

INTERMOUNTAIN COMMUNITY BANCORP

Form 10-K

March 19, 2010

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**Form 10-K**

(Mark One)

- þ** **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the year ended December 31, 2009**
- OR**
- o** **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the transition period from            to**

**COMMISSION FILE NUMBER 000-50667**

**INTERMOUNTAIN COMMUNITY BANCORP**  
*(Exact name of registrant as specified in its charter)*

**Idaho**  
*(State or other jurisdiction of  
incorporation or organization)*

**82-0499463**  
*(IRS Employer  
Identification No.)*

**414 Church Street, Sandpoint, ID 83864**  
*(Address of principal executive offices) (Zip code)*

**Registrant's telephone number, including area code:**  
**(208) 263-0505**

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

**None**  
*(Title of each class)*

**None**  
*(Name of each exchange on which registered)*

**Securities registered pursuant to Section 12(g) of the Act:**  
**Common Stock (no par value)**  
*(Title of class)*

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

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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

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

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

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☒  
(Do not check if a smaller reporting company)

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

As of June 30, 2009, the aggregate market value of the common equity held by non-affiliates of the registrant, computed by reference to the average of the bid and asked prices on such date as reported on the OTC Bulletin Board, was \$23,200,000.

The number of shares outstanding of the registrant's Common Stock, no par value per share, as of March 5, 2010 was 8,383,379.

#### DOCUMENTS INCORPORATED BY REFERENCE

Specific portions of the registrant's Proxy Statement for the 2010 Annual Meeting of Shareholders are incorporated by reference into Part III hereof.

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## TABLE OF CONTENTS

	<b>Page</b>
<b><u>PART I</u></b>	
<u>ITEM 1. BUSINESS</u>	4
<u>ITEM 1A. RISK FACTORS</u>	39
<u>ITEM 1B. UNRESOLVED STAFF COMMENTS</u>	49
<u>ITEM 2. PROPERTIES</u>	49
<u>ITEM 3. LEGAL PROCEEDINGS</u>	51
<u>ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u>	51
<b><u>PART II</u></b>	
<u>ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u>	51
<u>ITEM 6. SELECTED FINANCIAL DATA</u>	54
<u>ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	55
<u>ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	84
<u>ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	87
<u>ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u>	87
<u>ITEM 9A. CONTROLS AND PROCEDURES</u>	87
<u>MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING</u>	87
<u>REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u>	88
<u>ITEM 9B. OTHER INFORMATION</u>	89
<b><u>PART III</u></b>	
<u>ITEM 10. DIRECTORS EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE</u>	89
<u>ITEM 11. EXECUTIVE COMPENSATION</u>	90
<u>ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</u>	90
<u>ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE</u>	90
<u>ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES</u>	90
<b><u>PART IV</u></b>	
<u>ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES</u>	91
<u>SIGNATURES</u>	92
<u>EXHIBIT INDEX</u>	93
<u>Report of Independent Registered Public Accounting Firm</u>	F-1
<u>Consolidated Balance Sheets</u>	F-2
<u>Consolidated Statements of Operations</u>	F-3
<u>Consolidated Statements of Comprehensive Income (Loss)</u>	F-4
<u>Consolidated Statements of Changes in Stockholders' Equity</u>	F-5
<u>Consolidated Statements of Cash Flows</u>	F-8

Summary of Accounting Policies

F-10

Notes to Consolidated Financial Statements

F-20

EX-3.1

EX-3.2

EX-4.2

EX-21

EX-23

EX-31.1

EX-31.2

EX-32

EX-99.1

EX-99.2

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**Table of Contents**

**PART I**

**Forward-Looking Statements**

**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

*This report may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, statements about our plans, objectives, expectations and intentions that are not historical facts, and other statements identified by words such as expects, anticipates, intends, plans, believes, , will likely, should, projects, seeks, estimates or words of similar import. Forward-looking statements are based on current beliefs and expectations of management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. In addition to the factors set forth in the sections titled Risk Factors, Business and Management's Discussion and Analysis of Financial Condition and Results of Operations, as applicable, in this report, the following factors, among others, could cause actual results to differ materially from the anticipated results:*

inflation and interest rate levels, and market and monetary fluctuations;

the risks associated with lending and potential adverse changes in credit quality;

changes in market interest rates and spreads, which could adversely affect our net interest income and profitability;

increased delinquency rates;

trade, monetary and fiscal policies and laws, including interest rate and income tax policies of the federal government;

applicable laws and regulations and legislative or regulatory changes;

the timely development and acceptance of new products and services of Intermountain;

the willingness of customers to substitute competitors' products and services for Intermountain's products and services;

technological and management changes;

our ability to recruit and retain key management and staff;

changes in estimates and assumptions used in financial accounting;

the Company's critical accounting policies and the implementation of such policies;

growth and acquisition strategies;

lower-than-expected revenue or cost savings or other issues in connection with mergers and acquisitions;

changes in consumer spending, saving and borrowing habits;

the strength of the United States economy in general and the strength of the local economies in which Intermountain conducts its operations;

declines in real estate values supporting loan collateral;

our ability to attract new deposits and loans and leases;

competitive market pricing factors;

further deterioration in economic conditions that could result in increased loan and lease losses;

risks associated with concentrations in real estate-related loans;

stability of funding sources and continued availability of borrowings;

**Table of Contents**

Intermountain's success in gaining regulatory approvals, when required;

changes in legal or regulatory requirements or the results of regulatory examinations that could restrict growth;

our ability to comply with the requirements of regulatory orders issued to us and/or our banking subsidiary;

significant decline in the market value of the Company that could result in an impairment of goodwill;

our ability to raise capital or incur debt on reasonable terms;

regulatory limits on our subsidiary bank's ability to pay dividends to the Company;

effectiveness of the Emergency Economic Stabilization Act of 2008 ( EESA ), the American Recovery and Reinvestment Act of 2009 ( ARRA ), and other legislative and regulatory efforts to help stabilize the U.S. financial markets;

future legislative or administrative changes to the Troubled Asset Relief Program ( TARP ) Capital Purchase Program enacted under EESA; and

the impact of EESA and ARRA and related rules and regulations on our business operations and competitiveness, including the impact of executive compensation restrictions, which may affect our ability to retain and recruit executives in competition with other firms who do not operate under those restrictions; and

Intermountain's success at managing the risks involved in the foregoing.

Please take into account that forward-looking statements speak only as of the date of this report. We do not undertake any obligation to publicly correct or update any forward-looking statement whether as a result of new information, future events or otherwise.

**Item 1. BUSINESS**

**Overview & History**

Intermountain Community Bancorp ( Intermountain or the Company ) is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was formed as Panhandle Bancorp in October 1997 under the laws of the State of Idaho in connection with a holding company reorganization of Panhandle State Bank (the Bank ) that was approved by the shareholders on November 19, 1997 and became effective on January 27, 1998. In June 2000, Panhandle Bancorp changed its name to Intermountain Community Bancorp.

Panhandle State Bank, a wholly owned subsidiary of the Company, was first opened in 1981 to serve the local banking needs of Bonner County, Idaho. Panhandle State Bank is regulated by the Idaho Department of Finance, the State of Washington Department of Financial Institutions, the Oregon Division of Finance and Corporate Securities and by the Federal Deposit Insurance Corporation ( FDIC ), its primary federal regulator and the insurer of its deposits.

Since opening in 1981, the Bank has continued to grow by opening additional branch offices throughout Idaho and has also expanded into the states of Oregon and Washington. During 1999, the Bank opened its first branch under the name of Intermountain Community Bank, a division of Panhandle State Bank, in Payette, Idaho. Over the next several years, the Bank continued to open branches under both the Intermountain Community Bank and Panhandle State Bank



names. In January 2003, the Bank acquired a branch office from Household Bank F.S.B. located in Ontario, Oregon, which is now operating under the Intermountain Community Bank name. In 2004, Intermountain acquired Snake River Bancorp, Inc. ( Snake River ) and its subsidiary bank, Magic Valley Bank, and the Bank now operates three branches under the Magic Valley Bank name in south central Idaho. In 2005 and 2006, the Company opened branches in Spokane Valley and downtown Spokane, Washington, respectively, and operates these branches under the name of Intermountain Community Bank of Washington. It also opened branches in Kellogg under the Panhandle State Bank name and Fruitland, Idaho under the Intermountain Community Bank name.

## **Table of Contents**

In 2006, Intermountain also opened a Trust & Wealth Management division, and purchased a small investment company, Premier Alliance. The combined unit now operates as Intermountain's Trust & Investment Services division. The acquisition and development of these services improves the Company's ability to provide a full-range of financial services to its targeted customers. In 2007, the Company relocated its Spokane Valley office to a larger facility housing retail, commercial, and mortgage banking functions and administrative staff. In the second quarter of 2008, the Bank completed the Sandpoint Center, its new corporate headquarters, and relocated the Sandpoint branch and administrative staff into the building.

Intermountain offers banking and financial services that fit the needs of the communities it serves. Lending activities include consumer, commercial, commercial real estate, residential construction, mortgage and agricultural loans. A full range of deposit services are available including checking, savings and money market accounts as well as various types of certificates of deposit. Trust and wealth management services, investment and insurance services, and business cash management solutions round out the Company's product offerings.

The Company's equity investments include Panhandle State Bank, as previously noted, and Intermountain Statutory Trust I and Intermountain Statutory Trust II, financing subsidiaries formed in January 2003 and March 2004, respectively. Each Trust has issued \$8.0 million in preferred securities, the purchasers of which are entitled to receive cumulative cash dividends from the Trusts. The Company has issued junior subordinated debentures to the Trusts, and payments from these debentures are used to make the cash dividends to the holders of the Trusts' preferred securities.

## **Business Strategy & Opportunities**

Intermountain seeks to differentiate itself by attracting, retaining and motivating highly experienced employees who are local market leaders, and supporting them with advanced technology, training and compensation systems. This approach allows the Bank to provide local marketing and decision-making to respond quickly to customer opportunities and build leadership in its communities. Simultaneously, the Bank has focused on standardizing and centralizing administrative and operational functions to improve risk management, efficiency and the ability of the branches to serve customers effectively.

Intermountain is positioning itself to prosper in the new economy arising from the prolonged economic downturn. Its strengths provide the foundation for growth and profitability in the future. These include the following:

A strong, loyal and low-cost deposit franchise with proven growth capabilities: Over 60% of Intermountain's deposits are in low-cost transaction accounts, resulting in a cost of funds that has consistently been below its peer group. Intermountain has maintained this low-cost deposit focus while growing since 1999 from the 8th ranked bank by deposit market share to the 2nd in the core markets it serves (Source: FDIC and Federal Financial Institutions Examination Council (FFIEC) Uniform Bank Performance Report (UBPR) data).

A high net interest margin with significant opportunity for improvement in a future rising rate environment: Intermountain has consistently maintained a higher net interest margin than its peer group (Source: UBPR data), and has positioned its balance sheet to capitalize on the likelihood of future rising market interest rates.

A sophisticated, and increasingly effective, risk management system: Tempered by its experiences during the current downturn, Intermountain has developed a refined credit loss forecasting system, an integrated approach to credit, liquidity, capital and other risk factors, and a well-seasoned credit administration function.

An operational and compliance infrastructure built for future profitable growth: During the past three years, Intermountain has focused on upgrading talent, technology and operational processes to facilitate further balance sheet growth without corresponding expense increases.

A relatively young, but highly experienced, management team: The executive and senior management team average under 50 years old, but still generally exceeds 20 years in banking experience, most of which has been in the Company's defined core and growth markets. The current economic cycle has provided outstanding learning opportunities for the team, which it is incorporating into current and future plans.

## **Table of Contents**

Management anticipates that banking in the future will be similar in some ways to the past, and very different in other ways. Management has defined potential opportunities in terms of prospects within its core markets of north, southwest rural, and south central Idaho, and within its growth markets of Spokane, Boise, and contiguous eastern Washington and northern Idaho counties. While it cannot guarantee that it will pursue, or be successful in pursuing opportunities in this new environment, it believes the following represent potential prospects.

In respect to lending, a return to more conservative credit management, underwriting and structuring and the exit of a number of distressed competitors may lead to better pricing opportunities and lower future credit risk for the Company. Management is responding by diversifying its current portfolio and positioning for prudent growth opportunities. It believes these prospects will include pursuing attractive mid-market commercial credits in its markets, originating commercial real estate loans to strong borrowers at lower real estate prices, originating and seasoning mortgage loans to strong borrowers at conservative loan-to-values in rural and smaller suburban areas not well-served by current secondary market appraisal standards, expanding and diversifying its agricultural portfolio, and expanding its already strong government-guaranteed loan marketing efforts. Management also believes that credit spreads may generally be wider, and when combined with the Company's high proportion of variable rate loans, should lead to improved asset yields in the future.

Deposit growth and pricing will continue to be a cornerstone of the Company's success. As demonstrated by its past successes, the growth of low-cost core deposits has always been a focus. Management will continue this core focus, while pursuing opportunities to gain additional market share from stressed competitors in its defined core and growth markets. Based on FDIC call report data, the Company has identified approximately \$1 billion in deposits at banks in its core markets that are exhibiting relatively high levels of distress, and another \$3 billion in its growth markets. When combined with potential organic growth, a relatively small capture of these distressed deposits over the next few years would allow the Bank to double its total deposits.

The Company also sees additional opportunities in improving its efficiency. The last three years have been challenging for the Company as it first sought to build operational infrastructure for a larger institution, then faced very significant credit-related costs. These costs masked underlying improvement in operating expenses. In the future, management believes the infrastructure that has been built will allow the Company to expand its assets and revenues to a great extent without corresponding increases in expenses. When combined with lower anticipated credit costs, this could lead to relatively rapid improvement in efficiency for the Company. During 2010, it will continue to focus on rationalizing its cost structure and has already made significant additional expense reduction moves, including reducing staff and executing additional outsourcing contracts.

Management believes that non-interest revenue growth may be challenging in the near-term because of additional regulatory restrictions, particularly on overdraft income. However, it continues to take steps to expand and diversify its revenue sources. These include expanding its trust and investment service opportunities to both new and existing customers, increasing debit and credit card revenues, pursuing other partners to work with on its secured savings credit card program, and reorganizing and enhancing its mortgage banking operation.

In addition to the above, management believes that disruption and consolidation in the market may lead to other opportunities as well. Subject to regulatory and capital constraints, management believes that there may be attractive acquisition opportunities within its footprint that the Company may be in a unique position to capitalize on. Intermountain is the largest publicly traded bank holding company headquartered in Idaho, and has existing branches in Washington and Oregon, which may help facilitate future transactions. Even if these opportunities are not available, large disruptions create potential opportunities to attract strong new employees and customers.

## **Primary Market Area**

The Company conducts its primary banking business through its bank subsidiary, Panhandle State Bank. The Bank maintains its main office in Sandpoint, Idaho and has 18 other branches. In addition to the main office, seven branch offices operate under the name of Panhandle State Bank. Eight branches are operated under the name Intermountain Community Bank, a division of Panhandle State Bank, and three branches operate under the name Magic Valley Bank, a division of Panhandle State Bank. Sixteen of the Company's branches are located throughout Idaho in the cities of Bonners Ferry, Caldwell, Coeur d'Alene, Fruitland, Gooding, Kellogg, Nampa, Payette, Ponderay, Post Falls, Priest River, Rathdrum, Sandpoint, Twin Falls (2) and Weiser. One branch is located in

## **Table of Contents**

Spokane Valley, Washington and one branch is located in downtown Spokane, Washington. In addition, the Company has one branch located in Ontario, Oregon. The Company focuses its banking and other services on individuals, professionals, and small to medium-sized businesses throughout its market area.

Based on asset size and deposits, Intermountain is the largest independently owned bank holding company headquartered in Idaho. After two decades of almost uninterrupted economic and population growth, the Idaho economy slowed significantly in 2009. Population growth in the state was the 5th fastest of any state over the period from 2000 to 2008, and dropped to the 12th fastest in 2009. Based on U.S. Census Bureau estimates, the State is projected to sustain future population growth rates well in excess of the national average. Idaho experienced rapid employment growth during the period of 2000 to 2008 (14% versus U.S. 8%), then sustained net job losses in 2009 (Source: Idaho Department of Labor). The unemployment rate at the end of 2009 was 9.1% versus a national average of 9.7%. However, job losses appear to be moderating and longer-term prospects for the economy are still strong. These prospects are based on a diverse economic base, including government, agriculture, health care, technology, light manufacturing, retirement, tourism, and professional services segments, a low-cost of living and doing business, favorable state government policies, and a strong quality of life. The Oregon, Washington and California governments have all recently enacted unfriendly business policies, which should increase the attractiveness of doing business in Idaho. While Idaho faces difficult state budget issues as well, the conservative legislature and governor have indicated a strong reluctance to implement any proposals that would increase taxes or otherwise harm businesses. The Idaho Department of Labor forecasts unemployment at 8.5% at the end of 2010, then dropping to around 8.0% in 2011.

Real estate valuations throughout the state have shown considerable variability, based on specific geographical location and type of property. In general, while Idaho has experienced higher than average foreclosure rates over the past year, price declines at 5.6% (Source: FDIC Fourth Quarter, 2009 State Profile) on finished residential property have been lower than average. The Boise area has been hit harder than the rest of the State, with price declines on finished properties averaging 10% to 30% as a result of increasing unemployment and substantial overbuilding. While the slowing economy has hurt other areas as well, the amount of available inventory was generally smaller, resulting in smaller price declines, mostly in the 5% to 20% percent range. Generally, residential land prices have dropped more throughout the state, as available residential supply far exceeded the demand for it. As such, price declines in land have ranged anywhere from 15% on the low end to 85% on the high end, depending on location (Source: Aulsebrook Idaho and Eastern Washington Real Estate Report). It is too early to determine whether stabilization has occurred statewide, although various areas, including Boise, southwest rural Idaho, and parts of north Idaho appear to have bottomed out.

The Bank's primary service area covers four distinct geographical regions. The north Idaho and eastern Washington region encompasses the four northernmost counties in Idaho, including Boundary County, Bonner County, Shoshone County and Kootenai County and Spokane County in eastern Washington. Bonner and Boundary Counties are heavily forested and contain numerous lakes. As such, the economies of these counties are primarily based on tourism, real estate development and natural resources, including logging, mining and agriculture. Bonner County has also experienced expansion in the areas of light industrial, commercial, retirement and retail development over the past ten years, and management believes both counties are likely to benefit from Canadian spending and investment as the dollar has weakened against the Canadian currency. Shoshone County continues to experience expansion in the areas of residential and tourism development relating to the outdoor recreation industry in the area and has seen a strong resurgence in mining activity as mineral prices have rebounded. Kootenai County is more diverse than the other north Idaho counties, with light industrial, high-tech, commercial, retail, medical, tourism and real estate development all contributing to the economic base. It, along with Spokane County in Washington, should also benefit from additional Canadian investment.

In general, the north Idaho and eastern Washington economy has been impacted less by the recession than other areas of the Pacific Northwest. While unemployment rates have risen to an average of 10% for the region in December 2009, and real estate values have declined, the changes are not as dramatic throughout this region as in many other

areas. Diversification, strengthening mining prices, less aggressive development in earlier periods, favorable business cost structures, continuing tourism activity and Canadian investment have helped cushion the downturns experienced in the real estate development, retail and service industries. Although unemployment rates are high in some north Idaho counties, they have historically been high, so the relative impact is not as significant.

**Table of Contents**

Data on real estate activity is limited for a good part of this region, but it generally appears that residential home price declines have ranged from 5% to 20%, while lot prices are down 20% to 50% based on location. Commercial real estate activity and pricing appear to be softening, although there is not a significant overhang of commercial properties in this region. Intermountain holds 55% of its loans and 49% of its deposits in this region.

The second region served by the Bank encompasses two counties in southwestern Idaho (Payette, and Washington) and one county in southeastern Oregon (Malheur). The economies of these counties are primarily based on agriculture and related or supporting businesses. A variety of crops are grown in the area including beans, onions, corn, apples, peaches, cherries and sugar beets. Livestock, including cattle, sheep and pigs, are also raised. Agriculture has been strong over the past several years which has cushioned the impact of the downturn on these counties. Unemployment is historically high in this area, and stood at 11.2% in December 2009, but real estate values have held up much better, given the predominance of agricultural land in the region. Commercial real estate property is relatively limited and has not grown significantly. The Company holds 20% of its loans and 19% of its deposits in this region.

The third region, known as the greater Boise area, is comprised of two counties, Ada and Canyon. The cities of Boise, Nampa and Caldwell have been hit hard because of excessive residential and commercial real estate development, volatility in the area's high-tech industries, and reductions in other corporate and state and local government activity. Unemployment in the area appears to have stabilized at 9.2% in December 2009, and some forecasters expect improvement in 2010 as the area's technology industry possibly recovers. Real estate price declines have been the steepest of any in the Company's market areas, ranging from 20% to 30% drops in finished residential home prices to 50% to 75% in bare land and subdivision developments. Although recent indicators, including real estate inventory levels and valuations may indicate a bottoming, the recovery is likely to be slow in these two counties. 12% of the Company's loans and 9% of its deposits are in this region.

The fourth region served by the Bank encompasses two counties in south central Idaho (Twin Falls and Gooding), also known as the Magic Valley region. The economies of these counties are primarily based on agriculture and related or supporting businesses. A variety of crops are grown in the area including beans, peas, corn, hay, sugar beets and potatoes. Fish farms, dairies and beef cattle are also contributors to the local economy. Twin Falls County has experienced significant commercial growth over the past 10 years, and as a result, residential and commercial construction has been a much larger driver of the local economy. The area is also experiencing growth in light manufacturing and retail development.

Twin Falls' strong agricultural base, along with its status as the commercial, medical, retail, retirement and services hub for the area, has cushioned it somewhat from the impacts of the recession, resulting in a December 2009 unemployment rate of 7.8%. Several large commercial projects have also contributed to the economy over the past several years. With the completion of these projects, the next several years are likely to be slower for the area, but still better than many other areas that lack similar diversity. In addition, the region maintains a conservative character with little evidence of significant overbuilding or excess inventory. The Company has little exposure to the dairy industry, which has been the one significantly weaker sector in agriculture. Residential valuation declines have been relatively moderate, in the 5% to 15% range for homes and 20% to 50% range for development land. The Company has 8% of its loans and 9% of its deposits in the Magic Valley region.

As demonstrated by the loan and deposit totals in each market, Intermountain pursues a long-term strategy of balancing loan and deposit balances in each of its regions. As it enters new markets, it may lead with either a heavier emphasis on loans or deposits depending on specific market opportunities. Over the long-term, however, management believes that both Intermountain and the local markets are well-served by pursuing a balanced strategy and the discipline this requires.



Intermountain has also segmented its market area into core and growth markets to facilitate future planning activities. The Company defines its core market as including the four counties of northern Idaho listed above, Canyon, Payette and Washington Counties in southwestern Idaho, Malheur County in eastern Oregon, and Gooding and Magic Valley Counties in Southwest Idaho. Deposits in this market totaled \$5.8 billion, of which Intermountain held \$796 million, or 14% (Source: FDIC Survey of Banking Institutions). The Company's growth markets consist of Spokane County in Washington, and Ada County in Idaho (where Boise is located), as well as counties contiguous to its existing markets in north Idaho and eastern Washington. Deposits in Ada and Spokane County

## **Table of Contents**

totaled \$13.2 billion at June 30, 2009 and Intermountain held \$35 million or 0.3% of deposits in this market at the time. The Company believes that it has significant future opportunities in these growth markets, because of an established brand presence, strong market contacts in other banking institutions, and the presence of larger distressed competitors.

## **Competition**

As noted previously, based on total asset size and deposit balances as of December 31, 2009, the Company continues to be the largest independent community bank headquartered in Idaho. The Company competes with a number of international banking groups, out-of-state banking companies, state-wide banking organizations, and several local community banks, as well as savings banks, savings and loans, credit unions and other non-bank competitors throughout its market area. Banks and similar financial institutions compete based on a number of factors, including price, customer service, convenience, technology, local market knowledge, operational efficiency, advertising and promotion, and reputation. In competing against other institutions, the Company focuses on delivering highly personalized customer service with an emphasis on local involvement and empowerment. It recruits, retains and motivates seasoned, knowledgeable bankers who have worked in the Company's market areas for extended periods of time and supports them with current technology. Product offerings, pricing and location convenience are generally competitive with other banks in its market areas. The Company seeks to differentiate itself based on the high skill levels and local knowledge of its staff, combined with sophisticated relationship management and profit systems that pinpoint marketing and service opportunities.

The Company has employed these competitive tools to grow market share over the past ten years, since it began expanding beyond its Sandpoint, Idaho base. During this time period, the Company has grown from eighth overall in market share in its defined core markets to second, with a consolidated market share of 13.6%. The chart below shows strong growth in virtually all of the Company's markets, including continued growth in 2009. Based on the June 2009 FDIC Survey of Banking Institutions, the Company is the market share leader in deposits in five of the eleven counties in which it operates. As noted previously, the Spokane and Boise market areas represent potential future growth markets for the Company, as total market deposits in these two counties exceed by a two-to-one margin the total market deposits in the Company's core markets. The Company has a relatively small, but growing presence in Spokane County with strong local market talent. The Company does not have any branches in Ada County, which includes Boise, but has a number of key managers who came from or worked in the Boise area.

## **Table of Contents**

As discussed above, the Company's principal market area is divided into four separate regions based upon population and the presence of banking offices. In northern Idaho/eastern Washington, the primary competitors include US Bank, Wells Fargo, Washington Trust Bank, Sterling Savings Bank, Banner Bank and Bank of America, all large international or regional banks, and Idaho Independent Bank and Mountain West Bank, both community banks.

Primary competitors in the Company's other regions in southwestern and south central Idaho and eastern Oregon include international or regional banks, US Bank, Wells Fargo, Key Bank, Bank of America, Banner Bank and Zions Bank, and community banks, Bank of the Cascades, Idaho Independent Bank, DL Evans Bank, First Federal Savings Bank and Farmers National Bank.

The severe economic downturn and additional regulatory changes are altering Intermountain's competitive landscape. Many non-FDIC insured competitors, including residential mortgage brokers, commercial finance operations, and commercial real estate mortgage brokers have exited the market, a trend which is likely to continue over the next several years. Additional bank failures and significant consolidation of the banking industry are forecasted as well. These events will likely present both opportunities and challenges to Intermountain. Previous sections have highlighted various opportunities that may arise, such as improved credit structuring and pricing, additional growth through attracting strong employees and customers from disaffected institutions, and potential acquisition opportunities. Potential challenges include stronger remaining competitors, additional credit losses created by market disruption and significant levels of disposition of loan collateral at depressed prices, and additional regulatory constraints.

## **Services Provided**

### ***Lending Activities***

The Bank offers and encourages applications for a variety of secured and unsecured loans to help meet the needs of its communities, dependent upon the Bank's financial condition and size, regulatory restrictions, local economic conditions and consistency with safe and sound operating practices. While specific credit programs may vary from time to time, based on Bank policies and market conditions, the Bank makes every effort to encourage applications for the following credit services throughout its communities.

*Commercial Loans.* The Bank offers a wide range of loans and open-end credit arrangements to businesses of small and moderate size, from small sole proprietorships to larger corporate entities, with purposes ranging from working capital and inventory acquisition to equipment purchases and business expansion. The Bank also participates in the Small Business Administration (SBA) and United States Department of Agriculture (USDA) financing programs. Operating loans or lines of credit typically carry annual maturities. Straight maturity notes are also available, in which the maturities match the anticipated receipt of specifically identified repayment sources. Term loans for purposes such as equipment purchases, expansion, term working capital, and other purposes generally carry terms that match the borrower's cash flow capacity, typically with maturities of three years or longer. Risk is controlled by applying sound, consistent underwriting guidelines, concentrating on relationship loans as opposed to transaction type loans, and requiring sound alternative repayment sources, such as collateral or strong guarantor support. While underwriting guidelines vary, depending on the type of loan, in general businesses are required to maintain a minimum 1.25 debt service coverage (DSC). Loan-to-value (LTV) guidelines generally range from a low of 40% on illiquid equipment and inventory to a high of 75% of liquidation value on easily convertible accounts receivable, inventory or equipment. Government guaranty programs are also utilized when appropriate, and are currently being emphasized, given favorable changes made by the federal government to the programs and the difficult credit environment.

The Bank also offers loans for agricultural and ranching purposes. These include expansion loans, short-term working capital loans, equipment loans, cattle or livestock loans, and real estate loans on a limited basis. Terms are generally

up to one year for operating loans or lines of credit and up to seven years for term loans. As with other business loans, sound underwriting is applied by a staff of lending and credit personnel seasoned in this line of lending. Underwriting guidelines for agricultural credit lines depend on the type of loan and collateral, but generally require a minimum DSC of 1.25, and hard collateral coverage (collateral other than the crops being grown) of greater than 50% of peak borrowing. Term equipment loans generally require a minimum 1.25 DSC and maximum

## **Table of Contents**

75% liquidation LTV. Government guaranteed programs are utilized whenever appropriate and available. Agricultural real estate loans are considered for financially sound borrowers with strong financial and management histories. Many of the Company's agricultural customers are third or fourth generation family farmers with strong real estate equity and limited real estate debt.

*Real Estate Loans.* For consumers, the Bank offers first mortgage loans to purchase or refinance homes, home improvement loans and home equity loans and credit lines. Conforming first mortgage loans are offered with up to 30-year maturities, while typical maturities for second mortgages (home improvement and home equity loans and lines) are as stated below under Consumer Loans. First mortgage loans are underwritten with the intention to sell the loans on the secondary market, so guidelines generally reflect secondary market standards. Lot acquisition and construction loans are also offered to consumer customers with typical terms up to 36 months (interest only loans are also available) and up to 12 months (with six months extension), respectively, and are underwritten to both secondary market standards and with a solid take-out mortgage loan approval required.

Loans for purchase, construction, rehabilitation or repurchase of commercial and industrial properties are also available through the Bank. Commercial real estate loans are generally confined to owner-occupied properties unless there is a strong customer relationship or sound business project justifying otherwise. Non-owner occupied commercial real estate loans are restricted to borrowers with established track records and the ability to fund potential project cash flow shortfalls from other income sources or liquid assets. Project due diligence is conducted by the Bank, to help provide for adequate contingencies, collateral and/or government guaranties. General underwriting requirements for owner-occupied loans require a minimum DSC of 1.25 and a maximum LTV of 75%. For non-owner occupied loans, a minimum global DSC of 1.25 is required, excluding rents on the subject property, and the LTV maximum is generally less than 75%, depending on the type of property.

With current housing market conditions, the Bank is not currently offering residential land acquisition, development or builder loans, and has significantly reduced its concentrations of these types of loans.

*Consumer Loans.* The Bank offers a variety of consumer loans, including personal loans, motor vehicle loans, boat loans, recreational vehicle loans, home improvement loans, home equity loans, open-end credit lines, both secured and unsecured, and overdraft protection credit lines. The Bank's terms and underwriting on these loans are consistent with what is offered by competing community banks and credit unions, which generally require sufficient disposable income, solid credit histories, and equity in the collateral. Generally, underwriting guidelines include a maximum debt to income of 40%, credit scores exceeding 700, and maximum LTVs ranging from 80% on home equity loans and lines to 50% to 90% on other types of consumer collateral. Loans for the purchase of new autos typically range up to 60 months. Loans for the purchase of smaller RV's, pleasure crafts and used vehicles range up to 60 months. Loans for the purchase of larger RV's and larger pleasure crafts, mobile homes, and home equity loans range up to 120 months (180 months if credit factors and value warrant). Unsecured loans are usually limited to two years, except for credit lines, which may be open-ended but are reviewed by the Bank periodically. Relationship lending is emphasized, which, along with credit control practices, minimizes risk in this type of lending.

*Municipal Financing.* Operating and term loans are available to entities that qualify for the Bank to offer such financing on a tax-exempt basis. Operating loans are generally restricted by law to the duration of one fiscal year. Term loans, which under certain circumstances can extend beyond one year, typically range up to five years. Municipal financing is restricted to loans with sound purposes and with established tax bases or other revenue to adequately support repayment.

## ***Deposit Services***

The Bank offers the full range of retail deposit services typically available in most banks and savings and loan associations, including checking accounts, savings accounts, money market accounts and various types of certificates of deposit. The transaction accounts and certificates of deposit are tailored to the Bank's primary market area at rates competitive with those offered in the area. All deposit accounts are insured by the FDIC to the maximum amount permitted by law. The Bank also offers a number of business-oriented deposit accounts, including various types of FDIC-insured checking, savings, money market and time deposit accounts, and non-FDIC insured alternatives including reverse repurchase agreements and sweep accounts. Its deposit product

## **Table of Contents**

offerings are generally competitive with both large and small direct competitors and provide strong opportunities for fee income generation through direct service charges, overdraft fee income, and fees associated with related services (see Other Services below).

### ***Investment Services***

The Bank provides non-FDIC insured investment services through its division, Trust and Investment Services. Products offered to its customers include annuities, equity and fixed income securities, mutual funds, insurance products and brokerage services. The Bank offers these products in a manner consistent with the principles of prudent and safe banking and in compliance with applicable laws, rules, regulations and regulatory guidelines. The Bank earns fees for providing these services, either on a per-product basis or through a percentage of the balances invested. The Bank is also authorized to provide investment management services through the Trust & Wealth Management Department to clients in all fifty states.

### ***Trust & Wealth Management Services***

The Bank provides trust and wealth management services to its higher net worth customers to assist them in investment, tax and estate planning and to serve as their trustee or other fiduciary. The Bank offers these services in a manner consistent with the principles of prudent and safe banking and in compliance with applicable laws, rules, regulations and regulatory guidelines. The Bank earns fees for managing client assets and providing trust services. The Company is one of the few smaller banking institutions in the northwest to offer in-house trust services, and activity and income from these services has increased continuously since its beginning in 2006. The Bank's Trust & Wealth Management Department operates under a Trust Charter through the FDIC and the Idaho Department of Finance. Due to the reciprocity arrangements with the states of Oregon and Washington applicable to the Bank's general banking business, the Bank is authorized to provide fiduciary services and to serve as a fiduciary in relationships located or sited in any of those three states. The Bank is also authorized to provide investment management services through the Trust & Wealth Management Department to clients in all fifty states.

### ***Other Services***

Other consumer-oriented services include automated teller machines (ATMs), debit cards, safe deposit boxes, internet and phone banking services, savings bonds, and VISA/Mastercard credit cards. The Bank is a member of the Star, Plus, Exchange, Interlink and Accell ATM networks. New consumer products and services introduced over the past several years include identity theft protection, Certificate of Deposit Account Registry Service (CDARS) certificates of deposit, and EZ Points, a debit and credit card rewards program.

The Company also offers numerous business services that improve its customers' operations. Its *Business Smart Online* product allows companies to manage their financial operations efficiently from any location, including originating ACH entries for payroll, outgoing tax and other payments, and incoming collections. The system also allows transfers of funds to and from various accounts and operating credit lines. Intermountain's *Business Advantage* service improves cash flow and accounts receivable collection activities. Credit card acceptance, remote deposit capture, night deposit and concentration account services make it more convenient for businesses to receive and deposit funds quickly, and the Company's *Check Collect* service assists them in collecting on returned checks. Intermountain's positive pay and credit card monitoring services help reduce fraud, and its employee benefits program enhances business customers' existing benefits programs by providing valuable banking services to their employees at a reduced cost. These services are generally superior to those offered by similar sized and smaller institutions and competitive with those offered by larger institutions. They provide additional fee income to Intermountain, and management is currently evaluating and adjusting pricing on these services to enhance future revenue.





## **Table of Contents**

### **Loan Portfolio**

The loan portfolio is the largest component of earning assets, and is comprised of net loans receivable and loans held for sale. In 2009, net loans receivable, which includes loans the Company generally intends to keep until repayment or maturity, decreased by 12.9% or \$97.0 million. The majority of the decline was in land and land development loans, down \$47.9 million, residential construction loans, down \$23.4 million, and commercial construction loans, down \$14.5 million. Loans held for sale, primarily residential real estate loans originated for sale in the secondary market, increased by 604.6% or \$5.6 million.

During the past several years, the Company continued to respond to the effects of the economic downturn by tightening underwriting standards and aggressively resolving problem loans through workouts with borrowers, refinances from other sources, and/or collateral liquidation. The Company significantly tightened standards so that new funding for residential land, subdivision and development, and construction lending has generally ceased. Any future lending in this area would require very low loan-to-value ratios and significant outside support from the borrowers. Management also changed underwriting standards on both owner and non-owner occupied commercial real estate loans to require additional hard equity, lower LTVs, and higher DSC ratios, and as part of its underwriting process, subjects commercial real estate loan requests to stress testing using relatively severe scenarios. Commercial and consumer standards were also tightened to reflect tougher economic conditions and generally reduced borrower strength.

Overall demand for agriculture, commercial and commercial real estate loans softened, leading to relatively static balances in these types as well. In a difficult economic climate, the Bank continues to pursue quality loans using conservative underwriting and control practices, and is expanding its emphasis on SBA, USDA and other financing assistance programs.

The Company has also responded to declining economic conditions by more aggressively monitoring and managing its existing loan portfolio, and adding expertise and resources to these efforts. Additional steps the Company has taken include hiring an in-house appraiser, developing a weekly senior management review of all credit requests over \$250,000, increasing the staffing and scope of its internal credit review team, hiring a highly experienced external review team to evaluate the Company's portfolio, and conducting more rigorous annual evaluations of its home equity credit line portfolio. Bank lending staff continues to utilize relationship pricing models and other techniques to manage interest rate risk and increase customer profitability.

The Company's average loan yield fell from 7.13% in 2008 to 5.92% in 2009 as the Federal Reserve reduced its target rate to a range between 0.00% and 0.25% at the end of 2008 and maintained it there throughout 2009. Other market rates, including the Wall Street Journal prime lending rate, the London Interbank Offered Rate ( LIBOR ) and Federal Home Loan Bank Advance rates also declined, reducing the Company's loan yields in 2009. In addition, the reversal of interest on non-accrual and charged off loans, totaling \$1.9 million in 2009, had a substantial impact on loan yields, reducing the overall loan yield by 0.26%.

In 2008, the Company's net loans receivable declined by \$3.9 million or 0.5%. Commercial real estate, commercial construction, multifamily and residential real estate loans all increased, but were offset by significant declines in residential construction, land and land development, and commercial loans.

In 2007, the Company increased net loans receivable by 13.9%, or \$91.7 million. Increases in commercial real estate and construction and development loans comprised most of the growth.

**Table of Contents**

The following table contains information related to the Company's total loans and net loans receivable portfolio for the five-year period ended December 31, 2009 (dollars in thousands).

	<b>2009</b>	<b>2008</b>	<b>December 31, 2007</b>	<b>2006</b>	<b>2005</b>
Commercial loans	\$ 131,562	\$ 139,443	\$ 156,109	\$ 167,784	\$ 152,972
Commercial real estate loans	172,726	161,628	134,214	255,220	178,954
Commercial construction	45,581	60,057	53,541	*	*
Land and land development loans	88,604	136,514	155,257	*	*
Agriculture loans	110,256	112,358	108,102	103,841	92,378
Multifamily loans	18,067	18,617	3,699	500	702
Residential real estate loans	65,544	72,301	57,910	112,569	107,553
Residential construction loans	16,626	40,001	68,616	*	*
Consumer loans	18,287	23,245	26,286	31,800	29,109
Municipal loans	5,061	5,109	5,222	4,082	2,856
Total loans	672,314	769,273	768,956	675,796	564,524
Allowance for loan losses	(16,608)	(16,433)	(11,761)	(9,837)	(8,100)
Deferred loan fees, net of direct origination costs	(104)	(225)	(646)	(1,074)	(971)
Loans receivable, net	\$ 655,602	\$ 752,615	\$ 756,549	\$ 664,885	\$ 555,453
Weighted average interest rate	6.15%	6.38%	8.16%	8.65%	7.90%

\* Loan break outs for Commercial and Residential Construction not available for 2006 and 2005

**Table of Contents*****Loan Portfolio Concentrations***

The Bank continuously monitors concentrations of loan categories in regards to industries, loan types and market areas. Concentration guidelines are established and then approved by the Board of Directors at least annually, and are reviewed by management and the Board monthly. Circumstances affecting industries and market areas involved in loan concentrations are reviewed as to their impact as they occur, and appropriate action is determined regarding the loan portfolio and/or lending strategies and practices.

As of December 31, 2009, the Bank's loan portfolio by loan type and geographical market area was:

Loan Portfolio by Location 12/31/09	North Idaho Eastern Washington	Magic Valley Idaho	Greater Boise Area	E. Oregon, SW Idaho, excluding Boise	Other	Total	% of Loan type to total loans
(Dollars in thousands)							
Commercial loans	\$ 86,682	\$ 11,057	\$ 14,067	\$ 18,090	\$ 1,666	\$ 131,562	19.6
Commercial real estate loans	106,913	17,051	20,063	15,564	13,135	172,726	25.7
Commercial construction loans	35,335	187	9,105	180	774	45,581	6.8
Land and land development loans	61,329	7,434	11,403	7,342	1,096	88,604	13.2
Agriculture loans	2,145	8,883	19,618	74,730	4,880	110,256	16.4
Multifamily loans	9,133	135	1,078		7,721	18,067	2.6
Residential real estate loans	41,614	6,904	4,136	8,399	4,491	65,544	9.7
Residential construction loans	11,698	795	1,141	2,884	108	16,626	2.5
Consumer loans	9,629	2,140	1,449	4,377	692	18,287	2.7
Municipal loans	4,766	295				5,061	0.8
Total	\$ 369,244	\$ 54,881	\$ 82,060	\$ 131,566	\$ 34,563	\$ 672,314	100.0
Percent of total loans in geographic area	54.92%	8.16%	12.21%	19.57%	5.14%	100.00%	
Percent of total loans where real estate is the primary collateral	72.08%	63.88%	60.09%	40.98%	79.06%	64.22%	

**Construction and Development Loans**

Management has focused over the past couple of years on shifting the mix of the loan portfolio away from residential construction, acquisition and development loans to a more balanced mix of commercial, commercial real estate, and residential real estate. It has done this through a combination of more conservative underwriting practices on construction and land development lending, limited marketing, and aggressive resolution and disposal of loans in these categories. As a result, combined loan balances in the commercial, land and land development, and residential construction categories have fallen by \$85.8 million, or 36% in 2009.

Still, the land development and construction loan components continue to pose higher levels of loan-type concentration risk, and continue to comprise the majority of the Company's problem loans and other real estate owned

( OREO ) properties. Residential real estate values tend to fluctuate with economic conditions, and have been falling rapidly in many of the Bank's markets for the last two years, although the rate of decline is generally slowing. Management plans to continue curtailing new lending in this segment, and maintaining its aggressive resolution efforts to further reduce risk in this segment.

Within this segment, the Bank has lent to contractors and developers, and has also been active in custom construction lending, where the loan is made to the individual consumer who will occupy the home. The Bank is committed to reducing and maintaining its real estate lending concentrations to levels that are below the interagency regulatory guidelines issued in late 2007. Institutions that exceed the levels established in the guidelines are subject to greater supervisory scrutiny. These guidelines established concentration limits as measured against Total Risk

## **Table of Contents**

Based Capital (generally, the Company's common stock, non-cumulative perpetual preferred stock and a portion of its loan loss reserves). The first regulatory guideline establishes the limit for construction, land development and other land loan balances to total risk-based capital not to exceed 100%. Company totals for this category were 151.86%, 183.26% and 270.95% for 2009, 2008 and 2007, respectively, demonstrating the Company's significant progress toward meeting this guideline. The second guideline establishes the limit for total commercial real estate loans, defined as including the above categories plus loans secured by multifamily and non-farm nonresidential property but excluding loans secured by owner-occupied properties, not to exceed 300% of total risk-based capital. Accordingly, the Company has decreased these balances from 348.78% in 2007 to 254.93% in 2008 and to 214.29% at the end of 2009. As a result, Intermountain is now below the regulatory guideline.

## **Commercial Loans**

Although the impacts of the economic downturn are increasing risk in the commercial portfolio, management does not consider this portfolio to present a particular concentration risk at this time. Management believes there is adequate diversification by type, industry, and geography to mitigate excessive risk. The commercial portfolio includes a mix of term loan facilities and operating loans and lines made to a variety of different business types in the markets it serves. The Company utilizes SBA, USDA and other government-assisted or guaranteed financing programs whenever advantageous to further mitigate risk in this area. With the exception of the agricultural portfolio, there is no other significant concentration of industry types in its loan portfolio, and no dominant employer or industry across all the markets it serves. Underwriting focuses on the evaluation of potential future cash flows to cover debt requirements, sufficient collateral margins to buffer against devaluations, credit history of the business and its principals, and additional support from willing and capable guarantors.

## **Agricultural Loans**

The agricultural portfolio represents a larger percentage of the loans in the Bank's southern Idaho region. At December 31, 2009, agricultural loans and agricultural real estate loans totaled \$110.3 million or 16.4% of the total loan portfolio. The agricultural portfolio consists of loans secured by livestock, crops and real estate. To mitigate credit risk, specific underwriting is applied to retain only borrowers that have proven track records in the agricultural industry. Many of Intermountain's agricultural borrowers are third or fourth generation farmers and ranchers with limited real estate debt, which reduces overall debt coverage requirements and provides extra flexibility and collateral for equipment and operating borrowing needs. In addition, the Bank has hired senior lenders with significant experience in agricultural lending to administer these loans. Further mitigation is provided through frequent collateral inspections, adherence to farm operating budgets, and annual or more frequent review of financial performance. The Company has minimal exposure to the dairy industry, the one significant agricultural segment that has been under extreme pressure for the last couple of years.

## **Commercial Real Estate Loans**

Difficult economic conditions are increasing risk in the non-residential component of the commercial real estate portfolio. However, in comparison to peers, the Company has less overall exposure to commercial real estate and a stronger mix of owner-occupied (where the borrower occupies and operates in at least part of the building) versus non-owner occupied loans. Based on December 31, 2009 UBPR data, the Company's total commercial real estate exposure excluding construction loans was 25.4% versus the peer group average of 36.7%. Of that total, 45% was owner-occupied or farmland versus 43% of the peer groups (Source: UBPR data from the FFIEC for 12-31-09). The loans represented in this category are spread across the Company's footprint, and there are no significant concentrations by industry type or borrower. The most significant property types represented in the portfolio are office (17%), industrial (15%), multifamily (10%), health care (6%), and retail (6%). The other 46% is a mix of property types with smaller concentrations, including religious facilities, auto-related properties, restaurants, convenience

stores, storage units, motels and commercial investment land. Finished condominiums comprise only

**Table of Contents**

2% of the commercial real estate portfolio, although there are also several unfinished condo projects in the construction and development portfolio.

<b>Commercial Real Estate by Property Types</b>	<b>December 31,</b>	
	<b>2009</b>	<b>% of Loans</b>
	<b>(Dollars in thousands)</b>	
Condominiums	\$ 4,504	2.4%
Office	32,265	16.9%
Industrial warehouse	29,206	15.3%
Storage units	6,984	3.7%
Retail	12,177	6.4%
Restaurants	6,028	3.2%
Land and land development	10,281	5.4%
Other commercial	19,560	10.3%
Health care	11,345	5.9%
Religious facilities	2,538	1.3%
Gas stations & convenience stores	2,712	1.4%
Auto R/E (car lot, wash, repair)	2,554	1.3%
Hotel/Motel	3,351	1.8%
Miscellaneous	29,221	15.2%
Total Commercial real estate loans	172,726	90.5%
Multifamily	18,067	9.5%
Total Commercial real estate and Multifamily Loans	\$ 190,793	100.0%

While 62% of the Company's commercial real estate portfolio is in its Northern Idaho/Eastern Washington region, this region is a large and diverse region with differing local economies and real estate markets. Given this diversity, and the diversity of property types and industries represented, management does not believe that this concentration represents a significant concentration risk.

Non-owner occupied commercial real estate loans are made only to borrowers with established track records and the ability to fund potential project cash flow shortfalls from other income sources or liquid assets. Project due diligence is conducted by the Bank, to help provide for adequate contingencies, collateral and/or government guaranties. The Company has largely avoided speculative financing of investment properties, particularly of the types most vulnerable in the current downturn, including investment office buildings and retail strip developments. Management believes geographic, borrower and property-type diversification, and prudent underwriting and monitoring standards applied by seasoned commercial lenders mitigate concentration risk in this segment.

**Residential Real Estate and Consumer**

Residential real estate and consumer loans comprise smaller segments of the loan portfolio. Management does not believe they represent significant concentration risk. While debt service ability and collateral values have declined in these segments, underwriting has generally been more conservative, with higher debt-to-income and equity requirements than found elsewhere in the financial industry.

### **Geographic Distribution**

In terms of geographic distribution, 74% of the Company's loans are in north Idaho, eastern Washington and southwest Idaho outside the Boise area. Although economic trends and real estate valuations have worsened in these market areas, delinquency levels and price declines have been less significant than in Boise or other areas of the country. This reflects the differing economies in these areas, generally more conservative lending and borrowing norms, and more restrained building and development activity. In particular, large national and regional developers and builders did not enter and subsequently exit these markets. The southwest Idaho and Magic Valley markets are largely agricultural areas which have not seen rapid price appreciation or depreciation over the last few years. Through aggressive loan workout efforts, the Company has reduced its exposure to the Boise area market significantly over the past year, resulting in proportionally higher loan balances in the regions outside of Boise



## **Table of Contents**

from the prior year. The Other category noted above largely represents loans made to local borrowers where the collateral is located outside the Company's communities. The mix in this category is relatively diverse, with the highest proportions in Oregon, Washington, California, Nevada and Wyoming, but no single state comprising more than 27% of this total or 1.5% of the total loan portfolio.

Participation loans where Intermountain purchased part of the loan and was not the lead bank totaled \$17.5 million at year end, of which one loan totaling \$1.7 million was outside the Company's footprint. This loan was subsequently paid off after year end. \$7.1 million of the remaining total is a condominium project in Boise that is currently classified, but is being managed very closely. The remaining loans are all within the Company's footprint and considered not to present significant risk at this time.

### ***Classification of Loans***

The Bank is required under applicable law and regulations to review its loans on a regular basis and to classify them as satisfactory, special mention, substandard, doubtful or loss. A loan which possesses no apparent weakness or deficiency is designated satisfactory. A loan which possesses weaknesses or deficiencies deserving close attention is designated as special mention. A loan is generally classified as substandard if it possesses a well-defined weakness and the Bank will probably sustain some loss if the weaknesses or deficiencies are not corrected. A loan is classified as doubtful if a probable loss of principal and/or interest exists but the amount of the loss, if any, is subject to the outcome of future events which are undeterminable at the time of classification. It is a transitional category, and once the amount of the loss is determined, this amount is charged off and the remaining balance of the loan would most likely be classified as substandard. The typical duration of a loan in the doubtful category would be one to two months. If a loan is classified as loss, the Bank either establishes a specific valuation allowance equal to the amount classified as loss or charges off such amount.

During 2007, the Company modified its risk grade allocation factors to better reflect varying loss experiences in different types of loans. As of December 31, 2009, the risk factors range from cash equivalent secured loans (Risk Grade 1) to loss (Risk Grade 8). Risk Grades 3, 5, 6, 7 and 8 closely reflect the FDIC's definitions for special mention, substandard, doubtful and loss, respectively. Risk Grade 4 is an internally designated watch. At December 31, 2009, the Company had \$6.7 million in the special mention, \$75.6 million in the substandard, \$1.6 million in the doubtful and \$0 in the loss loan categories. At December 31, 2008, the Company had \$7.3 million in the special mention, \$50.8 million in the substandard, \$3.0 million in the doubtful and \$0 in the loss loan categories.

At December 31, 2009, classified loans (loans with risk grades 6, 7 or 8) by loan type are as follows (dollars in thousands):

### **Classified Loans**

Commercial	\$ 11,685
Commercial real estate	12,409
Commercial construction	15,554
Land and land development loans	20,136
Agriculture	9,637
Multifamily	695
Residential real estate	5,433
Residential construction	1,165
Consumer	461
Municipal	

Total classified loans	\$ 77,175
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Overall, classified loans (loans with risk grades 6, 7, or 8) increased from \$53.8 million at the end of 2008 to \$77.2 million at the end of 2009. The increase reflected the impact of the deteriorating economy and real estate conditions throughout the Company's market area. Unemployment rates increased significantly, placing additional stress on businesses and consumers alike. This resulted in more borrowers facing difficulties in maintaining their ability to service the Company's debts. At the same time, real estate and other property valuations declined as well,

**Table of Contents**

reducing the ability of borrowers or the Bank to liquidate assets or rely on other repayment sources to cover shortfalls in the cash flow required to service their debts. Construction and land development loans, in which debt repayment is primarily based on liquidation of property, were particularly hard hit, as real estate purchase markets slowed significantly and property values declined. Most of the increase in classified loans between 2008 and 2009 were in loans that were real-estate related, particularly construction and land development.

Non-accrual loans are those loans that have become delinquent for more than 90 days (unless well-secured and in the process of collection). Placement of loans on non-accrual status does not necessarily mean that the outstanding loan principal will not be collected, but rather that timely collection of principal and interest is in question. When a loan is placed on non-accrual status, interest accrued but not received is reversed. The amount of interest income which was reversed from income in fiscal years 2009, 2008, 2007, 2006 and 2005 on non-accrual and other problem loans was approximately \$1.9 million, \$465,000, \$161,000, \$21,000 and \$95,000, respectively. A non-accrual loan may be restored to accrual status if it is brought current and has performed in accordance with contractual terms for a reasonable period of time, and the collectability of the total contractual principal and interest is no longer in doubt. Other problem loans are loans that were not put in the non-accrual status but were charged off or transferred to OREO during the year.

Information with respect to non-performing loans and other non-performing assets is as follows (dollars in thousands):

**Non-Accrual Trending**

	December 31,				
	2009	2008	2007	2006	2005
Non-accrual loans	\$ 18,468	\$ 26,365	\$ 5,569	\$ 1,201	\$ 807
Non-accrual loans as a percentage of net loans receivable	2.82%	3.50%	0.74%	0.18%	0.14%
Total allowance related to these loans	\$ 965	\$ 6,856	\$ 585	\$ 531	\$ 341
Interest income recorded on these loans	\$ 1,126	\$ 1,193	\$ 270	\$ 230	\$ 8

**Credit Quality Trending**

		At December 31,			
	2009	2008	2007	2006	2005
	(in thousands)				
Loans past due in excess of 90 days and still accruing	\$ 586	\$ 913	\$ 797	\$ 87	\$ 456
Non-accrual loans	18,468	26,365	5,569	1,201	807
Total non-performing loans	19,054	27,278	6,366	1,288	1,263
OREO	11,538	4,541	1,682	795	18
Total non-performing assets ( NPAs )	\$ 30,592	\$ 31,819	\$ 8,048	\$ 2,083	\$ 1,281
Troubled debt restructured loans(1)	\$ 4,604	\$ 13,424	\$	\$	\$
	2.91%	3.62%	0.84%	0.19%	0.23%

Total non-performing loans as a % of net  
loans receivable

Total NPA as a % of loans receivable	4.67%	4.23%	1.06%	0.31%	0.23%
Allowance for loan losses ( ALLL ) as a % of non-performing loans	87.2%	60.2%	184.7%	763.7%	641.3%
Total NPA as a % of total assets	2.83%	2.88%	0.77%	0.23%	0.17%
Total NPA as a % of tangible capital + ALLL(2)	32.85%	27.75%	8.99%	2.76%	2.14%
Loan Delinquency Ratio (30 days and over)	0.93%	0.90%	0.40%	0.15%	0.44%

(1) Represents accruing restructured loans performing according to their modified terms. Restructured loans that are not performing according to their modified terms are included in non-accrual loans. Funds are not available for additional disbursement on restructured loans.

(2) Tangible capital equals total equity less intangible assets and goodwill.

**Table of Contents**

The \$7.9 million decrease in non-accrual loans from December 31, 2008 to December 31, 2009 resulted from a combination of aggressive efforts by our special assets team to work out or liquidate these loans and chargedowns in cases where there was a collateral deficiency. This team continued to move properties through the collections process and made steady progress in reducing overall levels of both classified and non-accrual loans through multiple management strategies, including borrower workouts, individual asset sales to local and national investors, and bulk sales and auctions of like properties. NPAs fell \$6.1 million from the third quarter of 2009, and totaled 2.83% of total assets at December 31, 2009, down from 3.47% in the preceding quarter. NPAs reached their peak of \$47.7 million in May 2009 and have trended down since then. Loan delinquencies (30 days or more past due) also declined during the fourth quarter to 0.93% from 1.48% of total loans at the end of the third quarter, although they were up slightly from the fourth quarter 2008 level of 0.90%. Loan delinquencies (30 days or more past due) reached their peak in April 2009 at a rate of 3.10%. The \$20.8 million increase in non-accrual loans from December 31, 2007 to December 31, 2008 consisted primarily of residential land, subdivision and construction loans where repayment was primarily reliant on selling the asset. The Company continues to monitor its non-accrual loans closely and revalue the collateral on a periodic basis. This re-evaluation may create the need for additional write-downs or additional loss reserves on these assets.

**Other Real Estate Owned Activity**

	<b>2009</b>	<b>2008</b>	<b>2007</b>
	<b>(Dollars in thousands)</b>		
Balance, beginning of period, January 1	\$ 4,541	\$ 1,682	\$ 795
Additions to OREO	20,789	4,092	896
Proceeds from sale of OREO	(9,830)	(474)	(9)
Valuation Adjustments in the period(1)	(3,962)	(759)	
Balance, end of period, December 31	\$ 11,538	\$ 4,541	\$ 1,682

(1) Amount includes chargedowns and gains/losses on sale of OREO

The balance of OREO increased by \$7.0 million during 2009, as the Bank worked higher levels of non-performing loans through the collection and foreclosure process. Disposition of OREO assets increased markedly in the latter half of 2009, resulting in a reduction between the end of the third and fourth quarters of \$2.9 million. At year end, OREO assets consisted of commercial land (25%), developed residential lots (23%), raw land (23%), commercial buildings (17%), and single family residences (12%). The Credit Risk Management and Asset Disposition groups continue to work rapidly to dispose of OREO properties through a combination of individual sales to homeowners and investors, bulk sales to investors, and auction sales, generally as a last resort.

**Table of Contents****December 31, 2009 Non-Performing Assets by Loan/Property Type and Location**

NPA by location 12/31/2009	North		E. Oregon,			Total	% of Loan Type to Total Non-Performing Assets
	Idaho Eastern Washington	Magic Valley Idaho	Greater Boise Area	SW Idaho Excluding Boise	Other		
	(Dollars in thousands)						
Commercial loans	\$ 2,194	\$ 303	\$ 28	\$ 128	\$	\$ 2,653	8.7%
Commercial real estate loans	3,096	1,182	399	527	31	5,235	17.1%
Commercial construction loans	3,133					3,133	10.4%
Land and land development loans	6,568	1,153	2,337	1,122	2,875	14,055	45.9%
Agriculture loans			521	313		834	2.7%
Multifamily loans		135				135	0.4%
Residential real estate loans	2,194		422	199	380	3,195	10.4%
Residential construction loans	1,264					1,264	4.1%
Consumer loans	64	18	6			88	0.3%
Total	\$ 18,513	\$ 2,791	\$ 3,713	\$ 2,289	\$ 3,286	\$ 30,592	100.0%
Percent of total NPA	60.5%	9.1%	12.1%	7.5%	10.8%	100.0%	
Percent of NPA to total loans in each region(1)	5.0%	5.1%	4.5%	1.7%	9.5%	4.6%	

(1) NPAs include both nonperforming loans and OREO

Residential land, commercial construction and residential construction loans continue to comprise most of the nonperforming asset totals, reflecting continuing weakness in the real estate markets. The top 10 non-performing loans totaled \$7.6 million, or 40% of total non-performing loans and the top 6 OREO properties accounted for 59% of the OREO balance. The geographic distribution of NPAs generally correlates with the distribution of the overall loan portfolio, except that the percent of total NPAs in the North Idaho Eastern Washington region is slightly higher than the percent of the loan portfolio in this region, and correspondingly, the percent of total NPAs in the E. Oregon, SW Idaho excluding Boise is lower. This reflects generally stronger economic conditions in the Southwest Idaho market outside Boise, as a result of its agricultural base. The Other NPAs total is largely comprised of one commercial property in western Washington. All NPAs are reported at the Company's best estimate of net realizable value, and are frequently re-evaluated for changes that would require additional write downs.

Management continues to focus its efforts on managing down the level of non-performing assets, classified loans and delinquencies. It uses a variety of analytical tools and an integrated stress testing program involving both qualitative and quantitative modeling to assess the current and projected state of its credit portfolio. The results of this program are integrated with the Company's capital and liquidity modeling programs to manage and mitigate future risk in these areas as well. In early 2010, the Company contracted with an independent loan review firm to further evaluate and

provide independent analysis of its portfolio and make recommendations for portfolio management improvement. In particular, the review quantified and stratified the loans in the Bank's portfolio based upon layered risk, product type, asset class, loans to-one borrower, and geographic location. The purpose of the review was to provide an independent assessment of the potential imbedded risks and dollar exposure within the Bank's loan portfolio. The scope included 1,000 loans representing over 80% of the total loan portfolio and included specific asset evaluations and loss forecasts for the majority of the loan portfolio. The firm employed seasoned financial and commercial lending personnel to complete the individual loan reviews. Based on its evaluation of both external and internal loan review results, management does not believe that it needs to materially alter its 12-month forward loss projections. It has and continues to incorporate a number of the recommendations made by the review firm into its ongoing credit management process.

**Table of Contents*****Allowance for Loan Losses***

The allowance for loan losses is based upon management's assessment of various factors including, but not limited to, current and future economic trends, historical loan losses, delinquencies, and underlying collateral values, as well as current and potential risks identified in the loan portfolio. The allowance is evaluated on a monthly basis by management. The methodology for calculating the allowance is discussed in more detail below. An allocation is also included for unfunded loan commitments. However, this allocation is recorded as a liability, as required by bank regulatory guidance issued in early 2007.

**Allocation of the Allowance for Loan Losses  
and Non-Accrual Loans Detail  
(Dollars in thousands)**

	Percent of Loans to Total Loans	December 31, 2009		
		Gross Loans	Allowance	Non-Accrual Loans
Commercial loans	19.57%	\$ 131,562	\$ 4,785	\$ 2,653
Commercial real estate loans	25.69	172,726	3,827	3,209
Commercial construction loans	6.78	45,581	1,671	3,135
Land and land development loans	13.18	88,604	2,707	5,724
Agriculture loans	16.40	110,256	1,390	447
Multifamily loans	2.69	18,067	26	135
Residential real estate loans	9.75	65,544	1,412	2,872
Residential construction loans	2.47	16,626	170	205
Consumer loans	2.72	18,287	539	88
Municipal loans	0.75	5,061	81	
Totals	100.00%	\$ 672,314	\$ 16,608	\$ 18,468

	Percent of Loans to Total Loans	December 31, 2008		
		Gross Loans	Allowance	Non-Accrual Loans
Commercial loans	82.81%	\$ 636,982	\$ 14,277	\$ 22,783
Residential loans	13.51	103,937	1,653	3,491
Consumer loans	3.02	23,245	452	91
Municipal loans	0.66	5,109	51	
Totals	100.00%	\$ 769,273	\$ 16,433	\$ 26,365



	Percent of Loans to Total Loans	December 31, 2007		
		Gross Loans	Allowance	Non-Accrual Loans
Commercial loans	81.07%	\$ 623,439	\$ 9,965	\$ 4,732
Residential loans	14.83	114,010	1,196	837
Consumer loans	3.42	26,285	571	
Municipal loans	0.68	5,222	29	
Totals	100.00%	\$ 768,956	\$ 11,761	\$ 5,569

**Table of Contents**

	<b>December 31, 2006</b>			
	<b>Percent of Loans to Total Loans</b>	<b>Gross Loans</b>	<b>Allowance</b>	<b>Non-Accrual Loans</b>
Commercial loans	78.03%	\$ 527,345	\$ 7,924	\$ 1,201
Residential loans	16.66	112,569	1,543	
Consumer loans	4.71	31,800	339	
Municipal loans	0.60	4,082	31	
Totals	100.00%	\$ 675,796	\$ 9,837	\$ 1,201

	<b>December 31, 2005</b>			
	<b>Percent of Loans to Total Loans</b>	<b>Gross Loans</b>	<b>Allowance</b>	<b>Non-Accrual Loans</b>
Commercial loans	75.28%	\$ 425,005	\$ 5,793	\$ 671
Residential loans	19.05	107,554	1,827	10
Consumer loans	5.16	29,109	450	126
Municipal loans	0.51	2,856	30	
Totals	100.00%	\$ 564,524	\$ 8,100	\$ 807

In the table above, commercial loans for the periods 2005-2008 include commercial real estate loans, as well as residential land, subdivision acquisition and development, and builder loans, where the borrower is not a consumer.

During 2007, the Company changed its method of calculating its loan loss allowance in line with bank regulatory guidance issued earlier that year. It continued to refine this methodology in 2008 and 2009 with improved modeling and collateral valuation analysis. The loan portfolio is segregated into loans for which a specific reserve is calculated by management, and loans for which a reserve is calculated using an allowance model. For loans with a specific reserve, management evaluates each loan and derives the reserve based on such factors as expected collectability, collateral value and guarantor support. For loans with reserves calculated by the model, the model mathematically derives a base reserve allocation for each loan using probability of default and loss given default rates based on both historical company and industry experience. This base reserve allocation is then modified by management considering factors such as the current economic environment, portfolio delinquency trends, collateral valuation trends, quality of underwriting and quality of collection activities. The reserves derived from the model are modified by management, then added to the reserve for specifically identified loans to produce the total reserve. Management believes that this methodology provides a more accurate, reliable and verifiable reserve calculation and is in compliance with recent regulatory guidance. The Bank's total allowance for loan losses was 2.47% of total



**Table of Contents**

loans at December 31, 2009 and 2.14% of total loans at December 31, 2008. The following table provides additional detail on the allowance.

**Trend Analysis of the Allowance for Loan Losses**

	<b>2009</b>	<b>2008(1)</b>	<b>December 31, 2007(1)</b>	<b>2006(1)(2)</b>	<b>2005(1)(2)</b>
	<b>(Dollars in thousands)</b>				
Balance Beginning January 1	\$ (16,433)	\$ (11,761)	\$ (9,837)	\$ (8,100)	\$ (6,309)
Charge-Offs					
Commercial loans	5,037	1,486	886	283	307
Commercial real estate loans	3,194	186	8		
Commercial construction loans	4,982	663			
Land and land development loans	19,817	2,820	580		
Agriculture loans	988	162	50		
Multifamily loans	53				
Residential loans	1,598	173		9	21
Residential construction loans	241				
Consumer Loans	1,001	703	520	501	464
Municipal Loans					
Total Charge-offs	36,911	6,193	2,044	793	792
Recoveries					
Commercial Loans	(144)	(53)	(34)	(8)	(187)
Commercial real estate loans		(1)			
Commercial construction loans	(1)				
Land and land development loans	(347)	(198)			
Agriculture loans			(1)		
Multifamily loans					
Residential Loans	(9)		(10)	(4)	(19)
Residential construction loans					
Consumer Loans	(256)	(229)	(30)	(435)	(68)
Municipal Loans					
Total Recoveries	(757)	(481)	(75)	(447)	(274)
Net charge-offs	36,154	5,712	1,969	346	518
Transfers			3	65	(176)
Provision for losses on loans	(36,329)	(10,384)	(3,896)	(2,148)	(2,229)
Sale of loans					96
Balance at end of period	\$ (16,608)	\$ (16,433)	\$ (11,761)	\$ (9,837)	\$ (8,100)
Ratio of net charge-offs to loans outstanding	5.38%	0.75%	0.26%	0.06%	0.09%
Allowance    Unfunded Commitments					
Balance Beginning January 1	\$ (13)	\$ (18)	\$ (482)	\$ (417)	\$ (593)
Adjustment	2	5	467		
Transfers			(3)	(65)	176

Allowance	Unfunded Commitments										
at end of period		\$	(11)	\$	(13)	\$	(18)	\$	(482)	\$	(417)

- (1) The allowance analysis has been adjusted for the periods 2007, 2006 and 2005 to segregate the allowance for loan losses from an allowance for unfunded commitments, per new bank regulatory guidance issued in 2007.
- (2) The detail for allowance analysis breakout categories was not available in 2006 and 2005.

**Table of Contents**

Management's general policy is to charge off loans or portions of loans as soon as an identifiable loss amount can be determined from evidence obtained, such as updated appraisals or similar real estate evaluations, equipment, inventory or similar collateral evaluations, or accepted offers on loan sales or negotiated discounts. In situations where problem loans are dependent on collateral liquidation for repayment, management obtains updated independent valuations, generally no less frequently than once every six months and more frequently for larger or more troubled loans. In the time period between these independent valuations, it monitors market conditions for any significant event or events that would materially change the valuations, and updates them as appropriate.

The following table details loan maturity and repricing information for fixed and variable rate loans.

**Maturity and Repricing for the Bank's  
Loan Portfolio at December 31, 2009**

<b>Loan Repricing</b>	<b>Fixed Rate</b>	<b>Variable Rate (Dollars in thousands)</b>	<b>Total Loans</b>
0-90 days	\$ 33,921	\$ 161,244	\$ 195,165
91-365 days	41,970	97,324	139,294
1 year-5 years	127,664	132,254	259,918
5 years or more	68,767	9,170	77,937
Total	\$ 272,322	\$ 399,992	\$ 672,314

The Company has traditionally maintained a high level of variable rate loans as part of its overall balance sheet management approach. The significant unanticipated decrease in market rates experienced during the economic downturn and financial turmoil of the past several years impacted these loans negatively and created additional pressure on the Company's asset yields and net interest margin. However, this approach positions the Company well for a rising rate environment, in which event the Company may experience improvement in margin.

**Investments**

The investment portfolio is the second largest earning asset category and is comprised mostly of securities categorized as available-for-sale. These securities are carried at fair value. Unrealized gains and losses that are considered temporary are recorded as a component of accumulated other comprehensive income or loss.

The carrying value of the available-for-sale securities portfolio increased 23.1% to \$181.8 million at December 31, 2009 from \$147.6 million at December 31, 2008. The carrying value of the held-to-maturity securities portfolio decreased 13.8% to \$15.2 million at December 31, 2009 from \$17.6 million at December 31, 2008. During 2009, the Company deployed funds from reductions in the Company's loan portfolio and increases in deposits into the investment portfolio. In addition, market conditions caused a slight increase in the carrying value of some of the Company's available-for-sale securities. In a generally stable rate environment, the Company sought to maintain the yield on the investment portfolio, position it for potentially higher rates in the future, and otherwise use it to limit the Bank's overall interest rate risk during the year. In doing so, the Company shortened the duration of its portfolio in anticipation of future higher rates. The Company used a combination of U.S. agency debentures and mortgage-backed securities, whole loan collateralized mortgage obligations (CMOs), and municipal bonds to accomplish this

positioning. The average duration of the available for sale and the held-to-maturity portfolios was approximately 2.8 years and 8.5 years, respectively on December 31, 2009, compared to 4.9 years and 9.2 years, respectively on December 31, 2008. The average duration differs from the investments contractual maturity as average duration takes into account estimated prepayments.

As noted above, available-for-sale securities are required by generally accepted accounting principles to be accounted for at fair value (See Note 20 Fair Value of Financial Instruments in the Company's Consolidated Financial Statements for more information.

Active markets exist for securities totaling \$149.6 million classified as available for sale as of December 31, 2009. For these securities, the Company obtained fair value measurements from an independent pricing service and internally validated these measurements. The fair value measurements consider observable data that may include

**Table of Contents**

dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus, prepayment speeds, credit information and the bond's terms and conditions, among other things.

The available for sale portfolio also includes \$32.2 million in super senior or senior tranche collateralized mortgage obligations not backed by a government or other agency guarantee. These securities are collateralized by fixed rate prime or Alt A mortgages, are structured to provide credit support to the senior tranches, and are carefully analyzed and monitored by management. Because of disruptions in the current market for non-government agency guaranteed mortgage-backed securities and CMOs, an active market did not exist for these securities at December 31, 2009. This is evidenced by a significant widening in the bid-ask spread for these types of securities and the limited volume of actual trades made. As a result, less reliance can be placed on easily observable market data, such as pricing on transactions involving similar types of securities, in determining their current fair value. As such, significant adjustments were required to determine the fair value at the December 31, 2009 measurement date.

In valuing these securities, the Company utilized the same independent pricing service as for its other available-for-sale securities. In addition, it utilized a second pricing service that specializes in whole-loan obligation CMO valuation and Federal Home Loan Bank pricing indications to derive independent valuations and used this data to evaluate and adjust the values derived from the original independent pricing service. In addition to the observable market-based input including dealer quotes, market spreads, live trading levels and execution data, both services also employed a present-value income model that considered the nature and timing of the cash flows and the relative risk of receiving the anticipated cash flows as agreed. The discount rates used were based on a risk-free rate, adjusted by a risk premium for each security. In accordance with accounting guidance, the Company has determined that the risk-adjusted discount rates utilized appropriately reflect the Company's best estimate of the assumptions that market participants would use in pricing the assets in a current transaction to sell the asset at the measurement date. Risks include nonperformance risk (that is, default risk and collateral value risk) and liquidity risk (that is, the compensation that a market participant receives for buying an asset that is difficult to sell under current market conditions). To the extent possible, the pricing services and the Company validated the results from these models with independently observable data.

Two securities, with a book value of \$7.5 million were rated as substandard assets by the Company at December 31, 2009 based on the delinquency and default characteristics of the underlying mortgages and the ratings assigned by independent rating agencies. Both carry ratings that are below investment grade, as commonly defined with the securities industry. As with classified loans, the substandard rating does not mean that the Company will incur a loss on either security, particularly if the securities are held to maturity. Both these securities are monitored closely and evaluated periodically for other-than-temporary impairment. The following table summarizes the value of the substandard assets at December 31, 2009 (in thousands):

Security Issuer	Principal Balance	Fair Value	Unrealized (Loss) Gain	OTTI Credit	OTTI
				Loss Recorded in Income	Impairment Loss Recorded in OCI
RALI	\$ 3,794	\$ 2,229	\$ 259	\$ (526)	\$ (1,226)
BOAA	7,858	5,258	(2,538)		
Total	\$ 11,652	\$ 7,487	\$ (2,279)	\$ (526)	\$ \$(1,226)



***Other-than-Temporary Impairment***

As noted above, the Company evaluated these and other securities in the investment portfolio for

Other-than-Temporary Impairment per accounting guidance. In conducting this evaluation, the Company analyzed the following factors:

The length of time and the extent to which the market value of the securities have been less than their cost;

The financial condition and near-term prospects of the issuer or obligation, including any specific events, which may influence the operations of the issuer or obligation such as credit defaults and losses in mortgages

**Table of Contents**

underlying the security, changes in technology that impair the earnings potential of the investment or the discontinuation of a segment of the business that may affect the future earnings potential; and

The intent and ability of the holder to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value.

At March 31, 2009, one of the substandard securities noted above was considered to be other than temporarily impaired. Due to the lack of an orderly market for the security and the declining national economic and housing market, its fair value was determined to be \$2.5 million at that time based on analytical modeling taking into consideration a range of factors normally found in an orderly market. Of the \$1.7 million original other-than-temporary impairment ( OTTI ) on this security, based on an analysis of projected cash flows, \$244,000 was charged to earnings as a credit loss and \$1.5 million was recognized in other comprehensive income. The Company recorded additional credit loss impairments of \$198,000 and \$84,000, respectively in the third and fourth quarters of 2009, reducing the non-credit value impairment to \$1.2 million. The reduction of the non-credit impairment during the year is due to the fact that while the present value of the cash flows expected to be collected deteriorated, the overall estimated market value of the security improved. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income ( OCI ). Impairment losses related to all other factors are presented as separate categories within OCI. At this time, the Company anticipates holding the security until its value is recovered or until maturity, and will continue to adjust its net income and other comprehensive income to reflect potential future credit loss impairments and the security's market value. The Company calculated the credit loss charges against earnings each quarter by subtracting the estimated present value of future cash flows on the security from its amortized cost at the end of each period.

The following table displays investment securities balances and repricing information for the total portfolio:

**Investment Portfolio Detail  
As of December 31, 2009**

Carrying Value as of December 31,	2009 Amount	Percent Change Prev. Yr.	2008 Amount	Percent Change Prev. Yr.	2007 Amount
	(Dollars in thousands)				
U.S. treasury securities and obligations of government agencies	\$ 51	(99.32)%	\$ 7,546	(88.01)%	\$ 62,952
Mortgage-backed securities & collateralized mortgage obligations ( CMOs )	181,733	29.74	140,072	46.30	95,739
State and municipal bonds	15,177	(13.79)	17,604	54.10	11,424
Total	\$ 196,961	19.21%	\$ 165,222	(2.88)%	\$ 170,115
Available-for-Sale	181,784	23.14	147,618	(7.04)	158,791
Held-to-Maturity	15,177	(13.79)	17,604	55.46	11,324

Total	\$ 196,961	19.21%	\$ 165,222	(2.88)%	\$ 170,115
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**Table of Contents**

**Investments held as of December 31, 2009**  
**Mature as follows:**

	One Year		One to Five Years		Five to Ten Years		Over Ten Years		Total			
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield		
	(Dollars in thousands)											
U.S. treasury securities and obligations of government agencies	\$	0.00%	\$	51	1.93%	\$	0.00%	\$	0.00%	\$	51	1.93%
Mortgage-backed securities & CDOs	2,102	3.27	12,377	4.53	41,848	4.35	125,406	4.73	181,733	4.61		
State and municipal bonds (tax equivalent)	636	2.87	667	3.43	2,438	3.97	11,436	5.18	15,177	4.81		
Total	\$ 2,738	3.16%	\$ 13,095	4.46%	\$ 44,286	4.33%	\$ 136,842	4.77%	\$ 196,961	4.66%		

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Intermountain's investment portfolios are managed to provide and maintain liquidity; to maintain a balance of high quality, diversified investments to minimize risk; to offset other asset portfolio elements in managing interest rate risk; to provide collateral for pledging; and to maximize returns. At December 31, 2009, the Company does not intend to sell any of its available-for-sale securities that have a loss position and it is not likely that it will be required to sell the available-for-sale securities before the anticipated recovery of their remaining amortized cost. However, unforeseen changes in credit risk or other types of portfolio risk could cause management to change its position and sell individual securities on a case-by-case basis. The unrealized losses on residential mortgage-backed securities without other-than-temporary impairment were considered by management to be temporary in nature.

See Note 20 Fair Value of Financial Instruments in the Company's Consolidated Financial Statements for more information on the calculation of fair or carrying value for the investment securities.

### **Fed Funds Sold & Cash Equivalents**

The Bank held \$81.7 million in excess funds at the Federal Reserve at December 31, 2009, as compared to \$71.5 million in Fed Funds Sold at December 31, 2008. At December 31, 2009, excess funds were held at the Federal Reserve as opposed to Fed Funds Sold at a correspondent bank as there was a higher yield on the excess funds at the Federal Reserve. During 2009, the Company maintained an average balance of Fed Funds Sold and interest-bearing unrestricted cash equivalents (referred to in subsequent references as Fed Funds Sold for ease of reference and because the instruments are not materially different) of \$43.9 million as a strategy to preserve and enhance liquidity during a period of extreme market turmoil. This compares to an average balance of Fed Funds Sold in 2008 of \$17.7 million. The higher level of Fed Funds Sold maintained during 2009 resulted in a decrease in interest income

and net interest income as the Fed Funds Sold yield during 2009 was at historically low levels of between 0.00% and 0.25%.

**Table of Contents****Deposits**

<b>Deposit Composition &amp; Trends</b>	<b>December 31, 2009</b>		<b>December 31, 2008</b>	
	<b>Amount</b>	<b>%</b>	<b>Amount</b>	<b>%</b>
	<b>(Dollars in thousands)</b>			
Demand	\$ 168,244	20.5	\$ 154,265	19.4
NOW and money market 0.0% to 5.25%	340,070	41.6	321,556	40.7
Savings and IRA 0.0% to 5.75%	77,623	9.5	78,671	10.0
Certificate of deposit accounts ( CDs ) under \$100,000	86,381	10.5	98,744	12.5
Jumbo CDs	82,249	10.0	63,695	8.1
Brokered CDs	54,428	6.6	57,956	7.3
CDARS CDs to local customers	10,326	1.3	15,525	2.0
Total deposits	\$ 819,321	100.0	\$ 790,412	100.0
Weighted average interest rate on certificates of deposit		2.52%		3.22%
Core Deposits as a percentage of total deposits(1)		81.6%		81.7%
Deposits generated from the Company's market area as a % of total deposits		93.4%		92.7%

(1) Core deposits consist of non-interest bearing checking, interest-bearing checking, money market, and savings accounts, and retail certificate of deposit accounts of less than \$100,000.

Deposits totaled \$819.3 million, representing 82.7% of the Bank's liabilities at December 31, 2009. Total deposits grew 3.7% in 2009 with non-interest bearing deposits increasing 9.1% and interest-bearing deposits growing 2.4% over 2008 balances. Total transaction account deposits (demand, NOW and money market) increased by \$32.4 million during the period and now comprise 62.1% of total deposits, a percentage that significantly exceeds peer group averages. The Company continues to emphasize growth in transaction account balances to minimize its cost of funding, enhance fee income and other cross-selling opportunities, and match its asset composition.

59% of the Company's transaction accounts have been in existence for more than three years. When combined with the rapid growth rates of the Company's retail deposits over the past ten years, this demonstrates the Company's ability to both grow and retain its transaction deposit customers.

Overall certificate of deposit accounts decreased \$2.5 million or 1.1%, from \$235.9 million at December 31, 2008 to \$233.4 million at December 31, 2009. Certificates of deposit to local customers, including CDARs reciprocal CDs, increased by \$1.0 million while brokered certificates of deposit decreased \$3.5 million as the Company sought to acquire certificates at the most attractive price from both local and brokered markets. The Company also seeks to utilize CDs and other funding sources to manage its overall interest-rate risk and liquidity positions.

Deposits by location are as follows (in thousands):

<b>Deposits by Location</b>	<b>12/31/2009</b>	<b>% of total deposits</b>
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North Idaho Eastern Washington	\$ 402,620	49.1%
Magic Valley Idaho	69,430	8.5%
Greater Boise Area	77,291	9.4%
Southwest Idaho Oregon excluding Boise	158,919	19.4%
Administration, Secured Savings	111,061	13.6%
Total	\$ 819,321	100.0%

The Company seeks long-term balance between loans and deposits in each of its regions, and has generally succeeded in achieving this balance, although when it enters new markets, it may emphasize one or the other depending on the specific market.

**Table of Contents**

Business checking, NOW, money market and savings balances comprise about 41% of total non-maturity deposits, and consumer about 59%. The Company emphasizes balanced growth of both business and consumer deposits in its markets to diversify its funding sources. Consumer deposit growth is largely driven by branch marketing efforts in the communities served. Intermountain also employs specialized business services officers who target the acquisition of business deposit accounts and other fee-related services. With the exception of the secured savings program noted below, the Company is not reliant on any one depositor or small group of depositors, with the largest single depositor making up less than 1% of overall company deposits.

The Administration/Secured Savings deposits noted above include brokered and other wholesale deposits, as well as \$28.4 million in deposits used to secure credit cards marketed and maintained by another bank under a contractual arrangement. The contractual arrangement terminated in November, 2009 and was replaced by a transitional contract allowing the provider sufficient time to move these deposits into its own organization. This movement is not anticipated to occur until late 2010 or 2011, and Intermountain is pursuing opportunities to expand its management of secured savings accounts with other potential card providers.

The following table details repricing information for the Bank's time deposits with minimum balance of \$100,000 at December 31, 2009 (in thousands):

**Maturities**

Less than three months	\$ 13,797
Three to six months	40,060
Six to twelve months	30,990
Over twelve months	61,936
	\$ 146,783

In terms of overall deposits, the Company is the market share leader in 5 of the 11 markets in which it operates and has consistently grown deposits for the past ten years. See the market share information and graph under Competition on page 9 of this report for more information.

While growing deposits in 2009, the Company also succeeded in lowering the 2009 interest cost on its interest-bearing deposits by 0.44%. This resulted in overall liability interest costs to the Bank being 0.24% below the average of its peer group as of December 31, 2009 (Source: UBPR for December 31, 2009). This decrease occurred amidst an environment where several stressed competitors continued to offer high CD rates in order to retain and attract additional deposits. Given the current compressed market rate environment, management believes that this improvement and its overall competitive standing positions the Company well for future periods.

**Borrowings**

As part of the Company's funds management and liquidity plan, the Bank has arranged to have short-term and long-term borrowing facilities available. The short-term and overnight facilities are federal funds purchasing lines as reciprocal arrangements to the federal funds selling agreements in place with various correspondent banks. At December 31, 2009, the Bank had overnight unsecured credit lines of \$35.0 million available. For additional long and short-term funding needs, the Bank has credit available from the Federal Home Loan Bank of Seattle (FHLB), limited to a percentage of its total regulatory assets and subject to collateralization requirements and a blanket pledge agreement. It also has a Borrower in Custody line set up with the Federal Reserve Bank, subject to collateralization



requirements.

At December 31, 2009 the Bank had a \$10.0 million FHLB advance at 4.96% that matures in September 2010, a \$5.0 million FHLB advance at 0.86% that matures in September 2010, a \$5.0 million FHLB advance at 1.49% that matures in September 2011, a \$4.0 million FHLB advance at 3.11% that matures in September 2014 and a \$25.0 million FHLB advance at 2.06% that matures in October 2012. These notes totaled \$49.0 million, and the Bank had the ability to borrow an additional \$69.9 million from the FHLB.

The Bank has the ability to borrow up to \$35.4 million on a short term basis from the Federal Reserve Bank under the Borrower in Custody program, utilizing commercial loans as collateral. At December 31, 2009, the Bank had no borrowings outstanding under this line.

## **Table of Contents**

In March 2007, the Company entered into an additional borrowing agreement with Pacific Coast Bankers Bank ( PCBB ) in the amount of \$18.0 million and in December 2007 increased the amount to \$25.0 million. The borrowing agreement was a non-revolving line of credit with a variable rate of interest tied to LIBOR and was collateralized by Bank stock and the Company's headquarters building. This line was used primarily to fund the construction costs of this building in Sandpoint. The balance at December 31, 2008 was \$23.1 million at a variable interest rate of 3.4%. The borrowing had a maturity of January 2009 and was extended for 90 days with a fixed rate of 7.0%. The Company negotiated with PCBB to refinance this loan into three amortizing term loan facilities totaling \$23.0 million in May 2009. In August 2009, the Company sold the Sandpoint Center and paid off the PCBB borrowings.

In January 2006, the Company purchased land to build the headquarters building and entered into a Note Payable with the sellers of the property in the amount of \$1,130,000. The note had a fixed rate of 6.65%, matured in February 2026 and had an outstanding balance of \$941,000 at December 31, 2008. The Note Payable was paid off in May 2009 with the refinance of the PCBB debt.

Securities sold under agreements to repurchase, which are classified as other secured borrowings, generally are short-term agreements. These agreements are treated as financing transactions and the obligations to repurchase securities sold are reflected as a liability in the consolidated financial statements. The dollar amount of securities underlying the agreements remains in the applicable asset account. The majority of the repurchase agreements are with municipal customers in the Company's local markets and mature on a daily basis, with an institutional repurchase agreement in the amount of \$30.0 million maturing in July 2011. These agreements had a weighted average interest rate of 0.36%, 2.00% and 4.69% at December 31, 2009, 2008 and 2007, respectively. The average balances of securities sold subject to repurchase agreements were \$82.6 million, \$102.5 million and \$104.2 million during the years ended December 31, 2009, 2008 and 2007, respectively. The maximum amount outstanding at any month end during these same periods was \$100.3 million, \$124.4 million and \$124.1 million, respectively. The decrease in the repurchase amounts during 2009 reflected generally lower investable balances by municipal customers and movement from repurchase agreements to other higher yielding short term investments by these customers. In 2006, the Company entered into an institutional repurchase agreement to reduce interest rate risk in a down-rate environment. For most of 2009, this structured agreement carried an effective interest cost of 0.00%. At December 31, 2009, 2008, and 2007, the Company pledged as collateral certain investment securities with aggregate amortized costs of \$125.4 million, \$114.8 million and \$122.2 million, respectively. These investment securities had market values of \$125.7 million, \$116.3 million and \$123.7 million at December 31, 2009, 2008 and 2007, respectively.

In January 2003 the, Company issued \$8.0 million of Trust Preferred securities through its subsidiary, Intermountain Statutory Trust I. Approximately \$7.0 million was subsequently transferred to the capital account of Panhandle State Bank for capitalizing the Ontario branch acquisition. The debt associated with these securities bears interest on a variable basis tied to the 90-day LIBOR index plus 3.25% with interest payable quarterly. The debt was callable by the Company in March 2008 and matures in March 2033.

In March 2004, the Company issued \$8.0 million of additional Trust Preferred securities through a second subsidiary, Intermountain Statutory Trust II. This debt is callable by the Company in April 2009, bears interest on a variable basis tied to the 90-day LIBOR index plus 2.8%, and matures in April 2034. In July of 2008, the Company entered into a cash flow swap transaction with Pacific Coast Bankers Bank, by which the Company effectively pays a fixed rate on these securities of 7.38% through July 2013 (see Note 19 in the Company's Consolidated Financial Statements for more information on this swap). Funds received from this borrowing were used to support planned expansion activities during 2004, including the Snake River Bancorp acquisition.

During the third quarter of 2009, the Board of Directors of the Company approved the deferral of regularly scheduled interest payments on its outstanding Junior Subordinated Debentures related to its Trust Preferred Securities ( TRUPS Debentures ), beginning in December 2009. The Company is permitted to defer payments of interest on the TRUPS

Debentures for up to 20 consecutive quarterly periods without default. During the deferral period, the Company may not pay any dividends or distributions on, or redeem, purchase or acquire, or make a liquidation payment with respect to the Company's capital stock, or make any payment of principal or interest on, or repay, repurchase or redeem any debt securities of the Company that rank equally or junior to the TRUPS

## **Table of Contents**

Debentures. Deferred payments compound for the TRUPS Debentures. Although these expenses will continue to be accrued on the consolidated income statements for the Company, deferring these interest payments will preserve approximately \$140,000 per quarter in cash for the Company. Notwithstanding the current deferral of interest payments, the Company fully intends to meet all of its obligations to the holders of the TRUPS Debentures as quickly as it is prudent to do so.

## **Employees**

The Bank employed 406 full-time equivalent employees at December 31, 2009, down from 418 at the end of 2008 and 450 at the end of 2007. None of the employees are represented by a collective bargaining unit and the Company believes it has good relations with its employees. The Company reduced full-time equivalent employees during both 2008 and 2009 as part of an operating expense reduction strategy.

## **Supervision and Regulation**

### ***General***

The following discussion provides an overview of certain elements of the extensive regulatory framework applicable to Intermountain Community Bancorp (the Company) and Panhandle State Bank, which operates under the names Panhandle State Bank, Magic Valley Bank and Intermountain Community Bank (collectively referred to herein as the Bank). This regulatory framework is primarily designed for the protection of depositors, federal deposit insurance funds and the banking system as a whole, rather than for the protection of shareholders. Due to the breadth and growth of this regulatory framework, our costs of compliance continue to increase in order to monitor and satisfy these requirements.

To the extent that this section describes statutory and regulatory provisions, it is qualified by reference to those provisions. These statutes and regulations, as well as related policies, are subject to change by Congress, state legislatures and federal and state regulators. Changes in statutes, regulations or regulatory policies applicable to us, including the interpretation or implementation thereof, could have a material effect on our business or operations. In light of the recent financial crisis, numerous proposals to modify or expand banking regulation have surfaced. Based on past history, if any are approved, they will add to the complexity and cost of our business.

### ***Federal Bank Holding Company Regulation***

*General.* The Company is a bank holding company as defined in the Bank Holding Company Act of 1956, as amended (BHCA), and is therefore subject to regulation, supervision and examination by the Federal Reserve. In general, the BHCA limits the business of bank holding companies to owning or controlling banks and engaging in other activities closely related to banking. The Company must file reports with and provide the Federal Reserve such additional information as it may require.

*Holding Company Bank Ownership.* The BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve before (i) acquiring, directly or indirectly, ownership or control of any voting shares of another bank or bank holding company if, after such acquisition, it would own or control more than 5% of such shares; (ii) acquiring all or substantially all of the assets of another bank or bank holding company; or (iii) merging or consolidating with another bank holding company.

*Holding Company Control of Nonbanks.* With some exceptions, the BHCA also prohibits a bank holding company from acquiring or retaining direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or bank holding company, or from engaging directly or indirectly in activities other than

those of banking, managing or controlling banks, or providing services for its subsidiaries. The principal exceptions to these prohibitions involve certain non-bank activities that, by statute or by Federal Reserve regulation or order, have been identified as activities closely related to the business of banking or of managing or controlling banks.

*Transactions with Affiliates.* Subsidiary banks of a bank holding company are subject to restrictions imposed by the Federal Reserve Act on extensions of credit to the holding company or its subsidiaries, on investments in their securities and on the use of their securities as collateral for loans to any borrower. These regulations and restrictions

## **Table of Contents**

may limit the Company's ability to obtain funds from the Bank for its cash needs, including funds for payment of dividends, interest and operational expenses.

*Tying Arrangements.* The Company is prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, sale or lease of property or furnishing of services. For example, with certain exceptions, neither the Company nor its subsidiaries may condition an extension of credit to a customer on either (i) a requirement that the customer obtain additional services provided by us; or (ii) an agreement by the customer to refrain from obtaining other services from a competitor.

*Support of Subsidiary Banks.* Under Federal Reserve policy, the Company is expected to act as a source of financial and managerial strength to the Bank. This means that the Company is required to commit, as necessary, resources to support the Bank. Any capital loans a bank holding company makes to its subsidiary banks are subordinate to deposits and to certain other indebtedness of those subsidiary banks.

*State Law Restrictions.* As an Idaho corporation, the Company is subject to certain limitations and restrictions under applicable Idaho corporate law. For example, state law restrictions in Idaho include limitations and restrictions relating to indemnification of directors, distributions to shareholders, transactions involving directors, officers or interested shareholders, maintenance of books, records and minutes, and observance of certain corporate formalities.

### ***Federal and State Regulation of the Bank***

*General.* The Bank is an Idaho commercial bank operating in Idaho, with one branch in Oregon and two in Washington. Its deposits are insured by the FDIC. As a result, the Bank is subject to primary supervision and regulation by the Idaho Department of Finance and the FDIC. With respect to the Oregon branch and Washington branch, the Bank is also subject to supervision and regulation by, respectively, the Oregon Department of Consumer and Business Services and the Washington Department of Financial Institutions, as well as the FDIC. These agencies have the authority to prohibit banks from engaging in what they believe constitute unsafe or unsound banking practices.

*Community Reinvestment.* The Community Reinvestment Act of 1977 requires that, in connection with examinations of financial institutions within their jurisdiction, the Federal Reserve or the FDIC evaluate the record of the financial institution in meeting the credit needs of its local communities, including low and moderate-income neighborhoods, consistent with the safe and sound operation of the institution. A bank's community reinvestment record is also considered by the applicable banking agencies in evaluating mergers, acquisitions and applications to open a branch or facility.

*Insider Credit Transactions.* Banks are also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal shareholders or any related interests of such persons. Extensions of credit (i) must be made on substantially the same terms, including interest rates and collateral, and follow credit underwriting procedures that are at least as stringent as those prevailing at the time for comparable transactions with persons not covered above and who are not employees; and (ii) must not involve more than the normal risk of repayment or present other unfavorable features. Banks are also subject to certain lending limits and restrictions on overdrafts to insiders. A violation of these restrictions may result in the assessment of substantial civil monetary penalties, the imposition of a cease and desist order, and other regulatory sanctions.

*Regulation of Management.* Federal law (i) sets forth circumstances under which officers or directors of a bank may be removed by the institution's federal supervisory agency; (ii) places restraints on lending by a bank to its executive officers, directors, principal shareholders, and their related interests; and (iii) prohibits management personnel of a bank from serving as a director or in other management positions of another financial institution whose assets exceed

a specified amount or which has an office within a specified geographic area.

*Safety and Soundness Standards.* Federal law imposes certain non-capital safety and soundness standards on banks. These standards cover internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, such other operational and managerial standards as the agency determines to be appropriate, and standards for asset quality, earnings and stock valuation. An institution that fails to meet these standards must develop a plan acceptable to its

## **Table of Contents**

regulators, specifying the steps that the institution will take to meet the standards. Failure to submit or implement such a plan may subject the institution to regulatory sanctions.

### ***Interstate Banking and Branching***

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ( Interstate Act ) relaxed prior interstate branching restrictions under federal law by permitting nationwide interstate banking and branching under certain circumstances. Generally, bank holding companies may purchase banks in any state, and states may not prohibit these purchases. Additionally, banks are permitted to merge with banks in other states, as long as the home state of neither merging bank has opted out under the legislation. The Interstate Act requires regulators to consult with community organizations before permitting an interstate institution to close a branch in a low-income area. Federal banking regulations prohibit banks from using their interstate branches primarily for deposit production and the federal bank regulatory agencies have implemented a loan-to-deposit ratio screen to ensure compliance with this prohibition.

Idaho, Oregon and Washington have each enacted opting in legislation in accordance with the Interstate Act provisions allowing banks to engage in interstate merger transactions, subject to certain aging requirements. Idaho and Oregon also restrict an out-of-state bank from opening de novo branches; however, once an out-of-state bank has acquired a bank within either state, either through merger or acquisition of all or substantially all of the bank's assets, the out-of-state bank may open additional branches within the state. In contrast, under Washington law, an out-of-state bank may, subject to Department of Financial Institutions approval, open de novo branches in Washington or acquire an in-state branch so long as the home state of the out-of-state bank has reciprocal laws with respect to, respectively, de novo branching or branch acquisitions.

### ***Dividends***

The principal source of the Company's cash is from dividends received from the Bank, which are subject to government regulation and limitations. Regulatory authorities may prohibit banks and bank holding companies from paying dividends in a manner that would constitute an unsafe or unsound banking practice or would reduce the amount of its capital below that necessary to meet minimum applicable regulatory capital requirements. Idaho law also limits a bank's ability to pay dividends subject to surplus reserve requirements. Additionally, current guidance from the Federal Reserve provides, among other things, that dividends per share on the Company's common stock generally should not exceed earnings per share, measured over the previous four fiscal quarters.

In addition to the foregoing regulatory restrictions, we are subject to contractual restrictions that limit us from paying dividends on our common stock, including those contained in the securities purchase agreement between us and the Treasury, as described in more detail below.

### ***Capital Adequacy***

*Regulatory Capital Guidelines.* Federal bank regulatory agencies use capital adequacy guidelines in the examination and regulation of bank holding companies and banks. The guidelines are risk-based, meaning that they are designed to make capital requirements more sensitive to differences in risk profiles among banks and bank holding companies.

*Tier I and Tier II Capital.* Under the guidelines, an institution's capital is divided into two broad categories, Tier I capital and Tier II capital. Tier I capital generally consists of common stockholders' equity, surplus and undivided profits. Tier II capital generally consists of the allowance for loan losses, hybrid capital instruments, and term subordinated debt. The sum of Tier I capital and Tier II capital represents an institution's total regulatory capital. The guidelines require that at least 50% of an institution's total capital consist of Tier I capital.



*Risk-based Capital Ratios.* The adequacy of an institution's capital is gauged primarily with reference to the institution's risk-weighted assets. The guidelines assign risk weightings to an institution's assets in an effort to quantify the relative risk of each asset and to determine the minimum capital required to support that risk. An institution's risk-weighted assets are then compared with its Tier I capital and total capital to arrive at a Tier I risk-

## **Table of Contents**

based ratio and a total risk-based ratio, respectively. The guidelines provide that an institution must have a minimum Tier I risk-based ratio of 4% and a minimum total risk-based ratio of 8%.

***Leverage Ratio.*** The guidelines also employ a leverage ratio, which is Tier I capital as a percentage of average total assets, less intangibles. The principal objective of the leverage ratio is to constrain the maximum degree to which a bank holding company may leverage its equity capital base. The minimum leverage ratio is 3%; however, for all but the most highly rated bank holding companies and for bank holding companies seeking to expand, regulators expect an additional cushion of at least 1% to 2%.

***Prompt Corrective Action.*** Under the guidelines, an institution is assigned to one of five capital categories depending on its total risk-based capital ratio, Tier I risk-based capital ratio, and leverage ratio, together with certain subjective factors. The categories range from well capitalized to critically undercapitalized. Institutions that are undercapitalized or lower are subject to certain mandatory and other supervisory corrective actions. During these challenging economic times, the federal banking regulators have actively enforced these provisions.

### ***Regulatory Oversight and Examination***

The Federal Reserve conducts periodic inspections of bank holding companies, which are performed both onsite and offsite. The supervisory objectives of the inspection program are to ascertain whether the financial strength of the bank holding company is being maintained on an ongoing basis and to determine the effects or consequences of transactions between a holding company or its non-banking subsidiaries and its subsidiary banks. For holding companies under \$10 billion in assets, the inspection type and frequency varies depending on asset size, complexity of the organization, and the holding company's rating at its last inspection.

Banks are subject to periodic examinations by their primary regulators. Bank examinations have evolved from reliance on transaction testing in assessing a bank's condition to a risk-focused approach. These examinations are extensive and cover the entire breadth of operations of the bank. Generally, safety and soundness examinations occur on an 18-month cycle for banks under \$500 million in total assets that are well capitalized and without regulatory issues, and 12-months otherwise. Examinations alternate between the federal and state bank regulatory agency or may occur on a combined basis. The frequency of consumer compliance and Community Reinvestment Act (CRA) examinations is linked to the size of the institution and its compliance and CRA ratings at its most recent examination. However, the examination authority of the Federal Reserve and the FDIC allows them to examine supervised banks as frequently as deemed necessary based on the condition of the bank or as a result of certain triggering events.

### ***Corporate Governance and Accounting Legislation***

***Sarbanes-Oxley Act of 2002.*** The Sarbanes-Oxley Act of 2002 (the Act) addresses among other things, corporate governance, auditing and accounting, enhanced and timely disclosure of corporate information, and penalties for non-compliance. Generally, the Act (i) requires chief executive officers and chief financial officers to certify to the accuracy of periodic reports filed with the Securities and Exchange Commission (the SEC); (ii) imposes specific and enhanced corporate disclosure requirements; (iii) accelerates the time frame for reporting of insider transactions and periodic disclosures by public companies; (iv) requires companies to adopt and disclose information about corporate governance practices, including whether or not they have adopted a code of ethics for senior financial officers and whether the audit committee includes at least one audit committee financial expert; and (v) requires the SEC, based on certain enumerated factors, to regularly and systematically review corporate filings.

To deter wrongdoing, the Act (i) subjects bonuses issued to top executives to disgorgement if a restatement of a company's financial statements was due to corporate misconduct; (ii) prohibits an officer or director misleading or coercing an auditor; (iii) prohibits insider trades during pension fund blackout periods; (iv) imposes new criminal

penalties for fraud and other wrongful acts; and (v) extends the period during which certain securities fraud lawsuits can be brought against a company or its officers.

As an SEC public reporting company, the Company is subject to the requirements of the Act and related rules and regulations issued by the SEC. After enactment, we updated our policies and procedures to comply with the

## **Table of Contents**

Act's requirements and have found that such compliance, including compliance with Section 404 of the Act relating to management control over financial reporting, has resulted in significant additional expense for the Company. We anticipate that we will continue to incur such additional expense in our ongoing compliance.

### ***Anti-terrorism Legislation***

*USA Patriot Act of 2001.* The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, intended to combat terrorism, was renewed with certain amendments in 2006 (the Patriot Act). Certain provisions of the Patriot Act were made permanent and other sections were made subject to extended sunset provisions. The Patriot Act, in relevant part, (i) prohibits banks from providing correspondent accounts directly to foreign shell banks; (ii) imposes due diligence requirements on banks opening or holding accounts for foreign financial institutions or wealthy foreign individuals; (iii) requires financial institutions to establish an anti-money-laundering compliance program; and (iv) eliminates civil liability for persons who file suspicious activity reports. The Act also includes provisions providing the government with power to investigate terrorism, including expanded government access to bank account records. While the Patriot Act has had minimal effect on our record keeping and reporting expenses, we do not believe that the renewal and amendment will have a material adverse effect on our business or operations.

### ***Financial Services Modernization***

*Gramm-Leach-Bliley Act of 1999.* The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 brought about significant changes to the laws affecting banks and bank holding companies. Generally, the Act (i) repeals historical restrictions on preventing banks from affiliating with securities firms; (ii) provides a uniform framework for the activities of banks, savings institutions and their holding companies; (iii) broadens the activities that may be conducted by national banks and banking subsidiaries of bank holding companies; (iv) provides an enhanced framework for protecting the privacy of consumer information and requires notification to consumers of bank privacy policies; and (v) addresses a variety of other legal and regulatory issues affecting both day-to-day operations and long-term activities of financial institutions. Bank holding companies that qualify and elect to become financial holding companies can engage in a wider variety of financial activities than permitted under previous law, particularly with respect to insurance and securities underwriting activities.

### ***Recent Legislation***

*Emergency Economic Stabilization Act of 2008.* In response to the recent financial crisis, the United States government passed the Emergency Economic Stabilization Act of 2008 (the EESA) on October 3, 2008, which provides the United States Department of the Treasury (the Treasury) with broad authority to implement certain actions intended to help restore stability and liquidity to the U.S. financial markets.

*Insurance of Deposit Accounts.* The EESA included a provision for a temporary increase from \$100,000 to \$250,000 per depositor in deposit insurance effective October 3, 2008 through December 31, 2013. Deposit accounts are otherwise insured by the FDIC, generally up to a maximum of \$100,000 per separately insured depositor and up to a maximum of \$250,000 for self-directed retirement accounts.

*Deposit Insurance Assessments.* The FDIC imposes an assessment against institutions for deposit insurance. This assessment is based on the risk category of the institution and ranges from 5 to 43 basis points of the institution's deposits. In December, 2008, the FDIC adopted a rule that raised the current deposit insurance assessment rates uniformly for all institutions by 7 basis points (to a range from 12 to 50 basis points) for the first quarter of 2009. In February 2009, the FDIC adopted a final rule modifying the risk-based assessment system and setting initial base assessment rates beginning April 1, 2009, at 12 to 45 basis points. The rule also gives the FDIC the authority to, as

necessary, implement emergency special assessments to maintain the deposit insurance fund. In November 2009, the FDIC approved a final rule requiring all FDIC-insured depository institutions to prepay estimated quarterly assessments for the fourth quarter of 2009 and for all of 2010, 2011, and 2012. The prepayment was collected on December 30, 2009, along with our regular quarterly deposit insurance assessments for the third quarter of 2009. For the fourth quarter of 2009 and 2010, the prepaid assessments will be based on an institution's total base assessment rate in effect on September 30, 2009. The rate will be increased by three basis points for 2011

## **Table of Contents**

and 2012 prepayments. The prepaid assessments will be accounted for as a prepaid expenses amortized over the three year period.

### ***Troubled Asset Relief Program***

Pursuant to the EESA, the Treasury has the ability to purchase or insure up to \$700 billion in troubled assets held by financial institutions under the Troubled Asset Relief Program ( TARP ). On October 14, 2008, the Treasury announced it would initially purchase equity stakes in financial institutions under a Capital Purchase Program (the CPP ) of up to \$350 billion of the \$700 billion authorized under the TARP legislation. The CPP provides for direct equity investment in perpetual preferred stock by the Treasury in qualified financial institutions. The program is voluntary and requires an institution to comply with a number of restrictions and provisions, including limits on executive compensation, stock redemptions and declaration of dividends. For publicly traded companies, the CPP also requires the Treasury to receive warrants for common stock equal to 15% of the capital invested by the Treasury. The Company applied for and received \$27 million in the CPP. As a result, the Company is subject to the restrictions described below. The Treasury made an equity investment in the Company through its purchase of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Preferred Stock ). The description of the Preferred Stock set forth below is qualified in its entirety by the actual terms of the Preferred Stock, as are stated in the Certificate of Designation for the Preferred Stock, a copy of which was attached as Exhibit 3.1 to our Current Report on Form 8-K filed with the SEC on December 19, 2008 and incorporated by reference.

*General.* The Preferred Stock constitutes a single series of our preferred stock, consisting of 27,000 shares, no par value per share, having a liquidation preference amount of \$1,000 per share. The Preferred Stock has no maturity date. We issued the shares of Preferred Stock to Treasury on December 19, 2008 in connection with the CPP for a purchase price of \$27,000,000.

*Dividend Rate.* Dividends on the Preferred Stock are payable quarterly in arrears, when, as and if authorized and declared by our Board of Directors out of legally available funds, on a cumulative basis on the \$1,000 per share liquidation preference amount plus the amount of accrued and unpaid dividends for any prior dividend periods, at a rate of (i) 5% per annum, from the original issuance date to the fifth anniversary of the issuance date, and (ii) 9% per annum, thereafter. If the Company does not pay dividends for six quarterly dividend periods (whether or not consecutive), Treasury would be entitled to appoint two members to the Company's board of directors until all accrued but unpaid dividends have been paid.

Dividends on the Preferred Stock will be cumulative. If for any reason our Board of Directors does not declare a dividend on the Preferred Stock for a particular dividend period, or if our Board of Directors declares less than a full dividend, we will remain obligated to pay the unpaid portion of the dividend for that period and the unpaid dividend will compound on each subsequent dividend date (meaning that dividends for future dividend periods will accrue on any unpaid dividend amounts for prior dividend periods).

*Priority of Dividends.* Until the earlier of the third anniversary of Treasury's investment or our redemption or the Treasury's transfer of the Preferred Stock to an unaffiliated third party, we may not declare or pay a dividend or other distribution on our common stock (other than dividends payable solely in common stock), and we generally may not directly or indirectly purchase, redeem or otherwise acquire any shares of common stock or trust preferred securities.

*Liquidation Rights.* In the event of any voluntary or involuntary liquidation, dissolution or winding up of the affairs of the Company, holders of the Preferred Stock will be entitled to receive for each share of Preferred Stock, out of the assets of the Company or proceeds available for distribution to our shareholders, subject to any rights of our creditors, before any distribution of assets or proceeds is made to or set aside for the holders of our common stock and any other class or series of our stock ranking junior to the Preferred Stock, payment of an amount equal to the sum of (i) the

\$1,000 liquidation preference amount per share and (ii) the amount of any accrued and unpaid dividends on the Preferred Stock (including dividends accrued on any unpaid dividends). To the extent the assets or proceeds available for distribution to shareholders are not sufficient to fully pay the liquidation payments owing to the holders of the Preferred Stock and the holders of any other class or series of our stock ranking equally with the Preferred Stock, the holders of the Preferred Stock and such other stock will share ratably in the distribution. For

## **Table of Contents**

purposes of the liquidation rights of the Preferred Stock, neither a merger nor consolidation of the Company with another entity nor a sale, lease or exchange of all or substantially all of the Company's assets will constitute a liquidation, dissolution or winding up of the affairs of the Company.

*Compensation and Corporate Governance Standards and Restrictions under the CPP.* As a participant in the CPP, the Company is subject to compensation and corporate governance standards and restrictions under applicable legislation and Treasury regulations, which include but are not limited to (1) restrictions on bonus, incentive and retention awards to our five most highly-compensated employees, (2) a prohibition on severance and change-in-control payments to our executive officers and next five most highly-compensated employees, (3) ensuring that our compensation programs do not encourage unnecessary and excessive risks, (4) requiring the recovery or clawback of any incentive compensation paid to our executive officers and next 20 most highly-compensated employees if it is later determined that such payments were based on materially inaccurate financial or other performance criteria, (5) adoption of an excessive or luxury expenditures policy, and (6) certifications as to various matters by our CEO, CFO and board compensation committee. The applicable regulations and their impact on the Company will be discussed more fully in our proxy statement for the 2010 annual meeting of shareholders, incorporated by reference into Part III of this Form 10-K.

*Temporary Liquidity Guarantee Program.* In October 2008, the FDIC announced the Temporary Liquidity Guarantee Program, which has two components—the Debt Guarantee Program and the Transaction Account Guarantee Program. Under the Transaction Account Guarantee Program any participating depository institution is able to provide full deposit insurance coverage for non-interest bearing transaction accounts, regardless of the dollar amount. Under the program, effective November 14, 2008, insured depository institutions that have not opted out of the FDIC Temporary Liquidity Guarantee Program will be subject to a 10 basis point surcharge through December 31, 2009, applied to non-interest bearing transaction deposit account balances in excess of \$250,000, which surcharge will be added to the institution's existing risk-based deposit insurance assessments. Beginning January 1, 2010, the surcharge will range from 15 to 25 basis points depending on the institution's risk category. The Transaction Account Guarantee Program will expire on June 30, 2010. Under the Debt Guarantee Program, qualifying unsecured senior debt issued by a participating institution can be guaranteed by the FDIC. The Debt Guarantee Program has been extended for senior unsecured debt issued after April 1, 2009 and before October 31, 2009 and maturing on or before December 31, 2012. The Company and the Bank chose to participate in both components of the FDIC Temporary Liquidity Guaranty Program.

*American Recovery and Reinvestment Act of 2009.* On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (ARRA) was signed into law. ARRA is intended to help stimulate the economy and is a combination of tax cuts and spending provisions applicable to a broad range of areas with an estimated cost of \$787 billion. The impact that ARRA may have on the US economy, the Company and the Bank cannot be predicted with certainty.

## **Proposed Legislation**

Proposed legislation is introduced in almost every legislative session. Certain of such legislation could dramatically affect the regulation of the banking industry. In light of the 2008 financial crisis, legislation reshaping the regulatory landscape for financial institutions has been proposed. A current proposal includes measures aimed to prevent another financial crisis like the one in 2008 by forming a regulatory body to protect the interest of consumer by preventing abusive and risky lending practices, increasing supervision and regulation on financial firms deemed too big to fail, giving shareholders an advisory vote on executive pay, and regulating complex derivatives instruments. We cannot predict if any such legislation will be adopted or if it is adopted how it would affect the business of the Company or the Bank. Past history has demonstrated that new legislation or changes to existing laws or regulations usually results in a greater compliance burden and therefore generally increases the cost of doing business.



***Effects of Government Monetary Policy***

Our earnings and growth are affected not only by general economic conditions, but also by the fiscal and monetary policies of the federal government, particularly the Federal Reserve. The Federal Reserve implements

## **Table of Contents**

national monetary policy for such purposes as curbing inflation and combating recession, but its open market operations in U.S. government securities, control of the discount rate applicable to borrowings from the Federal Reserve, and establishment of reserve requirements against certain deposits, influence the growth of bank loans, investments and deposits, and also affect interest rates charged on loans or paid on deposits. The nature and impact of future changes in monetary policies and their impact on us cannot be predicted with certainty.

### **Where you can find more information**

The periodic reports Intermountain files with the SEC are available on Intermountain's website at <http://www.intermountainbank.com> after the reports are filed with the SEC. The SEC maintains a website located at <http://sec.gov> that also contains this information. The Company will provide you with copies of these reports, without charge, upon request made to:

Investor Relations  
Intermountain Community Bancorp  
414 Church Street  
Sandpoint, Idaho 83864  
(208) 263-0505

### **Item 1A. RISK FACTORS**

*Our business exposes us to certain risks. The following is a discussion of what we currently believe are the most significant risks and uncertainties that may affect our business, financial condition or results of operations, or the value of our common stock.*

*We cannot accurately predict the effect of the current economic downturn on our future results of operations or market price of our stock.*

The national economy and the financial services sector in particular, are currently facing challenges of a scope unprecedented in recent history. We cannot accurately predict the severity or duration of the current economic downturn, which has adversely impacted the markets we serve. Any further deterioration in the economies of the nation as a whole or in our markets would have an adverse effect, which could be material, on our business, financial condition, results of operations and prospects, and could also cause the market price of our stock to decline.

*The current economic downturn in the market areas we serve may continue to adversely impact our earnings and could increase our credit risk associated with our loan portfolio.*

Substantially all of our loans are to businesses and individuals in northern, southwestern and south central Idaho, eastern Washington and southwestern Oregon, and a further deterioration in economic conditions in the market areas we serve could result in the following consequences, any of which could have an adverse impact, which may be material, on our business, financial condition, and results of operations:

economic conditions may worsen, increasing the likelihood of credit defaults by borrowers;

loan collateral values, especially as they relate to commercial and residential real estate, may decline further, thereby increasing the severity of loss in the event of loan defaults;

nonperforming assets and write-downs of assets underlying troubled credits could adversely affect our earnings;

demand for banking products and services may decline, including services for low cost and non-interest-bearing deposits; and

changes and volatility in interest rates may negatively impact the yields on earning assets and the cost of interest-bearing liabilities.

**Table of Contents**

***Our allowance for loan losses may not be adequate to cover actual loan losses, which could adversely affect our earnings.***

We maintain an allowance for loan losses in an amount that we believe is adequate to provide for losses inherent in our loan portfolio. While we strive to carefully manage and monitor credit quality and to identify loans that may be deteriorating, at any time there are loans included in the portfolio that may result in losses, but that have not yet been identified as potential problem loans. Through established credit practices, we attempt to identify deteriorating loans and adjust the loan loss reserve accordingly. However, because future events are uncertain, there may be loans that deteriorate in an accelerated time frame. As a result, future additions to the allowance may be necessary. Because the loan portfolio contains a number of commercial real estate loans with relatively large balances, a deterioration in the credit quality of one or more of these loans may require a significant increase to the allowance for loan losses. Future additions to the allowance may also be required based on changes in the financial condition of borrowers, such as have resulted due to the current, and potentially worsening, economic conditions or as a result of incorrect assumptions by management in determining the allowance for loan losses. Additionally, federal banking regulators, as an integral part of their supervisory function, periodically review our allowance for loan losses. These regulatory agencies may require us to recognize further loan loss provisions or charge-offs based upon their judgments, which may be different from ours. Any increase in the allowance for loan losses would have a negative effect, which may be material, on our financial condition and results of operations.

***We have recently entered into an informal agreement with our regulators to take steps to further strengthen the Bank.***

Following a recently regularly scheduled examination, the Bank has entered into an informal agreement with the FDIC and the Idaho Department of Finance to take steps to further strengthen the Bank within specified timeframes, including, among other items, increasing capital by at least \$30 million by June 16, 2010 and thereafter maintaining a minimum 10% Tier 1 Capital to Average Assets ratio, not paying dividends from the Bank to the Company without prior approval, achieving staged reductions in the Bank's adversely classified assets and not engaging in transactions that would materially alter our balance sheet composition. Management has initiated steps to satisfy the conditions of the agreement, including seeking and obtaining shareholder approval to increase the Company's authorized common stock to facilitate raising capital. There can be no assurance that we will be successful in satisfying all of the conditions of the agreement within the specified timeframes.

***We will pursue additional capital in the future, which could dilute the holders of our outstanding common stock and may adversely affect the market price of our common stock.***

In the current economic environment, we believe it is prudent to consider alternatives for raising capital when opportunities to raise capital at attractive prices present themselves, in order to further strengthen our capital and better position ourselves to take advantage of opportunities that may arise in the future. In addition, as noted above, we have entered into an informal agreement with our primary regulators to increase capital levels at the Bank. Alternatives for raising capital may include issuance and sale of common or preferred stock, trust preferred securities, or borrowings by the Company, with proceeds contributed to the Bank. Our ability to raise additional capital will depend on, among other things, conditions in the capital markets at the time, which are outside of our control, and our financial performance. We cannot assure you that such capital will be available to us on acceptable terms or at all. Any such capital raising alternatives could dilute the holders of our outstanding common stock and may adversely affect the market price of our common stock.

***We incurred a significant loss over the last fiscal year and losses may continue in the future.***

During the 2009 fiscal year, we incurred a net loss available to common shareholders of \$23.6 million, or a loss of \$2.82 per common share, primarily due to a \$36.3 million expense for the provision for credit losses and \$5.4 million in OREO expenses and chargedowns. In light of the current economic environment, significant additional provisions for credit losses may be necessary to supplement the allowance for loan and lease losses in the future. As a result, we may incur significant credit costs, including legal and related collection expenses, throughout 2010, which would continue to have an adverse impact on our financial condition and results of operations and the value of our common stock. Additional credit losses or impairment charges could cause us to incur a net loss in the future and could adversely affect the price of, and market for, our common stock.

## **Table of Contents**

### ***Concentration in real estate loans and the deterioration in the real estate markets we serve could require material increases in our allowance for loan losses and adversely affect our financial condition and results of operations.***

The economic downturn is significantly affecting our market area. At December 31, 2009, 64.22% of our loans were secured with real estate as the primary collateral. Further deterioration in the local economies we serve could have a material adverse effect on our business, financial condition and results of operations due to a weakening of our borrowers' ability to repay these loans and a decline in the value of the collateral securing them. Our ability to recover on these loans by selling or disposing of the underlying real estate collateral is adversely impacted by declining real estate values, which increases the likelihood we will suffer losses on defaulted loans secured by real estate beyond the amounts provided for in the allowance for loan losses. This, in turn, could require material increases in our allowance for loan losses and adversely affect our financial condition and results of operations, perhaps materially.

### ***Non-performing assets take significant time to resolve and adversely affect our results of operations and financial condition.***

At December 31, 2009, our non-performing loans (which consist of non-accrual loans and loans that are 90 days or more past due) were 2.91% of the loan portfolio. At December 31, 2009, our non-performing assets (which also include OREO) were 2.83% of total assets. These levels of non-performing loans and assets are at elevated levels compared to historical norms. Non-performing loans and assets adversely affect us in a variety of ways. Until economic and market conditions improve, we may expect to continue to incur losses relating to an increase in non-performing assets. We do not record interest income on non-accrual loans, thereby adversely affecting our net interest income and increasing loan administration costs. When we receive collateral through foreclosures and similar proceedings, we are required to mark the related loan to the then fair market value of the collateral, which may ultimately result in a loss. An increase in the level of non-performing assets also increases our risk profile and may impact the capital levels our regulators believe are appropriate in light of such risks. We utilize various techniques such as loan sales, workouts and restructurings to manage our problem assets. Decreases in the value of these problem assets, the underlying collateral, or in the borrowers' performance or financial condition, could adversely affect our business, results of operations and financial condition, perhaps materially. In addition, the resolution of non-performing assets requires significant commitments of time from management and staff, which can be detrimental to the performance of their other responsibilities. There can be no assurance that we will not experience increases in non-performing loans and assets in the future.

### ***Our ability to receive dividends from our banking subsidiary accounts for most of our revenue and could affect our liquidity and ability to pay dividends.***

We are a separate and distinct legal entity from our banking subsidiary, Panhandle State Bank. We receive substantially all of our revenue from dividends from our banking subsidiary. These dividends are the principal source of funds to pay dividends on our common and preferred stock and principal and interest on our outstanding debt. Various federal and/or state laws and regulations limit the amount of dividends that the Bank may pay us. For example, Idaho law limits a bank's ability to pay dividends subject to surplus reserve requirements. In addition, as noted above, we have recently entered into an informal agreement with our regulators that prohibits the payment of dividends from the Bank to the Company without prior approval. Also, our right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. Limitations on our ability to receive dividends from our subsidiary could have a material adverse effect on our liquidity and on our ability to pay dividends on common or preferred stock. Additionally, if our subsidiary's earnings are not sufficient to make dividend payments to us while maintaining adequate capital levels, we may not be able to make dividend payments to our common and preferred shareholders or principal and interest payments on our outstanding debt.

In this regard, we have recently suspended payments on our trust preferred securities and Fixed Rate Cumulative Perpetual Preferred Stock, Series A, (the Preferred Stock ). In the event that we fail to pay dividends on the Preferred Stock for a total of at least six quarterly dividend periods (whether or not consecutive), the U.S. Treasury will have the right to appoint two directors to our board of directors until all accrued but unpaid

**Table of Contents**

dividends have been paid. If we do not make payments on our trust preferred securities for over 20 consecutive quarters, we could be in default under those securities.

***A continued tightening of credit markets and liquidity risk could adversely affect our business, financial condition and results of operations.***

A continued tightening of the credit markets or any inability to obtain adequate funds for continued loan growth at an acceptable cost could negatively affect our asset growth and liquidity position and, therefore, our earnings capability. In addition to core deposit growth, maturity of investment securities and loan payments, the Bank also relies on alternative funding sources including unsecured borrowing lines with correspondent banks, national certificates of deposit and borrowing lines with the Federal Home Loan Bank and the Federal Reserve Bank, public time certificates of deposits and out of area and brokered time certificates of deposit. Our ability to access these sources could be impaired by deterioration in our financial condition as well as factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations for the financial services industry or serious dislocation in the general credit markets. In the event such disruption should occur, our ability to access these sources could be negatively affected, both as to price and availability, which would limit, and/or potentially raise the cost of, the funds available to the Company.

***The FDIC has increased insurance premiums and imposed special assessments to rebuild and maintain the federal deposit insurance fund, and any additional future premium increases or special assessments could have a material adverse effect on our business, financial condition and results of operations.***

The FDIC adopted a final rule revising its risk-based assessment system, effective April 1, 2009. The changes to the assessment system involve adjustments to the risk-based calculation of an institution's unsecured debt, secured liabilities and brokered deposits. The revisions effectively result in a range of possible assessments under the risk-based system of 7.0 to 77.5 basis points. The potential increase in FDIC insurance premiums will add to our cost of operations and could have a significant impact on the Company.

The FDIC also has recently required insured institutions to prepay estimated quarterly risk-based deposit insurance assessments for the fourth quarter of 2009 and for all of 2010, 2011 and 2012, and increased the regular assessment rate by three basis points effective January 1, 2011, as a means of replenishing the deposit insurance fund. Intermountain's prepayment of \$7.0 million was collected on December 30, 2009, and is being accounted for as a prepaid expense amortized over the prepayment period.

The FDIC also recently imposed a special deposit insurance assessment of five basis points on all insured institutions. This emergency assessment was calculated based on the insured institution's assets at June 30, 2009, and collected on September 30, 2009. Based on our June 30, 2009 assets subject to the FDIC assessment, the assessment was \$475,000. The special assessment is in addition to the regular quarterly risk-based assessment.

The deposit insurance fund may suffer losses in the future due to additional bank failures. There can be no assurance that there will not be additional significant deposit insurance premium increases, special assessments or prepayments in order to restore the insurance fund's reserve ratio. Any significant premium increases or special assessments could have a material adverse effect on our financial condition and results of operations.

***If the goodwill recorded in connection with acquisitions becomes impaired, it could have an adverse impact on earnings and capital.***

Our estimates of the fair value of our goodwill may change as a result of changes in our business or other factors. As a result of new estimates, we may determine that an impairment charge for the decline in the value of goodwill is



necessary. Estimates of fair value are based on a complex model using, among other things, cash flows and company comparison. If our estimates of future cash flows or other components of our fair value calculations are inaccurate, the fair value of goodwill reflected in our financial statements could be inaccurate and we could be required to take impairment charges, which could have a material adverse effect on our results of operations and financial condition.

**Table of Contents**

***We may be required, in the future, to recognize impairment with respect to investment securities, including the FHLB stock we hold.***

Our securities portfolio contains whole loan private mortgage-backed securities and currently includes securities with unrecognized losses. The recent national downturn in real estate markets and elevated mortgage delinquency and foreclosure rates have increased credit losses in the portfolio of loans underlying these securities and resulted in substantial discounts in their market values. While these trends appear to have stabilized, any further deterioration in the loans underlying these securities and resulting market discounts could lead to other-than-temporary impairment in the value of these investments. We evaluate the securities portfolio for any other-than-temporary impairment each reporting period, as required by generally accepted accounting principles, and as of December 31, 2009, one security had been determined to be other than temporarily impaired, with the impairment totaling \$1.7 million. Of this \$1.7 million, \$0.5 million was recognized as a credit loss through the Company's income statement for the twelve months ended December 31, 2009, and the remaining \$1.2 million was reported as part of the Company's other comprehensive income (loss) on the balance sheet. There can be no assurance that future evaluations of the securities portfolio will not require us to recognize additional impairment charges with respect to these and other holdings.

In addition, as a condition to 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. At December 31, 2009, we had stock in the FHLB of Seattle totaling \$2.3 million. The FHLB stock held by us is carried at cost and is subject to recoverability testing under applicable accounting standards. The FHLB has discontinued the repurchase of its stock and discontinued the distribution of dividends. As of December 31, 2009, we did not recognize an impairment charge related to our FHLB stock holdings. There can be no assurance, however, that future negative changes to the financial condition of the FHLB may not require us to recognize an impairment charge with respect to such holdings.

***Our ability to access markets for funding and acquire and retain customers could be adversely affected by the deterioration of other financial institutions or if the financial service industry's reputation is damaged further.***

The financial services industry continues to be featured in negative reports about the global and national credit crisis and the resulting stabilization legislation enacted by the U.S. federal government. These reports can be damaging to the industry's image and potentially erode consumer confidence in insured financial institutions, such as our banking subsidiary. In addition, our ability to engage in routine funding and other transactions could be adversely affected by the actions and financial condition of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, correspondent, counterparty or other relationships. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry in general, could lead to market-wide liquidity problems, losses of depositor, creditor and counterparty confidence and could lead to losses or defaults by us or by other institutions. We could experience material changes in the level of deposits as a direct or indirect result of other banks' difficulties or failure, which could require us to increase capital levels.

***Recent levels of market volatility were unprecedented and we cannot predict whether they will return.***

The capital and credit markets have been experiencing volatility and disruption for over two years, at times reaching unprecedented levels. In some cases, the markets have produced downward pressure on stock prices and credit availability for certain companies without regard to those companies' underlying financial strength. If similar levels of market disruption and volatility return, there can be no assurance that we will not experience an adverse effect, which may be material, on our ability to access capital and on our business, financial condition and results of operations.

***We operate in a highly regulated environment and we cannot predict the effects of recent and pending federal legislation.***

As discussed further in the section [Supervision and Regulation](#) , we are subject to extensive regulation, supervision and examination by federal and state banking authorities. In addition, as a publicly traded company, we

## **Table of Contents**

are subject to regulation by the Securities and Exchange Commission. Any change in applicable regulations or federal, state or local legislation, or in policies or interpretations or regulatory approaches to compliance and enforcement, income tax laws and accounting principles, could have a substantial impact on us and our operations. Changes in laws and regulations may also increase our expenses by imposing additional fees or taxes or restrictions on our operations. Additional legislation and regulations that could significantly affect our powers, authority and operations may be enacted or adopted in the future, which could have a material adverse effect on our financial condition and results of operations. Failure to appropriately comply with any such laws, regulations or principles could result in sanctions by regulatory agencies, or damage to our reputation, all of which could adversely affect our business, financial condition or results of operations. In that regard, proposals for legislation restructuring the regulation of the financial services industry are currently under consideration. Adoption of such proposals could, among other things, increase the overall costs of regulatory compliance. Further, regulators have significant discretion and authority to prevent or remedy unsafe or unsound practices or violations of laws or regulations by financial institutions and holding companies in the performance of their supervisory and enforcement duties. Recently, these powers have been utilized more frequently due to the serious national, regional and local economic conditions we are facing. The exercise of regulatory authority may have a negative impact on our financial condition and results of operations. Additionally, our business is affected significantly by the fiscal and monetary policies of the U.S. federal government and its agencies, including the Federal Reserve Board.

Numerous actions have been taken by the Federal Reserve, the U.S. Congress, the U.S. Treasury, the FDIC, the SEC and others to address the liquidity and credit crisis. In addition, the Secretary of the Treasury has proposed fundamental changes to the regulation of financial institutions.

We cannot predict the actual effects of proposed regulatory reform measures and various governmental, regulatory, monetary and fiscal initiatives which have been and may be enacted on the financial markets generally, or on the Company and on the Bank specifically. The terms and costs of these activities, or the failure of these actions to help stabilize the financial markets, asset prices, market liquidity and a continuation or worsening of current financial market and economic conditions could materially and adversely affect our business, financial condition, results of operations, and the trading price of our common stock.

### ***Fluctuating interest rates could adversely affect our profitability.***

Our profitability is dependent to a large extent upon our net interest income, which is the difference between the interest earned on loans, securities and other interest-earning assets and interest paid on deposits, borrowings, and other interest-bearing liabilities. Because of the differences in maturities and repricing characteristics of our interest-earning assets and interest-bearing liabilities, changes in interest rates do not produce equivalent changes in interest income earned on interest-earning assets and interest paid on interest-bearing liabilities. Accordingly, fluctuations in interest rates could adversely affect our net interest margin, and, in turn, our profitability. We manage our interest rate risk within established guidelines and generally seek an asset and liability structure that insulates net interest income from large deviations attributable to changes in market rates. However, our interest rate risk management practices may not be effective in a highly volatile rate environment.

### ***Fluctuations in interest rates on loans could adversely affect our business.***

Significant increases in market interest rates on loans, or the perception that an increase may occur, could adversely affect both our ability to originate new loans and our ability to grow. Conversely, decreases in interest rates could result in an acceleration of loan prepayments. An increase in market interest rates could also adversely affect the ability of our floating-rate borrowers to meet their higher payment obligations. If this occurred, it could cause an increase in nonperforming assets and charge offs, which could adversely affect our business, financial condition and results of operations.

***We face strong competition from financial services companies and other companies that offer banking services.***

The banking and financial services businesses in our market area are highly competitive and increased competition may adversely impact the level of our loans and deposits. Ultimately, we may not be able to compete

## **Table of Contents**

successfully against current and future competitors. These competitors include national banks, foreign banks, regional banks and other community banks. We also face competition from many other types of financial institutions, including savings and loan associations, finance companies, brokerage firms, insurance companies, credit unions, mortgage banks and other financial intermediaries. In particular, our competitors include major financial companies whose greater resources may afford them a marketplace advantage by enabling them to maintain numerous locations and mount extensive promotional and advertising campaigns. Areas of competition include interest rates for loans and deposits, efforts to obtain loan and deposit customers and a range in quality of products and services provided, including new technology driven products and services. If we are unable to attract and retain banking customers, we may be unable to continue our loan growth and level of deposits.

### ***We may not be able to successfully implement our internal growth strategy.***

We have pursued and intend to continue to pursue an internal growth strategy, the success of which will depend primarily on generating an increasing level of loans and deposits at acceptable risk levels and terms without proportionate increases in non-interest expenses. There can be no assurance that we will be successful in implementing our internal growth strategy. Furthermore, the success of our growth strategy will depend on maintaining sufficient regulatory capital levels and on favorable economic conditions in our market areas.

### ***Certain built-in losses could be limited if we experience an ownership change, as defined in the Internal Revenue Code.***

Certain of our assets, such as loans, may have built-in losses to the extent the basis of such assets exceeds fair market value. Section 382 of the Internal Revenue Code ( IRC ) may limit the benefit of these built-in losses that exist at the time of an ownership change. A Section 382 ownership change occurs if a shareholder or a group of shareholders, who are deemed to own at least 5% of our common stock, increase their ownership by more than 50 percentage points over their lowest ownership percentage within a rolling three-year period. If an ownership change occurs, Section 382 would impose an annual limit on the amount of recognized built-in losses we can use to reduce our taxable income equal to the product of the total value of our outstanding equity immediately prior to the ownership change and the federal long-term tax-exempt interest rate in effect for the month of the ownership change. A number of special rules apply to calculating this limit. The limitations contained in Section 382 apply for a five-year period beginning on the date of the ownership change and any recognized built-in losses that are limited by Section 382 may be carried forward and reduce our future taxable income for up to 20 years, after which they expire. If an ownership change were to occur due to the issuance and sale of our securities, the annual limit of Section 382 could defer our ability to use some, or all, of the built-in losses to offset taxable income.

### ***Unexpected losses or our inability to successfully implement our tax planning strategies in future reporting periods may require us to establish a valuation allowance against our deferred income tax assets.***

We evaluate our deferred income tax assets for recoverability based on all available evidence. This process involves significant management judgment about assumptions that are subject to change from period to period based on changes in tax laws, our ability to successfully implement tax planning strategies, or variances between our future projected operating performance and our actual results. We are required to establish a valuation allowance for deferred income tax assets if we determine, based on available evidence at the time the determination is made, that it is more likely than not that some portion or all of the deferred income tax assets will not be realized. In determining the more-likely-than-not criterion, we evaluate all positive and negative available evidence as of the end of each reporting period. Future adjustments to the deferred income tax asset valuation allowance, if any, will be determined based upon changes in the expected realization of the net deferred income tax assets. The realization of the deferred income tax assets ultimately depends on the existence of sufficient taxable income in either the carry back or carry forward periods under the tax law. Net operating loss carryforwards, if any, may be limited should a stock offering or sale of

securities cause a change in control as defined in Internal Revenue Code Section 382. In addition, as discussed above, net unrealized built-in losses, as defined in IRC Section 382 may be limited. In addition, risk based capital rules require a regulatory calculation evaluating the Company's deferred income tax asset balance for realization against estimated pre-tax future income and net operating loss carry backs. Under the rules of this calculation and due to

## **Table of Contents**

significant estimates utilized in establishing the valuation allowance and the potential for changes in facts and circumstances, it is reasonably possible that we will be required to record adjustments to the valuation allowance in future reporting periods that would materially reduce our risk based capital ratios. Such a charge could also have a material adverse effect on our results of operations, financial condition and capital position.

### ***Changes in accounting standards could materially impact our financial statements.***

From time to time the Financial Accounting Standards Board and the SEC change the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can be very difficult to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in our restating prior period financial statements.

### ***The Preferred Stock diminishes the net income available to our common shareholders and earnings per common share.***

We have issued \$27 million of Preferred Stock to the U.S. Treasury pursuant to the Troubled Asset Relief Program ( TARP ) Capital Purchase Program. See BUSINESS Supervision and Regulation Troubled Asset Relief Program. The dividends accrued on the Preferred Stock reduce the net income available to common shareholders and our earnings per common share. The Preferred Stock is cumulative, which means that any dividends not declared or paid will accumulate and will be payable when the payment of dividends is resumed. We have deferred the payment of quarterly dividends on the Preferred Stock, beginning in December 2009. The dividend rate on the Preferred Stock will increase from 5% to 9% per annum five years after its original issuance if not earlier redeemed. If we are unable to redeem the Preferred Stock prior to the date of this increase, the cost of capital to us will increase substantially. Depending on our financial condition at the time, this increase in the Preferred Stock annual dividend rate could have a material adverse effect on our earnings and could also adversely affect our ability to pay dividends on our common shares. Shares of Preferred Stock will also receive preferential treatment in the event of the liquidation, dissolution or winding up of the Company.

Finally, the terms of the Preferred Stock allow the U.S. Treasury to impose additional restrictions, including those on dividends and including unilateral amendments required to comply with changes in applicable federal law. Under the terms of the Preferred Stock, our ability to declare or pay dividends on any of our shares is limited. Specifically, we are unable to declare dividend payments on common, junior preferred or pari passu preferred shares if we are in arrears on the dividends on the Series A Preferred Stock. As noted above, we have deferred the payment of dividend payments on the Series A Preferred Stock and we are therefore currently restricted from paying dividends on our common stock. Further, we are not permitted to increase dividends on our common stock above the amount of the last quarterly cash dividend per share declared prior to October 14, 2008 (which was zero) without the U.S. Treasury's approval until the third anniversary of the investment unless all of the Fixed Rate Cumulative Perpetual Preferred Stock has been redeemed or transferred.

### ***Holders of the Preferred Stock have certain voting rights that may adversely affect our common shareholders, and the holders of the Preferred Stock may have interests different from our common shareholders.***

In the event that we fail to pay dividends on the Preferred Stock for a total of at least six quarterly dividend periods (whether or not consecutive), the U.S. Treasury will have the right to appoint two directors to our board of directors until all accrued but unpaid dividends have been paid. In order to conserve the liquid assets of the Company, our board of directors has approved the deferral of the regular quarterly cash dividend on the Preferred Stock, beginning in December 2009. Otherwise, except as required by law, holders of the Preferred Stock have limited voting rights. So long as shares of Preferred Stock are outstanding, in addition to any other vote or consent of shareholders required by



law or our Articles of Incorporation, the vote or consent of holders of at least 66 2/3% of the shares of Preferred Stock outstanding is required for:

any authorization or issuance of shares ranking senior to the Preferred Stock;

any amendments to the rights of the Preferred Stock so as to adversely effect the rights, preferences, privileges or voting power of the Preferred Stock; or

**Table of Contents**

consummation of any merger, share exchange or similar transaction unless the shares of Preferred Stock remain outstanding, or if we are not the surviving entity in such transaction, are converted into or exchanged for preference securities of the surviving entity and the shares of Preferred Stock remaining outstanding or such preference securities have the rights, preferences, privileges and voting power of the Preferred Stock.

The holders of the Preferred Stock, including the U.S. Treasury, may have different interests from the holders of our common stock, and could vote to block the foregoing transactions, even when considered desirable by, or in the best interests of, the holders of our common stock.

***Because of our participation in TARP, we are subject to restrictions on compensation paid to our executives.***

Pursuant to the terms of the TARP Capital Purchase Program, we are subject to regulations on compensation and corporate governance for the period during which the U.S. Treasury holds our Series A Preferred Stock. These regulations require us to adopt and follow certain procedures and to restrict the compensation we can pay to key employees. Key impacts of the regulations on us include, among other things:

ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of Intermountain;

a prohibition on cash incentive bonuses to our five most highly-compensated employees, subject to limited exceptions;

a prohibition on equity compensation awards to our five most highly-compensated employees other than long-term restricted stock that cannot be sold, other than to pay related taxes, until Treasury no longer holds the Series A Preferred Stock;

a prohibition on any severance or change-in-control payments to our senior executive officers and next five most highly-compensated employees;

a required recovery or clawback of any bonus or incentive compensation paid to a senior executive officer or any of the next twenty most highly compensated employees based on financial or other performance criteria that are later proven to be materially inaccurate; and

an agreement not to deduct for tax purposes annual compensation in excess of \$500,000 for each senior executive officer.

The combined effect of these restrictions may make it more difficult to attract and retain key executives and employees, and the change to the deductibility limit on executive compensation may increase the overall cost of our compensation programs in future periods.

***Because of our participation in TARP, we are subject to restrictions on our ability to repurchase our shares.***

Because of our participation in TARP, our ability to repurchase our shares is restricted. The U.S. Treasury's consent generally is required for us to make any stock repurchase until the third anniversary of the investment by the U.S. Treasury unless all of the Series A Preferred Stock has been redeemed or transferred. Further, common, junior preferred or pari passu preferred shares may not be repurchased if we are in arrears on the Series A Preferred Stock dividends. As noted above, we have deferred dividend payments on the Series A Preferred Stock and we are therefore currently restricted from repurchasing our shares.

***Future acquisitions and expansion activities may disrupt our business and adversely affect our operating results.***

We regularly evaluate potential acquisitions and expansion opportunities. To the extent that we grow through acquisitions, we cannot ensure that we will be able to adequately or profitably manage this growth. Acquiring other banks, branches or other assets, as well as other expansion activities, involve various risks including the risks of incorrectly assessing the credit quality of acquired assets, encountering greater than expected costs of incorporating

**Table of Contents**

acquired banks or branches into our company, and being unable to profitably deploy funds acquired in an acquisition.

***We may not be able to replace key members of management or attract and retain qualified relationship managers in the future.***

We depend on the services of existing management to carry out our business and investment strategies. As we expand, we will need to continue to attract and retain senior management and other qualified staff. In particular, because we plan to continue to expand our locations, products and services, we will need to continue to attract and retain qualified commercial banking personnel and investment advisors. Competition for such personnel is significant in our geographic market areas. The loss of the services of any management personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on our business, financial condition and results of operations.

***The market price of our stock can be volatile.***

Our stock price is not traded at a consistent volume and can fluctuate widely in response to a variety of factors, including actual or anticipated variations in quarterly operating results, recommendations by securities analysts and news reports relating to trends, concerns and other issues in the financial services industry. Other factors include new technology used or services offered by our competitors, operating and stock price performance of other companies that investors deem comparable to us, and changes in government regulations.

***We are subject to a variety of operational risks, including reputational risk, legal risk and compliance risk, and the risk of fraud or theft by employees or outsiders, which may adversely affect our business and results of operations.***

We are exposed to many types of operational risks, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, and unauthorized transactions by employees or operational errors, including clerical or record-keeping errors or those resulting from faulty or disabled computer or telecommunications systems.

If personal, non-public, confidential or proprietary information of customers in our possession were to be mishandled or misused, we could suffer significant regulatory consequences, reputational damage and financial loss. Such mishandling or misuse could include, for example, if such information were erroneously provided to parties who are not permitted to have the information, either by fault of our systems, employees, or counterparties, or where such information is intercepted or otherwise inappropriately taken by third parties.

Because the nature of the financial services business involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. Our necessary dependence upon automated systems to record and process transactions and our large transaction volume may further increase the risk that technical flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. We also may be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control (for example, computer viruses or electrical or telecommunications outages, or natural disasters, disease pandemics or other damage to property or physical assets) which may give rise to disruption of service to customers and to financial loss or liability. We are further exposed to the risk that our external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as we are) and to the risk that our (or our vendors') business continuity and data security systems prove to be inadequate. The occurrence of any of these risks could result in a diminished ability of us to operate our business (for example, by requiring us to expend significant resources to correct the defect), as well as potential liability to clients, reputational damage and regulatory intervention, which could adversely affect our business, financial condition and results of operations, perhaps materially.



**Table of Contents*****Certain provisions in our Articles of Incorporation could make a third party acquisition of us difficult.***

Our Articles of Incorporation contain provisions that could make it more difficult for a third party to acquire us (even if doing so would be beneficial to our shareholders) and for holders of our common stock to receive any related takeover premium for their common stock. These provisions include:

certain non-monetary factors that the board of directors may consider when evaluating a takeover offer:

a requirement that any plan of merger or share exchange that would result in a change in control be approved by the affirmative vote of not less than 66 2/3% of the shares entitled to vote (a level in excess of the requirement that would otherwise be imposed by Idaho law); and

division of the board of directors into three classes serving a staggered term of office, with one class of directors elected each year for a three-year term.

These provisions could limit the price that investors might be willing to pay in the future for shares of our common stock.

**Item 1B. UNRESOLVED STAFF COMMENTS**

Not applicable.

**Item 2. PROPERTIES**

At December 31, 2009, the Company operated 19 branch offices, including the main office located in Sandpoint, Idaho. The following is a description of the branch and administrative offices.

City and County	Address	Sq. Feet	Date Opened or Acquired	Occupancy Status (Own/Lease)
<i>Panhandle State Bank Branches</i>				
<b>IDAHO</b>				
<b>(Kootenai County)</b>				
<i>Coeur d'Alene</i> (1)	200 W. Neider Avenue Coeur d'Alene, ID 83814	5,500	May 2005	Own building Lease land
<i>Rathdrum</i>	6878 Hwy 53 Rathdrum, ID 83858	3,410	March 2001	Own
<i>Post Falls</i>	3235 E. Mullan Avenue Post Falls, ID 83854	3,752	March 2003	Own
<b>(Bonner County)</b>				
<i>Ponderay</i>	300 Kootenai Cut-Off Road Ponderay, ID 83852	3,400	October 1996	Own
<i>Priest River</i>	301 E. Albeni Road Priest River, ID 83856	3,500	December 1996	Own
<i>Sandpoint Center Branch</i> (3)	414 Church Street Sandpoint, ID 83864	11,399	January 2006	Lease
<i>Sandpoint (Drive up)</i> (4)		225	May 1981	Own

	231 N. Third Avenue Sandpoint, ID 83864			
<b>(Boundary County)</b>				
<i>Bonnors Ferry</i>	6750 Main Street Bonnors Ferry, ID 83805	3,400	September 1993	Own
<b>(Shoshone County)</b>				
<i>Kellogg</i>	302 W. Cameron Avenue Kellogg, ID 83837	672	February 2006	Lease land Own modular unit
<i>Intermountain Community Bank Branches</i>				

**Table of Contents**

<b>City and County</b>	<b>Address</b>	<b>Sq. Feet</b>	<b>Date Opened or Acquired</b>	<b>Occupancy Status (Own/Lease)</b>
<b>(Canyon County)</b>				
<i>Caldwell</i>	506 South 10 <sup>th</sup> Avenue Caldwell, ID 83605	6,480	March 2002	Own
<i>Nampa</i>	521 12 <sup>th</sup> Avenue S. Nampa, ID 83653	5,000	July 2001	Own
<i>Nampa Loan Production Office</i>	5660 E. Franklin Road, Suite 100 Nampa, ID 83687	2,380	February 2007	Lease
<b>(Payette County)</b>				
<i>Payette</i>	175 North 16 <sup>th</sup> Street Payette, ID 83661	5,000	September 1999	Own
<i>Fruitland</i>	1710 N. Whitley Dr., Ste A Fruitland, ID 83619	1,500	April 2006	Lease
<b>(Washington County)</b>				
<i>Weiser</i>	440 E Main Street Weiser, ID 83672	3,500	June 2000	Own
<i>Magic Valley Bank Branches</i>				
<b>(Twin Falls County)</b>				
<i>Twin Falls</i>	113 Main Ave West Twin Falls, ID 83301	10,798	November 2004	Lease
<i>Canyon Rim(2)</i>	1715 Poleline Road East Twin Falls, ID 83301	6,975	September 2006	Lease
<b>(Gooding County)</b>				
<i>Gooding(2)</i>	746 Main Street Gooding, ID 83330	3,200	November 2004	Lease
<b>OREGON</b>				
<b>(Malheur County)</b>				
<i>Ontario</i>	98 South Oregon St. Ontario, OR 97914	10,272	January 2003	Lease
<i>Intermountain Community Bank Washington Branches</i>				
<b>WASHINGTON</b>				
<b>(Spokane County)</b>				
<i>Spokane Downtown</i>	801 W. Riverside, Ste 400 Spokane, WA 99201	4,818	April 2006	Lease
<i>Spokane Valley</i>	5211 E. Sprague Avenue Spokane Valley, WA 99212	16,000	Sept 2006	Own building Lease land
<b>ADMINISTRATIVE</b>				
<b>(Bonner County)</b>				
<i>Sandpoint Center(3)</i>	414 Church Street Sandpoint, ID 83864	26,725	January 2006	Lease
<b>(Kootenai County)</b>				
<i>Coeur d Alene Branch and Administrative Services(1)</i>	200 W. Neider Avenue Coeur d Alene, ID 83814	17,600	May 2005	Own building Lease land



- 1) The Coeur d'Alene branch is located in the 23,100 square foot branch and administration building located at 200 W. Neider Avenue in Coeur d'Alene. The branch occupies approximately 5,500 square feet of this building.

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**Table of Contents**

- 2) In December 2006, the Company entered in agreements to sell the Gooding and Canyon Rim branches, and subsequently lease them back. The sales were completed in January 2007 and the leases commenced in January 2007.
- 3) In January 2006, the Company purchased land on an installment contract and subsequently began building the 86,100 square foot Sandpoint Center. In second quarter 2008, the Company relocated the Sandpoint branch, corporate headquarters and administrative functions to the Sandpoint Center. The building also contains technical and training facilities, an auditorium and community room and space for other professional tenants. In August 2009, the Company sold the building and provided financing for the purchase of the building. Due to the non-recourse financing, the transaction was accounted for using the financing method.
- 4) The Sandpoint branch drive-up is located in the 10,000 square foot building which housed the Sandpoint Branch before it was relocated to the Sandpoint Center. The square footage of the drive-up totals 225 square feet. The Company has leased out part of the remaining space, and is currently pursuing tenants to occupy the other vacant square footage in this building.

**Item 3. *LEGAL PROCEEDINGS***

Intermountain and Panhandle are parties to various claims, legal actions and complaints in the ordinary course of business. In Intermountain's opinion, all such matters are adequately covered by insurance, are without merit or are of such kind, or involve such amounts, that unfavorable disposition would not have a material adverse effect on the consolidated financial position or results of operations of Intermountain.

**Item 4. *SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS***

Not applicable.

**PART II**

**Item 5. *MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES***

**Market Price and Dividend Information**

Bid and ask prices for the Company's Common Stock are quoted in the Pink Sheets and on the OTC Bulletin Board under the symbol IMCB.OB. As of March 5, 2010, there were 14 Pink Sheet/Bulletin Board Market Makers. The range of high and low closing prices for the Company's Common Stock for each quarter during the two most recent fiscal years is as follows:

**Quarterly Common Stock Price Ranges**

Quarter	2009		2008	
	High	Low	High	Low
1st	\$ 5.20	\$ 3.40	\$ 15.00	\$ 11.65
2nd	4.00	3.25	13.10	6.90
3rd	3.30	1.90	8.80	5.70

<b>4th</b>	3.50	2.06	7.25	4.32
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At March 5, 2010 the Company had 8,383,379 shares of common stock outstanding held by approximately 1,013 shareholders. As a bulletin board stock, Intermountain's stock is relatively thinly traded, with daily average volumes totaling 3,984 in 2009 and 2,418 in 2008, respectively.

The Company historically has not paid cash dividends, nor does it expect to pay cash dividends in the near future. The Company is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval. These restrictions may affect the amount of dividends the Company may declare for distribution to its shareholders in the future.

**Table of Contents**

Other than discussed below, there have been no securities of the Company sold within the last three years that were not registered under the Securities Act of 1933, as amended. The Company did not make any stock repurchases during the fourth quarter of 2009.

On December 19, 2008, the Company issued 27,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, no par value with a liquidation preference of \$1,000 per share ( Preferred Stock ) and a ten-year warrant to purchase up to 653,226 shares of Common Stock, no par value, as part of the Troubled Asset Relief Program Capital Purchase Program of the U.S. Department of Treasury ( U.S. Treasury ). The \$27.0 million cash proceeds were allocated between the Preferred Stock and the warrant to purchase common stock based on the relative estimated fair values at the date of issuance. The fair value of the warrants was determined under the Black-Scholes model. The model includes assumptions regarding the Company's common stock prices, dividend yield, and stock price volatility as well as assumptions regarding the risk-free interest rate. The strike price for the warrant is \$6.20 per share.

Dividends on the Preferred Stock will accrue and be paid quarterly at a rate of 5% per year for the first five years and thereafter at a rate of 9% per year. The shares of Preferred Stock have no stated maturity, do not have voting rights except in certain limited circumstances and are not subject to mandatory redemption or a sinking fund.

The Preferred Stock has priority over the Company's Common Stock with regard to the payment of dividends and liquidation distributions. The Preferred Stock qualifies as Tier 1 capital. The agreement with the U.S. Treasury contains limitations on certain actions of IMCB, including the payment of quarterly cash dividends on IMCB's common stock in excess of current cash dividends paid in the previous quarter and the repurchase of its common stock during the first three years of the agreement. In addition, IMCB agreed that, while the U.S. Treasury owns the Preferred Stock, IMCB's employee benefit plans and other executive compensation arrangements for its senior executive officers must comply with Section 111(b) of the Emergency Economic Stabilization Act of 2008.

**Equity Compensation Plan Information**

The Company has historically maintained equity compensation plans that provided for the grant of awards to its officers, directors and employees. These plans consisted of the 1988 Employee Stock Option Plan, the Amended and Restated 1999 Employee Stock Option and Restricted Stock Plan and the 1999 Director Stock Option Plan. Each of these plans has expired and shares may no longer be awarded under these plans. However, unexercised options or unvested awards remain under these plans. Management does not intend at this time to seek shareholder approval to renew these plans at the 2010 annual shareholders meeting. The following table sets forth information regarding shares reserved for issuance pursuant to outstanding awards:

<b>Plan Category</b>	<b>Number of Shares</b>	<b>Weighted-Average</b>	<b>Number of Shares</b>
	<b>to be Issued Upon</b>		<b>Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Shares Reflected in Column(a) (c))</b>
	<b>Exercise of Outstanding Options, Warrants and Rights (a)</b>	<b>Exercise Price of Outstanding Options, Warrants and Rights (b)</b>	

Equity compensation plans approved by shareholders	351,253	\$	6.35
Total	351,253	\$	6.35

**Table of Contents****Five-Year Stock Performance Graph**

The following graph shows a five-year comparison of the total return to shareholders of Intermountain's common stock, the SNL Securities \$500 million to \$1 billion Bank Asset Size Index ( SNL Index ) and the Russell 2000 Index. All of these cumulative returns are computed assuming the reinvestment of dividends at the frequency with which dividends were paid during the applicable years.

**Total Return Performance**

	<b>12/31/2004</b>	<b>12/31/2005</b>	<b>12/31/2006</b>	<b>12/31/2007</b>	<b>12/31/2008</b>	<b>12/31/2009</b>
Intermountain Community Bancorp	\$ 100	\$ 93	\$ 144	\$ 99	\$ 29	\$ 16
SNL Index	\$ 100	\$ 102	\$ 114	\$ 89	\$ 55	\$ 51
Russell 2000	\$ 100	\$ 103	\$ 121	\$ 118	\$ 77	\$ 96

**Table of Contents****Item 6. SELECTED FINANCIAL DATA**

The following selected financial data (in thousands) of the Company is derived from the Company's historical audited consolidated financial statements and related notes. The information set forth below should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and related notes contained elsewhere in this Form 10-K.

	<b>For the Year Ended December 31, (2)</b>				
	<b>2009(1)(4)</b>	<b>2008(1)(4)</b>	<b>2007(1)(4)</b>	<b>2006(1)(4)</b>	<b>2005(1)</b>
<b>INCOME STATEMENT DATA</b>					
Total interest income	\$ 53,867	\$ 63,809	\$ 72,858	\$ 59,580	\$ 41,648
Total interest expense	(16,170)	(20,811)	(26,337)	(17,533)	(10,717)
Net interest income	37,697	42,998	46,521	42,047	30,931
Provision for loan losses	(36,329)	(10,384)	(3,896)	(2,148)	(2,229)
Net interest income after provision for losses on loans	1,368	32,614	42,625	39,899	28,702
Total other income	11,991	13,932	13,199	10,838	9,620
Total other expense	(49,630)	(45,372)	(40,926)	(35,960)	(26,532)
Income (loss) before income taxes	(36,271)	1,174	14,898	14,777	11,790
Income tax (provision) benefit	14,360	80	(5,453)	(5,575)	(4,308)
Net income	(21,911)	1,254	9,445	9,202	7,482
Preferred stock dividend	1,662	45			
Net income (loss) applicable to common stockholders	\$ (23,573)	\$ 1,209	\$ 9,445	\$ 9,202	\$ 7,482
Net income (loss) per share(2)					
Basic	\$ (2.82)	\$ 0.15	\$ 1.15	\$ 1.15	\$ 1.06
Diluted	\$ (2.82)	\$ 0.14	\$ 1.10	\$ 1.07	\$ 0.97
Weighted average common shares outstanding(2)					
Basic	8,361	8,295	8,206	8,035	7,078
Diluted	8,361	8,515	8,605	8,586	7,684
Cash dividends per share					
<b>BALANCE SHEET DATA</b>					
Total assets	\$ 1,079,644	\$ 1,105,555	\$ 1,048,659	\$ 920,348	\$ 734,099
Net loans(3)	655,602	752,615	756,549	664,885	555,453

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Deposits	819,321	790,412	757,838	693,686	597,519
Securities sold subject to repurchase agreements	95,233	109,006	124,127	106,250	37,799
Advances from Federal Home Loan Bank	49,000	46,000	29,000	5,000	5,000
Other borrowings	16,527	40,613	36,998	22,602	16,527
Stockholders' equity	88,627	110,485	90,119	78,080	64,273