five basis point special assessment on each insured depository institution's total assets minus Tier 1 capital as of June 30, 2009, with the maximum amount of the special assessment for any institution not to exceed ten basis points times the institution's assessment base for the second quarter 2009 risk-based assessment. The special assessment was collected on September 30, 2009 at the same time the regular quarterly risk-based assessment for the second quarter of 2009 was collected. For Banner Corporation, this assessment was $2.1 million, which was recognized in other operating expenses during the quarter ended June 30, 2009. The FDIC Board may vote to impose additional special assessments if the FDIC estimates that the Deposit Insurance Fund reserve ratio will fall to a level that the Board believes would adversely affect public confidence or to a level that will be close to or below zero.

FDIC Temporary Liquidity Guarantee Program: Banner Corporation, Banner Bank and Islanders Bank have chosen to participate in the FDIC's Temporary Liquidity Guarantee Program (the "TLGP"), which applies to all U.S. depository institutions insured by the FDIC and all United States bank holding companies, unless they have opted out. Under the TLGP, the FDIC guarantees certain senior unsecured debt of insured institutions and their holding companies, as well as non-interest-bearing transaction account deposits. Under the transaction account guarantee component of the TLGP, all non-interest-bearing and certain interest-bearing transaction accounts maintained at Banner Bank and Islanders Bank are insured in full by the FDIC until June 30, 2010, regardless of the standard maximum deposit insurance amounts. The Banks are required to pay a fee (annualized) on balances of each covered account in excess of $250,000 while the extra deposit insurance is in place. The annualized fee for the transaction account guarantee program is 10 basis points through December 31, 2009 and will be within a range from 15 to 25 basis points from January 1 through June 30, 2010. On March 31, 2009, Banner Bank completed an offering of $50 million of qualifying senior bank notes covered by the TLGP at a fixed rate of 2.625% which mature on March 31, 2012. Under the debt guarantee component of the TLGP, the FDIC will pay the unpaid principal and interest on an FDIC-guaranteed debt instrument upon the uncured failure of the participating entity to make a timely payment of principal or interest. Under the terms of the TLGP, the Bank is not permitted to use the proceeds from the sale of securities guaranteed under the TLGP to prepay any of its other debt that is not guaranteed by the FDIC. Banner Bank is required to pay a 1.00% fee (annualized) on this debt, which will result in a total fee of $1.5 million over three years. None of the senior notes are redeemable prior to maturity.

Participation in the U.S. Treasury's Capital Purchase Program: On November 21, 2008, Banner Corporation received $124 million from the U.S. Treasury Department as part of the Treasury's Capital Purchase Program. The Company issued $124 million in senior preferred stock, with a related warrant to purchase up to $18.6 million in common stock, to the U.S. Treasury. The warrant provides the Treasury the option to purchase up to 1,707,989 shares of Banner Corporation common stock at a price of $10.89 per share at any time during the next ten years. The preferred stock will pay a 5% dividend for the first five years, after which the rate will increase to 9% if the preferred shares are not redeemed by the Company. The terms and conditions of the transaction and the preferred stock conform to those provided by the U.S. Treasury. A summary of the Capital Purchase Program can be found on the Treasury's web site at www.ustreas.gov/initiatives/eesa.

Goodwill write-off: As a result of the significant decline in Banner Corporation's stock price and market capitalization over the course of 2008 and in conjunction with similar declines in the value of most financial institutions and the ongoing disruption in related financial markets, the Company decided to reduce the carrying value of goodwill in the Consolidated Statements of Financial Condition by recording $50 million write-down in the second quarter and, in response to worsening economic indicators and further price declines, an additional $71 million write-down in the fourth quarter of 2008. The total $121 million write-off of goodwill was a non-cash charge that did not affect the Company's or the Banks' liquidity or operations. The adjustment brought book value and tangible book value more closely in line with each other and more accurately reflected current market conditions. Also, since goodwill is excluded from regulatory capital, the impairment charge (which was not deductible for tax purposes) did not have an adverse effect on the regulatory capital ratios of the Company or either of our subsidiary banks, each of which continues to remain "well capitalized" under the regulatory requirements. (See Note 24 of the Selected Notes to Consolidated Financial Statements for additional information with respect to our valuation of intangible assets.)

Fannie Mae and Freddie Mac Stock Valuation: In September 2008, the United States Treasury announced a plan to place the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") into conservatorship under the authority of the Federal Housing Finance Agency. As of June 30, 2008, Banner Corporation owned both common and preferred equity securities issued by Fannie Mae and Freddie Mac with a combined book value of $6.9 million. At December 31, 2009, the fair value of these securities had declined to approximately $328,000, with the decrease in the value included in the net fair value adjustments detailed in Note 25, Fair Value Accounting and Measurement. The Company does not anticipate a meaningful recovery with respect to the valuation of that stock.

Issuance of Shares through Dividend Reinvestment and Direct Stock Purchase and Sale Plan (DRIP): On July 22, 2008, the Board of Directors authorized the registration and issuance of an additional 3,000,000 shares of common stock through continuation of the DRIP. Also, on August 25, 2009 and January 26, 2010, the Board of Directors authorized the registration and issuance of an additional 3,875,000 shares and 4,500,000 shares, respectively, of common stock through continuation of the DRIP. During the year ended December 31, 2009, the Company added to its capital structure by issuing 4,387,552 shares at an average price, net of issuance costs, of $3.36 per share through the DRIP. This issuance of stock provided a net $14.7 million increase to capital during the year ended December 31, 2009. Likewise, for the year ended December 31, 2008, the Company issued 1,469,381 shares at an average price, net of issuance costs, of $14.41 per share through the DRIP, adding $21.2 million to capital.

Acquisitions of F&M Bank, San Juan Financial Holding Company and NCW Community Bank: The Company completed the acquisitions of F&M Bank (F&M) and San Juan Financial Holding Company (SJFHC) effective May 1, 2007, and NCW Community Bank (NCW) effective October 10, 2007. SJFHC was merged into Banner Corporation and its wholly owned subsidiary, Islanders Bank, has continued operations as a

subsidiary of Banner Corporation. F&M and NCW were merged into Banner Bank upon acquisition and now operate under the Banner Bank name. The financial results for the years ended December 31, 2009 and 2008 include the assets, liabilities and results of operations for all three of the acquired companies. The financial results for the year ended December 31, 2007 include the assets and liabilities acquired in the acquisitions with the impact of those acquisitions subsequent to the effective dates reported in the results of operations. (See Note 4 of Selected Notes to Consolidated Financial Statements for additional information with respect to these acquisitions.)

Note 3: ACCOUNTING STANDARDS RECENTLY ADOPTED OR ISSUED

Recently Adopted Accounting Standards: In August 2009, FASB issued ASU No. 2009-05, *Measuring Liabilities at Fair Value*. This update amends ASC 820, *Fair Value Measurements and Disclosure,* in regards to the fair value measurement of liabilities. FASB ASC 820 clarifies that in circumstances in which a quoted price for an identical liability in an active market is not available, a reporting entity shall utilize one or more of the following techniques: i) the quoted price of the identical liability when traded as an asset, ii) the quoted price for a similar liability or for a similar liability when traded as an asset, or iii) another valuation technique that is consistent with the principles of ASC 820. In all instances a reporting entity shall utilize the approach that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. Also, when measuring the fair value of a liability, a reporting entity shall not include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. This update was effective for the Company in the fourth quarter of 2009. The adoption of ASU 2009-05 did not have a material impact on the Company's Consolidated Financial Statements.

In May 2009, FASB amended the accounting standard for *Subsequent Events*. The updated standard, ASC 855, established general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The revisions did not result in significant changes in the subsequent events that an entity reports, either through recognition or disclosure in its financial statements. It does require disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. This disclosure should alert all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. The Company adopted the provisions of this guidance for the interim period ended June 30, 2009, and the effect of adoption on the Company's Consolidated Financial Statements was not material.

In April 2009, FASB revised accounting standards for *Financial Instruments*. The revised standard, ASC 825, requires fair value disclosures in the notes of an entity's interim financial statements for all financial instruments, whether or not recognized in the statement of financial position. This revision became effective for the interim reporting period ending after June 15, 2009. The adoption of the revised standards and the increased interim financial statement disclosures did not have a material effect on the Company's Consolidated Financial Statements.

In April 2009, FASB revised accounting standards for *Investments—Debt and Equity Securities*. The standard, ASC 320, changes the other-than-temporary impairment (OTTI) model for debt securities. Under previous guidance, an entity was required to assess whether it has the intent and ability to hold a security to recovery in determining whether an impairment of that security is other-than-temporary. If the impairment was deemed other-than-temporarily impaired, the investment was written-down to fair value through earnings. Under the revised guidance, OTTI is triggered if an entity has the intent to sell the security, it is more likely than not that it will be required to sell the security before recovery, or if the entity does not expect to recover the entire amortized cost basis of the security. If the entity intends to sell the security or it is more likely than not it will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If the entity does not intend to sell the security and it is not likely that the entity will be required to sell the security but the entity does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings as an OTTI. The credit loss is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected on a security. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment loss related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, would be recognized as a charge to other comprehensive income (OCI). Impairment losses related to all other factors are to be presented as a separate category within OCI. For investment securities held to maturity, this amount is accreted over the remaining life of the debt security prospectively based on the amount and timing of future estimated cash flows. The accretion of the OTTI amount recorded in OCI will increase the carrying value of the investment and would not affect earnings. If there is an indication of additional credit losses, the security is reevaluated accordingly based on the procedures described above. Upon adoption of the revised guidance, the noncredit portion of previously recognized OTTI is to be reclassified to accumulated OCI by a cumulative-effect adjustment to the opening balance of retained earnings. These revisions became effective in the interim reporting period ending after June 15, 2009. We adopted these revisions for the quarter ended June 30, 2009 and the effect of the adoption on the Company's Consolidated Financial Statements was not material.

In April 2009, FASB amended accounting standards for *Fair Value Measurements and Disclosures*. The amended standard, ASC 820, addresses issues related to the determination of fair value when the volume and level of activity for an asset or liability has significantly decreased, and identifying transactions that are not orderly. The revisions affirm the objective that fair value is the price that would be received to sell an asset in an orderly transaction (that is not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions, even if the market is inactive. The amendment provides additional guidance for estimating fair value when the volume and level of activity for the asset or liability have decreased significantly. It also provides guidance on identifying circumstances that indicate a transaction is not orderly. If it is determined that a quoted price is distressed (not orderly), and thereby not representative of fair value, the entity may need to make adjustments to the quoted price or utilize an alternative valuation technique (e.g., income approach or multiple valuation techniques) to determine fair value. Additionally, an entity must incorporate appropriate risk premium adjustments, reflective of an orderly transaction under current market conditions, due to uncertainty in cash flows. The revised guidance requires disclosures in interim and annual periods regarding the inputs and valuation techniques used to measure fair value and a discussion of changes in valuation techniques and related inputs, if any, during the period. It also requires financial institutions to disclose the fair values of investment securities by major security type. The changes were effective for the interim reporting period ending after June 15, 2009, and are to be applied prospectively. The

requirements of these amendments are consistent with the Company's practice of calculating fair value on the various assets and liabilities it carries at fair value. Therefore, there was no material impact on the fair value measurement of any assets or liabilities in the Consolidated Financial Statements.

In January 2009, FASB amended accounting standards for *Investments—Other*. The amended standard, ASC 325, addresses certain practices or issues related to the recognition of interest income and impairment on purchased beneficial interests and beneficial interests that continue to be held by a transferor in securitized financial assets, by making its (OTTI) assessment guidance consistent with the accounting standards for *Investments—Debt and Equity Securities*. The amendment removes the reference to the consideration of a market participant's estimates of cash flows and instead requires an assessment of whether it is probable, based on current information and events, that the holder of the security will be unable to collect all amounts due according to the contractual terms. If it is probable that there has been an adverse change in estimated cash flows, an OTTI is deemed to exist, and a corresponding loss shall be recognized in earnings equal to the entire difference between the investment's carrying value and its fair value at the balance sheet date of the reporting period for which the assessment is made. This amendment became effective for interim and annual reporting periods ending after December 15, 2008, and is applied prospectively. The amendment of these standards did not have a material impact on the Company's Consolidated Financial Statements.

In October 2008, FASB amended accounting standards for *Fair Value Measurements and Disclosures*. The amended standard, ASC 820, clarifies the application of fair value measurements in a market that is not active. The amendment is intended to address the following application issues: (a) how the reporting entity's own assumptions (that is, expected cash flows and appropriately risk-adjusted discount rates) should be considered when measuring fair value when relevant observable inputs do not exist; (b) how available observable inputs in a market that is not active should be considered when measuring fair value; and (c) how the use of market quotes (for example, broker quotes or pricing services for the same or similar financial assets) should be considered when assessing the relevance of observable and unobservable inputs available to measure fair value. The changes were effective on issuance, including prior periods for which financial statements had not been issued. We adopted the amendment for the quarter ended December 31, 2008 and the effect of adoption on the Consolidated Financial Statements was not material.

In December 2007, FASB revised accounting standards for *Business Combinations*. The standard, ASC 805, requires the acquiring entity to recognize and measure in its financial statements all the assets acquired, the liabilities assumed, any non-controlling interest in the acquired entity, and the goodwill acquired and establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed. Furthermore, acquisition-related and other costs will now be expensed rather than treated as cost components of the acquisition. ASC 805 also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. The revision to this guidance applies prospectively to business combinations for which the acquisition date occurs on or after January 1, 2009. We do not expect the adoption of these revisions will have a material impact on our consolidated financial statements as related to business combinations consummated prior to January 1, 2009. The adoption of these revisions will increase the costs charged to operations for acquisitions consummated on or after January 1, 2009.

Recently Issued Accounting Pronouncements: In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820)—Improving Disclosures about Fair Value Measurements*. FASB ASU No. 2009-06 requires (i) fair value disclosures by each class of assets and liabilities (generally a subset within a line item as presented in the statement of financial position) rather than major category, (ii) for items measured at fair value on a recurring basis, the amounts of significant transfers between Levels 1 and 2, and transfers into and out of Level 3, and the reasons for those transfers, including separate discussion related to the transfers into each level apart from transfers out of each level, and (iii) gross presentation of the amounts of purchases, sales, issuances, and settlements in the Level 3 recurring measurement reconciliation. Additionally, the ASU clarifies that a description of the valuation techniques(s) and inputs used to measure fair values is required for both recurring and nonrecurring fair value measurements. Also, if a valuation technique has changed, entities should disclose that change and the reason for the change. Disclosures other than the gross presentation changes in the Level 3 reconciliation are effective for the first reporting period beginning after December 15, 2009. The requirement to present the Level 3 activity of purchases, sales, issuances, and settlements on a gross basis will be effective for fiscal years beginning after December 15, 2010. The Company is currently evaluating the impact of adoption of FASB ASU No. 2010-06. We do not expect the adoption of this ASU will have a material impact on the Company's Consolidated Financial Statements.

In December 2009, FASB issued ASU No. 2009-17, *Transfers and Servicing (Topic 860)—Accounting for Transfers of Financial Assets.* This update codifies SFAS No. 166, *Accounting for Transfers of Financial Assets—an Amendment of FASB Statement No. 140*, which was previously issued by FASB in June 2009 but was not included in the original codification. ASU 2009-17 eliminates the concept of a qualifying special-purpose entity, creates more stringent conditions for reporting a transfer of a portion of a financial asset as a sale, clarifies other sale-accounting criteria, and changes the initial measurement of a transferor's interest in transferred financial assets. This statement is effective for annual reporting periods beginning after November 15, 2009, and for interim periods therein. This standard will primarily impact the Company's accounting and reporting of transfers representing a portion of a financial asset for which the Company has a continuing involvement. In order to recognize the transfer of a portion of a financial asset as a sale, the transferred portion and any portion that continues to be held by the transferor must represent a participating interest, and the transfer of the participating interest must meet the conditions for surrender of control. To qualify as a participating interest, (i) the portions of a financial asset must represent a proportionate ownership interest in an entire financial asset, (ii) from the date of transfer, all cash flows received from the entire financial asset must be divided proportionately among the participating interest holders in an amount equal to their share of ownership, (iii) involve no recourse (other than standard representation and warranties) to, or subordination by, any participating interest holder, and (iv) no party has the right to pledge or exchange the entire financial asset. If the participating interest or surrender of control criteria are not met, the transfer is not accounted for as a sale and derecognition of the asset is not appropriate. Rather, the transaction is accounted for as a secured borrowing arrangement. The impact of certain participations being reported as secured borrowings rather than derecognizing a portion of a financial asset would increase total assets, liabilities and their respective interest income and expense. An increase in total assets also increases regulatory risk-weighted assets and could negatively impact our capital ratios. The Company does not believe the impact of adoption will have a material impact on the Company's consolidated financial statements.

In December 2009, FASB issued ASU No. 2009-18, *Consolidations (Topic 810)—Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities.* This update codifies SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*, which was previously issued by FASB in June 2009 but was not included in the original codification. ASU 2009-18 eliminates FASB Interpretations 46(R) (FIN 46(R)) exceptions to consolidating qualifying special-purpose entities, contains new criteria for determining the primary beneficiary, and increases the frequency of required reassessments to determine whether a company is the primary beneficiary of a variable interest entity (VIE). The new guidance also contains a new requirement that any term, transaction, or arrangement that does not have a substantive effect on an entity's status as a variable interest entity, a company's power over a variable interest entity, or a company's obligation to absorb losses or its right to receive benefits of an entity must be disregarded in applying the previous provisions. The elimination of the qualifying special-purpose entity concept and its consolidation exceptions means more entities will be subject to consolidation assessments and reassessments. This statement requires additional disclosures regarding an entity's involvement in a variable interest entity. This statement is effective for annual reporting periods beginning after November 15, 2009, and for interim periods therein. The Company is still evaluating the impact of the adoption of this guidance, but does not anticipate that this new guidance will have any material impact on the Company's consolidated financial statements.

Note 4: ACQUISITIONS OF F&M BANK, SAN JUAN FINANCIAL HOLDING COMPANY AND NCW COMMUNITY BANK

On May 1, 2007, the Company completed the acquisition of F&M Bank, Spokane, Washington, in a stock and cash transaction valued at approximately $98.1 million, with $19.4 million of cash and 1,773,402 shares of Banner Corporation common stock, for 100% of the outstanding common shares of F&M Bank. F&M Bank was merged into Banner Bank and the results of its operations are included in those of Banner Bank starting in the quarter ended June 30, 2007.

On May 1, 2007, the Company completed the acquisition of San Juan Financial Holding Company (SJFHC), the parent company of Islanders Bank, Friday Harbor, Washington, in a stock and cash transaction valued at approximately $41.6 million, with $6.2 million of cash and 819,209 shares of Banner common stock, for 100% of the outstanding common shares of SJFHC. SJFHC was merged into Banner Corporation and Islanders Bank has continued to operate as a separate subsidiary of Banner Corporation. The results of its operations are included in the Company's consolidated operations beginning in the quarter ended June 30, 2007.

On October 10, 2007, the Company completed the acquisition of NCW Community Bank (NCW), Wenatchee, Washington, in a stock and cash transaction valued at approximately $18.5 million, with $6.5 million of cash and 339,860 shares of Banner Corporation common stock, for 100% of the outstanding common shares of NCW. NCW was merged into Banner Bank and the results of its operations are included in Banner Bank's consolidated operations beginning in the fourth quarter of 2007.

The acquisitions were accounted for as purchases in accordance with ASC 805. Accordingly, the purchase prices were allocated to the assets acquired and the liabilities assumed based on their estimated fair values at the acquisition date as summarized in the following table:

Date of acquisition	F&M May 1, 2007 (in thousands)	SJFHC May 1, 2007 (in thousands)	NCW October 10, 2007 (in thousands)	Total (in thousands)
New shares issued in acquisition	1,773,402	819,209	339,860	2,932,471
Cash paid to shareholders	$ 19,404	$ 6,159	$ 6,505	$ 32,068
Total value of Banner's common stock exchanged with acquiree's shareholders	78,030	35,177	11,813	125,020
Transaction closing costs	756	318	168	1,242
Total purchase price	$ 98,190	$ 41,654	$ 18,486	$ 158,330
Allocation of purchase price				
Acquisitions' equity	$ 32,987	$ 16,782	$ 9,601	$ 59,370
Adjustments to record assets and liabilities at estimated fair value				
Loans	(195)	(604)	(90)	(889)
Premises and equipment	3,315	1,800	--	5,115
Core deposit intangible (CDI)	10,867	6,147	1,245	18,259
Deposits	(336)	37	(197)	(496)
Deferred taxes, net	(4,916)	(2,659)	(345)	(7,920)
Estimated fair value of net assets acquired	41,722	21,503	10,214	73,439
Goodwill resulting from acquisition	$ 56,468	$ 20,151	$ 8,272	$ 84,891

The fair value of assets and liabilities of acquired institutions at the date of acquisition follows:

Date of acquisition	F&M May 1, 2007 (in thousands)	SJFHC May 1, 2007 (in thousands)	NCW October 10, 2007 (in thousands)	Total (in thousands)
Cash	$ 12,056	$ 7,449	$ 2,916	$ 22,421
Securities—available for sale	6,768	26,263	1,200	34,231
Federal funds sold and interest bearing deposits at banks	137	--	--	137
Loans, net of allowance for loan losses of $4,528, $1,429 and $1,319, respectively	389,290	116,999	90,522	596,811
Premises and equipment, net	11,872	5,756	3,012	20,640
BOLI	8,662	2,315	--	10,977
Other assets	7,528	2,082	1,597	11,207
Goodwill	56,468	20,151	8,272	84,891
Core deposit intangible (CDI)	10,867	6,298	1,245	18,410
Total assets	503,648	187,313	108,764	799,725
Deposits	(348,822)	(124,264)	(86,756)	(559,842)
Advances from Federal Home Loan Bank	(20,000)	(15,726)	--	(35,726)
Federal funds purchased and other borrowings	(19,625)	--	(1,590)	(21,215)
Other liabilities	(17,011)	(5,669)	(1,932)	(24,612)
Total liabilities	(405,458)	(145,659)	(90,278)	(641,395)
Net assets acquired	$ 98,190	$ 41,654	$ 18,486	$ 158,330

The CDI asset shown in the table above represents the value ascribed to the long-term deposit relationships acquired. This intangible asset is being amortized using an accelerated method over an estimated useful life of eight years. The core deposit intangible asset is not estimated to have a significant residual value. Goodwill represents the excess of the total purchase price paid for the Banks over the fair values of the assets acquired, net of the fair values of the liabilities assumed. Goodwill is not amortized, but is evaluated for possible impairment at least annually and more frequently if events and circumstances indicate that the asset might be impaired. During the year ended December 31, 2008, we recorded a goodwill impairment charge of $121.1 million. (See Note 24 of the Selected Notes to Consolidated Financial Statements.) No impairment losses have been recognized in connection with core deposit intangibles during the period from acquisition to the end of the current reporting period.

The following table presents unaudited pro forma condensed results of operations for the year ended December 31, 2007 prepared as if the acquisitions of F&M, SJFHC and NCW had occurred on January 1, 2007. Any cost savings realized as a result of the acquisitions are not reflected in the pro forma condensed statements of income as no assurance can be given with respect to the final amount of such cost savings. The pro forma results have been prepared for comparison purposes only and are not necessarily indicative of the results that would have been obtained had the acquisitions actually occurred on January 1, 2007.

Pro Forma Financial Information – Unaudited
(in thousands except per share data)

	Year Ended December 31, 2007										
		Four Months Ended April 30, 2007		9.3 Months Ended October 9, 2007							
	Banner	F&M	SJFHC	NCW	F&M Pro Forma Adjustments		SJFHC Pro Forma Adjustments		NCW Pro Forma Adjustments		Pro Forma Consolidated
Net interest income before provision for loan losses	$ 149,619	$ 5,803	$ 2,074	$ 4,034	$ (95)	(A)	$ 38	(A)	$ 22	(A)	$ 161,495
Provision for loan losses	5,900	1,028	20	155	--		--		--		7,103
Other operating income	38,583	1,375	599	158	--		(22)	(B)	--		40,693
Other operating expense	127,489	13,425	3,109	3,879	(7,341)	(C)	(937)	(D)	(1,186)	(E)	138,438
Income (loss) before provision for income taxes (benefits)	54,813	(7,275)	(456)	158	7,246		953		1,208		56,647
Provision for income taxes (benefits)	17,890	(2,612)	270	51	2,609	(F)	343	(F)	435	(F)	18,986
Net income (loss)	$ 36,923	$ (4,663)	$ (726)	$ 107	$ 4,637		$ 610		$ 773		$ 37,661
Basic earnings per share	$ 2.53										$ 2.40
Diluted earning per share	$ 2.49										$ 2.36
Basic weighted average shares outstanding	14,581	686	120	346	583	(G)	270	(G)	257	(G)	15,691
Diluted weighted average shares outstanding	14,383	686	120	346	583	(G)	270	(G)	257	(G)	15,948

(A) Consists of net accretion of fair value adjustments related to the acquisitions of F&M, SJFHC and NCW assuming acquired January 1, 2006.
(B) Reversal of effects of equity in earnings of San Juan Title Company not acquired in acquisition.
(C) Reversal of merger related expenses of $7.8 million, offset by additional core deposit amortization of $470,000 assuming acquired January 1, 2006.
(D) Reversal of merger related expenses of $1.3 million, offset by additional core deposit amortization of $320,000 assuming acquired January 1, 2006.
(E) Reversal of merger related expenses of $1.3 million, offset by additional core deposit amortization of $137,000 assuming acquired January 1, 2006.
(F) Income tax effect of pro forma adjustments at 36%.
(G) Additional shares issued at an exchange rate of 0.85 to 1 for F&M, 2.2503 to 1 for SJFHC and 0.7438 to 1 for NCW.

Note 5: CASH, DUE FROM BANKS AND CASH EQUIVALENTS

Cash, due from banks and cash equivalents consisted of the following (dollars in thousands):

	December 31	
	2009	2008
Cash on hand and due from banks	$ 322,346	$ 99,230
Cash equivalents:		
Short-term cash investments	659	3,520
Federal funds sold	--	--
	$ 323,005	$ 102,750

For the purpose of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, overnight investments and short-term deposits with original maturities of less than 90 days.

Federal regulations require depository institutions to maintain certain minimum reserve balances. Included in cash and demand deposits were required reserves of $13.8 million and $12.5 million at December 31, 2009 and 2008, respectively.

Note 6: SECURITIES

Securities—Trading: The amortized cost and estimated fair value of securities—trading at fair value under ASC 820 at December 31, 2009 and 2008 are summarized as follows; see Note 25 for further discussion (dollars in thousands):

	December 31, 2009				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Percent of Total
U.S. Government and agency obligations	$ 41,178	$ 270	$ (193)	$ 41,255	28.0 %
Municipal bonds:					
Taxable	1,004	30	--	1,034	0.7 %
Tax exempt	6,065	103	(51)	6,117	4.2 %
Total municipal bonds	7,069	133	(51)	7,151	4.9 %
Corporate bonds	76,411	--	(41,394)	35,017	23.8 %
Mortgage-backed or related securities:					
FHLMC certificates	20,939	718	--	21,657	14.7 %
FHLMC collateralized mortgage obligations	4,091	89	--	4,180	2.9 %
Total FHLMC mortgage-backed securities	25,030	807	--	25,837	17.6 %
FNMA certificates	27,055	1,085	(13)	28,127	19.1 %
FNMA collateralized mortgage obligations	9,195	227	--	9,422	6.4 %
Total FNMA mortgage-backed securities	36,250	1,312	(13)	37,549	25.5 %
Equity securities:					
FHLMC stock	1,023	11	(966)	68	0.0 %
FNMA stock	5,878	--	(5,618)	260	0.2 %
Other	14	--	--	14	--
	$ 192,853	$ 2,533	$ (48,235)	$ 147,151	100.0 %

Proceeds from only one sale of a single trading security for the year ended December 31, 2009 were $6,458,000. A gross gain of $140,000 was realized on that sale. Net unrealized holding losses of $4,334,000 were recognized on securities—trading carried at fair value for the year ended December 31, 2009.

Note 6: SECURITIES (continued)

	December 31, 2008				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Percent of Total
U.S. Government and agency obligations	$ 69,817	$ 590	$ (18)	$ 70,389	34.5 %
Municipal bonds:					
Taxable	1,990	54	(3)	2,041	1.0 %
Tax exempt	9,954	77	(43)	9,988	4.9 %
Total municipal bonds	11,944	131	(46)	12,029	5.9 %
Corporate bonds	76,497	--	(36,277)	40,220	19.7 %
Mortgage-backed or related securities:					
FHLMC certificates	28,444	258	--	28,702	14.1 %
FHLMC collateralized mortgage obligations	6,774	62	--	6,836	3.4 %
Total FHLMC mortgage-backed securities	35,218	320	--	35,538	17.5 %
FNMA certificates	31,939	667	--	32,606	16.0 %
FNMA collateralized mortgage obligations	12,935	26	(75)	12,886	6.3 %
Total FNMA mortgage-backed securities	44,874	693	(75)	45,492	22.3 %
Equity securities:					
FHLMC stock	1,022	--	(991)	31	-- %
FNMA stock	5,888	--	(5,692)	196	0.1 %
Other	14	--	(7)	7	--
	$ 245,274	$ 1,734	$ (43,106)	$ 203,902	100.0 %

Proceeds from sales of securities—trading at fair value during the year ended December 31, 2008 were $17,255,000. Gross gains of $44,000 and gross losses of $35,000 were realized on those sales. Net unrealized holding losses of $39,939,000 were recognized on securities carried at fair value for the year ended December 31, 2008.

The amortized cost and estimated fair value of securities—trading at December 31, 2009 and 2008, by contractual maturity, are shown below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2009		December 31, 2008	
	Amortized Cost	Estimated Fair value	Amortized Cost	Estimated Fair value
Due in one year or less	$ 550	$ 565	$ 9,513	$ 9,551
Due after one year through five years	40,232	40,277	53,961	54,482
Due after five years through ten years	21,230	21,641	25,100	25,156
Due after ten years through twenty years	20,931	21,186	33,961	33,341
Due after twenty years	102,995	63,140	115,814	81,138
	185,938	146,809	238,349	203,668
Equity securities	6,915	342	6,925	234
	$ 192,853	$ 147,151	$ 245,274	$ 203,902

Note 6: SECURITIES (continued)

Securities—Available-for-Sale: The amortized cost and estimated fair value of securities available for sale under ASC 820 at December 31, 2009 and 2008 are summarized as follows; see Note 25 for further discussion (in thousands):

	December 31, 2009				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Percent of Total
U.S. Government and agency obligations	$ 53,732	$ 22	$ (642)	$ 53,112	55.5 %
Mortgage-backed or related securities:					
FHLMC collateralized mortgage obligations	17,410	223	--	17,633	18.4 %
GNMA certificates	17,741	716	--	18,457	19.3 %
Other collateralized mortgage obligations	6,291	174		6,465	6.8 %
	$ 95,174	$ 1,135	$ (642)	$ 95,667	100.0 %

	December 31, 2008				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Percent of Total
Mortgage-backed or related securities:					
FHLMC collateralized mortgage obligations	$ 10,025	$ --	$ (20)	$ 10,005	18.8 %
GNMA certificates	32,702	1,027	--	33,729	63.3 %
Other collateralized mortgage obligations	9,463	181	(106)	9,538	17.9 %
	$ 52,190	$ 1,208	$ (126)	$ 53,272	100.0 %

At December 31, 2009 and 2008, an aging of unrealized losses and fair value of related securities—available-for-sale were as follows (in thousands):

	December 31, 2009					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government and agency obligations	$ 48,713	$ (642)	$ --	$ --	$ 48,713	$ (642)
	$ 48,713	$ (642)	$ --	$ --	$ 48,713	$ (642)

	December 31, 2008					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government and agency obligations	$ 12,690	$ (126)	$ --	$ --	$ 12,690	$ (126)
	$ 12,690	$ (126)	$ --	$ --	$ 12,690	$ (126)

There were no sales of securities—available-for-sale during the years ended December 31, 2009 and 2008. Management does not believe that any individual unrealized loss as of December 31, 2009 represents an other-than-temporary impairment. The decline in fair market value of these securities is generally due to changes in interest rates and changes in market-desired spreads subsequent to their purchase. There were eight securities—available-for-sale with unrealized losses at December 31, 2009 and two at December 31, 2008.

The amortized cost and estimated fair value of securities—available for sale at December 31, 2009 and 2008, by contractual maturity, are shown below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2009		December 31, 2008	
	Amortized Cost	Estimated Fair value	Amortized Cost	Estimated Fair value
Due in one year or less	$ --	$ --	$ --	$ --
Due after one year through five years	48,748	48,257	--	--
Due after five years through ten years	4,983	4,854	--	--
Due after ten years through twenty years	5,133	5,196	16,698	16,858
Due after twenty years	36,310	37,360	35,492	36,414
	$ 95,174	$ 95,667	$ 52,190	$ 53,272

Note 6: SECURITIES (continued)

Securities--Held to Maturity: The amortized cost and estimated fair value of securities held to maturity are summarized as follows (dollars in thousands):

	December 31, 2009				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Percent of Total
Municipal bonds:					
Taxable	$ 2,683	$ 66	$ (30)	$ 2,719	3.6 %
Tax Exempt	63,901	2,731	(72)	66,560	87.0 %
	66,584	2,797	(102)	69,279	90.6 %
Corporate bonds	8,250	--	(1,040)	7,210	9.4 %
	$ 74,834	$ 2,797	$ (1,142)	$ 76,489	100.0 %

	December 31, 2008				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Percent of total
Municipal bonds:					
Taxable	$ 2,925	$ 24	$ (47)	$ 2,902	4.9 %
Tax Exempt	48,619	882	(214)	49,287	81.3 %
	51,544	906	(261)	52,189	86.2 %
Corporate bonds	8,250	176	(85)	8,341	13.8 %
	$ 59,794	$ 1,082	$ (346)	$ 60,530	100.0 %

At December 31, 2009 and 2008, agings of unrealized losses and fair value of related securities held-to-maturity were as follows (in thousands):

	December 31, 2009					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate bonds	$ 2,556	$ (444)	$ 3,404	$ (596)	$ 5,960	$ (1,040)
Municipal bonds	2,920	(43)	10,112	(59)	13,032	(102)
	$ 5,476	$ (487)	$ 13,516	$ (655)	$ 18,992	$ (1,142)

	December 31, 2008					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate bonds	$ 3,915	$ (85)	$ --	$ --	$ 3,915	$ (85)
Municipal bonds	5,785	(245)	7,710	(16)	13,495	(261)
	$ 9,700	$ (330)	$ 7,710	$ (16)	$ 17,410	$ (346)

Management does not believe that any individual unrealized loss as of December 31, 2009 represents an other-than-temporary impairment. The decline in fair market value of these securities is generally due to changes in interest rates and changes in market-desired spreads subsequent to their purchase. There were 12 and 15 securities held-to-maturity with unrealized losses at December 31, 2009 and 2008, respectively.

The amortized cost and estimated fair value of securities held to maturity at December 31, 2009 and 2008, by contractual maturity, are shown below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

	December 31, 2009		December 31, 2008	
	Amortized cost	Estimated fair value	Amortized cost	Estimated fair value
Due in one year or less	$ 2,095	$ 2,131	$ 1,153	$ 1,164
Due after one year through five years	11,017	11,613	10,601	10,811
Due after five years through ten years	13,794	14,379	14,046	14,185
Due after ten years through twenty years	41,792	42,504	24,957	25,241
Due after twenty years	6,136	5,862	9,037	9,129
	$ 74,834	$ 76,489	$ 59,794	$ 60,530

Note 7: ADDITIONAL INFORMATION REGARDING INTEREST INCOME FROM SECURITIES AND CASH EQUIVALENTS

The following table sets forth the composition of income from securities for the periods indicated (in thousands):

	Years Ended December 31		
	2009	2008	2007
Mortgage-backed securities interest	$ 6,057	$ 4,639	$ 5,832
Taxable interest income	5,080	8,067	5,903
Tax-exempt interest income	3,203	2,485	2,075
Equity securities—dividend/(premium amortization)	(5)	401	142
FHLB stock—dividend income	--	355	222
	8,278	11,308	8,342
Total income from securities	$ 14,335	$ 15,947	$ 14,174

Note 8: LOANS RECEIVABLE

Loans receivable, including loans held for sale, at December 31, 2009 and 2008 are summarized as follows (dollars in thousands):

	December 31, 2009		December 31, 2008	
	Amount	Percent	Amount	Percent
Commercial real estate				
Owner occupied	$ 509,464	13.4 %	$ 459,446	11.6 %
Investment properties	573,495	15.1	554,263	14.0
Multifamily real estate	153,497	4.1	151,274	3.8
Commercial construction	80,236	2.1	104,495	2.6
Multifamily construction	57,422	1.5	33,661	0.8
One- to four-family construction	239,135	6.3	420,673	10.6
Land and land development				
Residential	284,331	7.5	401,129	10.1
Commercial	43,743	1.2	62,128	1.6
Commercial business	637,823	16.8	679,867	17.2
Agricultural business, including secured by farmland	205,307	5.4	204,142	5.2
One- to four-family real estate	703,277	18.6	599,169	15.1
Consumer	110,937	2.9	115,515	2.9
Consumer secured by one- to four family	191,454	5.1	175,646	4.5
Total consumer	302,391	8.0	291,161	7.4
Total loans outstanding	3,790,121	100.0 %	3,961,408	100.0 %
Less allowance for loan losses	(95,269)		(75,197)	
Total net loans at end of period	$ 3,694,852		$ 3,886,211	

Loan amounts are net of unearned, unamortized loan fees of $11,240,000 and $7,105,000 at December 31, 2009 and 2008, respectively.

Loans receivable included $449,000 and $367,000 of loans at December 31, 2009 and 2008, respectively, that were more than 90 days delinquent and still accruing interest.

The Company's outstanding loan commitments totaled $777,103,000 and $1,263,256,000 at December 31, 2009 and 2008, respectively. In addition, the Company had outstanding commitments to sell loans of $25,454,000 and $42,896,000 at December 31, 2009 and 2008, respectively.

A substantial portion of the loans are to borrowers in the states of Washington, Oregon and Idaho. Accordingly, their ultimate collectibility is particularly susceptible to, among other things, changes in market and economic conditions within these states.

The Company's loans by geographic concentration at December 31, 2009 were as follows (in thousands) (unaudited):

	Washington	Oregon	Idaho	Other	Total
Commercial real estate					
Owner occupied	$ 401,392	$ 61,821	$ 46,251	$ --	$ 509,464
Investment properties	413,570	105,956	43,684	10,285	573,495
Multifamily real estate	127,748	13,672	8,776	3,301	153,497
Commercial construction	57,493	13,625	9,118	--	80,236
Multifamily construction	29,956	27,466	--	--	57,422
One- to four-family construction	107,067	120,395	11,673	--	239,135
Land and land development					
Residential	140,539	112,945	30,847	--	284,331
Commercial	29,130	12,122	2,491	--	43,743
Commercial business	451,531	92,289	70,803	23,200	637,823
Agricultural business, including secured by farmland	94,452	50,419	60,436	--	205,307
One-to four-family real estate	485,185	185,573	30,064	2,455	703,277
Consumer	80,539	24,097	6,301	--	110,937
Consumer secured by one- to four-family real estate	135,776	41,467	13,710	501	191,454
Total consumer	216,315	65,564	20,011	501	302,391
	$ 2,554,378	$ 861,847	$ 334,154	$ 39,742	$ 3,790,121
Percent of total loans	67.4 %	22.7 %	8.8 %	1.1 %	100.0 %

Land and land development loans at December 31, 2009 were as follows (dollars in thousands):	Washington	Oregon	Idaho	Other	Total
Residential					
Acquisition and development	$ 56,540	$ 74,496	$ 8,946	$ --	$ 139,982
Improved lots	48,102	31,461	2,013	--	81,576
Unimproved land	35,897	6,988	19,888	--	62,773
Commercial and industrial					
Acquisition and development	8,531	--	552	--	9,083
Improved land	9,072	10,643	--	--	19,715
Unimproved land	11,527	1,479	1,939	--	14,945
Total land & land development loans outstanding	$ 169,669	$ 125,067	$ 33,338	$ --	$ 328,074
Percent of total land and land development loans	51.7 %	38.1 %	10.2 %	0.0 %	100.0 %

The Company's loans to directors, executive officers and related entities are on substantially the same terms and underwriting as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than normal risk of collectibility. Such loans had the following balances and activity during the years ended December 31, 2009 and 2008 (dollars in thousands):

	Years Ended December 31	
	2009	2008
Balance at beginning of year	$ 8,372	$ 7,952
New loans or advances	18,657	21,381
Repayments and adjustments	(16,868)	(20,961)
Balance, end of period	$ 10,161	$ 8,372

The amount of impaired loans and the related allocated reserve for loan losses were as follows (dollars in thousands):

	December 31, 2009		December 31, 2008	
	Loan amount	Allocated reserves	Loan amount	Allocated reserves
Impaired loans:				
Non-accrual	$ 213,401	$ 18,872	$ 186,978	$ 13,053
Accrual (includes TDRs of $43,683 and $23,635 as of December 31, 2009 and 2008, respectively)	48,337	3,309	23,635	1,195
	$ 261,738	$ 22,181	$ 210,613	$ 14,248

As of December 31, 2009, the Company had additional commitments to advance funds up to an amount of $5,017,000 related to impaired loans. The average balance of impaired loans and the related interest income recognized were as follows (in thousands):

	Years Ended December 31		
	2009	2008	2007
Average balance of impaired loans	$ 272,983	$ 124,342	$ 22,663
Interest income recognized	$ 1,800	$ 398	$ 28
Interest income not recognized	$ 17,686	$ 9,252	$ 2,491

The Company originates both adjustable- and fixed-rate loans. At December 31, 2009 and 2008, the maturity and repricing composition of those loans, less undisbursed amounts and deferred fees, were as follows (dollars in thousands):

	December 31	
	2009	2008
Fixed-rate (term to maturity):		
Due in one year or less	$ 162,894	$ 130,958
Due after one year through three years	198,107	206,455
Due after three years through five years	239,145	246,897
Due after five years through ten years	142,900	157,621
Due after ten years	551,375	425,213
	$ 1,294,421	$ 1,167,144
Adjustable-rate (term to rate adjustment):		
Due in one year or less	$ 1,582,046	$ 1,911,364
Due after one year through three years	417,777	402,482
Due after three years through five years	447,228	440,555
Due after five years through ten years	47,287	38,472
Due after ten years	1,362	1,391
	2,495,700	2,794,264
	$ 3,790,121	$ 3,961,408

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

Banner Bank has invested, as of December 31, 2009, $7,939,000 in four limited partnerships known as Homestead Equity Fund (HEF); HEF II, HEF III, HEF IV and Homestead Western Communities Fund (HWCF) that develop low income housing projects. Banner Bank's partnership interests commit it to invest up to $11,000,000 in the partnerships. In connection with the HWCF project development, Banner Bank also has a commercial loan outstanding with a balance of $3,845,000 at December 31, 2009. There are no additional loan commitments on these projects at December 31, 2009. The loan is secured by notes from the limited partners, which includes Banner Bank, to make capital contributions to the partnership.

Note 9: ALLOWANCE FOR LOAN LOSSES

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

	Years Ended December 31		
	2009	2008	2007
Balance, beginning of period	$ 75,197	$ 45,827	$ 35,535
Allowance added through business combinations		--	7,276
Provision	109,000	62,500	5,900
Recoveries of loans previously charged off:			
Commercial real estate	--	1,530	--
Construction and land	715	192	62
One- to four-family real estate	138	45	338
Commercial business	545	471	678
Agricultural business, including secured by farmland	38	1,048	275
Consumer	275	185	138
	1,711	3,471	1,491
Loans charged off:			
Commercial real estate	(1)	(7)	--
Multifamily real estate	--	--	--
Construction and land	(64,456)	(27,020)	(1,344)
One- to four-family real estate	(8,795)	(934)	(385)
Commercial business	(11,541)	(7,323)	(1,081)
Agricultural business, including secured by farmland	(3,877)	(60)	(650)
Consumer	(1,969)	(1,257)	(915)
	(90,639)	(36,601)	(4,375)
Net charge-offs	(88,928)	(33,130)	(2,884)
Balance, end of period	$ 95,269	$ 75,197	$ 45,827
Allowance for loan losses to loans	2.51 %	1.90 %	1.20 %
Net loan charge-offs to average outstanding loans during the period	2.28 %	0.84 %	0.08 %

The following is a schedule of the Company's allocation of the allowance for loan losses (dollars in thousands):

	December 31		
	2009	2008	2007
Commercial real estate	$ 8,278	$ 4,199	$ 3,771
Multifamily real estate	90	87	934
Construction and land	45,209	38,253	7,569
One- to four-family real estate	2,912	752	1,987
Commercial business	22,054	16,533	19,026
Agricultural business, including secured by farmland	919	530	1,419
Consumer	1,809	1,730	3,468
Total allocated	81,271	62,084	38,174
Estimated allowance for undisbursed commitments	1,594	1,108	330
Unallocated	12,404	12,005	7,323
Total allowance for loan losses	$ 95,269	$ 75,197	$ 45,827
Allowance for loan losses to non-performing loans	45 %	40 %	108 %

Note 10: REAL ESTATE OWNED, NET

The following table presents the changes in real estate owned (REO), net of valuation allowance, for the years ended December 31, 2009 and 2008 (dollars in thousands):

	December 31	
	2009	2008
Balance, beginning of period	$ 21,782	$ 1,867
Additions from loan foreclosures	101,853	27,236
Addition from capitalized costs	6,064	648
Dispositions of REO	(50,313)	(7,146)
Valuation adjustments in the period	(1,643)	(823)
Balance, end of period	$ 77,743	$ 21,782

REO properties are recorded at the lower of the recorded investment in the loan (prior to foreclosure) or the fair market value of the property, less expected selling costs. Valuation allowances on REO balances are based on updated appraisals of the underlying properties as received during a period or management's authorization to reduce the selling price of a property during the period.

Note 11: PROPERTY AND EQUIPMENT

Land, buildings and equipment owned by the Company and its subsidiaries at December 31, 2009 and 2008 are summarized as follows (dollars in thousands):

	December 31	
	2009	2008
Buildings and leasehold improvements	$ 95,494	$ 83,249
Furniture and equipment	52,917	49,387
	148,411	132,636
Less accumulated depreciation	63,706	54,069
	84,705	78,567
Land	18,837	19,080
Property and equipment, net	$ 103,542	$ 97,647

The Banks' depreciation expense related to property and equipment was $9,777,000, $10,525,000 and $8,233,000 for the years ended December 31, 2009, 2008 and 2007, respectively.

The Banks' rental expense was $7,049,000, $6,729,000, and $5,834,000 for the years ended December 31, 2009, 2008 and 2007, respectively.

The Banks' obligation under long-term property leases over the next five years is as follows: 2010, $6,693,000; 2011, $5,813,000; 2012, $5,175,000; 2013, $4,518,000; 2014, $3,946,000; and thereafter, $12,967,000.

Note 12: DEPOSITS

Deposits consist of the following at December 31, 2009 and 2008 (dollars in thousands):

	December 31 2009	Percent of Total	December 31 2008	Percent of Total
Demand and NOW accounts, including non-interest-bearing deposits at December 31, 2009 and 2008 of $582,480 and $509,105, respectively	$ 942,736	24.4 %	$ 888,057	23.5 %
Regular savings	538,765	13.9	474,885	12.6
Money market	442,124	11.4	284,041	7.5
Certificates of deposit:				
0.00% to 2.00%	581,148	15.0	132,230	3.4
2.01% to 4.00%	1,023,098	26.5	1,290,737	34.2
4.01% to 6.00%	335,652	8.7	706,404	18.7
6.01% and greater	2,027	0.1	2,496	0.1
	1,941,925	50.3	2,131,867	56.4
	$ 3,865,550	100.0 %	$ 3,778,850	100.0 %

Deposits at December 31, 2009 and 2008 included public funds of $166,388,000 and $339,317,000, respectively. Securities with a carrying value of $73,627,000 and $46,908,000 were pledged as collateral on these deposits at December 31, 2009 and 2008, respectively. The aggregate pledge of securities exceeded the minimum collateral requirements established by state regulations (see Note 22). Deposits at December 31, 2009 and 2008 also included $165,016,000 and $268,458,000, respectively, of brokered deposits.

Deposits at December 31, 2009 and 2008 included deposits from the Company's directors, executive officers and related entities totaling $23,063,000 and $17,979,000, respectively.

Scheduled maturities of certificate accounts at December 31, 2009 and 2008 are as follows (in thousands):

	December 31	
	2009	2008
Due in one year or less	$ 1,593,575	$ 1,542,925
Due after one year through two years	248,065	421,710
Due after two years through three years	63,050	121,025
Due after three years through four years	14,435	30,468
Due after four years through five years	19,043	11,466
Due after five years	3,757	4,273
	$ 1,941,925	$ 2,131,867

Included in deposits are certificate accounts in excess of $100,000 of $1,034,640,000 and $1,091,750,000 at December 31, 2009 and 2008, respectively. Interest on deposit accounts in excess of $100,000 totaled $38,775,000 for the year ended December 31, 2009, $46,456,000 for the year ended December 31, 2008 and $49,269,000 for the year ended December 31, 2007.

The following table sets forth the deposit activities for the years ended December 31, 2009, 2008 and 2007 (in thousands):

	Years Ended December 31		
	2009	2008	2007
Beginning balance	$ 3,778,850	$ 3,620,593	$ 2,794,592
Acquisitions	--	--	559,842
Net increase before interest credited	3,489	47,943	136,739
Interest credited	83,211	110,314	129,420
Net increase in deposits	86,700	158,257	826,001
Ending balance	$ 3,865,550	$ 3,778,850	$ 3,620,593

Deposit interest expense by type for the years ended December 31, 2009, 2008 and 2007 was as follows (in thousands):

	Years Ended December 31		
	2009	2008	2007
Certificates	$ 66,968	$ 85,493	$ 87,709
Demand, NOW and money market accounts	8,284	10,362	20,263
Regular savings	7,959	14,459	21,448
	$ 83,211	$ 110,314	$ 129,420

Note 13: ADVANCES FROM FEDERAL HOME LOAN BANK OF SEATTLE

The Banks have entered into borrowing arrangements with the FHLB of Seattle to borrow funds under a short-term floating-rate cash management advance program and fixed-term loan agreements. All borrowings are secured by stock of, and cash held by, the FHLB of Seattle. Additionally, a blanket pledge of qualifying loans receivable at December 31, 2009 were pledged as security for the loans and there were no securities pledged as collateral at that time. At December 31, 2009, FHLB advances were scheduled to mature as follows (dollars in thousands):

	Adjustable-rate advances		Fixed-rate advances		Total advances	
	Rate*	Amount	Rate*	Amount	Rate*	Amount
Due in one year or less	0.50 %	$ 132,500	3.25 %	$ 13,000	0.75 %	$ 145,500
Due after one year through two years			2.73	32,800	2.73	32,800
Due after three years through four years			2.38	10,000	2.38	10,000
Due after five years			5.94	228	5.94	228
Total FHLB advances, at par			2.80 %	$ 56,028	1.18 %	$ 188,528
Fair value adjustment						1,251
Total FHLB advances, carried at fair value						$ 189,779

*Weighted average interest rate

The maximum, average outstanding and year-end balances (excluding fair value adjustments) and average interest rates on advances from the FHLB were as follows for the years ended December 31, 2009, 2008 and 2007 (dollars in thousands):

	Years Ended December 31		
	2009	2008	2007
Maximum outstanding at any month end	$ 254,030	$ 244,537	$ 209,172
Average outstanding	102,210	187,920	87,957
Year-end outstanding	188,528	109,033	167,073
Weighted average interest rates:			
Annual	2.57 %	2.88 %	4.74 %
End of period	1.18 %	3.04 %	4.20 %
Interest expense during the period	$ 2,627	$ 5,407	$ 4,168

As of December 31, 2009, Banner Bank and Islanders Bank have each established a borrowing line with the FHLB to borrow up to the lesser of 35% of their total assets or adjusted qualifying collateral. This would provide a maximum total credit line of $1.0 billion and $42.5 million for Banner Bank and Islanders Bank, respectively, at December 31, 2009.

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Note 14: OTHER BORROWINGS

Other borrowings consist of retail repurchase agreements, wholesale repurchase agreements and other term borrowings.

Retail Repurchase Agreements: At December 31, 2009, retail repurchase agreements carry interest rates ranging from 0.40% to 0.90%, payable at maturity, and are secured by the pledge of certain mortgage-backed and agency securities with a carrying value of $146.8 million. The Bank has the right to pledge or sell these securities, but they must replace them with substantially the same security.

A summary of retail repurchase agreements at December 31, 2009 and 2008 by the period remaining to maturity is as follows (dollars in thousands):

	December 31			
	2009		2008	
	Weighted average rate	Balance	Weighted average rate	Balance
Retail repurchase agreements:				
Due in one year or less	0.49 %	$ 124,330	1.07 %	$ 145,080
Due after one year through two years	--	--	--	--
Due after five years	--	--	5.00	150
	0.49 %	$ 124,330	1.07 %	$ 145,230
Other short-term borrowings:				
Due in one year or less	-- %	$ --	-- %	$ --
Total retail repurchase agreements and other short-term borrowings	0.49 %	$ 124,330	1.07 %	$ 145,230

The maximum, average outstanding and year-end balances and average interest rates on retail repurchase agreements were as follows for the years ended December 31, 2009, 2008 and 2007, respectively (dollars in thousands):

	Years Ended December 31		
	2009	2008	2007
Maximum outstanding at any month end	$ 137,403	$ 145,230	$ 91,724
Average outstanding	124,738	101,409	73,646
Year-end outstanding	124,330	145,230	91,724
Weighted average interest rates:			
Annual	0.57 %	1.91 %	3.64 %
End of period	0.49 %	1.07 %	3.35 %

Wholesale Repurchase Agreements and other term borrowings: There were no wholesale repurchase agreements and other term borrowings, such as Fed Funds, outstanding as of December 31, 2009 and 2008.

The maximum, average outstanding and year-end balances and average interest rates on wholesale repurchase agreements and other term borrowings were as follows for the years ended December 31, 2009, 2008 and 2007 (dollars in thousands):

	Years Ended December 31		
	2009	2008	2007
Maximum outstanding at any month end	$ --	$ 73,000	$ 25,921
Average outstanding	--	12,668	8,794
Year-end outstanding	--	--	--
Weighted average interest rates:			
Annual	-- %	2.64 %	5.96 %
End of period	-- %	-- %	-- %

Temporary Liquidity Guarantee Program Notes: Banner Bank has issued $50 million of senior bank notes that are guaranteed by the FDIC under the Temporary Liquidity Guarantee Program (TLGP). These notes require interest only payments for a term of three years with principal payable in full at maturity. The maximum, average outstanding and year-end balances and average and end of period rates for these senior notes were as follows for the years ended December 31, 2009, 2008 and 2007, respectively (dollars in thousands):

	Years Ended December 31		
	2009	2008	2007
Maximum outstanding at any month end	$ 49,978	$ --	$ --
Average outstanding	37,788	--	--
Year-end outstanding	49,978	--	--
Weighted average interest rates:			
Annual (includes FDIC guarantee fee and amortization)	3.79 %	-- %	-- %
End of period	2.63 %	-- %	-- %

Federal Reserve Bank of San Francisco Borrowings: Banner Bank periodically borrows funds on an overnight basis from the Federal Reserve Bank of San Francisco (FRBSF) through the Borrower-In-Custody (BIC) program. Such borrowings are secured by a pledge of eligible loans. At December 31, 2009, based upon available unencumbered collateral, Banner Bank was eligible to borrow $373 million from the FRBSF, although, at that date, we had no funds borrowed under this arrangement. The maximum, average outstanding and year-end balances and average and end of period interest rates for FRBSF borrowings were as follows for the years ended December 31, 2009, 2008 and 2007, respectively (dollars in thousands):

	Years Ended December 31		
	2009	2008	2007
Maximum outstanding at any month end	$ 43,000	$ --	$ --
Average outstanding	12,138	103	--
Year-end outstanding	--	--	--
Weighted average interest rates:			
Annual	0.50 %	0.52 %	-- %
End of period	-- %	-- %	-- %

The table below summarizes interest expense for other borrowings for the years ended December 31, 2009, 2008 and 2007:

	Years Ended December 31		
	2009	2008	2007
Retail repurchase agreements	$ 711	$ 1,937	$ 2,688
Wholesale repurchase agreements and other	--	--	526
FDIC guaranteed debt	1,434	--	--
Federal Reserve borrowings	61	334	--
Total expense	$ 2,206	$ 2,271	$ 3,214

NOTE 15: JUNIOR SUBORDINATED DEBENTURES AND MANDATORILY REDEEMABLE TRUST PREFERRED SECURITIES

At December 31, 2009, six wholly-owned subsidiary grantor trusts, Banner Capital Trust II, III, IV, V, VI and VII (BCT II, BCT III, BCT IV, BCT V, BCT VI and BCT VII (collectively, the Trusts)), established by the Company had issued $120 million of trust preferred securities to third parties, as well as $3.7 million of common capital securities, carried among other assets, which were issued to the Company. Trust preferred securities and common capital securities accrue and pay distributions periodically at specified annual rates as provided in the indentures. The Trusts used the proceeds from the offerings to purchase a like amount of junior subordinated debentures (the Debentures) of the Company. The Debentures are the sole assets of the Trusts. The Company's obligations under the debentures and related documents, taken together, constitute a full and unconditional guarantee by the Company of the obligations of the Trusts. The trust preferred securities are mandatorily redeemable upon the maturity of the Debentures, or upon earlier redemption as provided in the indentures. The Company has the right to redeem the Debentures in whole on or after specific dates, at a redemption price specified in the indentures plus any accrued but unpaid interest to the redemption date.

BCT II, a $15 million issue, has a current interest rate of 3.63%, which is reset quarterly to equal three-month LIBOR plus 3.35%.
BCT III, a $15 million issue, has a current interest rate 3.18%, which is reset quarterly to equal three-month LIBOR plus 2.90%.
BCT IV, a $15 million issue, has a current interest rate of 3.13% which is reset quarterly to equal three-month LIBOR plus 2.85%.
BCT V, a $25 million issue, has a current interest rate of 1.84% which is reset quarterly to equal three-month LIBOR plus 1.57%.
BCT VI, a $25 million issue, has a current interest rate of 6.56% which is fixed until December 15, 2011, then is reset quarterly to equal three-month LIBOR plus 1.62%.
BCT VII, a $25 million issue, has a current interest rate of 1.67% which is reset quarterly to equal three-month LIBOR plus 1.38%.

The following table's are a summary of trust preferred securities at December 31, 2009 (in thousands):

	December 31, 2009						
Name of Trust	Aggregate Liquidation Amount of Trust Preferred Securities	Aggregate Liquidation Amount of Common Capital Securities	Aggregate Principal Amount of Junior Subordinated Debentures	Stated Maturity	Per Annum Interest Rate	Interest Deferral Period	Redemption Option
Banner Capital Trust II	$ 15,000	$ 464	$ 15,464	2033	3.63 %	20 Consecutive Quarters	On or after January 7, 2008
Banner Capital Trust III	15,000	465	15,465	2033	3.18	20 Consecutive Quarters	On or after October 8, 2008
Banner Capital Trust IV	15,000	465	15,465	2034	3.13	20 Consecutive Quarters	On or after April 7, 2009
Banner Capital Trust V	25,000	774	25,774	2035	1.84	20 Consecutive Quarters	On or after November 23, 2010
Banner Capital Trust VI	25,000	774	25,774	2037	6.56	20 Consecutive Quarters	On or after March 1, 2012
Banner Capital Trust VII	25,000	774	25,774	2037	1.67	20 Consecutive Quarters	On or after July 31, 2012
Total TPS liability at par	$ 120,000	$ 3,716	$ 123,716		3.34 %		
Fair value adjustment			(76,022)				
Total TPS liability at fair value			$ 47,694				

Note 16: INCOME TAXES

The following table presents the components of the provision for income tax (benefit) expense included in the Consolidated Statement of Operations for the years ended December 31, 2009, 2008 and 2007 (in thousands):

	Years Ended December 31		
	2009	2008	2007
Current	$ (17,983)	$ 1,428	$ 14,769
Deferred	(9,070)	(8,513)	3,121
	$ (27,053)	$ (7,085)	$ 17,890

The following tables present the reconciliation of the provision for income taxes computed at the federal statutory rate to the actual effective rate for the years ended December 31, 2009, 2008 and 2007 (dollars in thousands):

	Years Ended December 31		
	2009	2008	2007
Provision for (benefit from) income taxes computed at federal statutory rate	$ (21,986)	$ (47,277)	$ 19,185
Increase (decrease) in taxes due to:			
Goodwill write-off	--	42,392	--
Tax-exempt interest	(2,108)	(1,066)	(751)
Investment in life insurance	(758)	(375)	(672)
State income taxes (benefit) net of federal tax offset	(819)	(270)	740
Tax credits	(864)	(845)	(841)
Other	(518)	356	229
Provision for (benefit from) income taxes	$ (27,053)	$ (7,085)	$ 17,890

	Years Ended December 31		
	2009	2008	2007
Federal income tax statutory rate	35.0%	35.0%	35.0%
Increase (decrease) in tax rate due to:			
Goodwill write-off	--	(31.4)	--
Tax-exempt interest	3.4	0.8	(1.4)
Investment in life insurance	1.2	0.3	(1.2)
State income taxes (benefit) net of federal tax offset	1.3	0.2	1.3
Tax credits	1.4	0.6	(1.5)
Other	0.8	(0.3)	0.4
Effective income tax rate	43.1%	5.2%	32.6%

The following table reflects the effect of temporary differences that give rise to the components of the net deferred tax asset as of December 31, 2009, 2008 and 2007 (in thousands):

	December 31	
	2009	2008
Deferred tax assets:		
REO and loan loss reserves, book vs. tax	$ 35,653	$ 27,846
Deferred compensation	6,470	6,264
Net operating loss carryforward	5,586	--
Other	98	201
	47,807	34,311
Deferred tax liabilities:		
FHLB stock dividends	6,230	6,230
Depreciation	5,423	4,644
Deferred loan fees, servicing rights and loan origination costs	5,002	4,301
Intangibles	3,969	4,904
Financial instruments accounted for under fair value accounting	12,194	8,287
Other	1	27
	32,819	28,393
	14,988	5,918
Unrealized loss on securities available for sale	(177)	(390)
Deferred tax asset, net	$ 14,811	$ 5,528

The Company has determined that it is not required to establish a valuation allowance for the deferred tax assets of $47.8 million and $34.3 million at December 31, 2009 and 2008, respectively, as management believes it is more likely than not that the deferred tax assets will be realized principally through future reversals of existing taxable temporary differences and based on projections of future taxable income from operations.

The Company's federal and state net operating loss carryforwards will expire, if unused, by the end of 2029.

Effective January 1, 2007, the Company adopted revised accounting standards for income taxes. The standard, ASC 740 *Income Taxes*, provides guidance related to the accounting for uncertainty in income taxes. Adoption of this standard did not have a significant impact on the Company's financial position or results of operations. The revisions prescribe a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and also provides guidance on the de-recognition of previously recorded benefits and their classification, as well as the proper recording of interest and penalties, accounting in interim periods, disclosures and transition. The Company periodically reviews its income tax positions based on tax laws and regulations and financial reporting considerations, and records adjustments as appropriate. This review takes into consideration the status of current taxing authorities' examinations of the Company's tax returns, recent positions taken by the taxing authorities on similar transactions, if any, and the overall tax environment.

As of December 31, 2009, the Company has an insignificant amount of unrecognized tax benefits for uncertain tax positions, none of which would materially affect the effective tax rate if recognized. The Company does not anticipate that the amount of unrecognized tax benefits will significantly increase or decrease in the next twelve months. The Company's policy is to recognize interest and penalties on unrecognized tax benefits in the income tax expense. The amount of interest and penalties accrued for the years ended December 31, 2009 and 2008 is immaterial. The Company files consolidated income tax returns in Oregon and Idaho and for federal purposes. The tax years which remain subject to examination by the taxing authorities are the years ending December 31, 2006, 2007 and 2008.

Retained earnings at December 31, 2009 and 2008 include approximately $5,319,000 in tax basis bad debt reserves for which no income tax liability has been booked. In the future, if this tax bad debt reserve is used for purposes other than to absorb bad debts or the Company no longer qualifies as a bank or is completely liquidated, the Company will incur a federal tax liability at the then-prevailing corporate tax rate, established as $1,861,000 at December 31, 2009.

Note 17: EMPLOYEE BENEFIT PLANS

Employee Retirement Plans—Substantially all of the Company's employees are eligible to participate in its 401(k)/Profit Sharing Plan, a defined contribution and profit sharing plan sponsored by the Company. Employees may elect to have a portion of their salary contributed to the plan in conformity with Section 401(k) of the Internal Revenue Code. At the discretion of the Company's Board of Directors, the Company may elect to make matching and/or profit sharing contributions for the employees' benefit. The Company's contributions under the plan charged to expense amounted to $267,000, $2,089,000 and $1,864,000 for the years ended December 31, 2009, 2008 and 2007, respectively.

Supplemental Retirement and Salary Continuation Plans—Through the Banks, the Company is obligated under various non-qualified deferred compensation plans to help supplement the retirement income of certain executives, including certain retired executives, selected by resolution of the Banks' Boards of Directors or in certain cases by the former directors of acquired banks. These plans are unfunded, include both defined benefit and defined contribution plans, and provide for payments after the executive's retirement. In the event of a participant employee's death prior to or during retirement, the Bank is obligated to pay to the designated beneficiary the benefits set forth under the plan. For the years ended December 31, 2009, 2008, and 2007, expense recorded for supplemental retirement and salary continuation plan benefits totaled $1,361,000, $902,000 and $976,000, respectively. At December 31, 2009 and 2008, liabilities recorded for the various supplemental retirement and salary continuation plan benefits totaled $11,894,000 and $11,652,000, respectively, and are recorded in deferred compensation.

Deferred Compensation Plans and Rabbi Trusts—The Company and the Banks also offer non-qualified deferred compensation plans to members of their Boards of Directors and certain employees. The plans permit each participant to defer a portion of director fees, non-qualified retirement contributions, salary or bonuses for future receipt. Compensation is charged to expense in the period earned. In connection with its acquisitions, the Company also assumed liability for certain deferred compensation plans for key employees, retired employees and directors.

In order to fund the plans' future obligations, the Company has purchased life insurance or other investments, including Banner Corporation common stock, which in certain instances are held in irrevocable trusts commonly referred to as "Rabbi Trusts." As the Company is the owner of the investments and the beneficiary of the insurance policies, and in order to reflect the Company's policy to pay benefits equal to the accumulations, the assets and liabilities are reflected in the Consolidated Statements of Financial Condition. Banner Corporation common stock held for such plans is reported as a contra-equity account and was recorded at an original cost of $9,043,000 at December 31, 2009 and $8,808,000 at December 31, 2008. At December 31, 2009 and 2008, liabilities recorded in connection with deferred compensation plan benefits totaled $9,998,000 ($9,043,000 in contra-equity) and $10,013,000 ($8,808,000 in contra-equity), respectively, and are recorded in deferred compensation or equity as appropriate.

The Banks have purchased, or acquired through mergers, life insurance policies in connection with the implementation of certain executive supplemental retirement, salary continuation and deferred compensation retirement plans, as well as additional policies not related to any specific plan. These policies provide protection against the adverse financial effects that could result from the death of a key employee and provide tax-exempt income to offset expenses associated with the plans. It is the Banks' intent to hold these policies as a long-term investment. However, there will be an income tax impact if the Banks choose to surrender certain policies. Although the lives of individual current or former management-level employees are insured, the Banks are the owners and sole or partial beneficiaries. At December 31, 2009 and 2008, the cash surrender value of these policies was $54,596,000 and $52,680,000, respectively. The Banks are exposed to credit risk to the extent an

insurance company is unable to fulfill its financial obligations under a policy. In order to mitigate this risk, the Banks use a variety of insurance companies and regularly monitor their financial condition.

Note 18: EMPLOYEE STOCK OWNERSHIP PLAN AND TRUST

The Company established for eligible employees an ESOP and related trust that became effective upon the former mutual holding company's conversion to a stock-based holding company. Eligible employees of Banner Bank as of January 1, 1995 and eligible employees of the Banks or Company employed after such date who have been credited with at least 1,000 hours during a twelve-month period are participants.

The ESOP borrowed $8,728,500 from the Company in order to purchase the common stock. The loan is repaid principally from the Company's contributions to the ESOP over a period not to exceed 25 years, and the collateral for the loan is the unreleased, restricted common stock purchased by the ESOP. Contributions to the ESOP are discretionary. The interest rate for the loan is 8.75%. Shares are released to participants for allocation based on the cumulative debt service paid to the Company by the ESOP divided by cumulative debt service paid to date plus the scheduled debt service remaining. Dividends on allocated shares are distributed to the participants as additional earnings. Dividends on unallocated shares are used to reduce the Company's contribution to the ESOP.

Participants generally become 100% vested in their ESOP account after seven years of credited service or if their service was terminated due to death, early retirement, permanent disability or a change in control of the Company. Prior to the completion of one year of credited service, a participant who terminates employment for reasons other than death, retirement, disability or change in control of the Company will not receive any benefit. Forfeitures will be reallocated among remaining participating employees in the same proportion as contributions. Benefits are payable upon death, retirement, early retirement, disability or separation from service. The contributions to the ESOP are not fixed, so benefits payable under the ESOP cannot be estimated.

A summary of key transactions for the ESOP follows:

	Years Ended December 31		
	2009	2008	2007
ESOP contribution expense	$ --	$ 1,111,000	$ 1,821,000
Total contribution to ESOP/Debt service	--	--	--
Interest portion of debt service	--	--	--
Dividends on unallocated ESOP shares used to reduce ESOP contribution	19,230	156,248	182,490

No ESOP contribution was made for the year ended December 31, 2009. For the years ended December 31, 2008 and 2007, the ESOP trustees elected to use contributions to purchase shares on the open market. As of December 31, 2009, the Company has 240,381 unearned, restricted shares remaining to be released to the ESOP. The fair value of unearned, restricted shares held by the ESOP trust was $644,000 at December 31, 2009. The ESOP held 1,051,172 allocated, earned shares at December 31, 2009. No payments were made on the loan for the years ended December 31, 2009, 2008 and 2007.

Note 19: STOCK-BASED COMPENSATION PLANS

The Company operates the following stock-based compensation plans as approved by the shareholders: the 1996 Management Recognition and Development Plan (MRP), a restricted stock plan; and the 1996 Stock Option Plan, the 1998 Stock Option Plan and the 2001 Stock Option Plan (collectively, SOPs). In addition, during 2006 the Board of Directors approved the Banner Corporation Long-Term Incentive Plan, an account-based benefit plan which for reporting is considered a stock appreciation rights plan.

MRP Stock Grants: Under the MRP, the Company was authorized to grant up to 528,075 shares of restricted stock to its directors, officers and employees. On July 26, 2006, this plan expired with 522,660 shares having been granted and no additional shares eligible to be granted. Shares granted under the MRP vest ratably over a five-year period from the date of grant. The Consolidated Statements of Operations for the years ended December 31, 2009, 2008 and 2007 reflect expense accruals of $40,000, $65,000 and $159,000, respectively, for these grant awards. The fair value of the MRP stock grants equals their intrinsic value on the date of grant.

A summary of the Company's unvested MRP shares activity during the years ended December 31, 2007, 2008 and 2009 follows:

	Shares	Weighted-Average Grant-Date Fair Value
Unvested at December 31, 2006	19,360	$ 22.07
Granted	--	--
Vested	(8,620)	21.08
Forfeited	(700)	24.92
Unvested at December 31, 2007	10,040	$ 22.73

	Shares	Weighted-Average Grant-Date Fair Value
Unvested at December 31, 2007	10,040	$ 22.73
Granted	--	--
Vested	(6,920)	20.77
Forfeited	(200)	31.71
Unvested at December 31, 2008	2,920	$ 26.76

	Shares	Weighted-Average Grant-Date Fair Value
Unvested at December 31, 2008	2,920	$ 26.76
Granted	--	--
Vested	(2,315)	27.15
Forfeited	--	--
Unvested at December 31, 2009	605	$ 25.25

Stock Options: Under the SOPs, we reserved 2,284,186 shares for issuance pursuant to the exercise of stock options to be granted to directors and employees. Authority to grant additional options under the 1996 Stock Option Plan terminated on July 26, 2006. Authority to grant additional options under the 1998 Stock Option Plan terminated on July 24, 2008 with all options having been granted. As of December 31, 2009, there were 51,595 options eligible for grants under the 2001 plan. The exercise price of the stock options is set at 100% of the fair market value of the stock price on the date of grant. Options granted vest at a rate of 20% per year from the date of grant and any unexercised incentive stock options will expire ten years after date of grant or 90 days after employment or service ends.

During the years ended December 31, 2009 and 2008, the Company did not grant any stock options. During the year ended December 31, 2007, the Company awarded 52,500 stock options. Also, there were no significant modifications made to any stock option grants during the period. The fair values of stock options granted are amortized as compensation expense on a straight-line basis over the vesting period of the grant.

Stock-based compensation costs related to the SOPs were $122,100, $265,000 and $369,000 for the years ended December 31, 2009, 2008 and 2007, respectively. The SOPs' stock option grant compensation costs are generally based on the fair value calculated from the Black-Scholes option pricing on the date of the grant award. Assumptions used in the Black-Scholes model are an expected volatility based on the historical volatility at the date of the grant. The expected term is based on the remaining contractual life of the vesting period. The Company bases the estimate of risk-free interest rate on the U.S. Treasury Constant Maturities Indices in effect at the time of the grant. The dividend yield is based on the current quarterly dividend in effect at the time of the grant.

	Years Ended December 31		
	2009	2008	2007
Annual dividend yield	None granted	None granted	2.46 %
Expected volatility			24.0 to 28.8 %
Risk free interest rate			4.64 to 4.82 %
Expected lives			5 to 9 yrs

The Company is required to estimate potential forfeitures of stock option grants and adjust compensation cost recorded accordingly. The estimate of forfeitures is adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures are recognized through a cumulative catch-up adjustment in the period of change and also impact the amount of stock compensation expense to be recognized in future periods.

A summary of the Company's SOPs' stock compensation activity for the years ended December 31, 2007, 2008 and 2009 follows (dollars in thousands, except shares and per share data):

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term, In Years	Aggregate Intrinsic Value
Outstanding at December 31, 2006	713,460	$ 20.49		
Granted	52,500	30.88		
Exercised	(93,285)	18.39		$ 1,741
Forfeited	(4,085)	26.96		
Outstanding at December 31, 2007	668,590	$ 21.56	5.1	$ 4,791
Outstanding at December 31, 2007	668,590	$ 21.56		
Granted	--	--		
Exercised	(30,611)	19.41		$ 147
Forfeited	(72,994)	21.57		
Outstanding at December 31, 2008	564,985	$ 21.68	4.4	$ n/a
Outstanding at December 31, 2008	564,985	$ 21.68		
Granted	--	--		
Exercised	--	--		$ --
Forfeited	(69,607)	16.99		
Outstanding at December 31, 2009	495,378	$ 22.34	3.8	$ n/a
Vested at December 31, 2009 and expected to vest	494,595	$ 22.33	3.8	$ n/a
Exercisable at December 31, 2009	458,648	$ 21.71	3.5	$ n/a

The intrinsic value of stock options is calculated as the amount by which the market price of our common stock exceeds the exercise price at the time of exercise or the end of the period as applicable.

A summary of the Company's unvested stock option activity with respect to the years ended December 31, 2007, 2008 and 2009 follows:

	Shares	Weighted-Average Grant-Date Fair Value
Unvested at December 31, 2006	211,810	$ 7.57
Granted	52,500	8.62
Vested	(98,270)	7.73
Forfeited	(3,100)	7.63
Unvested at December 31, 2007	162,940	$ 7.81
Unvested at December 31, 2007	162,940	$ 7.81
Granted	--	--
Vested	(79,170)	7.47
Forfeited	(3,050)	8.39
Unvested at December 31, 2008	80,720	$ 8.11
Unvested at December 31, 2008	80,720	$ 8.11
Granted	--	--
Vested	(43,990)	8.35
Forfeited	--	--
Unvested at December 31, 2009	36,730	$ 7.82

At December 31, 2009, financial data pertaining to outstanding stock options was as follows:

Exercise Price	Weighted average exercise price of option shares granted	Number of option shares granted	Weighted average option shares vested and exercisable	Weighted average exercise price of option shares exercisable	Remaining contractual life
13.69 to 16.85	$ 15.39	209,423	209,423	$ 15.39	2.5 yrs
18.55 to 22.05	20.86	70,305	70,305	20.86	2.6 yrs
23.25 to 26.23	25.95	69,450	65,820	25.99	4.5 yrs
29.47 to 30.88	31.29	146,200	113,100	31.43	5.9 yrs
	$ 22.34	495,378	458,648	$ 21.71	

The Company had $85,000 of total unrecognized compensation costs related to stock options at December 31, 2009 that are expected to be recognized over a remaining period of 2.5 years.

During the year ended December 31, 2009, there were no exercises of stock options. Cash was not used to settle any equity instruments previously granted. The Company issues shares from authorized but unissued shares upon the exercise of stock options. The Company does not currently expect to repurchase shares from any source to satisfy such obligations under the SOPs.

The following are the stock-based compensation costs recognized in the Company's condensed consolidated statements of income (in thousands):

	Years Ended December 31		
	2009	2008	2007
Salary and employee benefits	$ 162	$ 330	$ 528
Total decrease in income before provision for income taxes	162	330	528
Decrease in provision for income taxes	(50)	(95)	(111)
Decrease in net income	$ 112	$ 235	$ 417

Banner Corporation Long-Term Incentive Plan: In June 2006, the Board of Directors adopted the Banner Corporation Long-Term Incentive Plan effective July 1, 2006. The Plan is an account-based type of benefit, the value of which is directly related to changes in the value of Company stock, dividends declared on the Company stock and changes in Banner Bank's average earnings rate, and is considered a stock appreciation right ("SAR"). Each SAR entitles the holder to receive cash, upon vesting, equal to the excess of the fair market value of a share of the Company's common stock on the date of exercise over the fair market value of such share on the date granted plus the dividends declared on the stock from the date of grant to the date of vesting. Vesting occurs upon the completion of 60 months of continuous service from the date of grant. On April 27, 2008, the Board of Directors amended the Plan and also authorized the repricing of certain awards to non-executive officers based upon the price of Banner common stock three business days following the public announcement of the Company's earnings for the quarter ended March 31, 2008. The primary objective of the Plan is to create a retention incentive by allowing officers who remain with the Company or the Banks for a sufficient period of time to share in the increases in the value of Company stock. Detailed information with respect to the Plan and the amendments to the Plan were disclosed on Forms 8-K filed with SEC on July 19, 2006 and May 6, 2008. The Company remeasures the fair value of SARs each reporting period until the award is settled and compensation expense is recognized each reporting period for changes in fair value and vesting. The Company recognized compensation expense of $68,000, $44,000 and $97,000, respectively, for the years ended December 31, 2009, 2008 and 2007 related to the increase in the fair value of SARs and additional vesting during the period. At December 31, 2009, the aggregate liability related to SARs was $359,500 and is included in deferred compensation.

Common Stock Warrants: On November 21, 2008, in connection with the issuance of the preferred stock, the Company issued a warrant to the U.S. Treasury to purchase up to 1,707,989 shares of the Company's common stock, par value $0.01 per share, at an initial exercise price of $10.89 per share, subject to certain customary anti-dilution and other adjustments. The warrants issued are immediately exercisable, in whole or in part, and have a ten-year term. The warrants are not subject to any contractual restrictions on transfer. The Company has granted the warrant holder piggyback registration rights for the warrants and the common stock underlying the warrants and has agreed to take such other steps as may be reasonably requested to facilitate the transfer of the warrants and the common stock underlying the warrants. The holders of the warrants are not entitled to any common stockholder rights. The U.S. Treasury agrees not to exercise voting power with respect to any shares of common stock of the Company issued to it upon exercise of the warrants.

Note 20: PREFERRED STOCK

On November 21, 2008, as part of the Capital Purchase Program established by the U.S. Department of the Treasury (Treasury) under the Emergency Economic Stabilization Act of 2008 (the EESA), the Company entered into a Purchase Agreement with Treasury pursuant to which the Company issued and sold to Treasury 124,000 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Series A Preferred Stock), having a liquidation preference of $1,000 per share (and $124 million liquidation preference in the aggregate), and a ten-year warrant to purchase up to 1,707,989 shares of the Company's common stock, par value $0.01 per share, at an initial exercise price of $10.89 per share, for an aggregate purchase price of $18.6 million in cash. In connection with the issuance and sale of the Company's securities, the Company entered into a Letter Agreement including the Securities Purchase Agreement—Standard Terms, dated November 21, 2008, with the U.S. Treasury (the Agreement). The Agreement grants the holders of the preferred stock, the warrant and the common stock to

be issued under the warrant registration rights and subjects the Company to executive compensation limitations included in the Emergency Economic Stabilization Act of 2008. For regulatory purposes, the preferred stock is considered Tier 1 capital.

Cumulative dividends on the Series A Preferred Stock accrue on the liquidation preference at a rate of 5% per annum for the first five years, and at a rate of 9% per annum thereafter, but are paid only if, as, and when declared by the Company's Board of Directors (the Board). The preferred stock ranks senior to our common stock (and on an equivalent basis with the Company's other authorized series of preferred stock, of which no shares are currently outstanding) with respect to the payment of dividends and distributions of amounts payable upon liquidation, dissolution and winding up the Company. The Company may not pay dividends on, repurchase, or redeem any other class of stock unless all dividends in arrears are fully paid. Additionally, the Agreement contains limitations on the payment of quarterly cash dividends on the Company's common stock in excess of $0.05 per share. So long as the preferred stock is outstanding and held by the U.S. Treasury, the Company may not repurchase common shares without the Treasury's consent through the third anniversary date of the issuance, other than when in connection with any benefit plan in the ordinary course of business consistent with past practice.

For three years from the date of the issuance, the preferred stock may only be redeemed with the proceeds from a qualified equity offering that results in aggregate gross proceeds to the Company of not less than 25% of the issue price of the preferred stock. A qualified equity offering means the sale of Tier 1 qualifying perpetual preferred stock or common stock for cash. After three years, the preferred stock may be redeemed by the Company at its issue price, plus all accrued and unpaid dividends, subject to the approval of the Company's primary federal bank regulator. The preferred stock has no maturity date. The preferred stock is not subject to any contractual restrictions on transfer. The holders of the preferred stock have no general voting rights, and have only limited class voting rights including authorization or issuance of shares ranking senior to the preferred stock, any amendment to the rights of the preferred stock, or any merger, exchange or similar transaction which would adversely affect the rights of the preferred stock. If dividends on the preferred stock are not paid in full for six dividend periods, whether or not consecutive, the preferred stockholders will have the right to elect two directors. The right to elect directors will end when full dividends have been paid for four consecutive dividend periods. The preferred stock is not subject to sinking fund requirements and has no participation rights.

The preferred stock and detachable warrants were initially recognized based on their relative fair values at the date of issuance. The $124 million of proceeds received in connection with the issuance of the Series A Preferred Stock was allocated between the preferred stock and detachable warrants based on their relative fair values on the date of issuance. As a result, the preferred stock's initial recorded value of $115.8 million is at a discount to the liquidation value or stated value. The discount of $8.2 million is considered an unstated dividend cost that is being amortized over the five-year period preceding commencement of the 9% perpetual dividend using the effective interest method, by charging the imputed dividend cost against retained earnings and increasing the carrying amount of the preferred stock by a corresponding amount. The total stated dividends (whether or not declared) and unstated dividend cost combined represents a period's total preferred stock dividend, which is deducted from net income to arrive at net income available to common shareholders. During the year ended December 31, 2009, the Board declared and the Company paid four preferred stock dividends totaling $6,097,000. These consisted of the first shorter period dividend of $1,447,000 and three regular period dividends of $1,550,000 each. As of December 31, 2009, accrued and unpaid dividends totaled $792,000 and no dividend payments on the preferred stock were in arrears.

Note 21: REGULATORY CAPITAL REQUIREMENTS

Banner Corporation is a bank holding company registered with the Federal Reserve. Bank holding companies are subject to capital adequacy requirements of the Federal Reserve under the Bank Holding Company Act of 1956, as amended (BHCA), and the regulations of the Federal Reserve. Banner Bank and Islanders Bank, as state-chartered federally insured commercial banks, are subject to the capital requirements established by the FDIC. The Federal Reserve requires Banner Corporation to maintain capital adequacy that generally parallels the FDIC requirements.

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 adjusted 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%. 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 their respective 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.

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 and qualifying noncumulative perpetual preferred stock, less most intangible assets. Tier 2 capital, which is recognized up to 100% of Tier 1 capital for risk-based capital purposes (after any deductions for disallowed intangibles and disallowed deferred tax assets), includes such items as qualifying general loan loss reserves (up to 1.25% of risk-weighted assets), cumulative perpetual preferred stock, long-term preferred stock, certain perpetual preferred stock, hybrid capital instruments including mandatory convertible debt, term subordinated debt, intermediate-term preferred stock (original average maturity of at least five years), 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 in 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 4% to 5% of total assets. The FDIC retains the right to require a particular 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—0%, 20%, 50% or 100%—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.

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.

The following table shows the regulatory capital ratios of the Company and the Banks and the minimum regulatory requirements:

(dollars in thousands)	Actual		Minimum for capital adequacy purposes		Minimum to be categorized as "well-capitalized" under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2009:						
The Company—consolidated						
Total capital to risk-weighted assets	$ 489,828	12.73 %	$ 307,744	8.00 %	N/A	N/A
Tier 1 capital to risk-weighted assets	441,160	11.47	153,872	4.00	N/A	N/A
Tier 1 leverage capital to average assets	441,160	9.62	183,421	4.00	N/A	N/A
Banner Bank						
Total capital to risk- weighted assets	474,830	12.95	293,282	8.00	$ 366,603	10.00 %
Tier 1 capital to risk- weighted assets	428,419	11.69	146,641	4.00	219,962	6.00
Tier 1 leverage capital to average assets	428,419	9.74	175,992	4.00	219,990	5.00
Islanders Bank						
Total capital to risk- weighted assets	26,727	13.17	16,240	8.00	20,301	10.00
Tier 1 capital to risk- weighted assets	24,731	12.18	8,120	4.00	12,180	6.00
Tier 1 leverage capital to average assets	24,731	11.58	8,543	4.00	10,679	5.00
December 31, 2008:						
The Company—consolidated						
Total capital to risk-weighted assets	$ 532,785	13.11 %	$ 325,037	8.00 %	N/A	N/A
Tier 1 capital to risk-weighted assets	481,697	11.86	162,519	4.00	N/A	N/A
Tier 1 leverage capital to average assets	481,697	10.32	186,692	4.00	N/A	N/A
Banner Bank						
Total capital to risk- weighted assets	468,473	12.02	311,762	8.00	$ 389,703	10.00 %
Tier 1 capital to risk- weighted assets	419,450	10.76	155,881	4.00	233,822	6.00
Tier 1 leverage capital to average assets	419,450	9.40	178,443	4.00	223,053	5.00
Islanders Bank						
Total capital to risk- weighted assets	24,088	13.27	14,522	8.00	18,152	10.00
Tier 1 capital to risk- weighted assets	22,703	12.51	7,261	4.00	10,891	6.00
Tier 1 leverage capital to average assets	22,703	10.74	8,454	4.00	10,568	5.00

At December 31, 2009, Banner and the Banks each exceeded all regulatory capital adequacy requirements; however, under the terms of its expected MOU, Banner Bank will be required to achieve and maintain a Tier 1 leverage capital to average assets ratio equal to or greater than 10.00%. There have been no conditions or events since December 31, 2009 that have materially adversely changed the Tier 1 or Tier 2 capital of the Company or the Banks. However, events beyond the control of the Banks, such as weak or depressed economic conditions in areas where the Banks have most of their loans, could adversely affect future earnings and, consequently, the ability of the Banks to meet their respective capital requirements. The Company may not declare or pay cash dividends on, or repurchase, any of its shares of common stock if the effect thereof would cause equity to be reduced below applicable regulatory capital maintenance requirements or if such declaration and payment would otherwise violate regulatory requirements.

Note 22: CONTINGENCIES

In the normal course of business, the Company and/or its subsidiaries 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 the Banks hold a security interest. Based upon the information known to management at this time, the Company and the Banks are not a party to any legal proceedings that management believes would have a material adverse effect on the results of operations or consolidated financial position at December 31, 2009.

In connection with certain asset sales, the Banks typically make representations and warranties about the underlying assets conforming to specified guidelines. If the underlying assets do not conform to the specifications, the Bank may have an obligation to repurchase the assets or indemnify the purchaser against any loss. The Banks believe that the potential for loss under these arrangements is remote. Accordingly, the fair value of such obligations is not material.

In February 2009, for the first time in its history, the State of Washington's Public Deposit Protection Commission assessed all Qualified Public Depositaries participating in the State's public deposit program an amount that, in aggregate, covered the uninsured portion of the public funds on deposit at a failed Washington bank. The Company's proportionate charge was $655,000, which was subsequently reduced by a refund of $147,000. Generally, the maximum liability should any member(s) of the State's public deposit program default on its uninsured public funds is

limited to 10% of the public funds held by the Banks. A similar program is also in place in Oregon, where Banner Bank also holds public deposits. Should other bank failures occur in either state, the Banks could be subject to additional assessments; however, the rules for participation have been revised to require 100% collateralization of these deposits, which serves to significantly limit the contingent liability that currently exists for Qualified Public Depositaries.

Note 23: INTEREST RATE RISK

The financial condition and operation of the Company are influenced significantly by general economic conditions, including the absolute level of interest rates as well as changes in interest rates and the slope of the yield curve. The Company's profitability is dependent to a large extent on its net interest income, which is the difference between the interest received from its interest-earning assets and the interest expense incurred on its interest-bearing liabilities.

The activities of the Company, like all financial institutions, inherently involve the assumption of interest rate risk. Interest rate risk is the risk that changes in market interest rates will have an adverse effect on the institution's earnings and underlying economic value. Interest rate risk is determined by the maturity and repricing characteristics of an institution's assets, liabilities and off-balance-sheet contracts. Interest rate risk is measured by the variability of financial performance and economic value resulting from changes in interest rates. Interest rate risk is the primary market risk impacting the Company's financial performance.

The greatest source of interest rate risk to the Company results from the mismatch of maturities or repricing intervals for rate-sensitive assets, liabilities and off-balance-sheet contracts. Additional interest rate risk results from mismatched repricing indices and formulae (basis risk and yield curve risk), product caps and floors, and early repayment or withdrawal provisions (option risk), which may be contractual or market driven, that are generally more favorable to customers than to the Company.

The Company's primary monitoring tool for assessing interest rate risk is "asset/liability simulation modeling," which is designed to capture the dynamics of balance sheet, interest rate and spread movements, and to quantify variations in net interest income and economic value of equity resulting from those movements under different rate environments. Another monitoring tool used by the Company to assess interest rate risk is "gap analysis." The matching of repricing characteristics of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are "interest sensitive" and by monitoring the Company's interest sensitivity "gap." Management is aware of the sources of interest rate risk and in its opinion actively monitors and manages it to the extent possible, and considers that the Company's current level of interest rate risk is reasonable.

Note 24: GOODWILL AND OTHER INTANGIBLE ASSETS AND MORTGAGE SERVICING RIGHTS

At December 31, 2009, intangible assets consisted 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. Prior to December 31, 2008, intangible assets also included goodwill, which represented the excess of the purchase price over the fair value of net assets acquired in several business combinations accounted for under the purchase method.

Goodwill is not amortized but is reviewed annually for impairment. During 2008, we engaged an independent valuation consultant to review goodwill for impairment and, as a result of the significant decline in the Company's stock price and market capitalization over the course of 2008 and in conjunction with similar declines in the value of most financial institutions and the ongoing disruption in related financial markets, we wrote off all previously recognized goodwill.

We amortize core deposit intangibles over their estimated useful life and review them at least annually for events or circumstances that could impact their recoverability. The core deposit intangible assets shown in the table below represent the value ascribed to the long-term deposit relationships acquired in three separate bank acquisitions during 2007. These intangible assets are being amortized using an accelerated method over estimated useful lives of eight years. The core deposit intangible assets are not estimated to have a significant residual value. Other intangible assets are amortized over their useful lives and are also reviewed for impairment.

The following table summarizes the changes in the Company's goodwill and other intangibles for the years ended December 31, 2009, 2008 and 2007 (dollars in thousands):

	Total	Goodwill	Core Deposit Intangibles	Other
Balance, December 31, 2006	$ 36,287	$ 36,230	$ --	$ 57
Additions through acquisitions	103,288	84,878	18,410	--
Adjustments in basis	(38)	--	--	(38)
Amortization	(1,883)	--	(1,881)	(2)
Impairment write-off	--	--	--	--
Balance, December 31, 2007	137,654	121,108	16,529	17
Additions through acquisitions	--	--	--	--
Adjustments in basis	13	13	--	--
Amortization	(2,830)	--	(2,828)	(2)
Impairment write-off	(121,121)	(121,121)	--	--
Balance, December 31, 2008	13,716	--	13,701	15
Additions through acquisitions	--	--	--	--
Adjustments in basis	--	--	--	--
Amortization	(2,646)	--	(2,645)	(1)
Impairment write-off	--	--	--	--
Balance, December 31, 2009	$ 11,070	$ --	$ 11,056	$ 14

Estimated amortization expense in future years with respect to existing intangibles (dollars in thousands):

Year Ended	Core Deposit Intangibles	Other	TOTAL
December 31, 2010	$ 2,459	$ 2	$ 2,461
December 31, 2011	2,276	2	2,278
December 31, 2012	2,092	2	2,094
December 31, 2013	1,908	2	1,910
December 31, 2014	1,724	2	1,726
Thereafter	598	3	601
Net carrying amount	$ 11,057	$ 13	$ 11,070

Mortgage servicing rights are reported in other assets. Mortgage servicing rights are initially reported at fair value and are amortized in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Mortgage servicing rights are subsequently evaluated for impairment based upon the fair value of the rights compared to the amortized cost (remaining unamortized initial fair value). If the fair value is less than the amortized cost, a valuation allowance is created through an impairment charge to servicing fee income. However, if the fair value is greater than the amortized cost, the amount above the amortized cost is not recognized in the carrying value. In 2009, the Company recorded $800,000 in impairment charges against mortgage servicing rights. Loans serviced for others totaled $678,548,000 and $445,528,000 at December 31, 2009 and 2008, respectively. Custodial accounts maintained in connection with this servicing totaled $7,426,000 and $3,975,000 at December 31, 2009 and 2008, respectively.

An analysis of the mortgage servicing rights for the years ended December 31, 2009, 2008 and 2007 is presented below (dollars in thousands):

	2009	2008	2007
Balance, beginning of the year	$ 3,554	$ 2,807	$ 2,684
Amounts capitalized	5,009	1,649	781
Amortization*	(2,060)	(902)	(658)
Impairment charge	(800)	--	--
Balance, end of the year	$ 5,703	$ 3,554	$ 2,807

*Amortization of mortgage servicing rights is recorded as a reduction of loan servicing income and accumulated amortization is fully written off if the loan repays in full.

Note 25: FAIR VALUE OF FINANCIAL INSTRUMENTS

We have elected to record certain assets and liabilities at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The GAAP standard (ASC 820) establishes a consistent framework for measuring fair value and disclosure requirements about fair value measurements. Among other things, the standards require us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our estimates for market assumptions. These two types of inputs create the following fair value hierarchy:

- Level 1 – Quoted prices for identical instruments in active markets. An active market is a market in which transactions occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and matrix or model-derived valuations whose inputs are observable or whose significant value drivers are observable.

- Level 3 – Instruments whose significant value drivers are unobservable. The valuation is generated from model-based techniques that use significant assumptions not observable in the market, but observable based on Company-specific data. These unobservable assumptions reflect our estimates for assumptions that market participants would use in pricing the asset or liability. Valuation techniques typically include discounted cash flow models and similar techniques, but may also include the use of market prices of assets or liabilities that are not directly comparable to the subject asset or liability.

Items Measured at Fair Value on a Recurring Basis:

We record trading account securities, securities available-for-sale, FHLB debt and junior subordinated debentures at fair value on a recurring basis.

- The securities assets primarily consist of U.S. Government Agency obligations, municipal bonds, corporate bonds—including certain trust preferred securities—mortgage-backed securities, equity securities and certain other financial instruments. At December 31, 2009 and 2008, management used inputs from each of the three fair value hierarchy levels to value these assets. The Level 1 measurements are based upon quoted prices in active markets. The Level 2 measurements are generally based upon a matrix pricing model from an

investment reporting and valuation service. Matrix pricing is a mathematical technique used principally to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities. The Level 3 measurements are based primarily on unobservable inputs. In 2008 and continuing during 2009, the lack of active markets and market participants for certain securities resulted in an increase in Level 3 measurements. In developing Level 3 measurements, management incorporates whatever market data might be available and uses discounted cash flow models where appropriate. These calculations include projections of future cash flows, including appropriate default and loss assumptions, and market based discount rates.

At December 31, 2009 and 2008, the disrupted financial markets made it especially difficult to determine the fair value of certain types of securities. As of December 31, 2009, we owned approximately $41.9 million in current face value of collateralized debt obligation securities that are backed by trust preferred securities issued by banks, thrifts and insurance companies (TRUP CDOs). The market for these securities, beginning in the third quarter of 2008 and continuing through December 31, 2009, was not active and markets for similar securities were also not active. The inactivity was evidenced first by a significant widening of the bid-ask spread in the brokered markets in which TRUP CDOs trade and then by a significant decrease in the volume of trades relative to historical levels. The new issue market is also inactive as almost no new TRUP CDOs have been issued since 2007. There are currently very few market participants who are willing and/or able to transact for these securities. Thus, a low market price for a particular bond may only provide evidence of stress in the credit markets in general rather than being an indicator of credit problems with a particular issuer.

Given these conditions in the debt markets and the absence of observable transactions in the secondary and new issue markets, management determined that for TRUP CDOs:

- The few observable transactions and market quotations that were available are not reliable for purposes of determining fair value at December 31, 2009 and 2008,

- An income valuation approach technique (present value technique) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs is equally or more representative of fair value than the market approach valuation technique used at prior measurement dates, and

- The Company's TRUP CDOs are classified within Level 3 of the fair value hierarchy because of the significant assumptions required to determine fair value at the measurement date.

The TRUP CDO valuations were prepared by an independent third party. Its approach to determining fair value involved the following steps:

1. The credit quality of the collateral was estimated using average risk-neutral probability of default values for each industry (i.e., banks, REITs and insurance companies were evaluated separately).

2. Asset defaults were then generated taking into account both the probability of default of the asset and an assumed level of correlation among the assets.

3. A higher level of correlation was assumed among assets from the same industry (e.g., banks with other banks) than among those from different industries.

4. The loss given default was assumed to be 95% (i.e., a 5% recovery).

5. The cash flows were forecast for the underlying collateral and applied to each CDO tranche to determine the resulting distribution among the securities.

6. The calculations were modeled in several thousand scenarios using a Monte Carlo engine.

7. The expected cash flows for each scenario were discounted at the risk-free rate plus 300 basis points for illiquidity (200 basis points for periods ended June 30, 2009 or earlier) to calculate the present value of the security.

8. The average of the calculated present values for each scenario was used for valuation purposes.

Management reviewed the valuation methodology and assumptions used by the independent third party providers, determined that with respect to performing securities the fair value estimates were reasonable and utilized those estimates in our reported financial statements. However, beginning with the quarter ended June 30, 2009 and continuing with the quarter ended December 31, 2009, for two securities for which we currently are not receiving any cash payments, management elected to override the third party fair value estimates and to reflect the fair value of these securities at zero.

At December 31, 2009 and 2008, we also directly owned approximately $35.0 million in current face value of trust preferred securities (TPS) issued by five individual financial institutions for which no market data or independent valuation source is available. Similar to the discussion of TRUP CDOs above, there were too few, if any, issuances of new TPS securities or sales of existing TPS securities to provide Level 1 or even Level 2 fair value measurements. Management, therefore, utilized a discounted cash-flow model to calculate the present value of each security's expected future cash flows to determine their respective fair values. Management took into consideration what little market data was available regarding discount rates, but concluded that most of the available information represented dated transactions and/or was not representative of active market transactions. Since these five TPS securities are also

concentrated in the financial institutions sector, which continues to be under extreme pricing pressure at December 31, 2009, management applied credit factors to differentiate these issues based upon its judgment of the risk profile of the various issuers. These credit factors were then incorporated into the model at December 31, 2009, and discount rates equal to three-month LIBOR plus 700 to 900 basis points were used to calculate the respective fair values of these securities. Additionally, in the third quarter, based on its credit analysis, management determined that collection of one specific TPS was highly unlikely and therefore elected to write off the balance of that security.

- Fair valuations for FHLB advances are estimated using fair market values provided by the lender, the FHLB of Seattle. The FHLB of Seattle prices advances by discounting the future contractual cash flows for individual advances using its current cost of funds curve to provide the discount rate. Management considers this to be a Level 2 input method.

- The fair valuations of junior subordinated debentures (TPS debt) were valued using discounted cash flows to maturity or to the next available call date, if based upon the current interest rate and credit market environment it was considered likely that we would elect early redemption. The majority, $98 million, of these debentures carry interest rates that reset quarterly, using the three-month LIBOR index plus spreads of 1.38% to 3.35%. The remaining $26 million issue has a current interest rate of 6.56%, which is fixed through December 2011 and then resets quarterly to equal three-month LIBOR plus a spread of 1.62%. In valuing the debentures at December 31, 2009, management evaluated discounted cash flows to maturity and for the discount rate used the December 31, 2009 three-month LIBOR plus 800 basis points. At December 31, 2008, the cash flows were valued using a discount rate equal to three-month LIBOR plus 700 basis points. While the quarterly reset of the index on this debt would seemingly keep it close to market values, the disparity in the fixed spreads above the index and the inability to determine realistic current market spreads, due to lack of new issuances and trades, resulted in having to rely more heavily on assumptions about what spread would be appropriate if market transactions were to take place. In periods prior to September 30, 2008, the discount rate used was based on recent issuances or quotes from brokers on the date of valuation for comparable bank holding companies and was considered to be a Level 2 input method. However, as noted above in the discussion of pricing trust preferred securities (TRUP CDOs), due to the unprecedented disruption of certain financial markets, management concluded that there were insufficient transactions or other indicators to continue to reflect these measurements as Level 2 inputs. Due to this reliance on assumptions and not on directly observable transactions, management considers this to now be a Level 3 input method.

The following tables present financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2009 and 2008 (dollars in thousands):

	December 31, 2009			
	Total	Level 1	Level 2	Level 3
Assets:				
Securities—available-for-sale				
U.S government and agency	$ 53,112	$ --	$ 53,112	$ --
Mortgage-backed securities	42,555	--	42,555	--
	$ 95,667	$ --	$ 95,667	$ --
Securities—trading				
U.S government and agency	$ 41,255	$ --	$ 41,255	$ --
Municipal bonds	7,151	--	7,151	--
Corporate bonds	35,017	4,825	--	30,192
Mortgage-backed securities	63,386	--	63,386	--
Equity securities and other	342	328	14	--
	$ 147,151	$ 5,153	$ 111,806	$ 30,192
	$ 242,818	$ 5,153	$ 207,473	$ 30,192
Liabilities				
Advances from FHLB at fair value	$ 189,779	$ --	$ 189,779	$ --
Junior subordinated debentures net of unamortized deferred issuance costs at fair value	47,694	--		47,694
	$ 237,473	$ --	$ 189,779	$ 47,694

	December 31, 2008			
	Total	Level 1	Level 2	Level 3
Assets:				
Securities—available-for-sale				
U.S government and agency	$ --	$ --	$ --	$ --
Mortgage-backed securities	53,272	--	53,272	--
	$ 53,272	$ --	$ 53,272	$ --
Securities—trading				
U.S government and agency	$ 70,389	$ --	$ 70,389	$ --
Municipal bonds	12,029	--	12,029	--
Corporate bonds	40,220	3,925	--	36,295
Mortgage-backed securities	81,030	--	81,030	--
Equity securities and other	234	227	7	--
	$ 203,902	$ 4,152	$ 163,455	$ 36,295
	$ 257,174	$ 4,152	$ 216,727	$ 36,295
Liabilities				
Advances from FHLB at fair value	$ 111,415	$ --	$ 111,415	$ --
Junior subordinated debentures net of unamortized deferred issuance costs at fair value	61,776	--	--	61,776
	$ 173,191	$ --	$ 111,415	$ 61,776

The following tables summarize the fair value gain or (loss) recorded for the year-to-date periods ended December 31, 2009, 2008 and 2007 (dollars in thousands):

	December 31, 2009	
	Fair value gain (loss) year to date	
	Recognized in other operating income	Recognized as other comprehensive income
Assets:		
Securities—available-for-sale		$ (377)
Securities—trading	$ (4,194)	
	$ (4,194)	$ (377)
Liabilities		
Advances from FHLB at fair value	$ 1,130	$ --
Junior subordinated debentures net of unamortized deferred issuance costs at fair value	14,082	
	$ 15,212	$ --
Total fair value gains (losses), net	$ 11,018	$ (377)

	December 31, 2008	
	Fair value gain (loss) year to date	
	Recognized in other operating income	Recognized as other comprehensive income
Assets:		
Securities—available-for-sale		$ 692
Securities—trading	$ (39,948)	
	$ (39,948)	$ 692
Liabilities		
Advances from FHLB at fair value	$ (2,409)	$ --
Junior subordinated debentures net of unamortized deferred issuance costs at fair value	51,513	
	$ 49,104	$ --
Total fair value gains (losses), net	$ 9,156	$ 692

	December 31, 2007	
	Fair value gain (loss) year to date	
	Recognized in other operating income	Recognized as other comprehensive income
Assets:		
Securities—available-for-sale		$ --
Securities—trading	$ 1,187	
	$ 1,187	$ --
Liabilities		
Advances from FHLB at fair value	$ (651)	$ --
Junior subordinated debentures net of unamortized deferred issuance costs at fair value	11,038	
	$ 10,387	$ --
Total fair value gains (losses), net	$ 11,574	$ --

The following table provides a reconciliation of the assets and liabilities measured at fair value using significant unobservable inputs (Level 3) on a recurring basis during the year ended December 31, 2009:

	December 31, 2009 (dollars in thousands)	
	Investments—trust preferred securities	Borrowings—junior subordinated debentures
Beginning balance	$ 36,295	$ 61,776
Total gains or losses recognized		
Assets gains (losses)	(6,103)	
Liabilities (gains) losses		(14,082)
Purchases, issuances and settlements		
Transfers in and/or out of Level 3		
Ending balance	$ 30,192	$ 47,694

The Company has elected to continue to recognize the interest income and dividends from the securities reclassified to fair value as a component of interest income as was done in prior years when they were classified as available for sale. Interest expense related to the FHLB advances and junior subordinated debentures continues to be measured based on contractual interest rates and reported in interest expense. The change in fair market value of these financial instruments has been recorded as a component of other operating income.

Items Measured at Fair Value on a Non-recurring Basis:

In 2008, our goodwill was analyzed for potential impairment and was subsequently written down completely by a charge to earnings of $50.0 million during the quarter ended June 30, 2008 and an additional charge of $71.1 million during the quarter ended December 31, 2008. Throughout 2008, we engaged an independent valuation consultant to assist us in determining whether and to what extent our goodwill asset was impaired. The key inputs used to determine the implied fair value of the Company and the corresponding amount of the write-off included the quoted market price of our common stock, market prices of common stocks of other banking organizations, common stock trading multiples, discounted cash flows and inputs from comparable transactions. In addition, consideration was given to the value that may arise from synergies and other benefits that would accrue from control over an entity. These valuation inputs are considered to be Level 3 inputs.

In accordance with the provisions of the accounting standards for fair value measurements and disclosures, as of December 31, 2009, impaired loans with an initial carrying value of $221 million were written down to their fair value of $192 million by recording charges of $29 million to the allowance for loan losses. Impaired loans are measured at an observable market price (if available) or at the fair value of the loan's collateral (if the loan is collateral dependent). Most of our impaired loans are collateral dependent and, accordingly, we measure such loans based on the fair value of the collateral. Fair value of the loan's collateral is determined by appraisals or independent valuation, or internal valuations based on appraisals or other independent valuations combined with other market data which is then adjusted for the cost related to liquidation of the collateral. These valuation inputs are considered to be Level 3 inputs.

Real estate owned held for sale, net and other foreclosed assets are recorded when the Company receives a long-lived asset, such as real estate, from a borrower in full or partial satisfaction of a loan. The long-lived asset is considered to be held for sale and, prior to the transfer from loans, its carrying value is reduced to its fair value less cost to sell. This fair value (less cost to sell) becomes the "cost" of the foreclosed asset which is subsequently reported at the lower of cost or fair value. Fair value of the foreclosed asset is determined by appraisals or independent valuation, which is then adjusted for the estimated cost to sell it. These valuation inputs are considered to be Level 3 inputs. The individual carrying values of these assets are reviewed for impairment at least annually and any additional impairment charges are expensed to operations. For the year ended December 31, 2009, we recognized $1.6 million of additional impairment charges related to these types of assets.

Certain non-financial assets are also measured at fair value on a non-recurring basis. These assets primarily consist of intangible assets and other non-financial long-lived assets which are measured at fair value for periodic impairment assessments. The following table presents the fair value measurement of assets and liabilities measured at fair value on a non-recurring basis and the level within the ASC 820 fair value hierarchy of the fair value measurements for those assets at December 31, 2009 and December 31, 2008 (in thousands):

	December 31, 2009			
	Fair Value	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Impaired loans	$ 191,730	--	--	$ 191,730
Other real estate owned	77,743	--	--	77,743

	December 31, 2008			
	Fair Value	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Impaired loans	$ 172,242	--	--	$ 172,242
Other real estate owned	21,782	--	--	21,782
Goodwill	--	--	--	--

Fair Values of Financial Instruments:

The following table presents estimated fair values of the Company's financial instruments as of December 31, 2009 and 2008, whether or not recognized or recorded in the consolidated balance sheets. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is necessary to interpret market data in the development of the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. The estimated fair value of financial instruments is as follows (dollars in thousands):

	December 31, 2009		December 31, 2008	
	Carrying value	Estimated fair value	Carrying value	Estimated fair value
Assets:				
Cash and due from banks	$ 323,005	$ 323,005	$ 102,750	$ 102,750
Securities—trading	147,151	147,151	203,902	203,902
Securities—available-for-sale	95,667	95,667	53,272	53,272
Securities—held-to-maturity	74,834	76,489	59,794	60,530
Loans receivable held for sale	4,497	4,534	7,413	7,540
Loans receivable	3,690,355	3,490,419	3,878,798	3,758,691
FHLB stock	37,371	37,371	37,371	37,371
Bank-owned life insurance (BOLI)	54,596	54,596	52,680	52,680
Mortgage servicing rights	5,703	5,703	3,554	2,906
Liabilities:				
Demand, NOW and money market accounts	1,384,860	1,272,322	1,172,098	1,190,712
Regular savings	538,765	495,409	474,885	493,802
Certificates of deposit	1,941,925	1,954,825	2,131,867	2,165,127
FHLB advances at fair value	189,779	189,779	111,415	111,415
Junior subordinated debentures at fair value	47,694	47,694	61,776	61,776
Other borrowings	176,842	176,447	145,230	144,933
Off-balance-sheet financial instruments:				
Commitments to originate loans	362	362	62	62
Commitments to sell loans	(362)	(362)	(62)	(62)

Fair value estimates, methods and assumptions are set forth below for the Company's financial and off-balance-sheet instruments:

Cash and Due from Banks: The carrying amount of these items is a reasonable estimate of their fair value.

Securities: The estimated fair values of investment securities and mortgaged-backed securities are priced using current active market quotes, if available, which are considered Level 1 measurements. For most of the portfolio, matrix pricing based on the securities' relationship to other benchmark quoted prices is used to establish the fair value. These measurements are considered Level 2. Due to the increasing credit concerns

in the capital markets and inactivity in the trust preferred markets that have limited the observability of market spreads for some of the Company's trust preferred securities (see earlier discussion above in determining the securities' fair market value), management has classified its trust preferred securities as a Level 3 fair value measure.

Loans Receivable: Fair values are estimated first by stratifying the portfolios of loans with similar financial characteristics. Loans are segregated by type such as multifamily real estate, residential mortgage, nonresidential mortgage, commercial/agricultural, consumer and other. Each loan category is further segmented into fixed- and adjustable-rate interest terms and by performing and non-performing categories. For performing loans held in portfolio, the fair value is based on discounted cash flows using as a discount rate the current rate offered on similar products. The carrying values of variable rate construction and land development loans and nonresidential real estate loans are discounted by a liquidity adjustment related to the current market environment.

The fair value of performing residential mortgages held for sale is estimated based upon secondary market sources by type of loan and terms such as fixed or variable interest rates.

Fair value for significant non-performing loans is based on recent appraisals or estimated cash flows discounted using rates commensurate with risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows and discount rates are judgmentally determined using available market information and specific borrower information.

FHLB Stock: The fair value is based upon the redemption value of the stock which equates to its carrying value.

Mortgage Servicing Rights: Fair values are estimated based on current pricing for sales of servicing for new loans adjusted up or down based on the serviced loan's interest rate versus current loan sales of servicing.

Deposit Liabilities: The fair value of deposits with no stated maturity, such as savings, checking and NOW accounts, is estimated by applying decay rate assumptions to segregated portfolios of similar deposit types to generate cash flows which are then discounted using short-term market interest rates. The market value of certificates of deposit is based upon the discounted value of contractual cash flows. The discount rate is determined using the rates currently offered on comparable instruments.

FHLB Advances and Other Borrowings: Fair valuations for our FHLB advances are estimated using fair market values provided by the lender, the FHLB of Seattle. The FHLB of Seattle prices advances by discounting the future contractual cash flows for individual advances using its current cost of funds curve to provide the discount rate. This is considered to be a Level 2 input method. Other borrowings are priced using discounted cash flows to the date of maturity based on using current rates at which such borrowings can currently be obtained.

Junior Subordinated Debentures: Due to the increasing credit concerns in the capital markets and inactivity in the trust preferred markets that have limited the observability of market spreads (see earlier discussion above in determining the junior subordinated debentures' fair market value), junior subordinated debentures have been classified as a Level 3 fair value measure. Management believes that the credit risk adjusted spread utilized is indicative of those that would be used by market participants.

Commitments: Commitments to sell loans with notional balances of $25,454,000 and $42,896,000 at December 31, 2009 and 2008, respectively, have a carrying value of $362,000 and $62,000, representing the fair value of such commitments. Interest rate lock commitments to originate loans held for sale with notional balances of $25,454,000 and $42,896,000 at December 31, 2009 and 2008, respectively, have a carrying value of ($362,000) and ($62,000). The fair value of commitments to sell loans and of interest rate locks reflect changes in the level of market interest rates from the date of the commitment or rate lock to the date of our financial statements. Other commitments to fund loans totaled $777,103,000 and $1,263,256,000 at December 31, 2009 and 2008, respectively, and have no carrying value at both dates, representing the cost of such commitments. There were no commitments to purchase or sell securities at December 31, 2009 or 2008.

Limitations: The fair value estimates presented herein are based on pertinent information available to management as of December 31, 2009 and 2008. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

Fair value estimates are based on existing on- and off-balance-sheet financial instruments without attempting to estimate the value of anticipated future business. The fair value has not been estimated for assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not financial instruments include the deferred tax assets/liabilities; land, buildings and equipment; costs in excess of net assets acquired; and real estate held for sale.

Note 26: BANNER CORPORATION
(PARENT COMPANY ONLY)

Summary financial information is as follows (in thousands):

Statements of Financial Condition

	December 31	
	2009	2008
ASSETS		
Cash	$ 6,190	$ 60,973
Investment in trust equities	3,716	3,716
Investment in subsidiaries	469,971	451,910
Deferred tax asset	--	--
Other assets	2,887	4,952
	$ 482,764	$ 521,551
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities	$ 11,066	$ 12,177
Deferred tax liability	18,875	14,250
Junior subordinated debentures at fair value	47,695	61,776
Stockholders' equity	405,128	433,348
	$ 482,764	$ 521,551

Statements of Operations

	Years Ended December 31		
	2009	2008	2007
INTEREST INCOME:			
Certificates, time deposits and dividends	$ 380	$ 452	$ 1,135
OTHER INCOME (EXPENSE):			
Dividend income from subsidiaries	1,603	5,175	17,686
Equity in undistributed income of subsidiaries	(41,755)	(159,726)	18,662
Other income	61	37	30
Net change in valuation of financial instruments carried at fair value	14,082	51,513	11,038
Interest on other borrowings	(4,754)	(7,353)	(8,887)
Other expense	(2,815)	(2,793)	(2,239)
	(33,198)	(112,695)	37,425
BENEFIT FROM INCOME TAXES	(2,566)	(15,298)	(502)
NET INCOME (LOSS)	$ (35,764)	$ (127,993)	$ 36,923

Statements of Cash Flows

For the years ended December 31, 2009, 2008 and 2007 (dollars in thousands):

	Years Ended December 31		
	2009	2008	2007
OPERATING ACTIVITIES:			
Net income (loss)	$ (35,764)	$ (127,993)	$ 36,923
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Equity in undistributed earnings of subsidiaries	41,755	159,726	(18,662)
Amortization	23	49	57
(Increase) decrease in deferred taxes	5,069	23,165	99
Tax benefits realized from equity-based compensation	--	(4)	(58)
Net change in valuation of financial instruments carried at fair value	(14,082)	(51,512)	(11,078)
(Increase) decrease in other assets	(1,829)	1,470	2,386
Increase (decrease) in other liabilities	3,118	(1,796)	3,333
Net cash provided (used) by operating activities	(1,710)	3,105	13,000
INVESTING ACTIVITIES:			
Funds transferred to deferred compensation trust	(252)	(272)	(209)
Payments received on loan to ESOP for release of shares	--	--	--
Additional funds invested in subsidiaries	(60,000)	(98,150)	(33,118)
Net cash provided (used) by investing activities	(60,252)	(98,422)	(33,327)
FINANCING ACTIVITIES:			
Proceeds from issuance of junior subordinated debentures	--	--	25,774
Investment in trust securities related to junior subordinated debentures	--	--	(774)
Proceeds from issuance of preferred stock	(46)	124,000	--
Repayment of trust securities related to junior subordinated debentures	--	--	(25,000)
Issuance of stock	14,723	21,021	37,460
Net proceeds from exercise of stock options	--	594	1,715
Repurchases of stock	--	(14,272)	(2,116)
Tax benefits realized from equity-based compensation	--	4	58
Cash dividends paid	(7,498)	(10,386)	(10,598)
Net cash provided (used) by financing activities	7,179	120,961	26,519
NET INCREASE (DECREASE) IN CASH	(54,783)	25,644	6,192
CASH, BEGINNING OF PERIOD	60,973	35,329	29,137
CASH, END OF PERIOD	$ 6,190	$ 60,973	$ 35,329

Note 27: STOCK REPURCHASE

The Company has periodically engaged in stock repurchase activity; however, the Company did not repurchase any stock during the year ended December 31, 2009. For the year ended December 31, 2008, the Company repurchased 614,103 shares of its stock at an average price of $23.24 per share. This included 605,800 shares purchased on the open market at an average price of $23.20 and 8,303 shares repurchased in connection with the exercise of stock options or the forfeiture of stock grants. Under the terms of the TARP CPP, the Company is prohibited from repurchasing shares as long as the U.S. Treasury owns our senior preferred stock.

Note 28: CALCULATION OF EARNINGS PER COMMON SHARE

The following tables show the calculation of earnings per common share (dollars in thousands, except per share data).

	Years Ended December 31		
	2009	2008	2007
Net income (loss)	$ (35,764)	$ (127,993)	$ 36,923
Preferred stock dividend accrual	(6,200)	(689)	--
Preferred stock discount accrual	(1,492)	(161)	--
Net income (loss) available to common shareholders	$ (43,456)	$ (128,843)	$ 36,923
Basic weighted average shares outstanding	18,647	16,225	14,581
Plus MRP, common stock option and common stock warrants considered outstanding for diluted EPS	4	42	257
Less dilutive shares not included as they are anti-dilutive for calculations of loss per share	(4)	(42)	--
	18,647	16,225	14,838
Earnings (loss) per common share			
Basic	$ (2.33)	$ (7.94)	$ 2.53
Diluted	$ (2.33)	$ (7.94)	$ 2.49

Options to purchase an additional 495,378 shares of common stock were not included in the computation of diluted earnings per share because their exercise price resulted in them being anti-dilutive. Also as of December 31, 2009, the warrant issued to the U.S. Treasury to purchase up to 1,707,989 shares of common stock in the fourth quarter of 2008 was not included in the computation of diluted EPS because the warrant's exercise price was greater than the average market price of common shares.

Note 29: SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

Results of operations on a quarterly basis were as follows (dollars in thousands except for per share data):

	Year Ended December 31, 2009			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest income	$ 60,331	$ 59,158	$ 59,573	$ 58,308
Interest expense	25,372	24,233	23,221	19,971
Net interest income before provision for loan losses	34,959	34,925	36,352	38,337
Provision for loan losses	22,000	45,000	25,000	17,000
Net interest income	12,959	(10,075)	11,352	21,337
Other operating income	4,648	19,977	13,453	5,612
Other operating expenses	33,793	36,891	36,629	34,767
Income before provision for income taxes	(16,186)	(26,989)	(11,824)	(7,818)
Provision (benefit) for income taxes	(6,923)	(10,478)	(5,376)	(4,276)
Net income (loss)	$ (9,263)	$ (16,511)	$ (6,448)	$ (3,542)
Preferred stock dividend	1,550	1,550	1,550	1,550
Preferred stock discount accretion	373	373	373	373
Net income (loss) available to common shareholders	$ (11,186)	$ (18,434)	$ (8,371)	$ (5,465)
Basic earnings (loss) per share	$ (0.65)	$ (1.04)	$ (0.44)	$ (0.27)
Diluted earnings (loss) per share	$ (0.65)	$ (1.04)	$ (0.44)	$ (0.27)
Cumulative dividends declared	$ 0.01	$ 0.01	$ 0.01	$ 0.01

Note 29: SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED) (continued)

	Year Ended December 31, 2008			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest income	$ 71,953	$ 68,042	$ 68,007	$ 64,896
Interest expense	34,586	31,062	30,381	29,316
Net interest income before provision from loan losses	37,367	36,980	37,626	35,580
Provision for loan losses	6,500	15,000	8,000	33,000
Net interest income	30,867	21,980	29,626	2,580
Other operating income	8,184	8,632	2,036	21,037
Other operating expenses	33,708	85,222	34,000	107,090
Income before provision for income taxes	5,343	(54,610)	(2,338)	(83,473)
Provision for income taxes	1,509	(2,305)	(1,347)	(4,942)
Net income	$ 3,834	$ (52,305)	$ (991)	$ (78,531)
Preferred stock dividend	--	--	--	689
Preferred stock discount accretion	--	--	--	161
Net income (loss) available to common shareholders	$ 3,834	$ (52,305)	$ (991)	$ (79,381)
Basic earnings per share	$ 0.24	$ (3.31)	$ (0.06)	$ (4.72)
Diluted earnings per share	$ 0.24	$ (3.31)	$ (0.06)	$ (4.72)
Cumulative dividends declared	$ 0.20	$ 0.20	$ 0.05	$ 0.05

	Year Ended December 31, 2007			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest income	$ 65,446	$ 74,411	$ 79,210	$ 76,242
Interest expense	33,269	36,301	38,540	37,580
Net interest income before provision for loan losses	32,177	38,110	40,670	38,662
Provision for loan losses	1,000	1,400	1,500	2,000
Net interest income	31,177	36,710	39,170	36,662
Other operating income	6,334	4,986	10,534	16,729
Other operating expenses	26,071	31,299	34,846	35,273
Income before provision for income taxes	11,440	10,397	14,858	18,118
Provision for income taxes	3,627	3,286	4,871	6,106
Net income	$ 7,813	$ 7,111	$ 9,987	$ 12,012
Basic earnings per share	$ 0.63	$ 0.49	$ 0.64	$ 0.75
Diluted earnings per share	$ 0.62	$ 0.48	$ 0.64	$ 0.74
Cumulative dividends declared	$ 0.19	$ 0.19	$ 0.19	$ 0.20

Note 30: BUSINESS SEGMENTS

The Company is managed by legal entity and not by lines of business. Each of the Banks is a community oriented commercial bank chartered in the State of Washington. The Banks' primary business is that of a traditional banking institution, gathering deposits and originating loans for portfolio in its respective primary market areas. The Banks offer a wide variety of deposit products to its consumer and commercial customers. Lending activities include the origination of real estate, commercial/agriculture business and consumer loans. Banner Bank is also an active participant in the secondary market, originating residential loans for sale on both a servicing released and servicing retained basis. In addition to interest income on loans and investment securities, the Banks receive other income from deposit service charges, loan servicing fees and from the sale of loans and investments. The performance of the Banks is reviewed by the Company's executive management and Board of Directors on a monthly basis. All of the executive officers of the Company are members of Banner Bank's management team.

Generally accepted accounting principles establish standards to report information about operating segments in annual financial statements and require reporting of selected information about operating segments in interim reports to stockholders. The Company has determined that its current business and operations consist of a single business segment.

Note 31: FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

The Banks have financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of their customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the Consolidated Statements of Financial Condition.

The Banks exposure to credit loss in the event of nonperformance by the other party to the financial instrument from commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Banks use the same credit policies in making commitments and conditional obligations as for on-balance sheet instruments. As of December 31, 2009, outstanding commitments for which no liability has been recorded consist of the following:

	Contract or Notional Amount (in thousands)
Financial instruments whose contract amounts represent credit risk:	
Commitments to extend credit	
Real estate secured for commercial, construction or land development	$ 109,094
Revolving open-end lines secured by 1-4 family residential properties	119,184
Credit card lines	63,618
Other, primarily business and agricultural loans	452,259
Real estate secured by one- to four-family residential properties	25,454
Standby letters of credit and financial guarantees	7,494
Total	$ 777,103
Commitments to sell loans secured by one- to four-family residential properties	$ 25,454

Commitments to extend credit are agreements to lend to a customer, as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Many of the commitments may expire without being drawn upon; therefore, the total commitment amounts do not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, and income producing commercial properties.

Standby letters of credit are conditional commitments issued to guarantee a customer's performance or payment to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

Interest rates on residential one- to four-family mortgage loan applications are typically rate locked (committed) to customers during the application stage for periods ranging from 15 to 45 days, the most typical period being 30 days. Typically, pricing for the sale of these loans is locked with various qualified investors under a best-efforts delivery program at or near the time the interest rate is locked with the customer. The Banks attempt to deliver these loans before their rate locks expire. This arrangement generally requires delivery of the loans prior to the expiration of the rate lock. Delays in funding the loans can require a lock extension. The cost of a lock extension at times is borne by the customer and at times by the Bank. These lock extension costs are not expected to have a material impact to our operations. This activity is managed daily. Changes in the value of rate lock commitments are recorded as assets and liabilities as explained in Note 1: "Derivative Instruments."

Note 32: INTEREST RATE SWAPS

The Company has stand-alone derivative instruments in the form of interest rate swap agreements, which derive their value from underlying interest rates (see Note 1). These transactions involve both credit and market risk. The notional amount is the amount on which calculations, payments, and the value of the derivative are based. The notional amount does not represent direct credit exposure. Direct credit exposure is limited to the net difference between the calculated amount to be received and paid. This difference represents the fair value of the derivative instrument.

The Company is 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 management does not expect the counterparty to fail its obligations.

Information pertaining to outstanding interest rate swaps at December 31, 2009 and 2008 follows (dollars in thousands):

	December 31	
	2009	2008
Notional amount	$ 20,427	$ 26,334
Weighted average pay rate	5.32 %	5.35 %
Weighted average receive rate	0.23 %	1.51 %
Weighted average maturity in years	7.8	7.4
Unrealized gain (loss) relating to interest rate swaps	$ 2,402	$ 4,642

The net changes in fair value of the derivatives are recorded in loans and other liabilities.

All of the Company's interest rate swap agreements are with the Pacific Coast Bankers Bank (PCBB) as the counterparty. The Company has swapped fixed-rate cash flows that it receives from its customers for variable-rate cash flows that it receives from PCBB.

Exhibit	Index of Exhibits
3{a}	Articles of Incorporation of Registrant [incorporated by reference to Exhibit B to the Proxy Statement for the Annual Meeting of Stockholders dated June 10, 1998].
3{b}	Certificate of designation relating to the Company's Fixed Rate Cumulative Perpetual Preferred Stock Series A [incorporated by reference to the Registrant's Current Report on Form 8-K filed on November 24, 2008 (File No. 000-26584)]
3{c}	Bylaws of Registrant [incorporated by reference to Exhibit 3.2 filed with the Current Report on Form 8-K dated July 24, 1998 (File No. 0-26584)].
4{a}	Warrant to purchase shares of Company's common stock dated November 21, 2008 [incorporated by reference to the Registrant's Current Report on Form 8-K filed on November 24, 2008 (File No. 000-26584)]
4{b}	Letter Agreement (including Securities Purchase Agreement Standard Terms attached as Exhibit A) dated November 21, 2008 between the Company and the United States Department of the Treasury [incorporated by reference to the Registrant's Current Report on Form 8-K filed on November 24, 2008 (File No. 000-26584)].
10{a}	Executive Salary Continuation Agreement with Gary L. Sirmon [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended March 31, 1996 (File No. 0-26584)].
10{b}	Employment Agreement with Michael K. Larsen [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended March 31, 1996 (File No. 0-26584)].
10{c}	Executive Salary Continuation Agreement with Michael K. Larsen [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended March 31, 1996 (File No. 0-26584)].
10{d}	1996 Stock Option Plan [incorporated by reference to Exhibit 99.1 to the Registration Statement on Form S-8 dated August 26, 1996 (File No. 333-10819)].
10{e}	1996 Management Recognition and Development Plan [incorporated by reference to Exhibit 99.2 to the Registration Statement on Form S-8 dated August 26, 1996 (File No. 333-10819)].
10{f}	Consultant Agreement with Jesse G. Foster, dated as of December 19, 2003. [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2003 (File No. 0-23584)].
10{g}	Supplemental Retirement Plan as Amended with Jesse G. Foster [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended March 31, 1997 (File No. 0-26584)].
10{h}	Employment Agreement with Lloyd W. Baker [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 0-26584)].
10{i}	Employment Agreement with D. Michael Jones [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 0-26584)].
10{j}	Supplemental Executive Retirement Program Agreement with D. Michael Jones [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2003 (File No. 0-26584)].
10{k}	Form of Supplemental Executive Retirement Program Agreement with Gary Sirmon, Michael K. Larsen, Lloyd W. Baker, Cynthia D. Purcell and Paul E. Folz [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2001 and the exhibits filed with the Form 8-K on May 6, 2008].
10{l}	1998 Stock Option Plan [incorporated by reference to exhibits filed with the Registration Statement on Form S-8 dated February 2, 1999 (File No. 333-71625)].
10{m}	2001 Stock Option Plan [incorporated by reference to Exhibit 99.1 to the Registration Statement on Form S-8 dated August 8, 2001 (File No. 333-67168)].
10{n}	Form of Employment Contract entered into with Cynthia D. Purcell, Richard B. Barton, Paul E. Folz, John R. Neill and Douglas M. Bennett [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2003 (File No. 0-26584)].
10{o}	2004 Executive Officer and Director Stock Account Deferred Compensation Plan [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2005 (File No. 0-26584)].
10{p}	2004 Executive Officer and Director Investment Account Deferred Compensation Plan [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2005 (File No. 0-26584)].
10{q}	Long-Term Incentive Plan [incorporated by reference to the exhibits filed with the Form 8-K on May 6, 2008].
10{r}	Form of Compensation Modification Agreement [incorporated by reference to the Registrant's Current Report on Form 8-K filed on November 24, 2008 (File No. 000-26584)].
10{s}	2005 Executive Officer and Director Stock Account Deferred Compensation Plan.
10{t}	Entry into an Indemnification Agreement with each of the Company's Directors [incorporated by reference to exhibits filed with the Form 8-K on January 29, 2010].
14	Code of Ethics [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2004 (File No. 0-26584)].

21	Subsidiaries of the Registrant.
23.1	Consent of Registered Independent Public Accounting Firm – Moss Adams LLP.
31.1	Certification of Chief Executive Officer pursuant to the Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to the Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certificate of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.1	Certification of Principal Executive Officer of Banner Corporation to Chief Compliance Officer of the Troubled Asset Relief Program Pursuant to 31 CFR § 30.15.
99.2	Certification of Principal Financial Officer of Banner Corporation to Chief Compliance Officer of the Troubled Asset Relief Program Pursuant to 31 CFR § 30.15.

EXHIBIT 21

SUBSIDIARIES OF THE REGISTRANT

Parent
Banner Corporation

Subsidiaries	Percentage of Ownership	Jurisdiction of State of Incorporation
Banner Bank (1)	100 %	Washington
Islanders Bank (1)	100 %	Washington
Community Financial Corporation (2)	100 %	Oregon
Northwest Financial Corporation (2)	100 %	Washington

(1) Wholly owned by Banner Corporation
(2) Wholly owned by Banner Bank

EXHIBIT 23.1

CONSENT OF REGISTERED INDEPENDENT PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 333-10819, 333-49193, 333-71625, and 333-67168 of Banner Corporation and subsidiaries on Form S-8 and Registration Statement Nos. 333-138162, 333-139520, 333-156340, 333-153209, 333-147946, 333-161619 and 333-164259 on Form S-3 of our report dated March 16, 2010, with respect to the consolidated statements of financial condition of Banner Corporation and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of operations, comprehensive income (loss), changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2009, and the effectiveness of internal control over financial reporting as of December 31, 2009, which report appears in the December 31, 2009, annual report on Form 10-K of Banner Corporation.

/s/ Moss Adams LLP

Portland, Oregon
March 16, 2010

EXHIBIT 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER OF BANNER CORPORATION PURSUANT TO RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES ACT OF 1934

I, D. Michael Jones, certify that:

1. I have reviewed this Annual Report on Form 10-K of Banner Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

    a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

March 16, 2009

/s/D. Michael Jones
D. Michael Jones
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER OF BANNER CORPORATION PURSUANT TO RULES 13a-14(a) AND 15d -14(a) UNDER THE SECURITIES ACT OF 1934

I, Lloyd W. Baker, certify that:

1. I have reviewed this Annual Report on Form 10-K of Banner Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

    a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

March 16, 2009

/s/Lloyd W. Baker
Lloyd W. Baker
Chief Financial Officer

EXHIBIT 32

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
OF BANNER CORPORATION
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned hereby certifies in his capacity as an officer of Banner Corporation pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and in connection with this Annual Report on Form 10-K, that:

- the report fully complies with the requirements of Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, and

- the information contained in the report fairly presents, in all material respects, the Company's financial condition and results of operations as of the dates and for the periods presented in the financial statements included in such report.

March 16, 2009

/s/D. Michael Jones
D. Michael Jones
Chief Executive Officer

March 16, 2009

/s/Lloyd W. Baker
Lloyd W. Baker
Chief Financial Officer

EXHIBIT 99.1

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER OF
BANNER CORPORATION
TO CHIEF COMPLIANCE OFFICER
OF THE TROUBLED ASSET RELIEF PROGRAM PURSUANT TO 31 CFR § 30.15**

I, D. Michael Jones, the President and Chief Executive Officer of Banner Corporation (the "Company"), certify, based on my knowledge, that the Company's TARP period began on November 21, 2008, and on November 18, 2008 the Compensation Committee reviewed with the Company's senior risk officers all incentive compensation plans and arrangements for senior executive officers and made reasonable efforts to ensure that such arrangements do not encourage senior executive officers to take unnecessary and excessive risks that threaten the value of the Company and certify, based on my knowledge, that:

1. The Company's Compensation Committee has discussed, reviewed, and evaluated with senior risk officers at least once every six months during the period beginning on September 14, 2009 and ending with the last day of the Company's fiscal year containing that date (the applicable period), the senior executive officer (SEO) compensation plans and employee compensation plans and the risks these plans pose to the Company;

2. The Company's Compensation Committee has identified and limited during the applicable period any features of the SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that could threaten the value of the Company and during the same applicable period has identified any features of the employee compensation plans that pose risks to the Company and has limited those features to ensure that the Company is not unnecessarily exposed to risks;

3. The Company's Compensation Committee has reviewed, at least every six months during the applicable period, the terms of each employee compensation plan and identified any features of the plan that could encourage the manipulation of reported earnings of the Company to enhance the compensation of an employee, and has limited any such features;

4. The Company's Compensation Committee will certify to the reviews of the SEO compensation plans and employee compensation plans required under (i) and (iii) above;

5. The Company's Compensation Committee will provide a narrative description of how it limited during any part of the most recently completed fiscal year that included a TARP period, to the extent required by the regulations and guidance established under Section 111 of EESA, the features in:

    a) SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that could threaten the value of the Company;

    b) Employee compensation plans that unnecessarily expose the Company to risks; and

    c) Employee compensation plans that could encourage the manipulation of reported earnings of the Company to enhance the compensation of an employee;

6. The Company has required that bonus payments, as defined in the regulations and guidance established under section 111 of EESA (bonus payments), of the SEOs and the twenty next most highly compensated employees be subject to a recovery or "clawback" provision during any part of the most recently completed fiscal year that was a TARP period, to the extent required by the regulations and guidance established under section 111 of EESA, if the bonus payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria;

7. The Company has prohibited any golden parachute payment, as defined in the regulations and guidance established under section 111 of EESA, to an SEO or any of the next five most highly compensated employees during the period beginning on June 15, 2009, and ending with the last day of the Company's fiscal year containing that date;

8. The Company has limited bonus payments to its applicable employees in accordance with section 111 of EESA and the regulations and guidance established thereunder during the period beginning on June 15, 2009 and ending with the last day of the Company's fiscal year containing that date;

9. The board of directors of the Company has established an excessive or luxury expenditures policy, as defined in the regulations and guidance established under section 111 of EESA, by September 14, 2009; this policy has been provided to Treasury and the Company's primary regulatory agency; the Company and its employees have complied with this policy during the applicable period; and any expenses that, pursuant to the policy, required approval of the board of directors, a committee of the board of directors, an SEO, or an executive officer with a similar level of responsibility were properly approved;

10. The Company will permit a non-binding shareholder resolution in compliance with any applicable federal securities rules and regulations on the disclosures provided under the federal securities laws related to SEO compensation paid or accrued during the period beginning on June 15, 2009, and ending with the last day of the Company's fiscal year containing that date;

11. The Company will disclose the amount, nature, and justification for the offering during the period beginning on June 15, 2009, and ending with the last day of the Company's fiscal year containing that date, of any perquisites, as defined in the regulations and guidance established under section 111 of EESA, whose total value exceeds $25,000 for each employee subject to the bonus payment limitations identified in paragraph (viii);

12. The Company will disclose whether the Company, the board of directors of the Company, or the Company's Compensation Committee has engaged a compensation consultant during any part of the most recently completed fiscal year that was a TARP period; and the services the compensation consultant or any affiliate of the compensation consultant provided during this period;

13. The Company has prohibited the payment of any gross-ups, as defined in the regulations and guidance established under section 111 of EESA, to the SEOs and the next twenty most highly compensated employees during the period beginning on June 15, 2009, and ending with the last day of the Company's fiscal year containing that date;

14. The Company has substantially complied with all other requirements related to employee compensation that are provided in the agreement between the Company and Treasury, including any amendments;

15. The Company has submitted to Treasury a complete and accurate list of the SEOs and the twenty next most highly compensated employees for the current fiscal year (2010) and the most recently completed fiscal year (2009), with the non-SEOs ranked in descending order of level of annual compensation, and with the name, title, and employer of each SEO and most highly compensated employee identified; and

16. I understand that a knowing and willful false or fraudulent statement made in connection with this certification may be punished by fine, imprisonment, or both. (See, for example, 18 USC 1001.)

March 16, 2010

/s/D. Michael Jones
D. Michael Jones
Chief Executive Officer

EXHIBIT 99.2

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER OF
BANNER CORPORATION
TO CHIEF COMPLIANCE OFFICER
OF THE TROUBLED ASSET RELIEF PROGRAM PURSUANT TO 31 CFR § 30.15

I, Lloyd W. Baker, the Executive Vice President and Chief Financial Officer of Banner Corporation (the "Company"), certify, based on my knowledge, that the Company's TARP period began on November 21, 2008, and on November 18, 2008 the Compensation Committee reviewed with the Company's senior risk officers all incentive compensation plans and arrangements for senior executive officers and made reasonable efforts to ensure that such arrangements do not encourage senior executive officers to take unnecessary and excessive risks that threaten the value of the Company and certify, based on my knowledge, that:

1. The Company's Compensation Committee has discussed, reviewed, and evaluated with senior risk officers at least once every six months during the period beginning on September 14, 2009 and ending with the last day of the Company's fiscal year containing that date (the applicable period), the senior executive officer (SEO) compensation plans and employee compensation plans and the risks these plans pose to the Company;

2. The Company's Compensation Committee has identified and limited during the applicable period any features of the SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that could threaten the value of the Company and during the same applicable period has identified any features of the employee compensation plans that pose risks to the Company and has limited those features to ensure that the Company is not unnecessarily exposed to risks;

3. The Company's Compensation Committee has reviewed, at least every six months during the applicable period, the terms of each employee compensation plan and identified any features of the plan that could encourage the manipulation of reported earnings of the Company to enhance the compensation of an employee, and has limited any such features;

4. The Company's Compensation Committee will certify to the reviews of the SEO compensation plans and employee compensation plans required under (i) and (iii) above;

5. The Company's Compensation Committee will provide a narrative description of how it limited during any part of the most recently completed fiscal year that included a TARP period, to the extent required by the regulations and guidance established under Section 111 of EESA, the features in:

    a) SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that could threaten the value of the Company;

    b) Employee compensation plans that unnecessarily expose the Company to risks; and

    c) Employee compensation plans that could encourage the manipulation of reported earnings of the Company to enhance the compensation of an employee;

6. The Company has required that bonus payments, as defined in the regulations and guidance established under section 111 of EESA (bonus payments), of the SEOs and the twenty next most highly compensated employees be subject to a recovery or "clawback" provision during any part of the most recently completed fiscal year that was a TARP period, to the extent required by the regulations and guidance established under section 111 of EESA, if the bonus payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria;

7. The Company has prohibited any golden parachute payment, as defined in the regulations and guidance established under section 111 of EESA, to an SEO or any of the next five most highly compensated employees during the period beginning on June 15, 2009, and ending with the last day of the Company's fiscal year containing that date;

8. The Company has limited bonus payments to its applicable employees in accordance with section 111 of EESA and the regulations and guidance established thereunder during the period beginning on June 15, 2009 and ending with the last day of the Company's fiscal year containing that date;

9. The board of directors of the Company has established an excessive or luxury expenditures policy, as defined in the regulations and guidance established under section 111 of EESA, by September 14, 2009; this policy has been provided to Treasury and the Company's primary regulatory agency; the Company and its employees have complied with this policy during the applicable period; and any expenses that, pursuant to the policy, required approval of the board of directors, a committee of the board of directors, an SEO, or an executive officer with a similar level of responsibility were properly approved;

10. The Company will permit a non-binding shareholder resolution in compliance with any applicable federal securities rules and regulations on the disclosures provided under the federal securities laws related to SEO compensation paid or accrued during the period beginning on June 15, 2009, and ending with the last day of the Company's fiscal year containing that date;

11. The Company will disclose the amount, nature, and justification for the offering during the period beginning on June 15, 2009, and ending with the last day of the Company's fiscal year containing that date, of any perquisites, as defined in the regulations and guidance established under section 111 of EESA, whose total value exceeds $25,000 for each employee subject to the bonus payment limitations identified in paragraph (viii);

12. The Company will disclose whether the Company, the board of directors of the Company, or the Company's Compensation Committee has engaged a compensation consultant during any part of the most recently completed fiscal year that was a TARP period; and the services the compensation consultant or any affiliate of the compensation consultant provided during this period;

13. The Company has prohibited the payment of any gross-ups, as defined in the regulations and guidance established under section 111 of EESA, to the SEOs and the next twenty most highly compensated employees during the period beginning on June 15, 2009, and ending with the last day of the Company's fiscal year containing that date;

14. The Company has substantially complied with all other requirements related to employee compensation that are provided in the agreement between the Company and Treasury, including any amendments;

15. The Company has submitted to Treasury a complete and accurate list of the SEOs and the twenty next most highly compensated employees for the current fiscal year (2010) and the most recently completed fiscal year (2009), with the non-SEOs ranked in descending order of level of annual compensation, and with the name, title, and employer of each SEO and most highly compensated employee identified; and

16. I understand that a knowing and willful false or fraudulent statement made in connection with this certification may be punished by fine, imprisonment, or both. (See, for example, 18 USC 1001.)

March 16, 2010

/s/Lloyd W. Baker
Lloyd W. Baker
Chief Financial Officer

Corporate Headquarters

10 South First Avenue
P.O. Box 907
Walla Walla, WA 99362-0265
509-527-3636
800-272-9933
Web site: www.bannerbank.com
E-mail: bannerbank@bannerbank.com

Subsidiaries

Banner Bank
Islanders Bank
Community Financial Corporation

Transfer Agent and Registrar

Computershare Investor Services
P.O. Box 43036
Providence, RI 02940

Independent Public Accountants & Auditors

Moss Adams LLP
805 S.W. Broadway, Suite 1200
Portland, OR 97205

Special Counsel

Breyer & Associates PC
8180 Greensboro Drive, Suite 785
McLean, VA 22102

Annual Meeting of Shareholders

10 a.m., Tuesday, April 27, 2010
Marcus Whitman Hotel
6 West Rose Street
Walla Walla, WA 99362

Dividend Payments Sent Quarterly

Dividend payments are reviewed quarterly by the Board of Directors and, if appropriate and authorized, have historically been paid during the months of January, April, July and October. To avoid delay or lost mail, and to reduce costs, we encourage you to request direct deposit of dividend payments to your bank account. To enroll in the Direct Deposit Plan, telephone the Company's Investor Services Department at 800-272-9933.

Dividend Reinvestment & Stock Purchase Plan

Banner Corporation offers a dividend reinvestment program whereby shareholders may reinvest all or a portion of their dividends in additional shares of the Company's common stock. Shareholders may also purchase additional shares of common stock through an optional cash payment feature. Information concerning this optional program is available from the Investor Services Department or from Computershare Investor Services at 800-697-8924.

Investor Information

Shareholders and others will find the Company's financial information, press releases and other information on the Company's web site at www.bannerbank.com. There is a direct link from the web site to the Securities and Exchange Commission (SEC) filings via the EDGAR database, including Forms 10-K, 10-Q and 8-K. Shareholders may contact Investor Relations, Banner Corporation, P.O. Box 907, Walla Walla, WA 99362, or call 800-272-9933 to obtain a hard copy of these reports without charge.

Directors

Robert D. Adams
Gordon E. Budke
David B. Casper
Edward L. Epstein
Jesse G. Foster
D. Michael Jones
David A. Klaue
Connie Kravas
Dean W. Mitchell
Robert J. Lane
John R. Layman
Brent A. Orrico
Wilber E. Pribilsky
Gary Sirmon
Michael M. Smith

Executive Officers

D. Michael Jones, *President and Chief Executive Officer*
Lloyd W. Baker, *EVP and Chief Financial Officer*
Richard B. Barton, *EVP, Chief Lending Officer*
Douglas M. Bennett, *EVP, Real Estate Lending Operations*
Tyrone J. Bliss, *EVP, Risk Management & Compliance Officer*
Paul E. Folz, *EVP, Community Banking*
Cynthia D. Purcell, *EVP, Chief Operating Officer*
Steven W. Rust, *EVP and Chief Information Officer*
Gary W. Wagers, *EVP, Retail Products and Services*

Corporate Profile

Banner Corporation is a dynamic banking organization that has developed a significant and expanding regional franchise throughout the Pacific Northwest. Banner Corporation is the holding company for Banner Bank, a Washington-chartered commercial bank headquartered in Walla Walla, Washington, with roots that date back to 1890. In 2007, the Company acquired Islanders Bank, which operates in Washington's San Juan Islands.

Banner Bank and Islanders Bank strive to deliver a high level of individualized service as community banks while offering advantages available from being part of a larger financial institution. The Company's leadership consists of an experienced executive management team headed by President and CEO, D. Michael Jones.

Banner Corporation aims to be the premier Pacific Northwest banking franchise. Serving a growing and prosperous region with a full range of deposit services and business, commercial real estate, construction, residential, agricultural and consumer loans, the Company provides community banking services through a combined total of 89 branch offices and seven loan offices located in 29 counties of Washington, Oregon and Idaho. The Company's employees take pride in extending the highest levels of service, convenience, and banking knowledge to their customers.

Banner Bank and Islanders Bank are members of the Federal Home Loan Bank of Seattle and their deposits are insured by the Federal Deposit Insurance Corporation.

Banner Bank and Islanders Bank are wholly-owned subsidiaries of Banner Corporation. Banner Corporation common stock is traded over the counter on The NASDAQ Stock Market® under the symbol "BANR." This document, together with the Company's Form 10-K, represents the annual report to shareholders of Banner Corporation.