

BANNER CORP  
Form 10-K  
February 27, 2017

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2016

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 (I.R.S.

or organization) Employer Identification Number)

10 South First Avenue, Walla Walla, Washington 99362

(Address of principal executive offices and zip code)

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

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

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

Securities registered pursuant to section 12(g) of the Act:

None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act

Yes  No

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

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

No

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

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

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

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

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

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, 2016, was:

Common Stock – \$1,434,750,706

(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, 2017:

Common Stock, \$.01 par value – 33,108,767 shares

Non-voting Common Stock, \$.01 par value – 84,788 shares

Documents Incorporated by Reference

Portions of Proxy Statement for Annual Meeting of Shareholders to be held April 25, 2017 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 conditional verbs such as “may,” “will,” “should,” “would” and “could.” Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, assumptions and statements about future economic performance and projections of financial items. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from the results anticipated or implied by our forward-looking statements, including, but not limited to: expected revenues, cost savings, synergies and other benefits from the merger of Banner Bank and AmericanWest Bank (AmericanWest) might not be realized within the expected time frames or at all, the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and changes in our allowance for loan losses and provision for loan losses that may be impacted by deterioration in the housing and commercial real estate markets and may lead to increased losses and non-performing assets, and may result in our allowance for loan losses not being adequate to cover actual losses and require us to materially increase our reserves; changes in economic conditions in general and in Washington, Idaho, Oregon, Utah and California in particular; changes in the levels of general interest rates and the relative differences between short and long-term interest rates, loan and deposit interest rates, our net interest margin and funding sources; fluctuations in the demand for loans, the number of unsold homes, land and other properties and fluctuations in real estate values in our market areas; secondary market conditions for loans and our ability to sell loans in the secondary market; results of safety and soundness and compliance examinations of us by the Federal Reserve (the Federal Reserve) and of our bank subsidiaries by the Federal Deposit Insurance Corporation (the FDIC), the Washington State Department of Financial Institutions, Division of Banks (the Washington DFI) or other regulatory authorities, including the possibility that any such regulatory authority may, among other things, require restitution or institute an informal or formal enforcement action against us or any of our bank subsidiaries which could require us to increase our reserve for loan losses, write-down assets, change our regulatory capital position or affect our ability to borrow funds, or maintain or increase deposits, or impose additional requirements and restrictions on us, any of which could adversely affect our liquidity and earnings; legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, or the interpretation of regulatory capital or other rules, including changes related to Basel III; the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the implementing regulations; our ability to attract and retain deposits; increases in premiums for deposit insurance; our ability to control operating costs and expenses; the use of estimates in determining fair value of certain of our assets and liabilities, which estimates may prove to be incorrect and result in significant changes in valuation; difficulties in reducing risk associated with the loans and securities on our balance sheet; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our work force and potential associated charges; the failure or security breach of computer systems on which we depend; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; our ability to implement our business strategies; future goodwill impairment due to changes in our business, changes in market conditions, or other factors; our ability to manage loan delinquency rates; increased competitive pressures among financial services companies; changes in consumer spending, borrowing and savings habits; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; our ability to pay dividends on our common stock and non-voting common stock, and interest or principal payments on our junior subordinated debentures; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; the economic impact of war or any terrorist activities; other economic, competitive, governmental, regulatory, and technological

factors affecting our operations, pricing, products and services; and other risks detailed from time to time in our filings with the 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, 2016, its 187 branch offices and 11 loan production offices located in Washington, Oregon, California, Utah and Idaho. Islanders Bank is also a Washington-chartered commercial bank that conducts business from three locations in San Juan County, Washington. Banner Corporation is subject to regulation by the Federal Reserve. Banner Bank and Islanders Bank (the Banks) are subject to regulation by the Washington DFI and the FDIC. As of December 31, 2016, we had total consolidated assets of \$9.79 billion, net loans of \$7.37 billion, total deposits of \$8.12 billion and total shareholders' equity of \$1.31 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, Utah 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 multi-family residential loans. Lending activities include commercial business and commercial real estate loans, agriculture business loans, construction and land development loans, one- to four-family residential loans and consumer loans.

Since becoming a public company in 1995, we have invested significantly in expanding our branch and distribution systems with a primary emphasis on strengthening our market presence in our five primary markets in the Northwest. Those markets include the four largest metropolitan areas in the Northwest: the Puget Sound region of Washington and the greater Portland, Oregon, Boise, Idaho, and Spokane, Washington markets, as well as our historical base in the vibrant agricultural communities in the Columbia Basin region of Washington and Oregon. Our aggressive franchise expansion during this period included the acquisition and consolidation of ten commercial banks, as well as the opening of 28 new branches, the acquisition of seven branches and relocating 12 others. More recently, our acquisition activity, included two whole bank transactions in 2015 and the purchase of six branches in 2014, has expanded our geographic focus to include additional markets in southwest Oregon, as well as select markets in California and Utah and more than doubled the size of the Company. The acquisition of Starbuck Bancshares, Inc. (Starbuck), the holding company for AmericanWest, which closed on October 1, 2015, with 98 branches and approximately \$4.46 billion in assets, \$3.00 billion in loans and \$3.64 billion in deposits, added scale to our operations, strengthened our Northwest presence and provided entry into attractive markets in California and Utah. Prior to that, the acquisition of Siuslaw Financial Group (Siuslaw), the holding company for Siuslaw Bank, which closed on March 6, 2015, with ten branches and approximately \$369.8 million in assets, \$247.1 million in loans and \$316.4 million in deposits, added further market penetration in western Oregon, including the Eugene market. Both the Starbuck and Siuslaw acquisitions have had a significant impact on the operating results of Banner. For additional details regarding these acquisitions and merger related expenses, see Note 3, Business Combinations, of the Notes to Consolidated Financial Statements contained in Item 8 of this report.

In addition to the acquisitions, branch openings and relocations, we also have invested heavily in marketing campaigns designed to significantly increase the brand awareness for Banner Bank as well as expanded product offerings. These investments, which have been significant elements in our strategies to grow loans, deposits and

customer relationships, have increased our presence within desirable marketplaces and allow us to better serve existing and future customers. This emphasis on growth and development resulted in an elevated level of non-interest expense during recent periods; however, we believe the expanded branch network, broader product line and heightened brand awareness have created a franchise that is well positioned and is allowing us to successfully execute on our super community bank model. That strategy is focused on delivering customers, including middle market and small businesses, business owners, their families and employees, a compelling value proposition by providing the financial sophistication and breadth of products of a regional bank while retaining the appeal, responsiveness, and superior service level of a community bank.

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

Like most financial institutions, our operating results in recent years have been meaningfully impacted by the exceptionally low interest rate environment and our future operating results and financial performance will be significantly affected by the course of economic activity. However, over the past seven years we have substantially added to our client relationships and account base, while maintaining a moderate risk profile, which has resulted in strong and sustainable revenues and low credit costs, and which we believe has positioned the Company well for continued success.

For the year ended December 31, 2016, our net income increased to \$85.4 million, or \$2.52 earnings per diluted share, compared to \$45.2 million, or \$1.89 earnings per diluted share, for the prior year. Our results for both years were significantly impacted by merger and acquisition activity and the related expenses. The 2016 results reflect the first full year of earnings contribution from the operations acquired in the AmericanWest and Siuslaw acquisitions. Acquisition-related expenses were \$11.7 million, or \$0.22 per diluted share net of tax benefit, in 2016 compared to \$26.1 million, or \$0.76 per diluted share net of tax benefit, in 2015.



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 55% to \$375.1 million for the year ended December 31, 2016, compared to \$242.3 million for the year ended December 31, 2015.

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 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 2016 increased \$154.0 million, or 51%, to \$458.5 million, compared to \$304.6 million for 2015. Our total non-interest income, which is a component of total revenue and includes the net gain on sale of securities and changes in the value of financial instruments carried at fair value, was \$83.5 million for the year ended December 31, 2016, compared to \$62.3 million for the year ended December 31, 2015.

Although our credit quality metrics continue to reflect our moderate risk profile, we recorded a \$6.0 million provision for loan losses in the year ended December 31, 2016, primarily due to the organic growth in the loan portfolio and the renewal of acquired loans out of the discounted loan portfolios, compared to no provision recorded in 2015. Non-performing loans increased modestly to \$22.6 million at December 31, 2016, compared to \$15.2 million a year earlier. Our allowance for loan losses at December 31, 2016 was \$86.0 million, or 1.15% of total loans outstanding and 381% 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 36% to \$322.9 million for the year ended December 31, 2016, compared to \$236.6 million for the year ended December 31, 2015. The year-over-year increase in non-interest expense was largely attributable to acquisition-related expenses and incremental costs associated with operating the 98 branches acquired in the AmericanWest acquisition on October 1, 2015 and the ten Siuslaw Bank branches acquired in March 2015 for a full year in 2016 and generally increased compensation, occupancy and payment and card processing services reflecting increased transaction volume.

Reflecting our previously announced strategy to maintain assets below \$10.0 billion through December 31, 2016, our total assets decreased slightly in 2016 to \$9.79 billion at December 31, 2016. Remaining below \$10.0 billion through year end had the beneficial effect of delaying the adverse impact on our future operating results from certain enhanced regulatory requirements and the Durbin Amendment cap on interchange revenues when exceeding that asset size.

## Recent Developments and Significant Events

### Acquisition of AmericanWest Bank

As of the close of business on October 1, 2015, the Company completed its acquisition of Starbuck and its subsidiary, AmericanWest, a Washington state chartered commercial bank headquartered in Spokane, Washington with 98

branches serving markets in Washington, Oregon, Idaho, California and Utah. On that date Starbuck merged with and into Banner and AmericanWest merged with and into Banner Bank. The merged banks are operating as Banner Bank. Pursuant to the previously announced terms of the merger, the equityholders of Starbuck received an aggregate of \$130.0 million in cash and 13.2 million shares of Banner common stock and non-voting common stock. At the time of closing, Starbuck had \$4.46 billion in assets, \$3.00 billion in loans and \$3.64 billion in deposits.

#### Acquisition of Siuslaw Financial Group, Inc.

On March 6, 2015, the Company completed its acquisition of Siuslaw, the holding company of Siuslaw Bank, an Oregon state chartered commercial bank. Siuslaw shareholders received consideration of \$1.416 in cash plus 0.322 of a share of Banner common stock in exchange for each share of Siuslaw common stock, which reflects a payment of approximately 90% stock and 10% cash. Upon closing of the transaction Siuslaw was merged into Banner and Siuslaw Bank was merged into Banner Bank. At the time of closing, Siuslaw had \$369.8 million in assets, \$247.1 million in loans and \$316.4 million in deposits.

#### 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, 2016, our net loan portfolio totaled \$7.37 billion compared to \$7.24 billion at December 31, 2015.

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. Although our level of activity and investment in commercial real estate loans has been relatively stable for many years, we have experienced an increase in new originations in recent periods. 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 for the past three 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 this period 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 these types of 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 exceptionally low interest rates have supported demand for loans to refinance existing debt as well as loans to finance home purchases. However, most of the one- to four-family loans that we originate are sold in the secondary markets with net gains on sales and loan servicing fees reflected in our revenues from mortgage banking. Our consumer loan activity is primarily directed at meeting demand from our existing deposit customers. We have increased our emphasis on consumer lending in recent years, which resulted in meaningful growth from originations in 2016 and 2015, primarily related to increased home equity lines of credit.

For additional information concerning our loan portfolio, see Item 7 of this report, “Management’s Discussion and Analysis of Financial Condition—Comparison of Financial Condition at December 31, 2016 and 2015—Loans and Lending” including Tables 3 and 4, which sets forth the composition and geographic concentration of our loan portfolio, and Tables 5 and 6, 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, 2016, \$813.1 million, or 11% 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. However, borrower demand for ARM loans versus fixed-rate mortgage loans is a function of the level of interest rates, the expectations of changes in the level of interest rates and the difference between the initial interest rates and fees charged for each type of loan. In recent years, borrower demand for ARM loans has been limited and we have chosen not to aggressively pursue ARM loans by offering minimally profitable, deeply discounted teaser rates or option-payment ARM products. As a result, ARM loans have represented only a small portion of our loans originated during recent periods.

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

**Construction and Land Lending:** Historically, we have invested a significant portion of our loan portfolio in residential construction and land loans to professional home builders and developers. We 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, 2016, construction, land and land development loans totaled \$823.1 million, or 11% of total loans; the balance was primarily comprised of one- to four-family construction and residential land or land development loans, and to a lesser extent commercial and multifamily real estate construction loans and commercial land or 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 because of the inherent difficulty in estimating both a property's value at completion of the project and the estimated cost of the project. If the estimate of construction cost proves to be inaccurate, we may be required to advance funds beyond the amount originally committed to permit completion of the project. If the estimate of value upon completion proves to be inaccurate, we may be confronted at, or prior to, the maturity of the loan with a project the value of which is insufficient to assure full repayment. Disagreements between borrowers and builders and the failure of builders to pay subcontractors may also jeopardize projects. Loans to builders to construct homes for which no purchaser has been identified carry additional risk because the payoff for the loan is dependent on the builder's ability to sell the property before the construction loan is due. We attempt to address these risks by adhering to strict underwriting policies, disbursement procedures and monitoring practices.

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 be identified either during or following the construction period. We actively monitor the number of unsold homes in our construction loan portfolio and local housing markets to attempt to maintain an appropriate balance between home sales and new loan originations. The maximum number of speculative 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 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 with numerous sub-markets within our service area.

Loans for the construction of one- to four-family residences are generally made for a term of twelve to eighteen months. Our loan policies include maximum loan-to-value ratios of up to 80% for speculative loans. Individual speculative loan requests are supported by an independent appraisal of the property, a set of plans, a cost breakdown and a completed specifications form. Underwriting is focused on the borrowers' financial strength, credit history and demonstrated ability to produce a quality product and effectively market and manage their operations. All speculative construction loans must be approved by senior loan officers.

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 underwriting policies and disbursement and monitoring procedures similar to those for construction loans. The initial term on land loans is typically one to three years with interest only payments, payable monthly, and provisions for principal reduction as lots are sold and released from the lien of the mortgage.

**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 properties. At December 31, 2016, our loan portfolio included \$1.99 billion in non-owner-occupied commercial real estate loans, \$1.35 billion in owner-occupied commercial real estate loans and \$248.2 million in multifamily loans which in aggregate comprised 48% of our total loans. Multifamily and commercial real estate lending affords us an opportunity to receive interest at rates higher than those generally available from one- to four-family residential lending. However, loans secured by multifamily and commercial properties are generally greater in amount, more difficult to evaluate and monitor and, therefore, potentially riskier than one- to four-family residential mortgage loans. Because payments on loans secured by

multifamily and commercial properties are often dependent on the successful operation and management of the properties, repayment of these loans may be affected by adverse conditions in the real estate market or the economy. In addition, many of our commercial and multifamily real estate loans often 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. 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 borrowers' willingness and ability to manage the property and repay the loan and the adequacy of the collateral in relation to the loan amount.

Multifamily and commercial real estate loans originated by us are both fixed- and adjustable-rate loans generally with intermediate terms of five to ten years. 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, 2016, the average size of our commercial real estate loans was \$618,000 and the largest commercial real estate loan in our portfolio was approximately \$17.7 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. While also strengthening our commitment to small business lending, our experienced commercial bankers and senior credit staff focus on corporate lending opportunities for borrowers with credit needs generally in a \$3 million to \$15 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 and lines of credit are available from \$5,000 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 may be unsecured or secured by special purpose or rapidly depreciating assets, such as equipment, inventory and receivables, which may not provide an adequate source of repayment on defaulted loans. In addition, commercial business loans are dependent on the borrower's continuing financial strength and management ability, as well as market conditions for various products, services and commodities. For these reasons, commercial business loans generally provide higher yields 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.

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, 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 products.

Our commercial business loans may be structured as term loans or as lines of credit. Commercial business term loans are generally made to finance the purchase of fixed assets and have maturities of five years or less. Commercial business lines of credit are typically made for the purpose of providing working capital and are usually approved with a term of one year. Adjustable- or floating-rate loans are primarily tied to various prime rate or LIBOR indices. At December 31, 2016, commercial business loans totaled \$1.21 billion, or 16% of our total loans, including \$138.9 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, 2016, agricultural business loans, including collateral secured loans to purchase farm land and equipment, totaled \$369.2 million, or 5% of our loan portfolio.

Agricultural operating loans generally are made as a percentage of the borrower's anticipated income to support budgeted operating expenses. These loans 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 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 reduced by the use of set price contracts. Normally, required beginning and projected operating margins provide for reasonable reserves to offset unexpected yield and price deficiencies. In addition to these risks, we also consider management succession, life insurance and business continuation plans when evaluating agricultural loans.

**Consumer and Other Lending:** We originate a variety of consumer loans, including home equity lines of credit, automobile, 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, 2016, we had \$650.5 million, or 9% of our loan portfolio, in consumer related loans, including \$493.2 million, or 7% of our loan portfolio, in consumer loans secured by one- to four-family residences.

Similar to commercial business loans, 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 which 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.

**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, 2016 and 2015, we originated loans, net of repayments, including our participation in syndicated loans and loans held for sale of \$1.11

billion and \$741.7 million, respectively. The increase in originations net of repayments for 2016 compared with 2015 largely reflects increased production capacity, including a full year of production from the former AmericanWest and Siuslaw Bank lending teams in 2016, with both periods being affected by high levels of repayments.

We sell many of our newly originated one- to four-family residential mortgage loans to secondary market purchasers as part of our interest rate risk management strategy. In addition, beginning in 2015, in conjunction with the acquisition of AmericanWest, we began to sell many of our newly originated multifamily loans to the secondary market purchasers. Originations of loans for sale increased to \$1.06 billion for the year ended December 31, 2016 from \$709.0 million during 2015, reflecting low interest rates, strong housing markets and our increased production capacity. Originations of loan for sale included \$367.6 million and \$41.2 million of multifamily held for sale loan production for the years ended December 31, 2016 and December 31, 2015, 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, 2016, we sold \$880.9 million of loans held for sale compared to \$677.2 million for the year ended December 31, 2015. The held for sale loans sold in 2016 and 2015 included \$198.1 million and \$66.8 million, respectively, of multifamily loans held for sale. In addition, we sold \$160.3 million and \$85.1 million of portfolio multifamily loans acquired through the merger with AmericanWest in 2016 and 2015, respectively. We sell 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. 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 made generally consistent with our underwriting standards; however, the loans may be located outside of our normal lending area. During the years ended December 31, 2016 and 2015, we purchased \$314.3 million and \$323.5 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, 2016, we were servicing \$2.55 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. These carrying values are adjusted when the valuation indicates the carrying value is impaired. At December 31, 2016, our MSRs were carried at a value of \$15.2 million, net of amortization. For additional information see Note 17, 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, 2016 and 2015—Asset Quality," and Table 11 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 losses on loans 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. 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, 2016 and 2015—Provision and Allowance for Loan Losses," and Tables 15 and 16 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, 2016 and 2015—Asset Quality” and Table 11 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, 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, 2016, our consolidated investment portfolio totaled \$1.09 billion and consisted principally of U.S. Government agency obligations, mortgage-backed securities, municipal bonds, corporate debt obligations, and asset-backed securities. From time to time, investment levels may be increased or decrease in order to manage balance sheet liquidity, interest rate risk, market risk and provide appropriate risk adjusted returns. Security sales, paydowns and maturities during the year ended December 31, 2016 exceeded purchases as the Company deleveraged the balance sheet primarily through reductions in our investment portfolio consistent with our asset management objectives to remain below \$10 billion in assets through December 31, 2016 to delay certain regulatory consequences associated with exceeding that asset size. For additional information regarding these regulatory consequences, see Item 1A, Risk Factors, "We may be subject to additional regulatory scrutiny if and when Banner or Banner Bank's total assets exceed \$10.0 billion."

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, 2016 and 2015—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 derivative contracts.

Our predominant derivative and hedging activities involve interest rate swaps related to certain term loans, interest rate locks 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 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. We have hedged our 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.

#### 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. Banner Bank also has a few interest rate swaps from a prior interest rate swap program that were also not designated in hedge relationships. 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 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 loans that are intended to be sold and for closed 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 residential mortgage loans or mortgage-backed securities to broker/dealers as 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 controlled through the credit approval, limits, and monitoring procedures and we do 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, 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, 2016 or 2015, 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 and do not take into account the effects of master netting agreements. 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.

#### 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 branch expansion, relocations and renovation and advertising and marketing campaigns has been directed toward attracting additional deposit customer relationships and balances. In addition, our electronic 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. Growing core deposits (non-interest-bearing checking and interest-bearing transaction and savings accounts) is a fundamental element of our business strategy. Core deposits increased to 87% of total deposits at December 31, 2016 compared to 83% a year earlier and 80% 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, cash management services and retirement savings plans. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit and the interest rate, among other factors. In determining the terms of deposit accounts, we consider current market interest rates, profitability to us, matching deposit and loan products and customer preferences and concerns. At December 31, 2016, we had \$8.12 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, 2016 and 2015—Deposit Accounts," including Table 7 contained therein, which sets forth the balances of deposits in the various types of accounts, and Table 8, which sets forth the amount of our certificates of deposit greater than \$100,000 by time remaining until maturity as of December 31, 2016. 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 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, 2016, we had \$54.2 million of borrowings from the FHLB. At that date, Banner Bank was authorized by the FHLB to borrow up to \$3.35 billion under a blanket floating lien security agreement, while Islanders Bank was approved to borrow up to \$98.1 million under a similar agreement. The Federal Reserve Bank also serves as an important 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, 2016, based upon our available unencumbered collateral, Banner Bank was eligible to borrow \$1.02 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, 2016 and 2015—Borrowings,” and Table 10 contained therein, as well as Notes 9 and 10 of the Notes to the Consolidated Financial Statements.

At December 31, 2016, Banner Bank had an uncommitted federal funds line of credit agreement with another financial institution totaling \$60.0 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, 2016. 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 cash management services provided to our larger deposit customers. At December 31, 2016, we had issued retail repurchase agreements totaling \$100.7 million. We also may borrow funds through the use of secured wholesale repurchase agreements with securities brokers; at December 31, 2016, we had one wholesale repurchase borrowing with a carrying value of \$5.0 million. The retail and wholesale repurchase borrowings were secured by pledges of certain U.S. Government and agency notes and mortgage-backed securities with a market value of \$114.9 million.

We have also issued \$120.0 million of junior subordinated debentures in connection with the sale of trust preferred securities (TPS). The TPS were issued from 2002 through 2007 by special purpose business trusts formed by Banner Corporation and were sold in private offerings to pooled investment vehicles. In addition, Banner has \$16.0 million of junior subordinated debentures that were acquired through the Siuslaw Bank and AmericanWest acquisitions, for a total of \$136.0 million in debentures at December 31, 2016. 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, 2016 the fair value of the junior subordinate debentures was \$95.2 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, 2016, under guidance issued by the Federal Reserve Board. 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, 2016, we had 1,942 full-time and 195 part-time employees. Banner Corporation has no employees except for those who are also employees of Banner Bank, its subsidiaries, and Islanders Bank. The employees are not represented by a collective bargaining unit. We believe our relationship with our employees is good.

## Taxation

### 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. Reference is made to 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 and Utah Taxation: Corporations with nexus in the states of California, Oregon, Idaho and Utah are subject to a corporate level income tax. As our operations in these states increase, the state income tax provision will have an increasing effect on our effective tax rate and results of operations.

## 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. Our ability to attract and retain deposits depends on our ability to provide transaction services and investment opportunities that satisfy the requirements of depositors. We compete for deposits by offering a variety of accounts and financial services, including robust electronic banking capabilities, with competitive rates and terms, at convenient locations and business hours, and delivered with a high level of personal service and expertise.

Competition for loans comes principally from other commercial banks, loan brokers, mortgage banking companies, savings banks and credit unions 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 laws and regulations affecting banks and bank holding companies have changed significantly, particularly in connection with the enactment of The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). Among other changes, the Dodd-Frank Act established the Consumer Financial Protection Bureau (CFPB) as an independent bureau of the Federal Reserve. The CFPB assumed responsibility 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 concerning the Dodd-Frank Act and the CFPB, 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" and "We may be subject to additional regulatory scrutiny if and when Banner or Banner Bank's total assets exceed \$10.0 billion."

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, California, and Utah, Banner Bank is subject not only to the applicable provisions of Washington law and regulations, but is also subject to Oregon, Idaho, California and Utah 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 depositor. As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of, and to require reporting by, FDIC-insured institutions.

The Dodd-Frank Act requires the FDIC's deposit insurance assessments to be based on assets instead of deposits. The FDIC has issued rules which specify that the assessment base for a bank is equal to its total average consolidated assets less average tangible capital. During 2016, because the Federal Deposit Insurance Fund's reserve ratio surpassed 1.15%, the FDIC revised the range of initial assessment rates from five to 35 basis points to 3 to 30 basis points for all institutions. The FDIC also imposed a 4.5 basis point surcharge on assessment rates for all large banks, defined as insured depository institutions with total consolidated assets of \$10 billion or more. The surcharge will be in place until the FDIC reserve ratio reaches 1.35%. When the reserve ratio reaches 1.38%, small banks will receive certain credits applicable to their assessments.

If the FDIC reserve ratio does not reach 1.35% by December 31, 2018, the FDIC will impose a shortfall assessment on all large banks in the first quarter of 2019.

Under the current rules, when the reserve ratio for the prior assessment period is equal to, or greater than 2.0% and less than 2.5%, initial base 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%, initial base assessment rates will range from one basis point to 25 basis points (in each case subject to adjustments for unsecured debt issued by the bank, unsecured debt issued by other FDIC-insured institutions, and brokered deposits held by the bank). 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.

Effective January 1, 2015 (with some changes transitioned into full effectiveness over two to four years), Banner Corporation and the Banks became subject to new capital regulations adopted by the Federal Reserve and the FDIC, which create a new required ratio for common equity Tier 1 ("CET1") capital, increase the minimum leverage and Tier 1 capital ratios, change the risk-weightings of certain assets for purposes of the risk-based capital ratios, create an additional capital conservation buffer over the required capital ratios, and change what qualifies as capital for purposes of meeting the capital requirements. These regulations implement the regulatory capital reforms required by the Dodd Frank Act and the "Basel III" requirements.

Under the new 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.

There are a number of changes in what constitutes regulatory capital compared to the rules in effect prior to January 1, 2015, some of which are subject to transition periods. These changes include the phasing-out of certain instruments as qualifying capital and eliminate or significantly reduce the use of hybrid capital instruments, especially trust preferred securities, as regulatory 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 under the new regulations. If an institution grows above \$15 billion as a result of an acquisition, the trust preferred securities will be excluded from Tier 1 capital and instead included in Tier 2 capital. Mortgage servicing assets and deferred tax assets over designated percentages of CET1 will be 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 for the one-time option of permanently opting out of the inclusion of unrealized gains and losses on available for sale debt and equity securities in our capital calculations. We elected this option in the first quarter of 2015.

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 new regulations make certain changes in the risk-weighting of assets to better reflect credit risk and other risk exposure compared to the earlier capital rules. These 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. The new capital conservation buffer requirement is to be phased in beginning on January 1, 2016 when a buffer greater than 0.625% of risk-weighted assets is required, which amount will increase each year by 0.625% until the buffer requirement is fully implemented on January 1, 2019.

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.

As of December 31, 2016, Banner Corporation and each of the Banks met the requirements to be "well capitalized" and the fully phased-in capital conservation buffer requirement.

**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.

At December 31, 2016, both Banner Bank and Islanders Bank were categorized as "well capitalized" under the prompt corrective action regulations of the FDIC. For additional information, see Note 16, 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, 2016, Banner Bank's and Islanders Bank's aggregate recorded loan balances for construction, land development and land loans were 81% and 30% of total regulatory capital, respectively. In addition, at December 31, 2016, Banner Bank's and Islanders Bank's loans on commercial real estate were 312% and 233% 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 a law regarding financial institution parity. Primarily, the law affords Washington-chartered commercial banks the same powers as Washington-chartered savings banks. In addition, the law provides that Washington-chartered commercial banks may exercise any of the powers that the Federal Reserve has determined to be closely related to the business of banking and the powers of national banks, subject to the approval of the Director in certain situations. 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 Board 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, 2016, 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, to establish a new branch office that will accept deposits, relocate an existing office or merge or consolidate with, or acquire the assets or assume the liabilities of, a federally regulated financial institution. Both

Banner Bank and Islanders Bank received a “satisfactory” rating during their most recently completed CRA examinations.

**Dividends:** The amount of dividends payable by the Banks to the Company depend upon their earnings and capital position, and is limited by federal and state laws, regulations and policies. Federal law further provides that no insured depository institution may make any capital distribution (which includes a cash dividend) if, after making the distribution, the institution would be “undercapitalized,” as defined in the prompt corrective action regulations. Moreover, the federal bank regulatory agencies also have the general authority to limit the dividends paid by insured banks if such payments should be deemed to constitute an unsafe and unsound practice. Dividends from Banner Bank to the Company require regulatory approval because Banner Bank remains in a cumulative negative retained earnings position primarily as a result of goodwill impairment recorded in 2010 and more recently the special dividend paid to the Company to fund the acquisition of Starbuck.

**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 a holding company's effectiveness in combating money laundering when ruling on Bank Holding Company Act and Bank Merger Act applications. Banner Bank's and Islanders Bank's policies and procedures comply with the requirements of the USA Patriot Act.

**Other Consumer Protection Laws and Regulations:** The Dodd-Frank Act established the CFPB and empowered it to exercise broad regulatory, supervisory and enforcement authority with respect to both new and existing consumer financial protection laws. The Banks are subject to consumer protection regulations issued by the CFPB, but as financial institutions with assets of less than \$10 billion, the Banks are generally subject to supervision and enforcement by the FDIC and the Washington DFI with respect to our compliance with consumer financial protection laws and CFPB regulations.

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.

#### 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, we are supervised by the Federal Reserve. The Federal Reserve has a policy that a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, the Dodd-Frank Act and earlier Federal Reserve policy provide that a bank holding company should serve as a source of strength to its subsidiary banks by having the ability to provide financial assistance to its subsidiary banks during periods of financial distress to the 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 doctrine required by the Dodd-Frank Act. Banner Corporation and any subsidiaries that it may control are considered "affiliates" within the meaning of the Federal Reserve Act, and transactions between Banner Bank and affiliates are subject to numerous restrictions. With some exceptions, Banner

Corporation and its subsidiaries are prohibited from tying the provision of various services, such as extensions of credit, to other services offered by Banner Corporation or by its affiliates.

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

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 new restrictions and an expanded framework of regulatory oversight for financial institutions, including depository institutions and implements new capital regulations for Banner Corporation and the Banks are subject to and 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) amend Item 402 of Regulation S-K to require companies to disclose the ratio of the Chief Executive Officer's annual total compensation to the median annual total compensation of all other employees. 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.

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.

**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 have been updated to comply with the requirements of the Sarbanes-Oxley Act.

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

The federal banking agencies are authorized to approve interstate merger transactions without regard to whether the transaction is prohibited by the law of any state, unless the home state of one of the banks adopted a law prior to June 1, 1997 which applies equally to all out-of-state banks and expressly prohibits merger transactions involving out-of-state banks. Interstate acquisitions of branches will be permitted only if the law of the state in which the branch is located permits such acquisitions. Interstate mergers and branch acquisitions will also be subject to the nationwide and statewide insured deposit concentration amounts described above. 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," beginning January 1, 2016 the capital conversion buffer requirement can also restrict Banner Corporation's and the Banks' ability to pay dividends.

**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, 2016, Banner Corporation repurchased 1,145,250 shares of its common stock at a average price of \$44.29 per share under its previously announced trading plan.

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, 2016:

Name	Age	Position with Banner Corporation	Position with Banner Bank
Mark J. Grescovich	52	President, Chief Executive Officer, Director	President, Chief Executive Officer, Director
Lloyd W. Baker	68	Executive Vice President, Chief Financial Officer	Executive Vice President
Richard B. Barton	73		Executive Vice President, Chief Credit Officer
Douglas M. Bennett	64		Executive Vice President, Real Estate Lending Operations
Peter J. Conner	51		Executive Vice President, Chief Financial Officer
Kayleen R. Kohler	44		Executive Vice President Human Resources
Kenneth A. Larsen	47		Executive Vice President, Mortgage Banking
Craig Miller	65		Executive Vice President General Counsel
Cynthia D. Purcell	59		Executive Vice President, Retail Banking and Administration
M. Kirk Quillin	54		Executive Vice President, East Region, Commercial Banking
James T. Reed, Jr.	54		Executive Vice President, West Region, Commercial Banking
Steven W. Rust	69		Executive Vice President, Chief Information Officer
Judith A. Steiner	54		Executive Vice President Chief Risk Officer
Gary W. Wagers	56		Executive Vice President, Retail Products and Services
Keith A. Western	61		Executive Vice President, California & S. Oregon Commercial Banking

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. Prior to joining Banner 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.



Lloyd W. Baker joined First Savings Bank of Washington (now Banner Bank) in 1995 as Asset/Liability Manager, has been a member of the executive management committee since 1998 and has served as the Chief Financial Officer of Banner Corporation since 2000 and of Banner Bank from 2000 to October 2015. His banking career began in 1973 and has included a variety of roles in financial management and reporting, strategic planning, asset, liability and portfolio management, mortgage lending and secondary marketing.

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. Mr. Barton was named Chief Lending Officer in 2008 and continues in his role as Chief Credit Officer.

Douglas M. Bennett, who joined First Federal Savings and Loan (now Banner Bank) in 1974, has over 40 years of experience in real estate lending. He has served as a member of Banner Bank's executive management committee since 2004.

Peter J. Conner joined Banner Bank in 2015 upon the acquisition of AmericanWest. Prior to joining Banner, Mr. Conner was the Chief Financial Officer for SKBHC LLC, the holding company for Starbuck, (SKBHC) and AmericanWest from 2010 until he joined Banner Bank in 2015. Mr. Conner has 25 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 Masters of Business from the Haas School of Business at U.C. Berkeley.

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 SPHR and SHRM-SCP certifications.

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 25-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.

Craig Miller is the Executive Vice President and General Counsel for Banner Bank. He joined Banner in 2016 and is responsible for overseeing the company's legal functions. Mr. Miller had previously served as senior litigation partner at Davis Wright Tremaine LLP in Seattle and served with the firm, Rose Joneson Vargas, in American Samoa. His extensive experience in state and federal commercial trials, mediations and arbitrations, cover a wide variety of

litigation matters, with special concentration in representing creditors in distressed credit cases, including collections, foreclosures, and bankruptcy adversary actions. Mr. Miller earned his Juris Doctor degree (JD) from the University of Southern California Law School. His community involvement includes board service with the YMCA of Greater Seattle, Childhaven, King County Sexual Assault Resource Center, and the Meany Center for the Performing Arts.

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 the 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 loan manager and was named to his current position as the East Region Commercial Banking Executive in July 2012. He is responsible for commercial and specialty banking for all locations in Eastern Washington, Eastern Oregon, Idaho and Utah. 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 to his current position as the West Region Commercial Banking Executive in July 2012. He is responsible for Commercial Banking in Western Washington and Western Oregon, 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 38 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 the 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.

Keith A. Western is Executive Vice President, Commercial Banking 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 39 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](http://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, Utah and Idaho. All of our branches and most of our deposit customers are also located in these five 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 the recent withdrawal by the United States from the Trans-Pacific Partnership trade agreement 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, California and Salt Lake City, Utah, we will be exposed to concentration risks in those areas as well.

A deterioration in economic conditions in the market areas 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 Salt Lake City, Utah 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;
- 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 return of recessionary conditions could result in increases in our level of non-performing loans and/or reduce demand for our products and services, which could have adverse effect on our results of operations.

A return of recessionary conditions and/or negative developments in the domestic and international credit markets may significantly affect the markets in which we do business, the value of our loans and investments, and our ongoing operations, costs and profitability. Declines in real estate values and sales volumes and high unemployment levels

may result in higher than expected loan delinquencies and a decline in demand for our products and services. These negative events may cause us to incur losses and may adversely affect our capital, liquidity, and financial condition.

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 \$6.64 billion outstanding in these types of higher risk loans at December 31, 2016 compared to \$6.36 billion at December 31, 2015. These loans typically present different risks to us for a number of reasons, including those discussed below:

**Construction and Land Loans.** At December 31, 2016, construction and land loans were \$823.1 million or 11% of our total loan portfolio. This type of lending contains the inherent difficulty in estimating both a property's value at completion of the project and the estimated cost (including interest) of the project. If the estimate of construction cost proves to be inaccurate, we may be required to advance funds beyond the amount originally committed to permit completion of the project. If the estimate of value upon completion proves to be inaccurate, we may be confronted at, or prior to, the maturity of the loan with a project the value of which is insufficient to assure full repayment. In addition, speculative construction loans to a builder are often associated with homes that are not pre-sold, and thus pose a greater potential risk to us than construction loans to individuals on their personal residences. Loans on land under development or held for future construction also 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 conditions. As a result, this type of lending often involves the disbursement of substantial funds with repayment dependent on the success of the ultimate project

and the ability of the borrower to sell the property, rather than the ability of the borrower or guarantor to independently repay principal and interest. While our origination of these types of loans has decreased significantly from earlier periods, as a result of the recent improvement in real estate values in certain of our market areas, this category of lending has increased in recent years and our investment in construction and land loans increased by \$248.7 million or 43% in 2016. At December 31, 2016, construction and land loans that were non-performing were \$1.7 million, or 8% of our total non-performing loans.

**Commercial and Multifamily Real Estate Loans.** At December 31, 2016, commercial and multifamily real estate loans were \$3.59 billion, or 48% 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. This risk was exacerbated in the recent recession and could remain an elevated risk in the current slow recovery economic environment. At December 31, 2016, commercial and multifamily real estate loans that were non-performing were \$9.1 million, or 40% of our total non-performing loans.

**Commercial Business Loans.** At December 31, 2016, commercial business loans were \$1.21 billion, or 16% 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. The borrowers' cash flow may prove to be unpredictable, and collateral securing these loans may fluctuate in value. Most often, this collateral is accounts receivable, inventory, equipment or real estate. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. Other collateral securing loans may depreciate over time, may be difficult to appraise, may be illiquid and may fluctuate in value based on the success of the business. At December 31, 2016, commercial business loans that were non-performing were \$3.1 million, or 14% of our total non-performing loans.

**Agricultural Loans.** At December 31, 2016, agricultural loans were \$369.2 million, or 5% 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 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, 2016, there were \$3.2 million of agricultural loans that were non-performing or 14% of total non-performing loans.

Consumer Loans. At December 31, 2016, consumer loans were \$650.5 million, or 9% of our total loan portfolio. Consumer loans (such as personal lines of credit) are collateralized, if at all, with assets that may not provide an adequate source of payment of the loan due to depreciation, damage, or loss. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on these loans. At December 31, 2016, consumer loans that were non-performing were \$1.9 million, or 9% of our total non-performing loans.

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; and
- changes in economic and industry conditions.

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, 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. 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.

The Financial Accounting Standards Board has adopted a new accounting standard that will be effective for our first fiscal year after December 15, 2019. This standard, referred to as Current Expected Credit Loss, or CECL, 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 that 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. 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 replenish 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 may be adversely affected by risks associated with completed and potential acquisitions.

As part of our general growth strategy, we have recently expanded our business through acquisitions. During 2015, we completed the acquisitions of AmericanWest and Siuslaw. 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 condition 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 the extent our costs of an acquisition exceed the fair value of the net assets acquired, the acquisition will generate goodwill. As discussed below, 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;

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; and

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.

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 on 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 expect 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.

Our expansion into new market areas in California and Utah may present increased risk.

AmericanWest's lending operations were concentrated in the states of California, Utah, Oregon, Idaho and Washington. The merger with AmericanWest resulted in Banner's initial entry into the states of California and Utah where Banner has little or no operating experience. Although Banner retained a number of AmericanWest's lending and business development officers with experience in these markets, Banner is new to these market areas and has conducted only limited banking business in California and Utah. Our entry into these markets presents us with different competitive conditions, customer preferences and banking products than we have experienced in the Pacific Northwest markets we know. As a result, it is possible that our operations in these states may be less successful than our operations in the Pacific Northwest. In addition, our financial condition and results of operations will be subject to general economic conditions and the conditions in the real estate markets prevailing in California and Utah as well as the Pacific Northwest markets we know. If economic conditions in any one of these states worsens or if the real estate market declines, we may suffer decreased net income or losses associated with higher default rates and decreased collateral values on our existing portfolio, and we may not be able to originate loans at acceptable risk levels and upon acceptable terms to maintain our risk profile and asset quality.

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.

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 Board. In an attempt to help the overall economy, the Federal Reserve Board has kept interest rates low through its targeted Fed Funds rate. In December 2016, the Federal Reserve Board slightly increased the Fed Funds rate by 25 basis points and intends further increases during 2017 subject to economic conditions. As the Federal Reserve Board increases the Fed Funds rate, overall interest rates will likely rise, which may negatively impact both the housing markets by reducing refinancing activity and new home purchases and the U.S. economic recovery.

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 loans and obtain deposits, (ii) the fair value of our financial assets and liabilities and (iii) the average duration of our mortgage-backed securities portfolio and other interest-earning assets.

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 rise, our funding costs may rise faster than the yield we earn on our assets, causing our net interest margin to contract until the yield catches 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 a result of the exceptionally low interest rate environment, an increasing percentage of our deposits have been 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 71% of our loan portfolio was comprised of adjustable or floating-rate loans at December 31, 2016, and approximately \$2.6 billion, or 49%, of those loans contained interest rate floors, below which the loans’ contractual interest rate may not adjust. At December 31, 2016, the weighted average floor interest rate of these loans was 4.60%. At that date, approximately \$1.40 billion, or 54%, 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.

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.

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 operations.

As state-chartered, federally insured commercial banks, Banner Bank and Islanders Bank (the Banks) are currently subject to extensive examination, supervision and comprehensive regulation by the FDIC and the Washington DFI and as a bank holding company Banner is subject to examination, supervision and regulation by the FRB. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the ability to impose restrictions on an institution's operations, reclassify assets, determine the adequacy of an institution's allowance for loan losses and determine the level of deposit insurance premiums assessed.

Additionally, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) has significantly changed the bank regulatory structure and affected the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new implementing rules and regulations and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting the implementing rules and regulations, and consequently many of the details and much of the impact of the Dodd-Frank Act may not be known for many months or years.

Certain provisions of the Dodd-Frank Act may have an indeterminable impact on us in the near term. For example, a provision of the Dodd-Frank Act eliminates the federal prohibitions on paying interest on demand deposits, thus allowing businesses to have interest bearing checking accounts. Depending on competitive responses, this significant change to existing law could have an adverse impact on our interest expense.

The Dodd-Frank Act created a new Consumer Financial Protection Bureau (the CFPB) with broad powers to supervise and enforce consumer protection laws. The CFPB has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The CFPB has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. Financial institutions such as Banner Bank with \$10 billion or less in assets will continue to be examined for compliance with the consumer laws by their primary bank regulators but are subject to the rules of the CFPB. See "We may be subject to additional regulatory scrutiny if and when Banner or Banner Bank's total assets exceed \$10.0 billion."

The CFPB has issued a number of final regulations and changes to certain consumer protections under existing laws. These final rules generally prohibit creditors from extending mortgage loans without regard for the consumer's ability-to-repay and add restrictions and requirements to mortgage origination and servicing practices. In addition, these rules limit prepayment penalties and require the creditor to retain evidence of compliance with the ability-to-repay requirement for three years. Compliance with these rules has increased our overall regulatory compliance costs and may require changes to our underwriting practices with respect to mortgage loans. This includes compliance with The Truth in Lending Act and the Real Estate Settlement Procedures Act Integrated Disclosure (TRID) rule, which combines certain disclosures that consumers receive in connection with applying for and closing a mortgage loan. Moreover, these rules may adversely affect the volume of mortgage loans that we underwrite and may subject us to increased potential liabilities related to such residential loan origination activities.

It is difficult to predict at this time what specific impact the Dodd-Frank Act and the rules and regulations implementing it will have on community banks. However, it is expected that at a minimum they will increase our operating and compliance costs, which could adversely affect key operating efficiency ratios, and could increase our interest expense. See "Business - Regulation" contained in Part I, Item I of this report.

We may be subject to additional regulatory scrutiny if and when Banner or Banner Bank's total assets exceed \$10.0 billion.

Banner's total assets were \$9.79 billion and Banner Bank's total assets were \$9.53 billion at December 31, 2016. Following the fourth consecutive quarter where the total assets of Banner or Banner Bank exceed \$10 billion, Banner or Banner Bank, as applicable, will become subject to a number of additional requirements (such as annual stress testing requirements implemented pursuant to the Dodd-Frank Act and general oversight by the CFPB) that will impose additional compliance costs on our business. As a result, there may also be additional higher expectations from regulators. The CFPB has near exclusive supervision authority, including examination authority, over institutions of that size and their affiliates to assess compliance with federal consumer financial laws, to obtain information about the institutions' activities and compliance systems and procedures, and to detect and assess risks to consumers and markets.

Under the Dodd-Frank Act, the minimum ratio of net worth to insured deposits of the Deposit Insurance Fund was increased from 1.15% to 1.35% and the FDIC is required, in setting deposit insurance assessments, to offset the effect of the increase on institutions with assets of less than \$10 billion, which results in institutions with assets greater than \$10 billion paying higher assessments. In addition, if Banner Bank exceeds \$10 billion in assets, its assessment base for federal deposit insurance would change from the amount of insured deposits to consolidated average assets less tangible capital to a scorecard method. The scorecard method uses a performance score and a loss severity score, which are combined and converted into an initial base assessment rate. The performance score is based on measures of the bank's ability to withstand asset-related stress and funding-related stress and weighted CAMELS ratings, which are ratings ascribed under the CAMELS supervisory rating system and assigned based on a supervisory authority's analysis of a bank's financial statements and on-site examinations. The loss severity score is a measure of potential losses to the FDIC in the event of the bank's failure. Under a formula, the performance score and loss severity score are combined and converted to a total score that determines the bank's initial base assessment rate. The FDIC has the discretion to alter the total score based on factors not captured by the scorecard. The resulting initial base assessment rate is also subject to adjustments downward based on long term unsecured debt issued by the bank, to adjustment upward based on long term unsecured debt held by the bank that is issued by other FDIC-insured institutions, and to further adjustment upward if the bank's brokered deposits exceed 10% of its domestic deposits.

Further, Banner Bank and Islanders Bank may be affected by the Durbin Amendment to the Dodd-Frank Act regarding limits on debit card interchange fees. The Durbin Amendment gave the Federal Reserve Board 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 and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer. The Federal Reserve Board 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. Based on expected debit card volume, we believe we could experience a reduction of approximately \$10 million a year in debit card related fee income and pre-tax earnings following the implementation of the Durbin Amendment.

The Dodd-Frank Act also requires publicly-traded bank holding companies with assets of \$10 billion or more to perform capital stress testing and establish a risk committee responsible for enterprise-wide risk management practices, comprised of independent directors, including one risk management expert.

As a result of the above, if and when Banner's or Banner Bank's total assets exceed \$10 billion, deposit insurance assessments, expenses related to regulatory compliance are likely to increase, and interchange fee income will decrease, the cumulative effect of which may be significant.

Reductions in interchange income could negatively impact our earnings.

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. We earn interchange fees on card transactions from its debit cards, including \$19.5 million during the year ended December 31, 2016. Merchants have attempted to negotiate lower interchange rates, and the Durbin Amendment to the Dodd-Frank Act, which we would become subject to once our total assets exceed \$10.0 billion, limits the amount of interchange fees that may be charged for certain debit card transactions. See "We may be subject to additional regulatory scrutiny if and when Banner or Banner Bank's total assets exceed \$10.0 billion." 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.



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

The banking industry is extensively regulated. Federal and state banking regulations are designed primarily to protect the deposit insurance funds and consumers, not to benefit a company's shareholders. These regulations may sometimes impose significant limitations on operations. The significant federal and state banking regulations that affect us are described in this report under the heading "Item 1. Business-Regulation." 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.

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 get 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 get 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.

The financial services market is undergoing rapid technological changes, and if we are unable to stay current with those changes, we will not be able to effectively compete.

The financial services market, including banking services, is undergoing rapid changes with frequent introductions of new technology-driven products and services. Our future success will depend, in part, on our ability to keep pace with the technological changes and to use technology to satisfy and grow customer demand for our products and services and to create additional efficiencies in our operations. We expect that we will need to make substantial investments in our technology and information systems to compete effectively and to stay current with technological changes. Some of our competitors have substantially greater resources to invest in technological improvements and will be able to invest more heavily in developing and adopting new technologies, which may put us at a competitive disadvantage. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. As a result, our ability to effectively compete to retain or acquire new business may be impaired, and our business, financial condition or results of operations may be adversely affected.

We may experience future goodwill impairment.

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 then 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 has an adverse effect on our results of shareholders' equity and financial results and could cause a decline in our stock price. The recent acquisitions of Starbuck, Siuslaw and their subsidiaries, AmericanWest and Siuslaw Bank, respectively, has substantially increased our goodwill.

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition.

Liquidity is essential to our business. We rely on a number of different sources in order to meet our potential liquidity demands. Our primary sources of liquidity are increases in deposit accounts, cash flows from loan payments and our securities portfolio. Borrowings also provide us with a source of funds to meet liquidity demands. An inability to raise funds through deposits, borrowings, the sale of loans or investment securities and other sources could have a

substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities or on terms which are acceptable to us could be impaired by factors that affect us specifically, or the financial services industry or economy in general. 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.

Additionally, collateralized public funds 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. Our ability to retain our key employees throughout the integration process following our recent acquisitions, including the recent acquisition of AmericanWest, may be challenging. 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.

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

Our loans to businesses and individuals and our deposit relationships and related transactions are subject to exposure to the risk of loss due to fraud and other financial crimes. 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.

Our framework for managing risks may not be effective in mitigating risk and loss to us.

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 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. 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 which could have a material adverse effect on our financial condition and results of operations.

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, unauthorized access, misuse, computer viruses, 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. Any compromise of our security also 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. These precautions may not protect our systems from compromises or breaches of our security measures, which could result in significant legal liability and significant damage to our reputation and our business.

Our security measures may not protect us from systems 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. If our third-party providers encounter difficulties, or if we have difficulty in communicating with them, our ability to adequately process and account for transactions could be affected, and our business operations could be adversely impacted. Threats to information security also exist in the processing of customer information through various other vendors and their personnel.

The occurrence of any failures or interruptions may require us 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.

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 contains 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, 2016, we have 190 branch offices located in Washington, Oregon, California, Utah and Idaho. 187 branches are Banner Bank branches and three of those 190 are Islanders Bank branches. 89 branches are located in Washington, 44 in Oregon, 36 in California, 14 in Idaho and seven in Utah. Of these branch locations, approximately half are owned and the other half are leased facilities. In addition to the branch locations, we also have eleven loan production offices nine of which are located in Washington and one each in

Oregon and California. 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 25 years. Administrative support offices are primarily in Washington, where we have eight facilities, of which we own four and lease four. Additionally, we have one leased administrative support office in Idaho and own one located in Oregon. In the opinion of management, all properties are adequately covered by insurance, are in a good state of repair and are appropriately designed for their present and future use.

#### Item 3 – Legal Proceedings

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

#### 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

## Price Range of Common Stock and Dividend Information

Our voting common stock is principally traded on the NASDAQ Global Select Market under the symbol “BANR.” Shareholders of record as of December 31, 2016 totaled 1,705 based upon securities position listings furnished to us by our transfer agent. This total does not reflect the number of persons or entities who hold stock in nominee or “street” name through various brokerage firms. The following tables show the reported high and low sale prices of our listed voting common stock for the periods presented as well as the cash dividends declared per share of common stock for each of those periods.

Year Ended December 31, 2016	High	Low	Cash Dividend Declared
First quarter	\$45.92	\$35.39	\$ 0.21
Second quarter	45.01	38.77	0.21
Third quarter	44.69	39.58	0.23
Fourth quarter	56.50	43.20	0.23
Year Ended December 31, 2015	High	Low	Cash Dividend Declared
First quarter	\$46.26	\$39.00	\$ 0.18
Second quarter	50.50	43.87	0.18
Third quarter	50.16	42.42	0.18
Fourth quarter	53.55	44.13	0.18

The timing and amount of cash dividends paid on our common stock depends on our earnings, capital requirements, financial condition and other relevant factors and is subject to the discretion of our board of directors. As a result of continued strong earnings, levels of capital, asset quality and financial condition, we increased the dividend in the first and third quarters of 2016. There can be no assurance that we will pay dividends on our common stock in the future.

Our ability to pay dividends on our common stock depends primarily on dividends we receive from Banner Bank and Islanders Bank. Under federal regulations, the dollar amount of dividends the Banks may pay depends upon their capital position and recent net income. Generally, if a bank satisfies its regulatory capital requirements, it may make dividend payments up to the limits prescribed under state law and FDIC regulations. In addition, an institution that has converted to a stock form of ownership may not declare or pay a dividend on, or repurchase any of, its common stock if the effect thereof would cause the regulatory capital of the institution to be reduced below the amount required for the liquidation account which was established in connection with the conversion. Banner Bank, our primary subsidiary, converted to a stock form of ownership and is therefore subject to the limitation described in the preceding sentence. 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.

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.

In addition to the foregoing regulatory considerations, there are numerous governmental requirements and regulations that affect our business activities. A change in applicable statutes, regulations or regulatory policy may have a material effect on our business and on our ability to pay dividends on our common stock.

Payments of the distributions on our trust preferred securities (TPS) from the special purpose subsidiary trusts we sponsored are fully and unconditionally guaranteed by us. The junior subordinated debentures that we have issued to our subsidiary trusts are ranked senior to our shares of common stock. We must make required payments on the junior subordinated debentures before any dividends can be paid on our TPS and our common stock and, in the event of our bankruptcy, dissolution or liquidation, the interest and principal obligations under the junior subordinated debentures must be satisfied before any distributions can be made on our common stock. We may defer the payment of interest on each of the junior subordinated debentures for a period not to exceed 20 consecutive quarters, provided that the deferral period does not extend beyond the stated maturity. During such deferral period, distributions on the corresponding TPSs will also be deferred and we may not pay cash dividends to the holders of shares of our common stock. At December 31, 2016, we were current on all interest payments.

## Issuer Purchases of Equity Securities

The following table provides information about repurchases of common stock by the Company during the quarter ended December 31, 2016:

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, 2016 - October 31, 2016	371,979	\$ 44.29	367,200	859,990
November 1, 2016 - November 30, 2016	293,700	45.66	293,700	566,290
December 1, 2016 - December 31, 2016	—	—	—	566,290
Total for quarter	665,679	44.90	660,900	566,290

On April 4, 2016, the Company announced that its Board of Directors had authorized the repurchase of up to 1,711,540 shares of the Company's common stock, or 5% of the Company's outstanding shares. During the quarter ended September 30, 2016, the Company adopted a pre-arranged stock trading plan, pursuant to the Board authorization, in accordance with guidelines specified under Rule 10b5-1 of the Securities Exchange Act of 1934. Repurchases under the Company's Rule 10b5-1 stock trading plan are administered through an independent broker. The stock trading plan authorizes the repurchase of up to 1,300,000 shares of the 1,711,540 shares of Company stock authorized to be repurchased. The stock trading plan will extend through March 12, 2017, unless completed sooner or otherwise extended or terminated. Repurchases are subject to the requirements of the SEC, including Rule 10b-18, as well as certain price and other requirements specified in the plan. During the quarter and year ended December 31, 2016, the Company repurchased 660,900 and 1,145,250 common shares, respectively, under the stock trading plan leaving 566,290 shares available for future repurchase under the Board authorization.

In addition, 4,779 shares were surrendered by employees to satisfy tax withholding obligations upon the vesting of restricted stock grants in the fourth quarter of 2016.

## Equity Compensation Plan Information

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

Performance Graph. The following graph compares the cumulative total shareholder return on Banner Corporation common stock with the cumulative total return on the NASDAQ (U.S. Stock) Index, a peer group of the SNL \$5 Billion to \$10 Billion Asset Bank Index and a peer group of the SNL NASDAQ Bank Index. Total return assumes the reinvestment of all dividends.

Index	Year Ended					
	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16
Banner Corporation	100.00	179.52	265.81	259.69	281.12	347.46
NASDAQ Composite	100.00	117.45	164.57	188.84	201.98	219.89
SNL Bank \$5B-\$10B	100.00	117.63	181.48	186.94	212.96	305.09
SNL Bank NASDAQ	100.00	119.19	171.31	177.42	191.53	265.56

\*Assumes \$100 invested in Banner Corporation common stock and each index at the close of business on December 31, 2011 and that all dividends were reinvested. Information for the graph was provided by SNL Financial L.C. © 2017.

## Item 6 – Selected Financial Data

The following condensed consolidated statements of financial condition and operations and selected performance ratios as of December 31, 2016, 2015, 2014, 2013, and 2012 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:

(In thousands)	December 31				
	2016	2015	2014	2013	2012
Total assets	\$9,793,668	\$9,796,298	\$4,723,163	\$4,388,257	\$4,265,264
Cash and securities <sup>(1)</sup>	1,353,583	1,655,290	708,609	772,614	811,902
Loans receivable, net	7,365,151	7,236,496	3,755,127	3,341,453	3,146,303
Deposits	8,121,414	8,055,068	3,898,950	3,617,926	3,557,804
Borrowings	255,101	324,186	187,436	184,234	160,000
Common shareholders’ equity	1,305,710	1,300,059	582,888	538,331	506,919
Total shareholders’ equity	1,305,710	1,300,059	582,888	538,331	506,919
Shares outstanding	33,193	34,242	19,572	19,544	19,455
Shares outstanding excluding unearned, restricted shares held in ESOP	33,193	34,242	19,572	19,509	19,421

## OPERATING DATA:

(In thousands)	For the Year Ended December 31				
	2016	2015	2014	2013	2012
Interest income	\$391,477	\$254,433	\$190,661	\$179,712	\$187,162
Interest expense	16,408	12,154	10,789	12,996	19,514
Net interest income before provision for loan losses	375,069	242,279	179,872	166,716	167,648
Provision for loan losses	6,030	—	—	—	13,000
Net interest income	369,039	242,279	179,872	166,716	154,648
Deposit fees and other service charges	49,156	40,607	30,553	26,581	25,266
Mortgage banking operations revenue	25,552	17,720	10,249	11,170	13,812
Other-than-temporary impairment recoveries (losses)	—	—	—	409	(409)
Net change in valuation of financial instruments carried at fair value	(2,620)	(813)	1,374	(2,278)	(16,515)
All other non-interest income	11,382	4,778	12,815	8,780	5,136
Total non-interest income	83,470	62,292	54,991	44,662	27,290
REO operations expense (recoveries), net	175	397	(446)	(689)	3,354
All other non-interest expenses	322,694	236,203	154,187	141,664	138,099
Total non-interest expense	322,869	236,600	153,741	140,975	141,453
Income before provision for income tax expense (benefit)	129,640	67,971	81,122	70,403	40,485
Provision for income tax expense (benefit)	44,255	22,749	27,052	24,189	(24,372)
Net income	\$85,385	\$45,222	\$54,070	\$46,214	\$64,857

(footnotes follow)



## PER COMMON SHARE DATA:

	At or For the Years Ended December 31				
	2016	2015	2014	2013	2012
Net income:					
Basic	\$2.52	\$1.90	\$2.79	\$2.39	\$3.17
Diluted	2.52	1.89	2.79	2.38	3.16
Common shareholders' equity per share <sup>(2)(9)</sup>	39.34	37.97	29.78	27.59	26.09
Common shareholders' tangible equity per share <sup>(2)(9)</sup>	31.06	29.64	29.64	27.42	25.87
Cash dividends	0.88	0.72	0.72	0.54	0.04
Dividend payout ratio (basic)	34.92 %	37.89 %	25.78 %	22.62 %	1.26 %
Dividend payout ratio (diluted)	34.92 %	38.10 %	25.84 %	22.67 %	1.27 %

## OTHER DATA:

	As of December 31				
	2016	2015	2014	2013	2012
Full time equivalent employees	2,078	2,063	1,150	1,084	1,074
Number of branches	190	202	93	88	88

(footnotes follow)

## KEY FINANCIAL RATIOS:

	At or For the Years Ended December 31				
	2016	2015	2014	2013	2012
Performance Ratios:					
Return on average assets <sup>(3)</sup>	0.87	% 0.72	% 1.17	% 1.09	% 1.54
Return on average common equity <sup>(4)</sup>	6.41	5.56	9.59	8.79	11.63
Average common equity to average assets	13.54	12.87	12.20	12.35	13.22
Interest rate spread <sup>(5)</sup>	4.19	4.09	4.04	4.08	4.13
Net interest margin <sup>(6)</sup>	4.20	4.10	4.07	4.11	4.17
Non-interest income to average assets	0.85	0.99	1.19	1.05	0.65
Non-interest expense to average assets	3.28	3.75	3.32	3.31	3.35
Efficiency ratio <sup>(7)</sup>	70.41	77.68	65.46	67.11	72.71
Average interest-earning assets to funding liabilities	105.84	107.59	108.78	108.28	109.11
Selected Financial Ratios:					
Allowance for loan losses as a percent of total loans at end of period	1.15	1.07	1.98	2.17	2.37
Net recoveries (charge-offs) as a percent of average outstanding loans during the period	0.03	0.04	0.05	(0.08)	(0.57)
Non-performing assets as a percent of total assets	0.35	0.28	0.43	0.66	1.18
Allowance for loan losses as a percent of non-performing loans <sup>(8)</sup>	380.87	512.47	453.56	299.81	223.20
Common shareholders' tangible equity to tangible assets <sup>(9)</sup>	10.83	10.68	12.29	12.23	11.80
Consolidated Capital Ratios:					
Total capital to risk-weighted assets	13.40	13.63	16.80	16.99	16.96
Tier 1 capital to risk-weighted assets	12.41	12.65	15.54	15.73	15.70
Tier 1 capital to average leverage assets	11.83	11.06	13.41	13.64	12.74
Common equity tier I capital to risk-weighted assets	11.19	12.13	na	na	na

(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.

(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, other intangible assets and preferred equity 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. In addition, excluding preferred equity, the level of which may vary from company to company, allows investors to more easily compare our capital adequacy to other companies in the industry that also use this measure. 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, "Management's Discussion and Analysis of Financial Condition—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 2016, as evidenced by our solid operating results and profitability. We have made substantial progress on our goals to achieve and maintain the Company's moderate risk profile as well as to develop and continue strong earnings momentum. Highlights for the year included continued strong asset quality, outstanding client acquisition and account growth and strong revenue generation from core operations. The year ended December 31, 2016 was also highlighted by the completed integration of Siuslaw Bank and AmericanWest Bank, which were acquired in 2015.

For the year ended December 31, 2016, our net income was \$85.4 million, or \$2.52 per diluted share, compared to net income of \$45.2 million, or \$1.89 per diluted share for the year ended December 31, 2015 and \$54.1 million, or \$2.79 per diluted share for the year ended December 31, 2014. The 2016 results reflect the first full year of earnings contribution from the operations acquired in the AmericanWest and Siuslaw acquisitions. Our results for the years ended December 31, 2016 and 2015 were significantly impacted by merger and acquisition activity and the related expenses. Acquisition-related expenses were \$11.7 million, or \$0.22 per diluted share net of tax benefit, in 2016 compared to \$26.1 million, or \$0.76 per diluted share net of tax benefit, in 2015. Results for 2014 included a \$9.1 million bargain purchase gain related to our June 2014 purchase of six branches in Oregon (the Branch purchase), which net of taxes contributed \$0.30 to diluted net income per share.

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 55% to \$375.1 million for the year ended December 31, 2016, compared to \$242.3 million for the year earlier. This increase in net interest income reflects a full year contribution in 2016 of the operations acquired in the the AmericanWest and Siuslaw acquisitions and organic loan and deposit growth from the legacy Banner Bank franchise. During the year ended December 31, 2016, our interest spread increased to 4.19% from 4.09% for the prior year while our net interest margin increased to 4.20% compared to 4.10% for the prior year. Our net interest margin was enhanced 16 basis points in 2016 and eight basis points in 2015 by acquisition accounting adjustments including the amortization of acquisition accounting discounts on purchased loans received in the acquisitions, which are accreted into loan interest income, as well as net premiums on non-market-rate certificate of deposit liabilities assumed in the acquisitions which are amortized as a reduction to deposit interest expense. Setting aside acquisition accounting adjustments, our net interest margin increased two basis points despite continuing pressure on asset yields in the very low interest rate environment as a result of changes to the mix of assets and liabilities.

Although our credit quality metrics continue to reflect our moderate risk profile, we recorded a \$6.0 million provision for loan losses in the year ended December 31, 2016, primarily due to the organic growth in the loan portfolio and the renewal of acquired loans out of the discounted loan portfolios, compared to no provision for loan losses recorded in 2015 or 2014. Non-performing loans increased modestly to \$22.6 million at December 31, 2016, compared to \$15.2 million a year earlier. Our allowance for loan losses at December 31, 2016 was \$86.0 million, representing 381% 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 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 of loans and 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 \$83.5 million for the year ended December 31, 2016, compared to \$62.3 million for the year ended December 31, 2015. For the year ended December 31, 2016, we recorded a net loss of \$2.6 million for fair value adjustments and \$843,000 in net gains on the sale of securities. In comparison, for the year ended December 31, 2015, we recorded a net loss of \$813,000 for fair value adjustments and \$540,000 in net losses on the sale of securities. Non-interest income excluding the net gain on sale of securities, and changes in the value of financial instruments carried at fair value, which we believe is more indicative of our core operations, increased 34% to \$85.2 million for the year ended December 31, 2016 compared to \$63.6 million for the same period a year earlier, as we experienced meaningful increases in deposit fees and service charges and mortgage banking revenues.

Our total revenues (net interest income before the provision for loan losses plus total non-interest income) for the year ended December 31, 2016 increased \$154.0 million, or 51%, to \$458.5 million, compared to \$304.6 million for the same period a year earlier, largely as a result of the full year of benefits from our 2015 acquisitions and organic growth. Our total revenues from core operations, which excludes net gains on sale of securities and fair value adjustments, increased by \$154.4 million, or 50%, to \$460.3 million for the year ended December 31, 2016, compared to \$305.9 million for the same period a year earlier.

For the year ended December 31, 2016, non-interest expense increased 36% to \$322.9 million, compared to \$236.6 million for the year ended December 31, 2015. The increase was largely attributable to the incremental costs associated with operating the 98 branches acquired in the AmericanWest acquisition on October 1, 2015 and the ten Siuslaw Bank branches acquired in March 2015 for a full year in 2016 compared to

a period of less than a year in 2015, as well as generally increased compensation, occupancy and payment and card processing services reflecting increased transaction volume.

Reflecting our previously announced strategy to maintain assets below \$10.0 billion through December 31, 2016, our total assets decreased slightly during 2016 to \$9.79 billion at December 31, 2016. As part of this strategy total securities and interest-bearing cash balances decreased as a result of repayments and sales of securities. Proceeds from these securities transactions were used to reduce FHLB advances and to repurchase 1,145,250 shares of common stock. Remaining below \$10.0 billion through the year end had the beneficial effect of delaying the adverse impact on our future operating results from certain enhanced regulatory requirements and the Durbin Amendment cap on interchange fees.

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 certain periods, 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, 2016 and 2015” 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		
	2016	2015	2014
<b>NON-INTEREST INCOME FROM CORE OPERATIONS:</b>			
Total non-interest income (GAAP)	\$83,470	\$62,292	\$54,991
Exclude net (gain) loss on sale of securities	(843 )	540	(42 )
Exclude change in valuation of financial instruments carried at fair value	2,620	813	(1,374 )
Exclude acquisition bargain purchase gain	—	—	(9,079 )
Total non-interest income from core operations (non-GAAP)	\$85,247	\$63,645	\$44,496
<b>REVENUE FROM CORE OPERATIONS:</b>			
Net interest income before provision for loan losses	\$375,069	\$242,279	\$179,872
Total non-interest income	83,470	62,292	54,991
Total GAAP revenue	458,539	304,571	234,863
Exclude net (gain) loss on sale of securities	(843 )	540	(42 )
Exclude change in valuation of financial instruments carried at fair value	2,620	813	(1,374 )
Exclude acquisition bargain purchase gain	—	—	(9,079 )
Revenue from core operations (non-GAAP)	\$460,316	\$305,924	\$224,368
<b>INCOME FROM CORE OPERATIONS:</b>			
Income before provision for taxes (GAAP)	\$129,640	\$67,971	\$81,122
Exclude net (gain) loss on sale of securities	(843 )	540	(42 )
Exclude change in valuation of financial instruments carried at fair value	2,620	813	(1,374 )
Exclude acquisition bargain purchase gain	—	—	(9,079 )
Exclude acquisition related costs	11,733	26,110	4,325
Income from core operations before provision for taxes (non-GAAP)	\$143,150	\$95,434	\$74,952
<b>EARNINGS FROM CORE OPERATIONS:</b>			
Net income (GAAP)	\$85,385	\$45,222	\$54,070
Exclude net (gain) loss on sale of securities	(843 )	540	(42 )
Exclude change in valuation of financial instruments carried at fair value	2,620	813	(1,374 )
Exclude acquisition bargain purchase gain	—	—	(9,079 )
Exclude acquisition related costs	11,733	26,110	4,325
Exclude related tax (benefit) expense	(4,857 )	(8,552 )	3,166
Total earnings from core operations (non-GAAP)	\$94,038	\$64,133	\$51,066
Diluted earnings per share (GAAP)	\$2.52	\$1.89	\$2.79
Diluted core earnings per share (non-GAAP)	\$2.78	\$2.69	\$2.63
<b>NET EFFECT OF ACQUISITION-RELATED COSTS ON EARNINGS:</b>			
Acquisition bargain purchase gain	\$—	\$—	\$9,079
Acquisition related costs	(11,733 )	(26,110 )	(4,325 )
Related tax benefit (expense)	4,217	8,065	(2,656 )
Total net effect of acquisitions on earnings	\$(7,516 )	\$(18,045 )	\$2,098
Diluted weighted shares outstanding	33,853,511	23,866,621	19,402,656
Total net effect of acquisitions on diluted earnings per share	\$(0.22 )	\$(0.76 )	\$0.11

	December 31			
RATIO OF ADJUSTED ALLOWANCE FOR LOAN LOSSES TO ADJUSTED LOANS:	2016	2015	2014	
Loans receivable (GAAP)	\$7,451,148	\$7,314,504	\$3,831,034	
Net loan discount on acquired loans	31,110	43,657	148	
Adjusted loans (non-GAAP)	\$7,482,258	\$7,358,161	\$3,831,182	
Allowance for loan losses (GAAP)	\$85,997	\$78,008	\$75,907	
Net loan discount on acquired loans	31,110	43,657	148	
Adjusted allowance for loan losses (non-GAAP)	\$117,107	\$121,665	\$76,055	
Allowance for loan losses/Total loans (GAAP)	1.15	% 1.07	% 1.98	%
Adjusted allowance for loan losses/Adjusted total loans (non-GAAP)	1.57	% 1.65	% 1.99	%

	December 31			
ACQUISITION ACCOUNTING IMPACT ON NET INTEREST MARGIN:	2016	2015	2014	
Net interest income before provision for loan losses (GAAP)	\$375,069	\$242,279	\$179,872	
Exclude discount accretion on purchased loans	(10,984 )	(3,566 )	(223 )	)
Exclude premium amortization on acquired certificates of deposit	(1,552 )	(748 )	(139 )	)
Net interest income before acquisition accounting impact (non-GAAP)	\$362,533	\$237,965	\$179,510	
Average interest-earning assets (GAAP)	\$8,930,910	\$5,902,143	\$4,419,594	
Exclude average net loan discount on acquired loans	38,561	17,615	151	
Average interest-earning assets before acquired loan discount (non-GAAP)	\$8,969,471	\$5,919,758	\$4,419,745	
Net interest margin (GAAP)	4.20	% 4.10	% 4.07	%
Exclude impact on net interest margin from discount accretion	(0.12 )	)% (0.06 )	)% (0.01 )	)%
Exclude impact on net interest margin from certificates of deposit premium amortization	(0.02 )	)% (0.01 )	)% —	)%
Exclude impact of net loan discount on average earning assets	(0.02 )	)% (0.01 )	)% —	)%
Net margin before discount accretion (non-GAAP)	4.04	% 4.02	% 4.06	%

	December 31		
NON-INTEREST EXPENSE FROM CORE OPERATIONS:	2016	2015	2014
Total non-interest expense (GAAP)	\$322,869	\$236,600	\$153,741
Exclude acquisition related costs	(11,733 )	(26,110 )	(4,325 )
Non-interest expense from core operations (non-GAAP)	\$311,136	\$210,490	\$149,416

	December 31			
	2016	2015	2014	
ADJUSTED EFFICIENCY RATIO:				
Non-interest expense (GAAP)	\$322,869	\$236,600	\$153,741	
Exclude acquisition-related costs	(11,733 )	(26,110 )	(4,325 )	
Exclude CDI amortization	(7,061 )	(3,164 )	(1,990 )	
Exclude state/municipal tax expense	(3,516 )	(1,889 )	(1,437 )	
Exclude REO gain (loss)	(175 )	(397 )	446	
Adjusted non-interest expense (non-GAAP)	\$300,384	\$205,040	\$146,435	
Net interest income before provision for loan losses (GAAP)	\$375,069	\$242,279	\$179,872	
Non-interest income (GAAP)	83,470	62,292	54,991	
Total revenue	458,539	304,571	234,863	
Exclude net (gain) loss on sale of securities	(843 )	540	(42 )	
Exclude net change in valuation of financial instruments carried at fair value	2,620	813	(1,374 )	
Adjusted revenue (non-GAAP)	\$460,316	\$305,924	\$233,447	
Efficiency ratio (GAAP)	70.41	% 77.68	% 65.46	%
Adjusted efficiency ratio (non-GAAP)	65.26	% 67.02	% 62.73	%

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  
2016