BANNER CORP
Form 10-K
March 14, 2008

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, 2007

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 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 (Check One):

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

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

The aggregate market value of the voting and nonvoting common equity held by nonaffiliates of the registrant based on the closing sales price of the registrant's common stock quoted on the Nasdaq Stock Market on June 30, 2007, was:
Common Stock - $534,077,353

(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 29, 2008:
Common Stock, $.01 par value – 16,041,875 shares

Documents Incorporated by Reference
Portions of Proxy Statement for Annual Meeting of Shareholders to be held April 22, 2008 are incorporated by reference into Part III.

BANNER CORPORATION AND SUBSIDIARIES

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Forward-Looking Statements

Management's Discussion and Analysis and other portions of this report on Form 10-K contain certain forward-looking statements concerning our future operations. Management desires to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and is including this statement so that we may rely on the protections of such safe harbor with respect to all forward-looking statements contained in this report. We have used forward-looking statements to describe future plans and strategies, including expectations of our future financial results. Our ability to predict results or the effect of future plans or strategies is inherently uncertain. Factors which could cause actual results to differ materially include, but are not limited to, the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates, deposit interest rates, our net interest margin and funding sources; fluctuations in the demand for loans and in real estate values in our market areas; fluctuations in agricultural commodity prices, crop yields and weather conditions; our ability to control operating costs and expenses; our ability to successfully implement our branch expansion strategy; 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; our ability to manage loan delinquency rates; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgements; increased competitive pressures among financial services companies; changes in consumer spending, borrowing and savings habits; legislative or regulatory changes that adversely affect our business; 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; war or 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. We caution readers not to place undue reliance on any forward-looking statements. We do not undertake and specifically disclaim any obligation to revise any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements. These risks could cause our actual results for 2008 and beyond to differ materially from those expressed in any forward-looking statements by, or on behalf of, us.

As used throughout this report, the terms "we", "our", "us", or the "Company" refer to Banner Corporation and its consolidated subsidiaries.

PART 1

Item 1 – Business
General

Banner Corporation (BANR or 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, subsequent to May 1, 2007, Islanders Bank, a recent acquisition, 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, 2007, its 81 branch offices and 12 loan production offices located in 28 counties 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 FDIC. As of December 31, 2007, we had total consolidated assets of $4.5 billion, total deposits of $3.6 billion and total stockholders' equity of $438 million.

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, Federal Home Loan Bank (FHLB) advances, repurchase agreements and junior subordinated debentures issued in connection with the sale of trust preferred securities. Our net income is also significantly affected by provisions for loan losses and the level of our other income, including deposit service charges, loan origination and servicing fees, and gains and losses on the sale of loans, as well as our non-interest operating expenses and income tax provisions. For 2007, our net income was also significantly impacted by a substantial net change in the value of financial instruments carried at fair value. Our net income for the year ended December 31, 2007 was $36.9 million, or $2.49 per share, on a fully diluted basis, and included $11.6 million ($7.4 million after tax) of net gains as a result of changes in the valuation of financial instruments carried at fair value in accordance with the adoption of Statement of Financial Accounting Standards (SFAS) No. 159 and SFAS No. 157. Our net income for the year ended December 31, 2006, as restated, was $31.5 million, or $2.58 per share on a fully diluted basis, which included a $5.5 million insurance settlement. The net amount of the settlement after costs contributed approximately $3.4 million, or $0.28 per share, to earnings for the year ended December 31, 2006. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" for more detailed information about our financial performance and critical accounting policies.

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

Over the past several years, we have invested significantly in expanding our branch and distributions systems with a primary emphasis on expanding our presence in the four largest areas of commerce in the Northwest: the Puget Sound region of Washington and the greater Boise, Idaho, Portland, Oregon, and Spokane, Washington markets. As a result of our aggressive franchise expansion, we have added 18 new branches through acquisition, opened 21 new branches

and relocated eight others in the last three years. In 2007, we completed the acquisitions of three smaller commercial banks in the State of Washington. These acquisitions increased our presence within desirable marketplaces and allow us to better serve existing and future customers. Our branch expansion has been a significant element in our strategy to grow loans, deposits and customer relationships. This emphasis on growth has resulted in an elevated level of operating expenses; however, we believe that over time these new branches should help improve profitability by providing lower cost core deposits which will allow us to proportionately reduce higher cost borrowings as a source of funds. We now have reached our goal in terms of the number of branches required to generate deposit growth sufficient to fund our expected loan growth and produce significant fee generating opportunities. As a result, we plan to open only three additional branches in 2008, a normal level of growth for a bank of our size.

Recent Developments

On May 1, 2007, we completed the acquisition of F&M Bank (F&M) Spokane, Washington, in a stock and cash transaction valued at approximately $98.3 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. F&M 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. The purchase of F&M allowed us to immediately expand Banner Bank's franchise in the Spokane, Washington area, the fourth largest metropolitan market in the Pacific Northwest, by the addition of 13 branches and one loan office.

On May 1, 2007, we also 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 Corporation 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 Banner's consolidated operations beginning in the quarter ended June 30, 2007. The acquisition of Islanders Bank, with its three branches located in the San Juan Islands, added to our presence in the North Puget Sound region.

On October 10, 2007, we completed the acquisition of NCW Community Bank (NCW), Wenatchee, Washington, in a transaction valued at approximately $18.5 million, with $6.5 million of cash and 339,860 shares of Banner Corporation common stock being exchanged for all of the outstanding common shares and stock options of NCW. NCW operated one branch in Wenatchee, Washington and had another branch under construction in East Wenatchee. NCW merged into Banner Bank in connection with this transaction during the fourth quarter of 2007. The

merger added to Banner's customer base and market share in the North Central Washington area and allowed for the consolidation of the two banks' branch locations and staffs.

See Note 5 of the Notes to the Consolidated Financial Statements contained in Item 8 for more detailed information with respect to our acquisitions.

Lending Activities

General: All of our lending activities are conducted through Banner Bank, its subsidiary, Community Financial Corporation, and Islanders Bank. We offer a wide range of loan products to meet the demands of our customers. We originate loans for our own loan portfolio and for sale in the secondary market. Management's strategy has been to maintain a significant percentage of assets in the loan portfolio with more frequent interest rate repricing terms or shorter maturities than traditional long-term fixed-rate mortgage loans. As part of this effort, we have developed a variety of floating or adjustable interest rate products that correlate more closely with our cost of funds. 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.

While we offer a wide range of loan products, we do not now and have not previously engaged in any sub-prime lending. Historically, our lending activities have been primarily directed toward the origination of real estate and commercial loans. Real estate lending activities have been significantly focused on residential construction and first mortgages on owner occupied, one- to four-family residential properties. In response to strong housing markets, construction and land loan growth has been particularly significant over the past three years, although our origination of new construction and land loans did slow appreciably during the second half of 2007 as market conditions became much less favorable. At December 31, 2007, construction and land loans represent nearly one third of our loan portfolio. Our lending activities have also included the origination of multifamily and commercial real estate loans. Commercial lending has been directed toward meeting the credit and related deposit needs of various small- to medium-sized business and agri-business borrowers operating in our primary market areas. We have also recently increased our emphasis on consumer lending, although the portion of the loan portfolio invested in consumer loans is still relatively small. While continuing our commitment to construction and residential lending, we expect commercial lending (including commercial real estate, commercial business and agricultural lending) and consumer lending to become increasingly important activities for us.

At December 31, 2007, our net loan portfolio totaled $3.76 billion. 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, 2007 and 2006—Loans/Lending." See also Table 5 contained therein, which sets forth the composition of our loan portfolio, and Tables 6 and 6(a), 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. Banner Bank's mortgage lending subsidiary, CFC, provides residential lending primarily in the greater Portland and Pasco (Tri Cities), Washington market areas. As noted above, we have not engaged in any sub-prime lending and we have not experienced a material increase in delinquencies on our residential loans despite clearly weakening housing market conditions. At December 31, 2007, $464 million, or 12.2% of our loan portfolio, consisted of permanent loans on one- to four-family residences.

We offer fixed- and adjustable-rate mortgages (ARMs) at rates and terms competitive with market conditions, primarily with the intent of selling these loans into the secondary market. Fixed rate loans generally are offered on a fully amortizing basis for terms ranging from 15 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%. These ARM products most frequently adjust based upon the average yield on U.S. Treasury securities adjusted to a constant maturity of one year plus a margin or spread above the index. Generally, ARM loans held in our portfolio do not allow for interest-only payments nor 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 higher interest-only option ARM products. As a result, ARM loans have represented only a small portion of 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 Corporation (Fannie Mae or FNMA). Government insured loans are generally 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. Generally, we lend up to 95% of the lesser of the appraised value of the property or purchase price of the property on conventional loans, although higher loan-to-value ratios are available on certain government insured programs. We usually require private mortgage insurance on residential loans with a loan-to-value ratio at origination exceeding 80%.

Through our mortgage banking activities, we sell residential loans on either a servicing-retained or servicing-released basis. The decision to hold or sell loans is based on asset/liability management goals and policies and market conditions. During the past three years, we have sold a significant portion of our conventional residential mortgage originations and nearly all of our government insured loans into the secondary market.

Construction and Land Lending: We invest a significant portion of our loan portfolio in residential construction and land loans to professional home builders and developers. To a lesser extent, we also originate construction loans for commercial and multifamily real estate. Residential

construction and land development lending is a core competency of Banner Bank and the primary focus of its subsidiary, CFC. Our largest concentration of construction and development loans is in the Portland/Vancouver market area. We also have a significant amount of construction loans for properties in the Puget Sound region and to a much smaller extent in the greater Boise and certain eastern Washington and eastern Oregon markets. At December 31, 2007, construction and land loans totaled $1.221 billion (including $498 million of land or land development loans and $109 million of commercial and multifamily real estate construction loans), or 32% of total loans of the Company.

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

Construction loans made by us include those with a sale contract or permanent loan in place for the finished homes and those for which purchasers for the finished homes may be identified either during or following the construction period. We actively monitor the number of unsold homes in our construction loan portfolio and local housing markets to ensure an appropriate balance between home sales and new loan originations. The maximum number of speculative loans approved for each builder is based on a combination of factors, including the financial capacity of the builder, the market demand for the finished product and the ratio of sold to unsold inventory the builder maintains. We have chosen to diversify the risk associated with speculative construction lending by doing business with a large number of small and mid-sized builders spread over a relatively large geographic area.

Loans for the construction of one- to four-family residences are generally made for a term of twelve months. Our loan policies include maximum loan-to-value ratios of up to 80% for speculative loans. Individual speculative loan requests are supported by an independent appraisal of the property, a set of plans, a cost breakdown and a completed specifications form. All speculative construction loans must be approved by senior loan officers.

We also make land loans to developers, builders and individuals to finance the acquisition and/or development of improved lots or unimproved land. In making land loans, we follow underwriting policies and disbursement and monitoring procedures similar to those for construction loans. The initial term on land loans is typically one to three years with interest only payments, payable monthly, and provisions for principal reduction as lots are sold and released from the lien of the mortgage.

We regularly monitor the construction and land loan portfolios and the economic conditions and housing inventory in each of our markets and decrease this type of lending if we perceive unfavorable market conditions. Although certainly better than other parts of the country, housing markets in most areas of the Pacific Northwest have clearly weakened over the past six to twelve months and our origination of new construction loans has declined. We believe that the underwriting policies and internal monitoring systems we have in place mitigate many of the risks inherent in construction and land lending; however, current slower housing market conditions have resulted in an increase of delinquencies in our construction and land loan portfolios. While construction and land loans represent 32% of our portfolio and approximately 80% of our non-performing assets, they are significantly diversified with respect to

geography and sub-markets, price ranges and borrowers. The vast majority of these loans are performing as agreed and we are experiencing continuing loan payoffs and portfolio turnover.

Commercial and Multifamily Real Estate Lending: We originate loans secured by multifamily and commercial real estate including, as noted above, loans for construction of multifamily and commercial real estate projects. At December 31, 2007, our loan portfolio included $166 million in multifamily and $883 million in commercial real estate loans which together comprised 28% of our total loans. Multifamily and commercial real estate lending affords us an opportunity to receive interest at rates higher than those generally available from one- to four-family residential lending. However, loans secured by multifamily and commercial properties are generally greater in amount, more difficult to evaluate and monitor and, therefore, riskier than one- to four-family residential mortgage loans. Because payments on loans secured by multifamily and commercial properties are often dependent on the successful operation and management of the properties, repayment of these loans may be affected by adverse conditions in the real estate market or the economy. In all multifamily and commercial real estate lending, we consider the location, marketability and overall attractiveness of the properties. Our current underwriting guidelines for multifamily and commercial real estate loans require an appraisal from a qualified independent appraiser and an economic analysis of each property with regard to the annual revenue and expenses, debt service coverage and fair value to determine the maximum loan amount. In the approval process we assess the borrowers' willingness and ability to repay the loan and the adequacy of the collateral in relation to the loan amount.

Multifamily and commercial real estate loans originated by us are both fixed- and adjustable-rate loans generally with intermediate terms of five to ten years. Most multifamily and commercial real estate loans originated in the past five years are linked to various U.S. Treasury indices, certain prime rates or other market rate indices. Rates on these adjustable-rate loans generally adjust with a frequency of one to five years after an initial fixed-rate period ranging from one to ten years. Our commercial real estate portfolio consists of loans on a variety of property types with no large concentrations by property type or location.

Commercial Business Lending: We are active in small- to medium-sized business lending, including the origination of loans guaranteed by the Small Business Administration (SBA), and are engaged to a lesser extent in agricultural lending primarily by providing crop production loans. Our officers devote a great deal of effort to developing customer relationships and the ability to serve these types of borrowers. Management believes that many larger banks have neglected these lending markets, which has contributed to our success. While strengthening our commitment to small business lending, in recent years we have added experienced officers and staff focused on middle market corporate lending opportunities for borrowers with credit needs generally in a $3 million to $15 million range. Management has leveraged the past success of these officers with local decision making ability to continue to expand this market niche. In addition to providing earning assets, this type of lending has helped us increase

our deposit base. Expanding commercial lending and related commercial banking services is currently an area of significant focus by us and staffing has been increased in the areas of credit administration, business development, and loan and deposit operations.

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

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

Our commercial business loans may be structured as term loans or as lines of credit. Commercial business term loans are generally made to finance the purchase of fixed assets and have maturities of five years or less. Commercial business lines of credit are typically made for the purpose of providing working capital and are usually approved with a term of one year. Adjustable- or floating-rate loans are generally tied to various prime rate and London Inter-Bank Offering Rate or LIBOR indices. At December 31, 2007, commercial loans totaled $696 million, or 18% of our total loans.

Agricultural Lending: Agriculture is a major industry in many parts of our service areas. While agricultural loans are not a large part of our portfolio, we intend to continue to make agricultural loans to borrowers with a strong capital base, sufficient management depth, proven ability to operate through agricultural cycles, reliable cash flows and adequate financial reporting. Payments on agricultural loans depend, to a large degree, on the results of operations of the related farm entity. The repayment is also subject to other economic and weather conditions as well as market prices for agricultural products, which can be highly volatile. At December 31, 2007, agricultural business loans, including collateral secured loans to purchase farm land and equipment, totaled $186 million, or 5% of our loan portfolio.

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

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

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

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

Consumer and Other Lending: We originate a variety of consumer loans, including home equity lines of credit, automobile loans and loans secured by deposit accounts. While consumer lending has traditionally been a small part of our business, with loans made primarily to accommodate our existing customer base, it has received renewed emphasis in recent years and management anticipates increased activity in future periods. Part of this emphasis has been the reintroduction of a Banner Bank-funded credit card program which we began marketing in the fourth quarter of 2005. Similar to other consumer loan programs, we primarily focus this credit card program on our existing customer base to add to the depth of our customer relationships. As a result of increased marketing efforts, an improved retail delivery network and strong borrower demand, as well as the three bank acquisitions, our consumer loans increased significantly in the past year. At December 31, 2007, we had $193 million, or 5% of our loans receivable, in consumer related loans, an increase of $75 million or 64% from December 31, 2006.

Similar to commercial loans, consumer loans often entail greater risk than residential mortgage loans, particularly in the case of consumer loans which are unsecured or secured by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans. These loans may also give rise to claims and defenses by a consumer loan borrower against an assignee of such loans such as us, and a borrower may be able to assert against the assignee claims and defenses that it has against the seller of the underlying collateral.

Loan Solicitation and Processing: We originate real estate loans in our market areas by direct solicitation of real estate brokers, builders, depositors, walk-in customers amd visitors to our internet website. Loan applications are taken by our loan officers and are processed in branch or regional locations. Most underwriting and loan administration functions for our real estate loans are performed by loan personnel at central locations.

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

We originate consumer loans through various marketing efforts directed primarily toward our existing deposit and loan customers. Consumer loan applications may be processed at branch locations or by administrative personnel at our main office.

Loan Originations, Sales and Purchases

While we originate a variety of loans, our ability to originate each type of loan is dependent upon the relative customer demand and competition in each market we serve. For the years ended December 31, 2007, 2006 and 2005, we originated loans, net of repayments, of $607 million, $921 million and $722 million, respectively. The decline in originations, net of repayments, in the current year is primarily the result of a decrease in the production of new construction and land loans.

In recent years, we generally have sold most of our newly originated one- to four-family residential mortgage loans and a portion of our SBA guaranteed loans to secondary market purchasers as part of our interest rate risk management strategy. Proceeds from sales of loans for the years ended December 31, 2007, 2006 and 2005, totaled $393 million, $442 million and $397 million, respectively. Sales of loans generally are beneficial to us because these sales may generate income at the time of sale, provide funds for additional lending and other investments and increase liquidity. We sell loans on both a servicing-retained and a servicing-released basis. All loans are sold without recourse. See "Loan Servicing." At December 31, 2007, we had $4.6 million in loans held for sale.

We periodically purchase whole loans and loan participation interests primarily during periods of reduced loan demand in our primary market area and at times to support our Community Reinvestment Act lending activities. Any such purchases are made consistent with our underwriting standards; however, the loans may be located outside of our normal lending area. During the years ended December 31, 2007, 2006 and 2005, we purchased $23 million, $45 million and $23 million, respectively, of loans and loan participation interests.

Loan Servicing

We receive fees from a variety of institutional owners in return for performing the traditional services of collecting individual payments and managing portfolios of sold loans. At December 31, 2007, we were servicing $362 million of loans for others. Loan servicing includes processing payments, accounting for loan funds and collecting and paying real estate taxes, hazard insurance and other loan-related items such as private mortgage insurance. In addition to earning fee income, we retain certain amounts in escrow for the benefit of the lender for which we incur no interest expense but are able to invest the funds into earning assets. At December 31, 2007, we held $3.1 million in escrow for our portfolio of loans serviced for others. The loan servicing portfolio at December 31, 2007 was composed of $178 million of Freddie Mac residential mortgage loans, $52 million of Fannie Mae residential mortgage loans and $132 million of both residential and non-residential mortgage loans serviced for a variety of private investors. The portfolio included loans secured by property located primarily in the states of Washington and Oregon. For the year ended December 31, 2007, $1.8 million of loan servicing fees, net of $758,000 of servicing rights amortization, was recognized in operations.

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 cost 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, 2007, 2006 and 2005, we capitalized $781,000, $1.6 million, and $502,000, respectively, of MSRs relating to loans sold with servicing retained. No MSRs were purchased in those periods. Amortization of MSRs for the years ended December 31, 2007, 2006 and 2005, was $758,000, $518,000, and $507,000, 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. MSRs generally are adversely affected by higher levels of current or anticipated prepayments resulting from decreasing interest rates. At December 31, 2007, MSRs were carried at a value of $2.8 million, net of amortization.

Asset Quality

Classified Assets: State and federal regulations require that the Banks review and classify their problem assets on a regular basis. In addition, in connection with examinations of insured institutions, state and federal examiners have authority to identify problem assets and, if appropriate, require them to be classified. Banner Bank’s Credit Policy Division reviews detailed information with respect to the composition and performance of the loan portfolios, including information on risk concentrations, delinquencies and classified assets for both Banner Bank and Islanders Bank. The Credit Policy Division approves all recommendations for new classified assets or changes in classifications, and develops and monitors action

plans to resolve the problems associated with the assets. The Credit Policy Division also approves recommendations for establishing the appropriate level of the allowance for loan losses. Significant problem loans are transferred to Banner Bank's Special Assets Department for resolution or collection activities. The Banks' and Banner Corporation's Boards of Directors are given a detailed report on classified assets and asset quality at least quarterly.

For additional information with respect to asset quality and non-performing loans, see Item 7, "Management's Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2007 and 2006—Asset Quality," and Table 10 contained therein.

Allowance for Loan Losses: In originating loans, we recognize that losses will be experienced and that the risk of loss will vary with, among other things, the type of loan being made, the creditworthiness of the borrower over the term of the loan, general economic conditions and, in the case of a secured loan, the quality of the security for the loan. As a result, we maintain an allowance for loan losses consistent with the generally acceptable accounting principles (GAAP) guidelines. We increase our allowance for loan losses by charging provisions for possible loan losses against our income. The allowance for losses on loans is maintained at a level which, in management's judgment, is sufficient to provide for estimated losses based on evaluating known and inherent risks in the loan portfolio and upon continuing analysis of the factors underlying the quality of the loan portfolio. At December 31, 2007, we had an allowance for loan losses of $46 million, which represented 1.20% of net loans and 108% of non-performing loans compared to 1.20% and 253%, respectively, at December 31, 2006. For additional information concerning our allowance for loan losses, see Item 7, "Management's Discussion and Analysis of Financial Condition—Comparison of Results of Operations for the Years Ended December 31, 2007 and 2006—Provision and Allowance for Loan Losses," and Tables 11 and 12 contained therein.

Investment Activities

Under Washington state law, banks are permitted to invest in various types of marketable securities. Authorized securities include but are not limited to U.S. Treasury obligations, securities of various federal agencies (including government-sponsored enterprises), mortgage-backed securities, certain certificates of deposit of insured banks and savings institutions, bankers' acceptances, repurchase agreements, federal funds, commercial paper, corporate debt and equity securities and obligations of states and their political subdivisions. Our investment policies are designed to provide and maintain adequate liquidity and to generate favorable rates of return without incurring undue interest rate or credit risk. Our policies generally limit investments to U.S. Government and government agency (including government-sponsored entities) securities, municipal bonds, certificates of deposit, marketable corporate debt obligations and mortgage-backed securities. Investment in mortgage-backed securities may include those issued or guaranteed by Freddie Mac, Fannie Mae, Government National Mortgage Association (Ginnie Mae or GNMA) and privately-issued mortgage-backed securities that have an AA credit rating or higher, as well as collateralized mortgage obligations (CMOs). A high credit rating indicates only that the rating agency believes there is a low risk of loss or default. To the best of our knowledge, we do not have any investments in mortgage-backed securities, collateralized debt obligations or structured investment vehicles that have a meaningful exposure to sub-prime mortgages. However, all of our investment securities, including those that have high credit ratings, are subject to market risk in so far as a change in market rates of interest or other conditions may cause a change in an investment's earning performance and/or market value.

At December 31, 2007, our consolidated investment portfolio totaled $256 million and consisted principally of U.S. Government agency obligations, mortgage-backed securities, municipal bonds, corporate debt obligations, and stock of Fannie Mae and Freddie Mac. From time to time, investment levels may be increased or decreased depending upon yields available on investment alternatives, and management's projections as to the demand for funds to be used in loan originations, deposits and other activities. During the year ended December 31, 2007, investments and securities decreased by $18 million. (See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of

Operation; Recent Developments and Significant Events.") During the year ended December 31, 2007, holdings of mortgage-backed securities decreased $50 million to $100 million, U.S. Treasury and agency obligations increased $3 million to $30 million, corporate and other securities increased $23 million to $72 million, and municipal bonds decreased $7 million to $54 million.

For detailed information on our investment securities, see Item 7, "Management's Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2007 and 2006—Investments," and Tables 1, 2, 3 and 4 contained therein.

Off-Balance-Sheet Derivatives: Derivatives include "off-balance-sheet" financial products whose value is dependent on the value of an underlying financial asset, such as a stock, bond, foreign currency, or a reference rate or index. Such derivatives include "forwards," "futures," "options" or "swaps." We generally have not invested in "off-balance-she derivative instruments, although investment policies authorize such investments. However, through our acquisition of F&M we became a party to approximately $23.0 million ($20.4 million as of December 31, 2007) 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. Also, as a part of mortgage banking activities, we issue "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 and as a result are accounted for as such in accordance with SFAS No. 133, as amended. Accordingly, on December 31, 2007, we recorded an asset of $8,000 and a liability of $8,000, representing the estimated market value of those commitments. On December 31, 2007, we had no other investment related off-balance-sheet derivatives.

Deposit Activities and Other Sources of Funds

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

We compete with other financial institutions and financial intermediaries in attracting deposits. There is strong competition for transaction balances and savings deposits from commercial banks, credit unions and nonbank corporations, such as securities brokerage companies, mutual funds and other diversified companies, some of which have nationwide networks of offices. Much of the focus of our recent branch expansion, relocations and renovation has been directed toward attracting additional deposit customer relationships and balances, and we have enjoyed strong deposit growth in recent years. In addition, our electronic banking activities including debit card and automated teller machine (ATM) programs, online Internet banking services and, most recently, customer remote deposit capabilities are all directed at providing products and services that enhance customer relationships and result in growing deposit balances. Growing deposits is a fundamental element of our core business strategies.

Deposit Accounts: We generally attract deposits from within our primary market areas by offering a broad selection of deposit instruments, including demand checking accounts, negotiable order of withdrawal (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. In determining the terms of deposit accounts, we consider current market interest rates, profitability to us, matching deposit and loan products and customer preferences and concerns. At December 31, 2007, we had $3.6 billion of deposits, including $1.8 billion of transaction and savings accounts and $1.8 billion in time deposits. For additional information concerning our deposit accounts, see Item 7, “Management’s Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2007 and 2006—Deposit Accounts.” See also Table 7 contained therein, which sets forth the balances of deposits in the various types of accounts offered by us, and Table 8, which sets forth the amount of our certificates of deposit greater than $100,000 by time remaining until maturity as of December 31, 2007.

Borrowings: While deposits are the primary source of funds for our lending and investment activities and for its general business purposes, we also use borrowings to supplement our supply of lendable funds, to meet deposit withdrawal requirements and to more efficiently leverage our capital position. The FHLB-Seattle serves as our primary borrowing source. The FHLB-Seattle provides credit for member financial institutions such as Banner Bank and Islanders Bank. As members, the Banks are required to own capital stock in the FHLB-Seattle and are authorized to apply for advances on the security of that stock and certain of their mortgage loans and securities provided certain credit worthiness standards have been met. Limitations on the amount of advances are based on the financial condition of the member institution and the adequacy of collateral pledged to secure the credit. At December 31, 2007, we had $167 million of combined borrowings from the FHLB-Seattle at a weighted average rate of 4.20%. At that date, Banner Bank had been authorized by the FHLB-Seattle to borrow up to $781 million under a blanket floating lien security agreement, while Islanders Bank was approved to borrow up to $23 million under a similar agreement. The Banks also have access to additional short-term funds through $115 million in commercial bank credit lines. At December 31, 2007, there was no outstanding balance on these commercial banking credit lines. For additional information concerning our borrowings from the FHLB-Seattle, see Item 7, “Management’s Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2007 and 2006—Borrowings,” Table 9 contained therein, and Note 15 of the Notes to the Consolidated Financial Statements.

We issue retail repurchase agreements, generally due within 90 days, as an additional source of funds, primarily in connection with cash management services provided to our larger deposit customers. At December 31, 2007, we had issued retail repurchase agreements totaling $92 million, with a weighted average interest rate of 3.34%, which were secured by a pledge of certain mortgage-backed securities with a market value of $96 million.

We also may borrow funds through the use of secured wholesale repurchase agreements with securities brokers. However, we did not have any wholesale repurchase borrowings at December 31, 2007. In these instances, the broker holds our investment securities while we continue to receive the principal and interest payments from the securities.

In addition to our borrowings, we have also issued $120 million of trust preferred securities (TPS). The TPS were issued in 2002, 2003, 2004, 2005, 2006 and 2007 by special purpose business trusts formed by Banner Corporation and were sold in private offerings to pooled investment vehicles. The junior subordinated debentures associated with the TPS have been recorded as liabilities on our Consolidated Statements of Financial Condition; however, at December 31, 2007, all of the TPS qualify as Tier 1 capital for regulatory capital purposes. We have invested a significant portion of the proceeds from the issuance of the TPS as additional paid in capital at Banner Bank. For additional information about deposits and other sources of funds, see Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources,” and Notes 14, 15 and 16 of the Notes to the Consolidated Financial Statements contained in Item 8.

Personnel

As of December 31, 2007, we had 1,092 full-time and 86 part-time employees. Banner Corporation has no employees except for those who are also employees of Banner Bank, its subsidiaries, and Islanders Bank. The employees are not represented by a collective bargaining unit. We believe our relationship with our employees is good.

Taxation

Federal Taxation

General: For tax reporting purposes, we report our income on a calendar year basis using the accrual method of accounting on a consolidated basis. We are subject to federal income taxation in the same manner as other corporations with some exceptions, including particularly the reserve for bad debts discussed below. The following discussion of tax matters is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to us. Reference is made to Note 17 of the Notes to the Consolidated Financial Statements contained in Item 8 of this Form 10-K for additional information concerning the income taxes payable by us.

Provisions of the Small Business Job Protection Act of 1996 (the Job Protection Act) significantly altered our tax bad debt deduction method and the circumstances that would require a tax bad debt reserve recapture. Prior to enactment of the Job Protection Act, savings institutions

(Banner Bank was previously chartered as a savings institution) were permitted to compute their tax bad debt deduction through use of either the reserve method or the percentage of taxable income method. The Job Protection Act repealed both of these methods for large savings institutions and allows bad debt deductions based only on actual current losses. While repealing the reserve method for computing tax bad debt deductions, the Job Protection Act allowed savings institutions to retain their existing base year bad debt reserves but required that reserves in excess of the balance at December 31, 1987, be recaptured into taxable income over six years. The reserves in excess of the base year (December 31, 1987) had been fully recaptured into taxable income as of December 31, 2003.

The base year reserve is recaptured into taxable income only in limited situations, such as in the event of certain excess distributions, complete liquidation or disqualification as a bank. None of the limited circumstances requiring recapture are contemplated by us. The amount of our tax bad debt reserves subject to recapture in these circumstances was approximately $5.3 million at December 31, 2007. As a result of the remote nature of events that may trigger the recapture provisions, no tax liability has been established in the accompanying Consolidated Financial Statements.

State Taxation

Washington Taxation: We are subject to a Business and Occupation (B&O) tax which is imposed under Washington law at the rate of 1.50% of gross receipts; however, interest received on loans secured by mortgages or deeds of trust on residential properties, residential mortgage-backed securities, and certain U.S. Government and agency securities is not subject to such tax. Our B&O tax expense was $2.0 million, $1.5 million and $1.3 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Oregon and Idaho Taxation: Corporations with nexus in the states of Oregon and Idaho are subject to a corporate level income tax. Our operations in those states resulted in corporate income taxes of approximately $740,000, $587,000 and $98,000 (net of federal tax benefit) for the years ended December 31, 2007, 2006 and 2005, respectively. For 2005, corporate income taxes for Oregon were reduced approximately $51,000 due to a one-time biannual state credit that is not guaranteed to be repeated. In addition, for 2005 our Oregon and Idaho taxes also decreased as a result of the overall decrease in pre-tax book income due to balance-sheet restructuring transactions. As our operations in these states increase, the state income tax provision will have an increasing effect on our effective tax rate and results of operations.

Environmental Regulation

Our business is affected from time to time by federal and state laws and regulations relating to hazardous substances. Under the federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), owners and operators of properties containing hazardous substances may be liable for the costs of cleaning up the substances. CERCLA and similar state laws can affect us both as an owner of branches and other properties used in our business and as a lender holding a security interest in property which is found to contain hazardous substances. While CERCLA contains an exemption for holders of security interests, the exemption is not available if the holder participates in the management of a property, and some courts have broadly defined what constitutes participation in management of property. Moreover, CERCLA and similar state statutes can affect our decision whether or not to foreclose on a property. Before foreclosing on commercial real estate, our general policy is to obtain an environmental report, thereby increasing the costs of foreclosure. In addition, the existence of hazardous substances on a property securing a troubled loan may cause us to elect not to foreclose on the property, thereby reducing our flexibility in handling the loan.

Competition

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

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

Regulation

Banner Bank and Islanders Bank

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

Federal and state banking laws and regulations govern all areas of the operation of the Banks, including reserves, loans, investments, deposits, capital, issuance of securities, payment of dividends and establishment of branches. Federal and state bank regulatory agencies also have the general authority to limit the dividends paid by insured banks and bank holding companies if such payments should be deemed to constitute an

unsafe and unsound practice. The respective primary federal regulators of Banner Corporation, Banner Bank and Islanders Bank have authority to impose penalties, initiate civil and administrative actions and take other steps intended to prevent banks from engaging in unsafe or unsound practices.

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

Deposit Insurance: The FDIC is an independent federal agency that insures the deposits, up to applicable limits, of depository institutions. As insurer of the Banks' deposits, the FDIC has examination, supervisory and enforcement authority over Banner Bank and Islanders Bank.

The deposits of the Banks are insured up to applicable limits by the Deposit Insurance Fund, or DIF, which is administered by the FDIC. The FDIC insures deposits up to the applicable limits and this insurance is backed by the full faith and credit of the United States government. As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of and to require reporting by institutions insured by the FDIC. It also may prohibit any institution insured by the FDIC from engaging in any activity determined by regulation or order to pose a serious risk to the institution. The FDIC also has the authority to initiate enforcement actions and may terminate the deposit insurance if it determines that an institution has engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

Under regulations effective January 1, 2007, the FDIC adopted a new risk-based premium system that provides for quarterly assessments based on an insured institution's ranking in one of four risk categories based upon supervisory and capital evaluations. Well-capitalized institutions (generally those with capital adequacy, asset quality, management, earnings, liquidity and sensitivity to market risk, or "CAMELS," composite ratings of 1 or 2) are grouped in Risk Category I and assessed for deposit insurance at an annual rate between five and seven basis points. The assessment rate for an individual institution is determined according to a formula based on a weighted average of the institution's individual CAMELS component ratings and either five financial ratios or, in the case of an institution with assets of $10.0 billion or more, the average ratings of its long-term debt. Institutions in Risk Categories II, III and IV are assessed at annual rates of 10, 28, and 43 basis points, respectively. Further, the FDIC issued one-time assessment credits that could be used to offset this new risk-based expense. Banner Bank's total credits were utilized against 2007 assessments and covered the majority of those assessments. Banner Bank does not have any remaining credits to offset assessments in 2008. Islanders Bank's total credits covered all of its 2007 assessments and are expected to cover one additional quarter in 2008. Absent those credits for most of 2008, even without any increases in the assessment rate, the Company's earnings will be materially affected by the addition of FDIC expenses.

Insured institutions are required to pay a Financing Corporation assessment in order to fund the interest on bonds issued to resolve thrift failures in the 1980s. For the semi-annual period ended December 31, 2007, the Financing Corporation assessment equaled 1.14 basis points for each $100 in domestic deposits. These assessments, which may be revised based upon the level of DIF deposits, will continue until the bonds mature in the years 2017 through 2019. For 2007, the Banks incurred $398,000 in FICO assessments.

The FDIC may terminate the deposit insurance of any insured depository institution if it determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by an agreement with the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent

termination of insurance if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as determined by the FDIC. Management is aware of no existing circumstances which would result in termination of the deposit insurance of either Banner Bank or Islanders Bank.

Prompt Corrective Action: Federal statutes establish a supervisory framework based on five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. An institution's category depends upon where its capital levels are in relation to relevant capital measures, which include a risk-based capital measure, a leverage ratio capital measure and certain other factors. The federal banking agencies have adopted regulations that implement this statutory framework. Under these regulations, an institution is treated as well capitalized if its ratio of total capital to risk-weighted assets is 10% or more, its ratio of core capital to risk-weighted assets is 6% or more, its ratio of core capital to 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 Tier 1 risk-based capital 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 Bank to comply with applicable capital requirements would, if unremedied, result in restrictions on its activities and lead to enforcement actions, including, but not limited to, the issuance of a capital directive to ensure the maintenance of required capital levels. Banking regulators will take prompt corrective action with respect to depository institutions that do not meet minimum capital requirements. Additionally, approval of any regulatory application filed for their review may be dependent on compliance with capital requirements.

At December 31, 2007, both Banner Bank and Islanders Bank were categorized as "well capitalized" under the prompt corrective action regulations of the FDIC.

Capital Requirements: Federally insured financial institutions, such as Banner Bank and Islanders Bank, are required to maintain a minimum level of regulatory capital. 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 limited to 100% of Tier 1 capital, includes such items as qualifying general loan loss reserves, cumulative perpetual preferred stock, mandatory convertible debt, term subordinated debt and limited life preferred stock; however, the amount of term subordinated debt and intermediate term preferred stock (original maturity of at least five years but less than 20 years) that may in included in Tier 2 capital 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. At December 31, 2007, Banner Bank and Islanders Bank had Tier 1 leverage capital ratios of 8.87% and 11.01%, respectively. 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 based on the relative risk of the category. In addition, certain off-balance-sheet items are converted to balance-sheet credit equivalent amounts, and each amount is then assigned to one of the four categories. Under the guidelines, the ratio of total capital (Tier 1 capital plus Tier 2 capital) to risk-weighted assets must be at least 8%, and the ratio of Tier 1 capital to risk-weighted assets must be at least 4%. In evaluating the adequacy of a bank's capital, the FDIC may also consider other factors that may affect the bank's financial condition. Such factors may include interest rate risk exposure, liquidity, funding and market risks, the quality and level of earnings, concentration of credit risk, risks arising from nontraditional activities, loan and investment quality, the effectiveness of loan and investment policies, and management's ability to monitor and control financial operating risks. At December 31, 2007, Banner Bank and Islanders Bank had Tier 1 risk-based capital ratios of 9.30% and 12.57%, respectively, and total risk-based capital ratios of 10.44% and 13.59%, respectively.

The Washington Department of Financial Institutions requires that net worth equal at least 5% of total assets. Intangible assets must be deducted from net worth and assets when computing compliance with this requirement. At December 31, 2007, Banner Bank had a net worth of 8.47% of total assets under this standard, while Islanders Bank had a similarly calculated net worth of 10.97%.

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

We believe that, under the current regulations, Banner Bank and Islanders Bank exceed their minimum capital requirements. However, events beyond the control of the Banks, such as weak or depressed economic conditions in areas where they have most of their loans, could adversely affect future earnings and, consequently, the ability of the Banks to meet their capital requirements. For additional information concerning Banner Bank's and Islanders Bank's capital, see Note 21 of the Notes to the Consolidated Financial Statements.

Standards for Safety and Soundness: The federal banking regulatory agencies have prescribed, by regulation, guidelines for all insured depository institutions relating to internal controls, information systems and internal audit systems; loan documentation; credit underwriting; interest rate risk exposure; asset growth; asset quality; earnings; and compensation, fees and benefits. The guidelines set forth the safety and soundness standards that the federal

banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. If the FDIC determines that an institution fails to meet any of these guidelines, it may require an institution to submit to the FDIC an acceptable plan to achieve compliance. We believe that at December 31, 2007, Banner Bank and Islanders Bank met all of the FDIC guidelines.

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

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

Federal Reserve System: The Federal Reserve Board requires, under Regulation D, reserves on all depository institutions that maintain transaction accounts or nonpersonal time deposits. These reserves may be in the form of cash or non-interest-bearing deposits with the regional Federal Reserve Bank. NOW accounts and other types of accounts that permit payments or transfers to third parties fall within the definition of transaction accounts and are subject to Regulation D reserve requirements, as are any nonpersonal time deposits at a bank. Under Regulation D, at the end of 2007, an institution was required to establish reserves equal to 3% of the first $43.9 million of transaction accounts, of which the

first $9.3 million was exempt, and 10% of the remainder. Similarly, Islanders Bank was also required to establish reserves equal to 3% of the first $45.8 million of transaction accounts, of which the first $8.5 million was exempt, and 10% of the remainder. Currently there is no reserve requirement on nonpersonal time deposits. As of December 31, 2007, the Banks met their reserve requirements.

Affiliate Transactions: Banner Corporation, Banner Bank and Islanders Bank are separate and distinct legal entities. Various legal limitations restrict the Banks from lending or otherwise supplying funds to us (an “affiliate”), generally limiting such transactions with the affiliate to 10% of the Bank’s capital and surplus and limiting all such transactions to 20% of the Bank’s capital and surplus and requiring eligible collateral to secure a loan to an affiliate. Such transactions, including extensions of credit, sales of securities or assets and provision of services, also must be on terms and conditions consistent with safe and sound banking practices, including credit standards that are substantially the same or at least as favorable to Banner Bank or Islanders Bank as those prevailing at the time for transactions with unaffiliated companies.

Federally insured banks are subject, with certain exceptions, to certain restrictions on extensions of credit to their parent holding companies or other affiliates, on investments in the stock or other securities of affiliates and on the taking of such stock or securities as collateral from any borrower. In addition, such banks are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit or the providing of any property or service.

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

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

Privacy Standards: On November 12, 1999, the Gramm-Leach-Bliley Financial Services Modernization Act of 1999 (“GLBA”) was signed into law. The purpose of this legislation is to modernize the financial services industry by establishing a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms and other financial service providers.

Banner Bank and Islanders Bank are subject to FDIC regulations implementing the privacy protection provisions of the GLBA. These regulations require the Banks to disclose their privacy policy, including identifying with whom it shares “non-public personal information,” to customers at the time of establishing the customer relationship and annually thereafter.

The regulations also require the Banks to provide their customers with initial and annual notices that accurately reflect their privacy policies and practices. In addition, the Banks are required to provide customers with the ability to

"opt-out" of having the Banks share their non-public personal information with unaffiliated third parties before they can disclose such information, subject to certain exceptions.

The Banks are subject to regulatory guidelines establishing standards for safeguarding customer information. These regulations implement certain provisions of the GLBA. The guidelines describe the agencies' expectations for the creation, implementation and maintenance of an information security program, which would include administrative, technical and physical safeguards appropriate to the size and complexity of the institution and the nature and scope of its activities. The standards set forth in the guidelines are intended to insure the security and confidentiality of customer records and information, protect against any anticipated threats or hazards to the security or integrity of such records and protect against unauthorized access to or use of such records or information that could result in substantial harm or inconvenience to any customer.

Anti-Money Laundering and Customer Identification: In response to the terrorist events of September 11, 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "USA Patriot Act") was signed into law on October 26, 2001. The USA Patriot Act gives the federal government new powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing, and broadened anti-money laundering requirements. The Bank Secrecy Act, Title III of the USA Patriot Act, takes measures intended to encourage information sharing among bank regulatory agencies and law enforcement bodies. Further, certain provisions of Title III impose affirmative obligations on a broad range of financial institutions. Title III of the USA Patriot Act and the related FDIC regulations impose the following requirements with respect to financial institutions:

- establishment of anti-money laundering programs;
- establishment of a program specifying procedures for obtaining identifying information from customers seeking to open new accounts, including verifying the identity of customers within a reasonable period of time; establishment of enhanced due diligence policies, procedures and controls designed to detect and report money laundering; and
- prohibitions on correspondent accounts for foreign shell banks and compliance with record keeping obligations with respect to correspondent accounts of foreign banks.

Bank regulators are directed to consider a holding company's effectiveness in combating money laundering when ruling on Bank Holding Company Act and Bank Merger Act applications. Banner Bank's and Islanders Bank's policies and procedures have been updated to reflect the requirements of the USA Patriot Act.

Banner Corporation

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

The Bank Holding Company Act: Under the BHCA, we are supervised by the Federal Reserve. The Federal Reserve has a policy that a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, the Federal Reserve provides that bank holding companies should serve as a source of strength to its subsidiary banks by being prepared to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity, and should maintain the financial flexibility and capital raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company’s failure to meet its obligation to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve to be an unsafe and unsound banking practice or a violation of the Federal Reserve’s regulations or both. We are required to file quarterly and periodic reports with the Federal Reserve and provide additional information as the Federal Reserve may require. The Federal Reserve may examine us, and any of our subsidiaries, and charge us for the cost of the examination. Banner Corporation and any subsidiaries that it may control are considered “affiliates” within the meaning of the Federal Reserve Act, and transactions between Banner Bank and affiliates are subject to numerous restrictions. With some exceptions, Banner Corporation, and its subsidiaries, are prohibited from tying the provision of various services, such as extensions of credit, to other services offered by Banner Corporation, or by its affiliates.

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

Sarbanes-Oxley Act of 2002: The Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley Act) was signed into law on July 30, 2002 in response to public concerns regarding corporate accountability in connection with various accounting scandals. The stated goals of the Sarbanes-Oxley Act are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws.

The Sarbanes-Oxley Act generally applies to all companies that file or are required to file periodic reports with the Securities and Exchange Commission (SEC), under the Securities Exchange Act of 1934 (Exchange Act).

The Sarbanes-Oxley Act includes very specific additional disclosure requirements and new corporate governance rules, requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules. The Sarbanes-Oxley Act represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees. Our policies and procedures have been updated to comply with the requirements of the Sarbanes-Oxley Act.

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

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

Dividends: The Federal Reserve has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses its view that although there are no specific regulations restricting dividend payments by bank holding companies other than state corporate laws, a bank holding company must maintain an adequate capital position and generally should not pay cash dividends unless the company's net income for the past year is sufficient to fully fund the cash dividends and that the prospective rate of earnings appears consistent with the

company's capital needs, asset quality, and overall financial condition. The Federal Reserve policy statement also indicates that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends.

Capital Requirements: The Federal Reserve has established capital adequacy guidelines for bank holding companies that generally parallel the capital requirements of the FDIC for the Banks, although the Federal Reserve regulations provide for the inclusion of certain trust preferred securities for up to 25% of Tier 1 capital in determining compliance with the guidelines. The Federal Reserve regulations provide that capital standards will be applied on a consolidated basis in the case of a bank holding company with $150 million or more in total consolidated assets. The guidelines require that a company's total risk-based capital must equal 8% of risk-weighted assets and one half of the 8% (4%) must consist of Tier 1 (core) capital. As of December 31, 2007, Banner Corporation's total risk-based capital was 11.72% of risk-weighted assets and its Tier 1 (core) capital was 10.58% of risk-weighted assets.

Stock Repurchases: A bank holding company, except for certain "well-capitalized" and highly rated bank holding companies, is required to give the Federal Reserve prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding twelve months, is equal to 10% or more of its consolidated net worth The Federal Reserve may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe or unsound practice or would violate any law, regulation, Federal Reserve order or any condition imposed by, or written agreement with, the Federal Reserve.. For information concerning our repurchase activities during the 2007 fiscal year and for the quarter ended December 31, 2007, see Item 5.

Management Personnel

Executive Officers

The following table sets forth information with respect to the executive officers of Banner Corporation and Banner Bank as of December 31, 2007.

Name	Age	Position with Banner Corporation	Position with Banner Bank
D. Michael Jones	65	President, Chief Executive Officer, Director	President, Chief Executive Officer, Director
Lloyd W. Baker	59	Executive Vice President, Chief Financial Officer	Executive Vice President, Chief Financial Officer
Michael K. Larsen	65		President, Mortgage Division
Cynthia D. Purcell	50		Executive Vice President, Bank Operations
Richard B. Barton	64		Executive Vice President, Chief Credit Officer
Paul E. Folz	53		Executive Vice President, Community Banking

Steven W. Rust	60	Executive Vice President, Chief Information Officer
Douglas M. Bennett	55	Executive Vice President, Real Estate Lending Operations
Tyrone J. Bliss	50	Executive Vice President, Risk Management and Compliance Officer
Gary W. Wagers	47	Executive Vice President Consumer Lending Administration

Biographical Information

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

D. Michael Jones joined Banner Bank in 2002 following an extensive career in banking, finance and accounting. Mr. Jones 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.

Lloyd W. Baker joined First Savings Bank of Washington (now Banner Bank) in 1995 as Asset/Liability Manager and has served as its Chief Financial Officer since 2000. His banking career began in 1972.

Michael K. Larsen joined First Savings Bank of Washington (now Banner Bank) in 1981 and has been Banner Bank's senior real estate lending officer since 1982. He serves as President of the Mortgage Division and as Chairman of the Board of Directors of Community Financial Corporation, a subsidiary of Banner Bank.

Cynthia D. Purcell was formerly the Chief Financial Officer of Inland Empire Bank (now Banner Bank), which she joined in 1981, and has served in her current position since 2000.

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

Paul E. Folz joined Banner Bank in 2002. Mr. Folz, who has 29 years of commercial lending experience, served in his last position before joining Banner Bank as Washington Mutual's Senior Vice President for new market planning and development for the commercial banking division, where he spearheaded the expansion of business banking into new markets. Prior to that position, he served from 1989 as Washington Mutual's Senior Vice President in charge of commercial banking operations in the State of Oregon.

Steven W. Rust joined Banner Bank in October 2005. Mr. Rust brings over 30 years of relevant industry experience to Banner Bank's management team. Prior to joining Banner Bank he was founder and president of InfoSoft Technology, through which he worked for nine years as a technology consultant and interim Chief Information Officer for banks and insurance companies. He worked 19 years with US Bank/West One Bancorp as Senior Vice President & Manager of Information Systems.

Douglas M. Bennett, who joined Banner Bank in 1974, has over 32 years of experience in real estate lending. He has served as a member of Banner Bank's executive management committee since 2004.

Tyrone J. Bliss joined Banner Bank in 2002. Mr. Bliss is a Certified Regulatory Compliance Manager with more than 29 years of commercial banking experience. Prior to joining Banner Bank, his career included senior risk management and compliance positions with Bank of America's Consumer Finance Group, Barnett Banks, Inc., and Florida-based community banks.

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

Corporate Information

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

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Item 1A – Risk Factors

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

The Maturity and Repricing Characteristics of Our Assets and Liabilities are Mismatched and Subject Us to Interest Rate Risk Which Could Adversely Affect Our Net Earnings and Economic Value.

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. Significant changes in market interest rates or errors or misjudgments in our interest rate risk management procedures could have a material adverse effect on our net earnings and economic value. We currently believe that declining interest rates will adversely affect our near-term net earnings.

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 our earnings and underlying economic value. Interest rate risk is determined by the maturity and repricing characteristics of our 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 our 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. 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.

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 and net market value of equity resulting from those movements under different rate environments. We update and prepare our simulation modeling at least quarterly for review by senior management and our 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 market value of our equity could vary substantially if different assumptions were used or if actual experience differs from the assumptions used and, as a result, our interest rate risk management strategies may prove to be inadequate.

See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Market Risk and Asset/Liability Management" for additional information concerning interest rate risk.

Our Loan Portfolio Includes Loans with a Higher Risk of Loss.

We originate construction and land loans, commercial and multifamily mortgage loans, commercial business loans, consumer loans, agricultural mortgage loans and agricultural loans as well as residential mortgage loans primarily within our market areas. Generally, the types of loans other than the residential mortgage loans have a higher risk of loss than the residential mortgage loans. We had approximately $3.3 billion outstanding in these types of higher risk loans at December 31, 2007, which is a significant increase since December 31, 2006. These loans have greater credit risk than residential real estate for the following reasons and the reasons discussed under Item 1, "Business-Lending Activities":

- Construction and Land Loans. This type of lending contains the inherent difficulty in estimating both a property's value at completion of the project and the estimated cost (including interest) of the project. If the estimate of construction cost proves to be inaccurate, we may be required to advance funds beyond the amount originally committed to permit completion of the project. If the estimate of value upon completion proves to be inaccurate, we may be confronted at, or prior to, the maturity of the loan with a project the value of which is insufficient to assure full repayment. In addition, speculative construction loans to a builder are often associated with homes that are not pre-sold, and thus pose a greater potential risk to us than construction loans to individuals on their personal residences. Loans on land under development or held for future construction also poses additional risk because of the lack of income being produced by the property and the potential illiquid nature of the security. These risks can be significantly impacted by supply and demand conditions. As a result, this type of lending often involves the disbursement of substantial funds with repayment dependent on the success of the ultimate project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor to repay principal and interest. During the years ended December 31, 2006 and 2005, we significantly increased our origination of construction and land loans. While new construction loan originations decreased by approximately 35% in 2007, we continue to have a significant investment in construction loan balances.

- Commercial and Multifamily Mortgage Loans. These loans typically involve higher principal amounts than other types of loans, and repayment is dependent upon income being generated from the property securing the loan in amounts sufficient to cover operating expenses and debt service, which may be adversely affected by changes in the economy or local market conditions. Commercial and

multifamily mortgage loans may expose a lender to greater credit risk than loans secured by residential real estate because the collateral securing these loans may not be sold as easily as residential real estate. In addition, many of our commercial and multifamily real estate loans are not fully amortizing and contain large balloon payments upon maturity. Such balloon payments may require the borrower to either sell or refinance the underlying property in order to make the payment.

- Commercial Business Loans. Our commercial loans are primarily made based on the cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The borrowers' cash flow may be unpredictable, and collateral securing these loans may fluctuate in value. Most often, this collateral is accounts receivable, inventory, equipment or real estate. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. Other collateral securing loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business.

- Agricultural Loans. Repayment is dependent upon the successful operation of the business, which is greatly dependent on many things outside the control of either us or the borrowers. These factors include weather, commodity prices, and interest rates among others. Collateral securing these loans may be difficult to evaluate, manage or liquidate and may not provide an adequate source of repayment.

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

For additional information, see Item I, "Business—Lending" and Item 7, "Management's Discussion of Financial Condition and Results of Operations—Asset Quality."

If Our Allowance for Loan Losses Is Not Sufficient to Cover Actual Loan Losses, Our Earnings Could Decrease.

We make various assumptions and judgments about the collectibility of our loan portfolio, including the creditworthiness of or borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we review our loans and the loss and delinquency experience, and evaluate economic conditions. If our assumptions are incorrect, the allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in the need for additions to our allowance. Material additions to the allowance could materially decrease our net income.

In addition, bank regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs. Any increase in our allowance for loan losses or loan charge-offs as required by these regulatory authorities may have a material adverse effect on our financial condition and results of operations.

We May Face Risks with Respect to Our Recent Acquisitions and Future Expansion.

We have recently completed three acquisitions and may acquire other financial institutions or parts of those institutions in the future. We also plan to continue to engage in additional de novo branch expansion. We may also consider and enter into new lines of business or offer new products or services. Acquisitions and mergers involve a number of risks, including:

- the time and costs associated with identifying and evaluating potential acquisitions and merger partners;
- the estimates and judgments used to evaluate credit, operations, management and market risks with respect to the target institution may not be accurate;
- the time and costs of evaluating new markets, hiring experienced local management and opening new offices, and the time lags between these activities and the generation of sufficient assets and deposits to support the costs of the expansion;
- our ability to finance an acquisition and possible dilution to our existing shareholders;
- the diversion of our management's attention to the negotiation of a transaction, and the integration of the operations and personnel of the combining businesses;
- entry into new markets where we lack experience;
- the introduction of new products and services into our business;
- the incurrence and possible impairment of goodwill associated with an acquisition and possible adverse short-term effects on our results of operations; and
- the risk of loss of key employees and customers.

We may incur substantial costs to expand, and we can give no assurance such expansion will result in the levels of profits we seek. There can be no assurance integration efforts for any future mergers or acquisitions will be successful. Also, we may issue equity securities, including common stock and securities convertible into shares of our common stock in connection with future acquisitions, which could cause ownership and economic dilution to our current shareholders and to investors purchasing common stock. There is no assurance that, following any future mergers or acquisition, our integration efforts will be successful or our Company, after giving effect to the acquisition, will achieve profits comparable to or better than our historical experience.

There Is No Assurance that the Change in the Mix of Our Assets and Liabilities Will Improve Our Operating Results.

In addition to lending and deposit gathering activities, we previously emphasized investments in government agency and mortgage-backed securities, funded with wholesale borrowings. This policy was designed to enhance profitability by allowing asset growth with low overhead expense, although securities generally have lower yields than loans, resulting in a lower interest rate spread and lower interest income. In recent years, we have pursued a strategy to change the mix of our assets and liabilities to have proportionately more loans and fewer securities and more customer deposits, particularly transaction and savings deposits, and fewer borrowings. Our implementation of this strategy has included significant loan and deposit growth and was accelerated by a series of balance-sheet restructuring transactions which we executed in the fourth quarter of 2005. While the objective of this strategy, including the balance-sheet restructuring, is to improve our net interest income and net income in future periods through an enhanced net interest margin, there is no assurance that this strategy will succeed. See Item 7, "Management Discussion and Analysis of Financial Condition and Results of Operations," for additional information concerning implementation of this strategy.

If We Are Not Able to Achieve Profitability on New Branches It May Negatively Affect Our Earnings.

We have expanded our presence throughout the market area, and intend to pursue further expansion by opening additional new branches. The profitability of our expansion strategy will depend on whether the income that we generate from the new branches will offset the increased expenses resulting from operating these branches. Largely as a result of this de novo branching strategy, our operating expenses have increased significantly, adversely affecting our operating efficiency. As a result, the efficiency ratio, which is the ratio of non-interest expense to net interest income and other income, is higher than many of our competitor institutions. We expect that it may take a period of time before certain of these branches can become profitable, especially in areas in which we do not have an established presence. During this period, the expense of operating these branches may negatively affect our net income.

If External Funds Were Not Available, This Could Adversely Impact Our Growth and Prospects.

We rely on deposits and advances from the FHLB of Seattle and other borrowings to fund our operations. Although we have historically been able to replace maturing deposits and advances if desired, we might not be able to replace such funds in the future if our financial condition or the financial condition of the FHLB of Seattle or market conditions were to change. Although we consider such sources of funds adequate for our liquidity needs, we may seek additional debt in the future to achieve our long-term business objectives. There can be no assurance additional borrowings, if sought, would be available to us or, if available, would be on favorable terms. If additional financing sources are unavailable or not available on reasonable terms, our growth and future prospects could be adversely affected.

Our Growth May Require Us to Raise Additional Capital in the Future, But That Capital May Not Be Available When It Is Needed.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. We anticipate that our existing capital resources will satisfy our capital requirements for the foreseeable future. However, we may at some point need to raise additional capital to support continued growth, both internally and through acquisitions.

Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial performance. Accordingly, we cannot assure you of our ability to raise additional capital if needed or on terms acceptable to us. If we cannot raise additional capital when needed, our ability

to further expand our operations through internal growth and acquisitions could be materially impaired.

Our Profitability Depends Significantly on Economic Conditions in the States of Washington, Oregon and Idaho.

Our success depends primarily on the general economic conditions of the States of Washington, Oregon and Idaho and the specific local markets in which we operate. Unlike larger national or other regional banks that are more geographically diversified, we provide banking and financial services to customers located primarily in these three states. The local economic conditions in our market areas have a significant impact on the demand for our products and services as well as the ability of our customers to repay loans, the value of the collateral securing loans and the stability of our deposit funding sources. Adverse economic conditions unique to these Northwest markets could have a material adverse effect on our financial condition and results of operations. Further, a significant decline in general economic conditions, caused by inflation, recession, acts of terrorism, outbreak of hostilities or other international or domestic occurrences, unemployment, changes in securities markets, increases in credit costs or other factors could impact these state and local markets and, in turn, also have a material adverse effect on our financial condition and results of operations.

During 2007, the housing market in the United States began to experience significant adverse trends, including accelerated price depreciation in some markets and rising delinquency and default rates. As a result of these trends, we saw an increase in delinquency and default rates particularly on construction and land loans in our primary market areas. These trends if they continue or worsen could cause further credit losses and loan loss provisioning and could adversely affect our earnings and financial condition

Strong Competition within Our Market Areas May Limit Our Growth and Profitability.

Competition in the banking and financial services industry is intense. We compete in our market areas with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies, and brokerage and investment banking firms operating locally and elsewhere. Some of these competitors have substantially greater resources and lending limits than we do, have greater name recognition and market presence that benefit them in attracting business, and offer certain services that we do not or cannot provide. In addition, larger competitors may be able to price loans and deposits more aggressively than we do. Our profitability depends upon our continued ability to successfully compete in our market areas. The greater resources and deposit and loan products offered by some of our competitors may limit our ability to increase our interest-earning assets. For additional information see Item 1, "Business-Competition."

The Loss of Key Members of Our Senior Management Team Could Adversely Affect Our Business.

We believe that our success depends largely on the efforts and abilities of our senior management. Their experience and industry contacts significantly benefit us. The competition for qualified personnel in the financial services industry is intense, and the loss of any of our key personnel or an inability to continue to attract, retain and motivate key personnel could adversely affect our business.

We Are Subject to Extensive Government Regulation and Supervision.

We are subject to extensive federal and state regulation and supervision, primarily through Banner Bank and Islanders Bank and certain non-bank subsidiaries. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not shareholders. These regulations affect our lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect us in substantial and unpredictable ways. Such changes could subject us to additional costs, limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on our business, financial condition and results of operations. While we have policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur. See Item 1, "Business-Regulation."

The Level of Our Commercial Real Estate Loan Portfolio May Subject Us to Additional Regulatory Scrutiny.

The FDIC, the Federal Reserve and the Office of the Comptroller of the Currency, have recently promulgated joint guidance on sound risk management practices for financial institutions with concentrations in commercial real estate lending. Under the guidance, a financial institution actively involved in commercial real estate lending should perform a risk assessment to identify concentrations. A financial institution may have a concentration in commercial real estate lending if, among other factors, (i) total reported loans for construction, land development, and other land represent 100% or more of total capital or (ii) total reported loans secured by multifamily and non-farm residential properties, loans for construction, land development and other land and loans otherwise sensitive to the general commercial real estate market, including loans to commercial real estate related entities, represent 300% or more of total capital. Management should also employ heightened risk management practices including board and management oversight and strategic planning, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing. While we believe we have implemented policies and procedures with respect to our commercial real estate loan portfolio consistent with the guidance, bank regulators could require us to implement additional policies and procedures consistent with their interpretation of the guidance which could result in additional costs to us.

Our Information Systems May Experience an Interruption or Breach in Security.

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us

to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

We Rely on Dividends from Subsidiaries for Most of Our Revenue.

Banner Corporation is a separate and distinct legal entity from its subsidiaries. We receive substantially all of our revenue from dividends from our subsidiaries. These dividends are the principal source of funds to pay dividends on our common stock and interest and principal on our debt. Various federal and/or state laws and regulations limit the amount of dividends that Banner Bank, Islanders Bank and certain non-bank subsidiaries may pay to Banner Corporation. Also, our right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. In the event the Banks are unable to pay dividends to Banner Corporation, we may not be able to service debt, pay obligations or pay dividends on Banner Corporation's common stock. The inability to receive dividends from the Banks could have a material adverse effect on our business, financial condition and results of operations. See Item 1, "Business-Regulation."

If We Fail to Maintain an Effective System of Internal Control over Financial Reporting, We May Not Be Able to Accurately Report Our Financial Results or Prevent Fraud, and, as a Result, Investors and Depositors Could Lose Confidence in Our Financial Reporting, Which Could Adversely Affect Our Business, the Trading Price of Our Stock and Our Ability to Attract Additional Deposits.

In connection with the enactment of the Sarbanes-Oxley Act of 2002 ("Act") and the implementation of the rules and regulations promulgated by the SEC, we document and evaluate our internal control over financial reporting in order to satisfy the requirements of Section 404 of the Act. This requires us to prepare an annual management report on our internal control over financial reporting, including among other matters, management's assessment of the effectiveness of internal control over financial reporting and an attestation report by our independent auditors addressing these assessments. If we fail to identify and correct any significant deficiencies in the design or operating effectiveness of our internal control over financial reporting or fail to prevent fraud, current and potential shareholders and depositors could lose confidence in our internal controls and financial reporting, which could adversely affect our business, financial condition and results of operations, the trading price of our stock and our ability to attract additional deposits.

Item 1B – Unresolved Staff Comments

None.

Item 2 – Properties

Banner Corporation maintains its administrative offices and main branch office, which is owned by us, in Walla Walla, Washington. In total, as of December 31, 2007, we have 84 branch offices located in Washington, Oregon and Idaho. Three of those 84 are Islanders Bank branches and 81 are Banner Bank branches. Sixty-two branches are located in Washington, fourteen in Oregon and eight in Idaho. Of those offices, approximately half are owned and the other half are leased facilities. We also have twelve leased locations for loan production offices spread throughout the same three-state area. The lease terms for our branch and loan production offices are not individually material. Lease expirations range from one to 25 years. Administrative support offices are primarily in Washington, where we have 11 facilities, of which we own four and lease seven. Additionally we have one leased administrative support office in Idaho and two in Oregon. In the opinion of management, all properties are adequately covered by insurance, are in a good state of repair and are appropriately designed for their present and future use.

Item 3 – Legal Proceedings

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

There have not been any Internal Revenue Service audits of our federal income tax returns during the past five years. We have not been required to pay any IRS penalties for failing to make disclosures with respect to certain transactions that have been identified by the IRS as abusive or that have a significant tax avoidance purpose.

Item 4 – Submission of Matters to a Vote of Security Holders

None.

PART II

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

Stock Listing

Our common stock is traded on the Nasdaq Global Select Market under the symbol "BANR" and newspaper stock tables list us as "Banner Corp." Stockholders of record at December 31, 2007 totaled 1,367 based upon securities position listings furnished to us by our transfer agent. This total does not reflect the number of persons or entities who hold stock in nominee or "street" name through various brokerage firms. The following tables show the reported high and low closing sale prices of our common stock for the years ended December 31, 2007, 2006 and 2005.

Year Ended December 31, 2007	High	Low	Cash Dividend Declared
First quarter	$ 45.06	$ 39.38	$ 0.19
Second quarter	41.68	34.06	0.19
Third quarter	36.39	28.37	0.19
Fourth quarter	35.83	27.38	0.20

Year Ended December 31, 2006	High	Low	Cash Dividend Declared
First quarter	$ 35.16	$ 31.05	$ 0.18
Second quarter	39.62	33.50	0.18
Third quarter	41.80	37.59	0.18
Fourth quarter	46.63	39.58	0.19

Dividends

Dividend payments by us depend primarily on dividends we receive from Banner Bank and Islanders Bank. Under federal regulations, the dollar amount of dividends the Banks may pay depends upon their capital position and recent net income. Generally, if the Bank satisfies its regulatory capital requirements, it may make dividend payments up to the limits prescribed under state law and FDIC regulations. However, an institution that has converted to a stock form of ownership may not declare or pay a dividend on, or repurchase any of, its common stock if the effect thereof would cause the regulatory capital of the institution to be reduced below the amount required for the liquidation account which was established in connection with the conversion. Under Washington law, we are prohibited from paying a dividend if, as a result of its payment, we would be unable to pay its debts as they become due in the normal course of business, or if our total liabilities would exceed our total assets.

Payments of the distributions on our trust preferred securities from the special purpose subsidiary trusts we sponsored are fully and unconditionally guaranteed by us. The junior subordinated debentures that we have issued to our subsidiary trusts are senior to our shares of common stock. As a result, we must make required payments on the junior subordinated debentures before any dividends can be paid on our common stock and, in the event of our bankruptcy,

dissolution or liquidation, the interest and principal obligations under the junior subordinated debentures must be satisfied before any distributions can be made on our common stock. We may defer the payment of interest on each of the junior subordinated debentures for a period not to exceed 20 consecutive quarters, provided that the deferral period does not extend beyond the stated maturity. During such deferral period, distributions on the corresponding trust preferred securities will also be deferred and we may not pay cash dividends to the holders of shares of our common stock.

Issuer Purchases of Equity Securities

The following table sets forth information for the three months ended December 31, 2007 with respect to repurchases of our outstanding common shares:

Period					Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares that May Yet be Purchased Under the Plan
Beginning	Ending	Total Number of Shares Purchased (1)		Average Price Paid per Share		
October 1, 2007	October 31, 2007	--		--	--	
November 1, 2007	November 30, 2007	57,800		28.68	--	
December 1, 2007	December 31, 2007	357		30.38	--	
Total		58,157	$	45.737	--	750,000(2)

(1) Shares indicated as purchased during the periods presented include 357 shares acquired at current market values as consideration for the exercise of certain fully vested options.

(2) On July 26, 2007, our Board of Directors authorized the repurchase of up to 750,000 shares of our outstanding common stock over the next twelve months. As of December 31, 2007, the Company had repurchased 57,800 shares of stock under this program.

Equity Compensation Plan Information

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

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

	Period Ending					
Index	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07
Banner Corporation	100.00	138.36	175.37	179.81	260.26	172.45
NASDAQ Composite	100.00	150.01	162.89	165.13	180.85	198.60
SNL $1B-$5B Bank Index	100.00	135.99	167.83	164.97	190.90	139.06
SNL NASDAQ Bank Index	100.00	129.08	147.94	143.43	161.02	126.42

*Assumes $100 invested in the Common Stock at the closing price per share and each index on December 31, 2002 and that all dividends were reinvested. Information for the graph was provided by SNL Financial L. C. © 2008.

Item 6 – Selected Consolidated Financial and Other Data

The following condensed consolidated statements of operations and financial condition and selected performance ratios as of December 31, 2007, 2006, 2005, 2004, and 2003 and for the years then ended have been derived from our audited consolidated financial statements. Certain information for prior years has been restated in accordance with the U.S. Securities and Exchange Commission Staff Accounting Bulletin No. 108 which addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements. See Note 2 to the Consolidated Financial Statements and accompanying Notes to the Consolidated Financial Statements contained in Item 8 of this Form 10-K.

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

FINANCIAL CONDITION DATA:					
			At December 31		
(In thousands)	2007	2006	2005	2004	2003
		Restated	Restated	Restated	Restated
Total assets	$ 4,495,141	$ 3,495,566	$ 3,040,555	$ 2,897,067	$ 2,635,313
Loans receivable, net	3,763,790	2,930,455	2,408,833	2,063,238	1,700,865
Cash and securities (1)	354,809	347,410	427,681	649,516	779,472
Deposits	3,620,593	2,794,592	2,323,313	1,925,909	1,670,940
Borrowings	372,039	404,330	459,821	723,842	738,699
Stockholders' equity	$ 437,846	$ 250,607	$ 220,857	$ 214,924	$ 202,087
Shares outstanding	16,266	12,314	12,082	11,857	11,473
Shares outstanding excluding unearned, restricted shares held in ESOP	16,026	12,074	11,782	11,482	11,039

OPERATING DATA:					
			For the Years Ended December 31		
(In thousands)	2007	2006	2005	2004	2003
		Restated	Restated	Restated	Restated
Interest income	$ 295,309	$ 243,019	$ 190,160	$ 156,230	$ 140,441
Interest expense	145,690	116,114	81,377	59,915	59,848
Net interest income before provision loan losses	149,619	126,905	108,783	96,315	80,593
Provision for loan losses	5,900	5,500	4,903	5,644	7,300
Net interest income	143,719	121,405	103,880	90,671	73,293
Mortgage banking operations	6,270	5,824	5,647	5,522	9,447
Gain (loss) on sale of securities	--	65	(7,302)	141	63
	11,574	--	--	--	--

Increase in valuation of financial instruments carried at fair value										
Other operating income		20,739		14,686		12,199		11,305		10,071
Insurance recovery, net proceeds		--		(5,350)		--		--		--
FHLB prepayment penalties		--		--		6,077		--		--
Other operating expenses		127,489		99,731		91,471		79,714		69,876
Income before provision for income taxes		54,813		47,599		16,876		27,925		22,998
Provision for income taxes		17,890		16,055		4,896		8,911		7,129
Net income	$	36,923	$	31,544	$	11,980	$	19,014	$	15,869

PER SHARE DATA:

				At or for the Years Ended December 31						
		2007		2006		2005		2004		2003
				Restated		Restated		Restated		Restated
Net income:										
Basic	$	2.53	$	2.65	$	1.04	$	1.71	$	1.47
Diluted		2.49		2.58		1.00		1.62		1.41
Book value per share (2)		27.32		20.76		18.74		18.72		18.31
Tangible book value per share (2)		18.73		17.75		15.67		15.53		15.00
Cash dividends		0.77		0.73		0.69		0.65		0.61
Dividend payout ratio (basic)		30.43%		27.55%		66.35%		38.01%		41.50%
Dividend payout ratio (diluted)		30.92%		28.29%		69.00%		40.12%		43.26%

(footnotes follow tables)

OTHER DATA:

	At December 31				
	2007	2006	2005	2004	2003
Full time equivalent employees	1,139	898	856	778	705
Number of branches	84	58	57	49	42

KEY FINANCIAL RATIOS:

	At or For the Years Ended December 31				
	2007	2006	2005	2004	2003
		Restated	Restated	Restated	Restated
Performance Ratios:					
Return on average assets (3)	0.91%	0.96%	0.39%	0.69%	0.65%
Return on average equity (4)	10.07	13.29	5.43	9.10	8.11
Average equity to average assets	9.06	7.19	7.23	7.59	8.00
Interest rate spread (5)	3.85	3.97	3.72	3.65	3.47
Net interest margin (6)	3.99	4.08	3.79	3.71	3.53
Non-interest income to average assets	0.95	0.62	0.35	0.62	0.80
Non-interest expense to average assets	3.15	2.86	3.20	2.90	2.86
Efficiency ratio (7)	67.74	64.00	81.75	70.37	69.75
Average interest-earning assets to interest-bearing liabilities	103.52	102.81	102.66	102.92	102.31
Asset Quality Ratios:					
Allowance for loan losses as a percent of total loans at end of period	1.20	1.20	1.27	1.41	1.51
Net charge-offs as a percent of average outstanding loans during the period	0.08	0.03	0.16	0.11	0.47
Non-performing assets as a percent of total assets	0.98	0.43	0.36	1.20	1.20
Ratio of allowance for loan losses to non-performing loans (8)	1.08	2.53	2.96	1.86	0.92
Consolidated Capital Ratios:					
Total capital to risk-weighted assets	11.72	11.80	12.29	12.24	12.77
Tier 1 capital to risk-weighted assets	10.58	9.53	10.17	10.94	11.48
Tier 1 leverage capital to average assets	10.04	8.76	8.59	8.93	8.73

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

(2) Calculated using shares outstanding excluding unearned restricted shares held in ESOP.

(3) Net income divided by average assets

(4) Net income divided by average equity

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

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

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

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

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

Executive Overview

We are 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, subsequent to May 1, 2007, Islanders Bank, a recent acquisition, 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, 2007, its 81 branch offices and 12 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. As of December 31, 2007, we had total consolidated assets of $4.5 billion, total loans of $3.8 billion, total deposits of $3.6 billion and total stockholders' equity of $438 million.

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

Branch expansion has been a significant element in our strategy to grow loans, deposits and customer relationships. Over the past several years, we have invested significantly in expanding our branch and distributions systems with a primary emphasis on expanding our presence in the four largest areas of commerce in the Northwest: the Puget Sound region of Washington and the greater Boise, Idaho, Portland, Oregon, and Spokane, Washington markets. As a result of our aggressive franchise expansion, we have added 18 new branches through acquisitions, opened 21 new branches and relocated eight others in the last three years. In 2007 alone, we opened ten branches, relocated five others and closed three acquisitions. In large part because of this expansion activity, we have experienced loan growth of $1.7 billion and deposit growth of $1.7 billion over the last three-year period. The acquisitions and new branches have increased our presence within desirable markets and allow us to better serve existing and future customers. This emphasis on growth has resulted in an elevated level of operating expenses; however, we believe that over time these new branches should help improve profitability by providing lower cost core deposits which will allow us to proportionately reduce higher cost borrowings as a source of funds. We now have reached our goal in terms of the number of branches required to generate deposit growth sufficient to fund our expected loan growth and produce significant fee generating opportunities. As a result, we plan to open only three additional branches in 2008, a normal level of growth for a bank of our size.

We completed the acquisitions of F&M Bank and San Juan Financial Holding Company effective May 1, 2007, and NCW Community Bank effective October 10, 2007. San Juan Financial Holding Company was merged into Banner Corporation and its wholly owned subsidiary, Islanders Bank, has continued operations as a subsidiary of Banner Corporation. F&M Bank and NCW Community Bank were merged into Banner Bank upon acquisition and now operate under the Banner Bank name. The financial results for the year ended December 31, 2007 include the assets, liabilities and results of operations for all three of the acquired companies from their respective acquisition dates of May 1, 2007 and October 10, 2007.

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, FHLB advances, other borrowings and junior subordinated debentures. 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. As more fully explained below, our net interest income before provision for loan losses increased $22.7 million for the year ended December 31, 2007 to $149.6 million as compared to the prior year, primarily as a result of significant growth in interest-earning assets and interest-bearing liabilities, including growth resulting from the three acquisitions, and as a result of changes in the mix of both interest-earning assets and interest-bearing liabilities.

Our net income also is affected by provisions for loan losses and the level of our other income, including deposit service charges, loan origination and servicing fees, and gains and losses on the sale of loans and securities, as well as our operating expenses and income tax provisions. The provision for loan losses was $5.9 million for the year ended December 31, 2007, an increase of $400,000 compared to the year ended December 1, 2006. The increase in the provision for loan losses in the current year reflects an increase in delinquencies and non-performing loans, balanced against slower growth in the size of the loan portfolio, excluding the effects of the mergers, continuing changes in the loan mix and a modest level of net charge-offs. Other operating income, excluding the fair value adjustments, increased by $6.5 million, or 32%, to $27.0 million for the year ended December 31, 2007 from $20.6 million for the year ended December 31, 2006, primarily as a result of increased deposit fees and other service charges reflecting in part the recent acquisitions. Revenues (net interest income before the provision for loan losses plus other operating income), excluding the gain on sale of securities and fair value adjustments, increased 20% to $176.6 million for the year ended December 31, 2007, compared to $147.4 million for the year ended December 31, 2006. Other operating expenses increased $33.1 million to $127.5 million for the year ended December 31, 2007 from $94.4 million for 2006, an increase of 35% from a year earlier, largely reflecting our continued growth and the effect of our acquisitions. Other operating expenses in the prior year were reduced by a $5.4 million (net of costs) insurance recovery. Without the recovery, those expenses would have been $99.7 million for the year ended December 31, 2006. Excluding the insurance recovery, recurring other operating expenses for the year ended December 31, 2007 would have increased by $27.8 million from $99.7 million in 2006, a 28% increase that was largely driven by the franchise expansion strategy, including the effect of the acquisitions.

Net income increased by $5.4 million to $36.9 million for the year ended December 31, 2007, while earnings from recurring operations (see following paragraph), exclusive of the change in valuation of financial instruments carried at fair value and the 2006 insurance recovery, increased by $1.4 million to $29.5 million, compared to $28.1 million for the year ended December 31, 2006. The modest increase in earnings

from recurring operations despite a much larger earning asset base primarily reflects a moderately narrower net interest margin and a higher level of operating expenses as a result of the new branches and integration activities associated with the acquisitions.

Earnings from recurring operations and other earnings information excluding the change in valuation of financial instruments carried at fair value and the insurance recovery represent non-GAAP (Generally Accepted Accounting Principles) financial measures. Management has presented these non-GAAP financial measures in this discussion and analysis because it believes that they provide more useful and comparative information to assess trends in our core operations. Where applicable, we have also presented comparable earnings information using GAAP financial measures.

We offer a wide range of loan products to meet the demands of our customers; however, we do not now and have not previously engaged in any sub-prime lending. Historically, our lending activities have been primarily directed toward the origination of real estate and commercial loans. Real estate lending activities have been significantly focused on residential construction and first mortgages on owner occupied, one- to four-family residential properties. Our lending activities have also included the origination of multifamily and commercial real estate loans. Our commercial business lending has been directed toward meeting the credit and related deposit needs of various small- to medium-sized business and agri-business borrowers operating in our primary market areas. We have also recently increased our emphasis on consumer lending, although the portion of the loan portfolio invested in consumer loans is still relatively small. While continuing our commitment to construction and residential lending, we expect commercial lending (including commercial real estate, commercial business and agricultural loans) and consumer lending to become increasingly important activities for us.

Deposits, including customer retail repurchase agreements, and loan repayments are the major sources of our funds for lending and other investment purposes. We compete with other financial institutions and financial intermediaries in attracting deposits. There is strong competition for transaction balances and savings deposits from commercial banks, credit unions and nonbank corporations, such as securities brokerage companies, mutual funds and other diversified companies, some of which have nationwide networks of offices. Much of the focus of our recent branch expansion, relocations and renovation has been directed toward attracting additional deposit customer relationships and balances.

We generally attract deposits from within our primary market areas by offering a broad selection of deposit instruments, including demand checking accounts, negotiable order of withdrawal (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. In determining the terms of deposit accounts, we consider current market interest rates, profitability, matching deposit and loan products, and customer preferences and concerns.

Management’s discussion and analysis of results of operations is intended to assist in understanding our financial condition and results of operations. The information contained in this section should be read in conjunction with the Consolidated Financial Statements and accompanying Notes to the Consolidated Financial Statements contained in Item 8 of this Form 10-K.

Critical Accounting Policies

In the opinion of management, the accompanying consolidated statements of financial condition and related interim consolidated statements of income, comprehensive income, changes in stockholders’ equity and cash flows reflect all adjustments (which include reclassification and normal recurring adjustments) that are necessary for a fair presentation in conformity with Generally Accepted Accounting Principles (GAAP). The preparation of financial

statements in conformity with GAAP requires management to make estimates and assumptions that affect amounts reported in the financial statements.

Various elements of our accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. In particular, management has identified several accounting policies that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of our financial statements. These policies relate to (i) the methodology for the recognition of interest income, (ii) determination of the provision and allowance for loan and lease losses and (iii) the valuation of financial assets and liabilities recorded at fair value, goodwill, mortgage servicing rights and real estate held for sale. These policies and judgments, estimates and assumptions are described in greater detail below in Management's Discussion and Analysis and in Note 1 of the Notes to the Consolidated Financial Statements. 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, 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 the results of operations or financial condition. There have been no significant changes in our application of accounting policies since December 31, 2006, except for the adoption of Statements of Financial Accounting Standards (SFAS) Nos. 157 and 159 discussed below. For additional information, see Notes 4 and 9 of the Notes to the Consolidated Financial Statements.

Adoption and Pending Adoption of Recent Accounting Pronouncements

Banner Corporation elected early adoption of SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, and SFAS No. 157, Fair Value Measurements, effective January 1, 2007. SFAS No. 159, which was issued in February 2007, generally permits the measurement of selected eligible financial instruments at fair value at specified election dates. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurement. We made this election to allow more flexibility with respect to the management of our investment securities, wholesale borrowings and interest rate risk position in future periods.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainties in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute 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 derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. On January 1, 2007, we adopted FIN 48. Currently, we are subject to U.S. federal

income tax and income tax of the States of Idaho and Oregon. The years 2004 through 2006 remain open to examination for federal income taxes and State income taxes. As of January 1, 2007 and December 31, 2007, we believe we had insignificant unrecognized tax benefits or uncertain tax positions. In addition, we have no material accrued interest or penalties as of January 1, 2007 or December 31, 2007. It is our policy to record interest and penalties as a component of income tax expense. The amount of interest and penalties for the year ended December 31, 2007 was immaterial. The adoption of this accounting standard did not have a material impact on our Consolidated Financial Statements.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140, Accounting for Transfers of Financial Assets and Extinguishment of Liabilities. The statement specifies under what situations servicing assets and servicing liabilities must be recognized. It requires these assets and liabilities to be initially measured at fair value and specifies acceptable measurement methods subsequent to their recognition. Separate presentation in the financial statements and additional disclosures are also required. This statement became effective January 1, 2007. The adoption of the statement has not had a material effect on our Consolidated Financial Statements.

Comparison of Financial Condition at December 31, 2007 and 2006

General: Total assets increased $1 billion, or 29%, from $3.496 billion at December 31, 2006, to $4.495 billion at December 31, 2007. Recent acquisitions on May 1, 2007 and October 10, 2007 contributed $800 million in assets, while the remaining increase largely resulted from growth in the loan portfolio and was funded primarily by deposit growth. Net loans receivable (gross loans less loans in process, deferred fees and discounts, and allowance for loan losses) increased $833 million, or 28%, from $2.931 billion at December 31, 2006, to $3.764 billion at December 31, 2007. Internal loan growth was substantial and broad-based; however, the portfolio growth largely reflects the $596 million of loans acquired (as of the closing dates of May 1 and October 10, 2007) through the purchases of F&M, SJFHC and NCW. Although internally generated production of new loans declined appreciably in the second half of 2007, we continue to maintain a significant investment in construction and land loans, reflecting a core competency of Banner Bank. Including the effect of the acquisitions, loans to finance the construction of one- to four-family residential real estate increased by $43 million, or 8%, and land and development loans increased by $95 million, or 24%, since December 31, 2006. In addition, and largely reflecting the acquisitions, loans to finance commercial real estate increased by $286 million, or 48%, while loans secured by multi-family real estate increased by $19 million, or 13%. Loan growth also included commercial business loans, which increased by $229 million, or 49%, consumer loans, which increased by $75 million, or 64%, and loans to finance existing one- to four-family residential properties, which increased by $102 million, or 28%, at December 31, 2007 compared to December 31, 2006. By contrast, at December 31, 2007 loans to finance commercial and multifamily construction decreased by $29 million, or 21%, from December 31, 2006.

Securities decreased $18 million, or 6%, from $274 million at December 31, 2006, to $256 million at December 31, 2007, as sales and repayments exceeded purchases and the $34 million added as a result of the acquisitions. Effective January 1, 2007, we elected to reclassify all our securities available for sale to fair value following our adoption of SFAS No. 159. At December 31, 2007, the amortized cost of our securities available for sale, which are carried at fair value, exceeded their fair value by $1.4 million. Property and equipment increased by $40 million to $98 million at December 31, 2007, from $58 million at December 31, 2006. The increase included additional site, construction and equipment costs associated with new facilities recently opened or in progress as part of our continuing branch expansion strategy, and $21 million added through recent acquisitions. We also had an increase of $13 million in bank-owned life insurance, with nearly $2.0 million coming from the growth of cash surrender values on existing policies and the remainder as a result of the acquisitions.

Deposits increased $826 million, or 30%, from $2.795 billion at December 31, 2006, to $3.620 billion at December 31, 2007. The acquisitions of F&M, SJFHC and NCW resulted in the addition of $560 million in total deposits as of the acquisition dates. Non-interest-bearing deposits increased $152 million, or 46%, to $484 million, while interest-bearing deposits increased $674 million, or 27%, to $3.136 billion at December 31, 2007. The aggregate total of transaction and savings accounts, including money market accounts, increased by $534 million, or 43%, to $1.772 billion, reflecting our focused efforts to grow these important core deposits, as well as the effects of the acquisitions. Increasing core deposits is a key element of our expansion strategy, including the recent and planned additions and renovations of branch locations. Reflecting internally generated growth and the effects of the acquisitions, transaction and savings accounts represent 49.0% of total deposits at December 31, 2007, compared to 44.3% a year earlier. FHLB advances decreased $10 million from $177 million at December 31, 2006, to $167 million at December 31, 2007, while other borrowings decreased $11 million to $92 million at December 31, 2007. The decrease in other borrowings reflects an increase of $15 million in retail repurchase agreements that are primarily related to customer cash management accounts, as well as a decrease of $26 million of repurchase agreement borrowings from securities dealers. Junior subordinated debentures decreased by $10 million, primarily reflecting the cumulative fair value adjustments recorded subsequent to the adoption of SFAS 159, as recent changes in credit market conditions had a particularly significant impact on this type of securities.

During the year ended December 31, 2007, we increased our capital by issuing 995,590 new shares of Banner Corporation common stock at an average net price of $37.75 through our Dividend Reinvestment and Direct Stock Purchase and Sale Plan. In addition, we issued a net 81,618 shares in connection with the exercise and forfeiture of vested stock options and grants, and 2,932,471 shares were issued in the acquisitions of F&M, SJFNC and NCW. This stock issuance, combined with the changes in retained earnings as a result of operations and the effects of fair value accounting, net of quarterly dividend distributions, resulted in a $187.2 million increase in stockholders' equity.

Investments: At December 31, 2007, our consolidated investment portfolio totaled $256 million and consisted principally of U.S. Government agency obligations, mortgage-backed and mortgage-related securities, municipal bonds, corporate debt obligations, and Freddie Mac stock. From time to time, our investment levels may be increased or decreased depending upon yields available on investment alternatives and management's projections as to the demand for funds to be used in our loan origination, deposit and other activities. During the year ended December 31, 2007, investment securities decreased by $18 million ($52 million excluding acquisitions) as we redeployed cash flow from securities to fund loan growth and pay down borrowings. Holdings of mortgage-backed securities decreased $50 million and U.S. Treasury and agency obligations increased $3 million. Ownership of corporate and other securities increased $23 million, largely as a result of the purchase of approximately $25 million of trust preferred securities issued by other financial institutions, while municipal bonds increased $7 million.

Mortgage-Backed Obligations: At December 31, 2007, our mortgage-backed and mortgage-related securities totaled $100 million, or 39% of the consolidated investment portfolio. Included within this amount were collateralized mortgage obligations (CMOs) with a net carrying value of $23 million. The estimated fair value of the mortgage-backed and mortgage-related securities at December 31, 2007 was $100 million, which is $1 million less than the amortized cost of $101 million. At December 31, 2007, our portfolio of mortgage-backed and mortgage-related securities had a weighted average coupon rate of 4.83%. At that date, 71% of the mortgage-backed and mortgage-related securities pay interest at a fixed rate and 29% pay at an adjustable-interest rate. The estimated weighted average remaining life of the portfolio was 4.5 years. We do not believe that any of our mortgage-backed obligations had a meaningful exposure to sub-prime mortgages.

Municipal Bonds: Our tax-exempt municipal bond portfolio at December 31, 2007 totaled $50 million at estimated fair value ($50 million at amortized cost), and was comprised of general obligation bonds (i.e., backed by the general credit of the issuer) and revenue bonds (i.e., backed by revenues from the specific project being financed) issued by cities and counties and various housing authorities, and hospital, school, water and sanitation districts located in the states of Washington, Oregon and Idaho, our primary service area. We also had taxable bonds in our municipal bond portfolio, which at December 31, 2007 totaled $5 million at estimated fair value ($5 million at amortized cost). At December 31, 2007, general obligation bonds and revenue bonds had total estimated fair values of $38 million and $17 million, respectively. Many of our qualifying municipal bonds are not rated by a nationally recognized credit rating agency due to the smaller size of the total issuance and a portion of these bonds have been acquired through direct private placement by the issuers. At December 31, 2007, our municipal bond portfolio had a weighted average maturity of approximately 10.7 years, an average coupon rate of 4.78% and an average taxable equivalent yield of 6.19%. The largest principal balance of any security in the municipal portfolio was a general obligation bond issued by the Public Hospital District No. 1, Columbia and Walla Walla Counties, Washington, with an amortized cost of $5.4 million and a fair value of $5.4 million.

Corporate Bonds: Our corporate bond portfolio, which totaled $65 million at fair value ($66 million at amortized cost) at December 31, 2007, was comprised principally of intermediate-term fixed-rate securities issued by a finance company and long-term fixed- and adjustable-rate capital securities issued by financial institutions. At December 31, 2007, the portfolio had a weighted average maturity of 26.8 years and a weighted average coupon rate of 6.73%.

U.S. Government and Agency Obligations: Our portfolio of U.S. Government and agency obligations had a fair value of $30 million ($30 million at amortized cost) at December 31, 2007, a weighted average maturity of 3.5 years and a weighted average coupon rate of 4.85%. Most of the U.S. Government and agency obligations we own include call features which allow the issuing agency the right to call the securities at various dates prior to the final maturity.

The following tables set forth certain information regarding carrying values and percentage of total carrying values of our consolidated portfolio of securities at fair value and securities available for sale, carried at estimated fair market value, and held to maturity, carried at amortized cost (dollars in thousands):

Table 1: Securities At Fair Value and Securities Available for Sale

	Securities At Fair Value December 31		Securities Available for Sale At December 31					
	2007		2006		2005		2004	
	Carrying Value	Percent of Total	Carrying Value	Percent of Total	Carrying Value	Percent of Total	Carrying Value	Percentof Total
U.S. Government Treasury and agency obligations	$ 30,015	14.7%	$ 27,295	12.1%	$ 24,921	9.6%	$ 139,872	25.6%
Municipal bonds:								
Taxable	2,043	1.0	4,555	2.0	5,334	2.0	5,565	1.0
Tax exempt	7,180	3.5	3,044	1.4	3,323	1.3	4,526	0.8
Corporate bonds	56,125	27.7	37,382	16.5	44,115	17.0	61,993	11.3
Mortgage-backed or related securities:								
Mortgage-backed securities								
GNMA	2,732	1.4	--	--	--	--	8,078	1.5
FHLMC	32,380	16.0	37,412	16.5	43,613	16.8	63,532	11.6
FNMA	41,377	20.4	42,943	19.0	50,054	19.2	88,967	16.2
Other	--	--	--	--	--	--	7,911	1.4
Total mortgage-backed securities	76,489	37.8	80,355	35.5	93,667	36.0	168,488	30.7
Mortgage-related securities								
CMOs–agency backed	23,286	11.5	43,998	19.5	54,936	21.0	111,601	20.4
CMOs–non-agency	--	0.0	25,814	11.4	30,303	11.6	51,853	9.5
Total mortgage-related securities	23,286	11.5	69,812	30.9	85,239	32.6	163,454	29.9
Total	99,775	49.3	150,167	66.4	178,906	68.6	331,942	60.6
Equity securities	7,725	3.8	3,710	1.6	3,685	1.5	3,937	0.7
Total securities available for sale	$ 202,863	100.0%	$ 226,153	100.0%	$ 260,284	100.0%	$ 547,835	100.0%

Table 2: Securities Held to Maturity											
Municipal bonds:											
Taxable	$	2,565	4.8%	$	99	0.2%	$	1,611	3.2%	$	1,647	3.3%
Tax exempt		42,701	79.8		39,773	83.1		41,521	81.5		40,276	80.7
Corporate bonds		8,250	15.4		8,000	16.7		7,750	15.2		7,750	15.5
Mortgage-backed securities:												
FHLMC certificates		--	--		--	--		--	--		--	--
FNMA certificates		--	--		--	--		67	0.1		241	0.5
Total mortgage-backed securities		--	--		--	--		67	0.1		241	0.5
Total	$	53,516	100.0%	$	47,872	100.0%	$	50,949	100.0%	$	49,914	100.0%
Estimated market value	$	54,721		$	49,008		$	52,398		$	51,437	

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

Table 3: Securities–At Fair Value—Maturity/Repricing and Rates

	Securities at Fair Value at December 31, 2007											
	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	Weighted Average Yield	Carrying Value	Weighted Average Yield (1)
U.S. Government Treasury and agency obligations:												
Fixed-rate	$ --	--%	$ 29,808	4.84%	$ --	--%	$ 207	5.21%	$ --	--%	$ 30,015	4.84%
Adjustable-rate	--	--	--	--	--	--	--	--	--	--	--	--
	--	--	29,808	4.84	--	--	207	5.21	--	--	30,015	4.84
Municipal bonds:												
Taxable	561	6.35	773	6.88	317	4.57	392	5.00	--	--	2,043	6.02
Tax exempt	1,087	4.19	4,524	4.26	699	4.10	870	4.07	--	--	7,180	4.21
	1,648	4.93	5,297	4.64	1,016	4.25	1,262	4.36	--	--	9,223	4.61
Corporate bonds:												
Fixed-rate	--	--	--	--	--	--	--	--	--	--	--	--
Adjustable-rate	56,125	6.92	--	--	--	--	--	--	--	--	56,125	6.92
	56,125	6.92	--	--	--	--	--	--	--	--	56,125	6.92
Mortgage-backed obligations:												
Fixed-rate	--	--	--	--	6,841	4.87	28,045	4.68	12,805	5.38	47,691	4.90
Adjustable-rate	2,732	4.11	2,515	5.04	23,551	4.67	--	--	--	--	28,798	4.65
	2,732	4.11	2,515	5.04	30,392	4.72	28,045	4.68	12,805	5.38	76,489	4.80
Mortgage-related obligations:												
Fixed-rate	--	--	--	--	4,740	4.41	8,173	4.76	10,373	4.26	23,286	4.47
Adjustable-rate	--	--	--	--	--	--	--	--	--	--	--	--
	--	--	--	--	4,740	4.41	8,173	4.76	10,373	4.26	23,286	4.47
Total mortgage-backed or related obligations	2,732	4.11	2,515	5.04	35,132	4.67	36,218	4.70	23,178	4.88	99,775	4.72
Equity securities	7,725	--	--	--	--	--	--	--	--	--	7,725	--
Total securities available for	$ 68,230	5.98	$ 37,620	4.83	$ 36,148	4.66	$ 37,687	4.51	$ 23,178	4.88	$ 202,863	5.16

sale—carrying value						
Total securities available for sale—amortized cost	$ 68,768	$ 37,419	$ 36,412	$ 38,025	$ 23,655	$ 204,279

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

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

Table 4: Securities–Held to Maturity—Maturity/Repricing and Rates

	Held to Maturity at December 31, 2007											
	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	Weighted Average Yield	Carrying Value	Weighted Average Yield (1)
Municipal bonds:												
Taxable	$ --	--%	$ 1,465	5.38%	$ --	--%	$ --	--%	$ 1,100	5.72%	$ 2,565	5.53%
Tax exempt	507	2.99	7,547	4.09	11,467	4.32	14,844	4.61	8,336	5.36	42,701	4.57
	507	2.99	9,012	4.30	11,467	4.32	14,844	4.61	9,436	5.40	45,266	4.62
Corporate bonds:												
Fixed-rate	--	--	--	--	1,250	2.80	--	--	7,000	10.36	8,250	9.21
Total securities held to maturity—carrying value	$ 507	2.99	$ 9,012	4.30	$ 12,717	4.17	$ 14,844	4.61	$ 16,436	7.51	$ 53,516	5.33
Total securities held to maturity—estimated market value	$ 505		$ 9,139		$ 12,857		$ 15,015		$ 17,205		$ 54,721	

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

Loans/Lending: Our net loan portfolio increased $833 million, or 28%, ($597 million was added through acquisitions), during the year ended December 31, 2007, compared to an increase of $522 million, or 22%, during the year ended December 31, 2006 and an increase of $346 million in the year ended December 31, 2005. 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. During the past three years, the low level of market interest rates and increasing real estate values led to very strong demand for new real estate loans, including construction loans; however, starting in the summer of 2007, sales of new homes in the markets we serve slowed appreciably, which significantly reduced the demand for new construction and land development loans and slowed our portfolio growth compared to prior years. By contrast, demand for and our production of commercial business loans strengthened somewhat during the second half of 2007. For the years ended December 31, 2007, 2006 and 2005, we originated, net of repayments, $608 million, $921 million and $720 million of loans, respectively.

In recent years, we generally have sold most 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, 2007, 2006 and 2005 totaled $393 million, $442 million and $397 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 slightly to $4.6 million at December 31, 2007, compared to $5.1 million at December 31, 2006.

At various times, we also purchase whole loans and participation interests in loans. During the years ended December 31, 2007, 2006 and 2005, we purchased $23 million, $45 million and $23 million, respectively, of loans and loan participation interests.

One- to Four-Family Residential Real Estate Lending: At December 31, 2007, $464 million, or 12.2% 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 softening markets in the second half of the year, continued in-migration and strong employment gains in the Northwest and the still relatively low mortgage interest rate environment in 2007 sustained demand for residential loans, permitting us to originate a combined total of $524 million of one- to four-family residential loans for the year ended December 31, 2007. The loan sales noted above, coupled with principal repayments, offset much of the increase from current year acquisitions and origination activity, resulting in a $102 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 and, to a lesser extent, land loans and construction loans for commercial and multifamily real estate. In 2007, in response to softening housing markets, higher mortgage rates and tighter credit standards, we significantly slowed our construction and development lending as the year progressed. Nevertheless, at December 31, 2007, construction and land loans totaled $1.221 billion (including $498 million of land or land development loans and $109 million of commercial and multifamily real estate construction loans), or 32.1% of total loans, compared to $1.111 billion, or 37.4%, at December 31, 2006. Construction and land development loan originations totaled $835 million for the year ended December 31, 2007, a 35% decrease compared to $1.294 billion for the year ended December 31, 2006. The geographic distribution of our construction and land development loans is approximately 35% in the greater Puget Sound market, 45% in the greater Portland, Oregon market, and 9% in the greater Boise, Idaho market, with the remaining 11% distributed in various eastern Washington and eastern Oregon markets we serve.

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 2007; however, growth in these loan types was somewhat limited as certain competitors were willing to offer longer-term fixed-rate loans at interest rate levels that were lower than our investment objectives. Combined growth for these loan types was $305 million for the year with much of that resulting from the acquisitions. At December 31, 2007, our loan portfolio included $166 million in multifamily and $883 million in commercial real estate loans. Multifamily and commercial real estate loans comprised 27.5% of total loans at December 31, 2007, compared to 25.1% a year earlier.

Commercial Lending: We are active in small- to medium-sized business lending. While continuing and strengthening our commitment to small business lending, we also have experienced officers and staff focused on middle market corporate lending opportunities for borrowers with credit needs generally in a $3 million to $15 million range. We have leveraged the skills and relationships of these officers with responsive local decision making authority to continue to expand this market niche. In addition to providing earning assets, this type of lending has helped increase the deposit base. Expanding commercial lending and related commercial banking services has been an area of significant focus and staffing has been increased in the areas of credit administration, business development, and loan and deposit operations. Reflecting this effort along with the balances received through our acquisitions, for the year ended December 31, 2007, commercial business loans increased by 49%. At December 31, 2007, commercial business loans totaled $696 million, or 18.3% of total loans, compared to $468 million, or 15.8%, at December 31, 2006. 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 2007, weather conditions, production levels and market prices were quite good for our agricultural borrowers. At December 31, 2007, agricultural loans totaled $186 million, or 4.9% of the loan portfolio, compared to $164 million, or 5.5%, at December 31, 2006.

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 current acquisitions allowed non-

real estate-related consumer loans to increase meaningfully despite continuing high levels of prepayments. At December 31, 2007, we had $93 million, or 2.4% of our loans receivable, in non-real estate-secured consumer loans, compared to $51 million, or 1.7%, at December 31, 2006. In addition, consumer loans secured by one- to four-family real estate, including home equity lines of credit, increased by $33 million to $100 million, or 2.6% of total loans, at December 31, 2007, compared to $67 million, or 2.3%, at December 31, 2006. While consumer loans remain a relatively small portion of the loan portfolio, aggregate growth was 64% in 2007 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, 2007, we were servicing $362 million of loans for others, compared to $361 million at December 31, 2006. The loan servicing portfolio at December 31, 2007 included $178 million of Freddie Mac mortgage loans, $52 million of Fannie Mae mortgage loans and $132 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, 2007, $1.8 million of loan servicing fees, net of $758,000 of servicing rights amortization, was recognized in operations. For the prior year, net loan servicing fees were $1.3 million. The increased servicing income for the current year primarily reflects an increase loan servicing fees, a greater level of late charge fees and growth through acquisitions.

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 cost 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, 2007, 2006 and 2005, we capitalized $781,000, $1.6 million and $502,000, respectively, of MSRs relating to loans sold with servicing retained. Amortization of MSRs for the years ended December 31, 2007, 2006 and 2005, was $758,000, $518,000 and $507,000, 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. MSRs generally are adversely affected by current and anticipated prepayments resulting from decreasing interest rates. At December 31, 2007 and 2006, MSRs were carried at a value, net of amortization, of $2.8 and $2.7 million, respectively.

Table 5: 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									
	2007		2006		2005		2004		2003	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Loans :										
Commercial real estate	$ 882,523	23.2%	$ 596,488	20.1%	$ 555,889	22.8%	$ 547,574	26.2%	$ 455,964	26.4%
Multifamily real estate	165,886	4.4	147,311	5.0	144,512	5.9	107,745	5.1	89,072	5.2
Construction and land	1,221,182	32.0	1,111,298	37.4	691,652	28.4	506,137	24.2	398,954	23.1
Commercial business	696,350	18.3	467,745	15.8	442,232	18.1	395,249	18.9	321,671	18.6
Agricultural business, including secured by farmland	186,305	4.9	163,518	5.5	147,562	6.0	148,343	7.1	118,903	6.9
One- to four-family real estate	463,954	12.2	361,625	12.2	365,903	15.0	307,986	14.7	275,197	15.9
Consumer	93,183	2.5	50,826	1.7	42,573	1.8	36,556	1.8	35,887	2.1
Consumer secured by one- to four-family real estate	100,235	2.6	67,179	2.3	49,408	2.0	43,258	2.0	31,277	1.8
Total consumer	193,417	5.0	118,005	4.0	91,981	3.8	79,814	3.8	67,164	3.9
Total loans	3,809,617	100.0%	2,965,990	100.0%	2,439,731	100.0%	2,092,848	100.0%	1,726,925	100.0%
Less allowance for loan losses	(45,827)		(35,535)		(30,898)		(29,610)		(26,060)	
Total net loans at end of period:	$ 3,763,790		$ 2,930,455		$ 2,408,833		$ 2,063,238		$ 1,700,865	

The following table sets forth the Company's loans by geographic concentration at December 31, 2007 (in thousands):

	Washington	Oregon	Idaho	Other	Total
Loans:					
Commercial real estate	$ 684,863	$ 119,259	$ 46,281	$ 32,120	$ 882,523
Multifamily real estate	127,664	11,419	4,762	22,041	165,886
Construction and land	575,571	504,125	140,276	1,210	1,221,182
Commercial business	519,556	82,873	80,001	13,920	696,350
Agricultural business, including secured by farmland	69,197	53,068	63,842	198	186,305
One-to four-family real estate	407,995	27,189	19,835	8,935	463,954
Consumer	65,102	21,252	4,069	2,760	93,183
Consumer secured by one-to four-family real estate	77,244	14,248	6,493	2,249	100,234
Total consumer	142,346	35,500	10,562	5,009	193,417
	$ 2,527,192	$ 833,433	$ 365,559	$ 83,433	$ 3,809,617
Percent of total loans	66.3%	21.9%	9.6%	2.2%	100.0%

The following table sets forth certain information at December 31, 2007 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 (in thousands):

Table 6: 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	$ 64,713	$ 67,330	$ 75,129	$ 528,388	$ 146,963	$ 882,523
Multifamily real estate	18,841	13,197	20,178	70,772	42,898	165,886
Construction and land	659,417	145,762	19,604	21,876	374,523	1,221,182
Commercial business	331,500	115,567	131,208	105,387	12,688	696,350
Agricultural business, including secured by farmland	110,004	17,909	14,953	39,916	3,523	186,305
One- to four-family real estate	34,131	8,082	8,287	19,062	394,392	463,954
Consumer	35,565	9,991	11,475	11,490	24,662	93,183
Consumer secured by one- to four-family real estate	4,251	5,327	5,319	4,065	81,272	100,234
Total consumer	39,816	15,318	16,794	15,555	105,934	193,417
Total loans	$ 1,258,422	$ 383,165	$ 286,153	$ 800,956	$ 1,080,921	$ 3,809,617

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, 2007 which have fixed interest rates and floating or adjustable interest rates (in thousands):