2019

# Banner Corporation Annual Report

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EQUAL HOUSING
LENDER

# 2019: A Year of Innovating and Connecting

Building and deepening trusting client relationships has always been the cornerstone of Banner Corporation. Our commitment to delivering value-added financial products and services by maintaining our focus on client needs continued to serve us well last year.

Diversity shows up in every aspect of our business and remains a vital pillar of our fortress balance sheet which is designed to withstand all economic cycles. We wholeheartedly embrace how diversification contributes to our success in relation to our geography, our clients, our employees and our products. Taking a multi-faceted approach to building revenue while controlling expenses also contributes to our ability to produce strong results.

## A Snapshot of Deposit Success

Strong core deposits remained the primary foundation of our success last year, accounting for 89 percent of total deposits. Core deposits increased nine percent from 2018 as a result of successful deposit-gathering across our footprint, minimizing geographic concentrations while ensuring our loans remain primarily self-funded.

A unique added benefit of our footprint is how our diverse markets create a synergy in which especially strong deposits held in rural and suburban markets help fund brisk loan growth in our metro and urban markets.

Our focus on maintaining strong client relationships continued to drive growth in deposits, augmented by overall household acquisition activities. In fact, over the past 10 years our organic household growth rate exceeded 110 percent, further demonstrating that our value proposition continues to resonate across the markets we serve.

## Continued Loan Growth

Access to ample deposits again proved pivotal to funding the company's loan growth. Despite a flat yield curve and three interest rate reductions by the Federal Reserve last year, our experienced, trusted bankers maintained existing relationships and attracted new business to achieve seven percent loan growth. Our timeless commitment to diversification by business type, industry, loan type and market was essential to our success. Some of the many ways we employed our strategy in 2019 include:

- Reinforcing our commitment to affordable housing, Banner Bank booked more than $250 million toward creating, renovating and preserving affordable housing, resulting in more than 1,500 units and families served.
- Community Financial Corporation, a wholly owned subsidiary of Banner Bank, reinforced its position as a market leader, providing more than $360 million in loans to help build homes and housing developments.
- Helping more than 3,500 people achieve the American dream of home ownership, Banner Bank reached a landmark goal of $1 billion in home loan production. Additionally, our mortgage team offered more than 200 first-time homebuyer classes, educating 700 potential homebuyers.
- Serving business owners with a vision to grow and retool their companies, Banner Bank's Small Business Administration department booked 55 loans in 2019, with loan commitments totaling nearly $50 million. To help small businesses turn on a dime, Banner Bank also booked 243 SBA Express loans in 2019, with commitments over $25 million.

## Investing in Innovation

Pairing proven technology with knowledgeable bankers to deliver value-added products and services has long been our approach to ensuring our clients can bank when, where and how they want. Last year, technology again played a vital role in our commitment to build and support all types of client relationships and meet the needs of individuals, businesses and large commercial enterprises. In 2019, we continued to sagely invest in technology to diversify our service delivery, amplify our solutions and minimize processing times, all to improve the Banner Bank client experience, including:

- Streamlining commercial loan requests, we developed and began implementing a new loan origination platform to enhance workflow, security and team collaboration.
- Positioning our resources for today and tomorrow, we continued investing in our ATM fleet, introducing next-generation ATMs that do more, are easier to use and can offer a tailored client experience.
- Continually improving our online and mobile banking services, we expanded our online consumer and business options, adding features such as Live Chat. Clients who bank by mobile device gained a leading-edge user experience, with touchscreen and Face ID, enhanced security and reliability, digital wallet capabilities and simplified use of SnapShot® Deposit.
- Supporting client convenience, savings and security, we launched Debit Card Controls, a tool in online and mobile banking giving consumers and businesses real-time control to manage and protect their deposit accounts paired with a debit card.
- Complementing our diverse treasury management digital tools, we invested in faster payments and mobile solutions to support business clients' daily cash management.
- Expanding fraud prevention training and digital messaging services, our team remained focused on helping clients improve awareness and effectively manage payment risk.

# 2019 Accolades

→ Highest Customer Satisfaction with Retail Banking in the Northwest – *J.D. Power** (3 years in a row)

→ Best Bank in the Pacific Region of the U.S. (Wash., Calif., Ore. & Alaska) – *Money* Magazine (2 years in a row)

→ 100 Best Banks in America – *Forbes* (4 years in a row)

→ Top 200 Healthiest Banks – *DepositAccounts.com*

→ Repeatedly assigned BauerFinancial's 5-Star rating (their highest)

→ U.S. Small Business Administration Honors:

- Washington Regional Lender of the Year (5 years in a row) and Community Lender of the Year (2 consecutive years prior)
- Oregon Star Performer (4 years in a row)
- Northern California National Lender Recognition Award (4 years in a row)

*Banner Bank received the highest score in the Northwest in the J.D. Power 2018–2019 U.S. Retail Banking Satisfaction Studies of customer satisfaction with their retail bank. Visit jdpower.com/awards

President and CEO
**Mark Grescovich**

Fellow Shareholders,

Or should that be Fellow *Stakeholders*? Shareholders, stakeholders, they both mean about the same thing, right? Maybe not. There's a serious and growing discussion going on about these very words.

Who are a corporation's stakeholders? Can their various self-interests coexist? Is there "primacy" among them? What's the proper time horizon for a strategic plan? Throw in a concept like "short-termism" and you have a full-blown debate.

While this letter isn't the place to expound on the discussion, I want you to be aware that it's more complex than a couple of related words. And it's worth looking into, because it could lead to various movements impacting the governance of larger businesses, especially those that are publicly traded.

For instance, "The New Paradigm," presented at the 2016 World Economic Forum lays out a roadmap for businesses that would preserve a market-based perspective while fully considering the long-term interests of all stakeholders.

And last summer in its "Statement on the Purpose of a Corporation," the Business Roundtable departed from its long-held tenet of shareholder primacy. Instead, the statement reads, "... we share a fundamental commitment to all of our stakeholders ... to deliver value to all of them." It specifically identifies stakeholders as: clients, employees, suppliers, communities, and shareholders.

For 10 or more years now—well before the current buzz—as part of our super community bank business model, we've embraced a broad view of stakeholders. It's part of our culture. In early 2015, we began closing our investor presentation deck with this slide. For Banner to thrive and grow, common sense dictates that we balance the competing long-term interests of all our stakeholders (the investor deck is available as a Securities and Exchange Commission Form 8-K filing shortly after our quarterly earnings release).

**Building value at Banner**

Building value for ...

- **Shareholders** by delivering top quartile financial performance
- **Clients** by delivering super community bank service and products
- **Employees** by offering opportunity and reward
- **Communities** by providing capital and staying involved

We'll continue to listen to the discussion, comment when appropriate, and adapt as necessary. But we think Banner is already in step with the direction of this evolving shareholder/stakeholder conversation.

Last year, I wrote that judging whether we were successful during a year requires a plan, a commitment to doing what we said we'd do, and always putting ourselves in position to improve. My assessment of 2019 is that Banner was quite successful. Some targets, especially those tied into operating leverage, remain challenging, but we still see opportunity for future improvement.

You'll find a great deal of financial detail in the pages that follow, but let me highlight a few items:

- The acquisition of $426 million California-based AltaPacific Bank brought Banner's total year-end 2019 assets to $12.6 billion;
- Strong year-over-year growth in core deposits at 9%, loans at 7%, adjusted revenues at 8%, and pre-tax net income at 11%;
- A 4.30% net interest margin for the year, expected to keep Banner well within this measure's top quartile among bank holding companies larger than $10 billion;
- A very strong capital position and still moderate credit risk profile with non-performing assets of only 0.32% of total assets;
- A Banner record of $1 billion in residential mortgage loan originations;
- A commitment in excess of $250 million to finance more than 1,500 affordable housing units;
- A third consecutive year earning J.D. Power's highest ranking for retail bank customer satisfaction in the Pacific Northwest;
- A second consecutive year ranked as the best bank in the Pacific Region of the U.S. by *Money* magazine; and
- Net income available to common shareholders of $4.18 per diluted share compared to $4.15 in 2018.

In closing, I want to thank everyone at Banner for their extraordinary commitment and hard work, for executing on our strategic plan, and for being Connected, Knowledgeable and Responsive.

And thank you to *all* our stakeholders—shareholders in particular—for your continuing interest in and commitment to Banner. I look forward to pursuing our plan for 2020 and reporting further progress to you next year.

Mark J. Grescovich
President and Chief Executive Officer
Banner Corporation and Banner Bank

**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, 2019**

**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 | BANR | The NASDAQ Stock Market LLC |
|---|---|---|
| (Title of Each Class) | (Trading Symbol) | (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 X No __
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act Yes __ No X

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files) Yes X No ___

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards pursuant to Section 13(a) of the Exchange Act. ____

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 non-voting 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, 2019, was:
**Common Stock – $1,874,285,015**

(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 January 31, 2020:
**Common Stock, $.01 par value – 35,712,347 shares**
**Non-voting Common Stock, $.01 par value – 39,192 shares**

**Documents Incorporated by Reference**
Portions of Proxy Statement for Annual Meeting of Shareholders to be held April 29, 2020 are incorporated by reference into Part III.

**BANNER CORPORATION AND SUBSIDIARIES**

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**Forward-Looking Statements**

Certain matters in this Form 10-K constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to our financial condition, liquidity, results of operations, plans, objectives, future performance or business. Forward-looking statements are not statements of historical fact, are based on certain assumptions and are generally identified by use of the words "believes," "expects," "anticipates," "estimates," "forecasts," "intends," "plans," "targets," "potentially," "probably," "projects," "outlook" or similar expressions or future or conditional verbs such as "may," "will," "should," "would" and "could." Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, assumptions and statements about future economic performance and projections of financial items. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from the results anticipated or implied by our forward-looking statements, including, but not limited to: expected revenues, cost savings, synergies and other benefits from the merger of Banner and AltaPacific Bancorp (AltaPacific) might not be realized within the expected time frames or at all and costs or difficulties relating to integration matters, including but not limited to customer and employee retention, might be greater than expected; the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and changes in estimates of adequacy of the allowance for loan losses and provisions for loan losses that may be impacted by deterioration in the housing and commercial real estate markets and may lead to increased losses and non-performing assets, and may result in the allowance for loan losses not being adequate to cover actual losses and require a material increase in reserves; results of examinations by regulatory authorities, including the possibility that any such regulatory authority may, among other things, require the writing down of assets or increases in the allowance for loan losses; the ability to manage loan delinquency rates; competitive pressures among financial services companies; changes in consumer spending or borrowing and spending habits; interest rate movements generally and the relative differences between short and long-term interest rates, loan and deposit interest rates, net interest margin and funding sources; the impact of repricing and competitors' pricing initiatives on loan and deposit products; fluctuations in the demand for loans, the number of unsold homes, land and other properties and fluctuations in real estate values; the ability to adapt successfully to technological changes to meet customers' needs and developments in the marketplace; the ability to access cost-effective funding; increases in premiums for deposit insurance; the ability to control operating costs and expenses; the use of estimates in determining fair value of certain assets and liabilities which estimates may prove to be incorrect and result in significant changes in valuation; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect employees, and potential associated charges; disruptions, security breaches or other adverse events, failures or interruptions in, or attacks on information technology systems or on the third-party vendors who perform critical processing functions; changes in financial markets; changes in economic conditions in general and in Washington, Idaho, Oregon and California in particular; secondary market conditions for loans and the ability to originate loans for sale and sell loans in the secondary market; the costs effects and outcomes of litigation; legislation or regulatory changes or reforms, including changes in regulatory policies and principles, or the interpretation of regulatory capital or other rules, including changes related to Basel III; the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and the implementing regulations; results of safety and soundness and compliance examinations by the Board of Governors of the Federal Reserve System (the Federal Reserve), the Federal Deposit Insurance Corporation (the FDIC), the Washington State Department of Financial Institutions, Division of Banks (the Washington DFI) or other regulatory authorities, including the possibility that any such regulatory authority may, among other things, require restitution or institute an informal or formal enforcement action which could require an increase in reserves for loan losses, write-downs of assets, or changes in regulatory capital position or affect the ability to borrow funds, or maintain or increase deposits, or impose additional requirements and restrictions, any of which could adversely affect liquidity and earnings; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; adverse changes in the securities markets; the inability of key third-party providers to perform their obligations; changes in accounting principles, policies or guidelines, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; the economic impact of war or any terrorist activities; other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services; future acquisitions by Banner of other depository institutions or lines of business; and future goodwill impairment due to changes in Banner's business, changes in market conditions, or other factors; and other risks detailed from time to time in our filings with the U.S. Securities and Exchange Commission (SEC), including this report on Form 10-K. Any forward-looking statements are based upon management's beliefs and assumptions at the time they are made. We do not undertake and specifically disclaim any obligation to update any forward-looking statements included in this report or the reasons why actual results could differ from those contained in such statements, whether as a result of new information, future events or otherwise. These risks could cause our actual results to differ materially from those expressed in any forward-looking statements by, or on behalf of, us. In light of these risks, uncertainties and assumptions, the forward-looking statements discussed in this report might not occur, and you should not put undue reliance on any forward-looking statements.

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

## PART 1

**Item 1 – Business** **General**

Banner Corporation (the Company) is a bank holding company incorporated in the State of Washington. We are primarily engaged in the business of planning, directing and coordinating the business activities of our wholly-owned subsidiaries, Banner Bank and Islanders Bank. Banner Bank is a Washington-chartered commercial bank that conducts business from its main office in Walla Walla, Washington and, as of December 31, 2019, its 175 branch offices located in Washington, Oregon, California and Idaho. Banner Bank also has 18 loan production offices located in Washington, Oregon, California, Idaho and Utah. Islanders Bank is also a Washington-chartered commercial bank that conducts business from three branch offices in San Juan County, Washington. Banner Corporation is subject to regulation by the Federal Reserve. Banner Bank and Islanders Bank (the Banks) are subject to regulation by the Washington DFI and the FDIC. As of December 31, 2019, we had total consolidated assets of $12.60 billion, net loans of $9.20 billion, total deposits of $10.05 billion and total shareholders' equity of $1.59 billion. Our voting common stock is traded on the NASDAQ Global Select Market under the ticker symbol "BANR."

Banner Bank is a regional bank which offers a wide variety of commercial banking services and financial products to individuals, businesses and public sector entities in its primary market areas. Islanders Bank is a community bank which offers similar banking services to individuals, businesses and public entities located primarily in the San Juan Islands. The Banks' primary business is that of traditional banking institutions, accepting deposits and originating loans in locations surrounding our offices in portions of Washington, Oregon, California 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 and multifamily 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, small business administration (SBA) loans and consumer loans.

We continue to invest significantly in our delivery platform across the franchise with a primary emphasis on strengthening our presence in the higher growth regions of our markets including Puget Sound, greater Portland, Boise, Sacramento and Southern California. In 2019 we acquired AltaPacific, the holding company for AltaPacific Bank, which expanded the Company's presence by adding density within our existing California geographic footprint. The acquisition of AltaPacific, which closed on November 1, 2019, included six branches and approximately $425.7 million in assets, $332.4 million in loans and $313.4 million in deposits. In addition to our expansion efforts, we continue to improve the efficiency of our branch delivery channel with on-going branch consolidations and relocations and investments in streamlining the origination of new loan and deposit accounts.

In addition to bank acquisitions, relocations and consolidations, we also have focused on expanding our product offerings and invested heavily in marketing campaigns designed to significantly increase the brand awareness for Banner Bank. These investments have been significant elements in our strategy to grow customer relationships and increase our market presence, while allowing us to better serve existing and future customers. We believe our branch network, broad product line and heightened brand awareness have created a franchise that is well positioned for growth and to successfully execute on our super community bank model. Our strategy is focused on delivering customers, including middle market and small businesses, business owners, their families and employees, a compelling value proposition by providing the financial sophistication and breadth of products of a regional bank while retaining the appeal, responsiveness, and superior service level of a community bank.

Banner Corporation's successful execution of its strategic initiatives and its super community bank model has delivered sustainable growth and solid profitability. We have made substantial progress on our goals to achieve and maintain the Company's moderate risk profile as well as to continue our strong earnings growth momentum. Highlights of this success have included continued strong asset quality, organic client growth, significantly increased non-interest-bearing deposit balances and strong revenue generation.

For the year ended December 31, 2019, our net income increased to $146.3 million, or $4.18 earnings per diluted share, compared to $136.5 million, or $4.15 earnings per diluted share, for the prior year. Both the current year and prior year results were positively impacted by growth in interest-earnings assets, partially offset by acquisition-related expenses of $7.5 million in 2019 and $5.6 million in 2018.

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 of Des Moines (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, interest-bearing liabilities, and non-interest-bearing funding sources including non-interest-bearing deposits. Our net interest income before provision for loan losses increased 9% to $468.9 million for the year ended December 31, 2019, compared to $431.0 million for the year ended December 31, 2018. The increase in net interest income in 2019 was driven by growth in average interest-earning assets, due to the acquisitions of Skagit Bancorp, Inc. (Skagit) on November 1, 2018 and AltaPacific as well as organic growth.

Our net income also is affected by the level of our non-interest income, including deposit fees and service charges, results of mortgage banking operations, which includes loan origination and servicing fees and gains and losses on the sale of one- to four-family and multifamily loans, and gains and losses on the sale of securities, as well as our non-interest expenses, provisions for loan losses and income tax provisions. In addition, net income is affected by the net change in the value of certain financial instruments carried at fair value.

Our total revenues (net interest income before the provision for loan losses plus non-interest income) for 2019 increased $35.9 million, or 7%, to $550.9 million, compared to $515.0 million for 2018. Our total non-interest income, which is a component of total revenue, was $81.9 million for the year ended December 31, 2019, compared to $84.0 million for the year ended December 31, 2018. The decrease in non-interest income during 2019 is the result of Banner becoming subject to the Durbin Amendment to the Dodd-Frank Act regarding limits on debit card interchange fees on July 1, 2019, which reduced interchange fee income by approximately $7 million during the second half of 2019.

Although our credit quality metrics continue to reflect our moderate risk profile, we recorded a $10.0 million provision for loan losses in the year ended December 31, 2019, primarily due to organic growth in the loan portfolio, the increase in non-performing loans, the renewal and migration of acquired loans out of the discounted loan portfolio and increased net charge-offs, compared to an $8.5 million provision recorded in 2018. Non-performing loans increased to $39.6 million at December 31, 2019, compared to $15.7 million a year earlier. Net charge-offs increased to $5.9 million for the year ended December 31, 2019, compared to net charge-offs of $1.0 million for the prior year. Our allowance for loan losses at December 31, 2019 was $100.6 million, or 1.08% of total loans outstanding and 254% of non-performing loans. (See Note 5, Loans Receivable and the Allowance for Loan Losses, of the Notes to the Consolidated Financial Statements as well as "Asset Quality" below.)

Our non-interest expense increased 5% to $357.7 million for the year ended December 31, 2019, compared to $341.4 million for the year ended December 31, 2018. The year-over-year increase in non-interest expense was largely attributable to increased salary and employee benefits as compared to a year ago largely due to inclusion of the acquired Skagit operations for a full year and the AltaPacific operations for the last two months of 2019, partially offset by increases in capitalized loan origination costs.

## Recent Developments and Significant Events

*Acquisition of AltaPacific Bancorp*

Effective November 1, 2019, the Company acquired 100% of the outstanding common shares of AltaPacific and its wholly-owned subsidiary, AltaPacific Bank, a California State chartered bank headquartered in Santa Rosa, California, with six branches within California. On that date, AltaPacific merged with and into Banner and AltaPacific Bank merged with and into Banner Bank. Pursuant to the previously announced terms of the merger, the equity holders of AltaPacific received an aggregate of 1.6 million shares of Banner voting common stock, plus cash in lieu of fractional shares for a total consideration paid of $87.6 million. The acquisition provided $425.7 million of assets, $332.4 million of loans, and $313.4 million of deposits. See Note 3 of the Notes to the Consolidated Financial Statements for additional information.

*Acquisition of Skagit Bancorp, Inc.*

Effective November 1, 2018, the Company acquired 100% of the outstanding common shares of Skagit and its wholly-owned subsidiary, Skagit Bank, a Washington State chartered commercial bank headquartered in Burlington, Washington, with 11 branches serving markets along the I-5 corridor from Seattle to the Canadian border. On that date, Skagit merged with and into Banner and Skagit Bank merged with and into Banner Bank. Pursuant to the previously announced terms of the merger, the equity holders of Skagit received an aggregate of 3.1 million shares of Banner voting common stock, plus cash in lieu of fractional shares and to buy out Skagit stock options for a total consideration paid of $180.0 million. The acquisition provided $915.8 million in assets, $632.4 million in loans and $810.2 million in deposits. See Note 3 of the Notes to the Consolidated Financial Statements for additional information.

## Lending Activities

*General:* All of our lending activities are conducted through Banner Bank, its subsidiary, Community Financial Corporation, a residential construction lender located in Portland, Oregon, and Islanders Bank. We offer a wide range of loan products to meet the demands of our customers and our loan portfolio is very diversified by product type, borrower and geographic location within our market area. We originate loans for our own loan portfolio and for sale in the secondary market. Management's strategy has been to maintain a well-diversified portfolio with a significant percentage of assets in the loan portfolio having more frequent interest rate repricing terms or shorter maturities than traditional long-term fixed-rate mortgage loans. As part of this effort, we offer a variety of floating or adjustable interest rate products that correlate more closely with our cost of interest-bearing funds, particularly loans for commercial business and real estate, agricultural business, and construction and development purposes. However, in response to customer demand, we continue to originate fixed-rate loans, including fixed interest rate mortgage loans with terms of up to 30 years. The relative amount of fixed-rate loans and adjustable-rate loans that can be originated at any time is largely determined by the demand for each in a competitive environment. At December 31, 2019, our net loan portfolio totaled $9.20 billion compared to $8.59 billion at December 31, 2018.

Our lending activities are primarily directed toward the origination of real estate and commercial loans. Commercial real estate loans include owner-occupied, investment properties and multifamily residential real estate. Our level of activity and investment in commercial real estate loans has been relatively stable for many years. We also originate construction, land and land development loans, a significant component of which is our residential one- to four-family construction loans. Originations of one- to four-family construction loans have increased in recent years as builders have expanded production and experienced strong sales in many of the markets we serve. Our origination of construction and development loans has been significant during recent years and balances in this portion of the portfolio have increased in recent periods but not at the same pace of originations as brisk sales of new homes have produced rapid turnover through repayments. Our commercial business lending is directed toward meeting the credit and related deposit and treasury management needs of various small- to medium-sized business and agribusiness borrowers operating in our primary market areas. In recent years, our commercial business lending has also included participation in certain national syndicated loans. Reflecting the expanding economy of the western United States, demand for commercial business loans has strengthened and our production levels have increased in recent periods. Our residential mortgage loan originations have been relatively strong in

recent years, as sustained periods of low interest rates have supported demand for loans to refinance existing debt as well as loans to finance home purchases. Most of the one- to four-family loans that we originate are sold in the secondary markets with net gains on sales and loan servicing fees reflected in our revenues from mortgage banking. Our consumer loan activity is primarily directed at meeting demand from our existing deposit customers.

For additional information concerning our loan portfolio, see Item 7 of this report, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Comparison of Financial Condition at December 31, 2019 and 2018—Loans and Lending" including Tables 4 and 5, which sets forth the composition and geographic concentration of our loan portfolio, and Tables 6 and 7, 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 markets we serve. Through our mortgage banking activities, we sell residential loans on either a servicing-retained or servicing-released basis. In recent years, we have generally sold a significant portion of our conventional residential mortgage originations and nearly all of our government insured loans in the secondary market. At December 31, 2019, $945.6 million, or 10% of our loan portfolio, consisted of permanent loans on one- to four-family residences.

We offer fixed- and adjustable-rate mortgages (ARMs) at rates and terms competitive with market conditions, primarily with the intent of selling these loans into the secondary market. Fixed-rate loans generally are offered on a fully amortizing basis for terms ranging from 10 to 30 years at interest rates and fees that reflect current secondary market pricing. Most ARM products offered adjust annually after an initial period ranging from one to five years, subject to a limitation on the annual adjustment and a lifetime rate cap. For a small portion of the portfolio, where the initial period exceeds one year, the first interest rate change may exceed the annual limitation on subsequent adjustments. Our ARM products most frequently adjust based upon the average yield on Treasury securities adjusted to a constant maturity of one year or certain London Interbank Offered Rate (LIBOR) indices plus a margin or spread above the index. ARM loans held in our portfolio may allow for interest-only payments for an initial period up to five years but do not provide for negative amortization of principal and carry no prepayment restrictions. The retention of ARM loans in our loan portfolio can help reduce our exposure to changes in interest rates.

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

*Construction and Land Lending:* Historically, we have invested a significant portion of our loan portfolio in residential construction and land loans to professional home builders and developers. Our land loans are typically on improved or entitled land, versus raw land. We also make construction loans to qualified owner occupants, which upon completion of the construction phase convert to long-term amortizing one- to four-family residential loans that are eligible for sale in the secondary market. We regularly monitor our construction and land loan portfolios and the economic conditions and housing inventory in each of our markets and increase or decrease this type of lending as we observe market conditions change. Our residential construction and land and land development lending has been recently increasing in select markets and has made a meaningful contribution to our net interest income and profitability. To a lesser extent, we also originate construction loans for commercial and multifamily real estate. Although well diversified with respect to sub-markets, price ranges and borrowers, our construction, land and land development loans are significantly concentrated in the greater Puget Sound region of Washington State and the Portland, Oregon market area. At December 31, 2019, construction, land and land development loans totaled $1.17 billion, or 13% of total loans; 60% of the balance was comprised of one- to four-family construction and residential land and land development loans, with the remaining balance comprised of commercial and multifamily real estate construction loans and commercial land and land development loans.

Construction and land lending affords us the opportunity to achieve higher interest rates and fees with shorter terms to maturity than are usually available on other types of lending. Construction and land lending, however, involves a higher degree of risk than other lending opportunities. We attempt to address these risks by adhering to strict underwriting policies, disbursement procedures and monitoring practices. For additional information concerning the risks associated with construction and land lending, see Item 1A., "Risk Factors—Our loan portfolio includes loans with a higher risk of loss."

On a more limited basis, 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 more conservative underwriting policies but 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.

*Commercial and Multifamily Real Estate Lending:* We originate loans secured by multifamily and commercial real estate, including loans for construction of multifamily and commercial real estate projects. Commercial real estate loans are made for both owner-occupied and investor-owned properties. At December 31, 2019, our loan portfolio included $2.31 billion in non-owner-occupied commercial real estate loans, $1.58 billion in owner-occupied commercial real estate loans and $473.2 million in multifamily loans which in aggregate comprised 47% 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. In originating multifamily and commercial real estate loans, we consider the location, marketability

and overall attractiveness of the properties. Our underwriting guidelines for multifamily and commercial real estate loans require an appraisal from a qualified independent appraiser and an economic analysis of each property with regard to the annual revenue and expenses, debt service coverage and fair value to determine the maximum loan amount. In the approval process we assess the borrower's willingness and ability to manage the property and repay the loan and the adequacy of the collateral in relation to the loan amount. For information concerning the risks associated with commercial and multifamily real estate lending, see Item 1A., “Risk Factors—Our loan portfolio includes loans with a higher risk of loss.”

Multifamily and commercial real estate loans originated by us are both fixed- and adjustable-rate loans with intermediate terms of generally five to ten years. A significant portion of our multifamily and commercial real estate loans are linked to various FHLB advance rates, certain prime rates, US Treasury rates, or other market rate indices. Rates on these adjustable-rate loans generally adjust with a frequency of one to five years after an initial fixed-rate period ranging from one to ten years. Our commercial real estate portfolio consists of loans on a variety of property types with no large concentrations by property type, location or borrower. At December 31, 2019, the average size of our commercial real estate loans was $705,000 and the largest commercial real estate loan, in terms of an outstanding balance, in our portfolio was approximately $19.6 million.

*Commercial Business Lending:* We are active in small- to medium-sized business lending and are engaged in agricultural lending primarily by providing crop production loans. Our commercial bankers are focused on local markets and devote a great deal of effort to developing customer relationships and providing these types of borrowers with a full array of products and services delivered in a thorough and responsive manner. Our experienced commercial bankers and senior credit staff help us meet our commitment to small business lending while also focusing on corporate lending opportunities for borrowers with credit needs generally in a $3 million to $25 million range. In addition to providing earning assets, commercial business lending has helped us increase our deposit base. In recent years, our commercial business lending has included modest participation in certain national syndicated loans, including shared national credits. We also originate smaller balance business loans principally through our retail branch network, using our Quick Step business loan program, which is closely aligned with our consumer lending operations and relies on centralized underwriting procedures. Quick Step business loans are available up to $1.0 million, business lines of credit are available up to $500,000 and owner-occupied real estate loans are available up to $1.0 million.

Commercial business loans may entail greater risk than other types of loans. Commercial business loans generally provide higher yields or related revenue opportunities than many other types of loans but also require more administrative and management attention. Loan terms, including the fixed or adjustable interest rate, the loan maturity and the collateral considerations, vary significantly and are negotiated on an individual loan basis. For information concerning the risks associated with commercial business lending, see Item 1A., “Risk Factors—Our loan portfolio includes loans with a higher risk of loss.”

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

Our commercial business loans may be structured as term loans or as lines of credit. Commercial business term loans are generally made to finance the purchase of fixed assets and have maturities of five years or less. Commercial business lines of credit are typically made for the purpose of providing working capital and are usually approved with a term of one year. Adjustable- or floating-rate loans are primarily tied to various prime rate or LIBOR indices. At December 31, 2019, commercial business loans totaled $1.69 billion, or 18% of our total loans receivable, including $190.8 million of shared national credits.

*Agricultural Lending:* Agriculture is a major industry in several of our markets. We 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, 2019, agricultural business loans, including collateral secured loans to purchase farm land and equipment, totaled $370.5 million, or 4% of our loan portfolio.

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

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

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

Among the more common risks to agricultural lending can be weather conditions and disease. These risks may be mitigated through multi-peril crop insurance. Commodity prices also present a risk, which may be mitigated through 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. For additional information concerning the risks associated with agricultural lending, see Item 1A., "Risk Factors—Our loan portfolio includes loans with a higher risk of loss."

*Consumer and Other Lending:* We originate a variety of consumer loans, including home equity lines of credit, automobile, boat and recreational vehicle loans and loans secured by deposit accounts. While consumer lending has traditionally been a small part of our business, with loans made primarily to accommodate our existing customer base, it has received consistent emphasis in recent years. Part of this emphasis includes a Banner Bank-owned credit card program. Similar to other consumer loan programs, we focus this credit card program on our existing customer base to add to the depth of our customer relationships. In addition to earning balances, credit card accounts produce non-interest revenues through interchange fees and other activity-based revenues. Our underwriting of consumer loans is focused on the borrower's credit history and ability to repay the debt as evidenced by documented sources of income. At December 31, 2019, we had $762.8 million, or 8% of our loan portfolio, in consumer related loans, including $551.0 million, or 6% of our loan portfolio, in consumer loans secured by one- to four-family residences. For information concerning the risks associated with consumer lending, see Item 1A., "Risk Factors—Our loan portfolio includes loans with a higher risk of loss."

*Loan Solicitation and Processing:* We originate real estate loans in our market areas by direct solicitation of real estate brokers, builders, developers, depositors, walk-in customers and visitors to our Internet website. One- to four-family residential loan applications are taken by our mortgage loan officers or through our Internet website and are processed in branch or regional locations. In addition, we have specialized loan origination units, focused on construction and land development, commercial real estate and multifamily loans. Most underwriting and loan administration functions for our real estate loans are performed by loan personnel at central locations.

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

We originate consumer loans and small business (including Quick Step) commercial business loans through various marketing efforts directed primarily toward our existing deposit and loan customers. Consumer loans and Quick Step commercial business loan applications are primarily underwritten and documented by centralized administrative personnel.

**Loan Originations, Sales and Purchases**

While we originate a variety of loans, our ability to originate each type of loan is dependent upon the relative customer demand and competition in each market we serve. For the years ended December 31, 2019 and 2018, we originated loans, net of repayments, including our participation in syndicated loans and loans held for sale of $1.40 billion and $1.31 billion, respectively. For additional information concerning origination of portfolio loans by type, see Item 7 in this report, "Management's Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2019 and 2018—Loans and Lending," and Table 3 contained therein.

We sell many of our newly originated one- to four-family residential mortgage loans and multifamily loans to secondary market purchasers as part of our interest rate risk management strategy. Originations of loans for sale increased to $1.09 billion for the year ended December 31, 2019 from $896.5 million during 2018. Originations of loans for sale included $340.0 million and $372.8 million of multifamily held for sale loan production for the years ended December 31, 2019 and December 31, 2018, respectively. Sales of loans generally are beneficial to us because these sales may generate income at the time of sale, provide funds for additional lending and other investments, increase liquidity or reduce interest rate risk. During the year ended December 31, 2019, we sold $1.07 billion of loans held for sale compared to $781.9 million for the year ended December 31, 2018. The held for sale loans sold in 2019 and 2018 included $332.7 million and $256.5 million, respectively, of multifamily loans held for sale. We sell one- to four-family mortgage loans on both a servicing-retained and a servicing-released basis. All loans are sold without recourse. The decision to hold or sell loans is based on asset liability management goals, strategies and policies and on market conditions. For additional information, see *"Loan Servicing."*

We periodically purchase whole loans and loan participation interests or participate in syndicates originating new loans, including shared national credits, 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 or loan participations are generally made on terms consistent with our underwriting standards; however, the loans may be located outside of our normal lending area. During the years ended December 31, 2019 and 2018, we purchased $9.8 million and $33.7 million, respectively, of loans and loan participation interests, principally commercial real estate loans.

**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, 2019, we were servicing $2.85 billion of loans for others. Loan servicing includes processing payments, accounting for loan funds and collecting and paying real estate taxes, hazard insurance and other loan-related items such as private mortgage insurance. In addition to earning fee income, we retain certain amounts in escrow for the benefit of the lender for which we incur no interest expense but are able to invest the funds into earning assets.

*Mortgage Servicing Rights:* We record mortgage servicing rights (MSRs) with respect to loans we originate and sell in the secondary market on a servicing-retained basis. The value of MSRs is capitalized and amortized in proportion to, and over the period of, the estimated future net servicing income. Management periodically evaluates the estimates and assumptions used to determine the carrying values of MSRs and the amortization of MSRs. MSRs generally are adversely affected by higher levels of current or anticipated prepayments resulting from decreasing interest rates. MSRs are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is recognized through a valuation allowance, to the extent that fair value is less than the capitalized carrying amount. At December 31, 2019, our MSRs were carried at a value of $14.1 million, net of amortization. For additional information see Note 16, Goodwill, Other Intangible Assets and Mortgage Servicing Rights, of the Notes to the Consolidated Financial Statements.

**Asset Quality**

*Classified Assets:* State and federal regulations require that the Banks review and classify their problem assets on a regular basis. In addition, in connection with examinations of insured institutions, state and federal examiners have authority to identify problem assets and, if appropriate, require them to be classified. Historically, we have not had any meaningful differences of opinion with the examiners with respect to asset classification. Banner Bank's Credit Policy Division reviews detailed information with respect to the composition and performance of the loan portfolios, including information on risk concentrations, delinquencies and classified assets for both Banner Bank and Islanders Bank. The Credit Policy Division approves all recommendations for new classified loans or, in the case of smaller-balance homogeneous loans including residential real estate and consumer loans, it has approved policies governing such classifications, or changes in classifications, and develops and monitors action plans to resolve the problems associated with the assets. The Credit Policy Division also approves recommendations for establishing the appropriate level of the allowance for loan losses. Significant problem loans are transferred to Banner Bank's Special Assets Department for resolution or collection activities. The Banks' and Banner Corporation's Boards of Directors are given a detailed report on classified assets and asset quality at least quarterly. For additional information regarding asset quality and non-performing loans, see Item 7 of this report, "Management's Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2019 and 2018—Asset Quality," and Table 12 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 U.S. generally accepted accounting principles (GAAP) guidelines. We increase our allowance for loan losses by charging provisions for probable loan losses against our income. The allowance for loan losses is maintained at a level which, in management's judgment, is sufficient to provide for probable losses based on evaluating known and inherent risks in the loan portfolio and upon continuing analysis of the factors underlying the quality of the loan portfolio. In June 2016, Financial Accounting Standards Board issued ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments,* referred to as Current Expected Credit Loss, or CECL, which became effective for Banner on January 1, 2020. For additional information on CECL see Note 2, Accounting Standards Recently Issued or Adopted, of the Notes to the Consolidated Financial Statements. For additional information concerning our allowance for loan losses, see Item 7 of this report, "Management's Discussion and Analysis of Financial Condition—Comparison of Results of Operations for the Years Ended December 31, 2019 and 2018—Provision and Allowance for Loan Losses," and Tables 16 and 17 contained therein.

*Real Estate Owned:* Real estate owned (REO) is property acquired by foreclosure or receiving a deed in lieu of foreclosure, and is recorded at the estimated fair value of the property, less expected selling costs. Development and improvement costs relating to the property are capitalized to the extent they add value to the property. The carrying value of the property is periodically evaluated by management and, if necessary, allowances are established to reduce the carrying value to net realizable value. Gains or losses at the time the property is sold are credited or charged to operations in the period in which they are realized. The amounts we will ultimately recover from REO may differ substantially from the carrying value of the assets because of market factors beyond our control or because of changes in our strategies for recovering the investment. For additional information on REO, see Item 7 of this report, "Management's Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2019 and 2018—Asset Quality" and Table 12 contained therein and Note 6, Real Estate Owned, Held for Sale, Net, of the Notes to the Consolidated Financial Statements.

**Investment Activities**

*Investment Securities*

Under Washington state law and FDIC regulation, banks are permitted to invest in various types of marketable securities. Authorized securities include but are not limited to Treasury obligations, securities of various federal agencies (including government-sponsored enterprises), mortgage-backed and asset-backed securities, certain certificates of deposit of insured banks and savings institutions, bankers' acceptances, repurchase agreements, federal funds, commercial paper, corporate debt and equity securities and obligations of states and their political subdivisions. Our investment policies are designed to provide and maintain adequate liquidity and to generate favorable rates of return without incurring undue interest rate or credit risk. Our policies generally limit investments to U.S. Government and agency (including government-sponsored entities) securities, municipal bonds, certificates of deposit, corporate debt obligations and mortgage-backed securities. Investment in mortgage-backed securities may include those issued or guaranteed by Freddie Mac, Fannie Mae, Government National Mortgage Association (Ginnie Mae or GNMA) and investment grade privately-issued mortgage-backed securities, as well as collateralized mortgage obligations (CMOs). All of our investment securities, including those that have high credit ratings, are subject to market risk in so far as a change in market rates of interest or other conditions may cause a change in an investment's earnings performance and/or market value.

At December 31, 2019, our consolidated investment portfolio totaled $1.81 billion and consisted principally of U.S. Government agency obligations, mortgage-backed securities, municipal bonds, corporate debt obligations, and asset-backed securities. Investment levels may be increased or decreased in order to manage balance sheet liquidity, interest rate risk, market risk and provide appropriate risk adjusted returns. Securities sales, paydowns and maturities during the year ended December 31, 2019 exceeded purchases slightly as the Company maintained the level of its securities portfolio consistent with its liquidity needs.

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, 2019 and 2018—Investments," and Tables 1 and 2 contained therein.

*Derivatives*

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

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

*Derivatives Not Designated in Hedge Relationships*

*Interest Rate Swaps:* Banner Bank uses an interest rate swap program for commercial loan customers, in which we provide the client with a variable rate loan and enter into an interest rate swap in which the client receives a fixed rate payment in exchange for a variable rate payment. We offset our risk exposure by entering into an offsetting interest rate swap with a dealer counterparty for the same notional amount and length of term as the client interest rate swap providing the dealer counterparty with a fixed rate payment in exchange for a variable rate payment. At December 31, 2019, Banner Bank had $372.0 million in notional amounts of these customer interest rate swaps outstanding that were not designated in hedge relationships, with an equal amount of offsetting third party swaps also in place. These swaps do not qualify as designated hedges; therefore, each swap is accounted for as a free standing derivative.

*Mortgage Banking:* In the normal course of business, the Company sells originated one- to four-family and multifamily mortgage loans into the secondary mortgage loan markets. During the period of loan origination and prior to the sale of the loans in the secondary market, the Company has exposure to movements in interest rates associated with written interest rate lock commitments with potential borrowers to originate one- to four-family loans that are intended to be sold and for closed one- to four-family and multifamily mortgage loans held for sale that are awaiting sale and delivery into the secondary market. The Company economically hedges the risk of changing interest rates associated with these mortgage loan commitments by entering into forward sales contracts to sell one- to four-family and multifamily mortgage loans or mortgage-backed securities to broker/dealers at specific prices and dates.

We are exposed to credit-related losses in the event of nonperformance by the counterparty to these agreements. Credit risk of the financial contract is mitigated through the credit approval, limits, and monitoring procedures.

In connection with the interest rate swaps between Banner Bank and the dealer counterparties, the agreements contain a provision such that if Banner Bank fails to maintain its status as a well/adequately capitalized institution, then the counterparty could terminate the derivative positions and Banner Bank would be required to settle its obligations. Similarly, we could be required to settle our obligations under certain of these agreements if specific regulatory events occur, such as a publicly issued prompt corrective action directive, cease and desist order, or a capital maintenance agreement that required Banner Bank to maintain a specific capital level. If we had breached any of these provisions at December 31, 2019 or 2018, we could have been required to settle our obligations under the agreements at the termination value. We generally post collateral

against derivative liabilities in the form of government agency-issued bonds, mortgage-backed securities, or commercial mortgage-backed securities.

Derivative assets and liabilities are recorded at fair value on the balance sheet. Master netting agreements allow us to settle all derivative contracts held with a single counterparty on a net basis and to offset net derivative positions with related collateral where applicable. In addition, some interest rate swap derivatives between Banner Bank and the dealer counterparties are cleared through central clearing houses. These clearing houses characterize the variation margin payments as settlements of the derivative's market exposure and not as collateral.

*Derivatives Designated in Hedge Relationships*

Our fixed-rate loans result in exposure to losses in value or net interest income as interest rates change. The risk management objective for hedging fixed-rate loans is to effectively convert the fixed rate received to a floating rate. Under a prior program that is now discontinued we hedged our exposure to changes in the fair value of certain fixed-rate loans through the use of interest rate swaps. As of December 31, 2019, Banner Bank was a party to $3.6 million in notional amounts of interest rate swaps designated in a hedge relationship. For a qualifying fair value hedge, changes in the value of the derivatives are recognized in current period earnings along with the corresponding changes in the fair value of the designated hedged item attributable to the risk being hedged.

**Deposit Activities and Other Sources of Funds**

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

We compete with other financial institutions and financial intermediaries in attracting deposits. There is strong competition for transaction balances and savings deposits from commercial banks, credit unions and non-bank corporations, such as securities brokerage companies, mutual funds and other diversified companies, some of which have nationwide networks of offices. Much of the focus of our acquisitions, branch relocations and renovation and advertising and marketing campaigns has been directed toward attracting additional deposit customer relationships and balances. In addition, our electronic and digital banking activities including debit card and automated teller machine (ATM) programs, on-line Internet banking services and, most recently, customer remote deposit and mobile banking capabilities are all directed at providing products and services that enhance customer relationships and result in growing deposit balances as well as fee income. Core deposits (non-interest-bearing checking and interest-bearing transaction and savings accounts) are a fundamental element of our business strategy. Core deposits were 89% of total deposits at December 31, 2019 compared to 86% a year earlier and 88% two years ago.

*Deposit Accounts:* We generally attract deposits from within our primary market areas by offering a broad selection of deposit instruments, including non-interest-bearing checking accounts, interest-bearing checking accounts, money market deposit accounts, regular savings accounts, certificates of deposit, treasury 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, 2019, we had $10.05 billion of deposits. For additional information concerning our deposit accounts, see Item 7 in this report, "Management's Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2019 and 2018—Deposit Accounts," including Table 8 contained therein, which sets forth the balances of deposits in the various types of accounts, and Table 9, which sets forth the amount of our certificates of deposit greater than $100,000 by time remaining until maturity as of December 31, 2019. In addition, see Note 8, Deposits of the Notes to the Consolidated Financial Statements.

*Borrowings:* While deposits are the primary source of funds for our lending and investment activities and for general business purposes, we also use borrowings to supplement our supply of lendable funds, to meet deposit withdrawal requirements and to more efficiently leverage our capital position. The FHLB serves as our primary borrowing source. The FHLB 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 and are authorized to apply for advances on the security of that stock and certain of their mortgage loans and securities, provided that certain credit worthiness standards have been met. Limitations on the amount of advances are based on the financial condition of the member institution, the adequacy of collateral pledged to secure the credit, and FHLB stock ownership requirements. At December 31, 2019, we had $450.0 million of borrowings from the FHLB. At that date, Banner Bank was authorized by the FHLB to borrow up to $5.31 billion under a blanket floating lien security agreement, while Islanders Bank was approved to borrow up to $132.7 million under a similar agreement. The Federal Reserve Bank serves as an additional source of borrowing capacity. The Federal Reserve Bank provides credit based upon acceptable loan collateral, which includes certain loan types not eligible for pledging to the FHLB. At December 31, 2019, based upon our available unencumbered collateral, Banner Bank was eligible to borrow $1.19 billion from the Federal Reserve Bank, although at that date we had no funds borrowed under this arrangement. Although eligible to participate, Islanders Bank has not applied for approval to borrow from the Federal Reserve Bank. For additional information concerning our borrowings, see Item 7 in this report, "Management's Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2019 and 2018—Borrowings," and Table 11 contained therein, as well as Note 9, Advances from Federal Home Loan Bank of Des Moines and Note 10, Other Borrowings of the Notes to the Consolidated Financial Statements.

At December 31, 2019, Banner Bank had uncommitted federal funds line of credit agreements with other financial institutions totaling $110.0 million, while Islanders Bank had an uncommitted federal funds line of credit agreement with another financial institution totaling $5.0 million.

No balances were outstanding under these agreements as of December 31, 2019. Availability of lines is subject to federal funds balances available for loan and continued borrower eligibility. These lines are intended to support short-term liquidity needs and the agreements may restrict consecutive day usage.

We issue retail repurchase agreements, generally due within 90 days, as an additional source of funds, primarily in connection with treasury management services provided to our larger deposit customers. At December 31, 2019, we had issued retail repurchase agreements totaling $118.5 million. We also may borrow funds through the use of secured wholesale repurchase agreements with securities brokers; at December 31, 2019, we had no borrowings outstanding under wholesale repurchase agreements. The retail repurchase borrowings were secured by pledges of certain U.S. Government and agency notes and mortgage-backed securities with a market value of $135.5 million at December 31, 2019.

We have also issued $120.0 million of junior subordinated debentures in connection with the sale of trust preferred securities (TPS) issued from 2002 through 2007 by special purpose business trusts formed by Banner Corporation and sold in private offerings to pooled investment vehicles. In addition, Banner has $23.5 million of junior subordinated debentures that were acquired through acquisitions, for a total of $143.5 million in debentures at December 31, 2019. The junior subordinated debentures associated with the TPS have been recorded as liabilities and are reported at fair value on our Consolidated Statements of Financial Condition. As of December 31, 2019 the fair value of the junior subordinate debentures was $119.3 million. All of the debentures issued to the trusts, measured at their fair value, less the common stock of the trusts, qualified as Tier I capital as of December 31, 2019. We invested substantially all of the proceeds from the issuance of the TPS as additional paid in capital at Banner Bank. See Note 11, Junior Subordinated Debentures and Mandatorily Redeemable Trust Preferred Securities, of the Notes to the Consolidated Financial Statements.

## Personnel

As of December 31, 2019, we had 2,198 full time equivalent 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.

## Taxation

### Tax-Sharing Agreement

Banner Corporation files its federal and state income tax returns on a consolidated basis under a tax-sharing agreement between the Company and each bank subsidiary. The Company prepares each subsidiary's minimum income tax which would be required if the individual subsidiary were to file federal and state income tax returns as a separate entity. Each subsidiary pays to the Company an amount equal to the estimated income tax due if it were to file as a separate entity. The payment is made on or about the time the subsidiary would be required to make such tax payments to the United States Treasury or the applicable State Departments of Revenue. In the event the computation of the subsidiary's federal or state income tax liability, after taking into account any estimated tax payments made, would result in a refund if the subsidiary were filing income tax returns as a separate entity, then the Company pays to the subsidiary an amount equal to the hypothetical refund. The Company is an agent for each subsidiary with respect to all matters related to the consolidated tax returns and refunds claims. If Banner's consolidated federal or state income tax liability is adjusted for any period, the liability of each party under the tax-sharing agreement is recomputed to give effect to such adjustments and any additional payments required as a result of the adjustments are made within a reasonable time after the corresponding additional tax payments are made or refunds are received.

### 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. See Note 12, Income Taxes, of the Notes to the Consolidated Financial Statements for additional information concerning the income taxes payable by us.

### State Taxation

*Washington Taxation:* We are subject to a Business and Occupation (B&O) tax which is imposed under Washington on gross receipts. Interest received on loans secured by mortgages or deeds of trust on residential properties, residential mortgage-backed securities, and certain U.S. Government and agency securities is not subject to this tax.

*California, Oregon, Idaho, Montana and Utah Taxation:* Corporations with nexus in the states of California, Oregon, Idaho, Montana and Utah are subject to a corporate level income tax. If a large percentage of our income were to come from these states the state income tax provision would have an increasing effect on our effective tax rate and results of operations.

## Competition

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

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

## Regulation

**Banner Bank and Islanders Bank**

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

Federal and state banking laws and regulations govern all areas of the operation of the Banks, including reserves, loans, investments, deposits, capital, issuance of securities, payment of dividends and establishment of branches. Federal and state bank regulatory agencies also have the general authority to limit the dividends paid by insured banks and bank holding companies if such payments should be deemed to constitute an unsafe and unsound practice and in other circumstances. The Federal Reserve and FDIC, as the respective primary federal regulators of Banner Corporation and each of 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. The Consumer Financial Protection Bureau (CFPB) is an independent bureau of the Federal Reserve. The CFPB is responsible for the implementation of the federal financial consumer protection and fair lending laws and regulations and has authority to impose new requirements.

Any change in applicable laws, regulations, or regulatory policies may have a material effect on our business, operations, and prospects. We cannot predict the nature or the extent of the effects on our business and earnings that any fiscal or monetary policies or new federal or state legislation may have in the future. For additional information, see Item 1A., “Risk Factors—We operate in a highly regulated environment and may be adversely affected by changes in federal and state laws and regulations that are expected to increase our costs of operation.” We may also be affected by changes in accounting standards. See "2018 Reforms" below.

The following is a summary discussion of certain laws and regulations applicable to Banner and the Banks which is qualified in its entirety by reference to the actual laws and regulations.

*State Regulation and Supervision*: As a Washington state-chartered commercial bank with branches in the States of Washington, Oregon, Idaho and California, Banner Bank is subject not only to the applicable provisions of Washington law and regulations, but is also subject to Oregon, Idaho and California law and regulations. These state laws and regulations govern Banner Bank's ability to take deposits and pay interest thereon, to make loans on or invest in residential and other real estate, to make consumer loans, to invest in securities, to offer various banking services to its customers and to establish branch offices. In a similar fashion, Washington state laws and regulations for state-chartered commercial banks also apply to Islanders Bank.

*Deposit Insurance*: The Deposit Insurance Fund of the FDIC insures deposit accounts of each of the Banks up to $250,000 per separately insured deposit relationship category. As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of, and to require reporting by, FDIC-insured institutions.

Under the FDIC's rules the assessment base for a bank is equal to its total average consolidated assets less average tangible capital. As of December 31, 2019, assessment rates ranged from 3 to 30 basis points for all institutions, subject to adjustments for unsecured debt issued by the institution, unsecured debt issued by other FDIC-insured institutions, and brokered deposits held by the institution.

Under the current rules, when the reserve ratio for the prior assessment period reaches, or is greater than 2.0% and less than 2.5%, assessment rates will range from two basis points to 28 basis points and when the reserve ratio for the prior assessment period is greater than 2.5%, assessment rates will range from one basis point to 25 basis points (in each case subject to adjustments as described above for current rates). No institution may pay a dividend if it is in default on its federal deposit insurance assessment.

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

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

*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. Each insured depository institution must implement a comprehensive written information security program that includes administrative, technical, and physical safeguards appropriate to the institution's size and complexity and the nature and scope of its activities. The information security program must be designed to ensure the security and confidentiality of customer information, protect against any unanticipated threats or hazards to the security or integrity of such information, protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer, and ensure the proper disposal of customer and consumer information. Each insured depository institution must also develop and implement a risk-based response program to address incidents of unauthorized access to customer information in customer information systems. If the FDIC determines that an institution fails to meet any of these guidelines, it may require an institution to submit to the FDIC an acceptable plan to achieve compliance.

*Capital Requirements:* Bank holding companies, such as Banner Corporation, and federally insured financial institutions, such as Banner Bank and Islanders Bank, are required to maintain a minimum level of regulatory capital.

Banner Corporation and the Banks are subject to minimum required ratios for Common Equity Tier 1 (“CET1”) capital, Tier 1 capital, total capital and the leverage ratio and a required capital conservation buffer over the required capital ratios.

Under the capital regulations, the minimum capital ratios are: (1) a CET1 capital ratio of 4.5% of risk-weighted assets; (2) a Tier 1 capital ratio of 6.0% of risk-weighted assets; (3) a total risk-based capital ratio of 8.0% of risk-weighted assets; and (4) a leverage ratio (the ratio of Tier 1 capital to average total consolidated assets) of 4.0%. CET1 generally consists of common stock; retained earnings; accumulated other comprehensive income (“AOCI”) unless an institution elects to exclude AOCI from regulatory capital; and certain minority interests; all subject to applicable regulatory adjustments and deductions. Tier 1 capital generally consists of CET1 and noncumulative perpetual preferred stock. Tier 2 capital generally consists of other preferred stock and subordinated debt meeting certain conditions plus an amount of the allowance for loan and lease losses up to 1.25% of assets. Total capital is the sum of Tier 1 and Tier 2 capital.

Trust preferred securities issued by a company, such as the Company, with total consolidated assets of less than $15 billion before May 19, 2010 and treated as regulatory capital are grandfathered, but any such securities issued later are not eligible as regulatory capital. If an institution grows above $15 billion as a result of an acquisition, the trust preferred securities are excluded from Tier 1 capital and instead included in Tier 2 capital. Mortgage servicing assets and deferred tax assets over designated percentages of CET1 are deducted from capital. In addition, Tier 1 capital includes AOCI, which includes all unrealized gains and losses on available for sale debt and equity securities. However, because of our asset size, we were eligible to elect, and did elect, to permanently opt out of the inclusion of unrealized gains and losses on available for sale debt and equity securities in our capital calculations.

For purposes of determining risk-based capital, assets and certain off-balance sheet items are risk-weighted from 0% to 1,250%, depending on the risk characteristics of the asset or item. The regulations include a 150% risk weight (up from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and for non-residential mortgage loans that are 90 days past due or otherwise in nonaccrual status; a 20% (up from 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable (up from 0%); and a 250% risk weight (up from 100%) for mortgage servicing and deferred tax assets that are not deducted from capital.

In addition to the minimum CET1, Tier 1, leverage ratio and total capital ratios, Banner and each of the Banks must maintain a capital conservation buffer consisting of additional CET1 capital greater than 2.5% of risk-weighted assets above the required minimum risk-based capital levels in order to avoid limitations on paying dividends, repurchasing shares, and paying discretionary bonuses.

To be considered "well capitalized," a bank holding company must have, on a consolidated basis, a total risk-based capital ratio of 10.0% or greater and a Tier 1 risk-based capital ratio of 6.0% or greater and must not be subject to an individual order, directive or agreement under which the FRB requires it to maintain a specific capital level. To be considered “well capitalized,” a depository institution must have a Tier 1 risk-based capital ratio of at least 8.0%, a total risk-based capital ratio of at least 10.0%, a CET1 capital ratio of at least 6.5% and a leverage ratio of at least 5.0% and not be subject to an individualized order, directive or agreement under which its primary federal banking regulator requires it to maintain a specific capital level.

*Prompt Corrective Action:* Federal statutes establish a supervisory framework for FDIC-insured institutions 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. The well-capitalized category is described above. An institution that is not well capitalized is subject to certain restrictions on brokered deposits, including restrictions on the rates it can offer on its deposits generally. To be considered adequately capitalized, an institution must have the minimum capital ratios described above. Any institution which is neither well capitalized nor adequately capitalized is considered undercapitalized.

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

As of December 31, 2019, Banner Corporation and each of the Banks met the requirements to be "well capitalized" and the fully phased-in capital conservation buffer requirement. For additional information, see Note 15, Regulatory Capital Requirements, of the Notes to the Consolidated Financial Statements.

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

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

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

The guidance provides that the strength of an institution's lending and risk management practices with respect to such concentrations will be taken into account in supervisory guidance on evaluation of capital adequacy. As of December 31, 2019, Banner Bank's and Islanders Bank's aggregate recorded loan balances for construction, land development and land loans were 93% and 33% of total regulatory capital, respectively. In addition, at December 31, 2019, Banner Bank's and Islanders Bank's loans on commercial real estate were 315% and 195% of total regulatory capital, respectively.

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

Washington State has enacted laws regarding financial institution parity. These laws afford Washington-chartered commercial banks the same powers as Washington-chartered savings banks and provide 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. Finally, the law provides additional flexibility for Washington-chartered 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.

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

*Federal Reserve System:* The Federal Reserve requires that all depository institutions maintain reserves on transaction accounts or non-personal time deposits. These reserves may be in the form of cash or non-interest-bearing deposits with the regional Federal Reserve Bank. Interest-bearing checking accounts and other types of accounts that permit payments or transfers to third parties fall within the definition of transaction accounts and are subject to Regulation D reserve requirements, as are any non-personal time deposits at a bank. At December 31, 2019, the Banks' deposits with the Federal Reserve Bank and vault cash exceeded their reserve requirements.

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

*Community Reinvestment Act:* Banner Bank and Islanders Bank are subject to the provisions of the Community Reinvestment Act of 1977 (CRA), which requires the appropriate federal bank regulatory agency to assess a bank's performance under the CRA in meeting the credit needs of the community serviced by the bank, including low and moderate income neighborhoods. The regulatory agency's assessment of the bank's record is made available to the public. Further, a bank's CRA performance rating must be considered in connection with a bank's application to, among other things, 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 recently completed CRA examinations.

*Dividends:* The amount of dividends payable by the Banks to the Company depends upon their earnings and capital position, and is limited by federal and state laws, regulations and policies, including the capital conservation buffer requirement. 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. In addition, under Washington law, no bank may declare or pay any dividend in an amount greater than its retained earnings without the prior approval of the Washington DFI. The Washington DFI also has the power to require any bank to suspend the payment of any and all dividends.

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

*Anti-Money Laundering and Customer Identification:* The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA Patriot Act) was signed into law on October 26, 2001. The USA PATRIOT and Bank Secrecy Acts require financial institutions to develop programs to prevent financial institutions from being used for money laundering and terrorist activities. If such activities are detected, financial institutions are obligated to file suspicious activity reports with the U.S. Treasury's Office of Financial Crimes Enforcement Network. These rules require financial institutions to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts, and, effective in 2018, the beneficial owners of accounts. Bank regulators are directed to consider an institution'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 are designed to comply with the requirements of the USA Patriot Act.

*Other Consumer Protection Laws and Regulations:* The CFPB is empowered to exercise broad regulatory, supervisory and enforcement authority with respect to both new and existing consumer financial protection laws. Effective the second quarter of 2019 Banner Bank and its affiliates and subsidiaries became subject to CFPB supervisory and enforcement authority.

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

**2018 Reforms**

In May 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the "Economic Growth Act") was enacted to modify or remove certain financial reform rules and regulations, including some of those implemented under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). While the Act maintains most of the regulatory structure established by the Dodd-Frank Act, it amends certain aspects of the regulatory framework for small depository institutions with assets of less than $10 billion and for large banks with assets of more than $50 billion.

In addition, the Economic Growth Act includes regulatory relief for community banks regarding regulatory examination cycles, call reports, the Volcker Rule (proprietary trading prohibitions), mortgage disclosures and risk weights for certain high-risk commercial real estate loans.

It is difficult at this time to predict when or how any new standards under the Economic Growth Act will ultimately be applied to us or what specific impact the Economic Growth Act and the yet-to-be-written implementing rules and regulations implementing the Economic Growth Act will have.

The Financial Accounting Standards Board (FASB) has adopted a new accounting standard, referred to as Current Expected Credit Loss, or CECL, which became effective for Banner on January 1, 2020. Upon adoption of CECL, a banking organization must record a one-time adjustment to its credit loss allowances as of the beginning of the fiscal year of adoption equal to the difference, if any, between the amount of credit loss allowances under the current methodology and the amount required under CECL. For additional information on CECL see Note 2, Accounting Standards Recently Issued or Adopted, of the Notes to the Consolidated Financial Statements. In 2018, the federal banking regulators (the Federal Reserve, the OCC and the FDIC) adopted a rule that gives a banking organization the option to phase in over a three-year period the day-one adverse effects of CECL on its regulatory capital.

**Banner Corporation**

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

*The Bank Holding Company Act:* Under the BHCA, Banner Corporation is supervised by the Federal Reserve. The Federal Reserve has a policy that a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, the Dodd-Frank Act provides that a bank holding company must serve as a source of financial strength to 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. No regulations have yet been proposed by the Federal Reserve to implement the source of strength provisions of the Dodd-Frank Act. Banner Corporation and any subsidiaries that it may control are considered "affiliates" of the Banks within the meaning of the Federal Reserve Act, and transactions between Banner Bank and affiliates are subject to numerous restrictions. With some exceptions, Banner Corporation and its subsidiaries are prohibited from tying the provision of various services, such as extensions of credit, to other services offered by Banner Corporation or by its affiliates.

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

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

*The Dodd-Frank Act:* On July 21, 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act imposes various restrictions and an expanded framework of regulatory oversight for financial institutions, including depository institutions, and implements certain capital regulations applicable to Banner Corporation and the Banks that are discussed above under the section entitled "Capital Requirements."

In addition, among other changes, the Dodd-Frank Act requires public companies, like Banner Corporation, to (i) provide their shareholders with a non-binding vote (a) at least once every three years on the compensation paid to executive officers and (b) at least once every six years on whether they should have a "say on pay" vote every one, two or three years; (ii) have a separate, non-binding shareholder vote regarding golden parachutes for named executive officers when a shareholder vote takes place on mergers, acquisitions, dispositions or other transactions that would trigger the parachute payments; (iii) provide disclosure in annual proxy materials concerning the relationship between the executive compensation paid and the financial performance of the issuer; and (iv) disclose the ratio of the Chief Executive Officer's annual total compensation to the median annual total compensation of all other employees.

The regulations to implement the provisions of Section 619 of the Dodd-Frank Act, commonly referred to as the Volcker Rule, contain prohibitions and restrictions on the ability of financial institutions holding companies and their affiliates to engage in proprietary trading and to hold certain interests in, or to have certain relationships with, various types of investment funds, including hedge funds and private equity funds. Banner Corporation is continuously reviewing its investment portfolio to determine if changes in its investment strategies are in compliance with the various provisions of the Volcker Rule regulations.

For certain of these changes, the implementing regulations have not been promulgated, so the full impact of the Dodd-Frank Act on public companies cannot be determined at this time. For information on the Economic Growth Act, which amended the Dodd-Frank Act, see "2018 Reforms" above.

*Sarbanes-Oxley Act of 2002:* As a public company that files periodic reports with the SEC, under the Securities Exchange Act of 1934, Banner Corporation is subject to the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley Act), which addresses, among other issues, corporate governance, auditing and accounting, executive compensation and enhanced and timely disclosure of corporate information. 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 are designed 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 generally authorized to approve interstate merger transactions without regard to whether the transaction is prohibited by the law of any state. Interstate acquisitions of branches are permitted only if the law of the state in which the branch is located permits such acquisitions. Interstate mergers and branch acquisitions are subject to the nationwide and statewide insured deposit concentration amounts described above. Under the Dodd-Frank Act, the federal banking agencies may generally approve interstate de novo branching.

*Dividends:* The Federal Reserve has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses its view that although there are no specific regulations restricting dividend payments by bank holding companies other than state corporate laws, a bank holding company must maintain an adequate capital position and generally should not pay cash dividends unless the company's net income for the past year is sufficient to fully fund the cash dividends and that the prospective rate of earnings appears consistent with the company's capital needs, asset quality, and overall financial condition. The Federal Reserve policy statement also indicates that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. As described above under "Capital Requirements," the capital conversion buffer requirement can also restrict Banner Corporation's and the Banks' ability to pay dividends. Further, under Washington law, Banner Corporation is prohibited from paying a dividend if, after making such dividend payment, it would be unable to pay its debts as they become due in the usual course of business, or if its total liabilities, plus the amount that would be needed in the event Banner Corporation were to be dissolved at the time of the dividend payment, to satisfy preferential rights on dissolution of holders of preferred stock ranking senior in right of payment to the capital stock on which the applicable distribution is to be made, exceed our total assets.

*Stock Repurchases:* A bank holding company, except for certain "well-capitalized" and highly rated bank holding companies, is required to give the Federal Reserve prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding twelve months, is equal to 10% or more of its consolidated net worth. The Federal Reserve may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe or unsound practice or would violate any law, regulation, Federal Reserve order or any condition imposed by, or written agreement with, the Federal Reserve. During the year ended December 31, 2019, Banner Corporation repurchased 1.0 million shares of its common stock at an average price of $53.90 per share.

## 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, 2019:

| Name | Age | Position with Banner Corporation | Position with Banner Bank |
|---|---|---|---|
| Mark J. Grescovich | 55 | President, Chief Executive Officer, Director | President, Chief Executive Officer, Director |
| Richard B. Barton | 76 | | Executive Vice President, Chief Credit Officer |
| Peter J. Conner | 54 | Executive Vice President Chief Financial Officer Treasurer | Executive Vice President, Chief Financial Officer |
| James P. Garcia | 60 | | Executive Vice President, Chief Audit Executive |
| Kenneth W. Johnson | 57 | | Executive Vice President Operations |
| Kayleen R. Kohler | 47 | | Executive Vice President Human Resources |
| Kenneth A. Larsen | 50 | | Executive Vice President, Mortgage Banking |
| James P. G. McLean | 55 | | Executive Vice President, Commercial Real Estate Lending Division |
| Craig Miller | 68 | Executive Vice President General Counsel | Executive Vice President General Counsel |
| Cynthia D. Purcell | 62 | | Executive Vice President, Retail Banking and Administration |
| M. Kirk Quillin | 57 | | Executive Vice President, Commercial Executive |
| James T. Reed, Jr. | 57 | | Executive Vice President, Commercial Banking West |
| Steven W. Rust | 72 | | Executive Vice President, Chief Information Officer |
| Judith A. Steiner | 57 | | Executive Vice President Chief Risk Officer |
| Gary W. Wagers | 59 | | Executive Vice President, Retail Products and Services |
| Keith A. Western | 64 | | Executive Vice President, Commercial Banking South |

**Biographical Information**

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

*Mark J. Grescovich* is President and Chief Executive Officer, and a director, of Banner Corporation and Banner Bank. Mr. Grescovich joined Banner Bank in April 2010 and became Chief Executive Officer in August 2010 following an extensive banking career specializing in finance, credit administration and risk management. Under his leadership, Banner has grown from $4.7 billion in assets in 2010 to more than $12 billion today through organic growth as well as selective acquisition. During that time, Mr. Grescovich has guided the expansion of the Company's footprint to over 200 locations in four states. Prior to joining the Bank, Mr. Grescovich was the Executive Vice President and Chief Corporate Banking Officer for Akron, Ohio-based FirstMerit Corporation and FirstMerit Bank N.A., a commercial bank with $14.5 billion in assets and over 200 branch offices in three states. He assumed the role and responsibility for FirstMerit's commercial and regional line of business in 2007, having served since 1994 in various commercial and corporate banking positions, including that of Chief Credit Officer. Prior to joining FirstMerit, Mr.

Grescovich was a Managing Partner in corporate finance with Sequoia Financial Group, Inc. of Akron, Ohio and a commercial and corporate lending officer and credit analyst with Society National Bank of Cleveland, Ohio. He has a Bachelor of Business Administration degree in finance from Miami University and a Master of Business Administration degree, also in finance, from The University of Akron.

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

*Peter J. Conner* joined Banner Bank in 2015 upon the acquisition of AmericanWest Bank (AmericanWest). Prior to joining Banner, Mr. Conner was the Chief Financial Officer for SKBHC LLC, the holding company for Starbuck Bancshares, Inc. (Starbuck), the holding company for AmericanWest, and AmericanWest from 2010 until he joined Banner Bank in 2015. Mr. Conner has 30 years of experience in executive finance positions at Wells Fargo Bank as well as regional community banks. Additionally, he spent time as a managing director for FSI Group, where he evaluated and placed equity fund investments in community banks. He earned a B.S. in Quantitative Economics from the University of California at San Diego and a Master's of Business degree from the Haas School of Business at U.C. Berkeley.

*James P. Garcia* is the Chief Audit Executive responsible for proactively identifying and mitigating risks as well as providing internal audit services in the areas of financial compliance, IT Governance, and operations. He has more than 42 years of experience in the financial services industry. Prior to joining Banner in 2017, Mr. Garcia served for 16 years at the Bank of Hawaii, most recently as Executive Vice President and Chief Audit Executive, with prior positions as Vice President and Senior Audit Manager. Mr. Garcia also has 24 years of experience at Bank of America where he held several positions in consumer and commercial operations management and audit, including that of Audit Director. Mr. Garcia earned his bachelor's degree in management from St. Mary's College of California and is a graduate of the School of Mortgage Banking. He is a Certified Bank Auditor (CBA), holds a Certification in Risk Management Assurance (CRMA) and is a Certified Information Systems Auditor (CISA).

*Kenneth W. Johnson* has over 31 years of banking experience. Prior to joining Skagit Bank in 2015, Mr. Johnson held various executive positions with Chemical Financial Corporation, including production oversight of commercial, mortgage, consumer and deposit generation. In addition, while at Chemical, he served nine years as Executive Vice President, Director of Bank Operations, responsible for nine business units including the branch system, information technology, corporate marketing, loan operations, deposit operations, electronic banking, facilities/purchasing, card services, and customer care centers. Prior to Chemical, he held leadership roles in retail banking and operations at Shoreline Bank and as Vice President, Zone Manager for Michigan National Bank. Mr. Johnson holds a Bachelor of Arts Degree in Business Administration from Michigan State University. He is also a graduate of Stonier Graduate School of Banking.

*Kayleen R. Kohler* joined Banner Bank in 2016 as Executive Vice President of Human Resources. Ms. Kohler's focus is on driving organizational design priorities at Banner Bank including: leadership development, talent acquisition, workforce planning, employee relations, compensation, benefits, diversity initiatives, payroll, and safety. Prior to joining Banner, Ms. Kohler served 20 years in progressive human resource leadership roles for Plum Creek Timber Company, now Weyerhaeuser. She holds bachelors' degrees in Marketing as well as Business Management from Northwest Missouri State University and a master's in Organizational Management from the University of Phoenix. Through continuing education, she maintains her certifications as a Senior Professional in Human Resources or SPHR and a Society of Human Resources Management Senior Certified Professional or SHRM-SCP.

*Kenneth A. Larsen* joined Banner Bank in 2005 as the Real Estate Administration Manager and was promoted to Mortgage Banking Director in 2010. Mr. Larsen is responsible for Banner Bank's mortgage banking activities from origination, administration, secondary marketing, through loan servicing. Mr. Larsen has had a 28-year career in mortgage banking, including holding positions in all facets of operations and management. A graduate of Eastern Washington University, he earned a Bachelor of Arts in Education with a degree in Social Science and earned certificates from the Pacific Coast Banking School and the School of Mortgage Banking. He is also a Certified Mortgage Banker, the highest designation recognized by the Mortgage Bankers Association. Mr. Larsen began his career at Action Mortgage/Sterling Savings, later moving to Peoples Bank of Lynden where he managed the mortgage banking operation. Mr. Larsen also served as the 90th President of the Seattle Mortgage Bankers Association. Formerly he was the Chairman of the Washington Mortgage Bankers Association and currently serves as a commissioner on the Washington State Housing Finance Commission. He was promoted to Executive Vice President in 2015.

*James P.G. McLean* joined Banner Bank in November 2010 and is Executive Vice President of the Commercial Real Estate Lending Division, leading teams within the Multifamily Lending Group, Commercial Real Estate Specialty Unit, Affordable Housing, Residential Construction and Income Property Divisions, as well as the loan administration functions related to this division. Mr. McLean has 29 years of real estate finance experience at large national commercial banks as well as community banks. This experience includes ten years in executive leadership roles and as a principal of a mid-sized regional commercial real estate development firm. Mr. McLean earned his bachelor's degree from the University of Washington. His community volunteering is focused on organizations that serve local youth, including the Boy Scouts of America, Lake Washington School District and numerous coaching positions.

*Craig Miller* is the Executive Vice President and General Counsel for Banner Corporation and Banner Bank. He joined Banner in 2016 and is responsible for overseeing the company's legal functions, and he serves also as Corporate Secretary and Ethics Officer for the company. Mr. Miller had previously served as senior litigation partner at Davis Wright Tremaine LLP in Seattle. Mr. Miller earned his B.A. degree from Grinnell College and his J.D. degree from the University of Southern California Law School. His community involvement includes board service with the YMCA of Greater Seattle, Childhaven (past board president), King County Sexual Assault Resource Center, and the Meany Center for the Performing Arts (past board president).

*Cynthia D. Purcell* is the Executive Vice President for Retail Banking and Administration. Ms. Purcell is responsible for leading the Retail Banking business line including Branch Banking, Mortgage Banking, Business Banking and Digital delivery channels, as well as oversight of administrative and support functions for Banner Bank. She was formerly the Chief Financial Officer of Inland Empire Bank (now Banner Bank), which she joined in 1981. Over her banking career, Ms. Purcell has been deeply involved in advocating for the industry through leadership roles on various Boards and committees including State Banking Associations and the American Bankers Association (ABA). She has also taught banking courses throughout her career, including the ABA Graduate School of Bank Investments and Financial Management, the Northwest Intermediate Banking School, and the Oregon Bankers Association Directors College.

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

*James T. Reed, Jr.* joined Towne Bank (now Banner Bank) as a Vice President and Commercial Branch Manager in July 1995 and was named as West Region Commercial Executive, later identified as North Region Commercial Banking Executive, in July 2012. He is responsible for Commercial Banking in Western Washington, Western Oregon, the Columbia Basin, and Spokane markets as well as Treasury Management and Specialty Banking Services. Mr. Reed began his banking career with Rainier Bank, which later became Security Pacific Bank and later still West One Bank. He earned a Bachelor of Arts in Interdisciplinary Arts and Sciences from the University of Washington and earned certificates from Pacific Coast Banking School, Northwest Intermediate Banking School and Northwest Intermediate Commercial Lending School. Currently, Mr. Reed is a member of the University of Washington Bothell Advisory Board and the Association of Washington Business Board of Directors.

*Steven W. Rust* joined Banner Bank in October 2005 as Senior Vice President and Chief Information Officer and was named to his current position as Executive Vice President and Chief Information Officer in September 2007. Mr. Rust has over 39 years of relevant industry experience prior to joining Banner Bank and was founder and President of InfoSoft Technology, through which he worked for nine years as a technology consultant and interim Chief Information Officer for banks and insurance companies. He also worked 19 years with US Bank/West One Bancorp as Senior Vice President & Manager of Information Systems.

*Judith A. Steiner* joined Banner Bank in 2016 as Executive Vice President and Chief Risk Officer. In this role, Ms. Steiner is responsible for overseeing the company's risk and compliance functions as well as Banner Bank's interactions with industry regulators. Prior to joining Banner, Ms. Steiner spent 25 years with FirstMerit Corporation in executive leadership positions including Executive Vice President & Chief Risk Officer, Secretary, and General Counsel. Ms. Steiner earned her bachelor's degree from the University of Akron and her Juris Doctor degree (JD) from the Case Western Reserve University School of Law.

*Gary W. Wagers* joined Banner Bank as Senior Vice President, Consumer Lending Administration in 2002 and was named to his current position in Retail Products and Services in January 2008. Mr. Wagers began his banking career in 1982 at Idaho First National Bank. Prior to joining Banner Bank, his career included senior management positions in retail lending and branch banking operations with West One Bank and US Bank. Mr. Wagers earned his bachelor's degree from Whitman College and his Master's of Business degree from the University of Oregon. He is also a graduate of the ABA's Stonier School of Banking.

*Keith A. Western* is Executive Vice President, Commercial Banking South for Banner Bank, joining Banner upon the merger of AmericanWest and Banner Bank. Prior to the merger, Mr. Western was President of Northwest Banking for AmericanWest since 2011. Mr. Western has 42 years of banking experience across multiple markets including the western, eastern and mid-western United States and Canada. The bulk of Mr. Western's career was with Bank of America (approximately 15 years) and Citibank (approximately 12 years) in a variety of assignments including asset based lending, commercial and business banking, and credit risk management.

**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 SEC.

**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. The risks described below are not the only ones we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition, capital levels, cash flows, liquidity, results of operations and prospects. The market price of our common stock could decline significantly due to any of these identified or other risks, and you could lose some or all of your investment. The risks discussed below also include forward-looking statements, and our actual results may differ substantially from those discussed in these forward-looking statements. This report is qualified in its entirety by these risk factors.**

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

Our operations are significantly affected by national and regional economic conditions. Weakness in the national economy or the economies of the markets in which we operate could have a material adverse effect on our financial condition, results of operations and prospects. We provide banking and financial services primarily to businesses and individuals in the states of Washington, Oregon, California and Idaho. All of our branches and most of our deposit customers are also located in these four states. Further, as a result of a high concentration of our customer base in the Puget Sound area and eastern Washington state regions, the deterioration of businesses in these areas, or one or more businesses with a large employee base in these areas, could have a material adverse effect on our business, financial condition, liquidity, results of operations and prospects. Weakness in the global economy has adversely affected many businesses operating in our markets that are dependent upon international trade and it is not known how changes in tariffs being imposed on international trade may also affect these businesses. In addition, adverse weather conditions as well as decreases in market prices for agricultural products grown in our primary markets can adversely affect agricultural businesses in our markets. As we expand our presence in areas such as San Diego and Sacramento, and throughout California, we will be exposed to concentration risks in those areas as well.

A deterioration in economic conditions in the markets we serve, in particular the Puget Sound area of Washington State, the Portland, Oregon metropolitan area, Spokane, Washington, Boise, Idaho, Eugene and southwest Oregon, San Diego and Sacramento, California and the agricultural regions of the Columbia Basin, could result in the following consequences, any of which could have a material adverse effect on our business, financial condition, liquidity and results of operations:

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

A decline in local economic conditions may have a greater effect on our earnings and capital than on the earnings and capital of larger financial institutions whose real estate loans are more geographically diverse. Many of the loans in our portfolio are secured by real estate. Deterioration in the real estate markets where collateral for a mortgage loan is located could negatively affect the borrower's ability to repay the loan and the value of the collateral securing the loan. Real estate values are affected by various other factors, including changes in general or regional economic conditions, governmental rules or policies and natural disasters such as earthquakes, flooding and tornadoes. If we are required to liquidate a significant amount of collateral during a period of reduced real estate values, our financial condition and profitability could be adversely affected.

Adverse changes in the regional and general economy could reduce our growth rate, impair our ability to collect loans and generally have a negative effect on our financial condition and results of operations.

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

In addition to first-lien one- to four -family residential real estate lending, we originate construction and land loans, commercial and multifamily mortgage loans, commercial business loans, agricultural mortgage loans and agricultural loans, and consumer loans, primarily within our market areas. We had $8.36 billion outstanding in these types of higher risk loans at December 31, 2019, compared to $7.71 billion at December 31, 2018. These loans typically present different risks to us for a number of reasons, including those discussed below:

- *Construction and Land Loans.* At December 31, 2019, construction and land loans were $1.17 billion, or 13% of our total loan portfolio. This type of lending is subject to the inherent difficulties in estimating both a property's value at completion of a project and the estimated cost (including interest) of the project. Because of the uncertainties inherent in estimating construction costs, as well as the market value of a completed project and the effects of governmental regulation on real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the completed project's loan-to-value ratio. If the estimate of construction cost proves to be inaccurate, we may be required to advance funds beyond the amount originally committed to ensure completion of the project. If our appraisal of the value of a completed project proves to be overstated, we may have inadequate security for the repayment of the loan upon completion of construction of the project and may incur a loss. Disagreements between borrowers and builders and the failure of builders to pay subcontractors may also jeopardize projects. This type of lending also typically involves higher loan principal

amounts and may be concentrated with a small number of builders. A downturn in housing, or the real estate market, could increase delinquencies, defaults and foreclosures, and significantly impair the value of our collateral and our ability to sell the collateral upon foreclosure. Some of the builders we deal with have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss. In addition, during the term of some of our construction loans, no payment from the borrower is required since the accumulated interest is added to the principal of the loan through an interest reserve. Increases in market rates of interest may have a more pronounced effect on construction loans by rapidly increasing the end-purchaser's borrowing costs, thereby possibly reducing the homeowner's ability to finance the home upon completion or the overall demand for the project. Properties under construction are often difficult to sell and typically must be completed in order to be successfully sold which also complicates the process of managing our problem construction loans. This may require us to advance additional funds and/or contract with another builder to complete construction and assume the market risk of selling the project at a future market price, which may or may not enable us to fully recover unpaid loan funds and associated construction and liquidation costs. In addition, speculative construction loans to a builder are often associated with homes that are not pre-sold, and thus pose a greater potential risk to us than construction loans to individuals on their personal residences. Loans on land under development or held for future construction also pose additional risk because of the lack of income being produced by the property and the potential illiquid nature of the collateral. These risks can be significantly impacted by supply and demand. 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 or obtain permanent take-out financing, rather than the ability of the borrower or guarantor to independently repay principal and interest.

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

As a result of the increasing real estate values in certain of our market areas, this category of lending has increased. Our investment in construction and land loans increased by $62.1 million or 6% in 2019. At December 31, 2019, construction and land loans that were non-performing were $2.2 million, or 6% of our total non-performing loans.

- *Commercial and Multifamily Real Estate Loans*. At December 31, 2019, commercial and multifamily real estate loans were $4.36 billion, or 47% of our total loan portfolio. These loans typically involve higher principal amounts than other types of loans and some of our commercial borrowers have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan. Repayment of these loans is dependent upon income being generated from the property securing the loan in amounts sufficient to cover operating expenses and debt service, which may be adversely affected by changes in the economy or local market conditions. In addition, many of our commercial and multifamily real estate loans are not fully amortizing and contain large balloon payments upon maturity. Such balloon payments may require the borrower to either sell or refinance the underlying property in order to make the payment, which may increase the risk of default or non-payment. If we foreclose on a commercial or multifamily real estate loan, our holding period for the collateral typically is longer than for one-to-four family residential loans because there are fewer potential purchasers of the collateral. At December 31, 2019, commercial and multifamily real estate loans that were non-performing were $6.1 million, or 15% of our total non-performing loans.

- *Commercial Business Loans.* At December 31, 2019, commercial business loans were $1.69 billion, or 18% of our total loan portfolio. Our commercial business loans are primarily made based on the cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. A borrower's cash flow may prove to be unpredictable, and collateral securing these loans may fluctuate in value. Most often, this collateral includes accounts receivable, inventory, equipment or real estate. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. Other collateral securing loans may depreciate over time, may be difficult to appraise, may be illiquid and may fluctuate in value based on the success of the business. At December 31, 2019, commercial business loans that were non-performing were $23.4 million, or 59% of our total non-performing loans.

- *Agricultural Loans*. At December 31, 2019, agricultural loans were $370.5 million, or 4% of our total loan portfolio. Agricultural lending involves a greater degree of risk and typically involves higher principal amounts than other types of 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 adverse weather conditions that prevent the planting of a crops or limit crop yields (such as hail, drought and floods), loss of livestock due to disease or other factors, declines in market prices for agricultural products (both domestically and internationally) and the impact of government regulations (including changes in price supports, subsidies, tariffs and environmental regulations). In addition, many farms are dependent on a limited number of key individuals whose injury or death may significantly affect the successful operation of the farm. If the cash flow from a farming operation is diminished, the borrower's ability to repay the loan may

be impaired. Consequently, agricultural loans may involve a greater degree of risk than other types of loans, particularly in the case of loans that are unsecured or secured by rapidly depreciating assets such as farm equipment (some of which is highly specialized with a limited or no market for resale), or assets such as livestock or crops. In such cases, any repossessed collateral for a defaulted agricultural operating 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 or because the assessed value of the collateral exceeds the eventual realization value. At December 31, 2019, there were $661,000 of agricultural loans that were non-performing, or 2% of total non-performing loans.

- *Consumer Loans*. At December 31, 2019, consumer loans were $762.8 million, or 8% of our total loan portfolio. Our consumer loans often entail greater risk than first-lien residential mortgage loans. Home equity lines of credit generally entail greater risk than do one- to four-family residential mortgage loans where we are in the first lien position. For those home equity lines secured by a second mortgage, it is less likely that we will be successful in recovering all of our loan proceeds in the event of default. Our foreclosure on these loans requires that the value of the property be sufficient to cover the repayment of the first mortgage loan, as well as the costs associated with foreclosure. In the case of consumer loans that are unsecured or secured by rapidly depreciating assets such as automobiles, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The remaining deficiency often does not warrant further substantial collection efforts against the borrower. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount which can be recovered on these consumer loans. Loans that we purchased, or indirectly originated, 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. At December 31, 2019, consumer loans that were non-performing were $2.9 million, or 7% of our total non-performing loans.

**Our business may be adversely affected by credit risk associated with residential property and declining property values.**

At December 31, 2019, first-lien one- to four-family real estate loans were $945.6 million or 10% of our total loan portfolio. Our first-lien one- to four-family real estate loans are primarily made based on the repayment ability of the borrower and the collateral securing these loans. Foreclosure on the loans requires that the value of the property be sufficient to cover the repayment of the loan, as well as the costs associated with foreclosure.

This type of lending is generally sensitive to regional and local economic conditions that significantly impact the ability of borrowers to meet their loan payment obligations, making loss levels difficult to predict. A downturn in the economy or the housing market in our market areas or a rapid increase in interest rates may reduce the value of the real estate collateral securing these types of loans and increase the risk that we would incur losses if borrowers default on their loans. Residential loans with high combined loan-to-value generally will be more sensistive to declining properly values than those with lower combined loan-to-value ratios and therefore may experience a higher incidence of default and severity of losses. In addition, if the borrowers sell their homes, the borrowers may be unable to repay their loans in full from the sale proceeds. As a result, these loans may experience higher rates of delinquencies, defaults and losses, which will in turn adversely affect our financial condition and results of operations.

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

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

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

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

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

The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. If our estimates are incorrect, the allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in the need for increases in our allowance for

loan losses through the provision for losses on loans which is recorded as charged against income. Management also recognizes that significant new growth in loan portfolios, new loan products and the refinancing of existing loans can result in portfolios comprised of unseasoned loans that may not perform in a historical or projected manner and will increase the risk that our allowance may be insufficient to absorb losses without significant additional provisions.

Deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in the allowance for loan losses. If current conditions in the housing and real estate markets weaken, we expect we will experience increased delinquencies and credit losses.

The FASB has adopted a new accounting standard referred to as Current Expected Credit Loss (CECL) which will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans and recognize the expected credit losses as allowances for credit losses. This will change the current method of providing allowances for credit losses only when they have been incurred and are probable, which may require us to increase our allowance for loan losses, and may greatly increase the types of data we would need to collect and review to determine the appropriate level of the allowance for credit losses. This accounting pronouncement became applicable to us on January 1, 2020. We will recognize a onetime cumulative-effect adjustment to the allowance for loan losses as of the date of adoption. We currently estimate that the adoption of this ASU will result in a combined increase to our allowance for credit losses and reserve for unfunded loan commitments of 10% to 20%. For additional information on CECL and the estimated impact of the one-time cumulative-effect adjustment see Note 2, Accounting Standards Recently Issued or Adopted, of the Notes to the Consolidated Financial Statements. The federal banking regulators, including the Federal Reserve and the FDIC, have adopted a rule that gives a banking organization the option to phase in over a three-year period the day-one adverse effects of CECL on its regulatory capital.

In addition, bank regulatory agencies periodically review our allowance for loan losses and may require an increase in the provision for possible loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. If charge-offs in future periods exceed the allowance for loan losses, we may need additional provisions to increase the allowance for loan losses. Any increases in the allowance for loan losses will result in a decrease in net income and, most likely, capital, and may have a material negative effect on our financial condition and results of operations.

**We pursue a strategy of supplementing internal growth by acquiring other financial companies or their assets and liabilities that we believe will help us fulfill our strategic objectives and enhance our earnings. We may be adversely affected by risks associated with potential acquisitions.**

As part of our general growth strategy, we have recently expanded our business through acquisitions. During the fourth quarter of 2019, we acquired AltaPacific, and expect system integration to be completed in the first quarter of 2020. Although our business strategy emphasizes organic expansion, we continue, from time to time in the ordinary course of business, to engage in preliminary discussions with potential acquisition targets. There can be no assurance that, in the future, we will successfully identify suitable acquisition candidates, complete acquisitions and successfully integrate acquired operations into our existing operations or expand into new markets. The consummation of any future acquisitions may dilute shareholder value or may have an adverse effect upon our operating results while the operations of the acquired business are being integrated into our operations. In addition, once integrated, acquired operations may not achieve levels of profitability comparable to those achieved by Banner's existing operations, or otherwise perform as expected. Further, transaction-related expenses may adversely affect our earnings. These adverse effects on our earnings and results of operations may have a negative impact on the value of Banner's stock. Acquiring banks, bank branches or businesses involves risks commonly associated with acquisitions, including:

- We may be exposed to potential asset quality issues or unknown or contingent liabilities of the banks, businesses, assets, and liabilities we acquire. If these issues or liabilities exceed our estimates, our results of operations and financial condition may be materially negatively affected;
- Higher than expected deposit attrition;
- Potential diversion of our management's time and attention;
- Prices at which acquisitions can be made fluctuate with market conditions. We have experienced times during which acquisitions could not be made in specific markets at prices we considered acceptable and expect that we will experience this situation in the future;
- The acquisition of other entities generally requires integration of systems, procedures and personnel of the acquired entity into our company to make the transaction economically successful. This integration process is complicated and time consuming and can also be disruptive to the customers of the acquired business. If the integration process is not conducted successfully and with minimal adverse effect on the acquired business and its customers, we may not realize the anticipated economic benefits of particular acquisitions within the expected time frame, and we may lose customers or employees of the acquired business. We may also experience greater than anticipated customer losses even if the integration process is successful;
- To finance an acquisition, we may borrow funds, thereby increasing our leverage and diminishing our liquidity, or raise additional capital, which could dilute the interests of our existing shareholders;
- We have completed various acquisitions in the past few years that enhanced our rate of growth. We may not be able to continue to sustain our past rate of growth or to grow at all in the future; and
- To the extent our costs of an acquisition exceed the fair value of the net assets acquired, the acquisition will generate goodwill. As discussed below under "-If the goodwill we have recorded in connection with acquisitions become impaired, our earnings and capital could be reduced," we are required to assess our goodwill for impairment at least annually, and any goodwill impairment charge could have a material adverse effect on our results of operations and financial condition.

**The required accounting treatment of loans we acquire through acquisitions including purchase credit impaired loans could result in higher net interest margins and interest income in current periods and lower net interest margins and interest income in future periods.**

Under GAAP, we are required to record loans acquired through acquisitions, including purchase credit impaired loans, at fair value. Estimating the fair value of such loans requires management to make estimates based on available information and facts and circumstances as of the acquisition date. Actual performance could differ from management's initial estimates. If these loans outperform our original fair value estimates, the difference between our original estimate and the actual performance of the loan (the "discount") is accreted into net interest income. Thus, our net interest margins may initially increase due to the discount accretion. We expect the yields on our loans to decline as our acquired loan portfolio pays down or matures and the discount decreases, and we could experience downward pressure on our interest income to the extent that the runoff on our acquired loan portfolio is not replaced with comparable high-yielding loans. This could result in higher net interest margins and interest income in current periods and lower net interest rate margins and lower interest income in future periods.

**Severe weather, natural disasters, or other catastrophes could significantly impact our business.**

Severe weather, natural disasters, widespread disease or pandemics, acts of war or terrorism or other adverse external events could have a significant impact on our ability to conduct business. In addition, such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans and leases, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue or cause us to incur additional expenses. The occurrence of any of these events in the future could have a material adverse effect on our business, financial condition or results of operations.

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

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

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

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

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

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

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

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

Our mortgage banking operations provide a significant portion of our non-interest income. We generate mortgage banking revenues primarily from gains on the sale of one- to four-family and multifamily mortgage loans. The one- to four-family mortgage loans are sold pursuant to programs currently offered by Fannie Mae, Freddie Mac, Ginnie Mae and non-Government Sponsored Enterprise (GSE) investors. These entities

account for a substantial portion of the secondary market in residential one- to four-family mortgage loans. Multifamily mortgage loans are sold primarily to non-GSE investors.

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

**Certain hedging strategies that we use to manage investment in mortgage servicing rights, mortgage loans held for sale and interest rate lock commitments may be ineffective to offset any adverse changes in the fair value of these assets due to changes in interest rates and market liquidity.**

We use derivative instruments to economically hedge mortgage servicing rights, mortgage loans held for sale and interest rate lock commitments to offset changes in fair value resulting from changing interest rate environments. Our hedging strategies are susceptible to prepayment risk, basis risk, market volatility and changes in the shape of the yield curve, among other factors. In addition, hedging strategies rely on assumptions and projections regarding assets and general market factors. If these assumptions and projections prove to be incorrect or our hedging strategies do not adequately mitigate the impact of changes in interest rates, we may incur losses that would adversely impact earnings.

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

Our earnings and cash flows are largely dependent upon our net interest income. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Federal Reserve. In an attempt to help the overall economy, the Federal Reserve kept interest rates low through its targeted Fed Funds rate for a number of years, however, the Federal Reserve steadily increased the targeted Fed Funds rate in 2018 and 2017. Beginning in August 2019 the Federal Reserve has reduced the targeted Fed Funds rate 25 basis points three times to a range of 1.50% to 1.75% at December 31, 2019 in response to some recent weaknesses in economic data and indicated possible further decreases, subject to economic conditions. If the Federal Reserve decreases the targeted federal funds rates further, overall interest rates will likely decline, which may negatively impact our net interest income. If the Federal Reserve increases the targeted federal funds rates, overall interest rates will likely rise, which will positively impact our net interest income but may negatively impact both the housing market by reducing refinancing activity and new home purchases and the U.S. economy. In addition, deflationary pressures, while possibly lowering our operational costs, could have a significant negative effect on our borrowers, especially our business borrowers, and the values of collateral securing loans which could negatively affect our financial performance.

We principally manage interest rate risk by managing our volume and mix of our earning assets and funding liabilities. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and investments and the amount of interest we pay on deposits and borrowings, but these changes could also affect (i) our ability to originate and/or sell loans and obtain deposits, (ii) the fair value of our financial assets and liabilities, which could negatively impact shareholders' equity, and our ability to realize gains from the sale of such assets, (iii) our ability to obtain and retain deposits in competition with other available investment alternatives, (iv) the ability of our borrowers to repay adjustable or variable rate loans, and (v) the average duration of our investment securities portfolio and other interest-earning assets. In a changing interest rate environment, we may not be able to manage this risk effectively. If we are unable to manage interest rate risk effectively, our business, financial condition and results of operations could be materially affected.

Changes in interest rates could also have a negative impact on our results of operations by reducing the ability of borrowers to repay their current loan obligations or by reducing our margins and profitability. Our net interest margin is the difference between the yield we earn on our assets and the interest rate we pay for deposits and our other sources of funding. Changes in interest rates—up or down—could adversely affect our net interest margin and, as a result, our net interest income. Although the yield we earn on our assets and our funding costs tend to move in the same direction in response to changes in interest rates, one can rise or fall faster than the other, causing our net interest margin to expand or contract. Our liabilities tend to be shorter in duration than our assets, so they may adjust faster in response to changes in interest rates. As a result, when interest rates decline, the yield we earn on our assets may decline faster than our funding costs, causing our net interest margin to contract until the funding costs catch up. Changes in the slope of the "yield curve"—or the spread between short-term and long-term interest rates—could also reduce our net interest margin. Normally, the yield curve is upward sloping, meaning short-term rates are lower than long-term rates. Because our liabilities tend to be shorter in duration than our assets, when the yield curve flattens or even inverts, we could experience pressure on our net interest margin as our cost of funds increases relative to the yield we can earn on our assets. Also, interest rate decreases can lead to increased prepayments of loans and mortgage-backed securities as borrowers refinance their loans to reduce borrowing costs. Under these circumstances, we are subject to reinvestment risk as we may have to redeploy such repayment proceeds into lower yielding investments, which would likely hurt our income.

A sustained increase in market interest rates could adversely affect our earnings. As is the case with many banks our emphasis on increasing core deposits has resulted in an increasing percentage of our deposits being comprised of deposits bearing no or a relatively low rate of interest and

having a shorter duration than our assets. We would incur a higher cost of funds to retain these deposits in a rising interest rate environment. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, our net interest income, and therefore earnings, could be adversely affected.

In addition, a substantial amount of our loans have adjustable interest rates. As a result, these loans may experience a higher rate of default in a rising interest rate environment. Further, a significant portion of our adjustable rate loans have interest rate floors below which the loan's contractual interest rate may not adjust. Approximately 66% of our loan portfolio was comprised of adjustable or floating-rate loans at December 31, 2019, and approximately $2.88 billion, or 47%, of those loans contained interest rate floors, below which the loans' contractual interest rate may not adjust. At December 31, 2019, the weighted average floor interest rate of these loans was 4.73%. At that date, approximately $1.23 billion, or 43%, of these loans were at their floor interest rate. The inability of our loans to adjust downward can contribute to increased income in periods of declining interest rates, although this result is subject to the risks that borrowers may refinance these loans during periods of declining interest rates. Also, when loans are at their floors, there is a further risk that our interest income may not increase as rapidly as our cost of funds during periods of increasing interest rates which could have a material adverse effect on our results of operations.

Changes in interest rates also affect the value of our interest-earning assets and in particular our securities portfolio. Generally, the fair value of fixed-rate securities fluctuates inversely with changes in interest rates. Unrealized gains and losses on securities available for sale are reported as a separate component of equity, net of tax. Decreases in the fair value of securities available for sale resulting from increases in interest rates could have an adverse effect on stockholders' equity.

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on our results of operations, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on our financial condition, liquidity and results of operations. Also, our interest rate risk modeling techniques and assumptions may not fully predict or capture the impact of actual interest rate changes on our balance sheet or projected operating results. For further discussion of how changes in interest rates could impact us, see "Part II, Item 7A. Quantitative and Qualitative Disclosures About Market Risk" for additional information about our interest rate risk management.

**Uncertainty relating to the London Interbank Offered Rate (LIBOR) calculation process and potential phasing out of LIBOR may adversely affect our results of operations.**

On July 27, 2017, the Chief Executive of the United Kingdom Financial Conduct Authority (FCA), which regulates LIBOR, announced that the FCA intends to stop persuading or compelling banks to submit rates for the calibration of LIBOR to the administrator of LIBOR after 2021. The announcement indicates that the continuation of LIBOR on the current basis cannot and will not be guaranteed after 2021. It is impossible to predict whether and to what extent banks will continue to provide LIBOR submissions to the administrator of LIBOR or whether any additional reforms to LIBOR may be enacted in the United Kingdom or elsewhere. At this time, no consensus exists as to what rate or rates may become acceptable alternatives to LIBOR and it is impossible to predict the effect of any such alternatives on the value of LIBOR-based securities and variable rate loans, subordinated debentures, or other securities or financial arrangements, given LIBOR's role in determining market interest rates globally. The Federal Reserve, in conjunction with the Alternative Reference Rates Committee, a steering committee comprised of large U.S. financial institutions, selected a new index calculated by short-term repurchase agreements, backed by Treasury securities (SOFR) to replace LIBOR. SOFR is observed and backward looking, which stands in contrast with LIBOR under the current methodology, which is an estimated forward-looking rate and relies, to some degree, on the expert judgment of submitting panel members. Given that SOFR is a secured rate backed government securities, it will be a rate that does not take into account bank credit risk (which is different for LIBOR). SOFR is therefore likely to be lower than LIBOR and is less likely to correlate with the funding costs of financial institutions. Whether or not SOFR attains market traction as a LIBOR replacement tool remains in question, although some transactions using SOFR have been completed in 2019, and the future of LIBOR remains uncertain at this time. Uncertainty as to the nature of alternative reference rates and as to potential changes or other reforms to LIBOR may adversely affect LIBOR rates and the value of LIBOR-based loans, and to a lesser extent, securities in our portfolio, and may impact the availability and cost of hedging instruments and borrowings, including the rates we pay on our subordinated debentures and trust preferred securities. If LIBOR rates are no longer available, and we are required to implement substitute indices for the calculation of interest rates under our loan agreements with our borrowers or our existing borrowings, we may incur significant expenses in effecting the transition, and may be subject to disputes or litigation with customers and creditors over the appropriateness or comparability to LIBOR of the substitute indices, which could have an adverse effect on our results of operations.

**Reductions in interchange income could further negatively impact our earnings.**

Effective July 1, 2019, Banner Bank and Islanders Bank were affected by the Durbin Amendment to the Dodd-Frank Act regarding limits on debit card interchange fees. The Durbin Amendment gave the Federal Reserve the authority to establish rules regarding interchange fees charged for electronic debit transactions by a payment card issuer that, together with its affiliates, has assets of $10 billion or more at year end and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer. Banner and Banner Bank exceeded $10 billion in assets as of December 31, 2018 and therefore Banner Bank and Islanders Bank were subject to the Durbin Amendment interchange fee limitation effective July 1, 2019. The Federal Reserve has adopted rules under this provision that limit the swipe fees that a debit card issuer can charge a merchant for a transaction to the sum of 21 cents and five basis points times the value of the transaction, plus up to one cent for fraud prevention costs. During the year ended December 31, 2019 we earned $19.2 million of interchange fees on card transactions, compared to $23.2 million during the year ended December 31, 2018. Debit card related fee income during 2019 was reduced by approximately $7 million as a result of the application of the Durbin Amendment to Banner Bank and Islanders Bank beginning July 1, 2019. Debit card related fee income is expected to be further reduced in 2020 as the full year will be subject to Durbin Amendment interchange fee limitation.

Interchange income is derived from fees paid by merchants to the interchange network in exchange for the use of the network's infrastructure and payment facilitation. These fees are paid to card issuers to compensate them for the costs associated with issuance and operation. Merchants have attempted to negotiate lower interchange rates, and the Durbin Amendment to the Dodd-Frank Act, which we have been subject to since July 1, 2019, limits the amount of interchange fees that may be charged for certain debit card transactions. As the financial services industry evolves, consumers may find debit financial services to be less attractive than traditional or other financial services. Consumers might not use debit card financial services for any number of reasons, including the general perception of our industry. If consumers do not continue or increase their usage of debit cards, including making changes in the way debit cards are loaded, our operating revenues and debit card deposits may remain at current levels or decline. Any projected growth for the industry may not occur or may occur more slowly than estimated. If consumer acceptance of debit financial services does not continue to develop or develops more slowly than expected or if there is a shift in the mix of payment forms, such as cash, credit cards, traditional debit cards and debit cards, away from our products and services, it could have a material adverse effect on our financial position and results of operations. Merchants may also continue to pursue alternative payment platforms, such as Apple Pay, to lower their processing costs. Any such new payment system may reduce our interchange income. Our failure to comply with the operating regulations set forth by payment card networks, which may change, could subject us to penalties, fees or the termination of our license to use the networks. Any of these scenarios could have a material impact on our business, financial condition and results of operations.

**Our business and financial results could be impacted materially by adverse results in legal proceedings.**

Legal proceedings could result in judgments, significant time and attention from our management, or other adverse effects on our business and financial results. We establish estimated liabilities for legal claims when payments associated with claims become probable and the amount of loss can be reasonably estimated. We may still incur losses for a matter even if we have not established an estimated liability. In addition, the actual cost of resolving a legal claim may be substantially higher than any amounts accrued for that matter. The ultimate resolution of any legal proceeding, depending on the remedy sought and granted, could materially adversely affect our results of operations and financial condition.

**New or changing tax, accounting, and regulatory rules and interpretations could significantly impact strategic initiatives, results of operations, cash flows, and financial condition.**

The financial services industry is extensively regulated. Federal and state banking regulations are designed primarily to protect the deposit insurance funds and consumers, not to benefit our shareholders. These regulations may sometimes impose significant limitations on operations. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of an institution, the classification of assets by the institution and the adequacy of an institution's allowance for loan losses. These bank regulators also have the ability to impose conditions in the approval of merger and acquisition transactions.

Additionally, actions by regulatory agencies or significant litigation against us and may lead to penalties that materially affect us. These regulations, along with the currently existing tax, accounting, securities, insurance, and monetary laws, regulations, rules, standards, policies, and interpretations control the methods by which financial institutions conduct business, implement strategic initiatives and tax compliance, and govern financial reporting and disclosures. These laws, regulations, rules, standards, policies, and interpretations are constantly evolving and may change significantly over time. Any new regulations or legislation, change in existing regulations or oversight, whether a change in regulatory policy or a change in a regulator's interpretation of a law or regulation, could have a material impact on our operations, increase our costs of regulatory compliance and of doing business and/or otherwise adversely affect us and our profitability. Further, changes in accounting standards can be both difficult to predict and involve judgment and discretion in their interpretation by us and our independent registered public accounting firm. These changes could materially impact, potentially even retroactively, how we report our financial condition and results of our operations as could our interpretation of those changes. We cannot predict what restrictions may be imposed upon us with future legislation.

**Non-compliance with the USA PATRIOT Act, Bank Secrecy Act, or other laws and regulations could result in fines or sanctions and limit our ability to obtain regulatory approval of acquisitions.**

The USA PATRIOT and Bank Secrecy Acts require financial institutions to develop programs to prevent financial institutions from being used for money laundering and terrorist activities. If such activities are detected, financial institutions are obligated to file suspicious activity reports with the U.S. Treasury's Office of Financial Crimes Enforcement Network. These rules require financial institutions to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts. Failure to comply with these regulations could result in fines or sanctions and limit our ability to obtain regulatory approval of acquisitions. Recently, several banking institutions have received large fines for non-compliance with these laws and regulations. While we have developed policies and procedures designed to assist in compliance with these laws and regulations, no assurance can be given that these policies and procedures will be effective in preventing violations of these laws and regulations. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us. Any of these results could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

**Development of new products and services may impose additional costs on us and may expose us to increased operational risk.**

Our financial performance depends, in part, on our ability to develop and market new and innovative services and to adopt or develop new technologies that differentiate our products or provide cost efficiencies, while avoiding increased related expenses. This dependency is exacerbated in the current "FinTech" environment, where financial institutions are investing significantly in evaluating new technologies, such as "Blockchain," and developing potentially industry-changing new products, services and industry standards. The introduction of new products and services can entail significant time and resources, including regulatory approvals. Substantial risks and uncertainties are associated with the introduction of new

products and services, including technical and control requirements that may need to be developed and implemented, rapid technological change in the industry, our ability to access technical and other information from our clients, the significant and ongoing investments required to bring new products and services to market in a timely manner at competitive prices and the preparation of marketing, sales and other materials that fully and accurately describe the product or service and its underlying risks. Our failure to manage these risks and uncertainties also exposes us to enhanced risk of operational lapses which may result in the recognition of financial statement liabilities. Regulatory and internal control requirements, capital requirements, competitive alternatives, vendor relationships and shifting market preferences may also determine if such initiatives can be brought to market in a manner that is timely and attractive to our clients. Failure to successfully manage these risks in the development and implementation of new products or services could have a material adverse effect on our business and reputation, as well as on our consolidated results of operations and financial condition.

**If the goodwill we have recorded in connection with acquisitions become impaired, our earnings and capital could be reduced.**

In accordance with GAAP, we record assets acquired and liabilities assumed at their fair value with the excess of the purchase consideration over the net assets acquired resulting in the recognition of goodwill. As a result, acquisitions typically result in recording goodwill. We perform a goodwill evaluation at least annually to test for goodwill impairment. As part of our testing, we first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If we determine the fair value of a reporting unit is less than its carrying amount using these qualitative factors, we then compare the fair value of goodwill with its carrying amount and measure impairment loss by comparing the implied fair value of goodwill with the carrying amount of that goodwill. Adverse conditions in our business climate, including a significant decline in future operating cash flows, a significant change in our stock price or market capitalization, or a deviation from our expected growth rate and performance may significantly affect the fair value of our goodwill and may trigger additional impairment losses, which could be materially adverse to our operating results and financial position.

We cannot provide assurance that we will not be required to take an impairment charge in the future. Any impairment charge would have an adverse effect on our results of shareholders' equity and financial results and could cause a decline in our stock price. The acquisitions of AltaPacific Bancorp, and its subsidiary, AltaPacific Bank have increased our goodwill.

**Liquidity risk could impair our ability to fund operations and jeopardize our financial condition, growth and prospects.**

Liquidity is essential to our business. We rely on a number of different sources in order to meet our potential liquidity demands. We require sufficient liquidity to meet customer loan requests, customer deposit maturities and withdrawals, payments on our debt obligations as they come due and other cash commitments under both normal operating conditions and other unpredictable circumstances, including events causing industry or general financial market stress. A tightening of the credit markets resulting in our inability to obtain adequate funding may negatively affect our liquidity, asset growth and, consequently, our earnings capability and capital levels. In addition to any deposit growth, and the sale of loans or investment securities, maturity of investment securities and loan payments, we rely from time to time on advances from the FHLB of Des Moines, and certain other wholesale funding sources to meet liquidity demands. Our liquidity position could be significantly constrained if we were unable to access funds from the FHLB of Des Moines or other wholesale funding sources. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity as a result of a downturn in the markets in which our loans are concentrated, negative operating results, or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry or deterioration in credit markets. Any decline in available funding in amounts adequate to finance our activities or on terms which are acceptable to us could adversely impact our ability to originate loans, invest in securities, meet our expenses, or fulfill obligations such as repaying our borrowings or meeting deposit withdrawal demands, any of which could, in turn, have a material adverse effect on our business, financial condition and results of operations

Additionally, our liquidity is affected by our collateralized public funds, which are bank deposits of state and local municipalities. These deposits are required to be secured by certain investment grade securities to ensure repayment, which on the one hand tends to reduce our contingent liquidity risk by making these funds somewhat less credit sensitive, but on the other hand reduces standby liquidity by restricting the potential liquidity of the pledged collateral. Although these funds historically have been a relatively stable source of funds for us, availability depends on the individual municipality's fiscal policies and cash flow needs.

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

Competition for qualified employees and personnel in the banking industry is intense and there are a limited number of qualified persons with knowledge of, and experience in, the community banking industry where the Banks conduct their business. The process of recruiting personnel with the combination of skills and attributes required to carry out our strategies is often lengthy. Our success depends to a significant degree upon our ability to attract and retain qualified management, loan origination, finance, administrative, marketing and technical personnel and upon the continued contributions of our management and personnel. In particular, our success has been and continues to be highly dependent upon the abilities of key executives, including our President, and certain other employees. We could undergo a difficult transition period if we were to lose the services of any of these individuals. Our success also depends on the experience of our banking facilities' managers and bankers and on their relationships with the customers and communities they serve. In addition, our success has been and continues to be highly dependent upon the services of our directors, many of whom are at or nearing retirement age, and we may not be able to identify and attract suitable candidates to replace such directors. The loss of these key persons could negatively impact the affected banking operations.

**We rely on other companies to provide key components of our business infrastructure.**

We rely on numerous external vendors to provide us with products and services necessary to maintain our day-to-day operations. Accordingly, our operations are exposed to risk that these vendors will not perform in accordance with the contracted arrangements under service level agreements. The failure of an external vendor to perform in accordance with the contracted arrangements under service level agreements because of changes in the vendor's organizational structure, financial condition, support for existing products and services or strategic focus or for any other reason, could be disruptive to our operations, which in turn could have a material negative impact on our financial condition and results of operations. We also could be adversely affected to the extent such an agreement is not renewed by the third party vendor or is renewed on terms less favorable to us. Additionally, the bank regulatory agencies expect financial institutions to be responsible for all aspects of our vendors' performance, including aspects which they delegate to third parties. Disruptions or failures in the physical infrastructure or operating systems that support our business and customers, or cyber-attacks or security breaches of the network system or devices that our customers use to access our products and services could result in client attrition, regulatory fines, penalties or intervention, reputational damage, reimbursement or other compensation costs, and/or additional compliance costs, any of which could materially adversely affect our results of operations or financial condition.

**Any inaccurate assumptions in our analytical and forecasting models could cause us to miscalculate our projected revenue or losses, which could adversely affect us.**

We use analytical and forecasting models to estimate the effects of economic conditions on our financial assets and liabilities as well as our mortgage servicing rights. Those models include assumptions about interest rates and consumer behavior that may be incorrect. If our model assumptions are incorrect, improperly applied or inadequate, we may record higher than expected losses or lower than expected revenues which could have a material adverse effect on our business, financial condition and results of operations.

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

The Banks are susceptible to fraudulent activity that may be committed against us or our customers which may result in financial losses or increased costs to us or our customers, disclosure or misuse of our information or our customer's information, misappropriation of assets, privacy breaches against our customers, litigation or damage to our reputation. Such fraudulent activity may take many forms, including check fraud, electronic fraud, wire fraud, phishing, social engineering and other dishonest acts. Nationally, reported incidents of fraud and other financial crimes have increased. We have also experienced losses due to apparent fraud and other financial crimes. While we have policies and procedures designed to prevent such losses, there can be no assurance that such losses will not occur.

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

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

**If our enterprise risk management framework is not effective at mitigating risk and loss to us, we could suffer unexpected losses and our results of operations could be materially adversely affected.**

Our enterprise risk management framework seeks to achieve an appropriate balance between risk and return, which is critical to optimizing stockholder value. We have established processes and procedures intended to identify, measure, monitor, report, analyze and control the types of risk to which we are subject. These risks include liquidity risk, credit risk, market risk, interest rate risk, operational risk, legal and compliance risk, and reputational risk, among others. We also maintain a compliance program designed to identify, measure, assess, and report on our adherence to applicable laws, policies and procedures. While we assess and improve these programs on an ongoing basis, there can be no assurance that our risk management or compliance programs, along with other related controls, will effectively mitigate all risk and limit losses in our business. However, as with any risk management framework, there are inherent limitations to our risk management strategies as there may exist, or develop in the future, risks that we have not appropriately anticipated or identified. If our risk management framework proves ineffective, we could suffer unexpected losses and our business financial condition and results of operations could be materially adversely affected.

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

*Our security measures may not be sufficient to mitigate the risk of a cyber attack.* Communications and information systems are essential to the conduct of our business, as we use such systems to manage our customer relationships, our general ledger and virtually all other aspects of our business. Our operations rely on the secure processing, storage, and transmission of confidential and other information in our computer systems and networks. Although we take protective measures and endeavor to modify them as circumstances warrant, the security of our computer systems, software, and networks may be vulnerable to breaches, fraudulent or unauthorized access, denial or degradation of service attacks, misuse, computer viruses, malware or other malicious code and cyber-attacks that could have a security impact. If one or more of these events occur, this could jeopardize our or our customers' confidential and other information processed and stored in, and transmitted through, our computer systems and networks, or otherwise cause interruptions or malfunctions in our operations or the operations of our customers or counterparties. We may be required to expend significant additional resources to modify our protective measures or to investigate and remediate vulnerabilities or other

exposures, and we may be subject to litigation and financial losses that are either not insured against or not fully covered through any insurance maintained by us. We could also suffer significant reputational damage.

*Security breaches in our internet banking activities could further expose us to possible liability and damage our reputation*. Increases in criminal activity levels and sophistication, advances in computer capabilities, new discoveries, vulnerabilities in third party technologies (including browsers and operating systems) or other developments could result in a compromise or breach of the technology, processes and controls that we use to prevent fraudulent transactions and to protect data about us, our clients and underlying transactions. Any compromise of our security could deter customers from using our internet banking services that involve the transmission of confidential information. We rely on standard internet security systems to provide the security and authentication necessary to effect secure transmission of data. Although we have developed and continue to invest in systems and processes that are designed to detect and prevent security breaches and cyber-attacks and periodically test our security, these precautions may not protect our systems from compromises or breaches of our security measures, and could result in losses to us or our customers, our loss of business and/or customers, damage to our reputation, the incurrence of additional expenses, disruption to our business, our inability to grow our online services or other businesses, additional regulatory scrutiny or penalties, or our exposure to civil litigation and possible financial liability, any of which could have a material adverse effect on our business, financial condition and results of operations.

*Our security measures may not protect us from system failures or interruptions.* While we have established policies and procedures to prevent or limit the impact of systems failures and interruptions, there can be no assurance that such events will not occur or that they will be adequately addressed if they do. In addition, we outsource certain aspects of our data processing and other operational functions to certain third-party providers. While we select third-party vendors carefully, we do not control their actions. If our third-party providers encounter difficulties including those resulting from breakdowns or other disruptions in communication services provided by a vendor, failure of a vendor to handle current or higher transaction volumes, cyber-attacks and security breaches or if we otherwise have difficulty in communicating with them, our ability to adequately process and account for transactions could be affected, and our ability to deliver products and services to our customers and otherwise conduct business operations could be adversely impacted. Replacing these third-party vendors could also entail significant delay and expense. Threats to information security also exist in the processing of customer information through various other vendors and their personnel.

We cannot assure you that such breaches, failures or interruptions will not occur or, if they do occur, that they will be adequately addressed by us or the third parties on which we rely. We may not be insured against all types of losses as a result of third party failures and insurance coverage may be inadequate to cover all losses resulting from breaches, system failures or other disruptions. If any of our third-party service providers experience financial, operational or technological difficulties, or if there is any other disruption in our relationships with them, we may be required to identify alternative sources of such services, and we cannot assure you that we could negotiate terms that are as favorable to us, or could obtain services with similar functionality as found in our existing systems without the need to expend substantial resources, if at all. Further, the occurrence of any systems failure or interruption could damage our reputation and result in a loss of customers and business, could subject us to additional regulatory scrutiny, or could expose us to legal liability. Any of these occurrences could have a material adverse effect on our financial condition and results of operations.

The board of directors oversees the risk management process, including the risk of cybersecurity breaches, and engages with management on cybersecurity issues.

**We are subject to certain risks in connection with our data management or aggregation.**

We are reliant on our ability to manage data and our ability to aggregate data in an accurate and timely manner to ensure effective risk reporting and management. Our ability to manage data and aggregate data may be limited by the effectiveness of our policies, programs, processes and practices that govern how data is acquired, validated, stored, protected and processed. While we continuously update our policies, programs, processes and practices, many of our data management and aggregation processes are manual and subject to human error or system failure. Failure to manage data effectively and to aggregate data in an accurate and timely manner may limit our ability to manage current and emerging risks, as well as to manage changing business needs.

**We rely on dividends from Banner Bank for substantially all of our revenue at the holding company level.**

We are an entity separate and distinct from our principal subsidiary, Banner Bank, and derive substantially all of our revenue at the holding company level in the form of dividends from that subsidiary. Accordingly, we are, and will be, dependent upon dividends from Banner Bank to pay the principal of and interest on our indebtedness, to satisfy our other cash needs and to pay dividends on our common stock. Banner Bank's ability to pay dividends is subject to its ability to earn net income and to meet certain regulatory requirements. In the event Banner Bank is unable to pay dividends to us, we may not be able to pay dividends on our common stock. 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.

**Our articles of incorporation contain a provision which could limit the voting rights of a holder of our common stock.**

Our charter provides that any person or group who acquires beneficial ownership of our common stock in excess of 10.0% of the outstanding shares may not vote the excess shares. Accordingly, if you acquire beneficial ownership of more than 10.0% of the outstanding shares of our common stock, your voting rights with respect to our common stock will not be commensurate with your economic interest in our company.

**Anti-takeover provisions could negatively affect our shareholders.**

Provisions in our articles of incorporation and bylaws, the corporate laws of the state of Washington and federal laws and regulations could delay or prevent a third party from acquiring us, despite the possible benefit to our shareholders, or otherwise negatively affect the market value of our stock. These provisions, among others, include: a prohibition on voting shares of our common stock beneficially owned in excess of 10.0% of total shares outstanding; advance notice requirements for nominations for election to our board of directors and for proposing matters that shareholders may act on at shareholder meetings; and staggered three-year terms for directors. Our articles of incorporation also authorize our board of directors to issue preferred or other stock, and preferred or other stock could be issued as a defensive measure in response to a takeover proposal. In addition, because we are a bank holding company, the ability of a third party to acquire us is limited by applicable banking laws and regulations. The Bank Holding Company Act requires any bank holding company to obtain the approval of the Federal Reserve before acquiring 5% or more of any class of our voting securities. Any entity that is a holder of 25% or more of any class of our voting securities, or in some circumstances a holder of a lesser percentage, is subject to regulation as a bank holding company under the Bank Holding Company Act. Under the Change in Bank Control Act of 1978, as amended, any person (or persons acting in concert), other than a bank holding company, is required to notify the Federal Reserve before acquiring 10% or more of any class of our voting securities.

**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, 2019, we have 178 branch offices located in Washington, Oregon, California, and Idaho. The 178 branches include 175 Banner Bank branches and three Islanders Bank branches. Geographically we have 87 branches are located in Washington, 43 in Oregon, 36 in California and 12 in Idaho. Of these branch locations, approximately half are owned and the other half are leased facilities. In addition to the branch locations, we also have 18 loan production offices, ten of which are located in Washington, three in California, two in both Oregon and Idaho, and one in Utah. All loan production offices are leased facilities. The lease terms for our branch and loan production offices are not individually material. Lease expirations range from one to 19 years. Administrative support offices are primarily in Washington, where we have eight facilities, of which we own two and lease six. Additionally, we have two leased administrative support offices in Idaho and three administrative support offices located in Oregon, two owned and one leased. 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 our business, we have various legal proceedings and other contingent matters pending. These proceedings and the associated legal claims are often contested and the outcome of individual matters is not always predictable. Furthermore, in some matters, it is difficult to assess potential exposure because the legal proceeding is still in the pretrial stage. We are not a party to any pending legal proceedings that we believe would have a material adverse effect on our financial condition, operations or cash flows.

**Item 4 – Mine Safety Disclosures**

Not applicable.

## PART II

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

Our voting common stock is principally traded on the NASDAQ Global Select Market under the symbol "BANR." Shareholders of record as of December 31, 2019 totaled 2,257 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.

### Issuer Purchases of Equity Securities

The following table provides information about repurchases of common stock by the Company during the quarter ended December 31, 2019:

| Period | Total Number of Common Shares Purchased | Average Price Paid per Common Share | Total Number of Shares Purchased as Part of Publicly Announced Plan | Maximum Number of Remaining Shares that May be Purchased at Period End under the Board Authorization |
|---|---|---|---|---|
| October 1, 2019 - October 31, 2019 | 85 | $ 55.96 | — | 757,637 |
| November 1, 2019 - November 30, 2019 | — | — | — | 757,637 |
| December 1, 2019 - December 31, 2019 | 22 | 58.64 | — | 757,637 |
| Total for quarter | 107 | 56.51 | — | 757,637 |

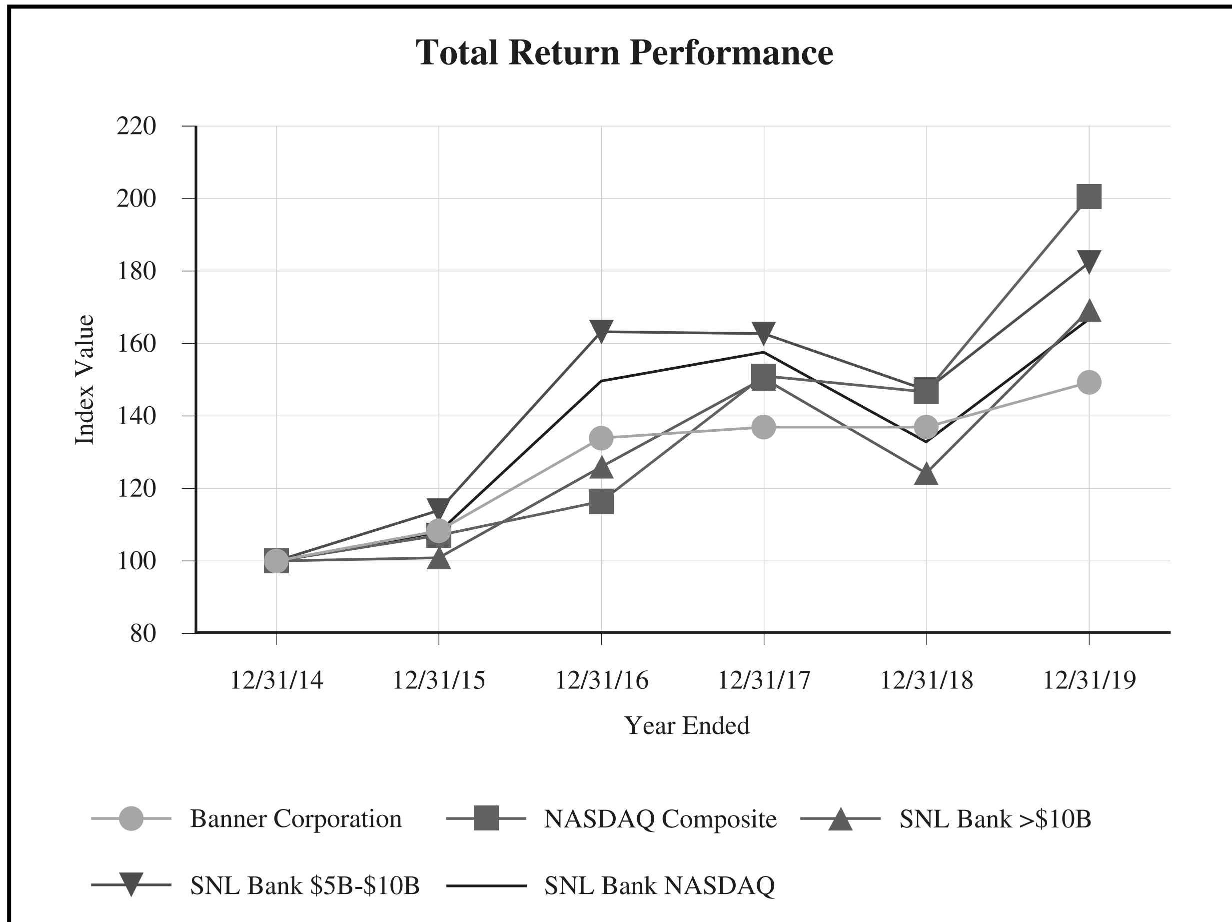
On March 27, 2019, the Company announced that its Board of Directors had renewed its authorization to repurchase up to 5% of the Company's common stock, or 1,757,637 of the Company's outstanding shares. Under the authorization, shares may be repurchased by the Company in open market purchases. The extent to which the Company repurchases its shares and the timing of such repurchases will depend upon market conditions and other corporate considerations. During the year ended December 31, 2019, the Company repurchased 1,000,000 shares under the 2019 stock repurchase authorization, leaving 757,637 shares available under this authorization for future repurchase. None of the shares repurchased during 2019 were repurchased during the fourth quarter of 2019.

In addition, 107 shares were surrendered by employees to satisfy tax withholding obligations upon the vesting of restricted stock grants in the fourth quarter of 2019.

There were no shares tendered in connection with option exercises during the years ended December 31, 2019 and 2018, respectively. Restricted shares canceled to pay withholding taxes totaled 33,777 and 27,653 during the years ended December 31, 2019 and 2018, respectively.

**Performance Graph**

The following graph compares the cumulative total shareholder return on Banner Corporation common stock with the cumulative total return on the NASDAQ (U.S. Stock) Index, a peer group of the SNL >$10 Billion Asset Bank Index and a peer group of the SNL NASDAQ Bank Index. Total return assumes the reinvestment of all dividends. This year the stock performance graph reflects a change made by the Company in the peer group comparison index from the SNL $5 Billion to $10 Billion Asset Bank Index to the SNL>$10 Billion Asset Bank Index. Management believes that the SNL>$10 Billion Asset Bank Index provides a better peer group comparison of financial institutions more comparable to the Company in asset size. In accordance with Item 201(e) of the Regulation S-K of the Securities and Exchange Commission, which requires the inclusion of all new indexes and all indexes used in the immediately preceding year, this year the performance graph also includes a comparison of the cumulative return for the SNL $5 Billion to $10 Billion Asset Bank Index.




| | Year Ended | | | | | |
|---|---|---|---|---|---|---|
| ***Index*** | **12/31/14** | **12/31/15** | **12/31/16** | **12/31/17** | **12/31/18** | **12/31/19** |
| Banner Corporation | 100.00 | 108.28 | 133.80 | 136.82 | 136.89 | 149.24 |
| NASDAQ Composite | 100.00 | 106.96 | 116.45 | 150.96 | 146.67 | 200.49 |
| SNL Bank >$10B | 100.00 | 100.83 | 125.97 | 150.29 | 124.17 | 169.21 |
| SNL Bank $5B-$10B | 100.00 | 113.92 | 163.21 | 162.61 | 147.16 | 182.35 |
| SNL Bank NASDAQ | 100.00 | 107.95 | 149.67 | 157.58 | 132.82 | 166.76 |

*Assumes $100 invested in Banner Corporation common stock and each index at the close of business on December 31, 2014 and that all dividends were reinvested. Information for the graph was provided by SNL Financial L.C. © 2019.

Our ability to pay dividends on our common stock depends primarily on dividends we receive from Banner Bank and Islanders Bank. The timing and amount of cash dividends paid on our common stock depends on our earnings, capital requirements, financial condition and other relevant factors, including required payments on our TPS, and is subject to the discretion of our board of directors. As a result of continued solid earnings, levels of capital, asset quality and financial condition during 2019, we increased our regular quarterly dividend to $0.41 per share for the first quarter of 2019 with $0.41 per share for the second, third and fourth quarters of 2019 and also declared a special dividend of $1.00 in the fourth quarter 2019. There can be no assurance that we will pay dividends on our common stock in the future. For additional information on our ability to pay dividends, see Item 1 of this report, “Business–Regulation–Banner Bank and Islanders Bank–Dividends” and “Banner Corporation–Dividends.”

**Item 6 – Selected Financial Data**

The following condensed consolidated statements of financial condition and operations and selected performance ratios as of December 31, 2019, 2018, 2017, 2016, and 2015 and for the years then ended have been derived from our audited consolidated financial statements.

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

**FINANCIAL CONDITION DATA:**

| | December 31 | | | | |
|---|---|---|---|---|---|
| (In thousands) | **2019** | 2018 | 2017 | 2016 | 2015 |
| Total assets | $ 12,604,031 | $ 11,871,317 | $ 9,763,209 | $ 9,793,688 | $ 9,796,298 |
| Cash and securities [1] | 2,121,022 | 2,168,535 | 1,473,608 | 1,353,583 | 1,655,290 |
| Loans receivable, net | 9,204,798 | 8,588,110 | 7,509,856 | 7,365,151 | 7,236,496 |
| Deposits | 10,048,641 | 9,477,048 | 8,183,431 | 8,121,414 | 8,055,068 |
| Borrowings | 687,778 | 773,275 | 194,769 | 255,101 | 324,186 |
| Common shareholders' equity | 1,594,034 | 1,478,595 | 1,272,626 | 1,305,710 | 1,300,059 |
| Total shareholders' equity | 1,594,034 | 1,478,595 | 1,272,626 | 1,305,710 | 1,300,059 |
| Shares outstanding | 35,752 | 35,183 | 32,726 | 33,193 | 34,242 |

**OPERATING DATA:**

| | For the Year Ended December 31 | | | | |
|---|---|---|---|---|---|
| (In thousands) | **2019** | 2018 | 2017 | 2016 | 2015 |
| Interest income | $ 525,679 | $ 463,632 | $ 412,284 | $ 391,477 | $ 254,433 |
| Interest expense | 56,768 | 32,659 | 19,250 | 16,408 | 12,154 |
| Net interest income before provision for loan losses | 468,911 | 430,973 | 393,034 | 375,069 | 242,279 |
| Provision for loan losses | 10,000 | 8,500 | 8,000 | 6,030 | — |
| Net interest income | 458,911 | 422,473 | 385,034 | 369,039 | 242,279 |
| Deposit fees and other service charges | 46,632 | 48,074 | 43,452 | 41,911 | 33,767 |
| Mortgage banking operations revenue | 22,215 | 21,343 | 20,880 | 25,552 | 17,720 |
| Net change in valuation of financial instruments carried at fair value | (208) | 3,775 | (2,844) | (2,620) | (813) |
| All other non-interest income | 13,310 | 10,816 | 23,712 | 11,382 | 4,778 |
| Total non-interest income | 81,949 | 84,008 | 85,200 | 76,225 | 55,452 |
| REO operations expense (recoveries), net | 303 | 804 | (2,030) | 175 | 397 |
| All other non-interest expenses | 357,425 | 340,567 | 321,000 | 315,449 | 229,363 |
| Total non-interest expense | 357,728 | 341,371 | 318,970 | 315,624 | 229,760 |
| Income before provision for income tax expense | 183,132 | 165,110 | 151,264 | 129,640 | 67,971 |
| Provision for income tax expense | 36,854 | 28,595 | 90,488 | 44,255 | 22,749 |
| Net income | $ 146,278 | $ 136,515 | $ 60,776 | $ 85,385 | $ 45,222 |

(footnotes follow)

**PER COMMON SHARE DATA:**

| | At or For the Years Ended December 31 | | | | |
|---|---|---|---|---|---|
| | **2019** | 2018 | 2017 | 2016 | 2015 |
| Net income: | | | | | |
| Basic | $ 4.20 | $ 4.16 | $ 1.85 | $ 2.52 | $ 1.90 |
| Diluted | 4.18 | 4.15 | 1.84 | 2.52 | 1.89 |
| Common shareholders' equity per share [2] | 44.59 | 42.03 | 38.89 | 39.34 | 37.97 |
| Common shareholders' tangible equity per share [2][9] | 33.33 | 31.45 | 30.78 | 31.06 | 29.64 |
| Cash dividends | 2.64 | 1.96 | 2.00 | 0.88 | 0.72 |
| Dividend payout ratio (basic) | 62.86% | 47.12% | 108.11% | 34.92% | 37.89% |
| Dividend payout ratio (diluted) | 63.16% | 47.23% | 108.70% | 34.92% | 38.10% |

**OTHER DATA:**

| | As of December 31 | | | | |
|---|---|---|---|---|---|
| | **2019** | 2018 | 2017 | 2016 | 2015 |
| Full time equivalent employees | 2,198 | 2,187 | 2,078 | 2,078 | 2,063 |
| Number of branches | 178 | 182 | 178 | 190 | 202 |

(footnotes follow)

**KEY FINANCIAL RATIOS:**

| | At or For the Years Ended December 31 | | | | |
|---|---|---|---|---|---|
| | **2019** | 2018 | 2017 | 2016 | 2015 |
| *Performance Ratios:* | | | | | |
| Return on average assets [3] | 1.22% | 1.29% | 0.60% | 0.87% | 0.72% |
| Return on average common equity [4] | 9.50 | 10.45 | 4.57 | 6.41 | 5.56 |
| Average common equity to average assets | 12.85 | 12.37 | 13.09 | 13.54 | 12.87 |
| Interest rate spread [5] | 4.27 | 4.40 | 4.23 | 4.19 | 4.09 |
| Net interest margin [6] | 4.30 | 4.43 | 4.24 | 4.20 | 4.10 |
| Non-interest income to average assets | 0.68 | 0.80 | 0.84 | 0.78 | 0.88 |
| Non-interest expense to average assets | 2.98 | 3.23 | 3.14 | 3.21 | 3.64 |
| Efficiency ratio [7] | 64.94 | 66.29 | 66.70 | 69.94 | 77.17 |
| Average interest-earning assets to funding liabilities | 106.09 | 106.09 | 105.69 | 105.84 | 107.59 |
| *Selected Financial Ratios:* | | | | | |
| Allowance for loan losses as a percent of total loans at end of period | 1.08 | 1.11 | 1.17 | 1.15 | 1.07 |
| Net (charge-offs) recoveries as a percent of average outstanding loans during the period | (0.07) | (0.01) | (0.07) | 0.03 | 0.04 |
| Non-performing assets as a percent of total assets | 0.32 | 0.16 | 0.28 | 0.35 | 0.28 |
| Allowance for loan losses as a percent of non-performing loans [8] | 253.95 | 616.36 | 329.38 | 380.87 | 512.47 |
| Common shareholders' tangible equity to tangible assets [9] | 9.77 | 9.62 | 10.61 | 10.83 | 10.68 |
| *Consolidated Capital Ratios:* | | | | | |
| Total capital to risk-weighted assets | 12.93 | 13.12 | 13.81 | 13.40 | 13.63 |
| Tier 1 capital to risk-weighted assets | 11.97 | 12.12 | 12.77 | 12.41 | 12.65 |
| Tier 1 capital to average leverage assets | 10.71 | 10.98 | 11.34 | 11.83 | 11.06 |
| Common equity tier I capital to risk-weighted assets | 10.63 | 10.75 | 11.30 | 11.19 | 12.13 |

(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 common equity.

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

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

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

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

(9) Common shareholders' tangible equity per share and the ratio of tangible common shareholders' equity to tangible assets are non-GAAP financial measures. We calculate tangible common equity by excluding the balance of goodwill and other intangible assets from shareholders' equity. We calculate tangible assets by excluding the balance of goodwill and other intangible assets from total assets. We believe that this is consistent with the treatment by our bank regulatory agencies, which exclude goodwill and other intangible assets from the calculation of risk-based capital ratios. Management believes that these non-GAAP financial measures provide information to investors that is useful in understanding the basis of our capital position. However, these non-GAAP financial measures are supplemental and are not a substitute for any analysis based on GAAP. Because not all companies use the same calculation of tangible common equity and tangible assets, this presentation may not be comparable to other similarly titled measures as calculated by other companies. For a reconciliation of these non–GAAP measures, see Item 7 of this report, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Executive Overview."

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

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

## Executive Overview

Banner Corporation's successful execution of its strategic plan and operating initiatives continued in 2019, as evidenced by our solid operating results and profitability. We continue to maintain the Company's moderate risk profile as well as to produce consistent and sustainable earnings momentum. Highlights for the year included continued strong asset quality, outstanding client acquisition, strong revenue generation from core operations and the AltaPacific acquisition.

For the year ended December 31, 2019, our net income was $146.3 million, or $4.18 per diluted share, compared to net income of $136.5 million, or $4.15 per diluted share for the year ended December 31, 2018 and $60.8 million, or $1.84 per diluted share for the year ended December 31, 2017. Current year results were positively impacted by growth in interest-earning assets from the full year benefit of the interest-earning assets from the Skagit acquisition and the two month benefit of the interest-earnings assets from the AltaPacific acquisition as well as organic loan growth. Net income for both 2018 and 2017 were impacted by one-time tax adjustments primarily as a result of the enactment of the Tax Cuts and Jobs Act (2017 Tax Act) in December 2017, which reduced the marginal federal corporate income tax rate from 35% to 21%. Our net income for the year ended December 31, 2018, was increased by $5.5 million of tax benefit adjustments, which included the release of a $4.2 million valuation reserve previously recorded as a provisional amount related to the 2017 Tax Act. Our net income for 2017 was reduced by $42.6 million, or $1.29 per diluted share, related to revaluation of our net deferred tax asset as a result of the 2017 Tax Act. In 2017, our results also included a net gain of $12.2 million as a result of the Utah Branch Sale. Our results for the years ended December 31, 2019 and 2018 were also impacted by $7.5 million and $5.6 million of acquisition-related expenses, respectively. There were no acquisition-related expenses in 2017.

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. Our net interest income before provision for loan losses increased 9% to $468.9 million for the year ended December 31, 2019, compared to $431.0 million for the prior year. This increase in net interest income is a result of growth in total loans receivable and core deposits. During the year ended December 31, 2019, our interest spread decreased to 4.27% from 4.40% for the prior year while our net interest margin decreased to 4.30% compared to 4.43% for the prior year. The decrease in our net interest margin during 2019 was primarily a result of higher funding costs as well as three 25 basis point decreases by the Federal Reserve in the targeted Fed Funds Rate coupled with a longer-term decline in the 10-year treasury yield that decreased yields on interest-earning assets during the second half of 2019. Our net interest margin was enhanced seven basis points in 2019 and ten basis points in 2018 by acquisition accounting adjustments, primarily the amortization of acquisition accounting discounts on purchased loans obtained from acquisitions, which are accreted into loan interest income.

Although our credit quality metrics continue to reflect our moderate risk profile, we recorded a $10.0 million provision for loan losses in the year ended December 31, 2019, primarily due to the organic growth in the loan portfolio, increased non-performing loans, the renewal and migration of acquired loans out of the discounted loan portfolios and increased net charge-offs, compared to an $8.5 million provision for loan losses recorded in 2018 and $8.0 million in 2017. Non-performing loans increased to $39.6 million at December 31, 2019, compared to $15.7 million a year earlier. Net charge-offs increased to $5.9 million for the year ended December 31, 2019, compared to net charge-offs of $1.0 million for the prior year. Our allowance for loan losses at December 31, 2019 was $100.6 million, representing 254% of non-performing loans, compared to $96.5 million, representing 616% of non-performing loans for the prior year. (See Note 5, Loans Receivable and the Allowance for Loan Losses, of the Notes to the Consolidated Financial Statements as well as "Asset Quality" below in this Form 10-K.)

Our net income also is affected by the level of our non-interest income, including deposit fees and other service charges, results of mortgage banking operations, which includes loan origination and servicing fees and gains and losses on the sale of loans, and gains and losses on the sale securities, as well as our non-interest expense and income tax provisions. In addition, our net income is affected by the net change in the value of certain financial instruments carried at fair value. Our total non-interest income was $81.9 million for the year ended December 31, 2019, compared to $84.0 million for the year ended December 31, 2018. For the year ended December 31, 2019, we recorded a net loss of $208,000 for fair value adjustments and $33,000 in net gains on the sale of securities. In comparison, for the year ended December 31, 2018, we recorded a net gain of $3.8 million for fair value adjustments and $837,000 in net losses on the sale of securities.

Our total revenues (net interest income before the provision for loan losses plus total non-interest income) for the year ended December 31, 2019 increased $35.9 million, or 7%, to $550.9 million, compared to $515.0 million for the same period a year earlier, largely as a result of increased interest income. Our total adjusted revenues (a non-GAAP financial measure), which excludes net gains and losses on sale of securities and fair value adjustments increased by $39.0 million, or 8%, to $551.0 million for the year ended December 31, 2019, compared to $512.0 million a year earlier.

For the year ended December 31, 2019, non-interest expense increased 5% to $357.7 million, compared to $341.4 million for the year ended December 31, 2018. The increase was largely attributable to the inclusion of acquired Skagit operations for the full year as well as acquired AltaPacific operations in the last two months of 2019, including higher salary and employee benefits due to additional staffing related to the

acquired operations as well as normal salary and wage adjustments and $7.5 million of merger and acquisition-related expenses in 2019, compared to $5.6 million in the prior year.

*Non-GAAP financial measures*: Non-interest income, revenues and other earnings information excluding fair value adjustments, net gains or losses on sale of securities and, in the year ended December 31, 2017, gain on the sale of branches including related loans and deposits, and non-interest expenses, excluding state/municipal business and occupational tax expense, CDI amortization, FHLB prepayment penalties, REO net gain or loss and acquisition-related costs, are non-GAAP financial measures. Management has presented these non-GAAP financial measures in this discussion and analysis because it believes that they provide useful and comparative information to assess trends in our core operations and in understanding our capital position. However, these non-GAAP financial measures are supplemental and are not a substitute for any analysis based on GAAP. Where applicable, we have also presented comparable earnings information using GAAP financial measures. For a reconciliation of these non-GAAP financial measures, see the tables below. Because not all companies use the same calculations, our presentation may not be comparable to other similarly titled measures as calculated by other companies. See "Comparison of Results of Operations for the Years Ended December 31, 2019 and 2018" for more detailed information about our financial performance.

The following tables set forth reconciliations of non-GAAP financial measures discussed in this report (dollars in thousands, except share and per share data):

| | For the Years Ended December 31 | | |
|---|---|---|---|
| | **2019** | 2018 | 2017 |
| **ADJUSTED REVENUE:** | | | |
| Net interest income before provision for loan losses (GAAP) | $ 468,911 | $ 430,973 | $ 393,034 |
| Total non-interest income | 81,949 | 84,008 | 85,200 |
| Total GAAP revenue | 550,860 | 514,981 | 478,234 |
| Exclude net (gain) loss on sale of securities | (33) | 837 | 2,080 |
| Exclude change in valuation of financial instruments carried at fair value | 208 | (3,775) | 2,844 |
| Exclude gain on sale of branches, including related loans and deposits | — | — | (12,189) |
| Adjusted Revenue (non-GAAP) | $ 551,035 | $ 512,043 | $ 470,969 |
| **ADJUSTED EARNINGS:** | | | |
| Net income (GAAP) | $ 146,278 | $ 136,515 | $ 60,776 |
| Exclude net loss (gain) on sale of securities | (33) | 837 | 2,080 |
| Exclude change in valuation of financial instruments carried at fair value | 208 | (3,775) | 2,844 |
| Exclude gain on sale of branches, including related loans and deposits | — | — | (12,189) |
| Exclude acquisition related costs | 7,544 | 5,607 | — |
| Exclude FHLB prepayment penalties | 735 | — | — |
| Exclude related tax (benefit) expense | (1,741) | (426) | 2,615 |
| Exclude tax adjustments related to tax reform and valuation reserves | — | (4,207) | 42,630 |
| Total adjusted earnings (non-GAAP) | $ 152,991 | $ 134,551 | $ 98,756 |
| Diluted earnings per share (GAAP) | $ 4.18 | $ 4.15 | $ 1.84 |
| Diluted adjusted earnings per share (non-GAAP) | $ 4.38 | $ 4.09 | $ 2.99 |

| ADJUSTED EFFICIENCY RATIO: | December 31 | | |
|---|---|---|---|
| | **2019** | 2018 | 2017 |
| Non-interest expense (GAAP) | $ 357,728 | $ 341,371 | $ 318,970 |
| Exclude acquisition-related costs | (7,544) | (5,607) | — |
| Exclude CDI amortization | (8,151) | (6,047) | (6,246) |
| Exclude state/municipal tax expense | (3,880) | (3,284) | (2,594) |
| Exclude REO operations | (303) | (804) | 2,030 |
| Exclude FHLB prepayment penalties | (735) | — | — |
| Adjusted non-interest expense (non-GAAP) | $ 337,115 | $ 325,629 | $ 312,160 |
| | | | |
| Net interest income before provision for loan losses (GAAP) | $ 468,911 | $ 430,973 | $ 393,034 |
| Non-interest income (GAAP) | 81,949 | 84,008 | 85,200 |
| Total revenue | 550,860 | 514,981 | 478,234 |
| Exclude net (gain) loss on sale of securities | (33) | 837 | 2,080 |
| Exclude net change in valuation of financial instruments carried at fair value | 208 | (3,775) | 2,844 |
| Exclude gain on sale of branches, including related loans and deposits | — | — | (12,189) |
| Adjusted revenue (non-GAAP) | $ 551,035 | $ 512,043 | $ 470,969 |
| | | | |
| Efficiency ratio (GAAP) | 64.94% | 66.29% | 66.70% |
| Adjusted efficiency ratio (non-GAAP) | 61.18% | 63.59% | 66.28% |

Common shareholders' tangible equity per share and the ratio of common shareholders' tangible equity to tangible assets referred to in footnote (9) to Item 6, Selected Financial Data above are also non-GAAP financial measures. We calculate common shareholders' tangible equity by excluding goodwill and other intangible assets from common shareholders' equity. We calculate tangible assets by excluding the balance of goodwill and other intangible assets from total assets. We believe that this is consistent with the treatment by our bank regulatory agencies, which exclude goodwill and other intangible assets from the calculation of risk-based capital ratios. Management believes that this non-GAAP financial measure provides information to investors that is useful in understanding our capital position (dollars in thousands).

| | December 31 | | |
|---|---|---|---|
| | **2019** | 2018 | 2017 |
| Shareholders' equity (GAAP) | $ 1,594,034 | $ 1,478,595 | $ 1,272,626 |
| Exclude goodwill and other intangible assets, net | 402,279 | 372,078 | 265,314 |
| Common shareholders' tangible equity (non-GAAP) | $ 1,191,755 | $ 1,106,517 | $ 1,007,312 |
| | | | |
| Total assets (GAAP) | $ 12,604,031 | $ 11,871,317 | $ 9,763,209 |
| Exclude goodwill and other intangible assets, net | 402,279 | 372,078 | 265,314 |
| Total tangible assets (non-GAAP) | $ 12,201,752 | $ 11,499,239 | $ 9,497,895 |
| Common shareholders' equity to total assets (GAAP) | 12.65% | 12.46% | 13.03% |
| Common shareholders' tangible equity to tangible assets (non-GAAP) | 9.77% | 9.62% | 10.61% |
| Common shares outstanding | 35,751,576 | 35,182,772 | 32,726,485 |
| Common shareholders' equity per share (GAAP) | $ 44.59 | $ 42.03 | $ 38.89 |
| Common shareholders' tangible equity per share (non-GAAP) | $ 33.33 | $ 31.45 | $ 30.78 |

Management's Discussion and Analysis of Financial Condition and 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 IV of this Form 10-K.

**Critical Accounting Policies**

In the opinion of management, the accompanying Consolidated Statements of Financial Condition and related Consolidated Statements of Operations, Comprehensive Income, Changes in Shareholders' Equity and Cash Flows reflect all adjustments (which include reclassification and normal recurring adjustments) that are necessary for a fair presentation in conformity with 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 losses, (iii) the valuation of financial assets and liabilities recorded at fair value, including OTTI losses, (iv) the valuation of intangibles, such as goodwill, core deposit intangibles, and mortgage servicing rights, (v) the valuation of real estate held for sale, (vi) the valuation of assets and liabilities acquired in business combinations and subsequent recognition of related income and expense, and (vii) the valuation of or recognition of deferred tax assets and liabilities. These policies and judgments, estimates and assumptions are described in greater detail below. Management believes the judgments, estimates and assumptions used in the preparation of the financial statements are appropriate based on the factual circumstances at the time. However, given the sensitivity of the financial statements to these critical accounting policies, the use of other judgments, estimates and assumptions could result in material differences in our results of operations or financial condition. Further, subsequent changes in economic or market conditions could have a material impact on these estimates and our financial condition and operating results in future periods. There have been no significant changes in our application of accounting policies since December 31, 2018. For additional information concerning critical accounting policies, see Notes 1, 3, 5, 12, 16 and 17 of the Notes to the Consolidated Financial Statements and the following:

*Interest Income:* (Notes 1 and 5) Interest on loans and securities is accrued as earned unless management doubts the collectability of the asset or the unpaid interest. Interest accruals on loans are generally discontinued when loans become 90 days past due for payment of interest and the loans are then placed on nonaccrual status. All previously accrued but uncollected interest is deducted from interest income upon transfer to nonaccrual status. For any future payments collected, interest income is recognized only upon management's assessment that there is a strong likelihood that the full amount of a loan will be repaid or recovered. Management's assessment of the likelihood of full repayment involves judgment including determining the fair value of the underlying collateral which can be impacted by the economic environment. A loan may be put on nonaccrual status sooner than this policy would dictate if, in management's judgment, the amounts owed, principal or interest, may be uncollectable. While less common, similar interest reversal and nonaccrual treatment is applied to investment securities if their ultimate collectability becomes questionable.

*Provision and Allowance for Loan Losses:* (Notes 1 and 5) The methodology for determining the allowance for loan losses is considered a critical accounting policy by management because of the high degree of judgment involved, the subjectivity of the assumptions used, and the potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses. The provision for loan losses reflects the amount required to maintain the allowance loan for losses at an appropriate level based upon management's evaluation of the adequacy of general and specific loss reserves. Determining the amount of the allowance for loan losses involves a high degree of judgment. Among the material estimates required to establish the allowance for loan losses are: overall economic conditions; value of collateral; strength of guarantors; loss exposure at default; the amount and timing of future cash flows on impaired loans; and determination of loss factors to be applied to the various elements of the portfolio. All of these estimates are susceptible to significant change. We have established systematic methodologies for the determination of the adequacy of our allowance for loan losses. The methodologies are set forth in a formal policy and take into consideration the need for an overall general valuation allowance as well as specific allowances that are tied to individual problem loans. We increase our allowance for loan losses by charging provisions for probable loan losses against our income.

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

residential construction and land, commercial real estate, commercial business loans and unsecured loans are individually evaluated for impairment.

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

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

*Fair Value Accounting and Measurement:* (Notes 1 and 17) We use fair value measurements to record fair value adjustments to certain financial assets and liabilities and to determine fair value disclosures. We include in the Notes to the Consolidated Financial Statements information about the extent to which fair value is used to measure financial assets and liabilities, the valuation methodologies used and the impact on our results of operations and financial condition. Additionally, for financial instruments not recorded at fair value we disclose, where required, our estimate of their fair value.

*Business Combinations:* (Notes 1 and 3) Business combinations are accounted for using the acquisition method of accounting and, accordingly, assets acquired and liabilities assumed, both tangible and intangible, and consideration exchanged are recorded at acquisition date fair values. The determination of the fair value of assets acquired and liabilities assumed involves a significant amount of judgment. The excess purchase consideration over the fair value of net assets acquired is recorded as goodwill. In the event that the fair value of net assets acquired exceeds the purchase price, including fair value of liabilities assumed, a bargain purchase gain is recorded on that acquisition. Expenses incurred in connection with a business combination are expensed as incurred. Changes in deferred tax asset valuation allowances related to acquired tax uncertainties are recognized in net income after the measurement period.

*Acquired Loans:* (Notes 3 and 5) Purchased loans, including loans acquired in business combinations, are recorded at their fair value at the acquisition date. Credit discounts are included in the determination of fair value; therefore, an allowance for loan losses is not recorded at the acquisition date. Establishing the fair value of acquired loans involves a significant amount of judgment, including determining the credit discount based upon historical data adjusted for current economic conditions and other factors. If any of these assumptions are inaccurate actual credit losses could vary significantly from the credit discount used to calculate the fair value of the acquired loans. Acquired loans are evaluated upon acquisition and classified as either purchased credit-impaired or purchased non-credit-impaired. Purchased credit-impaired (PCI) loans reflect credit deterioration since origination such that it is probable at acquisition that the Company will be unable to collect all contractually required payments. The accounting for PCI loans is periodically updated for changes in cash flow expectations, and reflected in interest income over the life of the loans as accretable yield. Any subsequent decreases in expected cash flows attributable to credit deterioration are recognized by recording a provision for loan losses.

For purchased non-credit-impaired loans, the difference between the fair value and unpaid principal balance of the loan at the acquisition date is amortized or accreted to interest income over the life of the loans. Any subsequent deterioration in credit quality is recognized by recording a provision for loan losses.

*Goodwill:* (Notes 1 and 16) Goodwill represents the excess of the purchase consideration paid over the fair value of the assets acquired, net of the fair values of liabilities assumed in a business combination and is not amortized but is reviewed annually, or more frequently as current circumstances and conditions warrant, for impairment. The Company completes its annual review of goodwill as of December 31. An assessment of qualitative factors is completed to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The qualitative assessment involves judgment by management on determining whether there have been any triggering events that have occurred which would indicate potential impairment. If the qualitative analysis concludes that further analysis is required, then a quantitative impairment test would be completed. The quantitative goodwill impairment test is used to identify the existence of impairment and the amount of impairment loss and compares the reporting unit's estimated fair value, including goodwill, to its carrying amount. If the fair value exceeds the carrying amount then goodwill is not considered impaired. If the carrying amount exceeds its fair value, an impairment loss would be recognized equal to the amount of excess, limited to the amount of total goodwill allocated to the reporting unit. The impairment loss would be recognized as a charge to earnings.

*Other Intangible Assets:* (Notes 1 and 16) Other intangible assets consists primarily of core deposit intangibles (CDI), which are amounts recorded in business combinations or deposit purchase transactions related to the value of transaction-related deposits and the value of the customer

relationships associated with the deposits. Core deposit intangibles are being amortized on an accelerated basis over a weighted average estimated useful life of eight years. The determination of the estimated useful life of the core deposit intangible involves judgment by management. The actual life of the core deposit intangible could vary significantly from the estimated life. These assets are reviewed at least annually for events or circumstances that could impact their recoverability. These events could include loss of the underlying core deposits, increased competition or adverse changes in the economy. To the extent other identifiable intangible assets are deemed unrecoverable, impairment losses are recorded in other non-interest expense to reduce the carrying amount of the assets.

*Mortgage Servicing Rights:* (Note 16) Mortgage servicing rights (MSRs) are recognized as separate assets when rights are acquired through purchase or through sale of loans. Generally, purchased MSRs are capitalized at the cost to acquire the rights. For sales of mortgage loans, the value of the MSR is estimated and capitalized. Fair value is based on market prices for comparable mortgage servicing contracts. The fair value of the MSRs includes an estimate of the life of the underlying loans which is affected by estimated prepayment speeds. The estimate of prepayment speeds is based on current market conditions. Actual market conditions could vary significantly from current conditions which could result in the estimated life of the underlying loans being different which would change the fair value of the MSR. Capitalized MSRs are reported in other assets and are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

*Real Estate Owned Held for Sale*: (Notes 1 and 6) Property acquired by foreclosure or deed in lieu of foreclosure is recorded at the estimated fair value of the property, less expected selling costs. Development and improvement costs relating to the property may be capitalized, while other holding costs are expensed. The carrying value of the property is periodically evaluated by management, property values are influenced by current economic and market conditions, changes in economic conditions could result in a decline in property value. To the extent that property values decline, allowances are established to reduce the carrying value to net realizable value. Gains or losses at the time the property is sold are charged or credited to operations in the period in which they are realized. The amounts the Banks will ultimately recover from real estate held for sale may differ substantially from the carrying value of the assets because of market factors beyond the Banks' control or because of changes in the Banks' strategies for recovering the investment.

*Income Taxes and Deferred Taxes*: (Note 12) The Company and its wholly-owned subsidiaries file consolidated U.S. federal income tax returns, as well as state income tax returns in Oregon, California, Idaho, Utah and Montana. Income taxes are accounted for using the asset and liability method. Under this method a deferred tax asset or liability is determined based on the enacted tax rates which are expected to be in effect when the differences between the financial statement carrying amounts and tax basis of existing assets and liabilities are expected to be reported in the Company's income tax returns. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. The Company assesses the appropriate tax treatment of transactions and filing positions after considering statutes, regulations, judicial precedent and other pertinent information and maintain tax accruals consistent with its evaluation. Changes in the estimate of accrued taxes occur periodically due to changes in tax rates, interpretations of tax laws, the status of examinations by the tax authorities and newly enacted statutory, judicial and regulatory guidance that could impact the relative merits of tax positions. These changes, when they occur, impact accrued taxes and can materially affect our operating results. A valuation allowance is required to be recognized if it is "more likely than not" that all or a portion of our deferred tax assets will not be realized. The evaluation pertaining to the tax expense and related deferred tax asset and liability balances involves a high degree of judgment and subjectivity around the measurement and resolution of these matters. The ultimate realization of the deferred tax assets is dependent upon the existence, or generation, of taxable income in the periods when those temporary differences and net operating loss and credit carryforwards are deductible.

In December 2017, the federal government enacted the 2017 Tax Act, which among other provisions, reduced the federal marginal corporate income tax rate from 35% to 21%. As a result of the passage of the 2017 Tax Act, the Company recorded a $42.6 million charge for the revaluation of its net deferred tax to account for the future impact of the decrease in the corporate income tax rate and other provisions of the legislation. The charge was recorded as an increase to tax expense and reduction of the net deferred asset for the year ended December 31, 2017. The Company's 2017 financial results reflected the income tax effects of the 2017 Tax Act for which the accounting was complete and provisional amounts for those specific income tax effects of the 2017 Tax Act for which the accounting was incomplete but a reasonable estimate could be determined. The $42.6 million charge recorded in 2017 by the Company included $4.2 million of provisional income tax expense related to Alternative Minimum Tax (AMT) credits that are limited under Internal Revenue Code of 1986 (Code) Section 383, which resulted in a reduction in the AMT deferred tax asset. The utilization of the limited AMT credits under the refundable AMT credit law was uncertain as of December 31, 2017. Subsequently, in 2018 the Company determined it could use the AMT credits and reversed the previously recorded $4.2 million provisional tax expense.

*Legal Contingencies:* In the normal course of our business, we have various legal proceedings and other contingent matters pending. We determine whether an estimated loss from a contingency should be accrued by assessing whether a loss is deemed probable and can be reasonably estimated. We assess our potential liability by analyzing our litigation and regulatory matters using available information. We develop our views on estimated losses in consultation with outside counsel handling our defense in these matters, which involves an analysis of potential results, assuming a combination of litigation and settlement strategies. The estimated losses often involve a level of subjectivity and usually are a range of reasonable losses and not an exact number, in those situations we accrue the best estimate within the range or the low end of the range if no estimate within the range is better than another.

**Accounting Standards Recently Adopted or Issued -** See Note 2 of the Notes to the Consolidated Financial Statements for a description of recently adopted and new accounting pronouncements, including the respective dates of adoption and expected effects on the Company's financial position and results of operations.

## Comparison of Financial Condition at December 31, 2019 and 2018

**General.** Total assets increased to $12.60 billion at December 31, 2019, compared to $11.87 billion at December 31, 2018. The increase in assets in 2019 reflects the assets acquired in the AltaPacific acquisition as well as organic loan growth.

Net loans receivable (gross loans less deferred fees and discounts, and allowance for loan losses and excluding loans held for sale) increased $616.7 million, or 7%, to $9.20 billion at December 31, 2019, from $8.59 billion at December 31, 2018. The increase in total loans receivable in 2019 included $332.4 million of portfolio loans acquired in the AltaPacific acquisition as well as $288.4 million of organic loan growth. The increase in net loans included increases of $328.7 million in commercial real estate loans, $210.2 million in commercial business loans, $104.3 million in multifamily real estate loans and $62.1 million in construction loans. The increase in construction loans was particularly helpful to the net interest margin as interest rates, loan fees and the velocity of turnover in this lending activity are generally higher than for most other categories of loans. Loans held for sale increased to $210.4 million at December 31, 2019, compared to $171.0 million at December 31, 2018, principally as a result of one- to four- family loan originations exceeding one- to four- family loan sales. Loans held for sale at December 31, 2019 included $137.1 million of multifamily loans and $73.3 million of one- to four-family loans.

Securities decreased to $1.81 billion at December 31, 2019, from $1.90 billion at December 31, 2018, as the Company maintained the level of its securities portfolio consistent with its liquidity needs. The aggregate total of securities and interest-bearing deposits decreased $50.8 million, or 3%, to $1.89 billion at December 31, 2019, compared to $1.94 billion a year earlier. The average effective duration of Banner's securities portfolio was approximately 3.5 years at December 31, 2019. The fair value of our trading securities was $1.6 million less than their amortized cost at December 31, 2019. In addition, fair value adjustments for securities designated as available-for-sale reflected an increase of $33.8 million for the year ended December 31, 2019, which was included as a component of other comprehensive income and largely occurred as a result of slightly increased market interest rates. Periodically, we also acquire securities (primarily municipal bonds) which are designated as held-to-maturity and this portfolio increased by $1.9 million from the prior year-end balance. (See Notes 4 and 17 of the Notes to the Consolidated Financial Statements.)

Goodwill increased $34.0 million to $373.1 million at December 31, 2019, compared to $339.2 million at December 31, 2018 as a result of the AltaPacific acquisition. Other intangibles decreased $3.8 million to $29.2 million at December 31, 2019, compared to $32.9 million at December 31, 2018, primarily due to CDI recorded in the AltaPacific acquisition, partially offset by scheduled amortization of CDI and the reclassification of the leasehold intangibles to the right of use lease asset in connection with the implementation of Lease Topic 842.

Deposits increased $571.6 million, or 6%, to $10.05 billion at December 31, 2019, from $9.48 billion at December 31, 2018, largely as a result of $313.4 million of deposits acquired in the AltaPacific acquisition as well as organic deposit growth. Core deposits were 89% of total deposits at December 31, 2019, compared to 86% of total deposits one year earlier. Non-interest-bearing deposits increased by $287.2 million, or 8%, to $3.95 billion from $3.66 billion at December 31, 2018; interest-bearing transaction and savings accounts increased by $484.3 million, to $4.98 billion at December 31, 2019 from $4.50 billion at December 31, 2018; and certificates of deposit decreased $199.9 million, or 15%, to $1.12 billion at December 31, 2019 from $1.32 billion at December 31, 2018. Brokered deposits decreased to $202.9 million at December 31, 2019, compared to $377.3 million a year earlier.

FHLB advances decreased $90.2 million, to $450.0 million at December 31, 2019 from $540.2 million at December 31, 2018, as core deposits were used to fund the growth in the loan portfolio. Other borrowings, consisting of retail repurchase agreements primarily related to customer cash management accounts, decreased $521,000 to $118.5 million at December 31, 2019, compared to $119.0 million at December 31, 2018. Junior subordinated debentures, which are carried at fair value, increased $5.2 million to $119.3 million at December 31, 2019 from $114.1 million a year ago, primarily due to the $5.8 million of junior subordinated debentures acquired in the AltaPacific acquisition. For more information, see Notes 9, 10 and 11 of the Notes to the Consolidated Financial Statements.

Total shareholders' equity increased $115.4 million, to $1.59 billion at December 31, 2019, compared to $1.48 billion at December 31, 2018. The increase in equity primarily reflects $85.2 million of common shares issued in connection with the AltaPacific acquisition and net income of $146.3 million, partially offset by the accrual of $93.5 million of dividends to common shareholders and the repurchase of $53.9 million of common stock. In the year ended December 31, 2019, we repurchased 1.0 million shares of our common stock at an average price of $53.90 per share. Tangible common shareholders' equity (a non-GAAP financial measure), which excludes goodwill and other intangible assets was $1.19 billion, or 9.77% of tangible assets at December 31, 2019, compared to $1.11 billion, or 9.62% at December 31, 2018. Banner's tangible book value per share (a non-GAAP financial measure) was $33.33 at December 31, 2019, compared to $31.45 per share a year ago.

**Investments.** At December 31, 2019, our consolidated investment securities portfolio totaled $1.81 billion and consisted principally of U.S. Government and agency obligations, mortgage-backed and mortgage-related securities, municipal bonds, corporate debt obligations, and asset-backed securities. 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, 2019, our aggregate investment in securities decreased $83.1 million, as the Company maintained the level of its securities portfolio consistent with its liquidity needs. Holdings of U.S. Government and agency obligations decreased $60.1 million, municipal bonds decreased $10.1 million, and asset-backed securities decreased $13.8 million. Partially offsetting these decreases was an increase mortgage-backed securities of $783,000.

*U.S. Government and Agency Obligations:* Our portfolio of U.S. Government and agency obligations had a carrying value of $90.0 million (with an amortized cost of $90.9 million) at December 31, 2019, a weighted average contractual maturity of 15.6 years and a weighted average coupon

rate of 4.13%. Many 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.

*Mortgage-Backed Obligations:* At December 31, 2019, our mortgage-backed and mortgage-related securities had a carrying value of $1.40 billion ($1.38 billion at amortized cost, with a net fair value adjustment of $17.3 million). The weighted average coupon rate of these securities was 3.23% and the weighted average contractual maturity was 20.9 years, although we receive principal payments on these securities each month resulting in a much shorter expected average life. As of December 31, 2019, 91% of the mortgage-backed and mortgage-related securities pay interest at a fixed rate and 9% pay at an adjustable interest rate.

*Municipal Bonds:* The carrying value of our tax-exempt bonds at December 31, 2019 was $231.8 million ($226.6 million at amortized cost), 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. We also had taxable bonds in our municipal bond portfolio, which at December 31, 2019 had a carrying value of $52.6 million ($52.5 million at amortized cost). Many of our qualifying municipal bonds are not rated by a nationally recognized credit rating agency due to the smaller size of the total issuance and a portion of these bonds have been acquired through direct private placement by the issuers. We have not experienced any defaults or payment deferrals on our current portfolio of municipal bonds. Our combined municipal bond portfolio is geographically diverse, with the majority within the states of Washington, Oregon, Texas and Idaho. At December 31, 2019, our municipal bond portfolio, including taxable and tax-exempt, had a weighted average maturity of approximately 12.6 years and a weighted average coupon rate of 3.85%.

*Corporate Bonds:* Our corporate bond portfolio had a carrying value of $33.4 million ($34.9 million at amortized cost, with a net fair value adjustment of $1.6 million) at December 31, 2019. Long-term adjustable-rate capital securities issued by financial institutions make up over half of our corporate bond portfolio. (See "Critical Accounting Policies" above and Note 17 of the Notes to the Consolidated Financial Statements.) At December 31, 2019, the portfolio had a weighted average maturity of 16.9 years and a weighted average coupon rate of 3.76%.

*Asset-Backed Securities:* At December 31, 2019, our asset-backed securities portfolio had a carrying value of $8.1 million (with an amortized cost of $8.2 million), and was comprised of securitized pools of student loans issued or guaranteed by the Student Loan Marketing Association and credit card receivables. The weighted average coupon rate of these securities was 3.18% and the weighted average contractual maturity was 10.1 years. At December 31, 2019, 100% of these securities had adjustable interest rates tied to three-month LIBOR while the remaining securities have fixed interest rates.

The following tables set forth certain information regarding carrying values and percentage of total carrying values of our portfolio of securities—trading and securities—available-for-sale, both carried at estimated fair market value, and securities—held-to-maturity, carried at amortized cost as of December 31, 2019, 2018 and 2017 (dollars in thousands):

**Table 1: Securities**

| | December 31 | | | | | |
|---|---|---|---|---|---|---|
| | **2019** | | 2018 | | 2017 | |
| | Carrying Value | Percent of Total | Carrying Value | Percent of Total | Carrying Value | Percent of Total |
| **Trading** | | | | | | |
| Municipal bonds | $ — | —% | $ — | —% | $ 100 | 0.5% |
| Corporate bonds | 25,636 | 100.0 | 25,896 | 100.0 | 22,058 | 98.8 |
| Equity securities | — | — | — | — | 160 | 0.7 |
| Total securities—trading | $ 25,636 | 100.0% | $ 25,896 | 100.0% | $ 22,318 | 100.0% |
| **Available-for-Sale** | | | | | | |
| U.S. Government and agency obligations | $ 89,598 | 5.8% | $ 149,112 | 9.1% | $ 72,466 | 7.9% |
| Municipal bonds | 107,157 | 6.9 | 117,822 | 7.2 | 68,733 | 7.5 |
| Corporate bonds | 4,365 | 0.3 | 3,495 | 0.2 | 5,393 | 0.6 |
| Mortgage-backed or related securities | 1,342,311 | 86.5 | 1,343,861 | 82.1 | 739,557 | 80.4 |
| Asset-backed securities | 8,126 | 0.5 | 21,933 | 1.4 | 27,758 | 3.0 |
| Equity securities | — | — | — | — | 5,578 | 0.6 |
| Total securities—available-for-sale | $ 1,551,557 | 100.0% | $ 1,636,223 | 100.0% | $ 919,485 | 100.0% |
| **Held-to-Maturity** | | | | | | |
| U.S. Government and agency obligations | $ 385 | 0.2% | $ 1,006 | 0.4% | $ 1,024 | 0.4% |
| Municipal bonds | 177,208 | 75.0 | 176,663 | 75.5 | 189,860 | 73.0 |
| Corporate bonds | 3,353 | 1.4 | 3,736 | 1.6 | 3,978 | 1.5 |
| Mortgage-backed or related securities | 55,148 | 23.4 | 52,815 | 22.5 | 65,409 | 25.1 |
| Total securities—held-to-maturity | $ 236,094 | 100.0% | $ 234,220 | 100.0% | $ 260,271 | 100.0% |
| Estimated market value | $ 237,805 | | $ 232,537 | | $ 262,188 | |

The following table shows the maturity or period to repricing of our consolidated portfolio of securities as of December 31, 2019 (dollars in thousands):

**Table 2: Securities—Maturity/Repricing and Rates**

| | December 31, 2019 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | One Year or Less | | After One to Five Years | | After Five to Ten Years | | After Ten to Twenty Years | | After Twenty Years | | Total | |
| | Carrying Value | Weighted Average Yield | Carrying Value | Weighted Average Yield | Carrying Value | Weighted Average Yield | Carrying Value | Weighted Average Yield | Carrying Value | Weighted Average Yield | Carrying Value | Weighted Average Yield |
| U.S. Government and agency obligations: | | | | | | | | | | | | |
| Fixed-rate | $ — | —% | $ 2,147 | 2.01% | $ 3,272 | 2.79% | $ 16,501 | 2.84% | $ — | —% | $ 21,920 | 2.75% |
| Adjustable-rate | — | — | — | — | 21,454 | (0.16) | 17,894 | 2.68 | 28,715 | 1.13 | 68,063 | 1.13 |
| | — | — | 2,147 | — | 24,726 | 0.22 | 34,395 | 2.76 | 28,715 | 1.13 | 89,983 | 1.52 |
| Municipal bonds: | | | | | | | | | | | | |
| Fixed-rate taxable | 1,500 | — | 32,965 | 2.23 | 13,490 | 3.44 | 4,149 | 4.23 | 494 | 3.29 | 52,598 | 2.64 |
| Fixed-rate tax exempt | 940 | 1.65 | 18,719 | 2.41 | 46,776 | 2.88 | 140,374 | 2.87 | 24,959 | 2.76 | 231,768 | 2.82 |
| Adjustable-rate taxable | — | — | — | — | — | — | — | — | — | — | — | — |
| Adjustable-rate tax exempt | — | — | — | — | — | — | — | — | — | — | — | — |
| | 2,440 | 0.63 | 51,684 | 2.29 | 60,266 | 3.01 | 144,523 | 2.91 | 25,453 | 2.77 | 284,366 | 2.79 |
| Corporate bonds: | | | | | | | | | | | | |
| Fixed-rate | — | — | 2,553 | 3.23 | — | — | — | — | 1,803 | — | 4,356 | 1.89 |
| Adjustable-rate | — | — | 2,268 | 2.73 | 500 | 2.91 | 26,230 | 5.57 | — | — | 28,998 | 5.32 |
| | — | — | 4,821 | 2.99 | 500 | 2.91 | 26,230 | 5.57 | 1,803 | — | 33,354 | 4.89 |
| Mortgage-backed or related securities: | | | | | | | | | | | | |
| Fixed-rate | — | — | 47,357 | 2.79 | 326,330 | 3.06 | 120,786 | 2.72 | 773,669 | 2.45 | 1,268,142 | 2.64 |
| Adjustable-rate | — | — | — | — | — | — | 49,258 | 2.54 | 80,059 | 2.92 | 129,317 | 2.78 |
| | — | — | 47,357 | 2.79 | 326,330 | 3.06 | 170,044 | 2.67 | 853,728 | 2.50 | 1,397,459 | 2.66 |
| Asset-backed securities: | | | | | | | | | | | | |
| Fixed-rate | — | — | — | — | — | — | — | — | — | — | — | — |
| Adjustable-rate | — | — | 5,270 | 2.96 | — | — | 1,016 | 2.72 | 1,840 | 2.73 | 8,126 | 2.88 |
| | — | — | 5,270 | 2.96 | — | — | 1,016 | 2.72 | 1,840 | — | 8,126 | — |
| Equity securities | — | — | — | — | — | — | — | — | — | — | — | — |
| Total securities—carrying value | $ 2,440 | 0.63 | $ 111,279 | 2.56 | $ 411,822 | 2.87 | $ 376,208 | 2.99 | $ 911,539 | 2.46 | $ 1,813,288 | 2.66 |
| Total securities—estimated market value | $ 2,441 | | $ 112,196 | | $ 413,322 | | $ 375,682 | | $ 911,357 | | $ 1,814,998 | |

**Loans and Lending.** Loans are our most significant and generally highest yielding earning assets. We attempt to maintain a portfolio of loans in a range of 90% to 95% of total deposits to enhance our revenues, while adhering to sound underwriting practices and appropriate diversification guidelines in order to maintain a moderate risk profile. At December 31, 2019, our net loan portfolio totaled $9.20 billion compared to $8.59 billion at December 31, 2018. Our total loan portfolio increased $620.8 million, or 7%, during the year ended December 31, 2019, compared to an increase of $1.09 billion, or 14%, during the year ended December 31, 2018. The increase included $332.4 million of portfolio loans acquired in the AltaPacific acquisition as well as organic loan growth. 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. We have implemented strategies designed to capture more market share and achieve increases in targeted loans resulting in strong loan originations in 2019 and 2018. Nonetheless, looking forward, new loan originations and portfolio balances will continue to be significantly affected by the course of economic activity and changes in interest rates.

Originations of loans for sale increased to $1.1 billion for the year ended December 31, 2019 from $896.5 million during 2018 and from $807.1 million during the year ended December 31, 2017. Originations of loans for sale included $340.0 million, $372.8 million, and $292.3 million of multifamily held-for-sale loan production for the years ended December 31, 2019, December 31, 2018, and December 31, 2017, respectively. We generally sell a significant portion of our newly originated one- to four-family residential mortgage loans and multifamily loans to secondary market purchasers. Proceeds from sales of loans for the years ended December 31, 2019, 2018 and 2017 totaled $1.1 billion, $791.7 million and $1.05 billion, respectively. See *"Loan Servicing Portfolio"* below. Loans held for sale increased $39.4 million to $210.4 million at December 31, 2019, compared to $171.0 million at December 31, 2018. The increase in loans held for sale was primarily due to the increased volume of originations of one- to four-family residential mortgage loans held-for-sale, which exceeded sales during the year.

The following table shows loan origination (excluding loans held for sale) activity for the years ended December 31, 2019, 2018, and 2017 (in thousands):

**Table 3: Loan Origination**

| | Years Ended | | |
|---|---|---|---|
| | **Dec 31, 2019** | Dec 31, 2018 | Dec 31, 2017 |
| Commercial real estate | $ 480,669 | $ 536,784 | $ 537,825 |
| Multifamily real estate | 80,761 | 25,771 | 77,409 |
| Construction and land | 1,435,501 | 1,460,536 | 1,216,227 |
| Commercial business | 757,721 | 839,290 | 647,079 |
| Agricultural business | 93,050 | 123,702 | 117,186 |
| One-to four- family residential | 117,297 | 177,332 | 249,558 |
| Consumer | 357,040 | 331,661 | 344,407 |
| Total loan originations (excluding loans held for sale) | $ 3,322,039 | $ 3,495,076 | $ 3,189,691 |

The loan origination table above includes loan participations and loan purchases. During the years ended December 31, 2019, 2018, and 2017 we purchased $9.8 million, $33.7 million, and $126.5 million respectively, of loans. The loan purchases in 2019 were one- to four-family and commercial loans compared to the loan purchases in 2018 which were one- to four-family loans. The loan purchases in 2017 included both one- to four-family and commercial real estate loans.

*One- to Four-Family Residential Real Estate Lending:* At December 31, 2019, $945.6 million, or 10% of our loan portfolio, consisted of permanent loans on one- to four-family residences. Our residential mortgage loan originations have been relatively strong in recent years, as interest rates have been low and declined during the current year. We are active originators of one- to four-family residential loans in most communities where we have established offices in Washington, Oregon, California and Idaho. Most of the one- to four-family loans that we originate are sold in the secondary markets with net gains on sales and loan servicing fees reflected in our revenues from mortgage banking. Our balance of loans for one- to four-family residences decreased by $28.0 million in 2019, compared to the prior year largely as a result of selling a greater percentage of our originations in the secondary markets.

*Construction and Land Lending:* Our construction loan originations have been relatively strong in recent years as builders have expanded production and experienced strong home sales in many markets where we operate. Despite the strong originations during 2019 one-to four-family construction loans only increased by $9.6 million in 2019 to total $544.3 million at December 31, 2019, as the velocity of one- to four-family home sales increased during the year. During the year ended December 31, 2019, land and land development loans (both residential and commercial) decreased by $34.8 million to $181.0 million at December 31, 2019, At December 31, 2019, construction, land and land development loans totaled $1.17 billion (including $544.3 million of one- to four-family construction loans, $154.7 million of residential land or land development loans, $444.3 million of commercial and multifamily real estate construction loans and $26.3 million of commercial land or land development loans), or 13% of total loans, compared to $1.11 billion, or 13%, at December 31, 2018.

*Commercial and Multifamily Real Estate Lending:* We also originate loans secured by commercial and multifamily real estate. Commercial and multifamily real estate loans originated by us include both fixed- and adjustable-rate loans with intermediate terms of generally 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. At December 31, 2019, our loan portfolio included $3.89 billion of commercial real estate loans, or 42% of the total loan portfolio, compared to $3.56 billion, or 41%, at December 31, 2018. Our portfolio of multifamily real estate loans was $473.2 million, or 5% of total loans at December 31, 2019, compared to $368.8 million, or 4%, at December 31, 2018. The increases in commercial real estate loans and multifamily real estate loans during 2019 were due to $227.3 million of commercial and multifamily loans acquired in the AltaPacific acquisition as well as organic growth.

*Commercial Business Lending:* Our commercial business lending is directed toward meeting the credit and related deposit needs of various small- to medium-sized business and agribusiness borrowers operating in our primary market areas. In addition to providing earning assets, this type of lending has helped increase our deposit base. At December 31, 2019, commercial business loans totaled $1.69 billion, or 18% of total loans, compared to $1.48 billion, or 17%, at December 31, 2018. This increase in the current year was due to organic growth in the commercial business loan portfolio. In recent years our commercial lending has also included participation in certain national syndicated loans, including shared national credits, which totaled $190.8 million at December 31, 2019.

*Agricultural Lending:* Agriculture is a major industry in many Washington, Oregon, California 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. At December 31, 2019, agricultural loans totaled $370.5 million, or 4% of the loan portfolio, compared to $404.9 million, or 5%, at December 31, 2018.

*Consumer and Other Lending:* Consumer lending has traditionally been a modest part of our business with loans made primarily to accommodate our existing customer base. At December 31, 2019, our consumer loans decreased $22.2 million to $762.8 million, or 8% of our loan portfolio, compared to $785.0 million, or 9%, at December 31, 2018. As of December 31, 2019, 72% of our consumer loans were secured by one- to four-family real estate, including home equity lines of credit. Credit card balances totaled $41.1 million at December 31, 2019 compared to $39.0 million a year earlier.

*Loan Servicing Portfolio:* At December 31, 2019, we were servicing $2.85 billion of loans for others and held $12.6 million in escrow for our portfolio of loans serviced for others. The loan servicing portfolio at December 31, 2019 was composed of $1.14 billion of Freddie Mac residential mortgage loans, $1.12 billion of Fannie Mae residential mortgage loans, $319.0 million of Oregon Housing residential mortgage loans and $260.5 million of other loans serviced for a variety of investors. The portfolio included loans secured by property located primarily in the states of Washington, Oregon, Idaho and California. For the year ended December 31, 2019, we recognized $1.8 million of loan servicing fees in our results of operations, which was net of $5.1 million of amortization for MSRs and included no impairment charges or reversals for a valuation adjustment to MSRs.

*Mortgage Servicing Rights:* For the years ended December 31, 2019, 2018 and 2017, we capitalized $4.4 million, $3.6 million, and $3.4 million, respectively, of MSRs relating to loans sold with servicing retained. Amortization of MSRs for the years ended December 31, 2019, 2018 and 2017 was $5.1 million, $3.9 million, and $4.0 million, respectively. Management periodically evaluates the estimates and assumptions used to determine the carrying values of MSRs and the amortization of MSRs. At December 31, 2019, our MSRs were carried at a value of $14.1 million, net of amortization, compared to $14.6 million at December 31, 2018.

The following table sets forth the composition of the Company's loan portfolio, net of discounts and deferred fees and costs, by type of loan as of the dates indicated (dollars in thousands):

**Table 4: Loan Portfolio Analysis**

| | December 31 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **2019** | | 2018 | | 2017 | | 2016 | | 2015 | |
| | Amount | Percent of Total | Amount | Percent of Total | Amount | Percent of Total | Amount | Percent of Total | Amount | Percent of Total |
| Commercial real estate: | | | | | | | | | | |
| Owner-occupied | $ 1,580,650 | 17.0% | $ 1,430,097 | 16.4% | $ 1,284,363 | 16.9% | $ 1,352,999 | 18.1% | $ 1,327,807 | 18.2% |
| Investment properties | 2,309,221 | 24.8 | 2,131,059 | 24.5 | 1,937,423 | 25.5 | 1,986,336 | 26.7 | 1,765,353 | 24.1 |
| Multifamily real estate | 473,152 | 5.1 | 368,836 | 4.2 | 314,188 | 4.1 | 248,150 | 3.3 | 472,976 | 6.5 |
| Commercial construction | 210,668 | 2.3 | 172,410 | 2.0 | 148,435 | 2.0 | 124,068 | 1.7 | 72,103 | 1.0 |
| Multifamily construction | 233,610 | 2.5 | 184,630 | 2.1 | 154,662 | 2.0 | 124,126 | 1.7 | 63,846 | 0.9 |
| One- to four-family construction | 544,308 | 5.8 | 534,678 | 6.2 | 415,327 | 5.5 | 375,704 | 5.0 | 278,469 | 3.8 |
| Land and land development: | | | | | | | | | | |
| Residential | 154,688 | 1.7 | 188,508 | 2.2 | 164,516 | 2.2 | 170,004 | 2.3 | 126,773 | 1.7 |
| Commercial | 26,290 | 0.3 | 27,278 | 0.3 | 24,583 | 0.3 | 29,184 | 0.4 | 33,179 | 0.5 |
| Commercial business | 1,693,824 | 18.2 | 1,483,614 | 17.1 | 1,279,894 | 16.8 | 1,207,879 | 16.2 | 1,207,944 | 16.5 |
| Agricultural business, including secured by farmland | 370,549 | 4.0 | 404,873 | 4.7 | 338,388 | 4.4 | 369,156 | 5.0 | 376,531 | 5.1 |
| One- to four-family real estate | 945,622 | 10.1 | 973,616 | 11.2 | 848,289 | 11.2 | 813,077 | 10.9 | 952,633 | 13.0 |
| Consumer secured by one- to four-family real estate | 550,960 | 5.9 | 568,979 | 6.6 | 522,931 | 6.9 | 493,211 | 6.6 | 478,420 | 6.5 |
| Consumer—other | 211,815 | 2.3 | 216,017 | 2.5 | 165,885 | 2.2 | 157,254 | 2.1 | 158,470 | 2.2 |
| Total loans outstanding | 9,305,357 | 100.0% | 8,684,595 | 100.0% | 7,598,884 | 100.0% | 7,451,148 | 100.0% | 7,314,504 | 100.0% |
| Less allowance for loan losses | (100,559) | | (96,485) | | (89,028) | | (85,997) | | (78,008) | |
| Net loans | $ 9,204,798 | | $ 8,588,110 | | $ 7,509,856 | | $ 7,365,151 | | $ 7,236,496 | |

The following table sets forth the Company's loans by geographic concentration at December 31, 2019, 2018 and 2017 (dollars in thousands):

**Table 5: Loans by Geographic Concentration**

| | **December 31, 2019** | | December 31, 2018 | | December 31, 2017 | |
|---|---|---|---|---|---|---|
| | Amount | Percent | Amount | Percent | Amount | Percent |
| Washington | $ 4,364,764 | 46.9% | $ 4,324,588 | 49.8% | $ 3,508,542 | 46.2% |
| California | 2,129,789 | 22.9 | 1,596,604 | 18.4 | 1,415,076 | 18.6 |
| Oregon | 1,650,704 | 17.7 | 1,636,152 | 18.8 | 1,590,233 | 20.9 |
| Idaho | 530,016 | 5.7 | 521,026 | 6.0 | 492,603 | 6.5 |
| Utah | 60,958 | 0.7 | 57,318 | 0.7 | 73,382 | 1.0 |
| Other | 569,126 | 6.1 | 548,907 | 6.3 | 519,048 | 6.8 |
| Total | $ 9,305,357 | 100.0% | $ 8,684,595 | 100.0% | $ 7,598,884 | 100.0% |

The following table sets forth certain information at December 31, 2019 regarding the dollar amount of loans maturing in our portfolio based on their contractual terms to maturity, but does not include scheduled payments or potential prepayments. Demand loans, loans having no stated schedule of repayments and no stated maturity, and overdrafts are reported as due in one year or less. Loan balances are net of unamortized premiums and discounts, and exclude loans held for sale and the allowance for loan losses (in thousands):

**Table 6: Loans by Maturity**

| | Maturing in One Year or Less | Maturing After One to Three Years | Maturing After Three to Five Years | Maturing After Five to Ten Years | Maturing After Ten Years | Total |
|---|---|---|---|---|---|---|
| Commercial real estate: | | | | | | |
| Owner-occupied | $ 45,254 | $ 123,281 | $ 205,356 | $ 849,944 | $ 356,815 | $ 1,580,650 |
| Investment properties | 83,161 | 211,314 | 264,087 | 1,140,816 | 609,843 | 2,309,221 |
| Multifamily real estate | 8,959 | 52,760 | 47,068 | 183,333 | 181,032 | 473,152 |
| Commercial construction | 116,713 | 41,029 | 4,976 | 33,674 | 14,276 | 210,668 |
| Multifamily construction | 116,648 | 116,911 | 51 | — | — | 233,610 |
| One- to four-family construction | 505,616 | 38,339 | — | — | 353 | 544,308 |
| Land and land development: | | | | | | |
| Residential | 84,376 | 62,981 | 2,309 | 4,290 | 732 | 154,688 |
| Commercial | 17,199 | 3,960 | 1,672 | 3,254 | 205 | 26,290 |
| Commercial business | 656,988 | 258,871 | 275,745 | 272,367 | 229,853 | 1,693,824 |
| Agricultural business, including secured by farmland | 114,308 | 36,535 | 45,357 | 143,956 | 30,393 | 370,549 |
| One- to four-family real estate | 10,147 | 16,736 | 21,881 | 75,795 | 821,063 | 945,622 |
| Consumer secured by one- to four-family real estate | 7,112 | 7,274 | 9,649 | 23,085 | 503,840 | 550,960 |
| Consumer—other | 39,724 | 20,253 | 29,816 | 28,234 | 93,788 | 211,815 |
| Total loans | $ 1,806,205 | $ 990,244 | $ 907,967 | $ 2,758,748 | $ 2,842,193 | $ 9,305,357 |

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

The following table sets forth the dollar amount of all loans maturing after December 31, 2020 which have fixed interest rates and floating or adjustable interest rates (in thousands):

**Table 7: Loans Maturing after One Year**

| | Fixed Rates | Floating or Adjustable Rates | Total |
|---|---|---|---|
| Commercial real estate: | | | |
| Owner-occupied | $ 381,357 | $ 1,154,039 | $ 1,535,396 |
| Investment properties | 573,860 | 1,652,200 | 2,226,060 |
| Multifamily real estate | 284,798 | 179,395 | 464,193 |
| Commercial construction | 32,669 | 61,286 | 93,955 |
| Multifamily construction | 46,768 | 70,194 | 116,962 |
| One- to four-family construction | 1,214 | 37,478 | 38,692 |
| Land and land development: | | | |
| Residential | 6,864 | 63,448 | 70,312 |
| Commercial | 1,597 | 7,494 | 9,091 |
| Commercial business | 614,666 | 422,170 | 1,036,836 |
| Agricultural business, including secured by farmland | 82,718 | 173,523 | 256,241 |
| One- to four-family real estate | 655,473 | 280,002 | 935,475 |
| Consumer secured by one- to four-family real estate | 15,497 | 528,351 | 543,848 |
| Consumer—other | 106,089 | 66,002 | 172,091 |
| Total loans maturing after one year | $ 2,803,570 | $ 4,695,582 | $ 7,499,152 |

**Deposits.** We compete with other financial institutions and financial intermediaries in attracting deposits and we generally attract deposits within our primary market areas. Much of the focus of our expansion and current marketing efforts have been directed toward attracting additional deposit customer relationships and balances. This effort has been particularly directed towards increasing transaction and savings accounts which has contributed to us being very successful in increasing these core deposit balances. The long-term success of our deposit gathering activities is reflected not only in the growth of deposit balances, but also in increases in the level of deposit fees, service charges and other payment processing revenues.

One of our key strategies is to strengthen our franchise by emphasizing core deposit activity in non-interest-bearing and other transaction and savings accounts with less reliance on higher cost certificates of deposit. Increasing core deposits is a fundamental element of our business strategy. This strategy continues to help control our cost of funds and increase the opportunity for deposit fee revenues, while stabilizing our funding base. Total deposits increased $571.6 million, or 6%, to $10.05 billion at December 31, 2019 from $9.48 billion at December 31, 2018. Deposit growth for 2019 included $313.4 million of deposits acquired in the AltaPacific acquisition as well as organic deposit growth. Non-interest-bearing deposits increased by $287.2 million, or 8%, to $3.95 billion at year end from $3.66 billion at December 31, 2018. Interest-bearing transaction and savings accounts increased by $484.3 million, to $4.98 billion at December 31, 2019 compared to $4.50 billion a year earlier. Certificates of deposit decreased $199.9 million, or 15%, to $1.12 billion at December 31, 2019 from $1.32 billion at December 31, 2018. The decrease in certificates of deposit balances in 2019 was largely due to the $174.5 million decrease in brokered deposits to $202.9 million at December 31, 2019.

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

**Table 8: Deposits**

| | December 31 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **2019** | | | 2018 | | | 2017 | |
| | Amount | Percent of Total | Increase (Decrease) | Amount | Percent of Total | Increase (Decrease) | Amount | Percent of Total |
| Non-interest-bearing checking | $ 3,945,000 | 39.3% | $ 287,183 | $ 3,657,817 | 38.6% | $ 392,273 | $ 3,265,544 | 39.9% |
| Interest-bearing checking | 1,280,003 | 12.7 | 88,987 | 1,191,016 | 12.6 | 219,879 | 971,137 | 11.9 |
| Regular savings | 1,934,041 | 19.3 | 91,460 | 1,842,581 | 19.4 | 285,081 | 1,557,500 | 19.0 |
| Money market | 1,769,194 | 17.6 | 303,825 | 1,465,369 | 15.5 | 43,056 | 1,422,313 | 17.4 |
| Total interest-bearing transaction and savings accounts | 4,983,238 | 49.6 | 484,272 | 4,498,966 | 47.5 | 548,016 | 3,950,950 | 48.3 |
| Certificates maturing: | | | | | | | | |
| Within one year | 846,941 | 8.4 | (154,265) | 1,001,206 | 10.6 | 315,614 | 685,592 | 8.4 |
| After one year, but within two years | 167,857 | 1.7 | (34,062) | 201,919 | 2.1 | 103,662 | 98,257 | 1.2 |
| After two years, but within five years | 103,357 | 1.0 | (11,536) | 114,893 | 1.2 | (65,993) | 180,886 | 2.2 |
| After five years | 2,248 | — | 1 | 2,247 | — | 45 | 2,202 | — |
| Total certificate accounts | 1,120,403 | 11.1 | (199,862) | 1,320,265 | 13.9 | 353,328 | 966,937 | 11.8 |
| Total Deposits | $ 10,048,641 | 100.0% | $ 571,593 | $ 9,477,048 | 100.0% | $ 1,293,617 | $ 8,183,431 | 100.0% |
| Included in Total Deposits: | | | | | | | | |
| Public transaction accounts | $ 244,418 | 2.4% | $ 27,017 | $ 217,401 | 2.3% | $ 18,682 | $ 198,719 | 2.5% |
| Public interest-bearing certificates | 35,184 | 0.4 | 5,095 | 30,089 | 0.3 | 6,404 | 23,685 | 0.3 |
| Total public deposits | $ 279,602 | 2.8% | $ 32,112 | $ 247,490 | 2.6% | $ 25,086 | $ 222,404 | 2.8% |
| Total brokered deposits | $ 202,884 | 2.0% | $ (174,463) | $ 377,347 | 4.0% | $ 320,119 | $ 57,228 | 0.7% |

The following table indicates the amount of the Banks' certificates of deposit with balances equal to or greater than $100,000 by time remaining until maturity as of December 31, 2019 (in thousands):

**Table 9: Maturity Period—$100,000 or greater CDs**

| | Certificates of Deposit $100,000 or Greater |
|---|---|
| Maturing in three months or less | $ 127,041 |
| Maturing after three months through six months | 81,831 |
| Maturing after six months through twelve months | 142,638 |
| Maturing after twelve months | 144,247 |
| Total | $ 495,757 |

The following table provides additional detail on geographic concentrations of our deposits at December 31, 2019, 2018, and 2017 (in thousands):

**Table 10: Geographic Concentration of Deposits**

| | **December 31, 2019** | | December 31, 2018 | | December 31, 2017 | |
|---|---|---|---|---|---|---|
| | Amount | Percent | Amount | Percent | Amount | Percent |
| Washington | $ 5,861,809 | 58.3% | $ 5,674,328 | 59.9% | $ 4,506,249 | 55.0% |
| Oregon | 2,006,163 | 20.0 | 1,891,145 | 20.0 | 1,797,147 | 22.0 |
| California | 1,698,289 | 16.9 | 1,434,033 | 15.1 | 1,432,819 | 17.5 |
| Idaho | 482,380 | 4.8 | 477,542 | 5.0 | 447,216 | 5.5 |
| Total deposits | $ 10,048,641 | 100.0% | $ 9,477,048 | 100.0% | $ 8,183,431 | 100.0% |

**Borrowings.** The FHLB-Des Moines serves as our primary borrowing source. To access funds, we are required to own a sufficient level of capital stock in the FHLB-Des Moines and may apply for advances on the security of such stock and certain of our mortgage loans and securities provided that certain creditworthiness standards have been met. At December 31, 2019, we had $450.0 million of FHLB advances outstanding at a weighted average rate of 2.09%, a decrease of $90.2 million compared to a year earlier. Also, at December 31, 2019, we had an investment of $28.3 million in FHLB capital stock. At that date, Banner Bank was authorized by the FHLB-Des Moines to borrow up to $5.31 billion under a blanket floating lien security agreement, while Islanders Bank was approved to borrow up to $132.7 million under a similar agreement.

The following table provides additional detail on our FHLB advances as of December 31, 2019 and 2018 (dollars in thousands):

**Table 11: FHLB Advances Outstanding**

| | December 31 | | | |
|---|---|---|---|---|
| | **2019** | | 2018 | |
| | Amount | Weighted Average Rate | Amount | Weighted Average Rate |
| Maturing in one year or less | $ 300,000 | 1.84% | $ 540,000 | 2.64% |
| Maturing after one year through three years | 150,000 | 2.58 | — | — |
| Maturing after three years through five years | — | — | — | — |
| Maturing after five years | — | — | 189 | 5.94 |
| Total FHLB advances | $ 450,000 | 2.09% | $ 540,189 | 2.64% |

At certain times the Federal Reserve Bank has also served as an important source of borrowings. The Federal Reserve Bank provides credit based upon acceptable loan collateral, which includes certain loan types not eligible for pledging to the FHLB-Des Moines. At December 31, 2019, based upon our available unencumbered collateral, Banner Bank was eligible to borrow $1.19 billion from the Federal Reserve Bank; however, at that date we had no funds borrowed under this arrangement.

We also issue retail repurchase agreements to customers that are primarily related to customer cash management accounts and in the past have borrowed funds through the use of secured wholesale repurchase agreements with securities brokers. In each case, the repurchase agreements are generally due within 90 days. At December 31, 2019, retail repurchase agreements totaled $118.5 million, had a weighted average rate of 0.35%, and were secured by pledges of certain mortgage-backed securities and agency securities. Retail repurchase agreement balances, which are primarily associated with customer sweep account arrangements, decreased $521,000, from the 2018 year-end balance. We had no borrowings under wholesale repurchase agreements at December 31, 2019 or December 31, 2018.

At December 31, 2019, we had an aggregate of $143.5 million, net of repayments, of TPS. This includes $120.0 million issued by us and $23.5 million acquired in our bank acquisitions. The junior subordinated debentures associated with the TPS have been recorded as liabilities on our Consolidated Statements of Financial Condition, although the TPS qualifies as Tier 1 capital for regulatory capital purposes. The junior subordinated debentures are carried at fair value on our Consolidated Statements of Financial Condition and had an estimated fair value of $119.3 million at December 31, 2019. At December 31, 2019, the TPS had a weighted average rate of 4.05%. See Note 11, Junior Subordinated Debentures and Mandatorily Redeemable Trust Preferred Securities, of the Notes to the Consolidated Financial Statements for additional information with respect to the TPS.

**Asset Quality.** Achieving and maintaining a moderate risk profile by employing appropriate underwriting standards, avoiding excessive asset concentrations and aggressively managing troubled assets has been and will continue to be a primary focus for us. During 2019, we continued to be actively engaged with our borrowers in resolving remaining problem assets and with the effective management of real estate owned as a result of foreclosures.

Non-performing assets increased to $40.5 million, or 0.32% of total assets, at December 31, 2019, from $18.9 million, or 0.16% of total assets, at December 31, 2018, and from $27.5 million, or 0.28% of total assets, at December 31, 2017. At December 31, 2019, our allowance for loan losses was $100.6 million, or 254% of non-performing loans, compared to $96.5 million, or 616% of non-performing loans at December 31, 2018. The increase in non-performing loans during 2019 was largely due to one commercial banking relationship moving to nonaccrual. We continue to believe our level of non-performing loans and assets is manageable and further believe that we have sufficient capital and human resources to manage the collection of our non-performing assets in an orderly fashion.

Loans are reported as restructured when we grant concessions to a borrower experiencing financial difficulties that we would not otherwise consider. As a result of these concessions, restructured loans, referred to as troubled debt restructures (TDRs), are considered impaired as the Banks will not collect all amounts of principal and interest due in accordance with the terms of the original loan agreement. If any TDR loan becomes delinquent or other matters call into question the borrower's ability to repay full interest and principal in accordance with the restructured terms, the TDR loan(s) would be reclassified as nonaccrual. At December 31, 2019, we had $6.5 million of TDR loans currently performing under their restructured terms.

The loans acquired in Banner's merger transactions that are determined to have deteriorated credit quality for which it is probable that all contractual payments will not be collected are accounted for as purchased credit-impaired pools. Typically this would include loans that were considered non-performing or restructured as of the acquisition date. Accordingly, subsequent to acquisition, loans included in the purchased credit-impaired pools are not reported as non-performing loans based upon their individual performance status, so the categories of nonaccrual, impaired and 90 day past due and accruing do not include any purchased credit-impaired loans. Purchased credit-impaired loans were $15.9 million at December 31, 2019, compared to $14.4 million at December 31, 2018.

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

**Table 12: Non-Performing Assets**

| | December 31 | | | | |
|---|---|---|---|---|---|
| | **2019** | 2018 | 2017 | 2016 | 2015 |
| Nonaccrual loans: [1] | | | | | |
| Secured by real estate: | | | | | |
| Commercial | $ 5,952 | $ 4,088 | $ 10,646 | $ 8,237 | $ 3,751 |
| Multifamily | 85 | — | — | — | — |
| Construction/land | 1,905 | 3,188 | 798 | 1,748 | 2,260 |
| One- to four-family | 3,410 | 1,544 | 3,264 | 2,263 | 4,700 |
| Commercial business | 23,015 | 2,936 | 3,406 | 3,074 | 2,159 |
| Agricultural business, including secured by farmland | 661 | 1,751 | 6,132 | 3,229 | 697 |
| Consumer | 2,473 | 1,241 | 1,297 | 1,875 | 703 |
| | 37,501 | 14,748 | 25,543 | 20,426 | 14,270 |
| Loans more than 90 days delinquent, still on accrual: | | | | | |
| Secured by real estate: | | | | | |
| Commercial | 89 | — | — | 701 | — |
| Multifamily | — | — | — | 147 | — |
| Construction/land | 332 | — | 298 | — | — |
| One- to four-family | 877 | 658 | 1,085 | 1,233 | 899 |
| Commercial business | 401 | 1 | 18 | — | 8 |
| Consumer | 398 | 247 | 85 | 72 | 45 |
| | 2,097 | 906 | 1,486 | 2,153 | 952 |
| Total non-performing loans | 39,598 | 15,654 | 27,029 | 22,579 | 15,222 |
| REO assets held for sale, net [2] | 814 | 2,611 | 360 | 11,081 | 11,627 |
| Other repossessed assets held for sale, net | 122 | 592 | 107 | 166 | 268 |
| Total non-performing assets | $ 40,534 | $ 18,857 | $ 27,496 | $ 33,826 | $ 27,117 |
| Total non-performing loans to net loans before allowance for loan losses | 0.43% | 0.18% | 0.36% | 0.30% | 0.21% |
| Total non-performing loans to total assets | 0.31% | 0.13% | 0.28% | 0.23% | 0.16% |
| Total non-performing assets to total assets | 0.32% | 0.16% | 0.28% | 0.35% | 0.28% |
| TDR loans [3] | $ 6,466 | $ 13,422 | $ 16,115 | $ 18,907 | $ 21,777 |
| Loans 30-89 days past due and on accrual | $ 20,178 | $ 25,108 | $ 29,278 | $ 11,571 | $ 18,834 |

(1) Includes $1.50 million of nonaccrual TDR loans as of December 31, 2019. For the year ended December 31, 2019, interest income was reduced by $1.7 million as a result of nonaccrual loan activity, which includes the reversal of accrued interest as of the date the loan was placed on nonaccrual. There was no interest income recognized on nonaccrual loans during the year ended December 31, 2019.

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

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

In addition to the non-performing loans noted in Table 12 and purchased credit-impaired loans as of December 31, 2019 and 2018, we had other classified loans with an aggregate outstanding balance of $61.7 million and $68.6 million, respectively, that are not on nonaccrual status with respect to which known information concerning possible credit problems with the borrowers or the cash flows of the properties securing the respective loans has caused management to be concerned about the ability of the borrowers to comply with present loan repayment terms. This may result in the future inclusion of such loans in the nonaccrual loan category.

The following table presents the REO activity for the years ended December 31, 2019, 2018 and 2017 (in thousands):

**Table 13: REO**

| | For the years ended December 31, | | |
|---|---|---|---|
| | **2019** | 2018 | 2017 |
| Balance, beginning of the period | $ 2,611 | $ 360 | $ 11,081 |
| Additions from loan foreclosures | 109 | 641 | 46 |
| Additions from acquisitions | 650 | 2,593 | — |
| Additions from capitalized costs | — | — | 54 |
| Proceeds from dispositions of REO | (2,588) | (838) | (13,474) |
| Gain on sale of REO | 32 | 242 | 2,909 |
| Valuation adjustments in period | — | (387) | (256) |
| Balance, end of period | $ 814 | $ 2,611 | $ 360 |

REO decreased $1.8 million, to $814,000 at December 31, 2019 compared to $2.6 million at December 31, 2018 and increased compared to $360,000 at December 31, 2017. The decrease in 2019 primarily reflects the sale of REO properties acquired in the Skagit acquisition and the increase during 2018 primarily reflects the addition of REO properties acquired in the Skagit acquisition.

From time to time, non-recurring fair value adjustments to REO are recorded to reflect partial write-downs based on an observable market price or current appraised value of property. The individual carrying values of these assets are reviewed for impairment at least annually and any additional impairment charges are expensed to operations.

**Comparison of Results of Operations for the Years Ended December 31, 2019 and 2018**

For the year ended December 31, 2019, our net income was $146.3 million, or $4.18 per diluted share, compared to net income of $136.5 million, or $4.15 per diluted share for the year ended December 31, 2018. Our net income for the year ended December 31, 2019 was positively impacted by growth in interest-earning assets from the full year benefit of the earning assets from the Skagit acquisition and the two month benefit of the interest-earnings assets from the AltaPacific acquisition as well as organic loan growth, partially offset by increases in both interest expense and non-interest expense. Our results for the years ended December 31, 2019 and 2018 included $7.5 million and $5.6 million, respectively, of acquisition-related expenses.

Our operating results depend largely on our net interest income which increased by $37.9 million to $468.9 million, primarily reflecting growth in the loan portfolio, partially offset by increased funding costs primarily due to an increase in interest rates paid. Our operating results for the year ended December 31, 2019 also reflected a $2.1 million decrease in non-interest income primarily as a result of a reduction in the fair value of financial instruments carried at fair value in 2019 of $208,000, compared to an increase in the fair value of financial instruments carried at fair value in 2018 of $3.8 million as well as a $1.4 million decrease in deposit fees and other service charges. The decrease in deposit fees and other service charges is a result of Banner becoming subject to the Durbin Amendment on July 1, 2019, which reduced interchange fee income by approximately $7 million during the second half of 2019. The increase in net interest income contributed to an increase of $35.9 million, or 7%, in revenue to $550.9 million for the year ended December 31, 2019, compared to $515.0 million for the year ended December 31, 2018. Non-interest expense increased to $357.7 million for the year ended December 31, 2019 compared with $341.4 million for the year ended December 31, 2018, largely as a result of higher salary and employee benefits due to additional staffing related to the operations acquired from the inclusion of the acquired Skagit operations for a full year and the AltaPacific operations for the last two months of 2019 and normal salary and wage adjustments, acquisition-related expenses, and smaller increases in other operational expenses associated with operating the branches acquired in the Skagit and AltaPacific acquisitions partially offset by increases in capitalized loan origination costs and reduced professional and legal expenses.

**Net Interest Income.** Net interest income before provision for loan losses increased by $37.9 million, or 9%, to $468.9 million for the year ended December 31, 2019, compared to $431.0 million one year earlier, largely reflecting growth in average interest-earning assets which was the result of recognizing the full year benefit of the earning assets from the Skagit acquisition and the two month benefit of the interest-earning assets from the AltaPacific acquisition as well as organic loan growth. Our net interest margin was enhanced by the amortization of acquisition accounting discounts on purchased loans acquired from bank acquisitions, which are accreted into loan interest income. The net interest margin of 4.30% for the year ended December 31, 2019 was 13 basis points lower than the prior year and included seven basis points from acquisition accounting adjustments compared to ten basis points from acquisition accounting adjustments in 2018. The average yield on interest-earning assets of 4.82% for the year ended December 31, 2019 increased 6 basis points compared to the prior year due to higher contractual yields on loans and securities. Funding costs were higher, as the average cost of funding liabilities increased by 19 basis points to 0.55% as compared to the prior year. As a result, the net interest spread decreased to 4.27% for the year ended December 31, 2019 compared to 4.40% for the prior year. The effect of recent changes in the targeted Fed Funds rate on the cost of funding liabilities typically lags the effect on the yield earned on interest-earning assets because rates on many deposit accounts are decision-based, not tied to a specific market-based index, and are based on competition for deposits while most interest-earning assets adjust earlier because they are tied to a specific market-based index.

**Interest Income.** Interest income for the year ended December 31, 2019 was $525.7 million, compared to $463.6 million for the prior year, an increase of $62.0 million, or 13%. The increase in interest income occurred as a result of increases in both the average balances and yields of total interest-earning assets. The average balance of total interest-earning assets was $10.91 billion for the year ended December 31, 2019, an increase of $1.18 billion, or 12%, compared to $9.73 billion one year earlier. The yield on average interest-earning assets was 4.82% for the year ended December 31, 2019, compared to 4.76% for the year ended December 31, 2018. The increased yield on interest-earning assets reflects improvement in yields on loans and securities. Average loan yields increased three basis points to 5.24% for the year ended December 31, 2019 compared to 5.21% in the preceding year, reflecting the positive impact of higher index interest rates, over the first half of 2019 on adjustable-rate and recently originated loans, partially offset by a four basis point decrease in acquisition accounting loan discount accretion to 9 basis points in 2019 from 13 basis points in 2018. Average loans receivable for the year ended December 31, 2019 increased $1.06 billion, or 13%, to $9.00 billion, compared to $7.94 billion for the prior year. Interest income on loans increased by $58.1 million, or 14%, to $471.5 million for the year ended December 31, 2019, from $413.4 million for the prior year, reflecting the impact of the $1.06 billion increase in average loan balances and the three basis point increase in the average yield on total loans.

The combined average balance of mortgage-backed securities, other investment securities, daily interest-bearing deposits and FHLB stock increased to $1.91 billion for the year ended December 31, 2019 (excluding the effect of fair value adjustments), compared to $1.80 billion for the year ended December 31, 2018, contributing to the $3.9 million increase in interest and dividend income compared to the prior year. The average yield on the combined portfolio increased to 2.83% for the year ended December 31, 2019, from 2.80% for the prior year. For the year ended December 31, 2019, the average yield on mortgage-backed securities increased one basis points to 2.82% compared to the prior year, while the yield on other securities decreased two basis points to 2.83% compared to the prior year.

**Interest Expense.** Interest expense for the year ended December 31, 2019 was $56.8 million, compared to $32.7 million for the prior year, an increase of $24.1 million, or 74%. The increase in interest expense occurred as a result of a $1.11 billion, or 12%, increase in average funding liabilities and a 19 basis point increase in the average cost of all funding liabilities to 0.55% for the year ended December 31, 2019, compared to 0.36% for the year ended December 31, 2018. This increase in average funding liabilities reflects increases in core deposits, including non-interest-bearing deposits and interest-bearing transaction and savings accounts, as well as increases in FHLB advances.

Deposit interest expense increased $17.0 million, or 82%, to $37.6 million for the year ended December 31, 2019 compared to $20.6 million for the prior year as a result of an $868.5 million, or 10%, increase in the average balance of deposits and a 15 basis point increase in the average cost of deposits. Average deposit balances increased to $9.54 billion for the year ended December 31, 2019, from $8.67 billion for the year ended December 31, 2018, while the average rate paid on deposit balances increased to 0.39% in the current year from 0.24% for the prior year. The cost of interest-bearing deposits increased by 26 basis points to 0.65% for the year ended December 31, 2019 compared to 0.39% in the prior year. The $340.9 million increase in the average balance of non-interest-bearing accounts during 2019 reduced the increase in total deposit costs. The increase in the cost of interest-bearing deposits between the periods was driven by market and competitive factors as a result of increases in the target Fed Funds Rate during 2018. Deposit costs are significantly affected by changes in the level of market interest rates; however, changes in the average rate paid for interest-bearing deposits frequently tend to lag changes in market interest rates. As a result, the decreases in the target Fed Funds Rate during the second half of 2019 had limited benefit on our 2019 deposit costs.

Average total borrowings increased to $741.6 million for the year end December 31, 2019, compared to $502.6 million for the prior year. The increase in average total borrowings was largely due to a $224.1 million increase in average FHLB advances. The average rate paid on total borrowings increased 19 basis points to 2.58% from 2.39% reflecting the 27 basis point increase in the average cost for our junior subordinated debentures (which reprice every three months based on changes in the three-month LIBOR index) and a 34 basis point increase in the average cost of FHLB advances reflecting increases to the Fed Funds target rate in 2018. The increase in the average cost of total borrowings was the primary reason for the $7.1 million increase in the related interest expense to $19.1 million for the year ended December 31, 2019, from $12.0 million in the prior year.

Table 14, *Analysis of Net Interest Spread,* presents, for the periods indicated, our condensed average balance sheet information, together with interest income and yields earned on average interest-earning assets and interest expense and rates paid on average interest-bearing liabilities. Average balances are computed using daily average balances. (See the footnotes to the tables for more information on average balances.)

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

**Table 14: Analysis of Net Interest Spread**

| | **Year Ended December 31, 2019** | | | Year Ended December 31, 2018 | | | Year Ended December 31, 2017 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Average Balance | Interest and Dividends | Yield/ Cost [3] | Average Balance | Interest and Dividends | Yield/ Cost [3] | Average Balance | Interest and Dividends | Yield/ Cost [3] |
| Interest-earning assets: | | | | | | | | | |
| Held for sale loans | $ 126,086 | $ 5,343 | 4.24% | $ 81,873 | $ 3,926 | 4.80% | $ 128,480 | $ 5,245 | 4.08% |
| Mortgage loans | 6,911,067 | 361,158 | 5.23 | 6,188,279 | 320,264 | 5.18 | 5,932,300 | 290,132 | 4.89 |
| Commercial/agricultural loans | 1,784,468 | 93,742 | 5.25 | 1,519,871 | 79,605 | 5.24 | 1,485,985 | 70,266 | 4.73 |
| Consumer and other loans | 176,373 | 11,230 | 6.37 | 149,184 | 9,575 | 6.42 | 140,500 | 8,806 | 6.27 |
| Total loans [1] | 8,997,994 | 471,473 | 5.24 | 7,939,207 | 413,370 | 5.21 | 7,687,265 | 374,449 | 4.87 |
| Mortgage-backed securities | 1,368,927 | 38,640 | 2.82 | 1,247,758 | 35,076 | 2.81 | 1,043,599 | 24,535 | 2.35 |
| Other securities | 441,402 | 12,510 | 2.83 | 468,416 | 13,332 | 2.85 | 464,680 | 12,448 | 2.68 |
| Interest-bearing deposits with banks | 72,579 | 1,649 | 2.27 | 59,031 | 1,080 | 1.83 | 49,573 | 583 | 1.18 |
| FHLB stock | 29,509 | 1,407 | 4.77 | 20,496 | 774 | 3.78 | 16,379 | 269 | 1.64 |
| Total investment securities | 1,912,417 | 54,206 | 2.83 | 1,795,701 | 50,262 | 2.80 | 1,574,231 | 37,835 | 2.40 |
| Total interest-earning assets | 10,910,411 | 525,679 | 4.82 | 9,734,908 | 463,632 | 4.76 | 9,261,496 | 412,284 | 4.45 |
| Non-interest-earning assets | 1,078,277 | | | 828,184 | | | 892,052 | | |
| Total assets | $ 11,988,688 | | | $ 10,563,092 | | | $ 10,153,548 | | |
| Deposits: | | | | | | | | | |
| Interest-bearing checking accounts | $ 1,188,985 | $ 2,224 | 0.19 | $ 1,048,327 | $ 1,200 | 0.11 | $ 933,978 | $ 850 | 0.09 |
| Savings accounts | 1,890,467 | 8,310 | 0.44 | 1,665,608 | 3,944 | 0.24 | 1,559,042 | 2,138 | 0.14 |
| Money market accounts | 1,534,909 | 10,693 | 0.70 | 1,421,161 | 4,107 | 0.29 | 1,515,854 | 2,638 | 0.17 |
| Certificates of deposit | 1,175,942 | 16,403 | 1.39 | 1,127,612 | 11,391 | 1.01 | 1,116,304 | 6,647 | 0.60 |
| Total interest-bearing deposits | 5,790,303 | 37,630 | 0.65 | 5,262,708 | 20,642 | 0.39 | 5,125,178 | 12,273 | 0.24 |
| Non-interest-bearing deposits | 3,751,878 | — | — | 3,411,010 | — | — | 3,233,889 | — | — |
| Total deposits | 9,542,181 | 37,630 | 0.39 | 8,673,718 | 20,642 | 0.24 | 8,359,067 | 12,273 | 0.15 |
| Other interest-bearing liabilities: | | | | | | | | | |
| FHLB advances | 477,796 | 12,234 | 2.56 | 253,661 | 5,636 | 2.22 | 151,295 | 1,908 | 1.26 |
| Other borrowings | 122,343 | 330 | 0.27 | 108,730 | 245 | 0.23 | 111,903 | 317 | 0.28 |
| Junior subordinated debentures | 141,504 | 6,574 | 4.65 | 140,212 | 6,136 | 4.38 | 140,212 | 4,752 | 3.39 |
| Total borrowings | 741,643 | 19,138 | 2.58 | 502,603 | 12,017 | 2.39 | 403,410 | 6,977 | 1.73 |
| Total funding liabilities | 10,283,824 | 56,768 | 0.55 | 9,176,321 | 32,659 | 0.36 | 8,762,477 | 19,250 | 0.22 |
| Other non-interest-bearing liabilities [2] | 164,318 | | | 79,901 | | | 61,592 | | |
| Total liabilities | 10,448,142 | | | 9,256,222 | | | 8,824,069 | | |
| Shareholders' equity | 1,540,546 | | | 1,306,870 | | | 1,329,479 | | |
| Total liabilities and shareholders' equity | $ 11,988,688 | | | $ 10,563,092 | | | $ 10,153,548 | | |
| Net interest income/rate spread | | $ 468,911 | 4.27% | | $ 430,973 | 4.40% | | $ 393,034 | 4.23% |
| Net interest margin | | | 4.30% | | | 4.43% | | | 4.24% |
| Average interest-earning assets / average interest-bearing liabilities | | | 167.03% | | | 168.85% | | | 167.52% |
| Average interest-earning assets / average funding liabilities | | | 106.09% | | | 106.09% | | | 105.69% |

(footnotes follow)

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

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

**Table 15: Rate/Volume Analysis**

| | Year Ended **December 31, 2019** Compared to Year Ended December 31, 2018 Increase (Decrease) in Income/Expense Due to | | | Year Ended **December 31, 2018** Compared to Year Ended December 31, 2017 Increase (Decrease) in Income/Expense Due to | | |
|---|---|---|---|---|---|---|
| | Rate | Volume | Net | Rate | Volume | Net |
| Interest-earning assets: | | | | | | |
| Held for sale loans | $ (388) | $ 1,805 | $ 1,417 | $ 1,224 | $ (2,543) | $ (1,319) |
| Mortgage loans | 3,416 | 37,478 | 40,894 | 17,303 | 12,829 | 30,132 |
| Commercial/agricultural loans | 189 | 13,948 | 14,137 | 7,707 | 1,632 | 9,339 |
| Consumer and other loans | (71) | 1,726 | 1,655 | 215 | 554 | 769 |
| Total loans [1] | 3,146 | 54,957 | 58,103 | 26,449 | 12,472 | 38,921 |
| Mortgage-backed securities | 111 | 3,453 | 3,564 | 5,271 | 5,270 | 10,541 |
| Other securities | (75) | (747) | (822) | 784 | 100 | 884 |
| Interest-bearing deposits with banks | 291 | 278 | 569 | 370 | 127 | 497 |
| FHLB stock | 237 | 396 | 633 | 423 | 82 | 505 |
| Total investment securities | 564 | 3,380 | 3,944 | 6,848 | 5,579 | 12,427 |
| Total net change in interest income on interest-earning assets | 3,710 | 58,337 | 62,047 | 33,297 | 18,051 | 51,348 |
| Interest-bearing liabilities: | | | | | | |
| Interest-bearing checking accounts | 880 | 144 | 1,024 | 237 | 113 | 350 |
| Savings accounts | 3,780 | 586 | 4,366 | 1,651 | 155 | 1,806 |
| Money market accounts | 6,284 | 302 | 6,586 | 1,622 | (153) | 1,469 |
| Certificates of deposit | 4,448 | 564 | 5,012 | 4,676 | 68 | 4,744 |
| Total interest-bearing deposits | 15,392 | 1,596 | 16,988 | 8,186 | 183 | 8,369 |
| FHLB advances | 969 | 5,629 | 6,598 | 1,974 | 1,754 | 3,728 |
| Other borrowings | 52 | 33 | 85 | (63) | (9) | (72) |
| Junior subordinated debentures | 387 | 51 | 438 | 1,384 | — | 1,384 |
| Total borrowings | 1,408 | 5,713 | 7,121 | 3,295 | 1,745 | 5,040 |
| Total net change in interest expense on interest-bearing liabilities | 16,800 | 7,309 | 24,109 | 11,481 | 1,928 | 13,409 |
| Net change in net interest income | $ (13,090) | $ 51,028 | $ 37,938 | $ 21,816 | $ 16,123 | $ 37,939 |

(1) Includes loans accounted for on a nonaccrual basis and loans 90 days or more past due. Amortization of net deferred loan fees/costs is included with interest on loans.

**Provision and Allowance for Loan Losses**. Although our credit quality metrics continue to reflect strong performance and our moderate risk profile, we recorded an $10.0 million provision for loan losses in the year ended December 31, 2019, primarily due to the organic growth in the loan portfolio, the increase in non-performing loans, the maturity, subsequent renewal and migration of acquired loans out of the discounted loan portfolios and increased net charge-offs, compared to the $8.5 million provision for loan losses recorded in 2018. As discussed in the "Summary of Critical Accounting Policies" section above and in Note 1 of the Notes to the Consolidated Financial Statements, the provision and allowance for loan losses is one of the most critical accounting estimates included in our Consolidated Financial Statements.

The provision for loan losses reflects the amount required to maintain the allowance for losses at an appropriate level based upon management's evaluation of the adequacy of general and specific loss reserves, trends in delinquencies, net charge-offs and current economic conditions. We continue to maintain a strong allowance for loan losses at December 31, 2019.

In accordance with acquisition accounting, loans acquired from acquisitions were recorded at their estimated fair value, which resulted in a net discount to the contractual amounts of the loans, of which a portion reflects a discount for possible credit losses. Credit discounts are included in the determination of fair value and as a result no allowance for loan and lease losses is recorded for acquired loans at the acquisition date. Although the discount recorded on the acquired loans is not reflected in the allowance for loan losses, or related allowance coverage ratios, we believe it should be considered when comparing the current ratios to similar ratios in periods prior to the acquisitions. The discount on acquired loans was $25.0 million at December 31, 2019 compared to $25.7 million at December 31, 2018.

We recorded net charge-offs of $5.9 million for the year ended December 31, 2019, compared to net charge-offs of $1.0 million for the prior year. Non-performing loans increased by $23.9 million during the year to $39.6 million at December 31, 2019, compared to $15.7 million at December 31, 2018. The increase in non-performing loans during the quarter was largely due to one commercial banking relationship moving to nonaccrual. A comparison of the allowance for loan losses at December 31, 2019 and 2018 reflects an increase of $4.1 million, or 4%, to $100.6 million at December 31, 2019, from $96.5 million at December 31, 2018. Included in our allowance at December 31, 2019 was an unallocated portion of $2.4 million, which was based upon our evaluation of various factors that were not directly measured in the determination of the formula and specific allowances. The allowance for loan losses as a percentage of total loans (loans receivable excluding allowance for losses) decreased to 1.08% at December 31, 2019, compared to 1.11% at December 31, 2018.

We believe that the allowance for loan losses was adequate to absorb the known and inherent risks of loss in the loan portfolio as of December 31, 2019. While we believe the estimates and assumptions used in our determination of the adequacy of the allowance are reasonable, there can be no assurance that these estimates and assumptions will not be proven incorrect in the future, or that the actual amount of future provisions will not exceed the amount of past provisions or that any increased provisions that may be required will not adversely impact our financial condition and results of operations. In addition, the determination of the amount of the allowance for loan losses is subject to review by bank regulators as part of the routine examination process, which may result in the establishment of additional reserves based upon their judgment of information available to them at the time of their examination.

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

**Table 16: Changes in Allowance for Loan Losses**

| | Years Ended December 31 | | | | |
|---|---|---|---|---|---|
| | **2019** | 2018 | 2017 | 2016 | 2015 |
| Balance, beginning of period | $ 96,485 | $ 89,028 | $ 85,997 | $ 78,008 | $ 75,907 |
| Provision | 10,000 | 8,500 | 8,000 | 6,030 | — |
| Recoveries of loans previously charged off: | | | | | |
| Commercial real estate | 476 | 1,646 | 372 | 582 | 819 |
| Multifamily real estate | — | — | 11 | — | 113 |
| Construction and land | 208 | 213 | 1,237 | 2,171 | 1,811 |
| Commercial business | 561 | 1,049 | 1,226 | 1,993 | 772 |
| Agricultural business, including secured by farmland | 625 | 64 | 134 | 59 | 948 |
| One- to four-family real estate | 47 | 750 | 270 | 1,283 | 1,927 |
| Consumer | 548 | 366 | 481 | 610 | 570 |
| | 2,465 | 4,088 | 3,731 | 6,698 | 6,960 |
| Loans charged off: | | | | | |
| Commercial real estate | (1,138) | (401) | (1,180) | (746) | (64) |
| Construction and land | (45) | (479) | — | (616) | (891) |
| Commercial business | (86) | (2,051) | (3,803) | (948) | (419) |
| Agricultural business, including secured by farmland | (4,171) | (756) | (2,374) | (567) | (746) |
| One- to four-family real estate | (911) | (43) | (38) | (375) | (1,225) |
| Consumer | (2,040) | (1,401) | (1,305) | (1,487) | (1,514) |
| | (8,391) | (5,131) | (8,700) | (4,739) | (4,859) |
| Net (charge-offs) recoveries | (5,926) | (1,043) | (4,969) | 1,959 | 2,101 |
| Balance, end of period | $ 100,559 | $ 96,485 | $ 89,028 | $ 85,997 | $ 78,008 |
| Allowance for loan losses as a percent of total loans | 1.08 % | 1.11 % | 1.17 % | 1.15% | 1.07% |
| Net loan (charge-offs) recoveries as a percent of average outstanding loans during the period | (0.06)% | (0.01)% | (0.06)% | 0.03% | 0.04% |
| Allowance for loan losses as a percent of non-performing loans | 254 % | 616 % | 329 % | 381% | 512% |

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

**Table 17: Allocation of Allowance for Loan Losses**

| | December 31 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **2019** | | 2018 | | 2017 | | 2016 | | 2015 | |
| | Amount | Percent of Loans in Each Category to Total Loans | Amount | Percent of Loans in Each Category to Total Loans | Amount | Percent of Loans in Each Category to Total Loans | Amount | Percent of Loans in Each Category to Total Loans | Amount | Percent of Loans in Each Category to Total Loans |
| Specific or allocated loss allowances [1]: | | | | | | | | | | |
| Commercial real estate | $ 30,591 | 41.8% | $ 27,132 | 41.0% | $ 22,824 | 42.4% | $ 20,993 | 44.9% | $ 20,716 | 42.3% |
| Multifamily real estate | 4,754 | 5.1 | 3,818 | 4.2 | 1,633 | 4.1 | 1,360 | 3.3 | 4,195 | 6.5 |
| Construction and land | 22,994 | 12.6 | 24,442 | 12.8 | 27,568 | 12.0 | 34,252 | 11.0 | 27,131 | 7.9 |
| Commercial business | 23,370 | 18.2 | 19,438 | 17.1 | 18,311 | 16.8 | 16,533 | 16.2 | 13,856 | 16.5 |
| Agricultural business, including secured by farmland | 4,120 | 4.0 | 3,778 | 4.7 | 4,053 | 4.4 | 2,967 | 5.0 | 3,645 | 5.1 |
| One-to-four-family real estate | 4,136 | 10.1 | 4,714 | 11.2 | 2,055 | 11.2 | 2,238 | 10.9 | 4,732 | 13.0 |
| Consumer | 8,202 | 8.2 | 7,972 | 9.0 | 3,866 | 9.1 | 4,104 | 8.7 | 902 | 8.7 |
| Total allocated | 98,167 | | 91,294 | | 80,310 | | 82,447 | | 75,177 | |
| Unallocated [1] | 2,392 | n/a | 5,191 | n/a | 8,718 | n/a | 3,550 | n/a | 2,831 | n/a |
| Total allowance for loan losses | $ 100,559 | 100.0% | $ 96,485 | 100.0% | $ 89,028 | 100.0% | $ 85,997 | 100.0% | $ 78,008 | 100.0% |

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

**Non-interest Income.** The following table presents the key components of non-interest income for the years ended December 31, 2019, 2018, 2017 (dollars in thousands):

**Table 18: Non-interest Income**

| | 2019 compared to 2018 | | | | 2018 compared to 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | 2019 | 2018 | Change Amount | Change Percent | 2018 | 2017 | Change Amount | Change Percent |
| Deposit fees and other service charges | $ 46,632 | $ 48,074 | $ (1,442) | (3.0)% | $ 48,074 | $ 43,452 | $ 4,622 | 10.6 % |
| Mortgage banking operations | 22,215 | 21,343 | 872 | 4.1 % | 21,343 | 20,880 | 463 | 2.2 % |
| Bank owned life insurance | 4,645 | 4,505 | 140 | 3.1 % | 4,505 | 4,618 | (113) | (2.4)% |
| Miscellaneous | 8,632 | 7,148 | 1,484 | 20.8 % | 7,148 | 8,985 | (1,837) | (20.4)% |
| | 82,124 | 81,070 | 1,054 | 1.3 % | 81,070 | 77,935 | 3,135 | 4.0 % |
| Net gain (loss) on sale of securities | 33 | (837) | 870 | (103.9)% | (837) | (2,080) | 1,243 | (59.8)% |
| Net change in valuation of financial instruments carried at fair value | (208) | 3,775 | (3,983) | (105.5)% | 3,775 | (2,844) | 6,619 | (232.7)% |
| Gain on sale of branches, including related loans and deposits | — | — | — | — % | — | 12,189 | (12,189) | (100.0)% |
| Total non-interest income | $ 81,949 | $ 84,008 | $ (2,059) | (2.5)% | $ 84,008 | $ 85,200 | $ (1,192) | (1.4)% |

**Non-interest income**, which includes deposit fees and other service charges, mortgage banking operations, bank owned life insurance as well as changes in the valuation of financial instruments carried at fair value, decreased $2.1 million, or 2%, to $81.9 million for the year ended December 31, 2019, compared to $84.0 million for the year ended December 31, 2018. This decrease was primarily due to the decrease in deposit fees and other service charges as well as the reduction in the fair value of financial instruments carried at fair value, partially offset by the increase in miscellaneous income. Income from deposit fees and other service charges decreased by $1.4 million, or 3%, to $46.6 million for the year ended December 31, 2019, compared to $48.1 million for the prior year as a result of Banner becoming subject to the Durbin Amendment on July 1, 2019, which reduced interchange fee income by approximately $7 million during the second half of 2019. Mortgage banking revenues, including gains on one- to four-family and multifamily loan sales and loan servicing fees, increased by $872,000 to $22.2 million for the year ended December 31, 2019, compared to $21.3 million in the prior year. Sales of one- to four-family loans held for sale for the year ended December 31, 2019 resulted in gains of $18.0 million, compared to $14.9 million for the year ended December 31, 2018. In addition, for the year ended December 31, 2019, mortgage banking revenues included $2.4 million of gains on the sale of multifamily loans, compared to $3.8 million for the year ended December 31, 2018. The $1.5 million increase in miscellaneous income was primarily driven by higher gains on the sales of Small Business Administration loans as well as an increase in interest rate swap income, partially offset by an increase in losses related to the disposition of assets. Securities sales for the year ended December 31, 2019 resulted in a gain of $33,000 compared to an $837,000 loss for securities sold for the year ended December 31, 2018.

For the year ended December 31, 2019, we recorded a net loss of $208,000 for changes in the valuation of financial instruments carried at fair value, compared to a net gain of $3.8 million for the year ended December 31, 2018. The adjustments in 2018 primarily reflected changes in the valuation of certain corporate bonds largely as a result of a combination of both increased market interest rates and increased spreads. Following the adoption of new accounting guidance, beginning in the first quarter of 2018, Banner no longer reflects changes in the fair value of its junior subordinated debentures related to instrument-specific credit risk in the Consolidated Statements of Operations, but rather reports such changes in the Consolidated Statements of Comprehensive Income and includes them in total shareholders' equity in the Consolidated Statements of Financial Condition.

**Non-interest Expense.** The following table represents key elements of non-interest expense for the years ended December 31, 2019, 2018, 2017 (dollars in thousands).

**Table 19: Non-interest Expense**

| | 2019 compared to 2018 | | | | 2018 compared to 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | 2019 | 2018 | Change Amount | Change Percent | 2018 | 2017 | Change Amount | Change Percent |
| Salary and employee benefits | $ 226,409 | $ 202,613 | $ 23,796 | 11.7 % | $ 202,613 | $ 192,096 | $ 10,517 | 5.5 % |
| Less capitalized loan origination costs | (28,934) | (17,925) | (11,009) | 61.4 % | (17,925) | (17,379) | (546) | 3.1 % |
| Occupancy and equipment | 52,390 | 49,215 | 3,175 | 6.5 % | 49,215 | 47,866 | 1,349 | 2.8 % |
| Information/computer data services | 22,458 | 18,823 | 3,635 | 19.3 % | 18,823 | 17,245 | 1,578 | 9.2 % |
| Payment and card processing expenses | 16,993 | 15,412 | 1,581 | 10.3 % | 15,412 | 14,330 | 1,082 | 7.6 % |
| Professional and legal expenses | 9,736 | 17,945 | (8,209) | (45.7)% | 17,945 | 17,534 | 411 | 2.3 % |
| Advertising and marketing | 7,836 | 8,346 | (510) | (6.1)% | 8,346 | 8,637 | (291) | (3.4)% |
| Deposit insurance | 2,840 | 4,446 | (1,606) | (36.1)% | 4,446 | 4,689 | (243) | (5.2)% |
| State/Municipal business and use taxes | 3,880 | 3,284 | 596 | 18.1 % | 3,284 | 2,594 | 690 | 26.6 % |
| REO operations | 303 | 804 | (501) | (62.3)% | 804 | (2,030) | 2,834 | (139.6)% |
| Amortization of core deposit intangibles | 8,151 | 6,047 | 2,104 | 34.8 % | 6,047 | 6,246 | (199) | (3.2)% |
| Miscellaneous | 28,122 | 26,754 | 1,368 | 5.1 % | 26,754 | 27,142 | (388) | (1.4)% |
| | $ 350,184 | $ 335,764 | $ 14,420 | 4.3 % | $ 335,764 | $ 318,970 | $ 16,794 | 5.3 % |
| Acquisition-related costs | $ 7,544 | $ 5,607 | $ 1,937 | 34.5 % | $ 5,607 | $ — | $ 5,607 | nm |
| Total non-interest expense | $ 357,728 | $ 341,371 | $ 16,357 | 4.8 % | $ 341,371 | $ 318,970 | $ 22,401 | 7.0 % |

Non-interest expense for the year ended December 31, 2019 was $357.7 million, an increase of $16.4 million, or 5%, as compared to the same period in 2018. The increase was largely attributable to the inclusion of acquired Skagit operations for the full year of 2019, as well as the AltaPacific operations for the last two months of 2019, higher salary and employee benefits and expenses related primarily to the operations acquired in the Skagit acquisition, partially offset by increases in capitalized loan origination costs as well as lower professional and legal expenses.

Salary and employee benefits expenses increased $23.8 million to $226.4 million for the year ended December 31, 2019 from $202.6 million for the year ended December 31, 2018, primarily reflecting additional staffing related to the operations acquired from the acquisition of Skagit on November 1, 2018, normal salary and wage adjustments and a $1.6 million expense recognized in the third quarter of 2019 as a result of decreasing the discount rate the Company uses to calculate its liability associated with deferred compensation plans. Capitalized loan origination costs increased $11.0 million for the year ended December 31, 2019, compared to the same periods in the prior year, reflecting the increase in held-for-sale loan originations and loan renewals as well as higher deferred costs on a per loan basis related to the annual update of our deferred loan cost models. Occupancy and equipment expenses increased $3.2 million, or 6%, to $52.4 million in 2019, compared to $49.2 million in 2018, primarily reflecting the operations acquired from the Skagit acquisition. Information and computer data services expense increased $3.6 million, or 19%, to $22.5 million in the current year, compared to $18.8 million in the prior year, reflecting incremental costs as the Company continued to grow. Professional and legal expense decreased $8.2 million to $9.7 million for the year ended December 31, 2019 from $17.9 million for the year ended December 31, 2018. The decrease in professional and legal expenses was primarily driven by the completion of projects associated with the build-out of compliance and risk management infrastructure during 2018 as well as a $4.0 million accrual for pending litigation recorded in the fourth quarter of 2018. Deposit insurance expense decreased $1.6 million for the year ended December 31, 2019, compared to the same period in 2018 as the result of a credit of $2.7 million recognized in the third quarter of 2019 for previously paid deposit insurance premiums. REO operations for the year ended December 31, 2019 resulted in expense of $303,000, compared to expense of $804,000 in the prior year. The amortization of core deposit intangibles for the year ended December 31, 2019 increased $2.1 million, compared to the same period in 2018 as a result of the core deposit intangible acquired from the Skagit acquisition. There were $7.5 million of acquisition-related costs added to non-interest expense in the current year, compared to $5.6 million in the year ended December 31, 2018.

**Income Taxes.** For the year ended December 31, 2019, we recognized $36.9 million in income tax expense for an effective rate of 20.1%, which reflects the new lower federal corporate income tax rate effective beginning in 2018, as well as the benefits from tax exempt income sources. Our blended federal and state statutory income tax rate is 23.5%, representing a blend of the statutory federal income tax rate of 21.0% and apportioned effects of the state and local jurisdictions where we do business. For the year ended December 31, 2018, we recognized $28.6 million in income tax expense for an effective tax rate of 17.3%, which included $5.5 million of tax benefit adjustments primarily due to the release of a $4.2 million valuation reserve previously recorded in the fourth quarter of 2017 as a provisional amount related to the enactment of the 2017 Tax Act. For more information on income taxes and deferred taxes, see Note 12 of the Notes to the Consolidated Financial Statements.

## Comparison of Results of Operations for the Years Ended December 31, 2018 and 2017

See Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2018 filed with the SEC.

## Market Risk and Asset/Liability Management

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

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

The greatest source of interest rate risk to us results from the mismatch of maturities or repricing intervals for rate sensitive assets, liabilities and off-balance sheet contracts. This mismatch or gap is generally characterized by a substantially shorter maturity structure for interest-bearing liabilities than interest-earning assets, although our floating-rate assets tend to be more immediately responsive to changes in market rates than most funding deposit liabilities. Additional interest rate risk results from mismatched repricing indices and formula (basis risk and yield curve risk), and product caps and floors and early repayment or withdrawal provisions (option risk), which may be contractual or market driven, that are generally more favorable to customers than to us. An exception to this generalization is the beneficial effect of interest rate floors on a substantial portion of our performing floating-rate loans, which help us maintain higher loan yields in periods when market interest rates decline significantly. However, in a declining interest rate environment, as loans with floors are repaid they generally are replaced with new loans which have lower interest rate floors. As of December 31, 2019, our loans with interest rate floors totaled approximately $2.88 billion and had a weighted average floor rate of 4.73% compared to a current average note rate of 5.31%.

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

### Sensitivity Analysis

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

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

The following table sets forth as of December 31, 2019, the estimated changes in our net interest income over one-year and two-year time horizons and the estimated changes in economic value of equity based on the indicated interest rate environments (dollars in thousands):

**Table 20: Interest Rate Risk Indicators**

| | December 31, 2019 | | | | | |
|---|---|---|---|---|---|---|
| | Estimated Increase (Decrease) in | | | | | |
| Change (in Basis Points) in Interest Rates [1] | Net Interest Income Next 12 Months | | Net Interest Income Next 24 Months | | Economic Value of Equity | |
| +400 | $ 11,386 | 2.4% | $ 53,293 | 5.7% | $ (151,681) | (6.7)% |
| +300 | 17,181 | 3.7 | 60,988 | 6.5 | (59,290) | (2.6) |
| +200 | 17,889 | 3.8 | 56,764 | 6.0 | 18,185 | 0.8 |
| +100 | 12,401 | 2.6 | 37,958 | 4.0 | 49,479 | 2.2 |
| 0 | — | — | — | — | — | — |
| -50 | (9,889) | (2.1) | (29,259) | (3.1) | (73,682) | (3.3) |
| -100 | (22,230) | (4.7) | (64,129) | (6.8) | (168,942) | (7.5) |

(1) Assumes an instantaneous and sustained uniform change in market interest rates at all maturities; however, no rates are allowed to go below zero. The current targeted federal funds rate is between 1.50% and 1.75%.

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

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

Table 21, *Interest Sensitivity Gap,* presents our interest sensitivity gap between interest-earning assets and interest-bearing liabilities at December 31, 2019. The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities which are anticipated by us, based upon certain assumptions, to reprice or mature in each of the future periods shown. At December 31, 2019, total interest-earning assets maturing or repricing within one year exceeded total interest-bearing liabilities maturing or repricing in the same time period by $3.13 billion, representing a one-year cumulative gap to total assets ratio of 24.83%.

Management is aware of the sources of interest rate risk and in its opinion actively monitors and manages it to the extent possible. Management believes that our current level of interest rate risk is reasonable.

The following table provides a GAP analysis as of December 31, 2019 (dollars in thousands):

**Table 21: Interest Sensitivity Gap**

| | December 31, 2019 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Within 6 Months | After 6 Months Within 1 Year | After 1 Year Within 3 Years | After 3 Years Within 5 Years | After 5 Years Within 10 Years | Over 10 Years | Total |
| Interest-earning assets: [1] | | | | | | | |
| Construction loans | $ 823,216 | $ 55,370 | $ 112,350 | $ 19,724 | $ 10,276 | $ 1,037 | $ 1,021,973 |
| Fixed-rate mortgage loans | 321,792 | 226,084 | 735,192 | 482,134 | 438,854 | 26,995 | 2,231,051 |
| Adjustable-rate mortgage loans | 1,155,874 | 447,070 | 1,272,478 | 663,200 | 169,849 | — | 3,708,471 |
| Fixed-rate mortgage-backed securities | 97,447 | 93,975 | 286,184 | 197,459 | 409,285 | 172,599 | 1,256,949 |
| Adjustable-rate mortgage-backed securities | 135,168 | 9,566 | 40,330 | 11,185 | 5,219 | — | 201,468 |
| Fixed-rate commercial/agricultural loans | 148,831 | 113,898 | 233,900 | 94,812 | 73,220 | 28,006 | 692,667 |
| Adjustable-rate commercial/agricultural loans | 993,941 | 35,098 | 79,658 | 49,600 | 27,748 | — | 1,186,045 |
| Consumer and other loans | 470,205 | 60,895 | 75,619 | 17,370 | 16,721 | 37,524 | 678,334 |
| Investment securities and interest-earning deposits | 117,032 | 22,710 | 44,234 | 46,018 | 72,072 | 99,608 | 401,674 |
| Total rate sensitive assets | 4,263,506 | 1,064,666 | 2,879,945 | 1,581,502 | 1,223,244 | 365,769 | 11,378,632 |
| Interest-bearing liabilities: [2] | | | | | | | |
| Interest-bearing checking accounts | 100,846 | 52,665 | 187,748 | 156,021 | 284,804 | 497,919 | 1,280,003 |
| Regular savings | 200,227 | 135,421 | 437,916 | 311,208 | 447,568 | 401,701 | 1,934,041 |
| Money market deposit accounts | 178,518 | 118,036 | 390,440 | 286,519 | 425,890 | 369,792 | 1,769,195 |
| Certificates of deposit | 507,107 | 339,775 | 247,563 | 24,021 | 2,207 | — | 1,120,673 |
| FHLB advances | 300,000 | — | 150,000 | — | — | — | 450,000 |
| Trust preferred securities | 147,944 | — | — | — | — | — | 147,944 |
| Retail repurchase agreements | 118,474 | — | — | — | — | — | 118,474 |
| Total rate sensitive liabilities | 1,553,116 | 645,897 | 1,413,667 | 777,769 | 1,160,469 | 1,269,412 | 6,820,330 |
| Excess (deficiency) of interest-sensitive assets over interest-sensitive liabilities | $ 2,710,390 | $ 418,769 | $ 1,466,278 | $ 803,733 | $ 62,775 | $ (903,643) | $ 4,558,302 |
| Cumulative excess of interest-sensitive assets | $ 2,710,390 | $ 3,129,159 | $ 4,595,437 | $ 5,399,170 | $ 5,461,945 | $ 4,558,302 | $ 4,558,302 |
| Cumulative ratio of interest-earning assets to interest-bearing liabilities | 274.51% | 242.30% | 227.20% | 222.98% | 198.40% | 166.83 % | 166.83% |
| Interest sensitivity gap to total assets | 21.50% | 3.32% | 11.63% | 6.38% | 0.50% | (7.17)% | 36.17% |
| Ratio of cumulative gap to total assets | 21.50% | 24.83% | 36.46% | 42.84% | 43.33% | 36.17 % | 36.17% |

(footnotes follow)

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

(2) Adjustable-rate liabilities are included in the period in which interest rates are next scheduled to adjust rather than in the period they are due to mature. Although regular savings, demand, interest-bearing checking, and money market deposit accounts are subject to immediate withdrawal, based on historical experience management considers a substantial amount of such accounts to be core deposits having significantly longer maturities. For the purpose of the gap analysis, these accounts have been assigned decay rates to reflect their longer effective maturities. If all of these accounts had been assumed to be short-term, the one-year cumulative gap of interest-sensitive assets would have been $(1.07) billion, or (8.48)% of total assets at December 31, 2019. Interest-bearing liabilities for this table exclude certain non-interest-bearing deposits that are included in the average balance calculations reflected in Table 14, *Analysis of Net Interest Spread*.

## Liquidity and Capital Resources

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

Our primary investing activity is the origination and purchase of loans and, in certain periods, the purchase of securities. During the years ended December 31, 2019, 2018 and 2017, our loan originations exceeded our loan repayments by $1.40 billion, $1.31 billion and $1.10 billion, respectively. During those periods we purchased loans of $9.8 million, $33.7 million and $126.5 million, respectively. This activity was funded primarily by proceeds from the sale of loans, increased core deposits, principal repayment and maturities of securities, and additional borrowings in 2018. During the years ended December 31, 2019, 2018 and 2017, we sold $1.10 billion, $791.7 million, and $1.05 billion, respectively, of loans. Securities purchased during the years ended December 31, 2019, 2018 and 2017 totaled $332.4 million, $923.6 million, and $844.7 million, respectively, and securities repayments, maturities and sales in those periods were $458.6 million, $421.3 million, and $724.6 million, respectively.

Our primary financing activity is gathering deposits. Largely as a result of $313.4 million of deposits acquired in the AltaPacific acquisition as well as organic growth in deposits, our deposits increased by $571.6 million during the year ended December 31, 2019. Deposits increased by $1.29 billion during the year ended December 31, 2018, largely as a result of $810.2 million of deposits acquired in the Skagit acquisition as well as organic growth in deposits. Our core deposits have continued to increase as a result of our marketing focus on retail deposits. In addition, core deposits were positively impacted during 2019 by the acquisition of AltaPacific. At December 31, 2019, core deposits amounted to $8.93 billion, or 89% of total deposits, compared with $8.16 billion, or 86% of total deposits at December 31, 2018, and $7.22 billion, or 88% of total deposits at December 31, 2017. Certificates of deposit are generally more price sensitive than other retail deposits and our pricing of those deposits varies significantly based upon our liquidity management strategies at any point in time. At December 31, 2019, certificates of deposit amounted to $1.12 billion, or 11% of our total deposits, including $846.9 million which were scheduled to mature within one year. Certificates of deposit decreased from 14% of our total deposits at December 31, 2018, due to a decrease in brokered certificates of deposit and were 12% of total deposits at December 31,2017. While no assurance can be given as to future periods, historically, we have been able to retain a significant amount of our deposits as they mature.

FHLB advances (excluding fair value adjustments) decreased $90.2 million for the year ended December 31, 2019, after increasing $540.0 million for the year ended December 31, 2018. Other borrowings at December 31, 2019 decreased $521,000 to $118.5 million following an increase of $23.1 million in 2018.

We must maintain an adequate level of liquidity to ensure the availability of sufficient funds to accommodate deposit withdrawals, to support loan growth, to satisfy financial commitments and to take advantage of investment opportunities. During the years ended December 31, 2019, 2018 and 2017, we used our sources of funds primarily to fund loan commitments. At December 31, 2019, we had outstanding commitments to extend credit, originate loans and for letters of credit totaling $3.21 billion. While representing potential growth in the loan portfolio and lending activities, this level of commitments is proportionally consistent with our historical experience and does not represent a departure from normal operations.

We generally maintain sufficient cash and readily marketable securities to meet short-term liquidity needs; however, our primary liquidity management practice to supplement deposits is to increase or decrease short-term borrowings, including FHLB advances and Federal Reserve Bank of San Francisco (FRBSF) borrowings. We maintain credit facilities with the FHLB–Des Moines, that at December 31, 2019 provided for advances that in the aggregate may equal the lesser of 45% of Banner Bank's assets or adjusted qualifying collateral (subject to a sufficient level of ownership of FHLB stock), up to a total possible credit line of $5.31 billion, and 45% of Islanders Bank's assets or adjusted qualifying collateral, up to a total possible credit line of $132.7 million. Advances under these credit facilities (excluding fair value adjustments) totaled $450.0 million at December 31, 2019. In addition, Banner Bank has been approved for participation in the FRBSF's Borrower-In-Custody (BIC) program. Under this program Banner Bank had available lines of credit of approximately $1.19 billion as of December 31, 2019, subject to certain collateral requirements, namely the collateral type and risk rating of eligible pledged loans. We had no funds borrowed from the FRBSF at December 31, 2019 or 2018. At December 31, 2019, Banner Bank also had uncommitted federal funds line of credit agreements with other financial institutions totaling $110.0 million, while Islanders Bank had an uncommitted federal funds line of credit agreement with another financial institution totaling $5.0 million. No balances were outstanding under these agreements as of December 31, 2019. Availability of lines is subject to federal funds balances available for loan and continued borrower eligibility. These lines are intended to support short-term liquidity needs and the agreements

may restrict consecutive day usage. Management believes it has adequate resources and funding potential to meet our foreseeable liquidity requirements.

Banner Corporation is a separate legal entity from the Banks and, on a stand-alone level, must provide for its own liquidity and pay its own operating expenses and cash dividends. Banner's primary sources of funds consist of capital raised through dividends or capital distributions from the Banks, although there are regulatory restrictions on the ability of the Banks to pay dividends. At December 31, 2019, Banner Corporation (on an unconsolidated basis) had liquid assets of $54.3 million.

As noted below, Banner Corporation and its subsidiary banks continued to maintain capital levels in excess of the requirements to be categorized as "Well-Capitalized" under applicable regulatory standards. During the year ended December 31, 2019, total equity increased $115.4 million to $1.59 billion. At December 31, 2019, tangible common shareholders' equity, which excludes goodwill and other intangible assets, was $1.19 billion, or 9.77% of tangible assets. See the discussion and reconciliation of non-GAAP financial information above in the Executive Overview section of this Management's Discussion and Analysis of Financial Condition and Results of Operation for more detailed information with respect to tangible common shareholders' equity. Also, see the capital requirements discussion and table below with respect to our regulatory capital positions.

## Capital Requirements

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

The capital adequacy requirements are quantitative measures established by regulation that require Banner Corporation and the Banks to maintain minimum amounts and ratios of capital. The Federal Reserve requires Banner Corporation to maintain capital adequacy that generally parallels the FDIC requirements. The FDIC requires the Banks to maintain minimum ratios of Total Capital, Tier 1 Capital, and Common Equity Tier 1 Capital to risk-weighted assets as well as Tier 1 leverage capital to average assets. In addition to the minimum capital ratios, the Banks have to maintain a capital conservation buffer consisting of additional Common Equity Tier 1 Capital greater than 2.5% of risk-weighted assets above the required minimum levels in order to avoid limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses. At December 31, 2019, Banner Corporation and the Banks each exceeded all current regulatory capital requirements and the fully phased-in capital conservation buffer requirement.

The following table shows the regulatory capital ratios of Banner Corporation and its subsidiaries, Banner Bank and Islanders Bank, as of December 31, 2019.

**Table 22: Regulatory Capital Ratios**

| Capital Ratios | Banner Corporation | Banner Bank | Islanders Bank |
|---|---|---|---|
| Total capital to risk-weighted assets | 12.93% | 12.55% | 19.42% |
| Tier 1 capital to risk-weighted assets | 11.97 | 11.60 | 18.17 |
| Tier 1 capital to average leverage assets | 10.71 | 10.45 | 11.66 |
| Tier 1 common equity to risk-weighted assets | 10.63 | 11.60 | 18.17 |

(See Item 1, "Business–Regulation," and Note 15 of the Notes to the Consolidated Financial Statements for additional information regarding Banner Corporation's and Banner Bank's regulatory capital requirements.)

## Effect of Inflation and Changing Prices

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

## Contractual Obligations

The following table shows the obligations of Banner Corporation and its subsidiaries as of December 31, 2019 by maturity (in thousands):

**Table 23: Contractual Obligations**

| | One Year or Less | After One to Three Years | After Three to Five Years | After Five Years | Total |
|---|---|---|---|---|---|
| Advances from Federal Home Loan Bank | $ 300,000 | $ 150,000 | $ — | $ — | $ 450,000 |
| Junior subordinated debentures | — | — | — | 147,944 | 147,944 |
| Repurchase agreements | 118,474 | — | — | — | 118,474 |
| Certificates of Deposit | 846,941 | 247,279 | 23,935 | 2,248 | 1,120,403 |
| Operating lease obligations | 16,197 | 26,482 | 14,668 | 16,489 | 73,836 |
| Purchase obligation | 29,256 | 31,458 | 3,763 | 1,493 | 65,970 |
| Total | $ 1,310,868 | $ 455,219 | $ 42,366 | $ 168,174 | $ 1,976,627 |

In addition, we have contracts with various vendors to provide services, including information processing, for periods generally ranging from one to five years, for which our financial obligations are dependent upon acceptable performance by the vendor. For additional information regarding future financial commitments, this discussion should be read in conjunction with our Consolidated Financial Statements and related notes included elsewhere in this filing, including Note 22: "Commitments and Contingencies."

### ITEM 7A – Quantitative and Qualitative Disclosures about Market Risk

See pages 67–70 of Management's Discussion and Analysis of Financial Condition and Results of Operations.

### ITEM 8 – Financial Statements and Supplementary Data

For financial statements, see index on page 79.

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

Not applicable.

### ITEM 9A – Controls and Procedures

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

(a) *Evaluation of Disclosure Controls and Procedures:* An evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) was carried out under the supervision and with the participation of our Chief Executive Officer, Chief Financial Officer and several other members of our senior management as of the end of the period covered by this report. Based on their evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2019, our disclosure controls and procedures were effective in ensuring that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is (i) accumulated and communicated to our management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. The scope of management's assessment of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of December 31, 2019 includes all of the Company's consolidated operations except for those disclosure controls and procedures of AltaPacific that are subsumed by internal control over financial reporting.

(b) *Changes in Internal Controls Over Financial Reporting:* For the year ended December 31, 2019, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

*Management's Annual Report on Internal Control over Financial Reporting:* Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we included a report of management's assessment of the effectiveness of its internal controls as part of this Annual Report on Form 10-K for the year ended December 31, 2019. We are in the process of evaluating the existing controls and procedures of AltaPacific and integrating AltaPacific into

our internal control over financial reporting. In accordance with SEC Staff guidance permitting a company to exclude an acquired business from management's assessment of the effectiveness of internal control over financial reporting for the year in which the acquisition is completed, we have elected to exclude the non-integrated branches, systems, operations and related loans and deposits of AltaPacific, and AltaPacific Bank, from management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2019. The loans and deposits of AltaPacific and AltaPacific Bank represented $334.3 million, or 4%, and $292.6 million, or 3%, respectively, of the Company's total loans and deposits as reported in our consolidated financial statements as of December 31, 2019. Our assessment of the internal control over financial reporting of the Company also excluded an evaluation of the internal control over financial reporting of the non-integrated branches, systems, operations and related loans and deposits that were formerly part of AltaPacific and AltaPacific Bank.

**ITEM 9B – Other Information**

None.

## PART III

### ITEM 10 – Directors, Executive Officers and Corporate Governance

The information required by this item contained under the section captioned "Proposal 1– Election of Directors," "Meetings and Committees of the Board of Directors" and "Shareholder Proposals" in the Proxy Statement for the Annual Meeting of Shareholders, which will be filed with the SEC no later than 120 days after the end of our fiscal year, is incorporated herein by reference.

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

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

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

**Code of Ethics**

The Board of Directors has adopted a Code of Ethics and Business Conduct for our directors, officers (including its senior financial officers), and employees. The Code of Ethics and Business Conduct was most recently approved by the Board of Directors on July 23, 2019; and the Code of Ethics and Business Conduct is reviewed by the Board on an annual basis. The Code of Ethics and Business Conduct requires our officers, directors, and employees to maintain the highest standards of professional conduct. A copy of the Code of Ethics and Business Conduct in substantially its current form was filed as an exhibit with Form 8-K on July 20, 2018, and is available without charge, upon request to Investor Relations, Banner Corporation, P.O. Box 907, Walla Walla, WA 99362. The Code is also available on Banner's website at www.bannerbank.com.

**Whistleblower Program and Protections**

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

### ITEM 11 – Executive Compensation

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

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

(a) Security Ownership of Certain Beneficial Owners and Management

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

(b) Security Ownership of Management

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

(c) Change in Control

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

(d) Equity Compensation Plan Information

The following table sets forth information about equity compensation plans that provide for the award of securities or the grant of options to purchase securities to employees and directors of Banner and its subsidiaries that were in effect at December 31, 2019:

| Plan category | (A) Number of securities to be issued upon exercise of outstanding options or vesting of outstanding restricted stock and unit grants | (B) Weighted average exercise price of outstanding options and rights | (C) Number of securities remaining available for future issuance under equity compensation plans excluding securities reflected in column (A) |
|---|---|---|---|
| **Equity compensation plans approved by security holders** | | | |
| 2012 Restricted Stock and Incentive Bonus Plan | 169 | n/a | 30,137 |
| 2014 Omnibus Incentive Plan | 382,703 | n/a | 188,014 |
| 2018 Omnibus Incentive Plan | — | | 900,000 |
| | 382,872 | | 1,118,151 |
| **Equity compensation plans not approved by security holders** | — | | — |
| Total | 382,872 | | 1,118,151 |

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

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

**ITEM 14 – Principal Accounting Fees and Services**

The information required by this item contained under the section captioned “Proposal 4– Ratification of Selection of Independent Registered Public Accounting Firm” in the Proxy Statement for the Annual Meeting of Shareholders, which will be filed with the SEC no later than 120 days after the end of our fiscal year, is incorporated herein by reference.

## PART IV

### ITEM 15 – Exhibits and Financial Statement Schedules

(a) (1) Financial Statements

See Index to Consolidated Financial Statements on page 79.

(2) Financial Statement Schedules

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

(3) Exhibits

See Index of Exhibits on page 144.

(b) Exhibits

See Index of Exhibits on page 144.

**Item 16 - Form 10-K Summary.**

None.

## Signatures

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

Banner Corporation

Date: February 21, 2020

/s/ Mark J. Grescovich

Mark J. Grescovich
President and Chief Executive Officer
(Principal Executive Officer)

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

/s/ Mark J. Grescovich

Mark J. Grescovich
President and Chief Executive Officer; Director
(Principal Executive Officer)

Date: February 21, 2020

/s/ Peter J. Conner

Peter J. Conner
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: February 21, 2020

/s/ John R. Layman

John R. Layman
Director

Date: February 21, 2020

/s/ David I. Matson

David I. Matson
Director

Date: February 21, 2020

/s/ Connie R. Collingsworth

Connie R. Collingsworth
Director

Date: February 21, 2020

/s/ Merline Saintil

Merline Saintil
Director

Date: February 21, 2020

/s/ Brent A. Orrico

Brent A. Orrico
Chairman of the Board

Date: February 21, 2020

/s/ David A. Klaue

David A. Klaue
Director

Date: February 21, 2020

/s/ Cheryl R. Bishop

Cheryl R. Bishop
Director

Date: February 21, 2020

/s/ Kevin F. Riordan

Kevin F. Riordan
Director

Date: February 21, 2020

/s/ Roberto R. Herencia

Roberto R. Herencia
Director

Date: February 21, 2020

/s/ Terry Schwakopf

Terry Schwakopf
Director

Date: February 21, 2020

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**
**BANNER CORPORATION AND SUBSIDIARIES**
**(Item 8 and Item 15(a)(1))**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February 21, 2020

Report of Management

To the Shareholders:

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

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

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

Mark J. Grescovich, Chief Executive Officer
Peter J. Conner, Chief Financial Officer

Management Report on Internal Control over Financial Reporting

February 21, 2020

The management of Banner Corporation is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. The Company's internal control system is designed to provide reasonable assurance to our management and Board of Directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that:

- Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Company's assets;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with the authorizations of management and directors of the Company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

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

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2019. This assessment was based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control - Integrated*

*Framework (2013)*. Based on this assessment and those criteria, management believes that, as of December 31, 2019, the Company maintained effective internal control over financial reporting.

On November 1, 2019, the Company completed its acquisition of AltaPacific Bancorp, (AltaPacific) and its subsidiary, AltaPacific Bank. AltaPacific Bank was merged into Banner Bank, a wholly owned subsidiary of the Company, on November 1, 2019. As of December 31, 2019, the majority of the acquired systems and operations of AltaPacific and AltaPacific Bank, including the branches, loans, deposits and core operating system, had not been converted to the Company’s systems or integrated into its operations. As permitted by the Securities and Exchange Commission, management elected to exclude the non-integrated branches, systems, operations and related loans and deposits of AltaPacific, and AltaPacific Bank, from management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2019. The loans and deposits of AltaPacific and AltaPacific Bank represented $334.3 million, or 4%, and $292.6 million, or 3%, respectively, of the Company’s total loans and deposits as reported in our consolidated financial statements as of December 31, 2019. Our assessment of the internal control over financial reporting of the Company also excluded an evaluation of the internal control over financial reporting of the non-integrated branches, systems, operations and related loans and deposits that were formerly part of AltaPacific and AltaPacific Bank.

The Company's independent registered public accounting firm has audited the Company's consolidated financial statements that are included in this annual report and the effectiveness of our internal control over financial reporting as of December 31, 2019 and issued their Report of Independent Registered Public Accounting Firm, appearing under Item 8. The audit report expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2019.

**Report of Independent Registered Public Accounting Firm**

To the Shareholders and the Board of Directors of
Banner Corporation and Subsidiaries

***Opinions on the Financial Statements and Internal Control over Financial Reporting***

We have audited the accompanying consolidated statements of financial condition of Banner Corporation and Subsidiaries (the "Company") as of December 31, 2019 and 2018, the related consolidated statements of operations, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2019, and the related notes (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2019 and 2018, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2019, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by COSO.

***Basis for Opinions***

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management Report on Internal Control over Financial Reporting.* Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures to respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in the accompanying Management Report on Internal Control Over Financial Reporting, on November 1, 2019, the Company acquired AltaPacific Bancorp, Inc. and its subsidiary, AltaPacific Bank ("AltaPacific"). For the purposes of assessing internal control over financial reporting, management excluded the non-integrated branches, systems, operations and related loans and deposits of AltaPacific. The loans and deposits of AltaPacific represented $334.3 million, or 4%, and $292.6 million, or 3%, respectively, of the Company's consolidated total loans and deposits as reported in the consolidated financial statements as of December 31, 2019. Accordingly, our audit did not include the internal control over financial reporting of the non-integrated branches, systems, operations and related loans and deposits of AltaPacific.

***Definition and Limitations of Internal Control Over Financial Reporting***

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

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

***Critical Audit Matter***

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

**Allowance for Loan Losses**

As described in Notes 1 and 5 to the consolidated financial statements, the Company's consolidated allowance for loan losses balance was $100.6 million at December 31, 2019. The allowance for loan losses is maintained to provide for estimated inherent losses based on evaluating risks in the loan portfolio and is based upon the Company's analysis of the factors underlying the quality of the loan portfolio. These factors include, among others, changes in the size and composition of the loan portfolio, delinquency rates, actual loan loss experience, current economic conditions, analysis of individual loans for which full collectability may not be assured, and determination of the existence and realizable value of the collateral and guarantees securing the loans.

We identified management's risk ratings of loans and the estimation of qualitative and environmental factors, both of which are used in the allowance for loan losses calculation, as a critical audit matter. The Company uses credit quality indicators, including internally determined risk ratings, to classify loans into pools and to estimate inherent loss rates for each of the loan pools, which are used in the calculation of the allowance for loan losses. Determination of the risk rating involves significant management judgement. The qualitative and environmental factors are used to estimate losses related to factors that are not captured in the historical loss rates, and are based on management's evaluation of available internal and external data and involves significant management judgement. Auditing management's judgments regarding the determination of risk ratings and qualitative and environmental factors applied to the allowance for loan losses involved a high degree of subjectivity.

The primary procedures we performed to address this critical audit matter included:

- Testing the design, implementation, and operating effectiveness of controls relating to management's calculation of the allowance for loan losses, including controls over the accuracy of risk ratings of loans and the determination of the qualitative and environmental factors used.
- Testing a risk-based targeted selection of loans to gain substantive evidence that the Company is appropriately rating these loans in accordance with its policies, and that the risk ratings for the loans are reasonable.
- Obtaining management's analysis and supporting documentation related to the qualitative and environmental factors, and testing whether the environmental and qualitative factors used in the calculation of the allowance for loan losses are supported by the analysis provided by management.
- Testing the appropriateness of the methodology and assumptions used in the calculation of the allowance for loan losses, and testing the calculation itself, including completeness and accuracy of the data used in the calculation, application of the loan risk ratings determined by management and used in the calculation, application of the environmental and qualitative factors determined by management and used in the calculation, and recalculation of the allowance for loan losses balance.
- Performing an independent sensitivity analysis to evaluate the reasonableness of the qualitative and environmental factors used by management to account for inherent losses that are not captured in the calculation of the allowance for loan losses based on historical loss rates alone.

/s/ Moss Adams LLP

Spokane, Washington
February 21, 2020

We have served as the Company's auditor since 2004.

**BANNER CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**
**(in thousands, except shares)**
**December 31, 2019 and 2018**

| **ASSETS** | **2019** | 2018 |
|---|---|---|
| Cash and due from banks | $ 234,359 | $ 231,029 |
| Interest bearing deposits | 73,376 | 41,167 |
| Total cash and cash equivalents | 307,735 | 272,196 |
| Securities—trading | 25,636 | 25,896 |
| Securities—available-for-sale, amortized cost $1,529,946 and $1,648,421, respectively | 1,551,557 | 1,636,223 |
| Securities—held-to-maturity, fair value $237,805 and $232,537, respectively | 236,094 | 234,220 |
| Federal Home Loan Bank (FHLB) stock | 28,342 | 31,955 |
| Loans held for sale (includes $199.4 million and $164.8 million, respectively, at fair value) | 210,447 | 171,031 |
| Loans receivable | 9,305,357 | 8,684,595 |
| Allowance for loan losses | (100,559) | (96,485) |
| Net loans | 9,204,798 | 8,588,110 |
| Accrued interest receivable | 37,962 | 38,593 |
| Real estate owned (REO), held for sale, net | 814 | 2,611 |
| Property and equipment, net | 178,008 | 171,809 |
| Goodwill | 373,121 | 339,154 |
| Other intangible assets, net | 29,158 | 32,924 |
| Bank-owned life insurance (BOLI) | 192,088 | 177,467 |
| Deferred tax assets, net | 59,639 | 75,020 |
| Other assets | 168,632 | 74,108 |
| Total assets | $ 12,604,031 | $ 11,871,317 |
| **LIABILITIES** | | |
| Deposits: | | |
| Non-interest-bearing | $ 3,945,000 | $ 3,657,817 |
| Interest-bearing transaction and savings accounts | 4,983,238 | 4,498,966 |
| Interest-bearing certificates | 1,120,403 | 1,320,265 |
| Total deposits | 10,048,641 | 9,477,048 |
| Advances from FHLB | 450,000 | 540,189 |
| Other borrowings | 118,474 | 118,995 |
| Junior subordinated debentures at fair value (issued in connection with Trust Preferred Securities) | 119,304 | 114,091 |
| Accrued expenses and other liabilities | 227,889 | 102,061 |
| Deferred compensation | 45,689 | 40,338 |
| Total liabilities | 11,009,997 | 10,392,722 |
| **COMMITMENTS AND CONTINGENCIES (Note 22)** | | |
| **SHAREHOLDERS' EQUITY** | | |
| Preferred stock - $0.01 par value per share, 500,000 shares authorized; no shares issued and outstanding at December 31, 2019 and December 31, 2018 | — | — |
| Common stock and paid in capital - $0.01 par value per share, 50,000,000 shares authorized, 35,712,384 shares issued and outstanding at December 31, 2019; 35,107,839 shares issued and outstanding at December 31, 2018 | 1,373,198 | 1,336,030 |
| Common stock (non-voting) and paid in capital - $0.01 par value per share, 5,000,000 shares authorized; 39,192 shares issued and outstanding at December 31, 2019; 74,933 shares issued and outstanding at December 31, 2018 | 742 | 1,406 |
| Retained earnings | 186,838 | 134,055 |
| Accumulated other comprehensive income | 33,256 | 7,104 |
| Carrying value of shares held in trust for stock related compensation plans | (7,507) | (7,289) |
| Liability for common stock issued for stock related compensation plans | 7,507 | 7,289 |
| Total shareholders' equity | 1,594,034 | 1,478,595 |
| Total liabilities and shareholders' equity | $ 12,604,031 | $ 11,871,317 |

See notes to consolidated financial statements

**BANNER CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF OPERATIONS**
**(in thousands except for per share amounts)**
**For the Years Ended December 31, 2019, 2018 and 2017**

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| INTEREST INCOME: | | | |
| Loans receivable | $ 471,473 | $ 413,370 | $ 374,449 |
| Mortgage-backed securities | 38,640 | 35,076 | 24,535 |
| Securities and cash equivalents | 15,566 | 15,186 | 13,300 |
| Total interest income | 525,679 | 463,632 | 412,284 |
| INTEREST EXPENSE: | | | |
| Deposits | 37,630 | 20,642 | 12,273 |
| FHLB advances | 12,234 | 5,636 | 1,908 |
| Other borrowings | 330 | 245 | 317 |
| Junior subordinated debentures | 6,574 | 6,136 | 4,752 |
| Total interest expense | 56,768 | 32,659 | 19,250 |
| Net interest income before provision for loan losses | 468,911 | 430,973 | 393,034 |
| PROVISION FOR LOAN LOSSES | 10,000 | 8,500 | 8,000 |
| Net interest income | 458,911 | 422,473 | 385,034 |
| NON-INTEREST INCOME | | | |
| Deposit fees and other service charges | 46,632 | 48,074 | 43,452 |
| Mortgage banking operations | 22,215 | 21,343 | 20,880 |
| BOLI | 4,645 | 4,505 | 4,618 |
| Miscellaneous | 8,632 | 7,148 | 8,985 |
| | 82,124 | 81,070 | 77,935 |
| Net gain (loss) on sale of securities | 33 | (837) | (2,080) |
| Net change in valuation of financial instruments carried at fair value | (208) | 3,775 | (2,844) |
| Gain on sale of branches, including related loans and deposits | — | — | 12,189 |
| Total non-interest income | 81,949 | 84,008 | 85,200 |
| NON-INTEREST EXPENSE: | | | |
| Salary and employee benefits | 226,409 | 202,613 | 192,096 |
| Less capitalized loan origination costs | (28,934) | (17,925) | (17,379) |
| Occupancy and equipment | 52,390 | 49,215 | 47,866 |
| Information/computer data services | 22,458 | 18,823 | 17,245 |
| Payment and card processing expenses | 16,993 | 15,412 | 14,330 |
| Professional and legal expenses | 9,736 | 17,945 | 17,534 |
| Advertising and marketing | 7,836 | 8,346 | 8,637 |
| Deposit insurance | 2,840 | 4,446 | 4,689 |
| State/municipal business and use taxes | 3,880 | 3,284 | 2,594 |
| REO operations | 303 | 804 | (2,030) |
| Amortization of core deposit intangibles | 8,151 | 6,047 | 6,246 |
| Miscellaneous | 28,122 | 26,754 | 27,142 |
| | 350,184 | 335,764 | 318,970 |
| Acquisition related costs | 7,544 | 5,607 | — |
| Total non-interest expense | 357,728 | 341,371 | 318,970 |
| Income before provision for income taxes | 183,132 | 165,110 | 151,264 |
| PROVISION FOR INCOME TAXES | 36,854 | 28,595 | 90,488 |
| NET INCOME | $ 146,278 | $ 136,515 | $ 60,776 |
| | | | |
| Earnings per common share | | | |
| Basic | $ 4.20 | $ 4.16 | $ 1.85 |
| Diluted | $ 4.18 | $ 4.15 | $ 1.84 |
| Cumulative dividends declared per common share | $ 2.64 | $ 1.96 | $ 2.00 |
| | | | |
| Weighted average number of common shares outstanding: | | | |
| Basic | 34,868,434 | 32,784,724 | 32,888,007 |
| Diluted | 34,967,684 | 32,894,425 | 32,986,707 |

See notes to the consolidated financial statements

**BANNER CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
**(in thousands)**
**For the Years Ended December 31, 2019, 2018 and 2017**

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| NET INCOME | $ 146,278 | $ 136,515 | $ 60,776 |
| OTHER COMPREHENSIVE LOSS, NET OF INCOME TAXES: | | | |
| Unrealized holding gain (loss) on securities—available-for-sale arising during the period | 33,843 | (6,547) | (3,318) |
| Reclassification for net (gain) loss on securities—available-for-sale realized in earnings | (34) | 839 | 2,109 |
| Changes in fair value of junior subordinated debentures related to instrument specific credit risk | 601 | (15,384) | — |
| Income tax (expense) benefit related to other comprehensive income (loss) | (8,258) | 5,028 | 423 |
| Other comprehensive income (loss) | 26,152 | (16,064) | (786) |
| COMPREHENSIVE INCOME | $ 172,430 | $ 120,451 | $ 59,990 |

See notes to the consolidated financial statements

**BANNER CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**
**(in thousands, except shares)**
**For the Years Ended December 31, 2019, 2018 and 2017**

| | Common Stock and Paid in Capital | | Retained Earnings | Accumulated Other Comprehensive (Loss) Income | Shareholders' Equity |
|---|---|---|---|---|---|
| | Shares | Amount | | | |
| **Balance, January 1, 2017** | 33,193,387 | $ 1,213,837 | $ 95,328 | $ (3,455) | $ 1,305,710 |
| Net income | | | 60,776 | | 60,776 |
| Other comprehensive loss | | | | (786) | (786) |
| Reclassification of stranded tax effects from accumulated other comprehensive loss to retained earnings | | | 795 | (795) | — |
| Accrual of dividends on common stock ($2.00/share-cumulative) | | | (66,364) | | (66,364) |
| Repurchase of common stock | (545,166) | (31,045) | | | (31,045) |
| Amortization of stock-based compensation related to restricted stock grants, net of shares surrendered | 78,264 | 4,335 | | | 4,335 |
| **Balance, December 31, 2017** | 32,726,485 | $ 1,187,127 | $ 90,535 | $ (5,036) | $ 1,272,626 |
| **Balance, January 1, 2018** | 32,726,485 | $ 1,187,127 | $ 90,535 | $ (5,036) | $ 1,272,626 |
| Cumulative effect of reclassification of the instrument-specific credit risk portion of junior subordinated debentures fair value adjustments and reclassification of equity securities from available-for-sale | | | (28,204) | 28,204 | — |
| Net income | | | 136,515 | | 136,515 |
| Other comprehensive loss | | | | (16,064) | (16,064) |
| Accrual of dividends on common stock ($1.96/share-cumulative) | | | (64,791) | | (64,791) |
| Repurchase of common stock | (594,711) | (34,401) | | | (34,401) |
| Amortization of stock-based compensation related to restricted stock grants, net of shares surrendered | (57,073) | 5,001 | | | 5,001 |
| Issuance of shares for acquisition | 3,108,071 | 179,709 | | | 179,709 |
| **Balance, December 31, 2018** | 35,182,772 | $ 1,337,436 | $ 134,055 | $ 7,104 | $ 1,478,595 |

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**BANNER CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**
**(continued) (in thousands, except shares)**
**For the Years Ended December 31, 2019, 2018 and 2017**

| | Common Stock and Paid in Capital | | Retained Earnings | Accumulated Other Comprehensive Income | Shareholders' Equity |
|---|---|---|---|---|---|
| | Shares | Amount | | | |
| **Balance, January 1, 2019** | 35,182,772 | $ 1,337,436 | $ 134,055 | $ 7,104 | $ 1,478,595 |
| Net income | | | 146,278 | | 146,278 |
| Other comprehensive income | | | | 26,152 | 26,152 |
| Accrual of dividends on common stock ($2.64/share-cumulative) | | | (93,495) | | (93,495) |
| Repurchase of common stock | (1,000,000) | (53,922) | | | (53,922) |
| Amortization of stock-based compensation related to restricted stock grants, net of shares surrendered | (9,547) | 5,226 | | | 5,226 |
| Issuance of shares for acquisition | 1,578,351 | 85,200 | | | 85,200 |
| **Balance, December 31, 2019** | 35,751,576 | $ 1,373,940 | $ 186,838 | $ 33,256 | $ 1,594,034 |

See notes to the consolidated financial statements

**BANNER CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(in thousands)**
**For the Years Ended December 31, 2019, 2018 and 2017**

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| OPERATING ACTIVITIES: | | | |
| Net income | $ 146,278 | $ 136,515 | $ 60,776 |
| Adjustments to reconcile net income to net cash provided from (used by) operating activities: | | | |
| Depreciation | 17,282 | 15,232 | 14,701 |
| Deferred income and expense, net of amortization | (881) | (6,571) | 1,972 |
| Amortization of core deposit intangibles | 8,151 | 6,047 | 6,246 |
| (Gain) loss on sale of securities, net | (33) | 837 | 2,080 |
| Net change in valuation of financial instruments carried at fair value | 208 | (3,775) | 2,844 |
| Proceeds from sales of securities—trading | — | — | 1,258 |
| Principal repayments and maturities of securities—trading | — | 100 | 1,849 |
| Gain on sale of branches, including related loans and deposits | — | — | (12,189) |
| Decrease (increase) in deferred taxes | 15,548 | (3,498) | 56,267 |
| Increase (decrease) in current taxes payable | 607 | 3,938 | (2,965) |
| Equity-based compensation | 7,142 | 6,554 | 5,965 |
| Increase in cash surrender value of BOLI | (4,246) | (4,471) | (4,057) |
| Gain on sale of loans, net of capitalized servicing rights | (15,993) | (15,066) | (15,225) |
| Loss (gain) on disposal of real estate held for sale and property and equipment | 1,075 | (833) | (4,295) |
| Provision for loan loss | 10,000 | 8,500 | 8,000 |
| Provision for real estate held for sale | — | 387 | 256 |
| Origination of loans held for sale | (1,094,237) | (896,461) | (807,137) |
| Proceeds from sales of loans held for sale | 1,070,814 | 781,879 | 1,027,989 |
| Net change in: | | | |
| Other assets | (18,429) | (15,861) | 2,546 |
| Other liabilities | 5,588 | 17,322 | (179) |
| Net cash provided from operating activities | 148,874 | 30,775 | 346,702 |
| INVESTING ACTIVITIES: | | | |
| Purchases of securities—available-for-sale | (277,503) | (913,951) | (838,247) |
| Principal repayments and maturities of securities—available-for-sale | 321,510 | 173,454 | 187,080 |
| Proceeds from sales of securities—available-for-sale | 86,083 | 214,609 | 522,564 |
| Purchases of securities—held-to-maturity | (54,850) | (9,612) | (6,490) |
| Principal repayments and maturities of securities—held-to-maturity | 50,962 | 33,152 | 11,817 |
| Loan originations, net of repayments | (304,191) | (416,218) | (288,951) |
| Purchases of loans and participating interest in loans | (9,798) | (33,680) | (126,508) |
| Proceeds from sales of other loans | 27,560 | 9,853 | 21,923 |
| Net cash (paid) received from acquisitions and branch divestitures | 26,944 | (1,574) | 113,222 |
| Purchases of property and equipment | (24,700) | (23,094) | (12,244) |
| Proceeds from sale of real estate held for sale and sale of other property | 7,815 | 7,768 | 20,121 |
| Proceeds from FHLB stock repurchase program | 175,998 | 143,175 | 118,304 |
| Purchase of FHLB stock | (170,380) | (163,683) | (116,132) |
| Other | 1,436 | 3,583 | 254 |
| Net cash used by investing activities | (143,114) | (976,218) | (393,287) |

(Continued on next page)

**BANNER CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(continued) (in thousands)**
**For the Years Ended December 31, 2019, 2018 and 2017**

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| FINANCING ACTIVITIES: | | | |
| Increase in deposits, net | 272,625 | 503,814 | 222,334 |
| Proceeds from FHLB advances | 450,000 | — | — |
| Repayment of long term FHLB borrowing | (280,415) | (10) | (9) |
| Advances, net of (repayments) of overnight and short-term FHLB borrowings | (300,000) | 540,000 | (54,000) |
| (Decrease) increase in other borrowings, net | (520) | 7,870 | (9,825) |
| Cash dividends paid | (56,074) | (59,280) | (65,759) |
| Cash paid for repurchase of common stock | (53,922) | (34,401) | (31,045) |
| Taxes paid related to net share settlement for equity awards | (1,915) | (1,554) | (1,630) |
| Net cash provided from financing activities | 29,779 | 956,439 | 60,066 |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | 35,539 | 10,996 | 13,481 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 272,196 | 261,200 | 247,719 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | $ 307,735 | $ 272,196 | $ 261,200 |

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | | |
| Interest paid in cash | $ 58,239 | $ 28,098 | $ 18,875 |
| Taxes paid in cash | 27,329 | 21,664 | 35,500 |
| NON-CASH INVESTING AND FINANCING TRANSACTIONS: | | | |
| Loans, net of discounts, specific loss allowances and unearned income, transferred to real estate owned and other repossessed assets | 303 | 1,645 | 10 |
| Dividends accrued but not paid until after period end | 51,199 | 13,778 | 8,226 |
| ACQUISITIONS (DISPOSITIONS): | | | |
| Assets acquired (disposed) | 426,609 | 915,821 | (259,398) |
| Liabilities assumed (transferred) | 373,016 | 832,278 | (160,465) |

See notes to consolidated financial statements

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

***Nature of Business:*** Banner Corporation (Banner or the Company) is a bank holding company incorporated in the State of Washington. The Company is primarily engaged in the business of planning, directing and coordinating the business activities of two wholly-owned subsidiaries, Banner Bank and Islanders Bank. Banner Bank is a Washington-chartered commercial bank that conducts business from its headquarters in Walla Walla, Washington and, as of December 31, 2019, its 175 branch offices located in Washington, Oregon, California and Idaho. Banner Bank also has 18 loan production offices located in Washington, Oregon, California, Idaho and Utah. 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 (Federal Reserve Board). Banner Bank and Islanders Bank (the Banks) are subject to regulation by the Washington State Department of Financial Institutions, Division of Banks (DFI) and the Federal Deposit Insurance Corporation (the FDIC).

The Company's operating results depend primarily on its net interest income, which is the difference between interest income on interest-earning assets, consisting of loans and investment securities, and interest expense on interest-bearing liabilities, composed primarily of customer deposits, FHLB advances, other borrowings and junior subordinated debentures. Net income also is affected by the level of the Company's non-interest income, including deposit fees and other service charges, gains and losses on the sale of securities, results of mortgage banking operations, which includes loan origination and servicing fees and gains and losses on the sale of loans, as well as non-interest expense, provisions for loan losses and income tax provisions. In addition, net income is affected by the net change in the value of certain financial instruments carried at fair value.

***Basis of Presentation and Principles of Consolidation:*** The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany transactions, profits and balances have been eliminated. The consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles in the United States (GAAP) and under the rules and regulations of the U.S. Securities and Exchange Commission (the SEC). At December 31, 2019, the Company had ten wholly-owned subsidiary grantor trusts (the Trusts), each of which issued trust preferred securities (TPS) and common securities. The Trusts are not included in the Company's consolidated financial statements.

***Subsequent Events:*** The Company has evaluated events and transactions subsequent to December 31, 2019 for potential recognition or disclosure.

***Cash and Cash Equivalents:*** Cash and cash equivalents include cash and due from banks and temporary investments which are federal funds sold and interest bearing balances due from other banks. Cash and cash equivalents generally have maturities of three months or less at the date of purchase.

***Business Combinations:*** Business combinations are accounted for using the acquisition method of accounting and, accordingly, assets acquired and liabilities assumed, both tangible and intangible, and consideration exchanged are recorded at acquisition date fair values. The excess purchase consideration over fair value of net assets acquired is recorded as goodwill. In the event that the fair value of net assets acquired exceeds the purchase price, including fair value of liabilities assumed, a bargain purchase gain is recorded on that acquisition. Expenses incurred in connection with a business combination are expensed as incurred, except for those items permitted to be capitalized. Changes in deferred tax asset valuation allowances related to acquired tax uncertainties are recognized in net income after the measurement period.

***Use of Estimates:*** In the opinion of management, the accompanying consolidated statements of financial condition and related consolidated statements of operations, comprehensive income, changes in shareholders' equity and cash flows reflect all adjustments (which include reclassification and normal recurring adjustments) that are necessary for a fair presentation in conformity with GAAP. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements. Various elements of the Company's accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. In particular, management has identified several accounting policies that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of Banner's consolidated financial statements. These policies relate to (i) the methodology for the recognition of interest income, (ii) determination of the provision and allowance for loan and lease losses, (iii) the valuation of financial assets and liabilities measured at fair value, including other-than-temporary impairment (OTTI) losses, (iv) the valuation of intangible assets, such as goodwill, core deposit intangibles (CDI) and mortgage servicing rights, (v) the valuation of real estate held for sale, (vi) the valuation or recognition of deferred tax assets and liabilities and (vii) the valuation of assets and liabilities acquired in business combinations and subsequent recognition of related income and expense. These policies and judgments, estimates and assumptions are described in greater detail in subsequent Notes to the Consolidated Financial Statements. Management believes that the judgments, estimates and assumptions used in the preparation of the consolidated financial statements are appropriate based on the factual circumstances at the time. However, given the sensitivity of the consolidated financial statements to these critical accounting policies, the use of other judgments, estimates and assumptions could result in material differences in the Company's results of operations or financial condition. Further, subsequent changes in economic or market conditions could have a material impact on these estimates and the Company's financial condition and operating results in future periods.

***Securities:*** Debt securities are classified as held-to-maturity when the Company has the ability and positive intent to hold them to maturity. Debt securities classified as available-for-sale are available for future liquidity requirements and may be sold prior to maturity. Debt securities classified as trading are also available for future liquidity requirements and may be sold prior to maturity. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Debt securities classified as held-to-maturity are carried at cost,

adjusted for amortization of premiums to the earliest callable date and accretion of discounts to the maturity date and, if appropriate, any other-than-temporary impairment losses. Debt securities classified as available-for-sale are measured at fair value. Unrealized holding gains and losses on debt securities classified as available-for-sale are excluded from earnings and are reported net of tax as accumulated other comprehensive income (AOCI), a component of shareholders' equity, until realized. Debt securities classified as trading are also measured at fair value. Unrealized holding gains and losses on securities classified as trading are included in earnings. (See Note 17 for a more complete discussion of accounting for the fair value of financial instruments.) Declines in the fair value of debt securities below their cost that are deemed to be other-than-temporary are recognized in earnings as realized losses. Realized gains and losses on sale are computed on the specific identification method and are included in earnings on the trade date sold.

Beginning January 1, 2018, equity securities were required to be measured at fair value with changes in the fair value recognized through net income. Prior to January 1, 2018 the Company had classified its equity securities as available-for-sale, subsequent to this date equity securities are reported in other assets.

The Company reviews investment securities on an ongoing basis for the presence of OTTI or permanent impairment, taking into consideration current market conditions, fair value in relationship to cost, extent and nature of the change in fair value, issuer rating changes and trends, whether the Company intends to sell a security or if it is more likely than not that it will be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity, and other factors.

For debt securities, if the Company intends to sell the security or it is more likely than not that the Company will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security but the Company does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to AOCI. Impairment losses related to all other factors are presented as separate categories within AOCI.

For debt securities transferred from held-to-maturity to available-for-sale, unrealized gains or losses from the time of transfer are accreted or amortized over the remaining life of the debt security based on the amount and timing of future estimated cash flows. The accretion or amortization of the amount recorded in AOCI increases the carrying value of the investment and does not affect earnings.

***Investment in FHLB Stock:*** At December 31, 2019, the Banks had $28.3 million in FHLB of Des Moines stock (FHLB stock), compared to $32.0 million at December 31, 2018. FHLB stock does not have a readily determinable fair value. The Banks' investments in FHLB stock is carried at cost or par value ($100 per share) adjusted for observable changes in market prices minus impairment. Ownership of FHLB stock is restricted to the FHLB and member institutions and can only be purchased and redeemed at par, therefore there has been no observable changes in market prices. As members of the FHLB system, the Banks are required to maintain a minimum level of investment in FHLB stock based on specific percentages of their outstanding FHLB advances.

Management periodically evaluates FHLB stock for impairment. Management's determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB. The Company has determined there is no impairment on the FHLB stock investment as of December 31, 2019 and 2018.

***Loans Receivable:*** The Banks originate residential one- to four-family and multifamily mortgage loans for both portfolio investment and sale in the secondary market. The Banks also originate construction and land development, commercial real estate, commercial business, agricultural and consumer loans for portfolio investment. Loans receivable not designated as held for sale are recorded at the principal amount outstanding, net of allowance for loan losses, deferred fees, discounts and premiums. Premiums, discounts and deferred loan fees are amortized to maturity using the level-yield methodology.

Some of the Company's loans are reported as troubled debt restructures (TDRs). Loans are reported as TDRs when the Banks grant a concession(s) to a borrower experiencing financial difficulties that it would not otherwise consider. Examples of such concessions include forgiveness of principal or accrued interest, extending the maturity date(s) or providing a lower interest rate than would be normally available for a transaction of similar risk. As a result of these concessions, loans identified as TDRs are impaired as the Banks will not collect all amounts due, both principal and interest, in accordance with the terms of the original loan agreement. TDRs are accounted for in accordance with the Banks' impaired loan accounting policies.

***Loans Held for Sale***. Residential one- to four-family and multifamily mortgage loans originated with the intent to be sold in the secondary market are considered held for sale. Residential one- to four-family loans under best effort delivery commitments are carried at the lower of aggregate cost or estimated market value. Residential one- to four-family loans under mandatory delivery commitments are carried at fair value in order to match changes in the value of the loans with the value of the economic hedges on the loans. Fair values for residential mortgage loans held for sale are determined by comparing actual loan rates to current secondary market prices for similar loans. The Company elected fair value accounting on

multifamily held-for-sale loans in order to match changes in the value of the loans with the value of the economic hedges on the loans. Fair values for multifamily loans held for sale are calculated based on discounted cash flows using a discount rate that is a combination of market spreads for similar loan types added to selected index rates. Net unrealized losses on loans held for sale that are carried at lower of cost or market are recognized through the valuation allowance by charges to income. Non-refundable fees and direct loan origination costs related to loans held for sale carried at the lower of aggregate cost or estimated market value are recognized as part of the cost basis of the loan. Gains and losses on sales of loans held for sale are determined using the specific identification method and are recorded in the mortgage banking operations component of non-interest income.

***Acquired Loans:*** Purchased loans, including loans acquired in business combinations, are recorded at their fair value at the acquisition date. Credit discounts are included in the determination of fair value; therefore, an allowance for loan and lease losses is not recorded at the acquisition date. Acquired loans are evaluated upon acquisition and classified as either purchased credit-impaired or purchased non-credit-impaired. Purchased credit-impaired (PCI) loans reflect credit deterioration since origination such that it is probable at acquisition that the Company will be unable to collect all contractually required payments. The excess of the cash flows expected to be collected over a PCI pool's carrying value is considered to be the accretable yield and is recognized as interest income over the estimated life of the pool using the effective yield method. The excess of the undiscounted contractual balances due over the cash flows expected to be collected is considered to be the nonaccretable difference. The nonaccretable difference represents the Company's estimate of the credit losses expected to occur and was considered in determining the fair value of the loans as of the acquisition date. Subsequent to the acquisition date, any increases in expected cash flows over those expected at the purchase date are adjusted through a change to the accretable yield on a prospective basis. Any subsequent decreases in expected cash flows attributable to credit deterioration are recognized by recording a provision for loan losses.

For purchased non-credit-impaired loans, the difference between the fair value and unpaid principal balance of the loan at the acquisition date is amortized or accreted to interest income over the life of the loans. Any subsequent deterioration in credit quality is recognized by recording a provision for loan losses.

***Income Recognition on Nonaccrual and Impaired Loans and Securities:*** Interest on loans and securities is accrued as earned unless management doubts the collectability of the asset or the unpaid interest. Interest accruals on loans are generally discontinued when loans become 90 days past due for payment of interest or principal and the loans are then placed on nonaccrual status. All previously accrued but uncollected interest is deducted from interest income upon transfer to nonaccrual status. For any future payments collected, interest income is recognized only upon management's assessment that there is a strong likelihood that the full amount of a loan will be repaid or recovered. A loan may be put on nonaccrual status sooner than this policy would dictate if, in management's judgment, the interest may be uncollectable. While less common, similar interest reversal and nonaccrual treatment is applied to investment securities if their ultimate collectability becomes questionable.

***Provision and Allowance for Loan Losses:*** The provision for loan losses reflects the amount required to maintain the allowance for loan losses at an appropriate level based upon management's evaluation of the adequacy of general and specific loss reserves. The Company maintains an allowance for loan losses consistent in all material respects with GAAP. The Company has established systematic methodologies for the determination of the adequacy of the Company's allowance for loan losses. The methodologies are set forth in a formal policy and take into consideration the need for a general valuation allowance as well as specific allowances that are tied to individual problem loans. The Company increases its allowance for loan losses by charging provisions for probable loan losses against its income and values impaired loans consistent with accounting guidelines.

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

The Company's methodology for assessing the appropriateness of the allowance for loan losses consists of several key elements, which include specific allowances, an allocated formula allowance and an unallocated allowance. Losses on specific loans are provided for when the losses are probable and estimable. General loan loss reserves are established to provide for inherent loan portfolio risks not specifically provided for. The level of general reserves is based on analysis of potential exposures existing in the loan portfolio including evaluation of historical trends, current

market conditions and other relevant factors identified by us at the time the financial statements are prepared. The formula allowance is calculated by applying loss factors to outstanding loans, excluding those loans that are subject to individual analysis for specific allowances. Loss factors are based on the Company's historical loss experience adjusted for significant environmental considerations, including the experience of other banking organizations, which in the judgment of management affects the collectability of the loan portfolio as of the evaluation date. The unallocated allowance is based upon the Company's evaluation of various factors that are not directly measured in the determination of the formula and specific allowances.

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

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

***Reserve for Unfunded Commitments:*** A reserve for unfunded commitments is maintained at a level that, in the opinion of management, is adequate to absorb probable losses associated with the Banks' commitments to lend funds under existing agreements such as letters or lines of credit. Management determines the adequacy of the reserve for unfunded commitments based upon reviews of individual credit facilities, current economic conditions, the risk characteristics of the various categories of commitments and other relevant factors. The reserve is based on estimates and ultimate losses may vary from the current estimates. These estimates are evaluated on a regular basis and, as adjustments become necessary, they are reported in earnings in the periods in which they become known. Draws on unfunded commitments that are considered uncollectible at the time funds are advanced are charged to the allowance for loan losses. Provisions for unfunded commitment losses are recognized in non-interest expense and added to the reserve for unfunded commitments, which is included in other liabilities.

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

***Property and Equipment:*** Property and equipment is carried at cost less accumulated depreciation. Depreciation is based upon the straight-line method applied to individual assets and groups of assets acquired in the same year over the lesser of their estimated useful lives or the related lease terms of the assets:

| | |
|---|---|
| Buildings and leased improvements | 10–39 years |
| Furniture and equipment | 3–10 years |

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

Property is classified as held for sale when the Company commits to a plan to sell the property and is actively marketing the property for sale. Held for sale property is recorded at the lower of the estimated fair value of the property, less expected selling costs, or the book value at the date the property is transferred to held for sale. Depreciation is not recorded on held for sale property.

***Right of Use Lease Asset & Lease Liability:*** The Company leases retail space, office space, storage space, and equipment under operating leases. Most leases require the Company to pay real estate taxes, maintenance, insurance and other similar costs in addition to the base rent. Certain leases also contain lease incentives, such as tenant improvement allowances and rent abatement. Variable lease payments are recognized as lease expense as they are incurred. We record an operating lease right of use (ROU) asset and an operating lease liability (lease liability) for operating leases with a lease term greater than 12 months. The ROU asset and lease liability are recorded in other assets and other liabilities, respectively, in the consolidated statement of financial condition.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. ROU assets and lease liabilities are recognized at commencement date based on the present value of lease payments over the lease term. Accordingly, ROU assets are reduced by tenant improvement allowances from landlords plus any prepaid rent. We do not separate lease and non-lease components of contracts. As most of our leases do not provide an implicit rate, we generally use our incremental borrowing

rate based on the estimated rate of interest for collateralized borrowing over a similar term of the lease payments at commencement date. Many of our leases contain various provisions for increases in rental rates, based either on changes in the published Consumer Price Index or a predetermined escalation schedule, which are factored into our determination of lease payments when appropriate. Substantially all of the leases provide the Company with the option to extend the lease term one or more times following expiration of the initial term. The ROU asset and lease liability terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

***Goodwill:*** Goodwill represents the excess of the purchase consideration over the fair value of the assets acquired, net of the fair values of liabilities assumed in a business combination and is not amortized but is reviewed annually, or more frequently as current circumstances and conditions warrant, for impairment. The Company completes its annual review of goodwill as of December 31. An assessment of qualitative factors is completed to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the qualitative analysis concludes that further analysis is required, then a quantitative impairment test would be completed. The quantitative goodwill impairment test is used to identify the existence of impairment and the amount of impairment loss and compares the reporting unit's estimated fair value, including goodwill, to its carrying amount. If the fair value exceeds the carrying amount then goodwill is not considered impaired. If the carrying amount exceeds its fair value, an impairment loss would be recognized equal to the amount of excess, limited to the amount of total goodwill allocated to that reporting unit. The impairment loss would be recognized as a charge to earnings. The disposal of a portion of a reporting unit that meets the definition of a business requires goodwill to be allocated for purposes of determining the gain or loss on disposal.

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

***Mortgage Servicing Rights:*** Servicing assets are recognized as separate assets when rights are acquired through purchase or sale of loans. Generally, purchased servicing rights are capitalized at the cost to acquire the rights. For sales of mortgage loans, the fair value of the servicing right is estimated and capitalized. Fair values are estimated based on an independent dealer analysis of discounted cash flows. Capitalized servicing rights are reported in other assets and are amortized into mortgage banking operations in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

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

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

***Bank-Owned Life Insurance (BOLI):*** The Banks have purchased, or acquired through mergers, life insurance policies in connection with the implementation of certain executive supplemental income, salary continuation and deferred compensation retirement plans. These policies provide protection against the adverse financial effects that could result from the death of a key employee and provide tax-exempt income to offset expenses associated with the plans. It is the Banks' intent to hold these policies as a long-term investment; however, there may be an income tax impact if the Bank chooses to surrender certain policies. Although the lives of individual current or former management-level employees are insured, the Banks are the respective owners and sole or partial beneficiaries. BOLI is carried at the cash surrender value (CSV) of the underlying insurance contract. Changes in the CSV and any death benefits received in excess of the CSV are recognized as non-interest income.

***Derivative Instruments:*** Derivatives include "off-balance-sheet" financial products, the value of which is dependent on the value of underlying financial assets, such as stock, bonds, foreign currency, or a reference rate or index. Such derivatives include "forwards," "futures," "options" or "swaps." Banner Bank is a party to $3.6 million (all of which is designated in a hedge relationship) in notional amounts of interest rate swaps at December 31, 2019. Some of 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. In addition, Banner Bank uses an interest rate swap program for commercial loan customers that provides the customer with a variable rate loan and enters into an interest rate swap allowing them to effectively fix their loan interest rates. These customer swaps are matched with third party swaps with qualified broker/dealer or banks to offset the risk. At December 31, 2019, Banner Bank had $372.0 million in notional amounts of these customer interest rate swaps outstanding, with an equal amount of offsetting third party swaps also in place. The fair value adjustments for these swaps are reflected in other assets or other liabilities as appropriate.

Further, as a part of its mortgage banking activities, the Company issues "rate lock" commitments to one- to four-family loan borrowers and obtains offsetting "best efforts" delivery commitments from purchasers of loans. The Company uses forward contracts for the sale of mortgage-backed securities and mandatory delivery commitments for the sale of loans to hedge one- to four-family loan "rate lock" commitments and one- to four-family loans held for sale. The Company also uses forward contracts for the sale of mortgage backed securities to hedge multifamily loans held for sale. The commitments to originate mortgage loans held for sale and the related delivery contracts are considered derivatives. The

Company recognizes all derivatives as either assets or liabilities in the balance sheet and requires measurement of those instruments at fair value through adjustments to current earnings. None of these residential mortgage loan related derivatives are designated as hedging instruments for accounting purposes. Rather, they are accounted for as free-standing derivatives, or economic hedges, and the Company reports changes in fair values of its derivatives in current period net income. The fair values for these instruments, which generally change as a result of changes in the level of market interest rates, are estimated based on dealer quotes and secondary market sources. Assumptions used include rate assumptions based on historical information, current mortgage interest rates, the stage of completion of the underlying application and underwriting process, the time remaining until the expiration of the derivative loan commitment, and the expected net future cash flows related to the associated servicing of the loan (see Note 23 for a more complete discussion of derivatives and hedging).

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

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

***Income Taxes:*** The Company files a consolidated income tax return including all of its wholly-owned subsidiaries on a calendar year basis. Income taxes are accounted for using the asset and liability method. Under this method, a deferred tax asset or liability is determined based on the enacted tax rates which will be in effect when the differences between the financial statement carrying amounts and tax basis of existing assets and liabilities are expected to be reported in the Company's income tax returns. The effect on deferred taxes of a change in tax rates is recognized in income in the period of change. A valuation allowance is recognized as a reduction to deferred tax assets when management determines it is more likely than not that deferred tax assets will not be available to offset future income tax liabilities.

Accounting standards for income taxes prescribe a recognition threshold and measurement process for financial statement recognition and measurement of uncertain tax positions taken or expected to be taken in a tax return, and also provides guidance on the de-recognition of previously recorded benefits and their classification, as well as the proper recording of interest and penalties, accounting in interim periods, disclosures and transition. The Company periodically reviews its income tax positions based on tax laws and regulations and financial reporting considerations, and records adjustments as appropriate. This review takes into consideration the status of current taxing authorities' examinations of the Company's tax returns, recent positions taken by the taxing authorities on similar transactions, if any, and the overall tax environment.

***Stock-Based Compensation:*** The Company maintains a number of stock-based incentive plans, which are discussed in more detail in Note 14, Stock-Based Compensation Plans. Under these plans, the Company compensates employees and directors with time-based restricted stock and restricted stock unit grants. Some restricted stock awards include performance-based and market-based goals that impact the number of shares that ultimately vest based on the level of goal achievement. The Company measures the cost of employee or director services received in exchange for an award of equity instruments based on the fair value of the award, which is the intrinsic value on the grant date. This cost is recognized as expense in the Consolidated Statements of Operations ratably over the vesting period of the award. Any tax benefit or deficiency is recorded as income tax benefit or expense in the period the shares vest. Excess tax benefits are classified along with other income tax cash flows as an operating activity. The Company issues restricted stock and restricted stock unit awards which vest over a one or three year period during which time the employee or director accrues or receives dividends and may have full voting rights depending on the terms of the grant.

***Earnings Per Share:*** Earnings per common share is computed under the two-class method. Pursuant to the two-class method, non-vested stock-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and are included in the computation of EPS. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. Application of the two-class method resulted in the equivalent earnings per share to the treasury method.

Basic earnings per common share is computed by dividing net earnings allocated to common shareholders by the weighted-average number of common shares outstanding during the applicable period, excluding outstanding participating securities. Diluted earnings per common share is computed using the weighted-average number of shares determined for the basic earnings per common share computation plus the dilutive effect of stock compensation using the treasury stock method.

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

***Business Segments:*** The Company is managed by legal entity and not by lines of business. Each of the Banks is a community oriented commercial bank chartered in the State of Washington. The Banks' primary business is that of a traditional banking institution, gathering deposits and originating loans for portfolio in its respective primary market areas. The Banks offer a wide variety of deposit products to their consumer and commercial customers. Lending activities include the origination of real estate, commercial/agriculture business and consumer loans. Banner Bank is also an active participant in the secondary market, originating residential loans for sale on both a servicing released and servicing retained basis. In addition to interest income on loans and investment securities, the Banks receive other income from deposit service charges, loan

servicing fees and from the sale of loans and investments. The performance of the Banks is reviewed by the Company's executive management and Board of Directors on a monthly basis. All of the executive officers of the Company are members of Banner Bank's management team.

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

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

**Note 2: ACCOUNTING STANDARDS RECENTLY ISSUED OR ADOPTED**

*Leases (Topic 842)*

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-02, *Leases (Topic 842)*. The amendments in this ASU require lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date; a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. In July 2018, FASB issued ASU No. 2018-11, *Targeted Improvements*. The amendments in this ASU provide entities with an additional (and optional) transition method to adopt the new leases standard. The Company adopted the requirements of Topic 842 effective January 1, 2019. The Company elected the transition option provided in ASU No. 2018-11 and applied the modified retrospective approach for leases that existed as of January 1, 2019, or were entered into thereafter. The Company elected certain relief options for practical expedients: the option to not separate lease and non-lease components and instead to account for them as a single lease component, and the option to not recognize right-of-use assets and lease liabilities that arise from short-term leases (i.e. lease terms of twelve months or less). In addition, the Company elected the package of practical expedients in transition, which permitted us to not reassess our prior conclusions pertaining to lease identification, lease classification, and initial direct costs on leases that commenced prior to our adoption of the new standard. In connection with the adoption of this ASU, as of January 1, 2019, the Company recorded a $56 million right-of-use asset and a $59 million lease liability on its Consolidated Statements of Financial Condition.

*Derivatives and Hedging (Topic 815)*

In August 2017, FASB issued ASU No. 2017-12, *Targeted Improvements to Accounting for Hedging Activities*. The amendments in this ASU are intended to provide investors better insight into an entity's risk management hedging strategies by permitting a company to recognize the economic results of its hedging strategies in its financial statements. The amendments in this ASU permit hedge accounting for hedging relationships involving non-financial risk and interest rate risk by removing certain limitations in cash flow and fair value hedging relationships. In addition, the ASU requires an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. The Company adopted this ASU effective January 1, 2019. The adoption of this ASU did not have a material impact on the Company's Consolidated Financial Statements.

*Financial Instruments—Credit Losses (Topic 326)*

In June 2016, FASB issued ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*. Current GAAP requires an "incurred loss" methodology for recognizing credit losses that delays recognition until it is probable a loss has been incurred. The main objective of this ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The ASU affects loans, debt securities, trade receivables, net investments in leases, off-balance-sheet credit exposures, reinsurance receivables, and any other financial asset not excluded from the scope that have the contractual right to receive cash. The ASU replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. This ASU requires a financial asset (or group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. The measurement of expected credit losses will be based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This ASU broadens the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The use of forecasted information incorporates more timely information in the estimate of expected credit loss, which will be more decision useful to users of the financial statements. The Company adopted this ASU effective January 1, 2020. The Company has formed an internal committee to oversee the project, engaged a third-party vendor to assist with the project and has completed its gap analysis phase of the project. In addition, the Company has selected a second third-party vendor to assist with building and developing the required models and has completed the initial build out of the required models. The Company has also selected a different third-party vendor to provide various economic forecast scenarios. The Company has developed a reasonable and supportable forecast based upon these economic forecast scenarios and has incorporated the reasonable and supportable forecast into the models. The Company has also developed a qualitative factor methodology and incorporated the qualitative factors into the models. The Company is in the process of finalizing its review of the model results related to the adoption of this ASU. Based on current model results Banner estimates the adoption of this ASU will result in a combined increase to its Allowance for Credit Loss and Reserve for Unfunded Loan Commitments of 10% to

20%. The increase is primarily the result of an increased allowance for credit losses on one- to four-family and other homogeneous loans, as well as an increase in the reserve for unfunded loan commitments. The increase will be recorded as an adjustment to equity as of the adoption date. In addition to the increase in the allowance for credit losses upon adoption, the Company expects more variability in its quarterly provision for credit losses going forward due to the model sensitivity to changes in the economic forecast and other factors. Based on the credit quality of our held-to-maturity debt security portfolio, the allowance for credit losses recorded at adoption on this portfolio is expected to be nominal. In addition, the current accounting policy and procedures for other-than-temporary impairment on investment securities available-for-sale will be replaced with an allowance approach, no allowance for credit losses is expected to be recorded at adoption on this portfolio.

*Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20)*

In March 2017, FASB issued ASU No. 2017-08, *Premium Amortization on Purchased Callable Debt Securities*. The amendments in this ASU shorten the premium amortization period for callable debt securities purchased at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. Under current GAAP, premiums and discounts on callable debt securities generally are amortized to the maturity date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to the maturity date. The amendments in this ASU more closely align the amortization period of premiums and discounts to expectations incorporated in market pricing on the underlying securities. The Company adopted this ASU effective January 1, 2019. The adoption of this ASU did not have a material impact on the Company's Consolidated Financial Statements.

*Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40)*

In August 2018, FASB issued ASU 2018-15, *Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. The amendments in this ASU broaden the scope of ASC Subtopic 350-40 to include costs incurred to implement a hosting arrangement that is a service contract. The amendments align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The costs are capitalized or expensed depending on the nature of the costs and the project stage during which they are incurred, consistent with the accounting for costs for internal-use software. The amendments in this ASU result in consistent capitalization of implementation costs of a hosting arrangement that is a service contract and implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by the amendments in this ASU. This ASU is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. The amendments in this ASU should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. The Company adopted this ASU effective January 1, 2020 and is not expected to have a material impact on the Company's Consolidated Financial Statements.

*Fair Value Measurement (Topic 820)*

In August 2018, FASB issued ASU 2018-13, *Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement*. The amendments in this ASU modify the disclosure requirements on fair value measurements in Topic 820, Fair Value Measurement. The ASU removes, modifies and adds disclosure requirements in Topic 820. The following disclosure requirements were removed: 1) the amount and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, 2) the policy for timing of transfers between levels, and 3) the valuation processes for Level 3 fair value measurements. This ASU modified disclosure requirements by requiring: that the measurement uncertainty disclosure communicates information about the uncertainty in measurement as of the reporting date. The following disclosure requirements were added: 1) changes in unrealized gains and losses for the period included in other comprehensive income for the recurring Level 3 fair value measurements held at the end of the reporting period, and 2) the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. The amendments in this ASU are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this ASU and delay adoption of the additional disclosures until their effective date. The Company adopted this ASU effective January 1, 2020. Adoption of ASU 2018-13 is not expected to have a material impact on the Company's Consolidated Financial Statements.

**Note 3: BUSINESS COMBINATIONS**

*Acquisition of AltaPacific Bancorp*

On November 1, 2019, the Company completed the acquisition of 100% of the outstanding common shares of AltaPacific Bancorp (AltaPacific), the holding company for AltaPacific Bank, a California state-chartered commercial bank. AltaPacific was merged into Banner and AltaPacific Bank was merged into Banner Bank. Pursuant to the previously announced terms of the acquisition, AltaPacific shareholders received 0.2712 shares of Banner common stock in exchange for each share of AltaPacific common stock, plus cash in lieu of any fractional shares and to buy out AltaPacific stock options. The merged banks will operate as Banner Bank post system conversion. The primary reason for the acquisition was to expand the Company's presence in California by adding density within our existing geographic footprint. The acquisition provided $425.7 million in assets, $313.4 million in deposits and $332.4 million in loans to Banner.

The application of the acquisition method of accounting resulted in recognition of a CDI asset of $4.6 million and goodwill of $34.0 million. The acquired CDI has been determined to have a useful life of approximately ten years and will be amortized on an accelerated basis. Goodwill is not amortized but will be evaluated for impairment on an annual basis or more often if circumstances dictate to determine if the carrying value remains appropriate. Goodwill will not be deductible for income tax purposes as the acquisition is accounted for as a tax-free exchange for tax purposes.

The following table presents a summary of the consideration paid and the estimated fair values as of the acquisition date for each major class of assets acquired and liabilities assumed (in thousands):

| | AltaPacific | |
|---|---|---|
| | November 1, 2019 | |
| Consideration to AltaPacific equity holders: | | |
| Cash paid | | $ 2,360 |
| Fair value of common shares issued | | 85,200 |
| Total consideration | | 87,560 |
| | | |
| Fair value of assets acquired: | | |
| Cash and cash equivalents | 39,686 | |
| Securities | 20,348 | |
| Federal Home Loan Bank stock | 2,005 | |
| Loans receivable (contractual amount of $338.2 million) | 332,355 | |
| Real estate owned held for sale | 650 | |
| Property and equipment | 3,809 | |
| Core deposit intangible | 4,610 | |
| Bank-owned life insurance | 11,890 | |
| Deferred tax asset | 166 | |
| Other assets | 10,150 | |
| Total assets acquired | 425,669 | |
| | | |
| Fair value of liabilities assumed: | | |
| Deposits | 313,374 | |
| Advances from FHLB | 40,226 | |
| Junior subordinated debentures | 5,814 | |
| Deferred compensation | 4,508 | |
| Other liabilities | 8,154 | |
| Total liabilities assumed | 372,076 | |
| | | |
| Net assets acquired | | 53,593 |
| Goodwill | | $ 33,967 |

Acquired goodwill represents the premium the Company paid over the fair value of the net tangible and intangible assets acquired. The Company paid this premium for a number of reasons, including growing the Company's customer base, acquiring assembled workforces, and expanding its presence in existing markets. See Note 16, Goodwill, Other Intangible Assets and Mortgage Servicing Rights for the accounting for goodwill and other intangible assets.

Fair values are preliminary and subject to refinement for up to one year after the closing date of the acquisition as additional information regarding the closing date fair values becomes available. Additional adjustments to the acquisition accounting that may be required would most likely involve loans, property and equipment, or the deferred tax asset. As of November 1, 2019, the unpaid principal balance on purchased non-credit-impaired loans was $333.5 million. The fair value of the purchased non-credit-impaired loans was $328.2 million, resulting in a discount of $5.3 million recorded on these loans, which includes $5.8 million of a credit related discount. This discount is being accreted into income over the life of the loans on an effective yield basis.

The following table presents the acquired AltaPacific PCI loans as of the acquisition date (in thousands):

| | AltaPacific<br>November 1, 2019 |
|---|---|
| Acquired PCI loans: | |
| Contractually required principal and interest payments | $ 5,881 |
| Nonaccretable difference | (1,046) |
| Cash flows expected to be collected | 4,835 |
| Accretable yield | (683) |
| Fair value of PCI loans | $ 4,152 |

The financial results of the Company include the revenues and expenses produced by the acquired assets and assumed liabilities of AltaPacific since November 1, 2019. Disclosure of the amount of AltaPacific's revenue and net income (excluding integration costs) included in the Company's Consolidated Statements of Operations is impracticable due to the integration of the operations and accounting for this acquisition. The pro forma impact of the AltaPacific acquisition to the historical financial results was determined to not be significant.

*Acquisition of Skagit Bancorp, Inc.*

Effective as of the close of business on November 1, 2018, the Company acquired 100% of the outstanding common shares of Skagit Bancorp, Inc. ("Skagit") and its wholly-owned subsidiary, Skagit Bank, a Washington state chartered commercial bank headquartered in Burlington, Washington, with 11 branches serving markets along the I-5 corridor from Seattle to the Canadian border. On that date, Skagit merged with and into Banner and Skagit Bank merged with and into Banner Bank. Pursuant to the terms of the merger, the equity holders of Skagit received an aggregate of 3.1 million shares of Banner voting common stock, plus cash in lieu of fractional shares and cash to buyout Skagit stock options for total consideration paid of $180.0 million. The acquisition provided $915.8 million in assets, $810.2 million in deposits and $632.4 million in loans to Banner.

The application of the acquisition method of accounting resulted in recognition of a CDI asset of $16.4 million and goodwill of $96.5 million. The acquired CDI has been determined to have a useful life of approximately nine years and will be amortized on an accelerated basis. Goodwill is not amortized but will be evaluated for impairment on an annual basis or more often if circumstances dictate to determine if the carrying value remains appropriate. Goodwill will not be deductible for income tax purposes as the acquisition is accounted for as a tax-free exchange for tax purposes.

The following table presents a summary of the consideration paid and the estimated fair values as of the acquisition date for each major class of assets acquired and liabilities assumed (in thousands):

| | Skagit | |
|---|---|---|
| | November 1, 2018 | |
| Consideration to Skagit equity holders: | | |
| Cash paid | | $ 329 |
| Fair value of common shares issued | | 179,709 |
| Total consideration | | 180,038 |
| | | |
| Fair value of assets acquired: | | |
| Cash and cash equivalents | $ 19,167 | |
| Securities | 210,326 | |
| Loans receivable (contractual amount of $645.6 million) | 632,374 | |
| Real estate owned held for sale | 2,593 | |
| Property and equipment | 15,788 | |
| Core deposit intangible | 16,368 | |
| Deferred tax asset | 95 | |
| Other assets | 19,110 | |
| Total assets acquired | 915,821 | |
| | | |
| Fair value of liabilities assumed: | | |
| Deposits | 810,209 | |
| Other liabilities | 22,069 | |
| Total liabilities assumed | 832,278 | |
| | | |
| Net assets acquired | | 83,543 |
| Goodwill | | $ 96,495 |

Acquired goodwill represents the premium the Company paid over the fair value of the net tangible and intangible assets acquired. The primary reason for the acquisition was to expand the Company's presence and density in the North Sound region of the Pacific Northwest along the I-5 corridor. The Company paid this premium for a number of reasons, including growing the Company's customer base, acquiring assembled workforces, and expanding its presence in existing markets. See Note 16, Goodwill, Other Intangible Assets and Mortgage Servicing Rights for the accounting for goodwill and other intangible assets.

As of November 1, 2018, the unpaid principal balance on purchased non-credit-impaired loans was $637.4 million. The fair value of the purchased non-credit-impaired loans was $625.2 million, resulting in a discount of $12.2 million recorded on these loans, which includes $7.9 million of a credit related discount. This discount is being accreted into income over the life of the loans on an effective yield basis.

The following table presents the acquired Skagit PCI loans as of the acquisition date (in thousands):

| | Skagit |
|---|---|
| | November 1, 2018 |
| Acquired PCI loans: | |
| Contractually required principal and interest payments | $ 9,897 |
| Nonaccretable difference | (1,915) |
| Cash flows expected to be collected | 7,982 |
| Accretable yield | (995) |
| Fair value of PCI loans | $ 6,987 |

The financial results of the Company include the revenues and expenses produced by the acquired assets and assumed liabilities of Skagit since November 1, 2018. Disclosure of the amount of Skagit's revenue and net income (excluding integration costs) included in the Company's Consolidated Statements of Operations is impracticable due to the integration of the operations and accounting for this acquisition. The pro forma impact of the Skagit acquisition to the historical financial results was determined to not be significant.

**Note 4: SECURITIES**

The amortized cost, gross unrealized gains and losses and estimated fair value of securities at December 31, 2019 and 2018 are summarized as follows (in thousands):

| | December 31, 2019 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Trading: | | | | |
| Corporate bonds | $ 27,203 | | | $ 25,636 |
| Available-for-Sale: | | | | |
| U.S. Government and agency obligations | $ 90,468 | $ 286 | $ (1,156) | $ 89,598 |
| Municipal bonds | 101,927 | 5,233 | (3) | 107,157 |
| Corporate bonds | 4,357 | 14 | (6) | 4,365 |
| Mortgage-backed or related securities | 1,324,999 | 20,325 | (3,013) | 1,342,311 |
| Asset-backed securities | 8,195 | — | (69) | 8,126 |
| | $ 1,529,946 | $ 25,858 | $ (4,247) | $ 1,551,557 |
| Held-to-Maturity: | | | | |
| U.S. Government and agency obligations | $ 385 | $ 4 | $ — | $ 389 |
| Municipal bonds: | 177,208 | 3,733 | (2,213) | 178,728 |
| Corporate bonds | 3,353 | — | (11) | 3,342 |
| Mortgage-backed or related securities | 55,148 | 921 | (723) | 55,346 |
| | $ 236,094 | $ 4,658 | $ (2,947) | $ 237,805 |

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Trading: | | | | |
| Corporate bonds | $ 27,203 | | | $ 25,896 |
| Available-for-Sale: | | | | |
| U.S. Government and agency obligations | $ 151,012 | $ 149 | $ (2,049) | $ 149,112 |
| Municipal bonds | 116,548 | 1,806 | (532) | 117,822 |
| Corporate bonds | 3,556 | — | (61) | 3,495 |
| Mortgage-backed or related securities | 1,355,258 | 5,210 | (16,607) | 1,343,861 |
| Asset-backed securities | 22,047 | 6 | (120) | 21,933 |
| | $ 1,648,421 | $ 7,171 | $ (19,369) | $ 1,636,223 |
| Held-to-Maturity: | | | | |
| U.S. Government and agency obligations | $ 1,006 | $ 14 | $ (1) | $ 1,019 |
| Municipal bonds: | 176,663 | 1,727 | (2,578) | 175,812 |
| Corporate bonds | 3,736 | — | (13) | 3,723 |
| Mortgage-backed or related securities | 52,815 | 66 | (898) | 51,983 |
| | $ 234,220 | $ 1,807 | $ (3,490) | $ 232,537 |

At December 31, 2019 and 2018, the gross unrealized losses and the fair value for securities available-for-sale and held-to-maturity aggregated by the length of time that individual securities have been in a continuous unrealized loss position was as follows (in thousands):

| | December 31, 2019 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 12 Months | | 12 Months or More | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Available-for-Sale: | | | | | | |
| U.S. Government and agency obligations | $ 2,747 | $ (20) | $ 60,979 | $ (1,136) | $ 63,726 | $ (1,156) |
| Municipal bonds | 1,902 | — | 494 | (3) | 2,396 | (3) |
| Corporate bonds | 594 | (6) | — | — | 594 | (6) |
| Mortgage-backed or related securities | 300,852 | (2,829) | 33,360 | (184) | 334,212 | (3,013) |
| Asset-backed securities | 1,204 | (17) | 5,989 | (52) | 7,193 | (69) |
| | $ 307,299 | $ (2,872) | $ 100,822 | $ (1,375) | $ 408,121 | $ (4,247) |
| Held-to-Maturity: | | | | | | |
| U.S. Government and agency obligations | $ — | $ — | $ — | $ — | $ — | $ — |
| Municipal bonds | 44,605 | (1,889) | 19,017 | (324) | 63,622 | (2,213) |
| Corporate bonds | — | — | 489 | (11) | 489 | (11) |
| Mortgage-backed or related securities | 11,117 | (723) | — | — | 11,117 | (723) |
| | $ 55,722 | $ (2,612) | $ 19,506 | $ (335) | $ 75,228 | $ (2,947) |

| | December 31, 2018 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 12 Months | | 12 Months or More | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Available-for-Sale: | | | | | | |
| U.S. Government and agency obligations | $ 75,885 | $ (1,240) | $ 50,508 | $ (809) | $ 126,393 | $ (2,049) |
| Municipal bonds | 6,422 | (54) | 27,231 | (478) | 33,653 | (532) |
| Corporate bonds | 3,199 | (56) | 295 | (5) | 3,494 | (61) |
| Mortgage-backed or related securities | 316,074 | (2,939) | 571,989 | (13,668) | 888,063 | (16,607) |
| Asset-backed securities | 10,582 | (24) | 9,913 | (96) | 20,495 | (120) |
| | $ 412,162 | $ (4,313) | $ 659,936 | $ (15,056) | $ 1,072,098 | $ (19,369) |
| Held-to-Maturity: | | | | | | |
| U.S. Government and agency obligations | $ 145 | $ (1) | $ — | $ — | $ 145 | $ (1) |
| Municipal bonds | $ 29,898 | $ (274) | $ 44,637 | $ (2,304) | $ 74,535 | $ (2,578) |
| Corporate bonds | — | — | 487 | (13) | 487 | (13) |
| Mortgage-backed or related securities | 10,761 | (220) | 30,035 | (678) | 40,796 | (898) |
| | $ 40,804 | $ (495) | $ 75,159 | $ (2,995) | $ 115,963 | $ (3,490) |

At December 31, 2019, there were 90 securities—available-for-sale with unrealized losses, compared to 271 at December 31, 2018. At December 31, 2019, there were 17 securities—held-to-maturity with unrealized losses, compared to 90 at December 31, 2018. Management does not believe that any individual unrealized loss as of December 31, 2019 or 2018 represented OTTI. The decline in fair market value of these securities was generally due to changes in interest rates.

There were no sales of securities—trading for the year ended December 31, 2019. There were no sales of securities—trading for the year ended December 31, 2018. Sales of securities—trading for the year ended December 31, 2017 totaled $1.3 million with a resulting net gain of $28,000. There were no securities—trading in a nonaccrual status at both December 31, 2019 and 2018. Net unrealized holding losses of $208,000 and gains of $3.8 million were recognized in 2019 and 2018, respectively.

Sales of securities—available-for-sale totaled $66.3 million with a resulting net gain of $46,000 for the year ended December 31, 2019. In addition, partial calls of securities resulted in a net loss of $12,000 for the year ended December 31, 2019. Sales of securities—available-for-sale totaled $214.6 million with a resulting net loss of $839,000 for the year ended December 31, 2018. Sales of securities—available-for-sale totaled $522.6 million with a resulting net loss of $2.1 million for the year ended December 31, 2017. There were no securities—available-for-sale in a nonaccrual status at December 31, 2019 and 2018.

There were no sales of securities—held-to-maturity during the years ended December 31, 2019, 2018 or 2017 although there were partial calls of securities that resulted in a net loss of $1,000 for the year ended December 31, 2019 and a net gain of $2,000 for the year ended December 31, 2018. There were no securities—held-to-maturity in a nonaccrual status at December 31, 2019 and 2018.

The amortized cost and estimated fair value of securities at December 31, 2019, by contractual maturity, are shown below (in thousands). Expected maturities will differ from contractual maturities because some securities may be called or prepaid with or without call or prepayment penalties.

| | **December 31, 2019** | | | | | |
|---|---|---|---|---|---|---|
| | Trading | | Available-for-Sale | | Held-to-Maturity | |
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Maturing in one year or less | $ — | $ — | $ 1,630 | $ 1,630 | $ 810 | $ 811 |
| Maturing after one year through five years | — | — | 48,703 | 49,614 | 61,664 | 62,582 |
| Maturing after five years through ten years | — | — | 358,305 | 368,950 | 42,872 | 44,372 |
| Maturing after ten years through twenty years | 27,203 | 25,636 | 243,275 | 247,506 | 103,066 | 102,540 |
| Maturing after twenty years | — | — | 878,033 | 883,857 | 27,682 | 27,500 |
| | $ 27,203 | $ 25,636 | $ 1,529,946 | $ 1,551,557 | $ 236,094 | $ 237,805 |

The following table presents, as of December 31, 2019, investment securities which were pledged to secure borrowings, public deposits or other obligations as permitted or required by law (in thousands):

| | Carrying Value | Amortized Cost | Fair Value |
|---|---|---|---|
| Purpose or beneficiary: | | | |
| State and local governments public deposits | $ 146,220 | $ 145,407 | $ 149,552 |
| Interest rate swap counterparties | 17,301 | 17,006 | 17,480 |
| Repurchase transaction accounts | 135,523 | 134,233 | 135,523 |
| Other | 2,683 | 2,683 | 2,671 |
| Total pledged securities | $ 301,727 | $ 299,329 | $ 305,226 |

**Note 5: LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES**

Loans receivable at December 31, 2019 and 2018 are summarized as follows (dollars in thousands):

| | **December 31, 2019** | | December 31, 2018 | |
|---|---|---|---|---|
| | Amount | Percent of Total | Amount | Percent of Total |
| Commercial real estate: | | | | |
| Owner-occupied | $ 1,580,650 | 17.0% | $ 1,430,097 | 16.4% |
| Investment properties | 2,309,221 | 24.8 | 2,131,059 | 24.5 |
| Multifamily real estate | 473,152 | 5.1 | 368,836 | 4.2 |
| Commercial construction | 210,668 | 2.3 | 172,410 | 2.0 |
| Multifamily construction | 233,610 | 2.5 | 184,630 | 2.1 |
| One- to four-family construction | 544,308 | 5.8 | 534,678 | 6.2 |
| Land and land development: | | | | |
| Residential | 154,688 | 1.7 | 188,508 | 2.2 |
| Commercial | 26,290 | 0.3 | 27,278 | 0.3 |
| Commercial business | 1,693,824 | 18.2 | 1,483,614 | 17.1 |
| Agricultural business, including secured by farmland | 370,549 | 4.0 | 404,873 | 4.7 |
| One- to four-family residential | 945,622 | 10.1 | 973,616 | 11.2 |
| Consumer: | | | | |
| Consumer secured by one- to four-family | 550,960 | 5.9 | 568,979 | 6.6 |
| Consumer—other | 211,815 | 2.3 | 216,017 | 2.5 |
| Total loans outstanding | 9,305,357 | 100.0% | 8,684,595 | 100.0% |
| Less allowance for loan losses | (100,559) | | (96,485) | |
| Net loans | $ 9,204,798 | | $ 8,588,110 | |

Loan amounts are net of unearned loan fees in excess of unamortized costs of $438,000 and $1.4 million as of December 31, 2019 and 2018, respectively. Net loans include net discounts on acquired loans of $25.0 million and $25.7 million as of December 31, 2019 and 2018, respectively.

The Company's loans to directors, executive officers and related entities are on substantially the same terms and underwriting as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than normal risk of collectability. Such loans had balances of $3.3 million and $3.5 million at December 31, 2019 and 2018, respectively.

*Purchased credit-impaired loans:* The outstanding contractual unpaid principal balance of PCI loans, excluding acquisition accounting adjustments, was $23.5 million at December 31, 2019 and $22.0 million at December 31, 2018. The carrying balance of PCI loans was $15.9 million at December 31, 2019 and $14.4 million at December 31, 2018.

The following table presents the changes in the accretable yield for PCI loans for the years ended December 31, 2019 and 2018 (in thousands):

| | Years Ended December 31 | |
|---|---|---|
| | **2019** | 2018 |
| Balance, beginning of period | $ 5,216 | $ 6,520 |
| Additions | 683 | 995 |
| Accretion to interest income | (1,891) | (7,509) |
| Disposals and other | — | 58 |
| Reclassifications from non-accretable difference | 510 | 5,152 |
| Balance, end of period | $ 4,518 | $ 5,216 |

As of December 31, 2019 and December 31, 2018, the non-accretable difference between the contractually required payments and cash flows expected to be collected was $7.4 million and $7.1 million, respectively.

*Impaired Loans and the Allowance for Loan Losses:* A loan is considered impaired when, based on current information and circumstances, the Company determines it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan agreement, including scheduled interest payments. Factors involved in determining impairment include, but are not limited to, the financial condition of the borrower, the value of the underlying collateral and the current status of the economy. Impaired loans are comprised of loans on nonaccrual, TDRs, and loans that are 90 days or more past due, but are still on accrual. Purchased credit-impaired loans are considered performing within the scope of the PCI accounting guidance and are not included in the impaired loan tables.

The following tables provide additional information on impaired loans, excluding PCI loans, with and without specific allowance reserves at December 31, 2019 and 2018. Recorded investment includes the unpaid principal balance or the carrying amount of loans less charge-offs and net deferred loan fees (in thousands):

| | December 31, 2019 | | | |
|---|---|---|---|---|
| | | Recorded Investment | | |
| | Unpaid Principal Balance | Without Allowance (1) | With Allowance (2) | Related Allowance |
| Commercial real estate: | | | | |
| Owner-occupied | $ 4,185 | $ 3,816 | $ 194 | $ 18 |
| Investment properties | 3,536 | 1,883 | 690 | 40 |
| Multifamily real estate | 82 | 85 | — | — |
| Multifamily construction | 573 | 98 | — | — |
| One- to four-family construction | 1,799 | 1,799 | — | — |
| Land and land development: | | | | |
| Residential | 676 | 340 | — | — |
| Commercial business | 25,117 | 4,614 | 19,330 | 4,128 |
| Agricultural business/farmland | 3,044 | 661 | 2,243 | 141 |
| One- to four-family residential | 7,290 | 5,613 | 1,648 | 41 |
| Consumer: | | | | |
| Consumer secured by one- to four-family | 3,081 | 2,712 | 127 | 5 |
| Consumer—other | 222 | 159 | 52 | 1 |
| | $ 49,605 | $ 21,780 | $ 24,284 | $ 4,374 |

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | | Recorded Investment | | |
| | Unpaid Principal Balance | Without Allowance (1) | With Allowance (2) | Related Allowance |
| Commercial real estate: | | | | |
| Owner-occupied | $ 3,193 | $ 2,768 | $ 200 | $ 19 |
| Investment properties | 7,287 | 1,320 | 5,606 | 226 |
| Multifamily construction | 1,901 | 1,427 | — | — |
| One- to four-family construction | 919 | 919 | — | — |
| Land and land development: | | | | |
| Residential | 1,134 | 798 | — | — |
| Commercial | 44 | 44 | — | — |
| Commercial business | 4,014 | 2,937 | 391 | 16 |
| Agricultural business/farmland | 4,863 | 1,751 | 2,561 | 96 |
| One- to four-family residential | 6,724 | 4,314 | 2,358 | 51 |
| Consumer: | | | | |
| Consumer secured by one- to four-family | 1,622 | 1,438 | 133 | 6 |
| Consumer—other | 112 | 49 | 62 | 2 |
| | $ 31,813 | $ 17,765 | $ 11,311 | $ 416 |

(1) Includes loans without an allowance reserve that have been individually evaluated for impairment and that evaluation concluded that no reserve was needed, and $13.5 million and $9.0 million of homogeneous and small balance loans as of December 31, 2019 and December 31, 2018, respectively, that are collectively evaluated for impairment for which a general reserve has been established.

(2) Loans with a specific allowance reserve have been individually evaluated for impairment using either a discounted cash flow analysis or, for collateral dependent loans, current appraisals less costs to sell to establish realizable value.

The following table summarizes our average recorded investment and interest income recognized on impaired loans by loan class for the years ended December 31, 2019, 2018 and 2017 (in thousands):

| | **Year Ended December 31, 2019** | | Year Ended December 31, 2018 | | Year Ended December 31, 2017 | |
|---|---|---|---|---|---|---|
| | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| Commercial real estate: | | | | | | |
| Owner-occupied | $ 3,366 | $ 7 | $ 3,806 | $ 11 | $ 3,697 | $ 11 |
| Investment properties | 3,982 | 119 | 7,822 | 314 | 9,136 | 195 |
| Multifamily real estate | 36 | — | — | — | 251 | 10 |
| Commercial construction | 779 | — | 115 | — | — | — |
| One- to four-family construction | 1,319 | 18 | 778 | 6 | 418 | 27 |
| Land and land development: | | | | | | |
| Residential | 657 | — | 994 | 10 | 1,396 | 42 |
| Commercial | — | — | 4 | — | 867 | — |
| Commercial business | 5,510 | 26 | 3,443 | 21 | 5,996 | 68 |
| Agricultural business/farmland | 3,975 | 105 | 5,501 | 102 | 6,184 | 207 |
| One- to four-family residential | 6,589 | 249 | 7,845 | 302 | 9,499 | 322 |
| Consumer: | | | | | | |
| Consumer secured by one- to four-family | 2,694 | 22 | 1,583 | 17 | 1,635 | 9 |
| Consumer—other | 355 | 4 | 142 | 4 | 184 | 7 |
| | $ 29,262 | $ 550 | $ 32,033 | $ 787 | $ 39,263 | $ 898 |

The following table presents TDRs by accrual and nonaccrual status at December 31, 2019 and 2018 (in thousands):

| | **December 31, 2019** | | | December 31, 2018 | | |
|---|---|---|---|---|---|---|
| | Accrual Status | Nonaccrual Status | Total TDRs | Accrual Status | Nonaccrual Status | Total TDRs |
| Commercial real estate: | | | | | | |
| Owner-occupied | $ — | $ 263 | $ 263 | $ 200 | $ 78 | $ 278 |
| Investment properties | 690 | 1,037 | 1,727 | 5,606 | — | 5,606 |
| Commercial business | 380 | — | 380 | 391 | — | 391 |
| Agricultural business/farmland | 2,243 | — | 2,243 | 2,561 | — | 2,561 |
| One- to four-family residential | 2,974 | 196 | 3,170 | 4,469 | 239 | 4,708 |
| Consumer: | | | | | | |
| Consumer secured by one- to four-family | 127 | — | 127 | 133 | — | 133 |
| Consumer—other | 52 | — | 52 | 62 | — | 62 |
| | $ 6,466 | $ 1,496 | $ 7,962 | $ 13,422 | $ 317 | $ 13,739 |

As of December 31, 2019 and 2018, the Company had no commitments to advance funds up to an additional amount related to TDRs.

The following tables present new TDRs that occurred during the years ended December 31, 2019 and 2017. No new TDRs occurred during the year ended December 31, 2018 (dollars in thousands):

| | Number of Contracts | Pre-modification Outstanding Recorded Investment | Post-modification Outstanding Recorded Investment |
|---|---|---|---|
| **Year Ended December 31, 2019** | | | |
| Recorded Investment [(1)] [(2)] | | | |
| Commercial real estate: | | | |
| Investment properties | 1 | $ 1,090 | $ 1,090 |
| Commercial business | 1 | $ 160 | $ 160 |
| Agricultural business/farmland | 1 | $ 596 | $ 596 |
| Total | 3 | $ 1,846 | $ 1,846 |
| **Year Ended December 31, 2017** | | | |
| Recorded Investment [(1)] [(2)] | | | |
| Commercial real estate: | | | |
| Investment properties | 1 | $ 3,714 | $ 3,714 |
| Total | 1 | $ 3,714 | $ 3,714 |

(1) Since most loans were already considered classified and/or on non-accrual status prior to restructuring, the modifications did not have a material effect on the Company's determination of the allowance for loan losses.

(2) Generally, these modifications do not fit into one separate type, such as rate, term, amount, interest-only or payment, but instead are a combination of multiple types of modifications; therefore, they are disclosed in aggregate.

There were no TDRs which incurred a payment default within the years ended December 31, 2019 and December 31, 2018 for which the payment default occurred within twelve months of the restructure date. A default on a restructured loan results in a transfer to nonaccrual status, a charge-off or a combination of both.

*Credit Quality Indicators*: To appropriately and effectively manage the ongoing credit quality of the Company's loan portfolio, management has implemented a risk-rating or loan grading system for its loans. The system is a tool to evaluate portfolio asset quality throughout each applicable loan's life as an asset of the Company. Generally, loans and leases are risk rated on an aggregate borrower/relationship basis with individual loans sharing similar ratings. There are some instances when specific situations relating to individual loans will provide the basis for different risk ratings within the aggregate relationship. Loans are graded on a scale of 1 to 9. A description of the general characteristics of these categories is shown below:

*Overall Risk Rating Definitions*: Risk-ratings contain both qualitative and quantitative measurements and take into account the financial strength of a borrower and the structure of the loan or lease. Consequently, the definitions are to be applied in the context of each lending transaction and judgment must also be used to determine the appropriate risk rating, as it is not unusual for a loan or lease to exhibit characteristics of more than one risk-rating category. Consideration for the final rating is centered in the borrower's ability to repay, in a timely fashion, both principal and interest. There were no material changes in the risk-rating or loan grading system in 2019.

Risk Rating 1: Exceptional
A credit supported by exceptional financial strength, stability, and liquidity. The risk rating of 1 is reserved for the Company's top quality loans, generally reserved for investment grade credits underwritten to the standards of institutional credit providers.

Risk Rating 2: Excellent
A credit supported by excellent financial strength, stability and liquidity. The risk rating of 2 is reserved for very strong and highly stable customers with ready access to alternative financing sources.

Risk Rating 3: Strong
A credit supported by good overall financial strength and stability. Collateral margins are strong, cash flow is stable although susceptible to cyclical market changes.

Risk Rating 4: Acceptable
A credit supported by the borrower's adequate financial strength and stability. Assets and cash flow are reasonably sound and provide for orderly debt reduction. Access to alternative financing sources will be more difficult to obtain.

Risk Rating 5: Watch
A credit with the characteristics of an acceptable credit but one which requires more than the normal level of supervision and warrants formal quarterly management reporting. Credits in this category are not yet criticized or classified, but due to adverse events or aspects of underwriting require closer than normal supervision. Generally, credits should be watch credits in most cases for six months or less as the impact of stress factors are analyzed.

Risk Rating 6: Special Mention
A credit with potential weaknesses that deserves management's close attention is risk rated a 6. If left uncorrected, these potential weaknesses will result in deterioration in the capacity to repay debt. A key distinction between Special Mention and Substandard is that in a Special Mention credit, there are identified weaknesses that pose potential risk(s) to the repayment sources, versus well defined weaknesses that pose risk(s) to the repayment sources. Assets in this category are expected to be in this category no more than 9-12 months as the potential weaknesses in the credit are resolved.

Risk Rating 7: Substandard
A credit with well defined weaknesses that jeopardize the ability to repay in full is risk rated a 7. These credits are inadequately protected by either the sound net worth and payment capacity of the borrower or the value of pledged collateral. These are credits with a distinct possibility of loss. Loans headed for foreclosure and/or legal action due to deterioration are rated 7 or worse.

Risk Rating 8: Doubtful
A credit with an extremely high probability of loss is risk rated 8. These credits have all the same critical weaknesses that are found in a substandard loan; however, the weaknesses are elevated to the point that based upon current information, collection or liquidation in full is improbable. While some loss on doubtful credits is expected, pending events may strengthen a credit making the amount and timing of any loss indeterminate. In these situations taking the loss is inappropriate until it is clear that the pending event has failed to strengthen the credit and improve the capacity to repay debt.

Risk Rating 9: Loss
A credit that is considered to be currently uncollectible or of such little value that it is no longer a viable Bank asset is risk rated 9. Losses are taken in the accounting period in which the credit is determined to be uncollectible. Taking a loss does not mean that a credit has absolutely no recovery or salvage value but, rather, it is not practical or desirable to defer writing off the credit, even though partial recovery may occur in the future.

The following tables show Banner's portfolio of risk-rated loans and non-risk-rated loans by grade or other characteristic as of December 31, 2019 and 2018 (in thousands):

| | December 31, 2019 | | | | | |
|---|---|---|---|---|---|---|
| By class: | Pass (Risk Ratings 1-5)[1] | Special Mention | Substandard | Doubtful | Loss | Total Loans |
| Commercial real estate: | | | | | | |
| Owner-occupied | $ 1,546,649 | $ 4,198 | $ 29,803 | $ — | $ — | $ 1,580,650 |
| Investment properties | 2,288,785 | 2,193 | 18,243 | — | — | 2,309,221 |
| Multifamily real estate | 472,856 | — | 296 | — | — | 473,152 |
| Commercial construction | 198,986 | — | 11,682 | — | — | 210,668 |
| Multifamily construction | 233,610 | — | — | — | — | 233,610 |
| One- to four-family construction | 530,307 | 12,534 | 1,467 | — | — | 544,308 |
| Land and land development: | | | | | | |
| Residential | 154,348 | — | 340 | — | — | 154,688 |
| Commercial | 26,256 | — | 34 | — | — | 26,290 |
| Commercial business | 1,627,170 | 31,012 | 35,584 | 58 | — | 1,693,824 |
| Agricultural business, including secured by farmland | 352,408 | 10,840 | 7,301 | — | — | 370,549 |
| One- to four-family residential | 940,424 | 409 | 4,789 | — | — | 945,622 |
| Consumer: | | | | | | |
| Consumer secured by one- to four-family | 547,388 | — | 3,572 | — | — | 550,960 |
| Consumer—other | 211,475 | 3 | 337 | — | — | 211,815 |
| Total | $ 9,130,662 | $ 61,189 | $ 113,448 | $ 58 | $ — | $ 9,305,357 |

| By class: | December 31, 2018 | | | | | |
|---|---|---|---|---|---|---|
| | Pass (Risk Ratings 1-5)[1] | Special Mention | Substandard | Doubtful | Loss | Total Loans |
| Commercial real estate: | | | | | | |
| Owner-occupied | $ 1,396,721 | $ 6,963 | $ 26,413 | $ — | $ — | $ 1,430,097 |
| Investment properties | 2,122,621 | — | 8,438 | — | — | 2,131,059 |
| Multifamily real estate | 368,262 | — | 574 | — | — | 368,836 |
| Commercial construction | 159,167 | 11,816 | 1,427 | — | — | 172,410 |
| Multifamily construction | 184,630 | — | — | — | — | 184,630 |
| One- to four-family construction | 533,759 | — | 919 | — | — | 534,678 |
| Land and land development: | | | | | | |
| Residential | 187,710 | — | 798 | — | — | 188,508 |
| Commercial | 27,200 | — | 78 | — | — | 27,278 |
| Commercial business | 1,436,733 | 7,661 | 39,133 | 87 | — | 1,483,614 |
| Agricultural business, including secured by farmland | 392,318 | 4,214 | 8,341 | — | — | 404,873 |
| One- to four-family residential | 969,011 | 499 | 4,106 | — | — | 973,616 |
| Consumer: | | | | | | |
| Consumer secured by one- to four-family | 564,001 | — | 4,978 | — | — | 568,979 |
| Consumer—other | 215,706 | 9 | 302 | — | — | 216,017 |
| Total | $ 8,557,839 | $ 31,162 | $ 95,507 | $ 87 | $ — | $ 8,684,595 |

(1) The Pass category includes some performing loans that are part of homogeneous pools which are not individually risk-rated. This includes all consumer loans, all one- to four-family residential loans and, as of December 31, 2019 and 2018, in the commercial business category, $764.6 million and $590.9 million, respectively, of credit-scored small business loans. As loans in these homogeneous pools become non-accrual, they are individually risk-rated.

The following tables provide additional detail on the age analysis of Banner's past due loans as of December 31, 2019 and 2018 (in thousands):

| | December 31, 2019 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 30–59 Days Past Due | 60–89 Days Past Due | 90 Days or More Past Due | Total Past Due | Purchased Credit-Impaired | Current | Total Loans | Loans 90 Days or More Past Due and Accruing | Non-accrual |
| Commercial real estate: | | | | | | | | | |
| Owner-occupied | $ 486 | $ 1,246 | $ 2,889 | $ 4,621 | $ 8,578 | $ 1,567,451 | $ 1,580,650 | $ 89 | $ 4,069 |
| Investment properties | — | 260 | 1,883 | 2,143 | 6,345 | 2,300,733 | 2,309,221 | — | 1,883 |
| Multifamily real estate | 239 | 91 | — | 330 | 7 | 472,815 | 473,152 | — | 85 |
| Commercial construction | 1,397 | — | 98 | 1,495 | — | 209,173 | 210,668 | — | 98 |
| Multifamily construction | — | — | — | — | — | 233,610 | 233,610 | — | — |
| One- to four-family construction | 3,212 | — | 1,799 | 5,011 | — | 539,297 | 544,308 | 332 | 1,467 |
| Land and land development: | | | | | | | | | |
| Residential | — | — | 340 | 340 | — | 154,348 | 154,688 | — | 340 |
| Commercial | — | — | — | — | — | 26,290 | 26,290 | — | — |
| Commercial business | 2,343 | 1,583 | 3,412 | 7,338 | 368 | 1,686,118 | 1,693,824 | 401 | 23,015 |
| Agricultural business/farmland | 1,972 | 129 | 584 | 2,685 | 393 | 367,471 | 370,549 | — | 661 |
| One- to four-family residential | 3,777 | 1,088 | 2,876 | 7,741 | 74 | 937,807 | 945,622 | 877 | 3,410 |
| Consumer: | | | | | | | | | |
| Consumer secured by one- to four-family | 1,174 | 327 | 1,846 | 3,347 | 110 | 547,503 | 550,960 | 398 | 2,314 |
| Consumer—other | 350 | 161 | — | 511 | 63 | 211,241 | 211,815 | — | 159 |
| Total | $ 14,950 | $ 4,885 | $ 15,727 | $ 35,562 | $ 15,938 | $ 9,253,857 | $ 9,305,357 | $ 2,097 | $ 37,501 |

| | December 31, 2018 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 30–59 Days Past Due | 60–89 Days Past Due | 90 Days or More Past Due | Total Past Due | Purchased Credit-Impaired | Current | Total Loans | Loans 90 Days or More Past Due and Accruing | Non-accrual |
| Commercial real estate: | | | | | | | | | |
| Owner-occupied | $ 785 | $ 519 | $ 2,223 | $ 3,527 | $ 8,531 | $ 1,418,039 | $ 1,430,097 | $ — | $ 2,768 |
| Investment properties | 91 | 498 | 934 | 1,523 | 3,462 | 2,126,074 | 2,131,059 | — | 1,320 |
| Multifamily real estate | 317 | — | — | 317 | 138 | 368,381 | 368,836 | — | — |
| Commercial construction | — | — | 1,427 | 1,427 | — | 170,983 | 172,410 | — | 1,427 |
| Multifamily construction | — | — | — | — | — | 184,630 | 184,630 | — | — |
| One- to four-family construction | 4,781 | 1,078 | 919 | 6,778 | 137 | 527,763 | 534,678 | — | 919 |
| Land and land development: | | | | | | | | | |
| Residential | 450 | — | 798 | 1,248 | — | 187,260 | 188,508 | — | 798 |
| Commercial | 34 | — | 44 | 78 | — | 27,200 | 27,278 | — | 44 |
| Commercial business | 3,982 | 1,305 | 1,756 | 7,043 | 1,028 | 1,475,543 | 1,483,614 | 1 | 2,936 |
| Agricultural business/farmland | 343 | 1,518 | 1,601 | 3,462 | 493 | 400,918 | 404,873 | — | 1,751 |
| One- to four-family residential | 5,440 | 1,790 | 1,657 | 8,887 | 101 | 964,628 | 973,616 | 658 | 1,544 |
| Consumer: | | | | | | | | | |
| Consumer secured by one- to four-family | 1,136 | 765 | 706 | 2,607 | 432 | 565,940 | 568,979 | 238 | 1,201 |
| Consumer—other | 911 | 385 | 9 | 1,305 | 91 | 214,621 | 216,017 | 9 | 40 |
| Total | $ 18,270 | $ 7,858 | $ 12,074 | $ 38,202 | $ 14,413 | $ 8,631,980 | $ 8,684,595 | $ 906 | $ 14,748 |

The following tables provide additional information on the allowance for loan losses and loan balances individually and collectively evaluated for impairment at or for the year ended December 31, 2019 (in thousands):

| | For the Year Ended December 31, 2019 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Commercial Real Estate | Multifamily Real Estate | Construction and Land | Commercial Business | Agricultural Business | One- to Four-Family Residential | Consumer | Unallocated | Total |
| Allowance for loan losses: | | | | | | | | | |
| Beginning balance | $ 27,132 | $ 3,818 | $ 24,442 | $ 19,438 | $ 3,778 | $ 4,714 | $ 7,972 | $ 5,191 | $ 96,485 |
| Provision/(recapture) for loan losses | 4,121 | 936 | (1,611) | 7,478 | 1,206 | (1,053) | 1,722 | (2,799) | 10,000 |
| Recoveries | 476 | — | 208 | 625 | 47 | 561 | 548 | — | 2,465 |
| Charge-offs | (1,138) | — | (45) | (4,171) | (911) | (86) | (2,040) | — | (8,391) |
| Ending balance | $ 30,591 | $ 4,754 | $ 22,994 | $ 23,370 | $ 4,120 | $ 4,136 | $ 8,202 | $ 2,392 | $ 100,559 |

| | December 31, 2019 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Commercial Real Estate | Multifamily Real Estate | Construction and Land | Commercial Business | Agricultural Business | One- to Four-Family Residential | Consumer | Unallocated | Total |
| Allowance individually evaluated for impairment | $ 58 | $ — | $ — | $ 4,128 | $ 141 | $ 41 | $ 6 | $ — | $ 4,374 |
| Allowance collectively evaluated for impairment | 30,533 | 4,754 | 22,994 | 19,224 | 3,919 | 4,095 | 8,196 | 2,392 | 96,107 |
| Allowance for purchased credit-impaired loans | — | — | — | 18 | 60 | — | — | — | 78 |
| Total allowance for loan losses | $ 30,591 | $ 4,754 | $ 22,994 | $ 23,370 | $ 4,120 | $ 4,136 | $ 8,202 | $ 2,392 | $ 100,559 |

| | December 31, 2019 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Commercial Real Estate | Multifamily Real Estate | Construction and Land | Commercial Business | Agricultural Business | One- to Four-Family Residential | Consumer | Unallocated | Total |
| Loan balances: | | | | | | | | | |
| Loans individually evaluated for impairment | $ 4,738 | $ — | $ 1,467 | $ 19,331 | $ 2,243 | $ 4,390 | $ 235 | $ — | $ 32,404 |
| Loans collectively evaluated for impairment | 3,870,210 | 473,145 | 1,168,097 | 1,674,125 | 367,913 | 941,158 | 762,367 | — | 9,257,015 |
| Purchased credit-impaired loans | 14,923 | 7 | — | 368 | 393 | 74 | 173 | — | 15,938 |
| Total loans | $ 3,889,871 | $ 473,152 | $ 1,169,564 | $ 1,693,824 | $ 370,549 | $ 945,622 | $ 762,775 | $ — | $ 9,305,357 |

The following tables provide additional information on the allowance for loan losses and loan balances individually and collectively evaluated for impairment at or for the year ended December 31, 2018 (in thousands):

| | For the Year Ended December 31, 2018 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Commercial Real Estate | Multifamily Real Estate | Construction and Land | Commercial Business | Agricultural Business | One- to Four-Family Residential | Consumer | Unallocated | Total |
| Allowance for loan losses: | | | | | | | | | |
| Beginning balance | $ 22,824 | $ 1,633 | $ 27,568 | $ 18,311 | $ 4,053 | $ 2,055 | $ 3,866 | $ 8,718 | $ 89,028 |
| Provision/(recapture) for loan losses | 3,063 | 2,185 | (2,860) | 2,129 | 417 | 1,952 | 5,141 | (3,527) | 8,500 |
| Recoveries | 1,646 | — | 213 | 1,049 | 64 | 750 | 366 | — | 4,088 |
| Charge-offs | (401) | — | (479) | (2,051) | (756) | (43) | (1,401) | — | (5,131) |
| Ending balance | $ 27,132 | $ 3,818 | $ 24,442 | $ 19,438 | $ 3,778 | $ 4,714 | $ 7,972 | $ 5,191 | $ 96,485 |

| | December 31, 2018 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Commercial Real Estate | Multifamily Real Estate | Construction and Land | Commercial Business | Agricultural Business | One- to Four-Family Residential | Consumer | Unallocated | Total |
| Allowance individually evaluated for impairment | $ 246 | $ — | $ — | $ 16 | $ 96 | $ 51 | $ 7 | $ — | $ 416 |
| Allowance collectively evaluated for impairment | 26,886 | 3,818 | 24,442 | 19,399 | 3,622 | 4,663 | 7,965 | 5,191 | 95,986 |
| Allowance for purchased credit-impaired loans | — | — | — | 23 | 60 | — | — | — | 83 |
| Total allowance for loan losses | $ 27,132 | $ 3,818 | $ 24,442 | $ 19,438 | $ 3,778 | $ 4,714 | $ 7,972 | $ 5,191 | $ 96,485 |

| | December 31, 2018 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Commercial Real Estate | Multifamily Real Estate | Construction and Land | Commercial Business | Agricultural Business | One- to Four-Family Residential | Consumer | Unallocated | Total |
| Loan balances: | | | | | | | | | |
| Loans individually evaluated for impairment | $ 8,625 | $ — | $ 3,096 | $ 391 | $ 3,298 | $ 4,469 | $ 196 | $ — | $ 20,075 |
| Loans collectively evaluated for impairment | 3,540,538 | 368,698 | 1,104,271 | 1,482,195 | 401,082 | 969,046 | 784,277 | — | 8,650,107 |
| Purchased credit-impaired loans | 11,993 | 138 | 137 | 1,028 | 493 | 101 | 523 | — | 14,413 |
| Total loans | $ 3,561,156 | $ 368,836 | $ 1,107,504 | $ 1,483,614 | $ 404,873 | $ 973,616 | $ 784,996 | $ — | $ 8,684,595 |

The following table provides additional information on the allowance for loan losses for the year ended December 31, 2017 (in thousands):

| | For the Year Ended December 31, 2017 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Commercial Real Estate | Multifamily Real Estate | Construction and Land | Commercial Business | Agricultural Business | One- to Four-Family Residential | Consumer | Unallocated | Total |
| Allowance for loan losses: | | | | | | | | | |
| Beginning balance | $ 20,993 | $ 1,360 | $ 34,252 | $ 16,533 | $ 2,967 | $ 2,238 | $ 4,104 | $ 3,550 | $ 85,997 |
| Provision/(recapture) for loan losses | 2,639 | 262 | (7,921) | 4,355 | 3,326 | (415) | 586 | 5,168 | 8,000 |
| Recoveries | 372 | 11 | 1,237 | 1,226 | 134 | 270 | 481 | — | 3,731 |
| Charge-offs | (1,180) | — | — | (3,803) | (2,374) | (38) | (1,305) | — | (8,700) |
| Ending balance | $ 22,824 | $ 1,633 | $ 27,568 | $ 18,311 | $ 4,053 | $ 2,055 | $ 3,866 | $ 8,718 | $ 89,028 |

**Note 6: REAL ESTATE OWNED, HELD FOR SALE, NET**

The following table presents the changes in REO, net of valuation allowance, for the years ended December 31, 2019, 2018 and 2017 (in thousands):

| | Years Ended December 31 | | |
|---|---|---|---|
| | **2019** | 2018 | 2017 |
| Balance, beginning of period | $ 2,611 | $ 360 | $ 11,081 |
| Additions from loan foreclosures | 109 | 641 | 46 |
| Additions from capitalized costs | — | — | 54 |
| Additions from acquisitions | 650 | 2,593 | — |
| Proceeds from dispositions of REO | (2,588) | (838) | (13,474) |
| Gain on sale of REO | 32 | 242 | 2,909 |
| Valuation adjustments in the period | — | (387) | (256) |
| Balance, end of period | $ 814 | $ 2,611 | $ 360 |

The Company had $48,000 of foreclosed residential real estate properties held as REO at December 31, 2019 and had no foreclosed residential real estate properties held as REO at December 31, 2018. The recorded investment in one- to four-family residential loans in the process of foreclosure was $1.5 million at December 31, 2019 and $1.2 million at December 31, 2018.

**Note 7: PROPERTY AND EQUIPMENT, NET**

Land, buildings and equipment owned by the Company and its subsidiaries at December 31, 2019 and 2018 are summarized as follows (in thousands):

| | December 31 | |
|---|---|---|
| | **2019** | 2018 |
| Land[(1)] | $ 34,841 | $ 37,835 |
| Buildings and leasehold improvements[(1)] | 169,272 | 163,813 |
| Furniture and equipment | 123,851 | 122,614 |
| | 327,964 | 324,262 |
| Less accumulated depreciation | (149,956) | (152,453) |
| Property and equipment, net | $ 178,008 | $ 171,809 |

(1) The Company had $1.5 million and $557,000 of properties held for sale that were included in land and buildings at December 31, 2019 and 2018, respectively.

The Company's depreciation expense related to property and equipment was $17.3 million, $15.2 million, and $14.7 million for the years ended December 31, 2019, 2018 and 2017, respectively. The Company's rental expense was $17.3 million, $17.2 million, and $16.4 million for the years ended December 31, 2019, 2018 and 2017, respectively.

**Note 8: DEPOSITS**

Deposits consist of the following at December 31, 2019 and 2018 (in thousands):

| | December 31 | |
|---|---|---|
| | **2019** | 2018 |
| Non-interest-bearing checking | $ 3,945,000 | $ 3,657,817 |
| Interest-bearing checking | 1,280,003 | 1,191,016 |
| Regular savings accounts | 1,934,041 | 1,842,581 |
| Money market accounts | 1,769,194 | 1,465,369 |
| Total interest-bearing transaction and savings accounts | 4,983,238 | 4,498,966 |
| Certificates of deposit: | | |
| Certificates of deposit less than or equal to $250,000 | 936,940 | 1,143,303 |
| Certificates of deposit greater than $250,000 | 183,463 | 176,962 |
| Total certificates of deposit[(1)] | 1,120,403 | 1,320,265 |
| Total deposits | $ 10,048,641 | $ 9,477,048 |
| Included in total deposits: | | |
| Public fund transaction accounts | $ 244,418 | $ 217,401 |
| Public fund interest-bearing certificates | 35,184 | 30,089 |
| Total public deposits | $ 279,602 | $ 247,490 |
| Total brokered deposits | $ 202,884 | $ 377,347 |

(1) Certificates of deposit included $269,000 of acquisition discounts at December 31, 2019 and $563,000 of acquisition premiums at December 31, 2018.

Deposits at December 31, 2019 and 2018 included deposits from the Company's directors, executive officers and related entities totaling $7.9 million and $8.3 million, respectively. At December 31, 2019 and 2018, the Company had certificates of deposit of $189.0 million and $180.5 million, respectively, that were equal to or greater than $250,000.

Scheduled maturities and weighted average interest rates of certificates of deposits at December 31, 2019 are as follows (dollars in thousands):

| | **December 31, 2019** | |
|---|---|---|
| | Amount | Weighted Average Rate |
| Maturing in one year or less | $ 846,941 | 1.28% |
| Maturing after one year through two years | 167,857 | 1.77 |
| Maturing after two years through three years | 79,422 | 1.97 |
| Maturing after three years through four years | 11,374 | 1.75 |
| Maturing after four years through five years | 12,561 | 2.23 |
| Maturing after five years | 2,248 | 1.18 |
| Total certificates of deposit | $ 1,120,403 | 1.43% |

**Note 9: ADVANCES FROM FEDERAL HOME LOAN BANK OF DES MOINES**

Utilizing a blanket pledge, qualifying loans receivable at December 31, 2019 and 2018, were pledged as security for FHLB borrowings and there were no securities pledged as collateral as of December 31, 2019 or 2018. At December 31, 2019 and 2018, FHLB advances were scheduled to mature as follows (in thousands):

| | At or for the Years Ended December 31 | | | |
|---|---|---|---|---|
| | **2019** | | 2018 | |
| | Amount | Weighted Average Rate | Amount | Weighted Average Rate |
| Maturing in one year or less | $ 300,000 | 1.84% | $ 540,000 | 2.64% |
| Maturing after one year through three years | 150,000 | 2.58 | — | — |
| Maturing after three years through five years | — | — | — | — |
| Maturing after five years | — | — | 189 | 5.94 |
| Total FHLB advances | $ 450,000 | 2.09% | $ 540,189 | 2.64% |

The maximum amount outstanding from the FHLB advances at any month end for the years ended December 31, 2019 and 2018 was $666.0 million and $540.2 million, respectively. The average FHLB advances balance outstanding for the years ended December 31, 2019 and 2018 was $477.8 million and $253.7 million, respectively. The average contractual interest rate on the FHLB advances for the years ended December 31, 2019 and 2018 was 2.56% and 2.22%, respectively. As of December 31, 2019, Banner Bank has established a borrowing line with the FHLB to borrow up to 45% of its total assets, contingent on having sufficient qualifying collateral and ownership of FHLB stock. Islanders Bank similarly may borrow up to 45% of its total assets, also contingent on collateral and FHLB stock. At December 31, 2019, the maximum total FHLB credit line was $5.31 billion and $132.7 million for Banner Bank and Islanders Bank, respectively.

**Note 10: OTHER BORROWINGS**

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

*Repurchase Agreements:* At December 31, 2019, retail repurchase agreements carry interest rates ranging from 0.15% to 1.50%. These repurchase agreements are secured by the pledge of certain mortgage-backed and agency securities with a carrying value of $135.5 million. Banner Bank has the right to pledge or sell these securities, but it must replace them with substantially the same securities. Banner Bank had no borrowings under wholesale repurchase agreements at December 31, 2019 or December 31, 2018.

*Federal Reserve Bank of San Francisco and Other Borrowings:* Banner Bank periodically borrows funds on an overnight basis from the Federal Reserve Bank through the Borrower-In-Custody program. Such borrowings are secured by a pledge of eligible loans. At December 31, 2019, based upon available unencumbered collateral, Banner Bank was eligible to borrow $1.19 billion from the Federal Reserve Bank, although, at that date, as well as at December 31, 2018, Banner Bank had no funds borrowed under this or other borrowing arrangements.

At December 31, 2019, Banner Bank had uncommitted federal funds lines of credit agreements with other financial institutions totaling $110.0 million, while Islanders Bank had an uncommitted federal funds line of credit agreement with another financial institution totaling $5.0 million. No balances were outstanding under these agreements as of December 31, 2019 and 2018. Availability of lines is subject to federal funds balances available for loan and continued borrower eligibility. These lines are intended to support short-term liquidity needs and the agreements may restrict consecutive day usage.

A summary of all other borrowings at December 31, 2019 and 2018 by the period remaining to maturity is as follows (dollars in thousands):

| | At or for the Years Ended December 31 | | | |
|---|---|---|---|---|
| | **2019** | | 2018 | |
| | Amount | Weighted Average Rate | Amount | Weighted Average Rate |
| Repurchase agreements: | | | | |
| Maturing in one year or less | $ 118,474 | 0.35% | $ 118,995 | 0.21% |
| Maturing after one year through two years | — | — | — | — |
| Maturing after two years | — | — | — | — |
| Total year-end outstanding | $ 118,474 | 0.35% | $ 118,995 | 0.21% |
| Average outstanding | $ 121,771 | 0.27% | $ 108,065 | 0.21% |
| Maximum outstanding at any month-end | $ 124,415 | n/a | $ 121,766 | n/a |

## NOTE 11: JUNIOR SUBORDINATED DEBENTURES AND MANDATORILY REDEEMABLE TRUST PREFERRED SECURITIES

At December 31, 2019, the Company had ten wholly-owned subsidiary grantor trusts (the Trusts), which had issued $143.5 million of TPS to third parties, as well as $4.4 million of common capital securities, carried among other assets, which were issued to the Company. TPS and common capital securities accrue and pay distributions periodically at specified annual rates as provided in the indentures. The Trusts used the proceeds from the offerings to purchase a like amount of junior subordinated debentures (the Debentures) of the Company. The Debentures are the sole assets of the Trusts. The Company's obligations under the debentures and related documents, taken together, constitute a full and unconditional guarantee by the Company of the obligations of the Trusts. The TPS are mandatorily redeemable upon the maturity of the Debentures, or upon earlier redemption as provided in the indentures. The Company has the right to redeem the Debentures in whole on or after specific dates, at a redemption price specified in the indentures plus any accrued but unpaid interest to the redemption date. All of the TPS issued by the Trusts qualified as Tier 1 capital as of December 31, 2019. At December 31, 2019, the Trusts comprised $143.5 million, or 10.3% of the Company's total risk-based capital.

The following table is a summary of trust preferred securities at December 31, 2019 (dollars in thousands):

| Name of Trust | Aggregate Liquidation Amount of Trust Preferred Securities | Aggregate Liquidation Amount of Common Capital Securities | Aggregate Principal Amount of Junior Subordinated Debentures | Stated Maturity [1] | Current Interest Rate | Reset Period | Interest Rate Spread |
|---|---|---|---|---|---|---|---|
| Banner Capital Trust II | $ 15,000 | $ 464 | $ 15,464 | 2033 | 5.34% | Quarterly | Three-month LIBOR + 3.35% |
| Banner Capital Trust III | 15,000 | 465 | 15,465 | 2033 | 4.89 | Quarterly | Three-month LIBOR + 2.90% |
| Banner Capital Trust IV | 15,000 | 465 | 15,465 | 2034 | 4.84 | Quarterly | Three-month LIBOR + 2.85% |
| Banner Capital Trust V | 25,000 | 774 | 25,774 | 2035 | 3.48 | Quarterly | Three-month LIBOR + 1.57% |
| Banner Capital Trust VI | 25,000 | 774 | 25,774 | 2037 | 3.30 | Quarterly | Three-month LIBOR + 1.62% |
| Banner Capital Trust VII | 25,000 | 774 | 25,774 | 2037 | 3.48 | Quarterly | Three-month LIBOR + 1.38% |
| Siuslaw Statutory Trust I | 8,000 | 248 | 8,248 | 2034 | 4.60 | Quarterly | Three-month LIBOR + 2.70% |
| Greater Sacramento Bancorp Statutory Trust I | 4,000 | 124 | 4,124 | 2033 | 5.34 | Quarterly | Three-month LIBOR + 3.35% |
| Greater Sacramento Bancorp Statutory Trust II | 4,000 | 124 | 4,124 | 2035 | 3.57 | Quarterly | Three-month LIBOR + 1.68% |
| Mission Oaks Statutory Trust I | 7,500 | 232 | 7,732 | 2036 | 3.54 | Quarterly | Three-month LIBOR + 1.65% |
| Total TPS liability at par | $ 143,500 | $ 4,444 | 147,944 | | 4.05% | | |
| Fair value adjustment[2] | | | (28,640) | | | | |
| Total TPS liability at fair value[2] | | | $ 119,304 | | | | |

(1) All of the Company's trust preferred securities are eligible for redemption.
(2) The Company has elected to use fair value accounting on its TPS.

**Note 12: INCOME TAXES**

The following table presents the components of the provision for income taxes included in the Consolidated Statements of Operations for the years ended December 31, 2019, 2018 and 2017 (in thousands):

| | Years Ended December 31 | | |
|---|---|---|---|
| | **2019** | 2018 | 2017 |
| Current | | | |
| Federal | $ 25,278 | $ 21,869 | $ 30,961 |
| State | 2,494 | 4,130 | 3,085 |
| Total Current | 27,772 | 25,999 | 34,046 |
| Deferred | | | |
| Federal | 7,738 | 2,021 | 58,646 |
| State | 1,344 | 575 | (2,204) |
| Total Deferred | 9,082 | 2,596 | 56,442 |
| Provision for income taxes | $ 36,854 | $ 28,595 | $ 90,488 |

The following table presents the reconciliation of the federal statutory rate to the actual effective rate for the years ended December 31, 2019, 2018 and 2017:

| | Years Ended December 31 | | |
|---|---|---|---|
| | **2019** | 2018 | 2017 |
| Federal income tax statutory rate | 21.0% | 21.0% | 35.0% |
| Increase (decrease) in tax rate due to: | | | |
| Tax-exempt interest | (2.2) | (2.0) | (2.6) |
| Investment in life insurance | (0.5) | (0.6) | (1.1) |
| State income taxes, net of federal tax offset | 2.0 | 2.3 | 2.0 |
| Tax credits | (1.2) | (0.8) | (0.6) |
| Merger and acquisition costs | 0.1 | 0.1 | — |
| Valuation reserve release | — | (2.5) | — |
| Federal law change | — | — | 28.2 |
| State audits and amended returns | (0.5) | — | — |
| Other | 1.4 | (0.2) | (1.1) |
| Effective income tax rate | 20.1% | 17.3% | 59.8% |

The following table reflects the effect of temporary differences that gave rise to the components of the net deferred tax asset as of December 31, 2019 and 2018 (in thousands):

| | December 31 | |
|---|---|---|
| | **2019** | 2018 |
| Deferred tax assets: | | |
| Loan loss and REO | $ 24,285 | $ 24,156 |
| Deferred compensation | 17,470 | 15,991 |
| Net operating loss carryforward | 32,093 | 37,828 |
| Federal and state tax credits | 7,517 | 7,614 |
| State net operating losses | 5,632 | 6,105 |
| Loan discount | 5,466 | 5,756 |
| Lease liability | 15,485 | — |
| Unrealized loss on securities - available for sale | 349 | 983 |
| Total deferred tax assets | 108,297 | 98,433 |
| Deferred tax liabilities: | | |
| Depreciation | (5,373) | (3,771) |
| Deferred loan fees, servicing rights and loan origination costs | (11,525) | (10,197) |
| Intangibles | (7,756) | (8,428) |
| Right of use asset | (14,531) | — |
| Financial instruments accounted for under fair value accounting | (1,143) | (833) |
| Other | (8,146) | — |
| Total deferred tax liabilities | (48,474) | (23,229) |
| Deferred income tax asset | 59,823 | 75,204 |
| Valuation allowance | (184) | (184) |
| Deferred tax asset, net | $ 59,639 | $ 75,020 |

Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recognized or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period of enactment. In December 2017, the federal government enacted the Tax Cuts and Jobs Act (2017 Tax Act). Among other provisions, the 2017 Tax Act reduced the federal marginal corporate income tax rate from 35% to 21%. As a result of the passage of the 2017 Tax Act, the Company recorded a $42.6 million charge for the revaluation of its net deferred tax asset to account for the future impact of the decrease in the corporate income tax rate and other provisions of the legislation. The charge was recorded as an increase to tax expense and reduction of the net deferred tax asset for the year ended December 31, 2017. The $42.6 million charge recorded by the Company included $4.2 million of provisional income tax expense related to AMT credits that are limited under Section 382 of the Code, which resulted in a reduction in the AMT deferred tax asset. The adjustments to deferred tax assets and receivables related to the refundable nature of AMT credits were provisional amounts estimated based on information available as of December 31, 2017. During 2018, the Company determined the Section 382 alternative minimum tax credits carried forward indefinitely and therefore released the provisional $4.2 million valuation reserve recorded in 2017 against the tax credits. The release was recorded as a reduction to current tax expense and an increase to the net deferred tax assets.

At December 31, 2019, the Company has federal net operating loss carryforwards of approximately $152.8 million. The Company also has $80.1 million of state net operating loss carryforwards, against which the Company has established a $184,000 valuation reserve. The federal and state net operating losses will expire, if unused, by the end of 2034. The Company has federal general business credit carryforwards at December 31, 2019 of $3.3 million, which will expire, if unused, by the end of 2031. The Company also has federal alternative minimum tax credit carryforwards of $4.2 million, which are available to reduce future federal regular income taxes, if any, over an indefinite period. At December 31, 2018, the Company had federal and state net operating loss carryforwards of approximately $180.1 million and $86.8 million, respectively, and federal general business credits carryforwards of $3.4 million. At that same date, the Company also had federal alternative minimum tax credit carryforwards of approximately $4.2 million.

As a consequence of our 2015 acquisition of Starbuck Bancshares, Inc., the Company experienced a change in control within the meaning of Section 382 of the Code. In addition, the underlying Section 382 limitations at Starbuck Bancshares, Inc.'s level continue to apply to the Company. Section 382 limits the ability of a corporate taxpayer to use net operating loss carryforwards, general business credits, and recognized built-in-losses, on an annual basis, incurred prior to the change in control against income earned after the change in control. As a result of the Section 382 limitations, the Company is limited to utilizing $21.5 million on an annual basis (after the application of the Section 382 limitations carried over from Starbuck Bancshares, Inc.) of federal net operating loss carryforwards, general business credits, and recognized built-in losses. The applicable state Section 382 limitations range from $525,000 to $21.5 million. In 2017, the Company established a $184,000 valuation reserve against the portion of its various state net operating loss carryforwards and tax credits that it believed it is more likely than not that it would not realize the benefit because the application of the Section 382 limitations at the state level is based on future apportionment rates. For non-Section 382 limited alternative minimum tax credits, there is a five year carryover period.

As a consequence of Banner's capital raise in June 2010, the Company experienced a change in control within the meaning of Section 382 of the Code. As a result of the Section 382 limitations, the Company is limited to utilizing $6.9 million of net operating loss carryforwards which existed prior to the acquisition of Starbuck Bancshares, Inc., on an annual basis. Based on its analysis, the Company believes it is more likely than not that the June 2010 change in control will not impact its ability to utilize all of the related available net operating loss carryforwards, general business credits, and recognized built-in-losses.

As a consequence of our 2019 acquisition of AltaPacific and AltaPacific Bank, the Company did not experience a change in control within the meaning of Section 382 of the Code. However, the underlying Section 382 limitations at AltaPacific and AltaPacific Bank level continue to apply to the Company. As a result of the Section 382 limitations, the Company is limited to utilizing $110,000 of the federal net operating loss carryovers and general business credits acquired from AltaPacific and AltaPacific Bank based on underlying limits carried over. Based on its analysis, the Company believes it is more likely than not that the Section 382 limitations will not impact its ability to utilize all of the related available net operating loss carryforwards and general business credits.

Retained earnings at December 31, 2019 and 2018 included approximately $5.4 million in tax basis bad debt reserves for which no income tax liability has been recorded. In the future, if this tax bad debt reserve is used for purposes other than to absorb bad debts or the Company no longer qualifies as a bank or is completely liquidated, the Company will incur a federal tax liability at the then-prevailing corporate tax rate, established as $1.1 million at December 31, 2019.

As of December 31, 2019, the Company had $275,000 of unrecognized tax benefits for uncertain tax positions compared to an insignificant amount as of December 31, 2018, none of which if recognized would materially affect the effective tax rate. The Company does not anticipate that the amount of unrecognized tax benefits will significantly increase or decrease in the next twelve months. The Company's policy is to recognize interest and penalties on unrecognized tax benefits in income tax expense. The amount of interest and penalties accrued for the years ended December 31, 2019, 2018 and 2017 is immaterial. The Company files consolidated income tax returns in Oregon, California, Utah, Montana and Idaho and for federal purposes. The Company is no longer subject to tax examination for tax years before 2016, except for Idaho for which it is no longer subject to examination for tax years before 2015.

*Tax credit investments:* The Company invests in low income housing tax credit funds that are designed to generate a return primarily through the realization of federal tax credits. The Company accounts for these investments by amortizing the cost of tax credit investments over the life of the investment using a proportional amortization method and tax credit investment amortization expense is a component of the provision for income taxes.

The following table presents the balances of the Company's tax credit investments and related unfunded commitments at December 31, 2019 and 2018 (in thousands):

| | **December 31, 2019** | December 31, 2018 |
|---|---|---|
| Tax credit investments | $ 29,620 | $ 17,360 |
| Unfunded commitments—tax credit investments | 20,235 | 12,726 |

The following table presents other information related to the Company's tax credit investments for the years ended December 31, 2019, 2018 and 2017 (in thousands):

| | For the years ended December 31, | | |
|---|---|---|---|
| | **2019** | 2018 | 2017 |
| Tax credits and other tax benefits recognized | $ 1,916 | $ 1,456 | $ 1,140 |
| Tax credit amortization expense included in provision for income taxes | 1,633 | 1,151 | 1,144 |

**Note 13: EMPLOYEE BENEFIT PLANS**

*Employee Retirement Plans:* Substantially all of the Company's and the Banks' employees are eligible to participate in its 401(k)/Profit Sharing Plan, a defined contribution and profit sharing plan sponsored by the Company. Employees may elect to have a portion of their salary contributed to the plan in conformity with Section 401(k) of the Internal Revenue Code. At the discretion of the Company's Board of Directors, the Company may elect to make matching and/or profit sharing contributions for the employees' benefit. For the years ended December 31, 2019, 2018 and 2017, $6.2 million, $5.4 million and $4.8 million, respectively, was expensed for 401(k) contributions. The Board of Directors has elected to make a 4% of eligible compensation matching contribution for 2020.

*Supplemental Retirement and Salary Continuation Plans:* Through the Banks, the Company is obligated under various non-qualified deferred compensation plans to help supplement the retirement income of certain executives, including certain retired executives, selected by resolution of

the Banks' Boards of Directors or in certain cases by the former directors of acquired banks. These plans are unfunded, include both defined benefit and defined contribution plans, and provide for payments after the executive's retirement. In the event of a participant employee's death prior to or during retirement, the Company is obligated to pay to the designated beneficiary the benefits set forth under the plan. For the years ended December 31, 2019, 2018 and 2017, expense recorded for supplemental retirement and salary continuation plan benefits totaled $3.4 million, $2.3 million, and $3.5 million, respectively. At December 31, 2019 and 2018, liabilities recorded for the various supplemental retirement and salary continuation plan benefits totaled $41.8 million and $37.5 million, respectively, and are recorded in a deferred compensation liability account.

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

In order to fund the plans' future obligations, the Company has purchased life insurance policies or other investments, including Banner Corporation common stock, which in certain instances are held in irrevocable trusts commonly referred to as "Rabbi Trusts." As the Company is the owner of the investments and the beneficiary of the insurance policies, and in order to reflect the Company's policy to pay benefits equal to the accumulations, the assets and liabilities are reflected in the Consolidated Statements of Financial Condition. Banner Corporation common stock held for such plans is reported as a contra-equity account and was recorded at an original cost of $7.5 million at December 31, 2019 and $7.3 million at December 31, 2018. At December 31, 2019 and 2018, liabilities recorded in connection with deferred compensation plan benefits totaled $10.9 million ($7.5 million in contra-equity) and $9.0 million ($7.3 million in contra-equity), respectively, and are recorded in deferred compensation or equity as appropriate.

The Banks have purchased, or acquired through mergers, life insurance policies in connection with the implementation of certain executive supplemental retirement, salary continuation and deferred compensation retirement plans, as well as additional policies not related to any specific plan. These policies provide protection against the adverse financial effects that could result from the death of a key employee and provide tax-exempt income to offset expenses associated with the plans. It is the Banks' intent to hold these policies as a long-term investment. However, there will be an income tax impact if the Banks choose to surrender certain policies. Although the lives of individual current or former management-level employees are insured, the Banks are the owners and sole or partial beneficiaries. At December 31, 2019 and 2018, the cash surrender value of these policies was $192.1 million and $177.5 million, respectively. The Banks are exposed to credit risk to the extent an insurance company is unable to fulfill its financial obligations under a policy. In order to mitigate this risk, the Banks use a variety of insurance companies and regularly monitor their financial condition.

## Note 14: STOCK-BASED COMPENSATION PLANS

The Company operates the following stock-based compensation plans as approved by its shareholders:

- 2014 Omnibus Incentive Plan (the 2014 Plan).
- 2018 Omnibus Incentive Plan (the 2018 Plan).

The purpose of these plans is to promote the success and enhance the value of the Company by providing a means for attracting and retaining highly skilled employees, officers and directors of Banner Corporation and its affiliates and linking their personal interests with those of the Company's shareholders. Under these plans the Company currently has outstanding restricted stock share grants and restricted stock unit grants.

### *2014 Omnibus Incentive Plan*

The 2014 Plan was approved by shareholders on April 22, 2014. The 2014 Plan provides for the grant of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, performance units, other stock-based awards and other cash awards, and provides for vesting requirements which may include time-based or performance-based conditions. The Company has reserved 900,000 shares of its common stock for issuance under the 2014 Plan in connection with the exercise of awards. As of December 31, 2019, 315,548 restricted stock shares and 382,872 restricted stock units have been granted under the 2014 Plan of which 246,310 restricted stock shares and 82,973 restricted stock units have vested.

### *2018 Omnibus Incentive Plan*

The 2018 Plan was approved by shareholders on April 24, 2018. The 2018 Plan provides for the grant of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, performance units, other stock-based awards and other cash awards, and provides for vesting requirements which may include time-based or performance-based conditions. The Company reserved 900,000 shares of common stock for issuance under the 2018 Plan in connection with the exercise of awards. As of December 31, 2019, no shares have been granted under the 2018 Plan.

The expense associated with all restricted stock and unit grants was $7.1 million, $6.6 million and $6.0 million respectively, for the years ended December 31, 2019, 2018 and 2017. Unrecognized compensation expense for these awards as of December 31, 2019 was $11.4 million and will be amortized over the next 36 months.

A summary of the Company's Restricted Stock/Unit award activity during the years ended December 31, 2019, 2018 and 2017 follows:

| | Shares/Units | Weighted Average Grant-Date Fair Value |
|---|---|---|
| Unvested at January 1, 2017 | 290,719 | $ 42.26 |
| Granted (41,318 non-voting) | 153,777 | 55.86 |
| Vested | (103,259) | 43.81 |
| Forfeited | (39,160) | 39.83 |
| Unvested at December 31, 2017 | 302,077 | 48.97 |
| Granted (159,541 non-voting) | 161,598 | 55.04 |
| Vested | (103,363) | 48.60 |
| Forfeited | (42,215) | 47.05 |
| Unvested at December 31, 2018 | 318,097 | 52.43 |
| Granted (All non-voting) | 227,262 | 53.50 |
| Vested | (120,675) | 50.23 |
| Forfeited | (41,812) | 46.25 |
| Unvested at **December 31, 2019** (1) | 382,872 | 54.39 |

(1) Includes 169 unvested restricted stock grants related to the 2012 Restricted Stock and Incentive Bonus Plan.

**Note 15: REGULATORY CAPITAL REQUIREMENTS**

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

The following table shows the regulatory capital ratios of the Company and the Banks and the minimum regulatory requirements (dollars in thousands):

| | Actual | | Minimum for Capital Adequacy Purposes | | Minimum to be Categorized as "Well-Capitalized" Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| **December 31, 2019:** | | | | | | |
| The Company—consolidated: | | | | | | |
| Total capital to risk-weighted assets | $ 1,386,483 | 12.93% | $ 857,546 | 8.00% | $ 1,071,933 | 10.00% |
| Tier 1 capital to risk-weighted assets | 1,283,208 | 11.97 | 643,160 | 6.00 | 643,160 | 6.00 |
| Tier 1 common equity to risk-weighted assets | 1,139,708 | 10.63 | 482,370 | 4.50 | n/a | n/a |
| Tier 1 capital to average leverage assets | 1,283,208 | 10.71 | 479,458 | 4.00 | n/a | n/a |
| Banner Bank: | | | | | | |
| Total capital to risk- weighted assets | 1,321,580 | 12.55 | 842,219 | 8.00 | 1,052,773 | 10.00 |
| Tier 1 capital to risk- weighted assets | 1,220,811 | 11.60 | 631,664 | 6.00 | 842,219 | 8.00 |
| Tier 1 common equity to risk-weighted assets | 1,220,811 | 11.60 | 473,748 | 4.50 | 684,303 | 6.50 |
| Tier 1 capital to average leverage assets | 1,220,811 | 10.45 | 467,330 | 4.00 | 584,163 | 5.00 |
| Islanders Bank: | | | | | | |
| Total capital to risk- weighted assets | 37,044 | 19.42 | 15,258 | 8.00 | 19,073 | 10.00 |
| Tier 1 capital to risk- weighted assets | 34,658 | 18.17 | 11,444 | 6.00 | 15,258 | 8.00 |
| Tier 1 common equity to risk-weighted assets | 34,658 | 18.17 | 8,583 | 4.50 | 12,397 | 6.50 |
| Tier 1 capital to average leverage assets | 34,658 | 11.66 | 11,887 | 4.00 | 14,859 | 5.00 |
| December 31, 2018: | | | | | | |
| The Company—consolidated: | | | | | | |
| Total capital to risk-weighted assets | $ 1,302,239 | 13.12% | $ 794,072 | 8.00% | $ 992,590 | 10.00% |
| Tier 1 capital to risk-weighted assets | 1,203,155 | 12.12 | 595,554 | 6.00 | 595,554 | 6.00 |
| Tier 1 common equity to risk-weighted assets | 1,067,155 | 10.75 | 446,665 | 4.50 | n/a | n/a |
| Tier 1 capital to average leverage assets | 1,203,155 | 10.98 | 438,379 | 4.00 | n/a | n/a |
| Banner Bank: | | | | | | |
| Total capital to risk- weighted assets | 1,217,173 | 12.50 | 778,766 | 8.00 | 973,457 | 10.00 |
| Tier 1 capital to risk- weighted assets | 1,120,523 | 11.51 | 584,074 | 6.00 | 778,766 | 8.00 |
| Tier 1 common equity to risk-weighted assets | 1,120,523 | 11.51 | 438,056 | 4.50 | 632,747 | 6.50 |
| Tier 1 capital to average leverage assets | 1,120,523 | 10.50 | 426,799 | 4.00 | 533,498 | 5.00 |
| Islanders Bank: | | | | | | |
| Total capital to risk- weighted assets | 34,567 | 18.26 | 15,142 | 8.00 | 18,928 | 10.00 |
| Tier 1 capital to risk- weighted assets | 32,200 | 17.01 | 11,357 | 6.00 | 15,142 | 8.00 |
| Tier 1 common equity to risk-weighted assets | 32,200 | 17.01 | 8,518 | 4.50 | 12,303 | 6.50 |
| Tier 1 capital to average leverage assets | 32,200 | 11.16 | 11,543 | 4.00 | 14,428 | 5.00 |

At December 31, 2019, Banner Corporation and the Banks each exceeded the requirements to be "well capitalized" and the fully phased-in capital conservation buffer requirement. There have been no conditions or events since December 31, 2019 that have materially adversely changed the Tier 1 or Tier 2 capital of the Company or the Banks. However, events beyond the control of the Banks, such as weak or depressed economic conditions in areas where the Banks have most of their loans, could adversely affect future earnings and, consequently, the ability of the Banks to meet their respective capital requirements. The Company may not declare or pay cash dividends on, or repurchase, any of its shares of common stock if the effect thereof would cause equity to be reduced below applicable regulatory capital maintenance requirements or if such declaration and payment would otherwise violate regulatory requirements.

Banner Corporation and the Banks are subject to minimum required ratios for common equity Tier 1 ("CET1") capital, Tier 1 capital, total capital and the leverage ratio and a required capital conservation buffer over the required capital ratios.

Under capital regulations, the minimum capital ratios are: (1) a CET1 capital ratio of 4.5% of risk-weighted assets; (2) a Tier 1 capital ratio of 6.0% of risk-weighted assets; (3) a total risk-based capital ratio of 8.0% of risk-weighted assets; and (4) a leverage ratio (the ratio of Tier 1 capital to average total consolidated assets) of 4.0%. CET1 generally consists of common stock; retained earnings; accumulated other comprehensive income ("AOCI") unless an institution elects to exclude AOCI from regulatory capital; and certain minority interests; all subject to applicable regulatory adjustments and deductions. Tier 1 capital generally consists of CET1 and noncumulative perpetual preferred stock. Tier 2 capital generally consists of other preferred stock and subordinated debt meeting certain conditions plus an amount of the allowance for loan and lease losses up to 1.25% of assets. Total capital is the sum of Tier 1 and Tier 2 capital.

For purposes of determining risk-based capital, assets and certain off-balance sheet items are risk-weighted from 0% to 1,250%, depending on the risk characteristics of the asset or item. The regulations include a 150% risk weight (up from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and for non-residential mortgage loans that are 90 days past due or otherwise in nonaccrual status; a 20% (up from 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable (up from 0%); and a 250% risk weight (up from 100%) for mortgage servicing and deferred tax assets that are not deducted from capital.

In addition to the minimum CET1, Tier 1, leverage ratio and total capital ratios, Banner and each of the Banks must maintain a capital conservation buffer consisting of additional CET1 capital greater than 2.5% of risk-weighted assets above the required minimum risk-based capital levels in order to avoid limitations on paying dividends, repurchasing shares, and paying discretionary bonuses.

**Note 16: GOODWILL, OTHER INTANGIBLE ASSETS AND MORTGAGE SERVICING RIGHTS**

*Goodwill and Other Intangible Assets:* At December 31, 2019, intangible assets are comprised of goodwill and CDI acquired in business combinations. Goodwill represents the excess of the purchase consideration paid over the fair value of the assets acquired, net of the fair values of liabilities assumed in a business combination, and is not amortized but is reviewed at least annually for impairment. Banner has identified one reporting unit for purposes of evaluating goodwill for impairment. At December 31, 2019, the Company completed a qualitative assessment of goodwill and concluded that it is more likely than not that the fair value of Banner, the reporting unit, exceeds the carrying value.

CDI represents the value of transaction-related deposits and the value of the customer relationships associated with the deposits. For the years ended December 31, 2018 and 2017 intangible assets also included favorable leasehold intangibles (LHI). LHI represented the value ascribed to leases assumed in an acquisition in which the lease terms are favorable compared to a market lease at the date of acquisition. LHI was reclassified to the right of use lease asset in connection with the adoption of Lease Topic 842 on January 1, 2019. The Company amortizes CDI assets over their estimated useful lives and reviews them at least annually for events or circumstances that could impair their value. The CDI assets shown in the table below represent the value ascribed to the long-term deposit relationships acquired in various bank acquisitions. These intangible assets are being amortized using an accelerated method over estimated useful lives of three years to ten years. The CDI assets are not estimated to have a significant residual value.

The following table summarizes the changes in the Company's goodwill, CDI and LHI for the years ended December 31, 2019, 2018 and 2017 (in thousands):

| | Goodwill | CDI | LHI | Total |
|---|---|---|---|---|
| Balance, January 1, 2017 | $ 244,583 | $ 29,701 | $ 461 | $ 274,745 |
| Amortization | — | (6,247) | (184) | (6,431) |
| Adjustments to goodwill[1] | (1,924) | (1,076) | — | (3,000) |
| Balance, December 31, 2017 | 242,659 | 22,378 | 277 | 265,314 |
| Additions through acquisition[2] | 96,495 | 16,368 | — | 112,863 |
| Amortization | — | (6,047) | (52) | (6,099) |
| Balance, December 31, 2018 | 339,154 | 32,699 | 225 | 372,078 |
| Additions through acquisition[3] | 33,967 | 4,610 | — | 38,577 |
| Amortization | — | (8,151) | — | (8,151) |
| Adjustments[4] | — | — | (225) | (225) |
| **Balance, December 31, 2019** | $ 373,121 | $ 29,158 | $ — | $ 402,279 |

(1) Acquired Goodwill and CDI were adjusted for the sale of the Utah branches in 2017.
(2) The additions to Goodwill and CDI in 2018 relate to the acquisition of Skagit.
(3) The additions to Goodwill and CDI in 2019 relate to the acquisition of AltaPacific.

(4) The adjustment to LHI represents a reclassification to the right-of-use lease asset in connection with the implementation of Lease Topic 842.

Estimated amortization expense in future years with respect to CDI as of December 31, 2019 (in thousands):

| Year ended: | Estimated Amortization |
|---|---|
| 2020 | $ 7,732 |
| 2021 | 6,571 |
| 2022 | 5,317 |
| 2023 | 3,814 |
| Thereafter | 5,724 |
| Net carrying amount | $ 29,158 |

Mortgage servicing rights are reported in other assets. Mortgage servicing rights are initially recognized at fair value and are amortized in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Mortgage servicing rights are subsequently evaluated for impairment based upon the fair value of the rights compared to the amortized cost (remaining unamortized initial fair value). If the fair value is less than the amortized cost, a valuation allowance is created through an impairment charge to servicing fee income. However, if the fair value is greater than the amortized cost, the amount above the amortized cost is not recognized in the carrying value. In 2019, 2018 and 2017, the Company did not record any impairment charges or recoveries against mortgage servicing rights. Unpaid principal balance of loans for which mortgage servicing rights have been recognized totaled $2.48 billion and $2.36 billion at December 31, 2019 and 2018, respectively. Custodial accounts maintained in connection with this servicing totaled $12.0 million and $11.1 million at December 31, 2019 and 2018, respectively.

An analysis of the mortgage servicing rights for the years ended December 31, 2019, 2018 and 2017 is presented below (in thousands):

| | Years Ended December 31 | | |
|---|---|---|---|
| | **2019** | 2018 | 2017 |
| Balance, beginning of the year | $ 14,638 | $ 14,738 | $ 15,249 |
| Amounts capitalized | 4,392 | 3,623 | 3,361 |
| Additions through purchase | 168 | 166 | 94 |
| Amortization [1] | (5,050) | (3,889) | (3,966) |
| Balance, end of the year [2] | $ 14,148 | $ 14,638 | $ 14,738 |

(1) Amortization of mortgage servicing rights is recorded as a reduction of loan servicing income and any unamortized balance is fully written off if the loan repays in full.

(2) There was no valuation allowance as of December 31, 2019 and 2018.

**Note 17: FAIR VALUE**

The following table presents estimated fair values of the Company's financial instruments as of December 31, 2019 and 2018, whether or not recognized or recorded in the Consolidated Statements of Financial Condition (in thousands):

| | | **December 31, 2019** | | December 31, 2018 | |
|---|---|---|---|---|---|
| | Level | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Assets: | | | | | |
| Cash and cash equivalents | 1 | $ 307,735 | $ 307,735 | $ 272,196 | $ 272,196 |
| Securities—trading | 2,3 | 25,636 | 25,636 | 25,896 | 25,896 |
| Securities—available-for-sale | 2 | 1,551,557 | 1,551,557 | 1,636,223 | 1,636,223 |
| Securities—held-to-maturity | 2 | 233,241 | 234,952 | 230,984 | 229,301 |
| Securities—held-to-maturity | 3 | 2,853 | 2,853 | 3,236 | 3,236 |
| Loans receivable held for sale | 2 | 210,447 | 210,670 | 171,031 | 171,157 |
| Loans receivable | 3 | 9,305,357 | 9,304,340 | 8,684,595 | 8,629,450 |
| FHLB stock | 3 | 28,342 | 28,342 | 31,955 | 31,955 |
| Bank-owned life insurance | 1 | 192,088 | 192,088 | 177,467 | 177,467 |
| Mortgage servicing rights | 3 | 14,148 | 22,611 | 14,638 | 25,813 |
| Equity securities | 1 | — | — | 352 | 352 |
| Derivatives: | | | | | |
| Interest rate swaps | 2 | 15,202 | 15,202 | 3,138 | 3,138 |
| Interest rate lock and forward sales commitments | 2,3 | 1,108 | 1,108 | 471 | 471 |
| Liabilities: | | | | | |
| Demand, interest-bearing checking and money market | 2 | 6,994,197 | 6,994,197 | 6,314,202 | 6,314,202 |
| Regular savings | 2 | 1,934,041 | 1,934,041 | 1,842,581 | 1,842,581 |
| Certificates of deposit | 2 | 1,120,403 | 1,117,921 | 1,320,265 | 1,298,238 |
| Advances from FHLB | 2 | 450,000 | 452,720 | 540,189 | 540,189 |
| Junior subordinated debentures at fair value | 3 | 119,304 | 119,304 | 114,091 | 114,091 |
| Other borrowings | 2 | 118,474 | 118,474 | 118,995 | 118,995 |
| Derivatives: | | | | | |
| Interest rate swaps | 2 | 10,966 | 10,966 | 3,138 | 3,138 |
| Interest rate lock and forward sales commitments | 2 | 674 | 674 | 1,654 | 1,654 |

The Company measures and discloses certain assets and liabilities at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (that is, not a forced liquidation or distressed sale). GAAP establishes a consistent framework for measuring fair value and disclosure requirements about fair value measurements. Among other things, the standard requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's estimates for market assumptions. These two types of inputs create the following fair value hierarchy:

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

- Level 2 – Observable inputs other than Level 1 including quoted prices in active markets for similar instruments, quoted prices in less active markets for identical or similar instruments, or other observable inputs that can be corroborated by observable market data.

- Level 3 – Unobservable inputs supported by little or no market activity for financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation; also includes observable inputs from non-binding single dealer quotes not corroborated by observable market data. In developing Level 3 measurements, management incorporates whatever market data might be available and uses discounted cash flow models where appropriate. These calculations include projections of future cash flows, including appropriate default and loss assumptions, and market based discount rates.

The estimated fair value amounts of financial instruments have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize at a future date. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. In addition, reasonable comparability between financial institutions may not be likely due to the wide range of permitted valuation techniques and numerous estimates that must be made given the absence of active secondary markets for many of the financial instruments. This lack of uniform valuation methodologies also introduces a greater degree of subjectivity to these estimated fair values. Transfers between levels of the fair value hierarchy are deemed to occur at the end of the reporting period.

*Items Measured at Fair Value on a Recurring Basis:*

The following tables present financial assets and liabilities measured at fair value on a recurring basis and the level within the fair value hierarchy of the fair value measurements for those assets and liabilities as of December 31, 2019 and 2018 (in thousands):

| | **December 31, 2019** | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Securities—trading | | | | |
| Corporate Bonds (TPS securities) | $ — | $ — | $ 25,636 | $ 25,636 |
| Securities—available-for-sale | | | | |
| U.S. Government and agency | — | 89,598 | — | 89,598 |
| Municipal bonds | — | 107,157 | — | 107,157 |
| Corporate bonds | — | 4,365 | — | 4,365 |
| Mortgage-backed securities | — | 1,342,311 | — | 1,342,311 |
| Asset-backed securities | — | 8,126 | — | 8,126 |
| | — | 1,551,557 | — | 1,551,557 |
| Loans held for sale | — | 199,397 | — | 199,397 |
| Derivatives | | | | |
| Interest rate swaps | — | 15,202 | — | 15,202 |
| Interest rate lock and forward sales commitments | — | 317 | 791 | 1,108 |
| | $ — | $ 1,766,473 | $ 26,427 | $ 1,792,900 |
| Liabilities | | | | |
| Junior subordinated debentures at fair value | $ — | $ — | $ 119,304 | $ 119,304 |
| Derivatives | | | | |
| Interest rate swaps | — | 10,966 | — | 10,966 |
| Interest rate lock and forward sales commitments | — | 674 | — | 674 |
| | $ — | $ 11,640 | $ 119,304 | $ 130,944 |

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Securities—trading | | | | |
| Corporate Bonds (TPS securities) | $ — | $ — | $ 25,896 | $ 25,896 |
| Securities—available-for-sale | | | | |
| U.S. Government and agency | — | 149,112 | — | 149,112 |
| Municipal bonds | — | 117,822 | — | 117,822 |
| Corporate bonds | — | 3,495 | — | 3,495 |
| Mortgage-backed securities | — | 1,343,861 | — | 1,343,861 |
| Asset-backed securities | — | 21,933 | — | 21,933 |
| | — | 1,636,223 | — | 1,636,223 |
| Loans held for sale | — | 164,767 | — | 164,767 |
| Equity securities | — | 352 | — | 352 |
| Derivatives | | | | |
| Interest rate swaps | — | 3,138 | — | 3,138 |
| Interest rate lock and forward sales commitments | — | 198 | 273 | 471 |
| | $ — | $ 1,804,678 | $ 26,169 | $ 1,830,847 |
| Liabilities | | | | |
| Junior subordinated debentures at fair value | $ — | $ — | $ 114,091 | $ 114,091 |
| Derivatives | | | | |
| Interest rate swaps | — | 3,138 | — | 3,138 |
| Interest rate lock and forward sales commitments | — | 1,654 | — | 1,654 |
| | $ — | $ 4,792 | $ 114,091 | $ 118,883 |

The following methods were used to estimate the fair value of each class of financial instruments:

*Securities:* The estimated fair values of investment securities and mortgaged-backed securities are priced using current active market quotes, if available, which are considered Level 1 measurements. For most of the portfolio, matrix pricing based on the securities' relationship to other benchmark quoted prices is used to establish the fair value. These measurements are considered Level 2. Due to the continued limited activity in the trust preferred markets that have limited the observability of market spreads for some of the Company's TPS securities, management has classified these securities as a Level 3 fair value measure. Management periodically reviews the pricing information received from third-party pricing services and tests those prices against other sources to validate the reported fair values.

*Loans Held for Sale:* Fair values for residential mortgage loans held for sale are determined by comparing actual loan rates to current secondary market prices for similar loans. Fair values for multifamily loans held for sale are calculated based on discounted cash flows using as a discount rate a combination of market spreads for similar loan types added to selected index rates.

*Mortgage Servicing Rights:* Fair values are estimated based on an independent dealer analysis of discounted cash flows. The evaluation utilizes assumptions market participants would use in determining fair value including prepayment speeds, delinquency and foreclosure rates, the discount rate, servicing costs, and the timing of cash flows. The mortgage servicing portfolio is stratified by loan type and fair value estimates are adjusted up or down based on the serviced loan interest rates versus current rates on new loan originations since the most recent independent analysis.

*Junior Subordinated Debentures:* The fair value of junior subordinated debentures is estimated using an income approach technique. The significant inputs included in the estimation of fair value are the credit risk adjusted spread and three month LIBOR. The credit risk adjusted spread represents the nonperformance risk of the liability. The Company utilizes an external valuation firm to validate the reasonableness of the credit risk adjusted spread used to determine the fair value. The junior subordinated debentures are carried at fair value which represents the estimated amount that would be paid to transfer these liabilities in an orderly transaction amongst market participants. Due to inactivity in the trust preferred markets that have limited the observability of market spreads, management has classified this as a Level 3 fair value measure.

*Derivatives:* Derivatives include interest rate swap agreements, interest rate lock commitments to originate loans held for sale and forward sales contracts to sell loans and securities related to mortgage banking activities. Fair values for these instruments, which generally change as a result of changes in the level of market interest rates, are estimated based on dealer quotes and secondary market sources.

*Off-Balance Sheet Items:* Off-balance sheet financial instruments include unfunded commitments to extend credit, including standby letters of credit, and commitments to purchase investment securities. The fair value of these instruments is not considered to be material.

*Limitations:* The fair value estimates presented herein are based on pertinent information available to management as of December 31, 2019 and 2018. The factors used in the fair value estimates are subject to change subsequent to the dates the fair value estimates are completed, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

*Assets and Liabilities Measured at Fair Value Using Significant Unobservable Inputs (Level 3)*

The following table provides a description of the valuation technique, unobservable inputs, quantitative and qualitative information about the unobservable inputs for the Company's assets and liabilities classified as Level 3 and measured at fair value on a recurring and nonrecurring basis at December 31, 2019 and 2018:

| | | | **December 31** | |
|---|---|---|---|---|
| | | | **2019** | 2018 |
| Financial Instruments | Valuation Technique | Unobservable Inputs | Weighted Average Rate | Weighted Average Rate |
| Corporate bonds (TPS securities) | Discounted cash flows | Discount rate | 5.91% | 6.81% |
| Junior subordinated debentures | Discounted cash flows | Discount rate | 5.91% | 6.81% |
| Impaired loans | Collateral valuations | Discount to appraised value | 0.0% to 20.0% | 0.0% to 8.5% |
| REO | Appraisals | Discount to appraised value | 58.5% | 69.2% |
| Interest rate lock commitments | Pricing model | Pull-through rate | 89.61% | 88.96% |

*TPS Securities*: Management believes that the credit risk-adjusted spread used to develop the discount rate utilized in the fair value measurement of TPS securities is indicative of the risk premium a willing market participant would require under current market conditions for instruments with similar contractual rates, terms and conditions and issuers with similar credit risk profiles and with similar expected probability of default. Management attributes the change in fair value of these instruments, compared to their par value, primarily to perceived general market adjustments to the risk premiums for these types of assets subsequent to their issuance.

*Junior subordinated debentures*: Similar to the TPS securities discussed above, management believes that the credit risk-adjusted spread utilized in the fair value measurement of the junior subordinated debentures is indicative of the risk premium a willing market participant would require under current market conditions for an issuer with Banner's credit risk profile. Management attributes the change in fair value of the junior subordinated debentures, compared to their par value, primarily to perceived general market adjustments to the risk premiums for these types of liabilities subsequent to their issuance. Future contractions in the risk adjusted spread relative to the spread currently utilized to measure the Company's junior subordinated debentures at fair value as of December 31, 2019, or the passage of time, will result in negative fair value adjustments. At December 31, 2019, the discount rate utilized was based on a credit spread of 400 basis points and three month LIBOR of 191 basis points.

*Interest rate lock commitments:* The fair value of the interest rate lock commitments is based on secondary market sources adjusted for an estimated pull-through rate. The pull-through rate is based on historical loan closing rates for similar interest rate lock commitments. An increase or decrease in the pull-through rate would have a corresponding, positive or negative fair value adjustment.

The following table provides a reconciliation of the assets and liabilities measured at fair value using significant unobservable inputs (Level 3) on a recurring basis during the years ended December 31, 2019 and 2018 (in thousands):

| | Level 3 Fair Value Inputs | |
|---|---|---|
| | TPS Securities | Borrowings—Junior Subordinated Debentures |
| Balance at January 1, 2018 | $ 22,058 | $ 98,707 |
| Total gains or losses recognized | | |
| Assets gains | 3,838 | — |
| Liabilities losses | — | 15,384 |
| Balance at December 31, 2018 | 25,896 | 114,091 |
| Total gains or losses recognized | | |
| Assets gains | (260) | — |
| Liabilities losses | — | (601) |
| Purchases, issuances and settlements, including acquisitions | — | 5,814 |
| **Balance at December 31, 2019** | $ 25,636 | $ 119,304 |

Interest income and dividends from the TPS securities are recoded as a component of interest income. Interest expense related to the junior subordinated debentures is measured based on contractual interest rates and reported in interest expense. The change in fair market value on TPS securities and on junior subordinated debentures prior to 2018 has been recorded as a component of non-interest income. Beginning in 2018, the change in fair value of the junior subordinated debentures, which represents changes in instrument specific credit risk, is recorded in other comprehensive income (loss).

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

The following table presents financial assets and liabilities measured at fair value on a non-recurring basis and the level within the fair value hierarchy of the fair value measurements for those assets at December 31, 2019 and 2018 (in thousands):

| | **December 31, 2019** | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Impaired loans | $ — | $ — | $ 14,853 | $ 14,853 |
| REO | $ — | $ — | $ 814 | $ 814 |

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Impaired loans | $ — | $ — | $ 2,915 | $ 2,915 |
| REO | — | — | 2,611 | 2,611 |

The following table presents the losses resulting from non-recurring fair value adjustments for the years ended December 31, 2019, 2018 and 2017 (in thousands):

| | **For the years ended December 31,** | | |
|---|---|---|---|
| | **2019** | 2018 | 2017 |
| Impaired loans | $ (425) | $ (910) | $ (2,852) |
| REO | — | (387) | (256) |
| Total loss from nonrecurring measurements | $ (425) | $ (1,297) | $ (3,108) |

*Impaired loans*: Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of collateral if the loan is collateral dependent. If this practical expedient is used, the impaired loans are considered to be held at fair value. Subsequent changes in the value of impaired loans are included within the provision for loan losses in the same manner in which impairment initially was recognized or as a reduction in the provision that would otherwise be reported. Impaired loans are periodically evaluated to determine if valuation adjustments, or partial write-downs, should

be recorded. The need for valuation adjustments arises when observable market prices or current appraised values of collateral indicate a shortfall in collateral value compared to current carrying values of the related loan. If the Company determines that the value of the impaired loan is less than the carrying value of the loan, the Company either establishes an impairment reserve as a specific component of the allowance for loan losses or charges off the impaired amount. These valuation adjustments are considered non-recurring fair value adjustments.

*REO*: The Company records REO (acquired through a lending relationship) at fair value on a non-recurring basis. Fair value adjustments on REO are based on updated real estate appraisals which are based on current market conditions. All REO properties are recorded at the estimated fair value of the real estate, less expected selling costs. From time to time, non-recurring fair value adjustments to REO are recorded to reflect partial write-downs based on an observable market price or current appraised value of property. Banner considers any valuation inputs related to REO to be Level 3 inputs. The individual carrying values of these assets are reviewed for impairment at least annually and any additional impairment charges are expensed to operations.

**Note 18: BANNER CORPORATION (PARENT COMPANY ONLY)**

Summary financial information is as follows (in thousands):

| **Statements of Financial Condition** | December 31 | |
|---|---|---|
| | **2019** | 2018 |
| ASSETS | | |
| Cash | $ 54,257 | $ 38,029 |
| Investment in trust equities | 4,444 | 4,212 |
| Investment in subsidiaries | 1,691,907 | 1,540,251 |
| Other assets | 19,471 | 25,267 |
| Total assets | $ 1,770,079 | $ 1,607,759 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Miscellaneous liabilities | $ 52,322 | $ 15,073 |
| Deferred tax liability | 4,419 | — |
| Junior subordinated debentures at fair value | 119,304 | 114,091 |
| Shareholders' equity | 1,594,034 | 1,478,595 |
| Total liabilities and shareholders' equity | $ 1,770,079 | $ 1,607,759 |

| **Statements of Operations** | Years Ended December 31 | | |
|---|---|---|---|
| | **2019** | 2018 | 2017 |
| INTEREST INCOME: | | | |
| Interest-bearing deposits | $ 98 | $ 49 | $ 62 |
| OTHER INCOME (EXPENSE): | | | |
| Dividend income from subsidiaries | 119,333 | 72,604 | 40,570 |
| Equity in undistributed income of subsidiaries | 35,134 | 72,419 | 27,477 |
| Other income | 33 | 56 | 53 |
| Net change in valuation of financial instruments carried at fair value | — | — | (3,507) |
| Interest on other borrowings | (6,574) | (6,136) | (4,752) |
| Other expenses | (4,045) | (4,761) | (3,291) |
| Net income before taxes | 143,979 | 134,231 | 56,612 |
| BENEFIT FROM INCOME TAXES | (2,299) | (2,284) | (4,164) |
| NET INCOME | $ 146,278 | $ 136,515 | $ 60,776 |

**Statements of Cash Flows**

| | Years Ended December 31 | | |
|---|---|---|---|
| | **2019** | 2018 | 2017 |
| OPERATING ACTIVITIES: | | | |
| Net income | $ 146,278 | $ 136,515 | $ 60,776 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Equity in undistributed income of subsidiaries | (35,134) | (72,419) | (27,477) |
| Decrease (increase) in deferred taxes | 6,969 | 150 | (1,442) |
| Net change in valuation of financial instruments carried at fair value | — | — | 3,507 |
| Share-based compensation | 7,142 | 6,554 | 5,965 |
| (Increase) decrease in other assets | 2,594 | (19,268) | 10,684 |
| Increase (decrease) in other liabilities | (120) | 201 | 69 |
| Net cash provided from operating activities | 127,729 | 51,733 | 52,082 |
| INVESTING ACTIVITIES: | | | |
| Funds transferred to deferred compensation trust | (32) | (27) | (29) |
| Reduction in investment in subsidiaries | — | 37,000 | 5,000 |
| Acquisitions | 442 | (329) | — |
| Net cash provided from investing activities | 410 | 36,644 | 4,971 |
| FINANCING ACTIVITIES: | | | |
| Withholding taxes paid on share-based compensation | (1,915) | (1,554) | (1,630) |
| Repurchase of common stock | (53,922) | (34,401) | (31,045) |
| Cash dividends paid | (56,074) | (59,280) | (65,759) |
| Net cash used by financing activities | (111,911) | (95,235) | (98,434) |
| NET CHANGE IN CASH | 16,228 | (6,858) | (41,381) |
| CASH, BEGINNING OF PERIOD | 38,029 | 44,887 | 86,268 |
| CASH, END OF PERIOD | $ 54,257 | $ 38,029 | $ 44,887 |

**Note 19: STOCK REPURCHASES**

On March 31, 2017 the Company announced that its Board of Directors had authorized the repurchase up to 5% of the Company's common stock, or 1,658,245 of the Company's outstanding shares. Under the authorization, shares were repurchased by the Company in open market purchases. During the year ended December 31, 2017, the Company repurchased 545,166 common shares at an average price of $56.91 per share. In addition to the shares repurchased under the authorization, there were 29,579 shares surrendered during 2017 by employees to satisfy tax withholding obligations upon vesting of restricted stock grants.

On March 28, 2018 the Company announced that its Board of Directors had authorized the repurchase up to 5% of the Company's common stock, or 1,621,549 of the Company's outstanding shares. Under the authorization, shares could be repurchased by the Company in open market purchases. During the year ended December 31, 2018, the Company repurchased 594,711 common shares at an average price of $57.82 per share. Of the total shares repurchased, 269,711 shares were repurchased prior to March 28, 2018 and were therefore accounted for under the 2017 authorization. The remaining 325,000 shares were repurchased subsequent to March 28, 2018 and are accounted for under the 2018 authorization. In addition to the shares repurchased under the authorization, there were 27,653 shares surrendered during 2018 by employees to satisfy tax withholding obligations upon vesting of restricted stock grants.

On March 27, 2019, the Company announced that its Board of Directors had authorized the repurchase up to 5% of the Company's common stock, or 1,757,637 of the Company's outstanding shares. Under the authorization, shares may be repurchased by the Company in open market purchases. The extent to which the Company repurchases its shares and the timing of such repurchases will depend upon market conditions and other corporate considerations. During the year ended December 31, 2019, the Company repurchased 1,000,000 common shares at an average price of $53.90 per share. All repurchases of shares in 2019 occurred subsequent to March 27, 2019 and are accounted for under the 2019 authorization leaving 757,637 shares available for future repurchase. In addition to the shares repurchased under the 2019 authorization, there were 33,777 shares surrendered during 2019 by employees to satisfy tax withholding obligations upon vesting of restricted stock.

**Note 20: CALCULATION OF EARNINGS PER COMMON SHARE**

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

| | Years Ended December 31 | | |
|---|---|---|---|
| | **2019** | 2018 | 2017 |
| Net income | $ 146,278 | $ 136,515 | $ 60,776 |
| **Weighted average number of common shares outstanding** | | | |
| Basic | 34,868,434 | 32,784,724 | 32,888,007 |
| Diluted | 34,967,684 | 32,894,425 | 32,986,707 |
| **Earnings per common share** | | | |
| Basic | $ 4.20 | $ 4.16 | $ 1.85 |
| Diluted | $ 4.18 | $ 4.15 | $ 1.84 |

At December 31, 2019, 2018 and 2017 there were 367,230, 315,301, and 302,077, respectively, of issued but unvested restricted stock shares and units that were included in the computation of diluted earnings per share.

**Note 21: SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**

Results of operations on a quarterly basis for the years ended December 31, 2019, 2018 and 2017 were as follows (dollars in thousands except for per share data):

| | **Year Ended December 31, 2019** | | | |
|---|---|---|---|---|
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
| Interest income | $ 129,996 | $ 130,838 | $ 131,436 | $ 133,409 |
| Interest expense | 13,892 | 14,143 | 14,815 | 13,918 |
| Net interest income before provision for loan losses | 116,104 | 116,695 | 116,621 | 119,491 |
| Provision for loan losses | 2,000 | 2,000 | 2,000 | 4,000 |
| Net interest income | 114,104 | 114,695 | 114,621 | 115,491 |
| Non-interest income | 18,125 | 22,676 | 20,866 | 20,282 |
| Non-interest expense | 90,014 | 86,716 | 87,308 | 93,690 |
| Income before provision for income taxes | 42,215 | 50,655 | 48,179 | 42,083 |
| Provision for income taxes | 8,869 | 10,955 | 8,602 | 8,428 |
| Net income | $ 33,346 | $ 39,700 | $ 39,577 | $ 33,655 |
| Basic earnings per share | $ 0.95 | $ 1.14 | $ 1.15 | $ 0.96 |
| Diluted earnings per share | 0.95 | 1.14 | 1.15 | 0.95 |
| Dividends declared | 0.41 | 0.41 | 0.41 | 1.41 |

| | Year Ended December 31, 2018 | | | |
|---|---|---|---|---|
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
| Interest income | $ 104,820 | $ 112,423 | $ 117,648 | $ 128,741 |
| Interest expense | 5,447 | 7,360 | 8,570 | 11,282 |
| Net interest income before provision for loan losses | 99,373 | 105,063 | 109,078 | 117,459 |
| Provision for loan losses | 2,000 | 2,000 | 2,000 | 2,500 |
| Net interest income | 97,373 | 103,063 | 107,078 | 114,959 |
| Non-interest income | 21,362 | 21,217 | 20,411 | 21,018 |
| Non-interest expense | 81,706 | 82,637 | 81,632 | 95,396 |
| Income before provision for income taxes | 37,029 | 41,643 | 45,857 | 40,581 |
| Provision for income taxes | 8,239 | 9,219 | 8,084 | 3,053 |
| Net income | $ 28,790 | $ 32,424 | $ 37,773 | $ 37,528 |
| Basic earnings per share | $ 0.89 | $ 1.01 | $ 1.17 | $ 1.10 |
| Diluted earnings per share | 0.89 | 1.00 | 1.17 | 1.09 |
| Dividends declared | 0.35 | 0.85 | 0.38 | 0.38 |

| | Year Ended December 31, 2017 | | | |
|---|---|---|---|---|
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
| Interest income | $ 99,096 | $ 104,436 | $ 105,278 | $ 103,475 |
| Interest expense | 4,242 | 4,730 | 5,068 | 5,211 |
| Net interest income before provision for loan losses | 94,854 | 99,706 | 100,210 | 98,264 |
| Provision for loan losses | 2,000 | 2,000 | 2,000 | 2,000 |
| Net interest income | 92,854 | 97,706 | 98,210 | 96,264 |
| Non-interest income | 19,048 | 20,396 | 18,081 | 27,675 |
| Non-interest expense | 76,281 | 79,857 | 80,331 | 82,501 |
| Income before provision for income taxes | 35,621 | 38,245 | 35,960 | 41,438 |
| Provision for income taxes | 11,828 | 12,791 | 10,883 | 54,986 |
| Net income | $ 23,793 | $ 25,454 | $ 25,077 | $ (13,548) |
| Basic earnings per share | $ 0.72 | $ 0.77 | $ 0.76 | $ (0.41) |
| Diluted earnings per share | 0.72 | 0.77 | 0.76 | (0.41) |
| Dividends declared | 0.25 | 1.25 | 0.25 | 0.25 |

**Note 22: COMMITMENTS AND CONTINGENCIES**

Financial Instruments with Off-Balance Sheet Risk—The Company has financial instruments with off-balance-sheet risk generated in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, commitments related to standby letters of credit, commitments to originate loans, commitments to sell loans, and commitments to buy or sell securities. These instruments involve, to varying degrees, elements of credit and interest rate risk similar to the risk involved in on-balance sheet items recognized in our Consolidated Statements of Financial Condition.

Our exposure to credit loss in the event of nonperformance by the other party to the financial instrument from commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. We use the same credit policies in making commitments and conditional obligations as for on-balance sheet instruments.

Outstanding commitments for which no asset or liability for the notional amount has been recorded consisted of the following at the dates indicated (in thousands):

| | Contract or Notional Amount | |
|---|---|---|
| | **December 31, 2019** | December 31, 2018 |
| Commitments to extend credit | $ 3,051,681 | $ 2,837,981 |
| Standby letters of credit and financial guarantees | 14,298 | 17,784 |
| Commitments to originate loans | 39,676 | 32,145 |
| Risk participation agreement | 41,022 | 24,091 |
| *Derivatives also included in Note 23:* | | |
| Commitments to originate loans held for sale | 66,196 | 31,728 |
| Commitments to sell loans secured by one- to four-family residential properties | 70,895 | 18,328 |
| Commitments to sell securities related to mortgage banking activities | 239,320 | 144,250 |

In addition to the commitments disclosed in the table above, the Company is committed to funding its' unfunded tax credit investments (see Note 12, Income Taxes). During 2019, the Company entered into an agreement to invest $10 million in a limited partnership. At December 31, 2019, the Company had funded $467,000 of the commitment, with $9.5 million of the commitment remaining to be funded.

Commitments to extend credit are agreements to lend to a customer, as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Many of the commitments may expire without being drawn upon; therefore, the total commitment amounts do not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, and income producing commercial properties. The Company's reserve for unfunded loan commitments was $2.7 million and $2.6 million, at December 31, 2019 and 2018, respectively.

Standby letters of credit are conditional commitments issued to guarantee a customer's performance or payment to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Under a risk participation agreement, Banner Bank guarantees the financial performance of a borrower on the participated portion of an interest rate swap on a loan.

Interest rates on residential one- to four-family mortgage loan applications are typically rate locked (committed) to customers during the application stage for periods ranging from 30 to 60 days, the most typical period being 45 days. Traditionally, these loan applications with rate lock commitments had the pricing for the sale of these loans locked with various qualified investors under a best-efforts delivery program at or near the time the interest rate is locked with the customer. The Bank then attempts to deliver these loans before their rate locks expired. This arrangement generally required delivery of the loans prior to the expiration of the rate lock. Delays in funding the loans would require a lock extension. The cost of a lock extension at times was borne by the customer and at times by the Bank. These lock extension costs have not had a material impact to our operations. For mandatory delivery commitments the Company enters into forward commitments at specific prices and settlement dates to deliver either: (1) residential mortgage loans for purchase by secondary market investors (i.e., Freddie Mac or Fannie Mae), or (2) mortgage-backed securities to broker/dealers. The purpose of these forward commitments is to offset the movement in interest rates between the execution of its residential mortgage rate lock commitments with borrowers and the sale of those loans to the secondary market investor. There were no counterparty default losses on forward contracts during 2019 or 2018. Market risk with respect to forward contracts arises principally from changes in the value of contractual positions due to changes in interest rates. The Company limits its exposure to market risk by monitoring differences between commitments to customers and forward contracts with market investors and securities broker/dealers. In the event the Company has forward delivery contract commitments in excess of available mortgage loans, the transaction is completed by either paying or receiving a fee to or from the investor or broker/dealer equal to the increase or decrease in the market value of the forward contract. Changes in the value of rate lock commitments are recorded as assets and liabilities as explained in Note 1: "Derivative Instruments."

In the normal course of business, the Company and/or its subsidiaries have various legal proceedings and other contingent matters outstanding. These proceedings and the associated legal claims are often contested and the outcome of individual matters is not always predictable. These claims and counter-claims typically arise during the course of collection efforts on problem loans or with respect to action to enforce liens on properties in which the Banks hold a security interest. Based upon the information known to management at this time, the Company and the Banks are not a party to any legal proceedings that management believes would have a material adverse effect on the results of operations or consolidated financial position at December 31, 2019.

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

## NOTE 23: DERIVATIVES AND HEDGING

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

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

*Derivatives Designated in Hedge Relationships*

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

Under a prior program, customers received fixed interest rate commercial loans and Banner Bank subsequently hedged that fixed-rate loan by entering into an interest rate swap with a dealer counterparty. Banner Bank receives fixed-rate payments from the customers on the loans and makes similar fixed-rate payments to the dealer counterparty on the swaps in exchange for variable-rate payments based on the one-month LIBOR index. Some of these interest rate swaps are designated as fair value hedges. Through application of the “short cut method of accounting,” there is an assumption that the hedges are effective. Banner Bank discontinued originating interest rate swaps under this program in 2008.

As of December 31, 2019 and December 31, 2018, the notional values or contractual amounts and fair values of the Company's derivatives designated in hedge relationships were as follows (in thousands):

| | Asset Derivatives | | | | Liability Derivatives | | | |
|---|---|---|---|---|---|---|---|---|
| | **December 31, 2019** | | December 31, 2018 | | **December 31, 2019** | | December 31, 2018 | |
| | Notional/ Contract Amount | Fair Value [1] | Notional/ Contract Amount | Fair Value [1] | Notional/ Contract Amount | Fair Value [2] | Notional/ Contract Amount | Fair Value [2] |
| Interest rate swaps | $ 3,567 | $ 220 | $ 3,973 | $ 270 | $ 3,567 | $ 220 | $ 3,973 | $ 270 |

(1) Included in Loans Receivable on the Consolidated Statements of Financial Condition.
(2) Included in Other Liabilities on the Consolidated Statements of Financial Condition.

*Derivatives Not Designated in Hedge Relationships*

*Interest Rate Swaps:* Banner Bank uses an interest rate swap program for commercial loan customers, that provides the client with a variable-rate loan and enters into an interest rate swap in which the client receives a variable-rate payment in exchange for a fixed-rate payment. The Bank offsets its risk exposure by entering into an offsetting interest rate swap with a dealer counterparty for the same notional amount and length of term as the client interest rate swap providing the dealer counterparty with a fixed-rate payment in exchange for a variable-rate payment. These swaps do not qualify as designated hedges; therefore, each swap is accounted for as a free standing derivative.

*Mortgage Banking:* The Company sells originated one- to four-family and multifamily mortgage loans into the secondary mortgage loan markets. During the period of loan origination and prior to the sale of the loans in the secondary market, the Company has exposure to movements in interest rates associated with written interest rate lock commitments with potential borrowers to originate one- to four-family loans that are intended to be sold and for closed one- to four-family and multifamily mortgage loans held for sale that are awaiting sale and delivery into the secondary market. The Company economically hedges the risk of changing interest rates associated with these mortgage loan commitments by entering into forward sales contracts to sell one- to four-family and multifamily mortgage loans or mortgage-backed securities to broker/dealers at specific prices and dates.

As of December 31, 2019 and December 31, 2018, the notional values or contractual amounts and fair values of the Company's derivatives not designated in hedge relationships were as follows (in thousands):

| | Asset Derivatives | | | | Liability Derivatives | | | |
|---|---|---|---|---|---|---|---|---|
| | **December 31, 2019** | | December 31, 2018 | | **December 31, 2019** | | December 31, 2018 | |
| | Notional/ Contract Amount | Fair Value (1) | Notional/ Contract Amount | Fair Value (1) | Notional/ Contract Amount | Fair Value (2) | Notional/ Contract Amount | Fair Value (2) |
| Interest rate swaps | $ 371,957 | $ 14,982 | $ 272,374 | $ 2,868 | $ 371,957 | $ 10,746 | $ 272,374 | $ 2,868 |
| Mortgage loan commitments | 50,755 | 791 | 20,229 | 273 | 65,855 | 190 | 17,763 | 187 |
| Forward sales contracts | 70,895 | 317 | 18,328 | 198 | 239,320 | 484 | 144,250 | 1,467 |
| | $ 493,607 | $ 16,090 | $ 310,931 | $ 3,339 | $ 677,132 | $ 11,420 | $ 434,387 | $ 4,522 |

(1) Included in Other assets on the Consolidated Statements of Financial Condition, with the exception of certain interest swaps and mortgage loan commitments (with a fair value of $347,000 at December 31, 2019 and $282,000 at December 31, 2018), which are included in Loans Receivable.

(2) Included in Other Liabilities on the Consolidated Statements of Financial Condition.

Gains (losses) recognized in income on non-designated hedging instruments for the years ended December 31, 2019, 2018 and 2017 were as follows (in thousands):

| | | For the Years Ended December 31 | | |
|---|---|---|---|---|
| | Location on Income Statement | **2019** | 2018 | 2017 |
| Mortgage loan commitments | Mortgage banking operations | $ 518 | $ 47 | $ 195 |
| Forward sales contracts | Mortgage banking operations | (693) | (775) | (491) |
| | | $ (175) | $ (728) | $ (296) |

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

In connection with the interest rate swaps between Banner Bank and the dealer counterparties, the agreements contain a provision where if Banner Bank fails to maintain its status as a well/adequately capitalized institution, then the counterparty could terminate the derivative positions and Banner Bank would be required to settle its obligations. Similarly, Banner Bank could be required to settle its obligations under certain of its agreements if specific regulatory events occur, such as a publicly issued prompt corrective action directive, cease and desist order, or a capital maintenance agreement that required Banner Bank to maintain a specific capital level. If Banner Bank had breached any of these provisions at December 31, 2019 or December 31, 2018, it could have been required to settle its obligations under the agreements at the termination value. As of December 31, 2019 and 2018, the termination value of derivatives in a net liability position related to these agreements was $15.2 million and $1.3 million, respectively. The Company generally posts collateral against derivative liabilities in the form of cash, government agency-issued bonds, mortgage-backed securities, or commercial mortgage-backed securities. Collateral posted against derivative liabilities was $28.1 million and $13.6 million as of December 31, 2019 and 2018, respectively.

Derivative assets and liabilities are recorded at fair value on the balance sheet. Master netting agreements allow the Company to settle all derivative contracts held with a single counterparty on a net basis and to offset net derivative positions with related collateral where applicable. In addition, some of interest rate swap derivatives between Banner Bank and the dealer counterparties are cleared through central clearing houses. These clearing houses characterize the variation margin payments as settlements of the derivative's market exposure and not as collateral. The variation margin is treated as an adjustment to our cash collateral, as well as a corresponding adjustment to our derivative liability. As of December 31, 2019 the variation margin adjustment was a negative adjustment of $4.3 million. There was no variation margin adjustment as of December 31, 2018.

The following presents additional information related to the Company's derivative contracts, by type of financial instrument, as of December 31, 2019 and December 31, 2018 (in thousands):

| | **December 31, 2019** | | | | | |
|---|---|---|---|---|---|---|
| | | | | Gross Amounts of Financial Instruments Not Offset in the Statement of Financial Condition | | |
| | Gross Amounts Recognized | Amounts offset in the Statement of Financial Condition | Net Amounts in the Statement of Financial Condition | Derivative Amount | Fair Value of Financial Collateral in the Statement of Financial Condition | Net Amount |
| Derivative assets | | | | | | |
| Interest rate swaps | $ 15,242 | $ (40) | $ 15,202 | $ — | $ — | $ 15,202 |
| | $ 15,242 | $ (40) | $ 15,202 | $ — | $ — | $ 15,202 |
| Derivative liabilities | | | | | | |
| Interest rate swaps | $ 15,242 | $ (4,276) | $ 10,966 | $ — | $ (15,209) | $ (4,243) |
| | $ 15,242 | $ (4,276) | $ 10,966 | $ — | $ (15,209) | $ (4,243) |

| | December 31, 2018 | | | | | |
|---|---|---|---|---|---|---|
| | | | | Gross Amounts of Financial Instruments Not Offset in the Statement of Financial Condition | | |
| | Gross Amounts Recognized | Amounts offset in the Statement of Financial Condition | Net Amounts in the Statement of Financial Condition | Derivative Amount | Fair Value of Financial Collateral in the Statement of Financial Condition | Net Amount |
| Derivative assets | | | | | | |
| Interest rate swaps | $ 5,038 | $ (1,900) | $ 3,138 | $ — | $ — | $ 3,138 |
| | $ 5,038 | $ (1,900) | $ 3,138 | $ — | $ — | $ 3,138 |
| Derivative liabilities | | | | | | |
| Interest rate swaps | $ 5,038 | $ (1,900) | $ 3,138 | $ — | $ (1,320) | $ 1,818 |
| | $ 5,038 | $ (1,900) | $ 3,138 | $ — | $ (1,320) | $ 1,818 |

## NOTE 24: REVENUE FROM CONTRACTS WITH CUSTOMERS

***Disaggregation of Revenue:***

Deposit fees and other service charges for the years ended December 31, 2019, 2018 and 2017 are summarized as follows (in thousands):

| | Years Ended December 31 | | |
|---|---|---|---|
| | **2019** | 2018 | 2017 |
| Deposit service charges | 19,236 | 18,089 | 16,725 |
| Debit and credit interchange fees | 27,753 | 31,713 | 28,358 |
| Debit and credit card expense | (8,527) | (8,511) | (7,390) |
| Merchant services income | 13,111 | 10,226 | 10,159 |
| Merchant services expenses | (10,512) | (7,767) | (8,335) |
| Other service charges | 5,571 | 4,324 | 3,935 |
| Total deposit fees and other service charges | 46,632 | 48,074 | 43,452 |

*Deposit fees and other service charges*

Deposit fees and other service charges include transaction and non-transaction based deposit fees. Transaction based fees on deposit accounts are charged to deposit customers for specific services provided to the customer. These fees include such items as wire fees, official check fees, and overdraft fees. These are contract specific to each individual transaction and do not extend beyond the individual transaction. The performance obligation is completed and the fees are recognized at the time the specific transactional service is provided to the customer. Non-transactional deposit fees are typically monthly account maintenance fees charged on deposit accounts. These are day-to-day contracts that can be canceled by either party without notice. The performance obligation is satisfied and the fees are recognized on a monthly basis after the service period is completed.

*Debit and credit card interchange income and expenses*

Debit and credit card interchange income represent fees earned when a credit or debit card issued by the Banks is used to purchase goods or services at a merchant. The merchant's bank pays the Banks a default interchange rate set by MasterCard on a transaction by transaction basis. The merchant acquiring bank can stop accepting the Banks' cards at any time and the Banks can stop further use of cards issued by them at any time. The performance obligation is satisfied and the fees are earned when the cost of the transaction is charged to the Banks cardholders' card. Direct expenses associated with the credit and debit card are recorded as a net reduction against the interchange income.

*Merchant services income*

Merchant services income represents fees earned by the Banks for card payment services provided to its merchant customers. The Banks have a contract with a third party to provide card payment services to the Banks' merchants that contract for those services. The third party provider has contracts with the Banks' merchants to provide the card payment services. The Banks do not have a direct contractual relationship with its merchants for these services. The Banks set the rates for the services provided by the third party. The third party provider passes the payments made by the Banks' merchants through to the Banks. The Banks, in turn, pay the third party provider for the services it provides to the Banks' merchants. These payments to the third party provider are recorded as expenses as a net reduction against fee income. In addition, a portion of the payment received by the Banks represents interchange fees which are passed through to the card issuing bank. Income is primarily earned based on the dollar volume and number of transactions processed. The performance obligation is satisfied and the related fee is earned when each payment is accepted by the processing network.

## NOTE 25: LEASES

The Company leases 107 buildings and offices under non-cancelable operating leases. The leases contain various provisions for increases in rental rates, based either on changes in the published Consumer Price Index or a predetermined escalation schedule. Substantially all of the leases provide the Company with the option to extend the lease term one or more times following expiration of the initial term. The Company adopted the requirements of Topic 842 effective January 1, 2019, which required the Company to record a right-of-use lease asset and a lease liability for leases with an initial term of more than 12 months for leases that existed as of January 1, 2019. The periods prior to the date of adoption are accounted for under Lease Topic 840; therefore, the following disclosures include only the periods for which Topic 842 was effective.

***Lease Position as of December 31, 2019***

The table below presents the lease right-of-use assets and lease liabilities recorded on the balance sheet at December 31, 2019 (dollars in thousands):

| | Classification on the Balance Sheet | December 31, 2019 |
|---|---|---|
| **Assets** | | |
| Operating right-of-use lease assets | Other assets | $ 61,766 |
| **Liabilities** | | |
| Operating lease liabilities | Accrued expenses and other liabilities | $ 65,818 |
| Weighted-average remaining lease term | | |
| Operating leases | | 6.2 years |
| Weighted-average discount rate | | |
| Operating leases | | 3.7 % |

***Lease Costs***

The table below presents certain information related to the lease costs for operating leases for the year ended December 31, 2019 (in thousands):

| | Twelve Months Ended December 31, 2019 |
|---|---|
| Operating lease cost [1] | $ 15,388 |
| Short-term lease cost [1] | 327 |
| Variable lease cost [1] | 2,396 |
| Less sublease income [1] | (925) |
| Total lease cost | $ 17,186 |

[1] Lease expenses and sublease income are classified within occupancy and equipment expense on the Consolidated Statements of Operations.

***Supplemental Cash Flow Information***

Operating cash flows paid for operating lease amounts included in the measurement of lease liabilities were $15.4 million for the year ended December 31, 2019. During the year ended December 31, 2019, the Company recorded $78.8 million of right-of-use lease assets in exchange for operating lease liabilities.

***Undiscounted Cash Flows***

The table below reconciles the undiscounted cash flows for each of the first five years beginning with 2020 and the total of the remaining years to the operating lease liabilities recorded on the Consolidated Statements of Financial Position (in thousands):

| | Operating Leases |
|---|---|
| 2020 | $ 16,197 |
| 2021 | 15,058 |
| 2022 | 11,424 |
| 2023 | 8,275 |
| 2024 | 6,393 |
| Thereafter | 16,489 |
| Total minimum lease payments | 73,836 |
| Less: amount of lease payments representing interest | (8,018) |
| Lease obligations | $ 65,818 |

As of December 31, 2019, the Company had no undiscounted lease payments under an operating lease that had not yet commenced.

**BANNER CORPORATION**

| Exhibit | **Index of Exhibits** |
|---|---|
| 2{a} | Agreement and Plan of Merger, dated as of July 25, 2018, by and between Banner Corporation and Skagit Bancorp, Inc. (incorporated herein by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed with the SEC on July 27, 2018 (File No. 000-26584)). |
| 3{a} | Amended and Restated Articles of Incorporation of Registrant [incorporated by reference to the Registrant's Current Report on Form 8-K filed on April 29, 2010 (File No. 000-26584)]. |
| 3{b} | Articles of Amendment of Registrant (incorporated herein by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed with the SEC on June 1,2011 (File No. 000-26584)) |
| 3{c} | Articles of Amendment to Amended and Restated Articles of Incorporation of Registrant for nonvoting common stock (incorporated by reference to the Registrant's Current Report on Form 8-K filed on March 18, 2015 (File No. 00026584)). |
| 3{d} | Amended and Restated Bylaws of Registrant [incorporated by reference to Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed on December 20, 2016 (File No. 000-26584)]. |
| 4.2 | Description of Capital Stock |
| 10{a} | Executive Salary Continuation Agreement with Gary L. Sirmon [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended March 31, 1996 (File No. 000-26584)]. |
| 10{b} | Amended and Restated Employment Agreement, with Mark J. Grescovich [incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on June 4, 2013 (File No. 000-26584]. |
| 10{c} | Form of Supplemental Executive Retirement Program Agreement with Gary Sirmon, Michael K. Larsen, Lloyd W. Baker, Cynthia D. Purcell and Richard B. Barton [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2001 and the exhibits filed with the Form 8-K on May 6, 2008 (File No. 000-26584)]. |
| 10{d} | Form of Employment Contract entered into with Lloyd W. Baker, Cynthia D. Purcell and Richard B. Barton [incorporated by reference to exhibits filed with the Form 8-K on June 25, 2014 (File No. 000-26584)]. |
| 10{e} | Long-Term Incentive Plan and Form of Repricing Agreement [incorporated by reference to the exhibits filed with the Form 8-K on May 6, 2008 (File No. 000-26584)]. |
| 10{f} | 2005 Executive Officer and Director Stock Account Deferred Compensation Plan [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2008 (File No. 000-26584)]. |
| 10{g} | Entry into an Indemnification Agreement with each of the Registrant's Directors [incorporated by reference to exhibits filed with the Form 8-K on January 29, 2010 (File No. 000-26584)]. |
| 10{h} | 2012 Restricted Stock and Incentive Bonus Plan [incorporated by reference to Appendix B to the Registrant's Definitive Proxy Statement on Schedule 14A filed on March 19, 2013 (File No. 000-26584)]. |
| 10{i} | Form of Performance-Based Restricted Stock Award Agreement [incorporated by reference to Exhibit 10.1 included in the Registrant's Current Report on Form 8-K filed on June 4, 2013 (File No. 000-26584)]. |

| | |
|---|---|
| 10{j} | Form of Time-Based Restricted Stock Award Agreement [incorporated by reference to Exhibit 10.1 included in the Registrant's Current Report on Form 8-K filed on June 4, 2013 (File No. 000-26584)]. |
| 10{k} | 2014 Omnibus Incentive Plan [incorporated by reference as Appendix C to the Registrant's Definitive Proxy Statement on Schedule 14A filed on March 24, 2014 (File No. 000-26584)] and amendments [incorporated by reference to the Form 8-K filed on March 25, 2015 (File No. 000-26534)]. |
| 10{l} | Forms of Equity-Based Award Agreements: Incentive Stock Option Award Agreement, Non-Qualified Stock Option Award Agreement, Restricted Stock Award Agreement, Restricted Stock Unit Award Agreement, Stock Appreciation Right Award Agreement, and Performance Unit Award Agreement [incorporated by reference to Exhibits 10.2 - 10.7 included in the Registration Statement on Form S-8 dated May 9, 2014 (File No. 333-195835)]. |
| 10{m} | 2018 Omnibus Incentive Plan [incorporated by reference as Appendix D to the Registrant's Definitive Proxy Statement on Schedule 14A filed on March 23, 2018 (File No. 000-26584)] |
| 10{n} | Forms of Equity-Based Award Agreements: Incentive Stock Option Award Agreement, Non-Qualified Stock Option Award Agreement under the Banner Corporation 2018 Omnibus Incentive Plan; Director Restricted Stock Award Agreement; Director Restricted Stock Unit Award Agreement; Employee Time-based Restricted Stock Unit Award Agreement; Employee performance-based Restricted Stock Unit Award Agreement; Stock Appreciation Right Award Agreement; and Performance Unit Award Agreement [incorporated by reference to Exhibits 10.2 - 10.9 included in the Registration Statement on Form S-8 dated May 4, 2018 (File No. 333-224693)] |
| 14 | Code of Ethics [Registrant elects to satisfy Regulation S-K §229.406(c) by posting its Code of Ethics on its website at www.bannerbank.com in the section titled Corporate Overview: Governance Document |
| 21 | Subsidiaries of the Registrant. |
| 23.1 | Consent of Registered Independent Public Accounting Firm – Moss Adams LLP. |
| 31.1 | Certification of Chief Executive Officer pursuant to the Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to the Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32 | Certificate of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | Inline XBRL Instance Document - The instance document does not appear in the interactive data file because XBRL tags are embedded within the XBRL document. |
| 101.SCH | Inline XBRL Taxonomy Extension Schema Document |
| 101.CAL | Inline XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | Inline XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | Inline XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | Inline XBRL Taxonomy Extension Presentation Linkbase Document |
| 104 | The cover page from the Company's Annual Report on Form 10-K for the year ended December 31, 2019, formatted in Inline XBRL (included in Exhibit 101) |

**EXHIBIT 4.2**

## DESCRIPTION OF CAPITAL STOCK

*The following information summarizes certain features and rights of our capital stock. The summary does not purport to be exhaustive and is qualified in its entirety by reference to our articles of incorporation, bylaws, and to applicable Washington law.*

### General

Banner's authorized capital stock consists of:

- 50,000,000 shares of common stock, $0.01 par value per share;
- 5,000,000 shares of non-voting common stock, $0.01 par value per share; and
- 500,000 shares of preferred stock, $0.01 par value per share.

As of January 31, 2020, there were 35,712,347 shares of Banner common stock and 39,192 shares of Banner non-voting common stock issued and outstanding. No shares of Banner preferred stock are currently outstanding. Banner's common stock is traded on NASDAQ under the symbol "BANR."

### Common Stock

Each share of Banner common stock has the same relative rights and is identical in all respects with each other share of Banner common stock. Banner common stock represents non-withdrawable capital, is not of an insurable type and is not insured by the FDIC or any other government agency.

Subject to any prior rights of the holders of any preferred or other stock of Banner then outstanding, holders of Banner common stock are entitled to receive such dividends as are declared by the board of directors of Banner out of funds legally available for dividends.

Except with respect to greater than 10% stockholders, full voting rights are vested in the holders of Banner common stock and each share is entitled to one vote. See "—Anti-Takeover Effects—Restrictions on Voting Rights." Subject to any prior rights of the holders of any Banner preferred stock then outstanding, in the event of a liquidation, dissolution or winding up of Banner, holders of shares of Banner common stock will be entitled to receive, pro rata, any assets distributable to stockholders in respect of shares held by them. Holders of shares of Banner common stock will not have any preemptive rights to subscribe for any additional securities which may be issued by Banner, nor do they have cumulative voting rights.

### Nonvoting Common Stock

The holders of Banner nonvoting common stock have no voting rights except as required by the Washington Business Corporations Act, which we refer to as the "WBCA," and as described in the next sentence. In addition to any other vote required by law, the affirmative vote of the holders of a majority of the outstanding shares of Banner nonvoting common stock, voting separately as a class, is required to amend Banner's articles of incorporation to alter or change the designation, preferences, limitations or relative rights of all or part of the shares of Banner nonvoting common stock.

Except with respect to voting, Banner nonvoting common stock and Banner common stock have the same rights, preferences and privileges, share ratably in all assets of the corporation upon its liquidation, dissolution or winding-up, are entitled to receive dividends (other than certain stock dividends described in the next sentence) in the same amount per share and at the same time, as and if declared by Banner's board of directors, and are equal and identical in all other respects as to all other matters. In the event of any stock dividend having the effect of a stock split, stock combination or other reclassification of shares of either the Banner common stock or the Banner nonvoting common stock, the outstanding shares of the other class will be proportionately split, combined or reclassified in a similar manner, except that holders of Banner common stock will receive only shares of Banner common stock in respect of their shares of Banner common stock and holders of Banner nonvoting common stock will receive only shares of Banner nonvoting common stock in respect of their shares of Banner nonvoting common stock.

No transfer of shares of Banner nonvoting common stock by the initial holders of those shares (or such holders' affiliates) is permitted, except for specified permitted transfers or transfers to affiliates of the initial holders of the nonvoting common stock. Each share of nonvoting common stock will be converted automatically into one share of common stock upon a permitted transfer.

In the event of any merger, consolidation, reclassification or other transaction in which the shares of Banner common stock are exchanged for or changed into other stock or securities, cash and/or any other property, each share of Banner nonvoting common stock will simultaneously be similarly exchanged or changed into an amount per whole share equal to the aggregate amount of stock, securities, cash and/or any other property that such Banner nonvoting common stock would be entitled to receive if it were converted into a share of Banner common stock immediately prior to such transaction. In case of any offer to repurchase shares, pro rata subscription offer, rights offer or similar offer to holders of Banner common stock, Banner is required to provide the holders of Banner nonvoting common stock the right to participate.

**Preferred Stock**

Our Articles of Incorporation permit our board of directors to authorize the issuance of up to 500,000 shares of preferred stock, par value $0.01, in one or more series, at such time or times and for such consideration as the board of directors of Banner may determine, without stockholder action. The board of directors of Banner is expressly authorized at any time, and from time to time, to issue Banner preferred stock, with such voting and other powers, liquidation preferences and participating, optional or other special rights, and qualifications, limitations or restrictions, as are stated and expressed in the board resolution providing for the issuance. The board of directors of Banner is authorized to designate the series and the number of shares comprising such series, the dividend rate on the shares of such series, the redemption rights, if any, any purchase, retirement or sinking fund provisions, any conversion rights and any voting rights. The ability of Banner's board of directors to approve the issuance of preferred or other stock without stockholder approval could dilute the voting power or other rights or adversely affect the market value of our common stock and may make an acquisition by an unwanted suitor of a controlling interest in Banner more difficult, time-consuming or costly, or otherwise discourage an attempt to acquire control of Banner.

Shares of preferred stock redeemed or acquired by Banner may return to the status of authorized but unissued shares, without designation as to series, and may be reissued by Banner upon approval of its board of directors.

**Anti-Takeover Effects**

The provisions of our Articles of Incorporation, our Bylaws, and Washington law summarized in the following paragraphs may have anti-takeover effects and could delay, defer, or prevent a tender offer or takeover attempt that a stockholder might consider to be in such stockholder's best interest, including those attempts that might result in a premium over the market price for the shares held by stockholders, and may make removal of the incumbent management and directors more difficult.

*Authorized Shares*. Our Articles of Incorporation authorize the issuance of 50,000,000 shares of common stock, 5,000,000 shares of non-voting common stock and 500,000 shares of preferred stock. These shares of common stock and preferred stock provide our board of directors with as much flexibility as possible to effect, among other transactions, financings, acquisitions, stock dividends, stock splits and the exercise of employee stock options. However, these additional authorized shares may also be used by the board of directors consistent with its fiduciary duty to deter future attempts to gain control of us. The board of directors also has sole authority to determine the terms of any one or more series of preferred stock, including voting rights, conversion rates and liquidation preferences. As a result of the ability to fix voting rights for a series of preferred stock, the board of directors has the power to the extent consistent with its fiduciary duty to issue a series of preferred stock to persons friendly to management in order to attempt to block a tender offer, merger or other transaction by which a third party seeks control of us, and thereby assist members of management to retain their positions.

*Restrictions on Voting Rights*. Our Articles of Incorporation provide for restrictions on voting rights of shares owned in excess of 10% of any class of our equity securities. Specifically, our Articles of Incorporation provide that if any person or group acting in concert acquires the beneficial ownership of more than 10% of any class of our equity securities without the prior approval by a two-thirds vote of our "Continuing Directors," (as defined therein) then, with respect to each vote in excess of 10% of the voting power of our outstanding shares of voting stock which such person would otherwise have been entitled to cast, such person is entitled to cast only one-hundredth of one vote per share. Exceptions from this limitation are provided for, among other things, any proxy granted to one or more of our "Continuing Directors" and for our employee benefit plans. Under our Articles of Incorporation, the restriction on voting shares beneficially owned in violation of the foregoing limitations is imposed automatically, and the Articles of Incorporation provide that a majority of our Continuing Directors have the power to construe the forgoing restrictions and to make all determinations necessary or desirable to implement these restrictions. These restrictions would, among other things, restrict voting power of a beneficial owner of more than 10% of our outstanding shares of common stock in a proxy contest or on other matters on which such person is entitled to vote.

*Board of Directors*. Our board of directors is divided into three classes, each of which contains approximately one-third of the members of the board of directors. The members of each class are elected for a term of three years, with the terms of office of all members of one class expiring each year so that approximately one-third of the total number of directors is elected each year. The classification of directors, together with the provisions in our Articles of Incorporation described below that limit the ability of stockholders to remove directors and that permit only the remaining directors to fill any vacancies on the board of directors, have the effect of making it more difficult for stockholders to change the composition of the board of directors. As a result, at least two annual meetings of stockholders will be required for the stockholders to change a majority of the directors, whether or not a change in the board of directors would be beneficial and whether or not a majority of stockholders believe that such a change would be desirable.

Our Articles of Incorporation provide that the size of the board of directors is not less than five or more than 25 as set in accordance with the Bylaws. In accordance with the Bylaws, the number of directors is currently set at 11. The Articles of Incorporation provide that any vacancy

occurring in the board of directors, including a vacancy created by an increase in the number of directors, will be filled by a vote of two-thirds of the directors then in office and any director so chosen will hold office for a term expiring at the annual meeting of stockholders at which the term of the class to which the director has been chosen expires. The classified board of directors is intended to provide for continuity of the board of directors and to make it more difficult and time consuming for a stockholder group to fully use its voting power to gain control of the board of directors without the consent of incumbent members of the board of directors. The Articles of Incorporation further provide that a director may be removed from the board of directors prior to the expiration of his term only for cause and only upon the vote of the holders of 80% of the total votes eligible to be cast thereon. In the absence of this provision, the vote of the holders of a majority of the shares could remove the entire board of directors, but only with cause, and replace it with persons of such holders' choice.

*Cumulative Voting, Special Meetings and Action by Written Consent*. Our Articles of Incorporation do not provide for cumulative voting for any purpose. Moreover, the Articles of Incorporation provide that special meetings of stockholders may be called only by our board of directors or by a committee of the board of directors. In addition, our Bylaws require that any action taken by written consent must receive the consent of all of the outstanding voting stock entitled to vote on the action taken.

*Stockholder Vote Required to Approve Business Combinations with Principal Stockholders*. The Articles of Incorporation require the approval of the holders of (i) at least 80% of the outstanding shares entitled to vote thereon (and, if any class or series of shares is entitled to vote thereon separately, the approval of the holders of at least 80% of the outstanding shares of each such class or series) and (ii) at least a majority of the outstanding shares entitled to vote thereon, not including shares deemed beneficially owned by a "Related Person," for certain "Business Combinations" involving a Related Person, except in cases where the proposed transaction has been approved in advance by two-thirds of those members of Banner's board of directors who are unaffiliated with the Related Person and were directors prior to the time when the Related Person became a Related Person. The term "Related Person" is defined to include any individual, corporation, partnership or other entity (other than tax-qualified benefit plans of Banner) which owns beneficially or controls, directly or indirectly, 10% or more of the outstanding shares of common stock of Banner or an affiliate of such person or entity. The term "Business Combination" is defined to include: (i) any merger or consolidation of Banner with or into any Related Person; (ii) any sale, lease, exchange, mortgage, transfer, or other disposition of 25% or more of the assets of Banner to a Related Person; (iii) any merger or consolidation of a Related Person with or into Banner or a subsidiary of Banner; (iv) any sale, lease, exchange, transfer or other disposition of certain assets of a Related Person to Banner or a subsidiary of Banner; (v) the issuance of any securities of Banner or a subsidiary of Banner to a Related Person; (vi) the acquisition by Banner or a subsidiary of Banner of any securities of a Related Person; (vii) any reclassification of common stock of Banner or any recapitalization involving the common stock of Banner; or (viii) any agreement or other arrangement providing for any of the foregoing.

Washington law imposes restrictions on certain transactions between a corporation and certain significant stockholders. Chapter 23B.19 of the WCBA prohibits a "target corporation," with certain exceptions, from engaging in certain "significant business transactions" with an "Acquiring Person" who acquires 10% or more of the voting securities of a target corporation for a period of five years after such acquisition, unless the transaction or acquisition of shares is approved by a majority of the members of the target corporation's board of directors prior to the date of the acquisition or, at or subsequent to the date of the acquisition, the transaction is approved by a majority of the members of the target corporation's board of directors and authorized at a stockholders' meeting by the vote of at least two-thirds of the outstanding voting shares of the target corporation, excluding shares owned or controlled by the Acquiring Person. The prohibited transactions include, among others, a merger or consolidation with, disposition of assets to, or issuance or redemption of stock to or from, the Acquiring Person, termination of 5% or more of the employees of the target corporation as a result of the Acquiring Person's acquisition of 10% or more of the shares, or allowing the Acquiring Person to receive any disproportionate benefit as a stockholder. After the five-year period during which significant business transactions are prohibited, certain significant business transactions may occur if certain "fair price" criteria or stockholder approval requirements are met. Target corporations include all publicly-traded corporations incorporated under Washington law, as well as publicly traded foreign corporations that meet certain requirements.

*Amendment of Articles of Incorporation and Bylaws*. Amendments to our Articles of Incorporation must be approved by our board of directors by a majority vote of the board of directors and by our stockholders by a majority of the voting group comprising all the votes entitled to be cast on the proposed amendment, and a majority of each other voting group entitled to vote separately on the proposed amendment; provided, however, that the affirmative vote of the holders of at least 80% of votes entitled to be cast by each separate voting group entitled to vote thereon (after giving effect to the provision limiting voting rights, if applicable) is required to amend or repeal certain provisions of the Articles of Incorporation, including the provision limiting voting rights, the provisions relating to the removal of directors, stockholder nominations and proposals, the approval of certain business combinations, calling special meetings, director and officer indemnification by us and amendment of our Bylaws and Articles of Incorporation. Our Bylaws may be amended by a majority vote of our board of directors, or by a vote of 80% of the total votes entitled to vote generally in the election of directors at a duly constituted meeting of stockholders.

*Stockholder Nominations and Proposals*. Our Articles of Incorporation generally require a stockholder who intends to nominate a candidate for election to the board of directors, or to raise new business at a stockholder meeting to give not less than 30 nor more than 60 days' advance notice to the Secretary of Banner. The notice provision requires a stockholder who desires to raise new business to provide certain information to us concerning the nature of the new business, the stockholder and the stockholder's interest in the business matter. Similarly, a stockholder wishing to nominate any person for election as a director must provide us with certain information concerning the nominee and the proposing stockholder.

The cumulative effect of the restrictions on a potential acquisition of us that are contained in our Articles of Incorporation and Bylaws, and federal and Washington law, may be to discourage potential takeover attempts and perpetuate incumbent management, even though certain stockholders may deem a potential acquisition to be in their best interests, or deem existing management not to be acting in their best interests.

**EXHIBIT 21**

**SUBSIDIARIES OF THE REGISTRANT**

| Parent | | |
|---|---|---|
| Banner Corporation | | |
| **Subsidiaries** | **Percentage of Ownership** | **Jurisdiction of State of Incorporation** |
| Banner Bank [1] | 100% | Washington |
| Islanders Bank [1] | 100% | Washington |
| Banner Capital Trusts II, III, IV, V, VI, and VII [1] | 100% | Washington |
| Springer Development LLC [2] | 100% | Washington |
| Community Financial Corporation [2] | 100% | Oregon |
| Northwest Financial Corporation [2] | 100% | Washington |
| Banner Investment Advisors, LLC [2] | 100% | Washington |
| Siuslaw Statutory Trust I [1] | 100% | Connecticut |
| Greater Sacramento Bancorp Statutory Trust I [1] | 100% | Delaware |
| Greater Sacramento Bancorp Statutory Trust II [1] | 100% | Delaware |
| Mission Oak Statutory Trust I [1] | 100% | Delaware |

(1) Wholly-owned by Banner Corporation.
(2) Wholly-owned by Banner Bank.

**EXHIBIT 23.1**

**Consent of Independent Registered Public Accounting Firm**

We consent to the incorporation by reference in Registration Statement Nos. 333-187256, 333-195835, and 333-224693 on Form S-8, Registration Statement Nos. 333-226991 and 333-233497 on Form S-4, and Registration Statement No. 333-211332 on Form S-3 of our report dated February 21, 2020, with respect to the consolidated statements of financial condition of Banner Corporation and Subsidiaries as of December 31, 2019 and 2018, and the related consolidated statements of operations, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2019, and the effectiveness of internal control over financial reporting as of December 31, 2019, which reports appear in this Annual Report on Form 10-K of Banner Corporation for the year ended December 31, 2019.

/s/ Moss Adams LLP

Spokane, Washington
February 21, 2020

**EXHIBIT 31.1**

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER OF BANNER CORPORATION PURSUANT TO RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES ACT OF 1934**

I, Mark J. Grescovich, certify that:

1. I have reviewed this Annual Report on Form 10-K of Banner Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

    a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 21, 2020

/s/ Mark J. Grescovich
Mark J. Grescovich
Chief Executive Officer

**EXHIBIT 31.2**

**CERTIFICATION OF CHIEF FINANCIAL OFFICER OF BANNER CORPORATION PURSUANT TO RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES ACT OF 1934**

I, Peter J. Conner, certify that:

1. I have reviewed this Annual Report on Form 10-K of Banner Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

    a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 21, 2020

/s/ Peter J. Conner

Peter J. Conner
Chief Financial Officer

**EXHIBIT 32**

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
OF BANNER CORPORATION
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned hereby certify in his capacity as an officer of Banner Corporation, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and in connection with this Annual Report on Form 10-K, that:

- the report fully complies with the requirements of Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, and

- the information contained in the report fairly presents, in all material respects, the Company's financial condition and results of operations as of the dates and for the periods presented in the financial statements included in such report.

February 21, 2020

/s/ Mark J. Grescovich

Mark J. Grescovich
Chief Executive Officer

February 21, 2020

/s/ Peter J. Conner

Peter J. Conner
Chief Financial Officer

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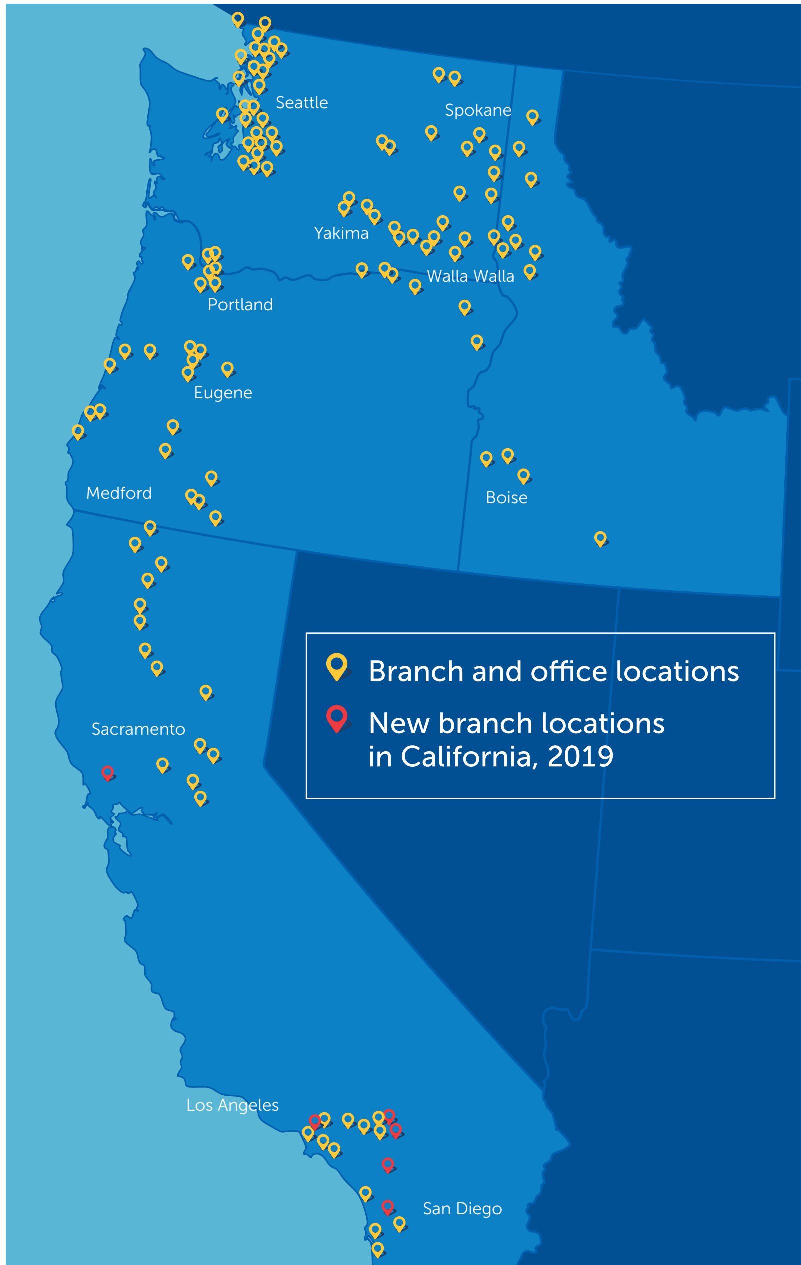
# Embracing the Strengths of our Diversified Footprint




- 210 branches and offices
- Serving 6 of the top 9 MSAs in the Western U.S.
- Growing region includes 3 of top 5 states in the nation for inbound relocations (Idaho no. 1, Oregon no. 2 and Washington no. 5).*
- California boasts a gross state product in excess of $3 trillion—when viewed independently, it is the 6th largest economy in the world.

*Source: United Van Lines National Movers Study

## Giving Back to the Community

Balancing our reason to be in business with the values that keep us in business is vital to our success. Our commitment to being an active corporate citizen and engaging in the communities we serve is always the foundation of our approach.

Through diverse initiatives and proven community partnerships, we gave in excess of $2.5 million to more than 1,300 nonprofit organizations in 2019. And our employees contributed their time and talent with hundreds of non-profit organizations and community causes. The company continued encouraging employee involvement, through paid time off to all full- and part-time employees to volunteer with organizations of their choice.

## Our Vision Statement

We strive to be the bank of choice in the markets we serve. We are committed to being the best provider of financial services in the West.

## Our Mission Statement

Banner Corporation is a dynamic full service financial institution, operating safely and profitably within a framework of shared integrity. Working as a team, we will deliver superior products and services to our valued clients. We will emphasize strong client relationships and a high level of community involvement. We will provide a culture which attracts, empowers, rewards and provides growth opportunities for our employees. Our success will build long-term shareholder value.

## Our Value Proposition

Connected. Knowledgeable. Responsive.
It's not only what we do, it's how we do it—with relentless effort.

## Values

*"Do the Right Thing."*

This means we believe in:

- → Honesty and Integrity
- → Mutual Respect
- → Quality
- → Trust
- → Teamwork
- → Accountability

## Directors

Cheryl R. Bishop
Connie R. Collingsworth
Brent A. Orrico
Kevin F. Riordan
Mark J. Grescovich
Roberto R. Herencia
David A. Klaue
John R. Layman
David I. Matson
Merline Saintil
Terry S. Schwakopf

## Executive Officers

Mark J. Grescovich
*President and Chief Executive Officer*

Richard B. Barton
*EVP, Chief Credit Officer*

Peter J. Conner
*EVP, Chief Financial Officer*

James P. Garcia
*EVP, Chief Audit Executive*

Kenneth W. Johnson
*EVP, Operations*

Kayleen R. Kohler
*EVP, Human Resources*

Kenneth A. Larsen
*EVP, Mortgage Banking*

James P.G. McLean
*EVP, Commercial Real Estate Lending*

Craig Miller
*EVP, General Counsel*

Cynthia D. Purcell
*EVP, Retail Banking and Administration*

M. Kirk Quillin
*EVP, Commercial Executive*

James T. Reed, Jr.
*EVP, Commercial Banking West*

Steven W. Rust
*EVP, Chief Information Officer*

Judith A. Steiner
*EVP, Chief Risk Officer*

Gary W. Wagers
*EVP, Retail Products and Services*

Keith A. Western
*EVP, Commercial Banking South*

## Corporate Headquarters

10 South First Avenue
PO Box 907
Walla Walla, WA 99362-0265
509-527-3636
800-272-9933
Website: bannerbank.com
Email: bannerbank@bannerbank.com

## Subsidiaries

Banner Bank – bannerbank.com
Islanders Bank – islandersbank.com
Community Financial Corporation

## Transfer Agent and Registrar

Computershare Trust Company, N.A.
PO Box 505000
Louisville, KY 40233-5000

## Independent Public Accountants and Auditors

Moss Adams LLP
805 SW Broadway, Suite 1200
Portland, OR 97205

## Special Counsel

Breyer & Associates PC
8180 Greensboro Drive, Suite 785
McLean, VA 22102

## Annual Meeting of Shareholders

10 a.m., Wednesday, April 29, 2020
Marcus Whitman Hotel
6 West Rose Street
Walla Walla, WA 99362

## Dividend Payments Sent Quarterly

Dividend payments are reviewed quarterly by the board of directors and, if appropriate and authorized, have historically been paid during the months of January, April, July and October. To avoid delay or lost mail, and to reduce costs, we encourage you to request direct deposit of dividend payments to your bank account. To enroll in the Direct Deposit Plan, call the Company's Investor Services Department at 800-272-9933.

## Dividend Reinvestment and Stock Purchase Plan

Banner Corporation offers a dividend reinvestment program whereby shareholders may reinvest all or a portion of their dividends in additional shares of the Company's common stock. Information concerning this optional program is available from the Investor Services Department or from Computershare Investor Services at 800-697-8924.

## Investor Information

Shareholders and others will find the Company's financial information, press releases and other information on the Company's website at www.bannerbank.com. There is a direct link from the website to the Securities and Exchange Commission (SEC) filings via the EDGAR database, including Forms 10-K, 10-Q and 8-K.

## Shareholders May Contact:

Investor Relations, Banner Corporation
PO Box 907
Walla Walla, WA 99362

Or call 800-272-9933 to obtain a hard copy of these reports without charge.

# 2019
# Banner Corporation Annual Report

bannerbank.com

Let's create tomorrow, together.

Corporate Headquarters
10 South First Ave.
PO Box 907
Walla Walla, WA  99362-0265

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bannerbank@bannerbank.com