Lazard Ltd
Form SC 13G/A
February 14, 2007

SCHEDULE 13G

Amendment No. 1
Lazard Limited
Class A Common Stock
Cusip #G54050102

Cusip #G54050102
Item 1: Reporting Person - FMR Corp.
Item 4: Delaware
Item 5: 821,350
Item 6: 0
Item 7: 7,340,930
Item 8: 0
Item 9: 7,340,930
Item 11: 14.535%
Item 12: HC

Cusip #G54050102
Item 1: Reporting Person - Edward C. Johnson 3d
Item 4: United States of America
Item 5: 0
Item 6: 0
Item 7: 7,340,930
Item 8: 0
Item 9: 7,340,930
Item 11: 14.535%
Item 12: IN

SCHEDULE 13G - TO BE INCLUDED IN
STATEMENTS
FILED PURSUANT TO RULE 13d-1(b) or 13d-2(b)

Item 1(a). Name of Issuer:

Lazard Limited

Item 1(b). Name of Issuer's Principal Executive Offices:

Clarendon House
2 Church Street
Hamilton, Bermuda HM II

Item 2(a). Name of Person Filing:

FMR Corp.

Item 2(b). Address or Principal Business Office or, if None,
Residence:

82 Devonshire Street, Boston, Massachusetts 02109

Item 2(c). Citizenship:

Not applicable

Item 2(d). Title of Class of Securities:

Class A Common Stock

Item 2(e). CUSIP Number:

G54050102

Item 3. This statement is filed pursuant to Rule 13d-1(b) or 13d-2(b) and the person filing, FMR Corp., is a parent holding company in accordance with Section 240.13d-1(b)(ii)(G). (Note: See Item 7).

Item 4. Ownership

(a) Amount Beneficially Owned: 7,340,930

(b) Percent of Class: 14.535%

(c) Number of shares as to which such person has:

(i) sole power to vote or to direct the vote: 821,350

(ii) shared power to vote or to direct the vote: 0

(iii) sole power to dispose or to direct the disposition of: 7,340,930

(iv) shared power to dispose or to direct the disposition of: 0

Item 5. Ownership of Five Percent or Less of a Class.

Not applicable.

Item 6. Ownership of More than Five Percent on Behalf of Another Person.

Various persons have the right to receive or the power to direct the receipt of dividends from, or the proceeds from the sale of, the Class A Common Stock of Lazard Limited. No one person's interest in the Class A Common Stock of Lazard Limited is more than five percent of the total outstanding Class A Common Stock.

Item 7. Identification and Classification of the Subsidiary Which Acquired the Security Being Reported on By the Parent Holding Company.

See attached Exhibit A.

Item 8. Identification and Classification of Members of the Group.

Not applicable. See attached Exhibit A.

Item 9. Notice of Dissolution of Group.

Not applicable.

Item 10. Certification.

By signing below I certify that, to the best of my knowledge and belief, the securities referred to above were acquired in the ordinary course of business and were not acquired for the purpose of and do not have the effect of changing or influencing the control of the issuer of such securities and were not acquired in connection with or as a participant in any transaction having such purpose or effect.

Signature

After reasonable inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

February 14, 2007
Date

/s/Eric D. Roiter
Signature

Eric D, Roiter
Duly authorized under Power of Attorney
dated December 30, 1997 by and on behalf of FMR Corp. and
its direct and indirect subsidiaries

SCHEDULE 13G - TO BE INCLUDED IN STATEMENTS
FILED PURSUANT TO RULE 13d-1(b) or 13d-2(b)

Pursuant to the instructions in Item 7 of Schedule 13G, Fidelity Management & Research Company ("Fidelity"), 82 Devonshire Street, Boston, Massachusetts 02109, a wholly-owned subsidiary of FMR Corp. and an investment adviser registered under Section 203 of the Investment Advisers Act of 1940, is the beneficial owner of 7,301,830 shares or 14.458% of the Class A Common Stock outstanding of Lazard Limited ("the Company") as a result of acting as investment adviser to various investment companies registered under Section 8 of the Investment Company Act of 1940.

Edward C. Johnson 3d and FMR Corp., through its control of Fidelity, and the funds each has sole power to dispose of the 7,301,830 shares owned by the Funds.

Members of the family of Edward C. Johnson 3d, Chairman of FMR Corp., are the predominant owners, directly or through trusts, of Series B shares of common stock of FMR Corp., representing 49% of the voting power of FMR Corp. The Johnson family group and all other Series B shareholders have entered into a shareholders' voting agreement under which all Series B shares will be voted in accordance with the majority vote of Series B shares. Accordingly, through their ownership of voting common stock and the execution of the shareholders' voting agreement, members of the Johnson family may be deemed, under the Investment Company Act of 1940, to form a controlling group with respect to FMR Corp.

Neither FMR Corp. nor Edward C. Johnson 3d, Chairman of FMR Corp., has the sole power to vote or direct the voting of the shares owned directly by the Fidelity Funds, which power resides with the Funds' Boards of Trustees. Fidelity carries out the voting of the shares under written guidelines established by the Funds' Boards of Trustees.

Pyramis Global Advisors Trust Company ("PGATC"), 53 State Street, Boston, Massachusetts, 02109, an indirect wholly-owned subsidiary of FMR Corp. and a bank as defined in Section 3(a)(6) of the Securities Exchange Act of 1934, is the beneficial owner of 39,100 shares or 0.077% of the outstanding Class A Common Stock of the Lazard Limited as a result of its serving as investment manager of institutional accounts owning such shares.

Edward C. Johnson 3d and FMR Corp., through its control of Pyramis Global Advisors Trust Company, each has sole dispositive power over 39,100 shares and sole power to vote or to direct the voting of 39,100 shares of Class A Common Stock owned by the institutional accounts managed by PGATC as reported above.

SCHEDULE 13G - TO BE INCLUDED IN STATEMENTS
FILED PURSUANT TO RULE 13d-1(b) or 13d-2(b)
RULE 13d-1(f)(1) AGREEMENT

The undersigned persons, on February 14, 2007, agree and consent to the joint filing on their behalf of this Schedule 13G in connection with their beneficial ownership of the Class A Common Stock of Lazard Limited at December 31, 2006.

FMR Corp.

By /s/ Eric D. Roiter
Eric D. Roiter
Duly authorized under Power of Attorney dated December 30, 1997, by and on behalf of FMR Corp. and its direct and indirect subsidiaries

Edward C. Johnson 3d

By /s/ Eric D. Roiter
Eric D. Roiter
Duly authorized under Power of Attorney dated December 30, 1997, by and on behalf of Edward C. Johnson 3d

Fidelity Management & Research Company

By /s/ Eric D. Roiter
Eric D. Roiter
Senior V.P. and General Counsel

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Total loans outstanding	$ 2,655,579	$ 847,101	$ 374,630	$ 38,237	$ 3,915,547
Percent of total loans	67.8 %	21.6 %	9.6 %	1.0 %	100.0 %

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The geographic concentration of our land and land development loans at March 31, 2009 was as follows (dollars in thousands):

	Washington	Oregon	Idaho	Other	Total
Residential					
Acquisition and development	$ 113,083	$ 118,945	$ 23,291	$ --	$ 255,319
Improved lots	53,563	30,321	5,467	--	89,351
Unimproved land	25,109	12,010	25,159	--	62,278
Commercial and industrial					
Acquisition and development	3,904	--	194	--	4,098
Improved land	17,207	699	402	--	18,308
Unimproved land	10,886	1,204	4,684	--	16,774
Total land & land development loans outstanding	$ 223,752	$ 163,179	$ 59,197	$ --	$ 446,128
Percent of total land and land development loans	50.1 %	36.6 %	13.3 %	0.0 %	100.0 %

As noted in the tables above, substantially all of our loans are to borrowers in the states of Washington, Oregon and Idaho. Accordingly, their ultimate collectibility is particularly susceptible to, among other things, changes in market and economic conditions within these states.

The amount of impaired loans, net of any charge-offs recorded as a result of specific impairment analysis, and the related allocated reserve for loan losses were as follows (dollars in thousands):

	March 31, 2009		December 31, 2008	
	Loan amount	Allocated reserves	Loan amount	Allocated reserves
Impaired loans:				
Non-accrual	$ 223,793	$ 17,821	$ 186,978	$ 13,053
Accrual	27,854	654	23,635	1,195
	$ 251,647	$ 18,475	$ 210,613	$ 14,248

The Company originates both adjustable- and fixed-rate loans. The maturity and repricing composition of those loans, less undisbursed amounts and deferred fees, were as follows (dollars in thousands):

	March 31 2009	December 31 2008	March 31 2008
Fixed-rate (term to maturity):			
Due in one year or less	$ 201,049	$ 130,958	$ 121,255
Due after one year through three years	200,264	206,455	201,046
Due after three years through five years	214,076	246,897	200,367
Due after five years through ten years	122,625	157,621	156,911
Due after ten years	445,292	425,213	355,811
	$ 1,183,306	$ 1,167,144	$ 1,035,390
Adjustable-rate (term to rate adjustment):			
Due in one year or less	$ 2,488,166	$ 1,912,755	$ 1,963,415
Due after one year through three years	84,071	402,482	413,712
Due after three years through five years	37,477	440,555	388,231

Due after five years through ten years		122,527		38,472		39,245
		2,732,241		2,794,264		2,804,603
	$	3,915,547	$	3,961,408	$	3,839,993

The adjustable-rate loans may have interest rate adjustment limitations and are generally indexed to various Prime or LIBOR rates, or One to Five Year Constant Maturity Treasury Indices or FHLB borrowing rates. Future market factors may affect the correlation of the interest rate adjustment with the rates the Banks pay on the short-term deposits that primarily have been utilized to fund these loans.

Note 7: ALLOWANCE FOR LOAN LOSSES

The following is a schedule of our allocation of the allowance for loan losses at the dates indicated (dollars in thousands):

	March 31 2009	December 31 2008	March 31 2008
Specific or allocated loss allowances:			
Commercial real estate	$ 4,972	$ 4,199	4,180
Multifamily real estate	84	87	587
Construction and land	46,297	38,253	11,117
One- to four-family real estate	814	752	2,054
Commercial business	18,186	16,533	17,842
Agricultural business, including secured by farmland	587	530	1,397
Consumer	1,682	1,730	2,807
Total allocated	72,622	62,084	39,984
Estimated allowance for undisbursed commitments	1,358	1,108	599
Unallocated	5,744	12,005	9,863
Total allowance for loan losses	$ 79,724	$ 75,197	$ 50,446
Allowance for loan losses as a percentage of total loans outstanding	2.04%	1.90%	1.31%
Allowance for loan losses as a percentage of non-performing loans	36%	40%	93%

An analysis of the changes in our allowance for loan losses is as follows (dollars in thousands):

	For the Quarter Ended		
	March 31 2009	December 31 2008	March 31 2008
Balance, beginning of the period	$ 75,197	58,846	$ 45,827
Provision for loan losses	22,000	33,000	6,500
Recoveries of loans previously charged off:			
Commercial real estate	--	--	--
Multifamily real estate	--	--	--
Construction and land	52	144	--
One- to four-family real estate	2	1	--
Commercial business	70	81	86
Agricultural business, including secured by farmland	--	430	3
Consumer	31	59	55
	155	715	144

Loans charged off:					
Commercial real estate		--	--		--
Multifamily real estate		--	--		--
Construction and land		(12,417)	(13,404)		(968)
One- to four-family real estate		(1,091)	(523)		(72)
Commercial business		(3,794)	(2,884)		(780)
Agricultural business, including secured by farmland		--	(553)		--
Consumer		(326)	--		(205)
		(17,628)	(17,364)		(2,025)
Net (charge-offs) recoveries		(17,473)	(16,649)		(1,881)
Balance, end of the period	$	79,724	75,197	$	50,446
Net loan charge-offs to average outstanding loans during the period		0.44%	0.42%		0.05%

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Note 8: GOODWILL AND OTHER INTANGIBLE ASSETS AND MORTGAGE SERVICING RIGHTS

Goodwill and Other Intangible Assets: Goodwill and other intangible assets consists primarily of goodwill, which represents the excess of the purchase price over the fair value of net assets acquired in a business combination accounted for under the purchase method, and core deposit intangibles (CDI), which are amounts recorded in business combinations or deposit purchase transactions related to the value of transaction-related deposits and the value of the customer relationships associated with the deposits.

We account for goodwill and other intangible assets in accordance with SFAS No. 142, Goodwill and Other Intangible Assets. Goodwill is not amortized but is reviewed annually for impairment. During 2008, we engaged an independent valuation consultant to review goodwill for impairment and, as a result of the significant decline in the Company's stock price and market capitalization over the course of 2008 and in conjunction with similar declines in the value of most financial institutions and the ongoing disruption in related financial markets, we wrote off all previously recognized goodwill. We amortize core deposit intangibles over their estimated useful life and review them at least annually for events or circumstances that could impact their recoverability. The core deposit intangible assets shown in the table below represent the value ascribed to the long-term deposit relationships acquired in three separate bank acquisitions during 2007. These intangible assets are being amortized using an accelerated method over an estimated useful life of eight years. The core deposit intangible assets are not estimated to have a significant residual value. Other intangible assets are amortized over their useful lives and are also reviewed for impairment.

The following table summarizes the changes in the Company's goodwill and other intangibles for the quarters ended March 31, 2008 and 2009 (dollars in thousands):

	Goodwill	Core Deposit Intangibles	Other	Total
Balance, December 31, 2007	$ 121,108	$ 16,529	$ 17	$ 137,654
Additions through acquisitions	--	--	--	--
Amortization	--	(736)	--	(736)
Impairment write-off	--	--	--	--
Balance, March 31, 2008	$ 121,108	$ 15,793	$ 17	$ 136,918

	Goodwill	Core Deposit Intangibles	Other	Total
Balance, December 31, 2008	$ --	$ 13,701	$ 15	$ 13,716
Additions through acquisitions	--	--	--	--
Amortization	--	(690)	--	(690)
Impairment write-off	--	--	--	--
Balance, March 31, 2009	$ --	$ 13,011	$ 15	$ 13,026

Estimated amortization expense in future years with respect to existing intangibles as of March 31, 2009 (dollars in thousands) is as follows:

Year Ended		Core Deposit Intangibles		Other		TOTAL
December 31, 2009	$	1,954	$	2	$	1,956
December 31, 2010		2,459		2		2,461
December 31, 2011		2,276		2		2,278
December 31, 2012		2,092		2		2,094
December 31, 2013		1,908		2		1,910
Thereafter		2,322		5		2,327
Net carrying amount	$	13,011	$	15	$	13,026

Mortgage Servicing Rights: Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of loans. Generally, purchased servicing rights are capitalized at the cost to acquire the rights. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage servicing contracts. Capitalized servicing rights are reported in other assets and are amortized as a charge or reduction of non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

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

We record servicing fee income for fees earned for servicing loans. Fees charged to the owners of the loans are based on a contractual percentage of the outstanding principal or a fixed amount per loan and are recorded as income when earned. Certain fees charged to borrowers are also recorded as servicing fee income. The amortization or impairment of mortgage servicing rights is netted against loan servicing fee income.

An analysis of our mortgage servicing rights for the quarters ended March 31, 2009 and 2008 is presented below (dollars in thousands):

	Quarters Ended March 31	
	2009	2008
Balance, beginning of the year	$ 3,554	$ 2,807
Amounts capitalized	1,510	397
Amortization*	(612)	(261)
Impairment	(300)	--
Balance, end of the quarter	$ 4,152	$ 2,943

*Amortization of mortgage servicing rights is recorded as a reduction of loan servicing income and includes any remaining unamortized balance, which is written off if the loan repays in full.

Note 9: DEPOSITS AND CUSTOMER REPURCHASE AGREEMENTS

Deposits consist of the following at March 31, 2009 and 2008 and December 31, 2008 (dollars in thousands):

	March 31 2009		December 31 2008		March 31 2008	
Deposits:	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Non-interest-bearing accounts	$ 508,593	14.0%	$ 509,105	13.5%	$ 486,201	13.2%
Interest-bearing checking	307,741	8.5	378,952	10.0	452,531	12.3
Regular savings accounts	490,239	13.5	474,885	12.6	610,085	16.5
Money market accounts	301,857	8.3	284,041	7.5	234,599	6.3
Total transaction and saving accounts	1,608,430	44.3	1,646,983	43.6	1,783,416	48.3
Certificates which mature or reprice:						
Within 1 year	1,504,958	41.5	1,542,925	40.8	1,656,117	44.8
After 1 year, but within 3 years	464,576	12.8	542,735	14.4	201,017	5.4
After 3 years	49,540	1.4	46,207	1.2	52,760	1.5
Total certificate accounts	2,019,074	55.7	2,131,867	56.4	1,909,894	51.7

Total	$	3,627,504	100.0%	$	3,778,850	100.0%	$	3,693,310	100.0%

Deposits at March 31, 2009, December 31, 2008 and March 31, 2008 included public funds of $231,502,000, $362,731,000 and $405,662,000, respectively. Securities with a carrying value of $48,515,000, $46,908,000 and $49,408,000 were pledged as collateral on these deposits at March 31, 2009, December 31, 2008 and March 31, 2008, respectively, which exceeded the minimum collateral requirements established by state regulations (see Note 21 of the Notes to the Consolidated Financial Statements in our Annual Report filed on Form 10-K for the year ended December 31, 2008).

Geographic Concentration of Deposits at March 31, 2009		Washington		Oregon		Idaho		Total
	$	2,843,305	$	559,972	$	224,227	$	3,627,504

In addition to deposits, we also offer retail repurchase agreements which are customer funds that are primarily associated with sweep account arrangements tied to transaction deposit accounts. While reported in our Consolidated Statements of Financial Condition as collateralized borrowings, these accounts primarily represent customer utilization of our cash management services and related deposit accounts. The following table presents customer repurchase agreement balances as of March 31, 2009 and 2008 and December 31, 2008 (dollars in thousands):

		March 31 2009		December 31 2008		March 31 2008
Customer Repurchase Agreements:	$	131,224	$	145,230	$	85,032

Note 10: FAIR VALUE ACCOUNTING AND MEASURMENT

We elected early adoption of SFAS No. 157, Fair Value Measurements and SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, effective January 1, 2007.

SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It also establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value measurements. SFAS No. 157, among other things, requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our estimates for market assumptions. These two types of inputs create the following fair value hierarchy:

- Level 1 – Quoted prices for identical instruments in active markets. An active market is a market in which transactions occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and matrix or model-derived valuations whose inputs are observable or whose significant value drivers are observable.

- Level 3 – Instruments whose significant value drivers are unobservable. The valuation is generated from model-based techniques that use significant assumptions not observable in the market, but observable based on Company-specific data. These unobservable assumptions reflect our estimates for assumptions that market participants would use in pricing the asset or liability. Valuation techniques typically include discounted cash flow models and similar techniques, but may also include the use of market prices of assets or liabilities that are not directly comparable to the subject asset or liability.

Items Measured at Fair Value on a Recurring Basis:

We record trading account securities, securities available-for-sale, FHLB debt and junior subordinated debentures at fair value on a recurring basis.

- The securities assets primarily consist of U.S. Government Agency obligations, municipal bonds, corporate bonds—including certain trust preferred securities—mortgage-backed securities, equity securities and certain other financial instruments. At December 31, 2008 and March 31, 2009, management used inputs from each of the three fair value hierarchy levels to value these assets. The Level 1 measurements are based upon quoted prices in active markets. The Level 2 measurements are generally based upon a matrix pricing model from an investment reporting and valuation service. Matrix pricing is a mathematical technique used principally to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities. The Level 3 measurements are based primarily on unobservable inputs. In 2008 and continuing in 2009, the lack of active markets and market participants for certain securities resulted in an increase in Level 3 measurements. In developing Level 3 measurements, management incorporates whatever market data might be available and uses discounted cash flow models where appropriate. These calculations include projections of future cash flows, including appropriate default and loss assumptions, and market based discount rates.

At December 31, 2008 and March 31, 2009, the disrupted financial markets made it especially difficult to determine the fair value of certain types of securities. We own approximately $42.0 million in current face value of collateralized debt obligation securities that are backed by trust preferred securities issued by banks, thrifts and insurance companies (TRUP CDOs). The market for these securities, beginning in the third quarter of 2008 and continuing through March 31, 2009, was not active and markets for similar securities were also not active. The inactivity was evidenced first by a significant widening of the bid-ask spread in the brokered markets in which TRUP CDOs trade and then by a significant decrease in the volume of trades relative to historical levels. The new issue market is also inactive as almost no new TRUP CDOs have been issued since 2007. There are currently very few market participants who are willing and or able to transact for these securities. Thus, a low market price for a particular bond may only provide evidence of stress in the credit markets in general rather than being an indicator of credit problems with a particular issuer.

Given these conditions in the debt markets and the absence of observable transactions in the secondary and new issue markets, management determined that for TRUP CDOs:

- The few observable transactions and market quotations that were available are not reliable for purposes of determining fair value at December 31, 2008 and March 31, 2009,

- An income valuation approach technique (present value technique) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs is equally or more representative of fair value than the market approach valuation technique used at prior measurement dates, and

- The Company's TRUP CDOs are classified within Level 3 of the fair value hierarchy because of the significant adjustments required to determine fair value at the measurement date.

The TRUP CDO valuations were prepared by an independent third party. Its approach to determining fair value involved these steps:

1. The credit quality of the collateral was estimated using average risk-neutral probability of default values for each industry (i.e., banks, REITs and insurance companies were evaluated separately).

2. Asset defaults were then generated taking into account both the probability of default of the asset and an assumed level of correlation among the assets.

3. A higher level of correlation was assumed among assets from the same industry (e.g., banks with other banks) than among those from different industries.

4. The loss given default was assumed to be 95% (i.e., a 5 % recovery).

5. The cash flows were forecast for the underlying collateral and applied to each CDO tranche to determine the resulting distribution among the securities.

6. The calculations were modeled in several thousand scenarios using a Monte Carlo engine.

7. The expected cash flows for each scenario were discounted at the risk-free rate plus 200 basis points (for illiquidity) to calculate the present value of the security.

8. The average price was used for valuation purposes.

At December 31, 2008 and March 31, 2009, we also directly owned approximately $35.0 million in current face value of trust preferred securities (TPS) issued by five individual financial institutions for which no market data or independent valuation source is available. Similar to the discussion of TRUP CDOs above, there were too few, if any, issuances of new TPS securities or sales of existing TPS securities to provide Level 1 or even Level 2 fair value measurements. Management, therefore, utilized a discounted cash-flow model to calculate the present value of each security's expected future cash flows to determine their respective fair values. Management took into consideration what little market data was available regarding discount rates, but concluded that most of the available information represented dated transactions and/or was not representative of active market transactions. Since these five TPS securities are also concentrated in the financial institutions sector, which continues to be under extreme pricing pressure at quarter-end, management felt it appropriate to increase the discount rate from previous periods and to apply credit factors to differentiate these issues based upon its judgment of the risk profile of the various issuers. In applying the model at March 31, 2009, discount rates equal to three-month Libor plus 700 to 900 basis points were used to calculate the respective fair values of these securities. At December 31, 2008, all of these securities were valued using a discount rate of three-month LIBOR plus 700 basis points. Management followed a similar process for evaluating TPS debt instruments issued by the Company that are also carried at fair value.

- Fair valuations for FHLB advances are estimated using fair market values provided by the lender, the FHLB of Seattle. The FHLB of Seattle prices advances by discounting the future contractual cash flows for individual advances using its current cost of funds curve to provide the discount rate. Management considers this to be a Level 2 input method.

- The fair valuations of junior subordinated debentures (TPS debt) were valued using discounted cash flows to maturity or to the next available call date, if based upon the current interest rate and credit market environment it was considered likely that we would elect early redemption. The majority, $98 million, of these debentures carry interest rates that reset quarterly, using the three-month LIBOR index plus spreads of 1.38% to 3.35%. The remaining $26 million issue has a current interest rate of 6.56%, which is fixed through December 2011 and then resets quarterly to equal three month LIBOR plus a spread of 1.62%. In valuing the debentures at March 31, 2009, management evaluated discounted cash flows to maturity and for the discount rate used the March 31, 2008 three-month LIBOR plus 800 basis points. At December 31, 2008, the cash flows were valued using a discount rate equal to three-month LIBOR plus 700 basis points. While the quarterly reset of the index on this debt would seemingly keep it close to market values, the disparity in the fixed spreads above the index and the inability to determine realistic current market spreads, due to lack of new issuances and trades, resulted in having to rely more heavily on assumptions about what spread would be appropriate if market transactions were to take place. In periods prior to September 30, 2008, the discount rate used was based on recent issuances or quotes from brokers on the date of valuation for comparable bank holding companies and was considered to be a Level 2 input method. However, as noted above in the discussion of pricing trust preferred securities (TRUP CDOs), due to the unprecedented disruption of certain financial markets, management concluded that there were insufficient transactions or other indicators to continue to reflect these measurements as Level 2 inputs. Due to this reliance on assumptions and not on directly observable transactions, management considers this to now be a Level 3 input method.

The following tables present financial assets and liabilities measured at fair value under SFAS 157 on a recurring basis as of March 31, 2009, December 31, 2008 and March 31, 2008 (dollars in thousands):

	March 31, 2009					
					Fair value gain (loss) for the quarter	
	Total	Level 1	Level 2	Level 3	Recognized in other operating income	Recognized as other comprehensive income
Assets:						
Securities—available-for-sale	$ 66,963	$ 66,963				$ 414
Securities—trading	161,963	2,554	$ 134,082	$ 25,327	$ (11,721)	
	$ 228,926	$ 69,517	$ 134,082	$ 25,327		
Liabilities						
Advances from FHLB at fair value	$ 172,102	$ --	$ 172,102	$ --	511	
Junior subordinated debentures net of unamortized deferred issuance costs at fair value	53,819	--	--	53,819	7,957	
	$ 225,921	$ --	$ 172,102	$ 53,819		
					$ (3,253)	$ 414

	December 31, 2008					
					Fair value gain (loss) for the quarter	
	Total	Level 1	Level 2	Level 3	Recognized in other operating income	Recognized as other comprehensive income
Assets:						
Securities—available-for-sale	$ 53,272	$ 53,272				$ 1,082
Securities—trading	203,902	4,152	$ 163,455	$ 36,295	$ (23,670)	
	$ 257,174	$ 57,424	$ 163,455	$ 36,295		
Liabilities						
Advances from FHLB at fair value	$ 111,415	$ --	$ 111,415	$ --	(2,173)	
Junior subordinated debentures net of unamortized deferred issuance costs at fair value	61,776	--	--	61,776	39,583	
	$ 173,191	$ --	$ 111,415	$ 61,776		
					$ 13,740	$ 1,082

	March 31, 2008					
					Fair value gain (loss) for the quarter	
	Total	Level 1	Level 2	Level 3	Recognized in other operating income	Recognized as other comprehensive income
Assets:						
Securities—trading	$ 226,910	$ --	$ 226,910	$ --	$ (5,554)	$ --
Liabilities						
Advances from FHLB at fair value	$ 155,405	$ --	$ 155,405	$ --	(1,396)	
Junior subordinated debentures net of unamortized deferred issuance costs at fair value	105,516	--	105,516	--	7,773	
	$ 260,921	$ --	$ 260,921	$ --	$ 823	$ --

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The following table provides a reconciliation of the assets and liabilities measured at fair value using significant unobservable inputs (Level 3) on a recurring basis during the quarter ended March 31, 2009:

	March 31, 2009 (dollars in thousands)	
	Investments—trust preferred securities	Borrowings—junior subordinated debentures
Beginning balance	$ 36,295	$ 61,776
Total gains or losses recognized		
Assets gains (losses)	(10,968)	
Liabilities (gains) losses		(7,957)
Purchases, issuances and settlements	--	--
Transfers in and/or out of Level 3	--	--
Ending balance	$ 25,327	$ 53,819

The Company has elected to continue to recognize the interest income and dividends from the securities reclassified to fair value as a component of interest income as was done in prior years when they were classified as available for sale. Interest expense related to the FHLB advances and junior subordinated debentures continues to be measured based on contractual interest rate and reported in interest expense. The change in fair market value of these financial instruments has been recorded as a component of other operating income.

Items Measured at Fair Value on a Non-recurring Basis:

In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, subsequent to appropriate impairment analysis, our total goodwill was written down completely by a charge to earnings of $50.0 million during the quarter ended June 30, 2008 and an additional charge of $71.1 million during the quarter ended December 31, 2008. Throughout 2008, we engaged an independent valuation consultant to assist us in determining whether and to what extent our goodwill asset was impaired. The key inputs used to determine the implied fair value of the Company and the corresponding amount of the write-off included the quoted market price of our common stock, market prices of common stocks of other banking organizations, common stock trading multiples, discounted cash flows and inputs from comparable transactions. In addition, consideration was given to the value that may arise from synergies and other benefits that would accrue from control over an entity. These valuation inputs are considered to be Level 2 and 3 inputs.

In accordance with the provisions of SFAS No. 118, as of March 31, 2009, impaired loans with an initial carrying value of $276.5 million were written down to their fair value of $251.6 million by recording charges of $24.9 million to the allowance for loan losses. Impaired loans are measured at an observable market price (if available) or at the fair value of the loan's collateral (if the loan is collateral dependent). Most of our loans are collateral dependent and, accordingly, we measure impaired loans based on the fair value of such collateral. Fair value of the loan's collateral is determined by appraisals or independent valuation, which is then adjusted for the cost related to liquidation of the collateral. These valuation inputs are considered to be Level 2 and 3 inputs.

Real estate owned held for sale, net and other foreclosed assets are recorded when the Company receives a long-lived asset, such as real estate, from a borrower in full satisfaction of a loan. The long-lived asset is considered to be held for sale and prior to the transfer from loans its carrying value is reduced to its fair value less cost to sell. This fair value (less cost to sell) becomes the "cost" of the foreclosed asset. Fair value of the foreclosed asset is determined by appraisals or independent valuation, which is then adjusted for the estimated cost to sell it. These valuation inputs are considered to be Level 2 and 3 inputs. The individual carrying values of these assets are reviewed for impairment at least annually and any additional impairment charges are expensed to operations. For the quarter ended March 31, 2009, we recognized $50,000 of additional impairment charges related to these types of assets.

Mortgage servicing rights are initially reported at fair value and are amortized in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Mortgage servicing rights are subsequently evaluated for impairment based upon the fair value of the rights compared to the amortized cost (remaining unamortized initial fair value). If the fair value is less than the amortized cost, a valuation allowance is created through an impairment charge to servicing fee income. However, if the fair value is greater than the amortized cost, the amount above the amortized cost is not recognized in the carrying value.

Note 11: CALCULATION OF WEIGHTED AVERAGE SHARES OUTSTANDING FOR EARNINGS (LOSS) PER SHARE (EPS)

The following table reconciles basic to diluted weighted shares outstanding used to calculate earnings per share data dollars and shares (in thousands):

	Quarters Ended March 31			
		2009		2008
Net income (loss)	$	(9,263)	$	3,834
Preferred stock dividend accrual		1,550		--
Preferred stock discount accretion		373		--
Net income (loss) available to common shareholders	$	(11,186)	$	3,834
Basic weighted average shares outstanding		17,160		15,848
Plus MRP, common stock option and common stock warrants considered outstanding for diluted EPS		2		117
Less dilutive shares not included as they are anti-dilutive for calculations of loss per share		(2)		--
		17,160		15,965
Earnings (loss) per common share				
Basic	$	(0.65)	$	0.24
Diluted	$	(0.65)	$	0.24

Note 12: STOCK-BASED COMPENSATION PLANS AND STOCK OPTIONS

The Company operates the following stock-based compensation plans as approved by the shareholders: the 1996 Management Recognition and Development Plan (MRP), a restricted stock plan; and the 1996 Stock Option Plan, the 1998 Stock Option Plan and the 2001 Stock Option Plan (collectively, SOPs). Authority to grant awards under the 1996 MRP and 1996 and 1998 SOPs has expired and, as of March 31, 2009, there were only 36,845 options eligible for grants under the 2001 SOP. We did not make any grants under any of these plans in the year ended December 31, 2008 or the quarter ended March 31, 2009. Stock based compensation costs related to the MRP and SOPs were $49,000 and $113,000 for the quarters ended March 31, 2009 and 2008, respectively. At March 31, 2009, there were options for 563,980 shares outstanding with a weighted average exercise price of $20.40 per share and a weighted average remaining contractual term of 3.7 years. None of the options had any intrinsic value on that date. The Company had $174,000 of total unrecognized compensation costs related to stock options at March 31, 2009 that are expected to be recognized over the remaining contractual term of the underlying options.

Banner Corporation Long-Term Incentive Plan: In June 2006, the Board of Directors adopted the Banner Corporation Long-Term Incentive Plan effective July 1, 2006. The Plan is an account-based type of benefit, the value of which is directly related to changes in the value of Company stock, dividends declared on the Company stock and changes in Banner Bank's average earnings rate, and under SFAS 123(R) is considered a stock appreciation right ("SAR"). Each SAR entitles the holder to receive cash, upon vesting, equal to the excess of the fair market value of a share of the Company's common stock on the date of exercise over the fair market value of such share on the date granted plus the dividends declared on the stock from the date of grant to the date of vesting. On April 27, 2008, the Board of Directors amended the Plan and also authorized the repricing of certain awards to non-executive officers based upon the price of Banner common stock three business days following the public announcement of the Company's earnings for the quarter ended March 31, 2008. The primary objective of the Plan is to create a retention incentive by allowing officers who remain with the Company or the Banks for a sufficient period of time to share in the increases in the value of Company stock. Detailed information with respect to the Plan and the amendments to the Plan were disclosed on Forms 8-K filed with SEC on July 19, 2006 and May 6, 2008. SFAS No. 123(R) requires us to remeasure the fair value of SARs each reporting period until the award is settled. In addition, compensation expense must be recognized each reporting period for changes in fair value and vesting. We recognized compensation expense (recovery) of $16,000 and $(42,000), respectively, for the quarters ended March 31, 2009 and 2008 related to the change in the fair value of SARs and additional vesting during the period.

Note 13: COMMITMENTS

Financial Instruments with Off-Balance-Sheet Risk

We have financial instruments with off-balance-sheet risk generated in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in our Consolidated Statements of Financial Condition.

Our exposure to credit loss in the event of nonperformance by the other party to the financial instrument from commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. We use the same credit policies in making commitments and conditional obligations as for on-balance sheet instruments. As of March 31, 2009, outstanding commitments for which no liability has been recorded consist of the following:

		Contract or Notional Amount (in thousands)
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit		
Real estate secured for commercial, construction or land development	$	203,750
Revolving open-end lines secured by 1-4 family residential properties		112,328
Credit card lines		55,841
Other, primarily business and agricultural loans		526,349
Real estate secured by one- to four-family residential properties		92,500
Standby letters of credit and financial guarantees		9,163
Total	$	999,931
Commitments to sell loans secured by one- to four-family residential properties	$	92,500
Interest rate swaps notional amount	$	26,225

Commitments to extend credit are agreements to lend to a customer, as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Many of the commitments may expire without being drawn upon, therefore the total commitment amounts do not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, and income producing commercial properties.

Standby letters of credit are conditional commitments issued to guarantee a customer's performance or payment to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

Interest rates on residential one- to four-family mortgage loan applications are typically rate locked (committed) to customers during the application stage for periods ranging from 15 to 45 days, the most typical period being 30 days. Typically, pricing for the sale of these loans is locked with various qualified investors under a best-efforts delivery program at or near the time the interest rate is locked with the customer. We attempt to deliver these loans before their rate locks expire. This arrangement generally requires us to deliver the loans prior to the expiration of the rate lock. Delays in funding the loans can require a lock extension. The cost of a lock extension at times is borne by the customer and at times by us. These lock extension costs paid by us are not expected to have a material impact to our operations. This activity is managed daily. Changes in the value of rate lock commitments are recorded as other assets and liabilities. See "Derivative Instruments" under Note 1 of the Notes to the Consolidated Financial Statement's in the Company's Annual Report on Form 10-K for the year ended December 31, 2008 filed with the SEC.

The Company has stand-alone derivative instruments in the form of interest rate swap agreements, which derive their value from underlying interest rates. These transactions involve both credit and market risk. The notional amount is the amount on which calculations, payments and the value of the derivative are based. The notional amount does not represent direct credit exposure. Direct credit exposure is limited to the net difference between the calculated amount to be received and paid. This difference represents the fair value of the derivative instrument.

The Company is exposed to credit-related losses in the event of nonperformance by the counterparty to these agreements. Credit risk of the financial contract is controlled through the credit approval, limits, and monitoring procedures and management does not expect the counterparty to fail its obligations.

All of the Company's interest rate swap agreements are with the Pacific Coast Bankers Bank (PCBB) as the counterparty. The Company has swapped fixed-rate cash flows that it receives from its customers for variable-rate cash flows that it receives from PCBB. The net changes in fair value of the derivatives are recorded in loans and other liabilities.

ITEM 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations
Special Note Regarding Forward-Looking Statements

Management's Discussion and Analysis and other portions of this report on Form 10-Q contain certain forward-looking statements concerning our future operations. Management desires to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and is including this statement so that we may rely on the protections of such safe harbor with respect to all forward-looking statements contained in this report and our Annual Report on form 10-K for the year ended December 31, 2008. We have used forward-looking statements to describe future plans and strategies, including expectations of our future financial results. Our ability to predict results or the effect of future plans or strategies is inherently uncertain. Factors which could cause actual results to differ materially include, but are not limited to, the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs, which may be affected by deterioration in the housing and commercial real estate markets, may lead to increased losses and nonperforming assets in our loan portfolio, and may result in our allowance for loan losses not being adequate to cover actual losses and require us to materially increase our reserves, write-down assets, change our regulatory capital position or affect our ability to borrow funds or maintain or increase deposits, which could adversely affect our liquidity or earnings; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates and the relative differences between short and long-term interest rates, deposit interest rates, our net interest margin and funding sources; fluctuations in the demand for loans and in real estate values in our market areas; fluctuations in agricultural commodity prices, crop yields and weather conditions; our ability to control operating costs and expenses, including further FDIC insurance premiums and possible shared-risk assessments for Washington and Oregon public funds deposits; the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect or result in significant declines in valuation; difficulties in reducing risk associated with the loans on our balance sheet; our ability to successfully implement our branch expansion strategy; our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we may acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames; our ability to manage loan delinquency rates; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; increased competitive pressures among financial services companies; changes in consumer spending, borrowing and savings habits; legislative or regulatory changes that adversely affect our business; adverse changes in the securities markets; changes as a result of regulatory exams and/or agreements with the regulators; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board; war or terrorist activities; other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services and other risks detailed from time to time in our filings with the Securities and Exchange Commission. We caution readers not to place undue reliance on any forward-looking statements. We do not undertake and specifically disclaim any obligation to revise any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements. These risks could cause our actual results to differ materially from those expressed in any forward-looking statements by, or on behalf of, us.

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

Executive Overview

We are a bank holding company incorporated in the State of Washington and own two subsidiary banks, 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 March 31, 2009, its 83 branch offices and nine loan production offices located in Washington, Oregon and Idaho. Islanders Bank is also a Washington-chartered commercial bank and conducts its business from three locations in San Juan County, Washington. As of March 31, 2009, we had total consolidated assets of $4.5 billion, total loans of $3.8 billion, total deposits of $3.6 billion and total stockholders' equity of $425 million.

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

Deteriorating economic conditions and ongoing strains in the financial and housing markets which accelerated throughout 2008 and continued in the current quarter have presented an unusually challenging environment for banks and their holding companies, including Banner Corporation. This has been particularly evident in our need to provide for credit losses during the past 15 months at significantly higher levels than our historical experience and has also affected our net interest income and other operating revenues. As a result of these factors, for the quarter ended March 31, 2009 we had a net loss of $9.3 million, which, after providing for the preferred stock dividend and related discount accretion resulted in a net loss of $11.2 million, or ($0.65) per diluted share, available to common shareholders compared to net income of $3.8 million, or $0.24 per diluted share, for the same quarter one year ago. The provision for loan losses was $22.0 million for the quarter ended March 31, 2009, an increase of $15.5 million compared to the same quarter in the prior year. Similar to recent quarters, the significant provision for loan losses in the current quarter reflects material increases in delinquencies, non-performing loans and net charge-offs, particularly for loans for the construction of one- to four-family homes and for acquisition and development of land for residential properties. While the provision for loan losses decreased compared to the immediately preceding quarter, housing markets remained weak in many of our primary services areas, resulting in the increase in delinquencies and non-performing assets, further deterioration in property values and the need to provide for an elevated level of losses. By contrast, other non-housing related segments of the loan portfolio, while showing signs of stress, have performed as expected with only normal levels of credit problems given the serious economic slowdown. Throughout 2008 and the first quarter of 2009, the higher than historical provision for loan losses has been the most significant factor affecting our operating results and, looking forward, we anticipate our credit costs will remain elevated for the balance of 2009. (See Note 7, Allowance for Loan Losses, as well as Asset Quality below.) Similar to recent quarters, the current quarter's results also include significant adjustments for the valuation of financial instruments carried at fair value. The net effect of these adjustments was a loss of $3.3 million ($2.1 million after tax); however, valuation adjustments of certain instruments were more substantial and continue to reflect disrupted financial markets, particularly for capital securities issued by financial institutions. (See Note 10, Fair Value Accounting and Measurement.)

Aside from the level of loan loss provision and fair value adjustments, our operating results depend primarily on our net interest income, which is the difference between interest income on interest-earning assets, consisting of loans and investment securities, and interest expense on interest-bearing liabilities, composed primarily of customer deposits and repurchase agreements, Federal Home Loan Bank (FHLB) advances, Federal Reserve Bank of San Francisco (FRBSF) borrowings and junior subordinated debentures. Net interest income is primarily a function of our interest rate spread, which is the difference between the yield earned on interest-earning assets and the rate paid on interest-bearing liabilities, as well as a function of the average balances of interest-earning assets and interest-bearing liabilities. As more fully explained below, our net interest income before provision for loan losses decreased by $2.5 million for the quarter ended March 31, 2009 to $35.0 million compared to $37.4 million for the same quarter in the prior year, primarily as a result of a contraction in our net interest margin as asset yields have declined sharply over the past twelve months in response to the Federal Reserve's monetary policy actions designed to dramatically lower short-term interest rates. Further, increased delinquencies and the resulting increased levels of non-accrual loans and other non-performing assets have had an adverse impact on our net interest margin, as well as on the amount of our loan loss provision.

Our net income also is affected by the level of our other operating income, including deposit service charges, loan origination and servicing fees, and gains and losses on the sale of loans and securities, as well as our operating expenses and income tax provisions. Other operating income, excluding the fair value adjustments, increased by $593,000, or 8%, to $7.9 million for the quarter ended March 31, 2009 from $7.3 million for the same quarter in the prior year, primarily as a result of increased gain on the sale of loans from mortgage banking operations somewhat offset by a reduction in loan servicing fees. Revenues (net interest income before the provision for loan losses plus other operating income), excluding fair value adjustments, decreased $1.9 million to $42.9 million for the quarter ended March 31, 2009, compared to $44.7 million for the quarter ended March 31, 2008, as the increased non-interest revenues were not sufficient to offset the decrease in net interest income. Other operating expenses were nearly unchanged, increasing by just $85,000 to $33.8 million for the quarter ended March 31, 2009 from $33.7 million for same quarter in the prior year. The current quarter's expenses reflect increased deposit insurance expense, elevated costs associated with problem loan collection activities including charges related to real estate owned, and increased advertising, generally offset by reductions in compensation and costs for information/computer data services.

As noted above, in the quarter ended March 31, 2009, our net income included a net decrease in the valuation of the selected financial assets and liabilities we record at fair value pursuant to the adoption of SFAS No. 159. The fair value adjustment resulted in a decrease of $2.1 million (net after tax), or ($0.12) per share (diluted) to net income reported for the quarter ended March 31, 2009. In contrast, the fair value adjustment for the same quarter one year earlier resulted in an increase of $527,000 (net after tax), or $0.03 per share (diluted). Excluding the net fair value adjustments in each quarter, the net loss from core operations was $7.2 million ($9.2 million available to common shareholders) for the quarter ended March 31, 2009, compared to net income from core operations of $3.3 million for the quarter ended March 31, 2008. Earnings or loss from core operations and other earnings information excluding the change in valuation of financial instruments carried at fair value represent 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. Where applicable, we have also presented comparable earnings information using GAAP financial measures. The decrease in earnings from core operations despite a larger earning asset base primarily reflects the increased loan loss provisioning and narrower net interest margin.

We offer a wide range of loan products to meet the demands of our customers. Historically, our lending activities have been primarily directed toward the origination of real estate and commercial loans. Real estate lending activities have been significantly focused on residential construction and first mortgages on owner occupied, one- to four-family residential properties; however, over the past two years our origination of construction and land development loans has declined materially. By contrast, for the quarter just ended, residential mortgage loan originations have significantly increased, primarily reflecting the impact of exceptionally low interest rates on the demand for loans to refinance existing debt. Our real estate lending activities have also included the origination of multifamily and commercial real estate loans. Our commercial business lending has been directed toward meeting the credit and related deposit needs of various small- to medium-sized business and agri-business borrowers operating in our primary market areas. Reflecting the slowing economy, for the two most recent quarters demand for these types of commercial business loans has been weak. We have also increased our emphasis on consumer lending. As a result, the portion of the loan portfolio invested in consumer loans is now slightly in excess of 7% and consumer loan balances have grown by 28% over the last twelve months. While continuing our commitment to residential lending, including our mortgage banking activities, we expect commercial lending (including commercial real estate, commercial business and agricultural loans) and consumer lending to become increasingly important activities for us. By contrast, we anticipate residential construction and land development lending, which at March 31, 2009 represented just under 20% of the loan portfolio, will continue to be restrained by market conditions for the foreseeable future with balances continuing to decline for a number of quarters.

Deposits, customer retail repurchase agreements and loan repayments are the major sources of our funds for lending and other investment purposes. We compete with other financial institutions and financial intermediaries in attracting deposits. There is strong competition for transaction balances and savings deposits from commercial banks, credit unions and nonbank corporations, such as securities brokerage companies, mutual funds and other diversified companies, some of which have nationwide networks of offices. Much of the focus of our recent branch expansion, relocations and renovation has been directed toward attracting additional deposit customer relationships and balances. The long-term success of our deposit gathering activities is reflected not only in the growth of deposit balances, but also in increases in the level of deposit fees, service charges and other payment processing revenues compared to periods prior to that expansion. However, during the most recent quarter our deposit balances decreased primarily because of our decision to significantly reduce our exposure to public funds deposits.

We generally attract deposits from within our primary market areas by offering a broad selection of deposit instruments, including demand checking accounts, negotiable order of withdrawal (NOW) accounts, money market deposit accounts, regular savings accounts, certificates of deposit, cash management services and retirement savings plans. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit and the interest rate, among other factors. In determining the terms of deposit accounts, we consider current market interest rates, profitability, matching deposit and loan products, and customer preferences and concerns.

Management's discussion and analysis of results of operations is intended to assist in understanding our financial condition and results of operations. The information contained in this section should be read in conjunction with the Consolidated Financial Statements and accompanying Selected Notes to the Consolidated Financial Statements contained in Item 1 of this Form 10-Q.

Summary of Critical Accounting Policies

Our significant accounting policies are described in Note 1 to the Consolidated Financial Statements for the year ended December 31, 2008 included in the Form 10-K filed with the SEC on March 16, 2009. Various elements of our accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. In particular, management has identified several accounting policies that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of our financial statements. These policies relate to (i) the methodology for the recognition of interest income, (ii) determination of the provision and allowance for loan and lease losses, (iii) the valuation of financial assets and liabilities recorded at fair value, (iv) the valuation of intangibles such as goodwill, core deposit intangibles and mortgage servicing rights and (v) the valuation of real estate held-for-sale. These policies and judgments, estimates and assumptions are described in greater detail below. Management believes that the judgments, estimates and assumptions used in the preparation of the financial statements are appropriate based on the factual circumstances at the time. However, given of the sensitivity of the financial statements to these critical accounting policies, the use of other judgments, estimates and assumptions could result in material differences in our results of operations or financial condition. Further, subsequent changes in economic or market conditions could have a material impact on these estimates and our financial condition and operating results in future periods. There have been no significant changes in our application of accounting policies since December 31, 2008.

Interest Income: (Note 6) Interest on loans and securities is accrued as earned unless management doubts the collectability of the asset or the unpaid interest. Interest accruals on loans are generally discontinued when loans become 90 days past due for payment of interest and the loans are then placed on nonaccrual status. All previously accrued but uncollected interest is deducted from interest income upon transfer to nonaccrual status. For any future payments collected, interest income is recognized only upon management's assessment that there is a strong likelihood that the full amount of a loan will be repaid or recovered. A loan may be put on nonaccrual status sooner than this policy would dictate if, in management's judgment, the interest may be uncollectible. While less common, similar interest reversal and nonaccrual treatment would apply to investment securities if their ultimate collectability became questionable.

Provision and Allowance for Loan Losses: (Notes 7) The provision for loan losses reflects the amount required to maintain the allowance for losses at an appropriate level based upon management's evaluation of the adequacy of general and specific loss reserves. We maintain an allowance for loan losses consistent in all material respects with the GAAP guidelines outlined in SFAS No. 5, Accounting for Contingencies. We have established systematic methodologies for the determination of the adequacy of our allowance for loan losses. The methodologies are set forth in a formal policy and take into consideration the need for an overall general valuation allowance as well as specific allowances that are tied to individual problem loans. We increase our allowance for loan losses by charging provisions for probable loan losses against our income and value impaired loans consistent with the guidelines in SFAS No. 114, Accounting by Creditors for Impairment of a Loan, and SFAS No. 118, Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosure.

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

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

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

Fair Value Accounting and Measurement: (Note 10) We use fair value measurements to record fair value adjustments to certain financial assets and liabilities and to determine fair value disclosures. We include in the Notes to the Financial Consolidated Statements information about the extent to which fair value is used to measure financial assets and liabilities, the valuation methodologies used and the impact on our results of operations and financial condition. Additionally, for financial instruments not recorded at fair value we disclose, where appropriate, our estimate of their fair value.

SFAS No. 157 defines fair value, establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value measurements. SFAS No. 157 defines fair value as the price that would be received to sell the financial asset or paid to transfer the financial liability in an orderly transaction between willing market participants at the measurement date. SFAS No. 157, among other things, requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market assumptions. These two types of inputs create the following fair value hierarchy:

- Level 1 – Quoted prices for identical instruments in active markets.
- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.
- Level 3 – Instruments whose significant value drivers are unobservable.

In accordance with SFAS 157, it is our policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. However, in certain instances, when market observable inputs are not available, we are required to make judgments about assumptions market participants would use in estimating the fair value of the financial instruments. In addition, changes in market conditions may reduce the availability of quoted prices or other observable inputs, requiring a change in the method, judgments and assumptions used to estimate fair value for specific instruments from that which was used in prior periods. The disruption of certain financial markets and lack of meaningful transaction activity for certain securities beginning in 2008 and continuing in the current quarter made estimating fair values more difficult and less reliable than in prior years.

Goodwill and Other Intangible Assets: (Notes 8 and 10) Goodwill and other intangible assets consists primarily of goodwill, which represents the excess of the purchase price over the fair value of net assets acquired in a business combination accounted for under the purchase method, and core deposit intangibles (CDI), which are amounts recorded in business combinations or deposit purchase transactions related to the value of transaction-related deposits and the value of the customer relationships associated with the deposits. We account for goodwill and other intangibles as provided for in SFAS No. 142, Goodwill and Other Intangible Assets. Prior to December 31, 2008, the largest component of our intangible assets was goodwill which arose from business combinations completed in previous periods. However, for the year ended December 31, 2008, we recorded $121.1 of million impairment charges which eliminated all of the goodwill previously carried in our Consolidated Statements of Financial Condition. The other major component of our intangible assets is core deposit intangibles, which is the value ascribed to the long-term deposit relationships arising from acquisitions. Core deposit intangibles are being amortized on an accelerated basis over a weighted average estimated useful life of eight years. These assets are reviewed at least annually for events or circumstances that could impact their recoverability. These events could include loss of the underlying core deposits, increased competition or adverse changes in the economy. To the extent other identifiable intangible assets are deemed unrecoverable, impairment losses are recorded in other non-interest expense to reduce the carrying amount of the assets.

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

Comparison of Financial Condition at March 31, 2009 and December 31, 2008

General. Total assets decreased $74 million, or 2%, from $4.584 billion at December 31, 2008, to $4.510 billion at March 31, 2009. Net loans receivable (gross loans less loans in process, deferred fees and discounts, and allowance for loan losses) decreased $50 million, or 1%, from $3.886 billion at December 31, 2008, to $3.836 billion at March 31, 2009. The slight contraction in net loans was largely due to decreases of $55 million in one- to four-family construction loans and $40 million in land and land development loans, as well as a decrease of $36 million in commercial and agricultural business loans. These changes were nearly offset by increases of $45 million in one- to four-family and $33 million in commercial and multi-family real estate loans. We continue to maintain a significant, although decreasing, investment in construction and land loans; however, new production of these types of loans during the past two years has declined appreciably and is expected to remain modest for the foreseeable future. As a result of the much slower pace of new originations and continuing payoffs on existing loans, loans to finance the construction of one- to four-family residential real estate, which totaled 365 million at March 31, 2009, have decreased by $289 million, or 44%, since their peak quarter-end balance of $655 million at June 30, 2007, including a decrease of $206 million over the last twelve months. In addition, land and development loans have decreased by $56 million, or 11%, also compared to their peak quarter-end balances at March 31, 2008. Given the current housing and economic environment and our reduced level of construction and land development loan originations, we anticipate that construction and land loan balances will continue to decline for the foreseeable future, although the pace of decline for land development loans will be modest until there are further significant reductions in the amount of completed new construction homes on the market.

Securities decreased $21 million, or 7%, from $317 million at December 31, 2008, to $296 million at March 31, 2009, as repayments and fair value adjustments exceeded purchases. During the quarter ended March 31, 2009, net fair value adjustments for trading and available-for-sale securities reduced their carrying values by $11 million. Effective January 1, 2007, we elected to reclassify most of our securities to fair value following our adoption of SFAS No. 159. At March 31, 2009, the fair value of our trading securities was $53 million less than their amortized cost. The reduction reflected in the fair value of these securities compared to their amortized cost primarily was due to a net decrease of $48 million (including $11 million in the current quarter) in the value of single-issuer trust preferred securities and collateralized debt obligations secured by pools of trust preferred securities issued by bank holding companies and insurance companies as well as a decrease of $7 million in the value of Fannie Mae and Freddie Mac common and preferred equity securities, offset by a small gain in all other trading securities. Although we do not normally engage in trading activities, these securities are reported as trading securities for financial reporting purposes. (See Note 10, Fair Value Accounting and Measurement, in the Selected Notes to the Consolidated Financial Statements.) Periodically, we also acquire securities which are designated as available-for-sale or held-to-maturity and accounted for under the provisions of SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. During the current quarter, we recorded an increase of $414,000 ($264,000 net of tax) in net fair value adjustments related to available-for-sale securities, which was included as a component of other comprehensive income.

Real estate owned acquired through foreclosures increased $17 million, from $22 million at December 31, 2008 to $39 million at March 31, 2009. This included $33 million in land or land development projects and $6 million in single family homes, primarily from builders' new construction inventory. During the quarter ended March 31, 2009, we transferred $19 million of loans into real estate owned and sold approximately $2 million of foreclosed properties. (See "Asset Quality" discussion below.)

Deposits decreased $151 million, or 4%, from $3.779 billion at December 31, 2008, to $3.628 billion at March 31, 2009. Non-interest-bearing deposits remained unchanged at $509 million, while interest-bearing deposits decreased

$151 million, or 5%, to $3.119 billion at March 31, 2009. Deposits declined during the current quarter primarily because we encouraged $125 million in public funds, including $76 million of interest-bearing transaction accounts, to run off since December 31, 2008 in anticipation of the higher costs of collateralizing these deposits and to reduce the shared risk exposure under new Washington and Oregon State regulations. We anticipate further declines in public fund deposits as we continue to adjust to these new regulations. In addition, we elected to reduce brokered deposits by $19 million during the quarter ended March 31, 2009.

FHLB advances increased $61 million, from $111 million at December 31, 2008, to $172 million at March 31, 2009, while other borrowings increased $36 million to $181 million at March 31, 2009. On March 31, 2009, Banner Bank completed an offering of $50 million of qualifying senior bank notes covered by the TLGP at a fixed interest rate of 2.625% and a maturity date of March 31, 2012. This debt, which does not require any collateralization, was issued to bolster our overall liquidity position as we adjust to a lower level of public funds deposits. Other borrowings also include $131 million of retail repurchase agreements that are primarily related to customer cash management accounts.

Junior subordinated debentures decreased by $8 million since December 31, 2008, reflecting the fair value adjustments recorded subsequent to the adoption of SFAS 159, as changes in credit market conditions had a particularly significant impact on the valuation of this type of security. The change in the fair value of the junior subordinated debentures, while significant, represents a non-cash valuation adjustment, had no effect on liquidity or our ability to fund our operations and was substantially offset by similar adjustments to certain investment securities as noted above. (See Note 10, Fair Value of Financial Instruments.)

During the quarter ended March 31, 2009, we issued 493,514 new shares of common stock for $2 million at an average net per share price of $3.84 through our Dividend Reinvestment and Direct Stock Purchase and Sale Plan. This stock issuance activity, combined with the changes in retained earnings as a result of operations and the accrual of preferred stock dividends, resulted in a net $9 million decrease in stockholders’ equity. We did not issue or repurchase any shares of Banner Corporation common stock in connection with the exercise of vested stock options and grants.

Comparison of Results of Operations for the Quarters Ended March 31, 2009 and 2008

Reflecting the deteriorating economic conditions and ongoing strains in the financial and housing markets, for the quarter ended March 31, 2009, we had a net loss of $9.3 million, which after providing for the preferred stock dividend of $1.6 million and related discount accretion of $373,000, resulted in a net loss of $11.2 million, or ($0.65) per diluted share, available to common shareholders. This loss compares to net income of $3.8 million, or $0.24 per diluted share, for the quarter ended March 31, 2008, when we did not have any preferred stock issued. The net loss for the current quarter reflects a material increase in our provision for loan losses compared to a year ago, as well as a significant contraction in our net interest margin as asset yields have declined sharply over the past twelve months in response to the Federal Reserve's monetary policy actions and as a result of increased levels of nonaccrual loans and other non-performing assets. As more fully explained below, our provision for loan losses was $22.0 million for the quarter ended March 31, 2009, compared to $6.5 million for the quarter ended March 31, 2008. The increased provision for losses in the current quarter primarily reflects an increase in delinquencies, non-performing loans and net charge-offs, particularly for loans for the construction of one- to four-family homes and for acquisition and development of land for residential properties.

Our operating results for the quarter ended March 31, 2009 also included a decrease in other operating income, which was particularly influenced by a $3.3 million ($2.1 million after tax) net loss as a result of changes in the valuation of financial instruments carried at fair value pursuant to the adoption of SFAS No. 159, compared to $823,000 ($527,000 after tax) net gain for the same quarter a year ago. Excluding these fair value adjustments, other operating income increased to $7.9 million for the quarter ended March 31, 2009 compared to $7.3 million for the same quarter in the prior year, primarily as a result of increased gain on the sale of loans from mortgage banking operations. Other operating expenses of $33.8 million for the quarter ended March 31, 2009 were nearly unchanged from $33.7 million a year earlier, as reduced compensation and costs for information/computer data services were generally offset by significantly increased professional services related to problem loan collection activities, deposit insurance charges and higher advertising expenditures.

Compared to levels a year ago, total assets decreased 1% to $4.510 billion at March 31, 2009, net loans increased 1% to $3.836 billion, and deposits decreased 2% to $3.628 billion, while borrowings, including customer sweep accounts (retail repurchase agreements) and junior subordinated debentures, increased $11 million, or 3%, to $407 million. The average balance of interest-earning assets was $4.346 billion for the quarter ended March 31, 2009, an increase of $203 million, or 5%, compared to $4.144 billion for the same quarter a year earlier.

Net Interest Income. Net interest income before provision for loan losses decreased to $35.0 million for the quarter ended March 31, 2009, compared to $37.4 million for the same quarter one year earlier, primarily as a result of the decrease in the net interest margin and despite the 5% growth in average interest-earning assets compared to the same quarter a year ago. The net interest margin of 3.26% for the quarter ended March 31, 2009 declined 37 basis points from the same quarter one year earlier, largely as a result of the effect of rapidly declining short-term interest rates on earning asset yields, particularly floating- and adjustable-rate loan yields. This decline in interest rates was further compounded by the adverse effect of an increase in the level of nonaccrual loans and other non-performing assets. Non-accruing loans reduced the margin by 38 basis points in the quarter ended March 31, 2009 compared to a 12 basis point reduction for the quarter ended March 31, 2008. Funding costs were also significantly lower; however, deposit costs in particular have been more adversely impacted by competitive pressures which, when combined with the more immediate impact of lower market rates on a substantial portion of our loan portfolio, resulted in compression of our net interest margin and more than offset benefits from the larger earning assets base. Reflecting generally lower market interest rates as well as changes in asset mix and a higher level of nonaccrual loans, the yield on earning assets for the quarter ended March 31, 2009 decreased by 136 basis points compared to the same quarter one year earlier, while funding costs for the same period decreased by only 96 basis points.

Interest Income. Interest income for the quarter ended March 31, 2009 was $60.3 million, compared to $72.0 million for the same quarter one year earlier, a decrease of $11.7 million, or 16%. The decrease in interest income occurred despite a $203 million increase in the average balance of interest earning assets, as the growth was more than offset by the 136 basis point decrease in the average yield on those assets. The yield on average interest-earning assets decreased to 5.63% for the quarter ended March 31, 2009, compared to 6.99% in the same quarter one year earlier. The decrease in the yield on earning assets reflects the significant changes in Federal Reserve monetary policy actions beginning in September 2007 and accelerating throughout 2008 designed to aggressively lower short-term interest rates. As a result of these policy actions, bank prime rates, which had averaged 6.21% for the quarter ended March 31, 2008, declined by 297 basis points to average 3.25% for the quarter ended March 31, 2009. Average loans receivable for the quarter ended March 31, 2009 increased by $112 million, or 3%, to $3.943 billion, compared to $3.831 billion for the same quarter one year earlier. Interest income on loans for the quarter, however, decreased by $11.8 million, or 17%, to $56.3 million from $68.1 million for the same quarter one year earlier, reflecting the impact of the 136 basis point decrease in the average yield on loans, which was partially offset by the increase in average loan balances. The decrease in average loan yields reflects the lower average level of market interest rates in the current quarter, particularly short-term interest rates including the prime rate and LIBOR indices which affect the yield on large portions of our construction, land development, commercial and agricultural loans. The decrease in average loan yields also reflects the adverse effect of increased loan delinquencies as well as changes in the mix of the loan portfolio and slower turn-over in the construction and land development portfolio which resulted in less recognition of deferred loan fee income. The average yield on loans was 5.80% for the quarter ended March 31, 2009, compared to 7.15% in the same quarter one year earlier.

The combined average balance of mortgage-backed securities, investment securities, daily interest-bearing deposits and FHLB stock increased by $91 million (excluding the effect of fair value adjustments) for the quarter ended March 31, 2009, and the interest and dividend income from those investments increased by $104,000 compared to the same quarter one year earlier. The effect of the increased average balance was substantially offset as the average yield on the securities portfolio and cash equivalents decreased to 4.00% for the quarter ended March 31, 2009, from 4.99% in the same quarter one year earlier. The 99 basis point decrease in the yield of the securities portfolio is a reflection of the current lower rate environment as well as change in the mix of those assets. In response to the ongoing turmoil in the credit and mortgage markets and the effect on the market value of certain of its mortgage assets, the FHLB of Seattle suspended its dividend indefinitely in the fourth quarter of 2008 until its earnings and capital position have adequately improved. By contrast, dividend income received from our investment in FHLB stock for the quarter ended March 31, 2008 was $93,000.

Interest Expense. Interest expense for the quarter ended March 31, 2009 was $25.4 million, compared to $34.6 million for the comparable quarter in 2008, a decrease of $9.2 million, or 27%. The decrease in interest expense occurred as a result of a 96 basis point decrease in the average cost of all interest-bearing liabilities to 2.50% for the quarter ended March 31, 2009, from 3.46% for the same quarter one year earlier, and despite a $93 million increase in average interest-bearing liabilities. The increase in interest-bearing balances reflects an $87 million increase in average deposits along with a $69 million increase in other borrowings, as well as a $64 million decrease in average FHLB advances. The effect of lower average market rates for the quarter on the cost of these funds was partially mitigated by deposit pricing characteristics noted below and by changes in the mix of deposits.

Deposit interest expense decreased $7.0 million, or 23%, to $23.1 million for the quarter ended March 31, 2009 compared to $30.1 million for the same quarter one year earlier as a result of an 81 basis point decrease in the cost of interest-bearing deposits and despite deposit growth during the past twelve months. Average deposit balances increased $87 million, or 2%, to $3.693 billion for the quarter ended March 31, 2009, from $3.606 billion for the quarter ended March 31, 2008, while the average rate paid on deposit balances decreased from 3.35% a year ago to 2.54% for the current quarter. Deposit costs are significantly affected by changes in the level of market interest rates; however, changes in the average rate paid for interest-bearing deposits tend to be less severe and to lag changes in market interest rates. In addition, non-interest-bearing deposits dampen the effect of changes in market rates on our aggregate cost of deposits. This lower degree of volatility and lag effect for deposit pricing have been evident in the relatively modest decrease in deposit costs as the Federal Reserve moved aggressively to lower short-term interest rates by 500 basis points from September 18, 2007 to December 31, 2008. Furthermore, competitive pricing pressure for interest-bearing deposits has been quite intense in recent quarters, as many financial institutions have experienced increased liquidity concerns in the current economic environment.

Average FHLB advances (excluding the effect of fair value adjustments) decreased to $134 million for the quarter ended March 31, 2009, compared to $198 million for the same quarter one year earlier. The average rate paid on FHLB advances for the quarter ended March 31, 2009 decreased to 2.18%, a decrease of 158 basis points compared to the same quarter one year earlier, and, combined with the $64 million decrease in average FHLB borrowings, resulted in a $1.1 million decrease in the related interest expense. Junior subordinated debentures which were issued in connection with trust preferred securities had an average balance of $124 million (excluding the effect of fair value adjustments) and an average cost of 4.37% for the quarter ended March 31, 2009. Junior subordinated debentures outstanding in the same quarter one year earlier, similarly, had the same average balance of $124 million (excluding the effect of fair value adjustments) with a higher average rate of 6.71%. Generally, the junior subordinated debentures are adjustable-rate instruments with repricing frequencies of three months based upon the three-month LIBOR index. The lower average cost of the junior subordinated debentures in the current quarter reflects the impact of lower short-term market interest rates. Other borrowings consist of retail repurchase agreements with customers, secured by certain investment securities as well as overnight federal funds borrowings from the FRBSF and correspondent banks. The average balance for other borrowings, consisting of $132 million in customer retail repurchase agreements and $26 million of Fed Funds, was $159 million for the quarter ended March 31, 2009, an increase of $69 million over the same quarter one year earlier. The related interest expense for other borrowings decreased by $383,000, to $227,000 from $610,000 for the respective periods, again reflecting significantly lower market interest rates. The average rate paid on other borrowings was 0.58% for the quarter ended March 31, 2009, compared to 2.73% in the same quarter one year earlier. Other borrowings generally have relatively short terms and therefore reprice to current market levels more quickly than deposits, which generally lag current market rates.

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The following tables provide additional comparative data on our operating performance (dollars in thousands):

Average Balances (in thousands)	Quarters Ended March 31 2009	2008
Investment securities and cash equivalents	$ 221,035	$ 176,596
Mortgage-backed obligations	145,108	98,629
FHLB stock	37,371	37,371
Total average interest-earning securities and cash equivalents	403,514	312,596
Loans receivable	3,942,917	3,830,992
Total average interest-earning assets	4,346,431	4,143,588
Non-interest-earning assets (including fair value adjustments on interest-earning assets)	193,188	359,474
Total average assets	$ 4,539,619	$ 4,503,062
Deposits	$ 3,693,345	$ 3,606,121
Advances from FHLB	134,022	197,886
Other borrowings	159,189	89,958
Junior subordinated debentures	123,716	123,716
Total average interest-bearing liabilities	4,110,272	4,017,681
Non-interest-bearing liabilities (including fair value adjustments on interest-bearing liabilities)	(7,922)	42,997
Total average liabilities	4,102,350	4,060,678
Equity	437,269	442,384
Total average liabilities and equity	$ 4,539,619	$ 4,503,062
Interest Rate Yield/Expense (rates are annualized)		
Interest Rate Yield:		
Investment securities and cash equivalents	4.01%	6.00%
Mortgage-backed obligations	5.03%	4.70%
FHLB stock	0.00%	1.00%
Total interest rate yield on securities and cash equivalents	4.00%	4.99%
Loans receivable	5.80%	7.15%
Total interest rate yield on interest-earning assets	5.63%	6.99%
Interest Rate Expense:		
Deposits	2.54%	3.35%
Advances from FHLB	2.18%	3.76%
Other borrowings	0.58%	2.73%
Junior subordinated debentures	4.37%	6.71%
Total interest rate expense on interest-bearing liabilities	2.50%	3.46%

Interest spread	3.13%	3.53%
Net interest margin on interest earning assets	3.26%	3.63%
Additional Key Financial Ratios (ratios are annualized)		
Return on average assets	(0.83)%	0.34%
Return on average equity	(8.59)%	3.49%
Average equity / average assets	9.63%	9.82%
Average interest-earning assets / interest-bearing liabilities	105.75%	103.13%
Non-interest income/average assets	0.42%	0.73%
Non-interest (other operating) expenses / average assets	3.02%	3.01%
Efficiency ratio [non-interest (other operating) expenses / revenues]	85.32%	74.00%
Tangible common stockholders' equity to tangible assets	6.56%	6.60%

Provision and Allowance for Loan Losses. During the quarter ended March 31, 2009, the provision for loan losses was $22.0 million compared to $6.5 million the quarter ended March 31, 2008. As discussed in the Summary of Critical Accounting Policies section above and in Note 1 of the Selected Notes to Consolidated Financial Statements, the provision and allowance for loan losses is one of the most critical accounting estimates included in our Consolidated Financial Statements. For the first quarter of 2009, the provision for loan losses was the most important factor contributing to our disappointing core operating results. The provision for loan losses reflects the amount required to maintain the allowance for losses at an appropriate level based upon management's evaluation of the adequacy of general and specific loss reserves, trends in delinquencies and net charge-offs. We believe that the allowance for loan losses as of March 31, 2009 was adequate to absorb the known and inherent risks of loss in the loan portfolio at that date and that the estimates and assumptions used in our determination of the adequacy of the allowance are reasonable.

The significantly greater provision for loan losses for the quarter ended March 31, 2009 primarily reflects the substantial increase in delinquent and non-performing construction, land and land development loans for one- to four-family properties and additional declines in property values as well as our concerns that an increasing number of distressed sellers and lender foreclosures may further disrupt certain housing markets and adversely affect home prices and the demand for building lots. These concerns heightened during the second half of 2008 and remained elevated in the most recent quarter as additional evidence of over-supply and price declines for certain housing and related lot and land markets became more apparent. This was particularly the case in certain outlying areas of the Puget Sound and Portland regions, which had previously demonstrated fewer signs of stress than some of the other markets that we serve. Aside from housing-related construction and development loans, non-performing loans generally reflect unique operating difficulties for the individual borrower; however, more recently the deteriorating pace of general economic activity has become a significant contributing factor. We recorded net charge-offs of $17.5 million for the quarter ended March 31, 2009, compared to $1.9 million for the same quarter one year earlier, and non-performing loans increased to $224 million at March 31, 2009, compared $187 million at December, 31, 2008 and $54 million at March 31, 2008. A comparison of the allowance for loan losses at March 31, 2009 and 2008 reflects an increase of $30 million, or 60%, to $80 million at March 31, 2009, from $50 million at March 31, 2008. Similarly, the allowance for loan losses as a percentage of total loans (loans receivable excluding allowance for losses) increased to 2.04% at March 31, 2009, compared to 1.31% at March 31, 2008. While the allowance as a percentage of non-performing loans decreased to 36% at March 31, 2009, compared to 93% a year earlier, significantly more of the non-performing loan balances have been reduced to expected recovery values as a result of specific impairment analysis and related charge-offs.

As of March 31, 2009, we had identified $252 million of impaired loans as defined by SFAS No. 114, including $28 million of restructured loans which are currently performing under their restructured terms. Of those impaired loans, $131 million have no allowances for credit losses as their estimated collateral value is equal to or exceeds their carrying costs. The remaining $121 million have related allowances for credit losses totaling $18 million. Impaired loans with related allowances for credit losses that are individually evaluated for reserve needs total $72 million and account for $15 million of the allowances for impaired loans. Impaired loans with related allowances for credit losses that are collectively evaluated as homogeneous pools total $49 million and account for $3 million of the total allowance related to impaired loans.

Other Operating Income. Other operating income, which includes changes in the valuation of financial instruments carried at fair value as well as non-interest revenues from core operations, was $4.6 million for the quarter ended March 31, 2009, compared to $8.1 million for the same quarter one year earlier. Reflecting increased mortgage banking activity, gain on sale of loans increased by $1.1 million to $2.7 million for the quarter ended March 31, 2009, compared to $1.6 million for the same quarter one year earlier. Loan sales for the quarter ended March 31, 2009 totaled $149 million, compared to $110 million for the same quarter one year earlier period. Reflecting an impairment charge of $300,000 on mortgage servicing rights along with accelerated amortization due to early loan payoffs, servicing fees decreased by $619,000 compared to a year earlier. The slowing economy adversely affected our payment processing revenues in the current quarter as activity levels for deposit customers, cardholders and merchants clearly declined compared to a year ago. Primarily reflecting this slow-down in customer transaction volumes, income from deposit fees and other service charges decreased by $77,000, or 2%, to $4.9 million for the quarter ended March 31, 2009, compared to $5.0 million for the same quarter one year earlier. For the quarter ended March 31, 2009, other income significantly reflects a net loss of $3.3 million for the change in valuation of financial instruments carried at fair value, compared to a net gain of $823,000 for the same quarter one year earlier. The fair value adjustments in the current quarter primarily reflect large reductions in the values of the trust preferred securities, including collateralized debt obligations secured by pools of trust preferred securities, that we own, which were partially offset by changes in the valuation of the junior subordinated debentures we have issued. As discussed more thoroughly in Note 10 of the Selected Notes to the Consolidated Financial Statements, the valuation of these financial instruments has become very difficult and more subjective in recent periods as current and reliable observable transaction data does not exist.

Other Operating Expenses. Other operating expenses in aggregate were nearly unchanged at $33.8 million for the quarter ended March 31, 2009, compared to $33.7 million for the quarter ended March 31, 2008. The current quarter's expenses reflect increased deposit insurance expense, elevated costs associated with problem loan collection activities including charges related to real estate owned, and increased advertising, generally offset by reductions in compensation and costs for information/computer data services. As a result, other operating expenses as a percentage of average assets was 3.02% for the quarter ended March 31, 2009, compared to 3.01% for the same quarter one year earlier. Salary and employee benefits decreased $2.0 million to $17.6 million for the quarter ended March 31, 2009 from $19.6 million for the quarter ended March 31, 2008, reflecting reduced staffing levels as well as the elimination of certain incentive accruals and reductions in the level of employer paid retirement contributions. Likewise, information/computer data services costs decreased $455,000 to $1.5 million for the current quarter compared to $2.0 million for the same period a year ago as we continued to achieve additional operating efficiencies in this important area following the successful integration of the 2007 acquisitions. While the current quarter's expenses include operating costs associated with the opening of two new branch offices in 2008 in Portland, Oregon and Bellevue, Washington, occupancy and equipment expenses only increased modestly by $186,000, or 3%, compared to one year earlier. By contrast, the cost of FDIC insurance increased $1.2 million, or 358%, to $1.5 million for the quarter ended March 31, 2009 compared to $327,000 for the same quarter a year ago, reflecting increased assessment rates and depletion of offsetting credits that had held the prior year's charges at a lower level. The current quarter's operating expenses also included $1.2 million for professional services, which was an increase of $439,000 compared to the quarter ended

March 31, 2008 largely as a result of increased collection expenses. We also continued our strong commitment to advertising and marketing expenditures which increased by $414,000, or 29%, to $1.8 million for the quarter ended March 31, 2009, compared to $1.4 million in the same quarter one year earlier. In addition, the current quarter's expense included a non-recurring $655,000 shared risk assessment from the Washington Public Deposit Protection Commission related to the failure of a Washington State chartered commercial bank.

Income Taxes. Our normal, expected statutory income tax rate is 36.4%, representing a blend of the statutory federal income tax rate of 35.0% and apportioned effects of the Oregon and Idaho income tax rates of 6.6% and 7.6%, respectively. Our effective tax rates for the quarters ended March 31, 2009 and 2008 were (42.8)% and 28.2%, respectively. In both years the effective tax rate reflects the recording of tax credits related to certain Community Reinvestment Act (CRA) investments combined with the tax benefits of tax exempt income from municipal securities and bank-owned life insurance policies. The impact of those tax credits and tax exempt income, combined with relatively modest amounts of taxable income, or in the current quarter taxable loss, results in effective tax rates that are substantially different than the expected statutory rate.

Asset Quality

We have always placed a strong emphasis on managing our asset quality by applying a disciplined approach to credit approval and monitoring for signs of deterioration in loan quality. Nonetheless, over the past two years as housing markets have continued to weaken in many of our primary service areas, we have experienced significantly increasing delinquencies and non-performing assets, primarily in our construction and land development loan portfolios. Beginning in the third quarter of 2008 and continuing through the quarter ended March 31, 2009, home and lot sales activity was exceptionally slow, causing additional stress on builders' and developers' cash flows and ability to service debt, which is reflected in our increased non-performing asset totals. In addition, other non-housing-related segments of the loan portfolio are beginning to show signs of stress and increasing levels of non-performing loans as the effects of the slowing economy are becoming more evident. As a result, in recent periods including the quarter ended March 31, 2009, our provision for loan losses has been significantly higher than historical levels and normal expectations. This higher level of delinquencies and non-accruals also had a material adverse effect on operating income as a result of foregone interest revenues and increased loan collection costs. Although our future results will depend on the depth and duration of the current economic recession, we believe that we can work our way through the housing market-related problems and we are actively engaged with our borrowers in resolving problem loans. While property values have continued to decline, our reserve levels are substantial and, along with our impairment analysis and charge-off actions, reflect current appraisals and valuation estimates.

Non-Performing Assets: Non-performing assets increased to $263 million, or 5.84% of total assets, at March 31, 2009, compared to $62 million, or 1.36% of total assets, at March 31, 2008. Slower sales and excess inventory in certain housing markets were the primary cause of the increase in delinquencies and foreclosures of residential construction and land development loans, which represented approximately 80% of our non-performing assets at March 31, 2009. While we have not engaged in any sub-prime lending programs and have not been directly impacted by the asset quality issues emanating from that market segment, the effect on home values, housing markets and construction lending from problems associated with sub-prime and other non-traditional mortgage lending programs has contributed to the increased levels of builder and developer delinquencies. As a result of this softness in the housing market, we are currently exercising extra monitoring vigilance with respect to our asset quality and for the ended quarter March 31, 2009, we further increased our allowance for loan losses even though total loans outstanding declined. While less significant, other non-housing-related segments of the loan portfolio also experienced increased non-performing loans as a result of deteriorating economic conditions and we are proactively monitoring and managing those portions of our portfolio as well. We continue to believe our level of non-performing loans and assets, while increased, is manageable, and we believe that we have sufficient capital and human resources to manage the collection of our one- to four-family residential construction and related land loan portfolios and other non-performing assets in an orderly fashion. However, our operating results will continue to be adversely impacted until we are able to significantly reduce the level of our non-performing assets.

While non-performing assets are geographically disbursed, they are concentrated largely in land and land development loans. The primary components of the $263 million in non-performing assets are $224 million in nonaccrual loans, including $176 million of construction and land development loans, and $39 million in real estate owned (REO) and other repossessed assets. The geographic distribution of non-performing construction, land and land development loans and real estate owned included approximately $97 million, or 45%, in the Puget Sound region, $80 million, or 37%, in the greater Portland market area and $23 million, or 11%, in the greater Boise market area. Within our non-performing assets, we have a total of 58 nonaccrual lending relationships, each with aggregate loan exposures in excess of $1 million that collectively comprise $211 million, or 80% of our total non-performing assets as of March 31, 2009.

The following table sets forth information with respect to our non-performing assets and restructured loans within the meaning of SFAS No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructuring, at the dates indicated (dollars in thousands):

	March 31 2009	December 31 2008	March 31 2008
Nonaccrual Loans: (1)			
Secured by real estate:			
Commercial	$ 15,180	$ 12,879	$ 3,273
Multifamily	968	--	--
Construction and land	175,794	154,823	44,192
One- to four-family	21,900	8,649	2,869
Commercial business	7,500	8,617	3,114
Agricultural business, including secured by farmland	2,176	1,880	386
Consumer	275	130	40
	223,793	186,978	53,874
Loans more than 90 days delinquent, still on accrual:			
Secured by real estate:			
Commercial	--	--	--
Multifamily	--	--	--
Construction and land	--	--	--
One- to four-family	161	124	488
Commercial business	--	--	--
Agricultural business, including secured by farmland	--	--	--
Consumer	143	243	73
	304	367	561
Total non-performing loans	224,097	187,345	54,435
Nonaccrual securities	160	--	--
Real estate owned and other repossessed assets held for sale, net (2)	39,109	21,886	7,579
Total non-performing assets	$ 263,366	$ 209,231	$ 62,014
Total non-performing loans to net loans before allowance for loan losses	5.72%	4.73%	1.42%
Total non-performing loans to total assets	4.97%	4.09%	1.19%
Total non-performing assets to total assets	5.84%	4.56%	1.36%
Restructured loans (3)	$ 27,550	$ 23,635	$ 2,026

(1) For the quarter ended March 31, 2009, $4.1 million in interest income would have been recorded had nonaccrual loans been current, and no interest income on these loans was included in net income for this period.

(2) Real estate acquired by us as a result of foreclosure or by deed-in-lieu of foreclosure is classified as real estate held for sale until it is sold. When property is acquired, it is recorded at the lower of its cost (the unpaid principal balance of the related loan plus foreclosure costs) or net realizable value. Subsequent to acquisition through foreclosure, the property is carried at the lower of the foreclosed amount or net realizable value. If a new appraisal

and market analysis determines that the net realizable value has decreased, the carrying value is written down to the anticipated sales price, less selling and holding costs, by a charge to operating expense. At March 31, 2009, we had $39.0 million of real estate owned. Of that total, $19.2 million, or 49.4%, are located in the greater Seattle, WA-Puget Sound region and consist of land development projects that include 213 residential lots, three single-family homes under construction and ten completed single-family homes. Another $12.6 million, or 32.4% of the total, are located in the greater Portland, OR area and consist of 89 residential lots and ten completed single-family homes. A further $6.1 million, or 15.8%, are split almost evenly between the greater Spokane, WA area and the greater Boise, ID area and consist of 19 residential lots, ten completed single-family homes and four completed single-family condominiums.

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

In addition to the non-performing loans as of March 31, 2009, we had other classified loans with an aggregate outstanding balance of $171 million that are not on nonaccrual status, with respect to which known information concerning possible credit problems with the borrowers or the cash flows of the properties securing the respective loans has caused management to be concerned about the ability of the borrowers to comply with present loan repayment terms. This may result in the future inclusion of such loans in the nonaccrual loan category.

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Detail and Geographic Concentration of Non-performing Assets at March 31, 2009	Washington	Oregon	Idaho	Other	Total
Secured by real estate:					
Commercial	$ 7,774	$ 7,406	$ --	$ --	$ 15,180
Multifamily	968	--	--	--	968
Construction and land					
One- to four-family construction	34,927	25,885	6,376	--	67,188
Residential land acquisition & development	30,555	36,678	6,533	--	73,766
Residential land improved lots	11,133	3,058	2,006	--	16,197
Residential land unimproved	8,415	200	5,543	--	14,158
Commercial land acquisition & development	--	--	--	--	--
Commercial land improved	--	--	--	--	--
Commercial land unimproved	4,076	409	--	--	4,485
Total construction and land	89,106	66,230	20,458	--	175,794
One- to four-family	9,442	2,820	8,667	1,132	22,061
Commercial business	6,115	1,118	267	--	7,500
Agricultural business, including secured by farmland	774	417	985	--	2,176
Consumer	418	--	--	--	418
Total non-performing loans	114,597	77,991	30,377	1,132	224,097
Securities on nonaccrual	--	--	--	160	160
Real estate owned (REO) and repossessed assets	23,390	12,650	3,069	--	39,109
Total non-performing assets	$ 137,987	$ 90,641	$ 33,446	$ 1,292	$ 263,366

The most significant of our non-performing loan and real estate owned (REO) exposures are included in the following two tables:

In thousands	Percent of total non-performing assets	Collateral securing the indebtedness	Geographic location
$ 17,723	6.73%	166 residential lots One multi-family site Eight completed homes in one plat 20 residential lots in a second plat One partially completed high-end home	Greater Portland, OR area
17,141	6.51	109 residential lots 22 homes under construction	Greater Seattle-Puget Sound
11,791	4.48	105 residential lots	Greater Seattle-Puget Sound
8,553	3.25	40 residential lots Four completed new homes Three homes under construction	Greater Portland, OR area
7,324	2.78	Commercial building office	Greater Portland, OR area
7,234	2.75	23 residential lots 11 completed new homes	Greater Seattle-Puget Sound
6,679	2.54	72 residential lots Two completed homes	Central Oregon
6,002	2.28	41 residential lots	Greater Portland, OR area
5,896	2.24	Ten residential lots 21 completed new homes or leased homes	Greater Portland, OR area
5,176	1.97	Nine residential lots 12 completed new or leased homes	Greater Portland, OR area
5,011	1.90	Five parcels of land with preliminary plat approval for 51 residential lots	Greater Seattle-Puget Sound

	4,810	1.83	155 acres undeveloped residential land	Greater Boise, ID area
	4,650	1.77	Three completed new homes Three residential lots	Greater Spokane, WA area
	4,076	1.55	Commercial lot	Greater Seattle-Puget Sound
	69,040	26.21	Various collateral; all relationships under $4 million	Washington
	26,533	10.07	Various collateral; all relationships under $4 million	Oregon
	15,022	5.70	Various collateral; all relationships under $4 million	Idaho
	40,705	15.46	REO, other repossessed assets and nonaccrual securities	Various
$	263,366	100.0%	Total non-performing assets	

In thousands		Percent of total REO and repossessed assets	REO description	Geographic location
$	11,304	29.02%	196-lot residential land development project	Greater Seattle-Puget Sound
	4,540	11.66	74 residential lots	Greater Portland, OR area
	3,907	10.03	Eight residential lots Four completed single-family homes	Greater Portland, OR area
	2,333	5.99	12 residential lots Four completed condominiums	Greater Spokane, WA area
	2,269	5.83	Seven residential lots Three completed single-family homes	Greater Portland, OR area
	1,914	4.91	Three completed single-family homes	Greater Portland, OR area
	1,320	3.39	Three completed single-family homes	Greater Seattle-Puget Sound
	1,260	3.23	Two completed single-family homes	Greater Seattle-Puget Sound
	1,207	3.10	Three residential lots One completed single-family home One single-family construction	Greater Seattle-Puget Sound
	4,140	10.63	Eight residential lots Four completed single-family homes Two single-family constructions	Greater Seattle-Puget Sound
	3,068	7.88	Seven residential lots Six completed single-family homes	Greater Boise, ID area
	735	1.89	Two completed single-family homes	Greater Spokane, WA area
	954	2.45		Other Washington

			One completed single-family home Three commercial buildings
$	38,951	100.0%	

Liquidity and Capital Resources

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

Our primary investing activity is the origination and purchase of loans. During the quarter ended March 31, 2009, we did not purchase any loans; however, we did originate $153 million of loans held for sale and we sold $149 million of loans held for sale. Other loan originations net of repayments resulted in net repayments of $32 million for the quarter. Total deposits decreased $151 million for the quarter ended March 31, 2009 primarily because we encouraged $125 million in public funds to run off in response to changes in the collateralization requirements under the Washington and Oregon State public deposit protection regulations. In addition to reducing our collateral requirements, allowing those deposits to run off also reduced our exposure to future shared-risk assessments under those regulations. Deposit activity in the first quarter of 2009 also included a net decrease of $19 million of brokered deposits. Brokered deposits and public funds are generally more price sensitive than retail deposits and our use of those deposits varies significantly based upon our liquidity management strategies at any point in time. FHLB advances (excluding fair value adjustments) increased $61 million for the quarter ended March 31, 2009, and other borrowings, including the $50 million of senior bank notes issued under the FDIC Temporary Liquidity Guarantee Program (TLGP) and our junior subordinated debentures (excluding fair value adjustments), increased $36 million for the quarter ended March 31, 2009.

We must maintain an adequate level of liquidity to ensure the availability of sufficient funds to accommodate deposit withdrawals, to support loan growth, to satisfy financial commitments and to take advantage of investment opportunities. During the quarter ended March 31, 2009, we used our sources of funds primarily to fund loan commitments, to purchase securities, and to pay maturing savings certificates and deposit withdrawals. At March 31, 2009, we had outstanding loan commitments totaling $1.000 billion, including undisbursed loans in process and unused credit lines totaling $906 million. This level of commitments was proportionally consistent with our historical experience and does not represent a departure from normal operations. We generally maintain sufficient cash and readily marketable securities to meet short-term liquidity needs; however, our primary liquidity management practice is to increase or decrease short-term borrowings, including FHLB advances and FRBSF borrowings. We maintain credit facilities with the FHLB-Seattle, which at March 31, 2009 provided for advances that in the aggregate may equal the lesser of 35% of Banner Bank's assets or adjusted qualifying collateral, up to a total possible credit line of $952 million, and 25% of Islanders Bank's assets or adjusted qualifying collateral, up to a total possible credit line of $43 million. Advances under these credit facilities totaled $172 million, or 4% of our assets at March 31, 2009. In addition, Banner Bank has been approved for participation in the Federal Reserve Bank of San Francisco's Borrower-for-Custody (BIC) program. Under this program we can borrow against eligible collateral not already pledged for other borrowings, which we currently estimate would provide additional borrowing capacity of $597 million. We utilized this facility on a limited basis during 2008; however, we had no funds borrowed from the Federal Reserve Bank at March 31, 2009.

At March 31, 2009, certificates of deposit amounted to $2.019 billion, or 56% of our total deposits, including $1.505 billion which were scheduled to mature within one year. While no assurance can be given as to future periods, historically, we have been able to retain a significant amount of our deposits as they mature. Management believes it has adequate resources and funding potential to meet our foreseeable liquidity requirements.

Capital Requirements

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

The capital adequacy requirements are quantitative measures established by regulation that require Banner Corporation and the Banks to maintain minimum amounts and ratios of capital. The Federal Reserve requires Banner Corporation to maintain capital adequacy that generally parallels the FDIC requirements. The FDIC requires the Banks to maintain minimum ratios of Tier 1 total capital to risk-weighted assets as well as Tier 1 leverage capital to average assets. At March 31, 2009, Banner Corporation and the Banks each exceeded all current regulatory capital requirements. (See Item 1, "Business–Regulation," and Note 20 of the Notes to the Consolidated Financial Statements included in Banner Corporation's Annual Report on Form 10-K for the year ended December 31, 2008 for additional information regarding regulatory capital requirements for Banner and the Banks for the year ended December 31, 2008.)

The actual regulatory capital ratios calculated for Banner Corporation, Banner Bank and Islanders Bank as of March 31, 2009, along with the minimum capital amounts and ratios, were as follows (dollars in thousands):

	Actual		Minimum for capital adequacy purposes		Minimum to be categorized as "well-capitalized" under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
March 31, 2009:						
Banner Corporation—consolidated						
Total capital to risk-weighted assets	$ 515,432	12.87%	$ 320,271	8.00%	N/A	N/A
	465,039	11.62	160,135	4.00	N/A	N/A

Tier 1 capital to risk-weighted assets							
Tier 1 leverage capital to average assets	465,039	10.27	181,200	4.00		N/A	N/A
Banner Bank							
Total capital to risk-weighted assets	464,079	12.09	307,020	8.00	$	383,774	10.00%
Tier 1 capital to risk-weighted assets	415,730	10.83	153,510	4.00		230,265	6.00
Tier 1 leverage capital to average assets	415,730	9.56	173,873	4.00		217,341	5.00
Islanders Bank							
Total capital to risk-weighted assets	24,860	13.56	14,663	8.00		18,329	10.00%
Tier 1 capital to risk-weighted assets	23,631	12.89	7,332	4.00		10,997	6.00
Tier 1 leverage capital to average assets	23,631	11.73	8,058	4.00		10,072	5.00

ITEM 3 – Quantitative and Qualitative Disclosures About Market Risk

Market Risk and Asset/Liability Management

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

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

The greatest source of interest rate risk to us results from the mismatch of maturities or repricing intervals for rate sensitive assets, liabilities and off-balance-sheet contracts. This mismatch or gap is generally characterized by a substantially shorter maturity structure for interest-bearing liabilities than interest-earning assets, although our floating-rate assets tend to be more immediately responsive to changes in market rates than most funding deposit liabilities. Additional interest rate risk results from mismatched repricing indices and formulae (basis risk and yield curve risk), and product caps and floors and early repayment or withdrawal provisions (option risk), which may be contractual or market driven, that are generally more favorable to customers than to us. An exception to this generalization is the beneficial effect of interest rate floors on a portion of our floating-rate loans, which help us maintain higher loan yields in periods when market interest rates decline significantly. However, in a declining interest rate environment, as loans with floors are repaid they generally are replaced with new loans which have lower interest rate floors. Further, as of March 31, 2009, many of the floating-rate loans with interest rate floors are in portions of the portfolio experiencing higher levels of delinquencies, which tends to mitigate the beneficial effect of the floors. An additional consideration is the lagging and somewhat inelastic pricing adjustments for interest rates on certain deposit products as market interest rates change. These deposit pricing characteristics are particularly relevant to the administered rates paid on certain checking, savings and money market accounts and contributed to the narrowing of our net interest margin following the Federal Reserve's actions to lower market interest rates beginning in late 2007 and accelerating in of 2008, as asset yields declined while the reduction in deposit costs lagged. Further, in recent quarters, deposit costs have not declined as much as other short-term market interest rates as credit concerns and liquidity issues for certain large financial institutions have created heightened competitive pricing pressures. As previously noted, our net interest margin has also been adversely affected by an increase in loan delinquencies as well as changes in the portfolio mix as construction and development lending has slowed.

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

Sensitivity Analysis

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

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

The table of Interest Rate Risk Indicators sets forth, as of March 31, 2009, the estimated changes in our net interest income over a on-year time horizon and the estimated changes in market value of equity based on the indicated interest rate environments.

Interest Rate Risk Indicators

Change (in Basis Points) in Interest Rates (1)	Estimated Change in Net Interest Income Next 12 Months			Net Economic Value (dollars in thousands)		
+400	$	7,115	4.6 %	$	(109,547)	(28.6)%
+300		4,583	3.0		(91,240)	(23.8)
+200		534	0.3		(62,637)	(16.3)
+100		(2,665)	(1.7)		(34,244)	(8.9)
0		0	0.0		0	0
-25		(119)	(0.1)		519	0.1
-50		(566)	(0.4)		11,907	3.1

(1) Assumes an instantaneous and sustained uniform change in market interest rates at all maturities.

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

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

The table of Interest Sensitivity Gap presents our interest sensitivity gap between interest-earning assets and interest-bearing liabilities at March 31, 2009. The table sets forth the amounts of interest-earning assets and interest-bearing liabilities which are anticipated by us, based upon certain assumptions, to reprice or mature in each of the future periods shown. At March 31, 2009, total interest-earning assets maturing or repricing within one year exceeded total interest-bearing liabilities maturing or repricing in the same time period by $175.2 million, representing a one-year cumulative gap to total assets ratio of 3.88%.

Management is aware of the sources of interest rate risk and in its opinion actively monitors and manages it to the extent possible. The interest rate risk indicators and interest sensitivity gaps as of March 31, 2009 are within our internal policy guidelines and management considers that our current level of interest rate risk is reasonable.

Interest Sensitivity Gap as of March 31, 2009	Within 6 Months	After 6 Months Within 1 Year	After 1 Year Within 3 Years	After 3 Years Within 5 Years	After 5 Years Within 10 Years	Over 10 Years	Total
			(dollars in thousands)				
Interest-earning assets: (1)							
Construction loans	$ 574,742	$ 24,094	$ 12,300	$ 603	$ --	$ --	$ 611,739
Fixed-rate mortgage loans	111,643	76,869	246,158	174,461	156,669	63,154	828,954
Adjustable-rate mortgage loans	614,909	158,315	383,037	210,743	6,073	--	1,373,077
Fixed-rate mortgage-backed securities	18,259	13,844	38,347	21,525	21,634	6,413	120,022
Adjustable-rate mortgage-backed securities	2,225	2,001	7,218	9,968	--	--	21,412
Fixed-rate commercial/agricultural loans	59,833	40,623	90,725	30,673	7,673	158	229,685
Adjustable-rate commercial/agricultural loans	557,820	9,408	36,921	16,031	238	--	620,418
Consumer and other loans	143,722	12,190	29,856	41,358	16,378	10,692	254,196
Investment securities and interest-earning deposits	90,282	16,421	22,505	30,857	24,383	67,360	251,808
Total rate sensitive assets	$ 2,173,435	$ 353,765	$ 867,067	$ 536,219	$ 233,048	$ 147,777	$ 4,311,311
Interest-bearing liabilities: (2)							
Regular savings and NOW accounts	142,261	115,715	270,002	270,002	--	--	797,980
Money market deposit accounts	150,929	90,557	60,371	--	--	--	301,857
Certificates of deposit	982,637	516,340	470,844	44,936	4,317	--	2,019,074
FHLB advances	91,432	33,000	35,800	10,000	--	--	170,232
Other borrowings	--	--	49,970	--	--	--	49,970
Junior subordinated debentures	97,942	--	25,774	--	--	--	123,716
Retail repurchase agreements	131,224	--	--	--	--	--	131,224
Total rate sensitive liabilities	1,596,425	755,612	912,761	324,938	4,317	--	3,594,053
Excess (deficiency) of interest-sensitive assets over interest-sensitive liabilities	$ 577,010	$ (401,847)	$ (45,694)	$ 211,281	$ 228,731	$ 147,777	$ 717,258
Cumulative excess (deficiency) of	$ 577,010	$ 175,163	$ 129,469	$ 340,750	$ 569,481	$ 717,258	$ 717,258

interest-sensitive assets							
Cumulative ratio of interest-earning assets to interest-bearing liabilities	136.14%	107.45%	103.97%	109.49%	115.85%	119.96%	119.96%
Interest sensitivity gap to total assets	12.79%	(8.91)%	(1.01)%	4.68%	5.07%	3.28%	15.90%
Ratio of cumulative gap to total assets	12.79%	3.88%	2.87%	7.56%	12.63%	15.90%	15.90%

(footnotes on following page)

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Footnotes for Table of Interest Sensitivity Gap

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

(2) Adjustable-rate liabilities are included in the period in which interest rates are next scheduled to adjust rather than in the period they are due to mature. Although regular savings, demand, NOW, and money market deposit accounts are subject to immediate withdrawal, based on historical experience management considers a substantial amount of such accounts to be core deposits having significantly longer maturities. For the purpose of the gap analysis, these accounts have been assigned decay rates to reflect their longer effective maturities. If all of these accounts had been assumed to be short-term, the one-year cumulative gap of interest-sensitive assets would have been $(425.2) million, or (9.4%) of total assets at March 31, 2009. Interest-bearing liabilities for this table exclude certain non-interest-bearing deposits which are included in the average balance calculations in the table contained in Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Comparison of Results of Operations for the Quarters Ended March 31, 2009 and 2008” of this report.

ITEM 4 - Controls and Procedures

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

(a) Evaluation of Disclosure Controls and Procedures: An evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) was carried out under the supervision and with the participation of our Chief Executive Officer, Chief Financial Officer and several other members of our senior management as of the end of the period covered by this report. Based on their evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2009, our disclosure controls and procedures were effective in ensuring that the information required to be disclosed by us in the reports it files or submits under the Exchange Act is (i) accumulated and communicated to our management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms.

(b) Changes in Internal Controls Over Financial Reporting: In the quarter ended March 31, 2009, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. 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 management believes would have a material adverse effect on our financial condition or operations.

Item 1A. Risk Factors

There have been no material changes in the risk factors previously disclosed in Part 1, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2008 (File No. 0-26584) except that the following risk factors are added to those previously contained in Form 10-K:

Our investment in Federal Home Loan Bank stock may be impaired.

At March 31, 2009, we owned $37.4 million of stock of the Federal Home Loan Bank of Seattle, or FHLB. As a condition of membership in the Federal Home Loan Bank of Seattle (FHLB), we are required to purchase and hold a certain amount of FHLB stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB and is calculated in accordance with the Capital Plan of the FHLB. Our FHLB stock has a par value of $100, is carried at cost and is subject to recoverability testing per SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. The FHLB recently announced that it had a risk-based capital deficiency under the regulations of the Federal Housing Finance Agency (the “FHFA”), its primary regulator, as of December 31, 2008, and that it would suspend future dividends and the repurchase and redemption of outstanding common stock. As a result, the FHLB did not pay a dividend for the fourth calendar quarter of 2008 or the first quarter of 2009. The FHLB has communicated that it believes the calculation of risk-based capital under the current rules of the FHFA significantly overstates the market risk of the FHLB’s private-label mortgage-backed securities in the current market environment and that it has enough capital to cover the risks reflected in the FHLB’s balance sheet. As a result, we have not recorded an “other than temporary impairment” on our investment in FHLB stock. However, continued deterioration in the FHLB’s financial position may result in impairment in the value of those securities. We will continue to monitor the financial condition of the FHLB as it relates to, among other things, the recoverability of our investment.

We are subject to various regulatory requirements and may be subject to future regulatory restrictions and enforcement actions.

Currently, Banner Bank must obtain prior regulatory approval before adding any new director or senior executive officer or changing the responsibilities of any current senior executive officer. In addition, Banner Bank may not pay pursuant to or enter into certain severance and other forms of compensation agreements without regulatory approval. Further, we require the approval of the FDIC to participate in any additional borrowings under the Temporary Liquidity Guarantee Program.

In light of the current challenging operating environment, along with our elevated level of non-performing assets, delinquencies, and adversely classified assets, we may be subject to additional increased regulatory scrutiny, regulatory restrictions, and potential enforcement actions. Such enforcement actions could place limitations on our business and adversely affect our ability to implement our business plans. Even though we remain well-capitalized in terms of our capital ratios, the regulatory agencies have the authority to restrict our operations to those consistent with adequately capitalized institutions. For example, if the regulatory agencies were to implement such a restriction, we would likely have limitations on our lending activities and be limited in our ability to utilize brokered funds as a funding source, an area that has been a source of funds for us in recent years. The regulatory agencies also have the power to limit the rates paid by the Banks to attract retail deposits in their local markets. We also may be required to reduce our levels of construction and land development loans and classified or non-performing assets within specified time frames. These time frames might not necessarily result in maximizing the price which might otherwise be received for the underlying properties. In addition, if such restrictions were also imposed upon other institutions which operate in the Bank’s markets, multiple institutions disposing of properties at the same time could further diminish the potential proceeds received from the sale of these properties. If any of these or similar additional restrictions are placed on us, it would limit the resources currently available to us as a well-capitalized institution.

The value of securities in our investment securities portfolio may be negatively affected by continued disruptions in securities markets.

The market for some of the investment securities held in our portfolio has become extremely volatile over the past twelve months. Volatile market conditions may detrimentally affect the value of these securities, such as through reduced valuations due to the perception of heightened credit and liquidity risks. There can be no assurance that the declines in market value associated with these disruptions 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.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the quarter ended March 31, 2009, we did not sell any securities that were not registered under the Securities Act of 1933. We did not have any repurchases of our common stock from January 1, 2009 through March 31, 2009.

Item 3. Defaults upon Senior Securities

Not Applicable.

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

None.

Item 5. Other Information

Not Applicable.

Item 6. Exhibits

Exhibit	Index of Exhibits
3{a}	Articles of Incorporation of Registrant [incorporated by reference to Exhibit B to the Proxy Statement for the Annual Meeting of Stockholders dated June 10, 1998].
3{b}	Certificate of designation relating to the Company's Fixed Rate Cumulative Perpetual Preferred Stock Series A [incorporated by reference to the Registrant's Current Report on Form 8-K filed on November 24, 2008 (File No. 000-26584)]
3{c}	Bylaws of Registrant [incorporated by reference to Exhibit 3.2 filed with the Current Report on Form 8-K dated July 24, 1998 (File No. 0-26584)].
4{a}	Warrant to purchase shares of Company's common stock dated November 21, 2008 [incorporated by reference to the Registrant's Current Report on Form 8-K filed on November 24, 2008 (File No. 000-26584)]
4{b}	Letter Agreement (including Securities Purchase Agreement Standard Terms attached as Exhibit A) dated November 21, 2008 between the Company and the United States Department of the Treasury [incorporated by reference to the Registrant's Current Report on Form 8-K filed on November 24, 2008 (File No. 000-26584)].
10{a}	Executive Salary Continuation Agreement with Gary L. Sirmon [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended March 31, 1996 (File No. 0-26584)].
10{b}	Employment Agreement with Michael K. Larsen [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended March 31, 1996 (File No. 0-26584)].
10{c}	Executive Salary Continuation Agreement with Michael K. Larsen [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended March 31, 1996 (File No. 0-26584)].
10{d}	1996 Stock Option Plan [incorporated by reference to Exhibit 99.1 to the Registration Statement on Form S-8 dated August 26, 1996 (File No. 333-10819)].
10{e}	1996 Management Recognition and Development Plan [incorporated by reference to Exhibit 99.2 to the Registration Statement on Form S-8 dated August 26, 1996 (File No. 333-10819)].
10{f}	Consultant Agreement with Jesse G. Foster, dated as of December 19, 2003. [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2003 (File No. 0-23584)].
10{g}	Supplemental Retirement Plan as Amended with Jesse G. Foster [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended March 31, 1997 (File No. 0-26584)].
10{h}	Employment Agreement with Lloyd W. Baker [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 0-26584)].
10{i}	Employment Agreement with D. Michael Jones [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 0-26584)].

10{j} Supplemental Executive Retirement Program Agreement with D. Michael Jones [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2003 (File No. 0-26584)].

10{k} Form of Supplemental Executive Retirement Program Agreement with Gary Sirmon, Michael K. Larsen, Lloyd W. Baker, Cynthia D. Purcell, Richard B. Barton and Paul E. Folz [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2001 and the exhibits filed with the Form 8-K on May 6, 2008].

10{l} 1998 Stock Option Plan [incorporated by reference to exhibits filed with the Registration Statement on Form S-8 dated February 2, 1999 (File No. 333-71625)].

10{m} 2001 Stock Option Plan [incorporated by reference to Exhibit 99.1 to the Registration Statement on Form S-8 dated August 8, 2001 (File No. 333-67168)].

10{n} Form of Employment Contract entered into with Cynthia D. Purcell, Richard B. Barton, Paul E. Folz, John R. Neill and Douglas M. Bennett [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2003 (File No. 0-26584)].

10{o} 2004 Executive Officer and Director Stock Account Deferred Compensation Plan [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2005 (File No. 0-26584)].

10{p} 2004 Executive Officer and Director Investment Account Deferred Compensation Plan [incorporated by reference to exhibits filed with the Annual Report on Form 10-K for the year ended December 31, 2005 (File No. 0-26584)].

10{q} Long-Term Incentive Plan [incorporated by reference to the exhibits filed with the Form 8-K on May 6, 2008].

10{r} Form of Compensation Modification Agreement [incorporated by reference to the Registrant's Current Report on Form 8-K filed on November 24, 2008 (File No. 000-26584)].

10{s} 2005 Executive Officer and Director Stock Account Deferred Compensation Plan.

31.1 Certification of Chief Executive Officer pursuant to the Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to the Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Banner Corporation

May 11, 2009	/s/ D. Michael Jones D. Michael Jones President and Chief Executive Officer (Principal Executive Officer)
May 11, 2009	/s/ Lloyd W. Baker Lloyd W. Baker Treasurer and Chief Financial Officer (Principal Financial and Accounting Officer)

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EXHIBIT 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER OF BANNER CORPORATION
PURSUANT TO RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES ACT OF 1934

I, D. Michael Jones, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2009 of Banner Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

May 11, 2009

/s/D. Michael Jones
D. Michael Jones
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER OF BANNER CORPORATION
PURSUANT TO RULES 13a-14(a) AND 15d -14(a) UNDER THE SECURITIES ACT OF 1934

I, Lloyd W. Baker, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2009 of Banner Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of registrant’s board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

May 11, 2009

/s/Lloyd W. Baker
Lloyd W. Baker
Chief Financial Officer

EXHIBIT 32

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
OF BANNER CORPORATION
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned hereby certify in his capacity as an officer of Banner Corporation, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and in connection with this Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2009, that:

- the report fully complies with the requirements of Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, and

- the information contained in the report fairly presents, in all material respects, the Company's financial condition and results of operations as of the dates and for the periods presented in the financial statements included in such report.

May 11, 2009	/s/D. Michael Jones D. Michael Jones Chief Executive Officer
May 11, 2009	/s/Lloyd W. Baker Lloyd W. Baker Chief Financial Officer