

BANNER CORP  
Form 10-Q  
August 08, 2014

---

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

FORM 10-Q  
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2014.

OR  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934 FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-26584

BANNER CORPORATION  
(Exact name of registrant as specified in its charter)

Washington  
(State or other jurisdiction of incorporation or  
organization)

91-1691604  
(I.R.S. Employer Identification Number)

10 South First Avenue, Walla Walla, Washington 99362  
(Address of principal executive offices and zip code)

Registrant's telephone number, including area code: (509) 527-3636

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Edgar Filing: BANNER CORP - Form 10-Q

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Title of class:	As of July 31, 2014
Common Stock, \$.01 par value per share	19,572,823 shares *

BANNER CORPORATION AND SUBSIDIARIES

Table of Contents

PART I – FINANCIAL INFORMATION

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

Consolidated Statements of Financial Condition as of June 30, 2014 and December 31, 2013	<u>4</u>
Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2014 and 2013	<u>5</u>
Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2014 and 2013	<u>6</u>
Consolidated Statements of Changes in Stockholders' Equity for the Six Months Ended June 30, 2014 and the Year Ended December 31, 2013	<u>7</u>
Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2014 and 2013	<u>9</u>
Selected Notes to the Consolidated Financial Statements	<u>11</u>

Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations

Executive Overview	<u>51</u>
Comparison of Financial Condition at June 30, 2014 and December 31, 2013	<u>57</u>
Comparison of Results of Operations for the Three and Six Months Ended June 30, 2014 and 2013	<u>57</u>
Asset Quality	<u>63</u>
Liquidity and Capital Resources	<u>65</u>
Capital Requirements	<u>66</u>

Item 3 – Quantitative and Qualitative Disclosures About Market Risk

Market Risk and Asset/Liability Management	<u>68</u>
Sensitivity Analysis	<u>68</u>

Item 4 – Controls and Procedures 72

PART II – OTHER INFORMATION

Item 1 – Legal Proceedings 73

Item 1A – Risk Factors 73

Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds 73

Item 3 – Defaults upon Senior Securities	<u>73</u>
Item 4 – Mine Safety Disclosures	<u>73</u>
Item 5 – Other Information	<u>73</u>
Item 6 – Exhibits	<u>74</u>
SIGNATURES	<u>76</u>

## Special Note Regarding Forward-Looking Statements

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

the time they are made. We do not undertake and specifically disclaim any obligation to update any forward-looking statements included in this report or the reasons why actual results could differ from those contained in such statements whether as a result of new information, future events or otherwise. These risks could cause our actual results to differ materially from those expressed in any forward-looking statements by, or on behalf of, us. In light of these risks, uncertainties and assumptions, the forward-looking statements discussed in this report might not occur, and you should not put undue reliance on any forward-looking statements.

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

BANNER CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(Unaudited) (In thousands, except shares)

June 30, 2014 and December 31, 2013

	June 30 2014	December 31 2013
<b>ASSETS</b>		
Cash and due from banks	\$ 146,561	\$ 137,349
Securities—trading, amortized cost \$70,472 and \$75,150, respectively	61,393	62,472
Securities—available-for-sale, amortized cost \$455,232 and \$474,960, respectively	455,353	470,280
Securities—held-to-maturity, fair value \$138,065 and \$103,610, respectively	133,186	102,513
Federal Home Loan Bank (FHLB) stock	31,191	35,390
Loans receivable:		
Held for sale	7,322	2,734
Held for portfolio	3,755,277	3,415,711
Allowance for loan losses	(74,310)	(74,258)
	3,688,289	3,344,187
Accrued interest receivable	15,579	13,996
Real estate owned (REO), held for sale, net	4,388	4,044
Property and equipment, net	91,912	90,267
Intangible assets, net	3,892	2,449
Bank-owned life insurance (BOLI)	62,815	61,945
Deferred tax assets, net	22,065	27,479
Income tax receivable	166	9,728
Other assets	28,509	26,799
	\$4,745,299	\$4,388,898
<b>LIABILITIES</b>		
Deposits:		
Non-interest-bearing	\$ 1,210,068	\$ 1,115,346
Interest-bearing transaction and savings accounts	1,771,865	1,629,885
Interest-bearing certificates	936,986	872,695
	3,918,919	3,617,926
Advances from FHLB at fair value	45,251	27,250
Other borrowings	88,946	83,056
Junior subordinated debentures at fair value (issued in connection with Trust Preferred Securities)	77,313	73,928
Accrued expenses and other liabilities	35,619	31,324
Deferred compensation	16,238	16,442
	4,182,286	3,849,926
<b>COMMITMENTS AND CONTINGENCIES (Note 15)</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Common stock and paid in capital - \$0.01 par value per share, 50,000,000 shares authorized, 19,568,704 shares issued and outstanding at June 30, 2014; 19,543,769 shares issued and 19,509,429 shares outstanding at December 31, 2013	567,483	569,028
Accumulated deficit	(4,541)	(25,073)
Accumulated other comprehensive income (loss)	71	(2,996)
Unearned shares of common stock issued to Employee Stock Ownership Plan (ESOP) trust at cost: no shares outstanding at June 30, 2014 and 34,340 shares outstanding at December 31, 2013	—	(1,987)
	563,013	538,972
	\$4,745,299	\$4,388,898

See Selected Notes to the Consolidated Financial Statements

4

---



BANNER CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited) (In thousands except for per share amounts)  
For the Three and Six Months Ended June 30, 2014 and 2013

	Three Months Ended June 30		Six Months Ended June 30	
	2014	2013	2014	2013
<b>INTEREST INCOME:</b>				
Loans receivable	\$43,199	\$42,292	\$84,942	\$83,781
Mortgage-backed securities	1,446	1,394	2,917	2,566
Securities and cash equivalents	1,895	1,885	3,787	3,733
	46,540	45,571	91,646	90,080
<b>INTEREST EXPENSE:</b>				
Deposits	1,910	2,490	3,874	5,210
FHLB advances	51	40	90	64
Other borrowings	45	51	89	107
Junior subordinated debentures	726	742	1,446	1,482
	2,732	3,323	5,499	6,863
Net interest income before provision for loan losses	43,808	42,248	86,147	83,217
<b>PROVISION FOR LOAN LOSSES</b>	—	—	—	—
Net interest income	43,808	42,248	86,147	83,217
<b>OTHER OPERATING INCOME:</b>				
Deposit fees and other service charges	7,346	6,628	13,947	12,928
Mortgage banking operations	2,600	3,574	4,440	6,412
Miscellaneous	644	664	1,281	1,455
	10,590	10,866	19,668	20,795
Gain on sale of securities	—	12	35	1,018
Other-than-temporary impairment recovery	—	—	—	409
Net change in valuation of financial instruments carried at fair value	464	(255)	) 209	(1,601)
Acquisition bargain purchase gain	9,079	—	9,079	—
Total other operating income	20,133	10,623	28,991	20,621
<b>OTHER OPERATING EXPENSES:</b>				
Salary and employee benefits	22,330	21,224	43,486	41,953
Less capitalized loan origination costs	(3,282)	) (3,070)	) (5,477)	) (5,941)
Occupancy and equipment	5,540	5,415	11,236	10,744
Information/computer data services	1,918	1,923	3,853	3,643
Payment and card processing expenses	2,746	2,449	5,261	4,753
Professional services	1,109	820	2,115	1,726
Advertising and marketing	1,370	1,798	2,425	3,297
Deposit insurance	637	617	1,213	1,263
State/municipal business and use taxes	388	538	547	1,003
REO operations	(109)	) (195)	) (70)	) (446)
Amortization of core deposit intangibles	450	477	929	982
Acquisition related costs	1,979	—	2,024	—
Miscellaneous	3,359	3,461	6,473	6,580
Total other operating expenses	38,435	35,457	74,015	69,557
Income before provision for income taxes	25,506	17,414	41,123	34,281
<b>PROVISION FOR INCOME TAXES</b>	8,499	5,661	13,545	10,945

Edgar Filing: BANNER CORP - Form 10-Q

NET INCOME	\$17,007	\$11,753	\$27,578	\$23,336
Earnings per common share:				
Basic	\$0.88	\$0.61	\$1.43	\$1.21
Diluted	\$0.88	\$0.60	\$1.42	\$1.20
Cumulative dividends declared per common share	\$0.18	\$0.12	\$0.36	\$0.24
See Selected Notes to the Consolidated Financial Statements				

5

---

BANNER CORPORATION AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited) (In thousands)

For the Three and Six Months Ended June 30, 2014 and 2013

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2014	2013	2014	2013
NET INCOME	\$17,007	\$11,753	\$27,578	\$23,336
OTHER COMPREHENSIVE INCOME (LOSS), NET OF INCOME TAXES:				
Unrealized holding gain (loss) on AFS securities arising during the period	2,330	(8,476	) 4,767	(8,854
Income tax benefit (expense) related to AFS unrealized holding gains (losses)	(845	) 3,043	(1,722	) 3,179
Reclassification for net (gains) losses on AFS securities realized in earnings	—	1	34	(116
Income tax benefit (expense) related to AFS realized gains (losses)	—	—	(12	) 42
Other comprehensive income (loss)	1,485	(5,432	) 3,067	(5,749
COMPREHENSIVE INCOME	\$18,492	\$6,321	\$30,645	\$17,587

See Selected Notes to the Consolidated Financial Statements

BANNER CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
(Unaudited) (In thousands, except for shares)  
For the Six Months Ended June 30, 2014

	Common Stock and Paid in Capital		Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Unearned Restricted ESOP Shares	Stockholders' Equity
	Shares	Amount				
Balance, January 1, 2014	19,509,429	\$569,028	\$ (25,073 )	\$ (2,996 )	\$(1,987 )	\$ 538,972
Net income			27,578			27,578
Other comprehensive income, net of income tax				3,067		3,067
Accrual of dividends on common stock (\$0.36/share cumulative)			(7,046 )			(7,046 )
Redemption of unallocated shares upon termination of ESOP		(1,987 )			1,987	—
Repurchase of shares upon termination of ESOP	(13,550 )	(556 )				(556 )
Proceeds from issuance of common stock for stockholder reinvestment program	1,451	60				60
Issuance of restricted stock and amortization of related compensation	71,374	938				938
BALANCE, June 30, 2014	19,568,704	\$567,483	\$ (4,541 )	\$ 71	\$—	\$ 563,013

See Selected Notes to the Consolidated Financial Statements

BANNER CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
(Unaudited) (In thousands, except for shares)  
For the Year Ended December 31, 2013

	Common Stock and Paid in Capital		Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Unearned Restricted ESOP Shares	Stockholders' Equity
	Shares	Amount				
Balance, January 1, 2013	19,420,625	\$567,907	\$ (61,102 )	\$ 2,101	\$(1,987 )	\$ 506,919
Net income			46,555			46,555
Other comprehensive loss, net of income tax				(5,097 )		(5,097 )
Accrual of dividends on common stock (\$0.54/share cumulative)			(10,526 )			(10,526 )
Proceeds from issuance of common stock for stockholder reinvestment program	2,098	72				72
Issuance of restricted stock and amortization of related compensation	86,706	1,049				1,049
BALANCE, December 31, 2013	19,509,429	\$569,028	\$ (25,073 )	\$ (2,996 )	\$(1,987 )	\$ 538,972

See Selected Notes to the Consolidated Financial Statements

BANNER CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited) (In thousands)

For the Six Months Ended June 30, 2014 and 2013

	Six Months Ended	
	June 30	
	2014	2013
<b>OPERATING ACTIVITIES:</b>		
Net income	\$27,578	\$23,336
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	4,053	3,679
Deferred income and expense, net of amortization	1,883	2,233
Amortization of core deposit intangibles	929	982
Gain on sale of securities	(35	) (1,018
Other-than-temporary impairment recovery	—	(409
Net change in valuation of financial instruments carried at fair value	(209	) 1,601
Purchases of securities—trading	(2,387	) (23,377
Proceeds from sales of securities—trading	2,387	25,267
Principal repayments and maturities of securities—trading	4,702	3,657
Bargain purchase gain on acquisition	(9,079	) —
Decrease in deferred taxes	5,414	570
Increase (decrease) in current taxes payable	9,562	(4,245
Equity-based compensation	818	478
Increase in cash surrender value of BOLI	(858	) (982
Gain on sale of loans, net of capitalized servicing rights	(2,528	) (4,303
Gain on disposal of real estate held for sale and property and equipment	(453	) (1,454
Provision for losses on real estate held for sale	37	299
Origination of loans held for sale	(160,625	) (263,111
Proceeds from sales of loans held for sale	158,565	272,941
Net change in:		
Other assets	(1,967	) 19,440
Other liabilities and equity	2,946	(5,019
Net cash provided from operating activities	40,733	50,565
<b>INVESTING ACTIVITIES:</b>		
Purchases of securities—available-for-sale	(30,272	) (179,555
Principal repayments and maturities of securities—available-for-sale	20,085	68,488
Proceeds from sales of securities—available-for-sale	28,207	103,274
Purchases of securities—held-to-maturity	(33,686	) (9,029
Principal repayments and maturities of securities—held-to-maturity	2,603	987
Loan originations, net of principal repayments	(155,279	) (66,066
Purchases of loans and participating interest in loans	(101,840	) (91
Proceeds from sales of other loans	2,491	3,288
Net cash received from acquisition	127,557	—
Purchases of property and equipment	(2,617	) (2,439
Proceeds from sale of real estate held for sale, net	2,672	11,787
Proceeds from FHLB stock repurchase program	4,199	665
Other	(2,054	) 120
Net cash used by investing activities	(137,934	) (68,571
<b>FINANCING ACTIVITIES:</b>		
Increase (decrease) in deposits, net	88,907	(97,480

Edgar Filing: BANNER CORP - Form 10-Q

Advances, net of repayments of FHLB borrowings	17,996	43,997
Increase in other borrowings, net	5,889	14,146
Cash dividends paid	(6,439	) (2,530 )
Cash proceeds from issuance of stock for stockholder reinvestment plan	60	23
Net cash provided from (used by) financing activities	106,413	(41,844 )
NET INCREASE (DECREASE) IN CASH AND DUE FROM BANKS	9,212	(59,850 )
CASH AND DUE FROM BANKS, BEGINNING OF PERIOD	137,349	181,298
CASH AND DUE FROM BANKS, END OF PERIOD	\$ 146,561	\$ 121,448

(Continued on next page)

BANNER CORPORATION AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)  
 (Unaudited) (In thousands)  
 For the Six Months Ended June 30, 2014 and 2013

	Six Months Ended June 30	
	2014	2013
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Interest paid in cash	\$5,527	\$7,087
Taxes paid, net of refunds received in cash	292	11,376
<b>NON-CASH INVESTING AND FINANCING TRANSACTIONS:</b>		
Loans, net of discounts, specific loss allowances and unearned income, transferred to real estate owned and other repossessed assets	2,885	1,770
<b>ACQUISITIONS (Note 2):</b>		
Assets acquired	221,206	—
Liabilities assumed	212,127	—

See Selected Notes to the Consolidated Financial Statements



BANNER CORPORATION AND SUBSIDIARIES  
SELECTED NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1: BASIS OF PRESENTATION AND CRITICAL ACCOUNTING POLICIES

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

These unaudited consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the Securities and Exchange Commission (SEC). In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the financial position and results of operations for the periods presented have been included. Certain information and disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC. Certain reclassifications have been made to the 2013 Consolidated Financial Statements and/or schedules to conform to the 2014 presentation. These reclassifications may have affected certain ratios for the prior periods. The effect of these reclassifications is considered immaterial. All significant intercompany transactions and balances have been eliminated.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect amounts reported in the financial statements. Various elements of the Company's accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. In particular, management has identified several accounting policies that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of Banner's financial statements. These policies relate to (i) the methodology for the recognition of interest income, (ii) determination of the provision and allowance for loan and lease losses, (iii) the valuation of financial assets and liabilities recorded at fair value, including other-than-temporary impairment (OTTI) losses, (iv) the valuation of intangibles, such as core deposit intangibles and mortgage servicing rights, (v) the valuation of real estate held for sale and (vi) the valuation of or recognition of deferred tax assets and liabilities. These policies and judgments, estimates and assumptions are described in greater detail in subsequent notes to the Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations (Critical Accounting Policies) in our Annual Report on Form 10-K for the year ended December 31, 2013 filed with the SEC. Management believes that the judgments, estimates and assumptions used in the preparation of the financial statements are appropriate based on the factual circumstances at the time. However, given the sensitivity of the financial statements to these critical accounting policies, the use of other judgments, estimates and assumptions could result in material differences in the Company's results of operations or financial condition. Further, subsequent changes in economic or market conditions could have a material impact on these estimates and the Company's financial condition and operating results in future periods.

The information included in this Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2013 as filed with the SEC (2013 Form 10-K). Interim results are not necessarily indicative of results for a full year.

Note 2: RECENT DEVELOPMENTS AND SIGNIFICANT EVENTS

Proposed Acquisition of Siuslaw Financial Group, Inc.

On August 7, 2014, the Company announced the execution of a definitive agreement to purchase Siuslaw Financial Group, Inc. (Siuslaw), the holding company of Siuslaw Bank, an Oregon state chartered commercial bank. The

consideration for the transaction is approximately 90% stock and 10% cash. Based on the Banner closing priced of \$39.14 per share on August 7, 2014 the aggregate consideration would be \$57.5 million. The purchase is subject to approval by Siuslaw shareholders, regulatory approval and other customary conditions of closing. Upon closing of the transaction, which is anticipated to take place in the latter part of the fourth quarter of 2014, Siuslaw will be merged into Banner and Siuslaw Bank will be merged into Banner Bank.

#### Termination of Proposed Acquisition of Idaho Banking Company

On June 30, 2014, the Company announced it had terminated its agreement to acquire Idaho Banking Company (Idaho Banking) through the bidding process under Section 363 of Chapter 11 of the United States Bankruptcy Code in the U.S. Bankruptcy Court for the District of Idaho (Bankruptcy Court). Banner proposed to purchase all of the issued and outstanding shares of Idaho Banking Company pursuant to an Asset Purchase Agreement (Agreement) it had entered into with Idaho Bancorp, the bank holding company of Idaho Banking, on April 24, 2014. In connection with the June 26, 2014 Bankruptcy Court-supervised auction process, as contemplated by the Agreement, Idaho Banking received the highest offer from another bidder. Accordingly, the Agreement has been terminated. Pursuant to the Agreement, the Company will be reimbursed for its expenses in connection with the transaction.

#### Acquisition of Six Oregon Branches

Effective as of the close of business on June 20, 2014, Banner Bank completed the purchase of six branches from Umpqua Bank, successor to Sterling Savings Bank. Five of the six branches are located in Coos County, Oregon and the sixth branch is located in Douglas County, Oregon. The purchase provided \$212 million in deposit accounts, \$88 million in loans, and \$3 million in branch properties. Banner Bank received \$128 million in cash from the transaction.

The assets acquired and liabilities assumed in the purchase have been accounted for under the acquisition method of accounting. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the acquisition date, and are subject to change for up to one year after the closing date of the acquisition. The application of the acquisition method of accounting resulted in recognition of a core deposit intangible asset of \$2.4 million and an acquisition bargain purchase gain of \$9.1 million. The bargain purchase gain represents the excess fair value of the net assets acquired over the purchase price, including fair value of liabilities assumed. The bargain purchase gain consisted primarily of a \$7 million discount on the assets acquired in this required branch divestiture combined with a \$2.4 million core deposit intangible, net of approximately \$300,000 in fair value adjustments. The acquired core deposit intangible has been determined to have a useful life of approximately eight years and will be amortized on an accelerated basis.

The following table displays the fair value as of the acquisition date for each major class of assets acquired and liabilities assumed (in thousands):

	Fair Value at June 20, 2014
Assets:	
Cash	\$ 127,557
Loans receivable, net (contractual amount of \$88.3 million)	87,923
Property and equipment, net	3,079
Core deposit intangible	2,372
Other assets	275
Total assets	221,206
Liabilities:	
Deposits	212,085
Other liabilities	42
Total liabilities	212,127
Acquisition bargain purchase gain	\$9,079

Amounts recorded are preliminary estimates of fair value. The primary reason for the acquisition was to continue the Company's growth strategy, including expanding our geographic footprint in markets throughout the Northwest. As of June 20, 2014 the transaction had no remaining contingencies. Pro forma results of operations for the three and six months ended June 30, 2014 and 2013, as if the branch acquisitions had occurred on January 1, 2013, have not been presented because historical financial information was not available.

The operating results of the Company include the operating results produced by the six acquired branches from June 21, 2014 to June 30, 2014. In connection with the acquisition, Banner recognized \$2.0 million of acquisition-related expenses for the three and six months ended June 30, 2014 as follows (in thousands):

	Three Months Ended June 30, 2014	Six Months Ended June 30, 2014
Acquisition-related costs recognized in other operating expenses:		
Non-capitalized equipment	\$29	\$29
Client communications	236	238
Information/computer data services	632	632
Payment and processing expenses	271	271
Professional services	587	619
Miscellaneous	224	235
	\$1,979	\$2,024

Stockholder Equity Transactions:

Omnibus Incentive Plan: On January 28, 2014, the Company's board of directors unanimously adopted, and on April 22, 2014 the Company's shareholders approved, the Banner Corporation 2014 Omnibus Incentive Plan. The purpose of the Plan is to promote the success and enhance the value of Banner by linking the personal interests of employees and directors with those of Banner's shareholders. The Plan is further intended to provide flexibility to Banner in its ability to motivate, attract, and retain the services of employees and directors upon whose judgment, interest and special effort Banner depends. The Plan also allows performance-based compensation to be provided in a manner that exempts such compensation from the deduction limits imposed by Section 162(m) of the Internal Revenue Code.

Note 3: ACCOUNTING STANDARDS RECENTLY ADOPTED

Unrecognized Tax Benefits

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-11, Presentation of an Unrecognized Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. This ASU requires an unrecognized tax benefit to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. An exception exists to the extent that a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax of the applicable jurisdiction does not require the entity to use, and entity does not intend to use, the deferred tax asset for such a purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. ASU No. 2013-11 is effective for fiscal years and interim periods beginning after December 15, 2013. The Company adopted the provisions of ASU No. 2013-11 effective January 1, 2014. The adoption of this guidance did not have a material effect on the Company's consolidated financial statements.

Investing in Qualified Affordable Housing Projects

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

Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure

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

Revenue from Contracts with Customers

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which creates Topic 606 and supersedes Topic 605, Revenue Recognition. The core principle of Topic 606 is that an entity recognizes revenue

to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In general, the new guidance requires companies to use more judgment and make more estimates than under current guidance, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The standard is effective for public entities for interim and annual periods beginning after December 15, 2016; early adoption is not permitted. For financial reporting purposes, the standard allows for either full retrospective adoption, meaning the standard is applied to all of the periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements with the cumulative effect of initially applying the standard recognized at the date of initial application. The Company is currently evaluating the provisions of ASU No. 2014-09 to determine the potential impact the standard will have on the Company's consolidated financial statements.

Note 4: BUSINESS SEGMENTS

The Company is managed by legal entity and not by lines of business. Each of the Banks is a community oriented commercial bank chartered in the State of Washington. Each of the Banks' primary business is that of a traditional banking institution, gathering deposits and originating loans for its portfolios in its markets. The Banks offer a wide variety of deposit products to their consumer and commercial customers. Lending activities include the origination of real estate, commercial/agriculture business and consumer loans. Banner Bank is also an active participant in the secondary market, originating residential loans for sale on both a servicing released and servicing retained basis. In addition to interest income on loans and investment securities, the Banks receive other income from deposit service charges, loan servicing fees and from the sale of loans and investments. The performance of the Banks is reviewed by the Company's executive management and Board of Directors on a monthly basis. All of the executive officers of the Company are members of Banner Bank's management team.

Generally Accepted Accounting Principles, or GAAP, establish standards to report information about operating segments in annual financial statements and require reporting of selected information about operating segments in interim reports to stockholders. The Company has determined that its current business and operations consist of a single business segment.

#### Note 5: INTEREST-BEARING DEPOSITS AND SECURITIES

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

	June 30 2014	December 31 2013
Interest-bearing deposits included in cash and due from banks	\$62,990	\$67,638
U.S. Government and agency obligations	55,908	61,327
Municipal bonds:		
Taxable	35,227	34,216
Tax exempt	138,859	119,588
Total municipal bonds	174,086	153,804
Corporate bonds	45,340	44,154
Mortgage-backed or related securities:		
One- to four-family residential agency guaranteed	56,063	58,117
One- to four-family residential other	911	1,051
Multifamily agency guaranteed	281,421	281,319
Multifamily other	10,676	10,234
Total mortgage-backed or related securities	349,071	350,721
Asset-backed securities:		
Student Loan Marketing Association (SLMA)	15,732	15,681
Other asset-backed securities	9,734	9,510
Total asset-backed securities	25,466	25,191
Equity securities (excludes FHLB stock)	61	68
Total securities	649,932	635,265
Total interest-bearing deposits and securities	\$712,922	\$702,903

Securities—Trading: The amortized cost and estimated fair value of securities—trading at June 30, 2014 and December 31, 2013 are summarized as follows (dollars in thousands):

	June 30, 2014			December 31, 2013		
	Amortized Cost	Fair Value	Percent of Total	Amortized Cost	Fair Value	Percent of Total
U.S. Government and agency obligations	\$1,370	\$1,530	2.5 %	\$1,370	\$1,481	2.4 %
Municipal bonds:						
Tax exempt	1,666	1,716	2.8	4,969	5,023	8.0
Corporate bonds	49,466	38,529	62.7	49,498	35,140	56.2
Mortgage-backed or related securities:						
One- to four-family residential agency guaranteed	9,222	9,987	16.3	10,483	11,230	18.0
Multifamily agency guaranteed	8,734	9,570	15.6	8,816	9,530	15.3
Total mortgage-backed or related securities	17,956	19,557	31.9	19,299	20,760	33.3
Equity securities	14	61	0.1	14	68	0.1
	\$70,472	\$61,393	100.0 %	\$75,150	\$62,472	100.0 %





There were three sales of securities—trading totaling \$2.4 million with a resulting net gain of \$1,000 during the six months ended June 30, 2014. There were 37 sales of securities—trading totaling \$25.3 million with a resulting net gain of \$1.0 million during the six months ended June 30, 2013, including \$1.0 million which represented recoveries on certain collateralized debt obligations that had previously been written off. In addition to the \$1.0 million net gain, the Company also recognized a \$409,000 OTTI recovery on sales of securities—trading during the six months ended June 30, 2013, which was related to the sale of certain equity securities issued by government-sponsored entities. The Company did not recognize any OTTI charges or recoveries on securities—trading during the six months ended June 30, 2014. No securities—trading were on nonaccrual status at June 30, 2014 and 2013.

The amortized cost and estimated fair value of securities—trading at June 30, 2014 and December 31, 2013, by contractual maturity, are shown below (in thousands). Expected maturities will differ from contractual maturities because some securities may be called or prepaid with or without call or prepayment penalties.

	June 30, 2014		December 31, 2013	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Maturing in one year or less	\$11,759	\$11,763	\$260	\$263
Maturing after one year through five years	6,524	6,969	7,056	7,298
Maturing after five years through ten years	8,976	9,915	12,602	13,572
Maturing after ten years through twenty years	21,352	17,930	33,335	27,472
Maturing after twenty years	21,847	14,755	21,883	13,799
	70,458	61,332	75,136	62,404
Equity securities	14	61	14	68
	\$70,472	\$61,393	\$75,150	\$62,472

Edgar Filing: BANNER CORP - Form 10-Q

Securities—Available-for-Sale: The amortized cost and estimated fair value of securities—available-for-sale at June 30, 2014 and December 31, 2013 are summarized as follows (dollars in thousands):

	June 30, 2014					Percent of Total	
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value			
U.S. Government and agency obligations	\$52,424	\$41	\$(253)	)	\$52,212	11.5	%
Municipal bonds:							
Taxable	19,733	116	(40)	)	19,809	4.4	
Tax exempt	30,876	194	(78)	)	30,992	6.8	
Total municipal bonds	50,609	310	(118)	)	50,801	11.2	
Corporate bonds	5,000	11	—		5,011	1.1	
Mortgage-backed or related securities:							
One- to four-family residential agency guaranteed	43,883	839	(452)	)	44,270	9.7	
One- to four-family residential other	860	51	—		911	0.2	
Multifamily agency guaranteed	266,339	877	(1,210)	)	266,006	58.4	
Multifamily other	10,554	122	—		10,676	2.3	
Total mortgage-backed or related securities	321,636	1,889	(1,662)	)	321,863	70.6	
Asset-backed securities:							
SLMA	15,508	224	—		15,732	3.5	
Other asset-backed securities	10,055	—	(321)	)	9,734	2.1	
Total asset-backed securities	25,563	224	(321)	)	25,466	5.6	
	\$455,232	\$2,475	\$(2,354)	)	\$455,353	100.0	%
	December 31, 2013						
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		Fair Value	Percent of Total	
U.S. Government and agency obligations	\$59,178	\$117	\$(635)	)	\$58,660	12.5	%
Municipal bonds:							