BANNER CORP
Form 10-K
March 16, 2015

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

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 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	91-1691604
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

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

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

Securities registered pursuant to Section 12(b) of the Act:

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

Securities registered pursuant to section 12(g) of the Act:
None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act Yes __ No X

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No ____

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) Yes X No ____

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

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

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

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

The aggregate market value of the voting and nonvoting common equity held by nonaffiliates of the registrant based on the closing sales price
of the registrant's common stock quoted on The NASDAQ Stock Market on June 30, 2014, was:
Common Stock – $755,828,076
(The exclusion from such amount of the market value of the shares owned by any person shall not be deemed an admission by the Registrant
that such person is an affiliate of the Registrant.)
The number of shares outstanding of the registrant's classes of common stock as of February 28, 2015:
Common Stock, $.01 par value – 19,579,326 shares
Documents Incorporated by Reference
Portions of Proxy Statement for Annual Meeting of Shareholders to be held April 21, 2015 are incorporated by reference into Part III.

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BANNER CORPORATION AND SUBSIDIARIES

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Forward-Looking Statements

Certain matters in this Form 10-K constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to our financial condition, liquidity, results of operations, plans, objectives, future performance or business. Forward-looking statements are not statements of historical fact, are based on certain assumptions and are generally identified by use of the words “believes,” “expects,” “anticipates,” “estimates,” “forecasts,” “intends,” “plans,” “targets,” “potentially,” “probably,” “projects,” “outlook” or similar expressions 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: expected revenues, cost savings, synergies and other benefits from the merger of Banner Bank and Siuslaw Bank and of the proposed merger of Banner Bank and AmericanWest Bank ("AmericanWest") might not be realized within the expected time frames or at all and costs or difficulties relating to integration matters, including but not limited to customers, systems and employee retention, might be greater than expected; the requisite shareholder and regulatory approvals for the AmericanWest transaction might not be obtained; 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 economic conditions in general and in Washington, Idaho, Oregon, Utah and California in particular; 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; future goodwill impairment due to changes in our business, changes in market conditions, or other factors; our ability to manage loan delinquency rates; increased competitive pressures among financial services companies; changes in consumer spending, borrowing and savings habits; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; our ability to pay dividends on our common stock and interest or principal payments on our junior subordinated debentures; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards

Board including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; the economic impact of war or any terrorist activities; other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services; and other risks detailed from time to time in our filings with the Securities and Exchange Commission, including this report on Form 10-K. Any forward-looking statements are based upon management's beliefs and assumptions at the time they are made. We do not undertake and specifically disclaim any obligation to update any forward-looking statements included in this report or the reasons why actual results could differ from those contained in such statements, whether as a result of new information, future events or otherwise. These risks could cause our actual results to differ materially from those expressed in any forward-looking statements by, or on behalf of, us. In light of these risks, uncertainties and assumptions, the forward-looking statements discussed in this report might not occur, and you should not put undue reliance on any forward-looking statements.

As used throughout this report, the terms "we," "our," "us," or the "Company" refer to Banner Corporation and its consolidated subsidiaries, unless the context otherwise requires. All references to "Banner" refer to Banner Corporation and those to "the Banks" refer to its wholly-owned subsidiaries, Banner Bank and Islanders Bank, collectively.

PART 1

Item 1 – Business General

Banner Corporation (the Company) is a bank holding company incorporated in the State of Washington. We are primarily engaged in the business of planning, directing and coordinating the business activities of our wholly-owned subsidiaries, Banner Bank and Islanders Bank. Banner Bank is a Washington-chartered commercial bank that conducts business from its main office in Walla Walla, Washington and, as of December 31, 2014, its 90 branch offices and ten loan production offices located in Washington, Oregon and Idaho. Islanders Bank is also a Washington-chartered commercial bank that conducts business from three locations in San Juan County, Washington. Banner Corporation is subject to regulation by the Board of Governors of the Federal Reserve System (the Federal Reserve Board). Banner Bank and Islanders Bank (the Banks) are subject to regulation by the Washington State Department of Financial Institutions, Division of Banks (the DFI) and the Federal Deposit Insurance Corporation (the FDIC). As of December 31, 2014, we had total consolidated assets of $4.7 billion, net loans of $3.8 billion, total deposits of $3.9 billion and total stockholders' equity of $584 million. Our common stock is traded on the NASDAQ Global Select Market under the ticker symbol "BANR."

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

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

At year end 2014, we had two previously announced and pending acquisitions that will significantly increase the size and geographic reach of the Company and Banner Bank. On August 7, 2014, we announced the execution of a definitive agreement to purchase Siuslaw Financial Group (Siuslaw), the holding company of Siuslaw Bank, an Oregon state chartered commercial bank headquartered in Florence, Oregon, with ten branches serving multiple locations in Lane County including Eugene, Oregon. This acquisition closed on March 6, 2015 at which time Siuslaw merged into Banner and Siuslaw Bank merged into Banner Bank. On November 5, 2014, we announced the execution of a definitive agreement to purchase Starbuck Bancshares, Inc. (Starbuck), the bank holding company of AmericanWest Bank (AmericanWest), a Washington state chartered commercial bank headquartered in Spokane, Washington, with 94 branches serving markets in Washington, Oregon, Idaho, California and Utah. The merger agreement provides that Starbuck will merge with and into a wholly-owned subsidiary of the Company. Immediately following the merger, Starbuck's wholly owned bank subsidiary, AmericanWest will merge with Banner Bank. At September 30, 2014, AmericanWest had $4.1 billion in assets, $2.5 billion in net loans, $3.3 billion in deposits and members' equity of $561.3 million excluding AmericanWest's recent acquisition of Greater Sacramento Bancorp. At September 30, 2014, Greater Sacramento Bancorp had $481 million in assets, $410 million in deposits and stockholders' equity of $39 million. The merged banks will operate under the Banner Bank brand. Under the terms of the agreement, the aggregate consideration to be received by AmericanWest equity holders will consist of a fixed amount of 13.23 million shares of Banner common stock and $130.0 million in cash. Upon completion of the transaction, such shares will represent an approximately 38.8% pro forma ownership interest in Banner. The merger is subject to approval by Banner's shareholders and regulatory agencies as well as other customary closing conditions and is expected to close late in the second quarter or early in the third quarter of 2015. In addition, in June of 2014, Banner Bank acquired six branches in southwestern Oregon (the "Branch Acquisition") which have been fully integrated into Banner Bank. In the aggregate, Banner Bank acquired $212 million in deposit accounts, $88 million in loans, and $3 million in branch properties. Banner Bank also received $128 million in cash from the transaction. Upon completion of the AmericanWest merger, Banner Bank will have more than 190 locations in five western states, a significantly expanded customer base and meaningfully increased business opportunities. See Notes 2 and 4 of the Notes to our Audited Consolidated Financial Statements contained in Item 8 of this report for additional information.

Banner Corporation's successful execution of its strategic turnaround plan and operating initiatives, which resulted in our return to profitability in 2011, continued and strengthened in 2012, 2013 and 2014 and delivered noteworthy results as evidenced by our solid profitability for each of these years. Over this period we achieved substantial success on our goals to achieve and maintain the Company's moderate risk profile as well as to develop and continue strong earnings momentum going forward. Highlights of this success have included continued substantial improvement in our asset quality, outstanding client acquisition results and account growth, significantly increased non-interest-bearing deposit balances and strong revenue generation from core operations. As a result, for the year ended December 31, 2014, we had net income available to common shareholders of $54.2 million, or $2.79 per diluted share, for the year ended December 31, 2013, we had net income available to common shareholders of $46.6 million, or $2.40 per diluted share, and for the year ended December 31, 2012, we had net income available to common shareholders of $64.9 million, or $3.16 per diluted share.

Although there continue to be indications that economic conditions are improving, the pace of expansion has been modest and uneven and ongoing uncertainty in the economy and low interest rates will likely continue to present a challenging banking environment going forward. As a result, our future operating results and financial performance will be significantly affected by the course of economic activity. However, over the past four years we have significantly added to our client relationships and account base, as well as substantially improved our risk profile by aggressively managing and reducing our problem assets, which has resulted in stronger and sustainable revenues and low credit costs, and which we believe has positioned the Company well to meet this challenging environment with continued success.

Our operating results depend primarily on our net interest income, which is the difference between interest income on interest-earning assets, consisting of loans and investment securities, and interest expense on interest-bearing liabilities, composed primarily of customer deposits and borrowings. Net interest income is primarily a function of our interest rate spread, which is the difference between the yield earned on interest-earning assets and the rate paid on interest-bearing liabilities, as well as a function of the average balances of interest-earning assets and interest-bearing liabilities. Our net interest income before provision for loan losses increased 8% to $179.9 million for the year ended December 31, 2014, compared to $166.7 million for the year earlier. This increase in net interest income reflects the significant growth in earning assets and occurred despite a decrease in the net interest spread. Our interest rate spread decreased to 4.04% for the year ending December 31, 2014 from 4.08% for the year ending December 31, 2013, while our net interest margin decreased to 4.07% in the current year compared to 4.11% a year earlier. The decrease in interest rate spread reflects declining yields on performing loans, partially offset by increased yields on securities, the net of which was only partially offset by continuing reductions in deposit and other funding costs. Pressure on our net interest margin in the exceptionally low market interest rate environment that the Federal Reserve has maintained for an extended period following the recessionary period of 2008 and 2009 is a particularly challenging issue for banks, which appears likely to persist in the foreseeable future.

Our net income also is affected by the level of our other operating income, including deposit fees and service charges, loan origination and servicing fees, and gains and losses on the sale of loans and securities, as well as our non-interest operating expenses and income tax provisions. In addition, our net income is affected by the net change in the value of certain financial instruments carried at fair value, and in certain periods by other-than-temporary impairment (OTTI) charges or recoveries. Further, in the year ended December 31, 2014, our net income was significantly augmented by an acquisition bargain purchase gain related to the purchase of the six branches in southwestern Oregon (see Note 4 of the Notes to the Consolidated Financial Statements) and in the year ended December 31, 2013 by a termination fee related to the cancellation of the proposed acquisition of Home Federal Bancorp, Inc. (See Note 22 of the Notes to the Consolidated Financial Statements.) For the year ended December 31, 2014, we recorded a net gain of $1.4 million for fair value adjustments, $42,000 in net gains on the sale of securities, and the $9.1 million acquisition bargain purchase gain. In comparison, for the year ended December 31, 2013, we recorded a net charge of $2.3 million for fair value adjustments, which was offset by $1.0 million in net gains on the sale of securities, $409,000 in OTTI recoveries and the $3.0 million acquisition termination fee.

Our total other operating income, which includes the net gain on sale of securities, OTTI losses and recoveries, changes in the value of financial instruments carried at fair value, as well as the acquisition bargain purchase gain in the current year and termination fee in the prior year, was $54.3 million for the year ended December 31, 2014, compared to $43.3 million for the year ended December 31, 2013. As a result, our total revenues (net interest income before the provision for loan losses plus other operating income) for 2014 increased to $234.1 million, compared to $210.1 million for 2013. However, our total revenues, excluding the net gain on sale of securities, OTTI, fair value adjustments, the bargain purchase gain in the current year and termination fee in the prior year, which we believe is more indicative of our core operations, were $223.6 million for the year ended December 31, 2014, an increase of 8% compared to $208.0 million for the year ended December 31, 2013. The increase in revenues in the current year reflects significant increases in net interest income and deposit fees and service charges, which were only partially offset by a modest decrease in mortgage banking revenues. Importantly, this increase in revenues is primarily the result of increased loan balances, deposit accounts and customer relationships.

As a result of adequate reserves already in place as well as declining net charge-offs, we did not record a provision for loan losses in the years ended December 31, 2014 and December 31, 2013. By contrast, we recorded a $13.0 million provision for the year ended December 31, 2012 and substantially larger provisions in the three years immediately prior to 2012. The decrease in loan loss provisioning compared to the earlier years reflects our significant progress in reducing the levels of delinquencies, non-performing loans and net charge-offs, particularly for loans for the construction of one- to four-family homes and for acquisition and development of land for residential properties. As a result of our focused efforts, non-performing loans decreased by 32% to $16.7 million at December 31, 2014, compared to $24.8 million a year earlier. Our allowance for loan losses at December 31, 2014 was $75.9 million, representing 1.98% of total loans outstanding and 454% of non-performing loans. (See Note 6, Loans Receivable and the Allowance for Loan Losses, as well as “Asset Quality” below in this Form 10-K.)

Our other operating expenses increased to $153.7 million for the year ended December 31, 2014, compared to $141.0 million for the year ended December 31, 2013, largely as a result of increased costs related to acquisition activities, including the operation of six newly acquired branches as well as transaction, integration and conversion-related expense for those branches and for the merger with Siuslaw and the pending merger with AmericanWest, as well as increased compensation expense.

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

Recent Developments and Significant Events

Proposed Acquisition of AmericanWest Bank

On November 5, 2014, the Company announced the execution of a definitive agreement to purchase Starbuck Bancshares, the holding company for AmericanWest, a Washington state charted commercial bank. Pursuant to the agreement, AmericanWest’s holding company will merge with and into Banner and AmericanWest will merge with and into Banner Bank. The merged banks will operate under the Banner Bank brand. Under the terms of the agreement, the aggregate consideration to be received by AmericanWest equityholders will consist of a fixed amount of 13.23 million shares of Banner common stock and $130.0 million in cash. Upon completion of the transaction, such shares will represent an approximately 38.8% pro forma ownership interest in Banner. The definitive merger agreement was approved unanimously by the boards of directors of both companies. The merger is expected to close late in the second quarter or early in the third quarter of 2015 and is subject to approval by regulatory agencies and obtaining the requisite shareholder approval to issue the shares necessary to complete the transaction, as well as other customary closing conditions.

Acquisition of Siuslaw Financial Group, Inc.

On March 6, 2015, the Company completed its acquisition of Siuslaw, the holding company of Siuslaw Bank, an Oregon state charted commercial bank. Siuslaw shareholders received consideration of $1.41622 in cash plus 0.32231 of a share of Banner common stock in exchange for each share of Siuslaw common stock, which reflects a payment of approximately 90% stock and 10% cash. Upon closing of the transaction Siuslaw was merged into Banner and Siuslaw Bank was merged into Banner Bank.

Acquisition of Six Sterling Savings Bank Branches

Effective as of the close of business on June 20, 2014, Banner Bank completed the purchase of the six branches in Oregon from Umpqua Bank (the "Branch Acquisition"), successor to Sterling Savings Bank. In the aggregate, Banner acquired $212 million in deposit accounts, $88 million in loans, and $3 million in branch properties. Banner Bank also received $128 million in cash from the transaction.

Income Tax Reporting and Accounting

Amended Federal Income Tax Returns: The Company has years 2011 - 2013 open for tax examination under the statute of limitation provisions of the state and of the Internal Revenue Code of 1986 (Code). Tax years 2008 - 2010 are not open for assessment of additional tax, but remain open for adjustment to the amount of Net Operating Losses (NOLs), credit, and other carryforwards utilized in open years or to be utilized in the future. The Company filed amended federal income tax returns for tax years 2008 and 2009 to claim additional bad debt deductions, which resulted in additional NOLs for tax years 2008 and 2009. The Company also filed amended federal income tax returns for tax years 2005 - 2006 and a tentative refund claim for tax year 2007 to carryback the NOLs and general business credits from 2008 and 2009 to those earlier years. Review of the amended returns for all years was completed by the Internal Revenue Service (IRS) in 2013 and the Company signed a closing agreement with the IRS related to refund claims of $9.8 million, primarily related to tax year 2006. As of December 31, 2013, the Company had recorded a tax receivable of $9.8 million with an offsetting adjustment to its deferred tax assets. As of December 31, 2014, the Company had reduced its tax receivable by $9.8 million due to the receipt of that amount in 2014.

Deferred Tax Asset Valuation Allowance: The Company and its wholly-owned subsidiaries file consolidated U.S. federal income tax returns, as well as state income tax returns in Oregon and Idaho. Income taxes are accounted for using the asset and liability method. Under this method a deferred tax asset or liability is determined based on the enacted tax rates which are expected to be in effect when the differences between the financial statement carrying amounts and tax basis of existing assets and liabilities are expected to be reported in the Company’s income tax returns. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. Under GAAP, a valuation allowance is required to be recognized if it is “more likely than not” that all or a portion of Banner’s deferred tax assets will not be realized. During 2010, the Company evaluated its net deferred tax asset and determined it was prudent to establish a full valuation allowance against the net asset. While the full valuation allowance remained in effect, the Company did not recognize any tax expense or benefit in its Consolidated Statements of Operations. During 2012, management analyzed the Company’s performance and trends since December 31, 2010, focusing on trends in asset quality, loan loss provisioning, capital position, net interest margin, core operating income and net income and the likelihood of continued profitability. Based on this analysis, management determined that a full valuation allowance was no longer appropriate and reversed all of the valuation allowance during the year ending December 31, 2012. The ultimate realization of deferred tax assets is dependent upon the existence, or generation, of taxable income in the periods when those temporary differences and net operating loss and credit carryforwards are deductible. See Note 13 of the Notes to the Consolidated Financial Statements for more information.

Stockholder Equity Transactions

Preferred Stock: On March 29, 2012, the Company's $124 million of Series A Preferred Stock with a liquidation value of $1,000 per share, originally issued to the U.S. Treasury (Treasury) as part of its Capital Purchase Program, was sold by the Treasury as part of its efforts to manage and recover its investments under the Troubled Asset Relief Program (TARP). While the sale of these preferred shares to new owners did not result in any proceeds to the Company and did not change the Company's capital position or accounting for these securities, it did eliminate restrictions put in place by the Treasury on TARP recipients. During the year ended December 31, 2012, the Company repurchased or redeemed all of its Series A Preferred Stock. The related warrants to purchase up to $18.6 million in Banner common stock (243,998 shares) were sold by the Treasury at public auction in June 2013. That sale did not change the Company's capital position and did not have any impact on the financial accounting and reporting for these securities.

Lending Activities

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

We offer a wide range of loan products to meet the demands of our customers. Our lending activities are primarily directed toward the origination of real estate and commercial loans. Commercial real estate loans for both owner-occupied and investment properties, including construction and development loans for these types of properties, totaled $1.432 billion, or approximately 37% of our loan portfolio at December 31, 2014. In addition, multifamily residential real estate loans, including construction and development loans for these types of properties, totaled $228 million or approximately 6% of our loan portfolio. While our level of activity and investment in commercial and multifamily real estate loans has been relatively stable for many years, we have experienced an increase in new originations in recent periods resulting in growth in these loan balances. Commercial real estate loans increased by $215 million and multifamily loans increased by $38 million during the year ended December 31, 2014. We also originate residential construction, land and land development loans and, although our portfolio balances are well below the peak levels before the recent recession, since 2011 we have experienced increased demand for one- to four-family construction loans. Outstanding residential construction, land and land development balances increased $46 million, or 17%, to $322 million at December 31, 2014 compared to $276 million at December 31, 2013. Still, residential construction, land and land development loans represented only approximately 8% of our total loan portfolio at December 31, 2014. Our commercial business lending is directed toward meeting the credit and related deposit needs of various small- to medium-sized business and agribusiness borrowers operating in our primary market areas. Reflecting the uncertain economy, demand for these types of commercial business loans has been modest although our production levels have increased in recent periods. In recent years, our commercial business lending has also included participation in certain national syndicated loans, including shared national credits, which totaled $119 million at December 31, 2014. Commercial and agricultural business loans increased $52 million, or 6%, to $962 million at December 31, 2014, compared to $910 million at December 31, 2013. Commercial and agricultural business loans represented approximately 25% of our portfolio at December 31, 2014. At December 31, 2014, our net loan portfolio totaled $3.758 billion compared to $3.344 billion at December 31, 2013.

Our residential mortgage loan originations have been relatively strong in recent years, as exceptionally low interest rates have supported demand for loans to refinance existing debt as well as loans to finance home purchases. However, most of the one- to four-family loans that we originate are sold in the secondary markets with net gains on sales and loan servicing fees reflected in our revenues from mortgage banking. As a result growth in this portion of our portfolio has been modest. At December 31, 2014, our outstanding balances for residential mortgages increased $10 million to $540 million and represented nearly 14% of our loan portfolio.

Our consumer loan activity is primarily directed at meeting demand from our existing deposit customers. We have increased our emphasis on consumer lending in recent years, and while demand for consumer loans has been modest during most of this period as we believe many consumers have been focused on reducing their personal debt, we saw some meaningful growth in 2014. At December 31, 2014, consumer loans, including consumer loans secured by one- to four-family residences, increased $54 million to $349 million, or 9% of our portfolio with most of the increase arising from increased usage of home equity lines of credit.

For additional information concerning our loan portfolio, see Item 7, “Management’s Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2014 and 2013—Loans and Lending” including Tables 7 and 8, which sets forth the composition and geographic concentration of our loan portfolio, and Tables 9 and 10, which contain information regarding the loans maturing in our portfolio.

One- to Four-Family Residential Real Estate Lending: At both Banner Bank and Islanders Bank, we originate loans secured by first mortgages on one- to four-family residences in the Northwest communities where we have offices. Through our mortgage banking activities, we sell residential loans on either a servicing-retained or servicing-released basis. In recent years, we have generally sold a significant portion of our conventional residential mortgage originations and nearly all of our government insured loans in the secondary market. At December 31, 2014,

$540 million, or 14% of our loan portfolio, consisted of permanent loans on one- to four-family residences compared with $529 million, or 15% at December 31, 2013.

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

Our residential loans are generally underwritten and documented in accordance with the guidelines established by the Federal Home Loan Mortgage Corporation (Freddie Mac or FHLMC) and the Federal National Mortgage Association (Fannie Mae or FNMA). Government insured loans are underwritten and documented in accordance with the guidelines established by the Department of Housing and Urban Development (HUD) and the Veterans Administration (VA). In the loan approval process, we assess the borrower’s ability to repay the loan, the adequacy of the proposed security, the employment stability of the borrower and the creditworthiness of the borrower. For ARM loans, our standard practice provides for underwriting based upon fully indexed interest rates and payments. Generally, we will lend up to 95% of the lesser of the appraised value or purchase price of the property on conventional loans, although higher loan-to-value ratios are available on secondary market programs. We require private mortgage insurance on conventional residential loans with a loan-to-value ratio at origination exceeding 80%.

Construction and Land Lending: Historically, we have invested a significant portion of our loan portfolio in residential construction and land loans to professional home builders and developers. We regularly monitor our construction and land loan portfolios and the economic conditions and housing inventory in each of our markets and increase or decrease this type of lending as we observe market conditions change. As housing markets weakened, the amount of this investment was substantially reduced from 2009 through 2011. However, beginning in 2012, in response to improvement in certain sub-markets, our residential construction and land and land development lending has been increasing and has made a meaningful contribution to net income and profitability. To a lesser extent, we also originate construction loans for commercial and multifamily real estate. Although well diversified with respect to sub-markets, price ranges and borrowers, our construction, land and land development loans are significantly concentrated in the greater Puget Sound region of Washington State and the Portland, Oregon market area. At December 31, 2014, construction, land and land development loans totaled $411 million, or 11% of total loans, consisting of $220 million of one- to four-family construction loans, $102 million of residential land or land development loans, $78 million of commercial and multifamily real estate construction loans and