INTERMOUNTAIN COMMUNITY BANCORP
Form 10-K
March 04, 2011

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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, 2010

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	**82-0499463**
(State or other jurisdiction of incorporation or organization)	*(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	**None**
(Title of each class)	*(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 o No þ

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 o No þ

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 þ No o

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 o No o

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. o

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 o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

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

As of June 30, 2010, 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 $12,252,000.

The number of shares outstanding of the registrant s Common Stock, no par value per share, as of February 28, 2011 was 8,406,578.

DOCUMENTS INCORPORATED BY REFERENCE

Specific portions of the registrant s Proxy Statement for the 2011 Annual Meeting of Shareholders are incorporated by reference into Part III hereof.

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PART I

Forward-Looking Statements

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains 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 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:

- further deterioration in economic conditions that could result in increased loan and lease losses;
- risks associated with concentrations in real estate-related loans;
- declines in real estate values supporting loan collateral;
- our ability to comply with the requirements of regulatory orders issued to us and/or our banking subsidiary;
- 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;
- applicable laws and regulations and legislative or regulatory changes, including the ultimate financial and operational burden of the recently enacted financial regulatory reform legislation and related regulations;
- 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;
- 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;

our ability to attract new deposits and loans and leases;

competitive market pricing factors;

stability of funding sources and continued availability of borrowings;

Intermountain s success in gaining regulatory approvals, when required;

results of regulatory examinations that could restrict growth;

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

the impact of the Emergency Economic Stabilization Act of 2008 (EESA), the American Recovery and Reinvestment Act of 2009 (ARRA) and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) 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*

General

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.

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.

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 continues to work through the challenges of the current economic downturn, while positioning itself to prosper in the economy and markets of the future. Its strengths provide the foundation for future growth and profitability, and include the following:

A strong, loyal and low-cost deposit franchise with proven growth capabilities: 64% of Intermountain s deposits at December 31, 2010 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 Deposit Market Share and Federal Financial Institutions Examination Council (FFIEC) Uniform Bank Performance Report (UBPR) data).

A high net interest margin (3.97% and 3.77% for the quarter and year ended December 31, 2010, respectively) relative to peers with opportunity for additional improvement if rates rise or the economy improves: Intermountain has consistently maintained a higher net interest margin than its peer group (Source: UBPR data), and believes it has positioned its balance sheet to protect against current challenges, and provide for opportunities 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 several years, Intermountain has focused on upgrading talent, technology and operational processes to facilitate further balance sheet growth while simultaneously reducing the expenses associated with these upgrades.

A young, but highly experienced, management team: The executive and senior management team averages about 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.

Management believes that the economic and financial crises of the past several years have fundamentally changed the future landscape for community banks. In a slower growth, more conservative environment, further consolidation of the industry is inevitable. Those banks and management teams with strong market positions, solid infrastructure, and staying power will be able to capitalize on the opportunities created by this changing environment. Management has defined potential opportunities in terms of prospects within the Company s 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 it is increasingly well-positioned to succeed in the changing landscape.

Lending conditions are currently challenging, with low borrowing demand, tight underwriting standards and challenging appraisal conditions. However, 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. While loan rate competition is likely to increase in the short term as banks aggressively pursue high-quality customers, management also believes that credit spreads may widen in the long-term as more consolidation occurs. When combined with expected market rate hikes, the Company s high proportion of variable rate loans should lead to improved asset yields in the future.

We believe 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 larger banks and smaller, more stressed competitors in its defined core and growth markets. Based on FDIC call report data, the Company has identified approximately $742.9 million in deposits at banks in its core markets that are exhibiting relatively high levels of distress, and another $781.7 million in its growth markets. When combined with potential organic growth, a relatively small capture of these distressed deposits over the next few years could allow the Company to rapidly expand its total deposits. More immediately, management has taken strong steps to reduce its current deposit and borrowing rates, which will produce lower interest expense in future periods. It sees additional opportunities to decrease its cost of funds and interest expense by continuing to reprice down maturing CDs, lower transaction account interest rates, and pay off or replace higher rate wholesale funding vehicles.

Management has undertaken significant efforts to improve its efficiency, and is confident that it can continue reducing its non-interest expenses. The last three years have been challenging as the Company 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. These improvements are now becoming increasingly apparent in the financial statements as the full impact of moves made in late 2009 and throughout 2010 register and credit operations costs begin to subside. In the future, management believes the infrastructure that has been built will allow the Company to expand its assets and revenues while tightly controlling its expense levels. When combined with lower anticipated credit costs, this should lead to rapid improvement in efficiency rates. During 2011, management will continue to focus on rationalizing its cost structure and restructuring organizational processes to deliver better service at lower costs.

Management believes that non-interest revenue growth may be challenging in the near-term because of new regulatory restrictions, particularly on overdraft and debit card 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 accounts and usage, pursuing other partners to work with on its secured savings credit card program, restructuring and enhancing its deposit and cash management service fees, and reducing waiver rates on current service fees.

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, we believe that attractive acquisition opportunities within our footprint will soon appear and that Intermountain could be in a unique position to capitalize on them. Intermountain is the largest publicly traded bank holding company headquartered in Idaho, with branches located throughout the state 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 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 publicly traded bank holding company headquartered in Idaho. After two decades of almost uninterrupted economic and population growth, the Idaho economy continued to struggle in 2010. Population growth in the state was the 4th fastest of any state over the period from 2000 to 2010, increasing by 21 percent during this time period. Population growth slowed in 2009 and 2010, with total 2010 growth estimated at 1.4%. Based on U.S. Census Bureau estimates, the State is projected to sustain future population growth rates in excess of the national average for the next 10 years. Idaho experienced rapid employment growth during the period of 2000 to 2008 (14% versus U.S. 8%), sustained net job losses in 2009, and then rebounded slightly in 2010 (Source: Idaho Department of Labor). The unemployment rate at the end of 2010 was 9.5%, slightly above the national average of 9.4%. However, job losses appear to be moderating and longer-term prospects for the economy are still strong. The Idaho Department of Labor forecasts unemployment at about 8.5% by the end of 2011, with employment expected to rise between 14% and 16% between now and 2018. These prospects are based on a diverse economic base, including agriculture, health care, technology, light manufacturing, retirement, tourism, education 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 has balanced the budget without increasing taxes or creating new burdensome business regulations.

Real estate valuations throughout the state have shown considerable variability, based on specific geographical location and type of property. In general, Idaho has experienced higher than average foreclosure rates over the past year, which is reflected in the price decline of 7.0% (Source: FDIC Third Quarter, 2010 State Profile). The Boise area has been hit harder than the rest of the State, with price declines on finished properties averaging 20% to 40% as a result of increasing unemployment earlier in the recession 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 10% to 30% 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: Auble Idaho and Eastern Washington Real Estate Report). It appears that prices are approaching stabilization, with various areas, including

Boise, southwest rural Idaho, and parts of north Idaho appearing 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 continue benefiting 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 northern Idaho and eastern Washington economy lagged the rest of the country and state in terms of feeling the impacts of the recession. In 2010, however, the recession caught up with the area. Unemployment rates in north Idaho have risen to an average exceeding 10% in December 2010, and real estate values have declined. However, 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 the unemployment rates are high in north Idaho, they have historically been high, so the relative impact is not as significant. Spokane has weathered the jobs downturn better, with an unemployment rate of 9.1% in December 2010 (Washington State Employment Security Department Labor Market & Economic Analysis). Strength in health care, agri-business, private education, technology and transportation have buffered eastern Washington from harder shocks. Data on real estate activity is limited for much of this region, but it generally appears that residential home price declines have ranged from 5% to 25%, while lot prices are down 20% to 50% based on location. Commercial real estate activity and pricing has softened, although there is not a significant overhang of commercial properties in this region. Intermountain holds 56% of its loans and 48% 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, cushioning the impact of the downturn on these counties. Unemployment is historically high in this area, and stood at 10.5% in December 2010, 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 19% of its loans and 21% 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 were 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 was 9.9% in December 2010, but some forecasters expect improvement in 2011 as the area s technology industry continues to recover. Real estate price declines have been the steepest of any in the Company s market areas, ranging from 25% to 35% 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. 11% of the Company s loans and 10% 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 2010 unemployment rate of 8.4%. 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 20% 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 $6.1 billion, of which Intermountain held $771 million or 13% (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 totaled $12.3 billion at June 30, 2010 and Intermountain held $39 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 distressed competitors.

Competition

As noted previously, based on total asset size and deposit balances as of December 31, 2010, 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 12.6%. Based on the June 2010 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. The Company also sees opportunities in the Idaho and eastern Washington counties contiguous to its current service area, as they contain a number of smaller struggling competitors, and management is familiar with many of the bankers and customers in these markets.

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 regulatory constraints, and additional credit losses created by market disruption and significant levels of disposition of loan collateral at depressed prices.

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 and/or collateral life, 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 ratio (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 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 has drastically curtailed 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 verified and documented 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 and leases are available to municipal entities, many of which qualify for financing on a tax-exempt basis. Operating loans are generally restricted by law to the duration of one fiscal year. Term loans and leases, 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 offerings are generally competitive with both large and small direct competitors and provide strong opportunities for fee income generation through direct service charges, transaction 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 electronic statements, mobile-phone banking access, 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.

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 2010, net loans receivable, which includes loans the Company generally intends to keep until repayment or maturity, decreased by 14.1% or $92.4 million. The majority of the decline was in land and land development loans, down $27.6 million, commercial construction loans, down $27.6 million, agricultural loans, down $22.9 million, and residential construction loans, down $13.4 million. Loans held for sale, primarily residential real estate loans originated for sale in the secondary market, decreased by $3.1 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 tightened standards so that new funding for residential land, subdivision and development, and speculative residential construction lending has generally ceased. Any future lending in this area would require relatively 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 various scenarios. Commercial and consumer standards were also tightened to reflect tougher economic conditions and generally reduced borrower strength.

Overall demand for commercial and commercial real estate loans softened, leading to relatively static balances in these types as well. The decrease in agricultural loans reflected the very strong year that area farmers had in 2010, which reduced the overall need to borrow and sped up the timing of repayment on their annual operating lines. 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 developing a weekly senior management review of all credit requests over $250,000, continuing to centralize credit approval and monitoring functions, 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 increased from 5.92% in 2009 to 6.01% in 2010 as the Federal Reserve maintained the target fed funds rate at about 0.23%. 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 remained low, pressuring the Company s loan yields in 2010. In addition, the reversal of interest on non-accrual and charged off loans, totaling $794,000 in 2010, compared to $1.9 million in 2009 had an impact on loan yields, reducing the overall loan yield by 0.08% in 2010, compared to 0.26% in 2009.

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.

Construction and Development Loans

Management has focused over the past several years on shifting the mix of the loan portfolio away from residential construction, acquisition and development loans to a more balanced mix of commercial, agriculture, commercial real estate, and residential real estate loans. 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 construction, land and land development, and residential construction categories have declined by $68.7 million from December 31, 2009 to December 31, 2010 and by $85.8 million from December 31, 2008 to December 31, 2009.

After the aggressive reduction efforts of the last two years, the land development and construction loan components pose much lower concentration risk for the total loan portfolio. However, the weakness of the overall construction sector still poses risk to the remaining construction and development portfolio. 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 three 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 its risk.

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, 2010, agricultural loans and agricultural real estate loans totaled $87.4 million or 15.2% 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 had 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. 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 (19%), industrial (13%), multifamily (13%), health care (6%), and retail (5%). The other 44% 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 1.1% of the commercial real estate portfolio, although there are also several unfinished condo projects in the construction and development portfolio.

While 66% 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, 76% 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 from the prior year.

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.

As of December 31, 2010, the risk grades 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 satisfactory, special mention, doubtful and loss , respectively. Risk Grade 4 is an internally designated watch category. At December 31, 2010, the Company had $14.0 million in the special mention, $54.1 million in the substandard, an immaterial amount in the doubtful and $0 in the loss loan categories. 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.

Overall, classified loans (loans with risk grades 6, 7, or 8) decreased from $77.2 million at the end of 2009 to $54.1 million at the end of 2010. The decrease reflected the Company s efforts in resolving or liquidating problem loans during the past year, even amidst economic conditions that were still very challenging. The continued levels of classified assets reflect poor employment conditions and slow real estate markets in the Company s market areas.

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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. Total non-accrual loans decreased from $18.5 million at December 31, 2009 to $11.5 million at the end of 2010. 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 2010, 2009, 2008, 2007 and 2006 on non-accrual and other problem loans was approximately $794,000, $1.9 million, $465,000, $161,000 and $21,000, 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.

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)

	December 31, 2010			
	Percent of Loans to Total Loans	**Gross Loans**	**Allowance**	**Non-Accrual Loans**
Commercial loans	21.31%	$ 122,656	$ 2,925	$ 3,859
Commercial real estate loans	30.50	175,559	3,655	3,566
Commercial construction loans	3.12	17,951	540	71
Land and land development loans	10.59	60,962	2,408	1,910
Agriculture loans	15.18	87,364	779	582
Multifamily loans	4.59	26,417	83	
Residential real estate loans	10.57	60,872	1,252	964
Residential construction loans	0.56	3,219	65	110
Consumer loans	2.45	14,095	613	389
Municipal loans	1.13	6,528	135	
Totals	100.00%	$ 575,623	$ 12,455	$ 11,451

	December 31, 2009			
	Percent of Loans to Total Loans	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

	December 31, 2008			
	Percent of Loans to Total Loans	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

	December 31, 2007			
	Percent of Loans to Total Loans	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

	December 31, 2006			
	Percent of Loans to Total Loans	Gross Loans	Allowance	Non-Accrual Loans
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

In the table above, commercial loans for the periods 2006-2008 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 the subsequent years 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 regional 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 reviewed and 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 reasonable, reliable and verifiable reserve calculation and is in compliance with recent regulatory guidance. The Bank s total allowance for loan losses was 2.16% of total loans at December, 31, 2010 and 2.47% of total loans at December 31, 2009. The decrease in the ratio is due primarily to the reduction in the loan portfolio and the level of classified and non-performing loans over the same period. Chargeoffs outpaced the loan loss provision in 2010 due to management s aggressive reduction of problem credits during 2010. In addition, in the third quarter of 2010, one large commercial credit was charged off in the amount of $4.5 million for which some recovery is anticipated in future periods.

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, 2010

Loan Repricing	**Fixed Rate**	**Variable Rate**	**Total Loans**
	(Dollars in thousands)		
0-90 days	$ 31,536	$ 129,208	$ 160,744
91-365 days	44,036	83,429	127,465
1 year-5 years	120,743	122,719	243,462
5 years or more	39,791	4,161	43,952
Total	$ 236,106	$ 339,517	$ 575,623

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 0.7% to $183.1 million at December 31, 2010 from $181.8 million at December 31, 2009. The carrying value of the held-to-maturity securities portfolio increased 46.4% to $22.2 million at December 31, 2010 from $15.2 million at December 31, 2009. During 2010, the Company deployed funds from reductions in the Company s loan portfolio 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 an environment where short rates stayed very low and the yield curve steepened on the long end, the Company sought to maintain the yield on the investment portfolio, while positioning it for higher rates in the future. In doing so, the Company generally maintained a short duration in its portfolio, but did purchase a small block of high quality longer-term municipals to maintain yield. Overall, 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 2.9 years and 8.2 years, respectively on December 31, 2010, compared to 2.8 years and 8.5 years, respectively on December 31, 2009. The average duration differs from the investment s 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 and readily available pricing exists for securities totaling $153.6 million classified as available for sale as of December 31, 2010. 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 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 $29.5 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, a less active market existed for these securities at December 31, 2010. This is evidenced by a widening in the bid-ask spread for these types of securities and the smaller 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, 2010 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 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 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.

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

Investment Portfolio Detail
As of December 31, 2010

Carrying Value as of December 31,	2010 Amount	Percent Change Prev. Yr.	2009 Amount	Percent Change Prev. Yr.	2008 Amount
	(Dollars in thousands)				
U.S. treasury securities and obligations of government agencies	$ 3,894	7,535.29%	$ 51	(99.32)%	$ 7,546
Mortgage-backed securities & collateralized mortgage obligations (CMOs)	173,957	(4.28)	181,733	29.74	140,072
State and municipal bonds	27,447	80.85	15,177	(13.79)	17,604
Total	$ 205,298	4.23%	$ 196,961	19.21%	$ 165,222
Available-for-Sale	183,081	0.71	181,784	23.14	147,618
Held-to-Maturity	22,217	46.39	15,177	(13.79)	17,604
Total	$ 205,298	4.23%	$ 196,961	19.21%	$ 165,222

Investments held as of December 31, 2010
Mature as follows:

	One Year Amount	One Year Yield	One to Five Years Amount	One to Five Years Yield	Five to Ten Years Amount	Five to Ten Years Yield	Over Ten Years Amount	Over Ten Years Yield	Total Amount	Total Yield
	(Dollars in thousands)									
U.S. treasury securities and obligations of government agencies	$ 3	0.76%	$ 28	2.02%	$ 3,894	2.08%	$	0.00%	$ 3,925	2.08%
Mortgage-backed securities & CMOs	458	3.90	2,836	3.58	31,492	4.24	139,140	4.06	173,926	4.03
State and municipal bonds (tax equivalent)	297	3.08	708	3.77	5,930	4.04	20,512	5.12	27,447	4.83
Total	$ 758	3.58%	$ 3,572	3.60%	$ 41,316	4.01%	$ 159,652	4.19%	$ 205,298	4.10%

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 risk-adjusted returns. At December 31, 2010, 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.

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 $131.8 million in excess funds at the Federal Reserve at December 31, 2010, as compared to $81.7 million in Fed Funds Sold at December 31, 2009. At December 31, 2010, 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 2010, 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 $101.1 million as a strategy to preserve and enhance liquidity during a period of continuing market turmoil. This compares to an average balance of Fed Funds Sold in 2009 of $43.9 million. The higher level of Fed Funds Sold maintained during 2010 resulted in a decrease in interest income and net interest income as the Fed Funds Sold yield during 2010 was at historically low levels of between 0.00% and 0.25%.

Deposits

Deposit Composition & Trends	December 31, 2010 Amount	%	December 31, 2009 Amount	%
	(Dollars in thousands)			
Demand	$ 168,519	21.6	$ 168,244	20.5
NOW and money market 0.0% to 4.65%	327,891	42.1	340,070	41.6
Savings and IRA 0.0% to 5.75%	75,387	9.7	77,623	9.5
Certificate of deposit accounts (CDs) under $100,000	79,533	10.2	86,381	10.5
Jumbo CDs	77,685	10.0	82,249	10.0
Brokered CDs	40,899	5.3	54,428	6.6
CDARS CDs to local customers	8,919	1.1	10,326	1.3
Total deposits	$ 778,833	100.0	$ 819,321	100.0
Weighted average interest rate on certificates of deposit		1.66%		2.52%
Core Deposits as a percentage of total deposits(1)		83.2%		81.6%
Deposits generated from the Company s market area as a % of total deposits		94.8%		93.4%

(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 $778.8 million, representing 82.4% of the Bank s liabilities at December 31, 2010. Total deposits decreased 4.9% in 2010, largely as a result of reductions in wholesale brokered CDs and higher-priced retail CDs where the bank did not have other accounts with the depositor. Given the high level of liquid assets, the Company moved aggressively to price down its deposit portfolio and allowed brokered, collateralized and single-service deposit accounts to run off. Total transaction account deposits (demand, NOW and money market) comprise 63.7% of total deposits, a percentage that significantly exceeds peer group averages. The Company continues to emphasize growth in low-cost transaction account balances to minimize its cost of funding, enhance fee income and other cross-selling opportunities, and match its asset composition.

65% of the Company s transaction accounts have been in existence for more than three years. When combined with the 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.

The Company s strong local, core funding base, high percentage of checking, money market and savings balances and careful management of its brokered CD funding provide lower-cost, more reliable funding to the Company than most of its peers and add to the liquidity strength of the Bank. Maintaining the local funding base at a reasonable cost remains a critical priority for the Company s management and production staff. The Company uses a combination of proactive branch staff efforts and a dedicated team of deposit sales specialists to target and grow low-cost deposit balances. It emphasizes personalized service, local community involvement and targeted campaigns to generate deposits, rather than media campaigns or advertised rate specials. The introduction of new sales platform technology, web-banking enhancements, and social networking capabilities in 2010 should spur additional low cost deposit growth when the Company needs it in the future.

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.

Business checking, NOW, money market and savings balances comprise about 42% of total non-maturity deposits, and consumer about 58%. 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 Company currently holds $22.5 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 2012, and Intermountain is pursuing opportunities to expand its management of secured savings accounts with other potential card providers.

The following table details re-pricing information for the Bank s time deposits with minimum balance of $100,000 at December 31, 2010 (in thousands):

Maturities/Repricing	
Less than three months	$ 37,655
Three to six months	10,316
Six to twelve months	27,661
Over twelve months	57,018
	$ 132,650

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 market share for the past ten years. See the market share information under Competition on page 9 of this report for more information.

By repricing its portfolio, the Company succeeded in lowering the 2010 interest cost on its interest-bearing deposits by 0.55%. This resulted in overall liability interest costs to the Bank being 0.22% below the average of its peer group as of December 31, 2010 (Source: UBPR for December 31, 2010). 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, 2010, 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, 2010 the Bank had a $5.0 million FHLB advance at 1.49% that matures in September 2011, a $25.0 million FHLB advance at 2.06% that matures in October 2012, and a $4.0 million FHLB advance at 3.11% that matures in September 2014. These notes totaled $34.0 million, and the Bank had the ability to borrow an additional $83.6 million from the FHLB.

The Bank has the ability to borrow up to $24.3 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, 2010, the Bank had no borrowings outstanding under this line.

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 0.27%, 0.36%, and 2.00% at December 31, 2010, 2009 and 2008, respectively. The average balances of securities sold subject to repurchase agreements were $87.2 million, $82.6 million, and $102.5 million during the years ended December 31, 2010, 2009 and 2008, respectively. The maximum amount outstanding at any month end during these same periods was $105.1 million, $100.3 million, and $124.4 million, respectively. The increase in the repurchase amounts during 2010 reflected movement of municipal funds into sweep agreements as a result of changes in FDIC coverage on low interest bearing accounts, and lower rates on municipal investment alternatives. In 2006, the Company entered into an institutional repurchase agreement to reduce interest rate risk in a down-rate environment. For all of 2010, this structured agreement carried an effective interest cost of 0.00%. At December 31, 2010, 2009, and 2008, the Company pledged as collateral certain investment securities with aggregate amortized costs of $126.2 million, $125.4 million, and $114.8 million, respectively. These investment securities had market values of $128.7 million, $125.7 million, and $116.3 million at December 31, 2010, 2009 and 2008, 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 was callable by the Company starting 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 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. At December 31, 2010, the total deferred interest payments totaled $682,000.

Employees

The Company employed 349 full-time equivalent employees at December 31, 2010, down from 406 at the end of 2009 and 418 at the end of 2008. 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 2009 and 2010 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 specifically 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. Recently, 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 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

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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 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. 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. As a result of the Dodd-Frank Act, prior restrictions on de novo branching by out of state banks have been removed. The Dodd-Frank Act generally permits all banks to branch into other states by opening a new branch or purchasing a branch from another financial institution, to the extent that banks chartered under the state in which the new branch is located can do so. In the past, the Interstate Act barred all financial institutions, except for thrifts, from branching into other states unless they purchased or merged with a bank located in the other state.

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. The Company entered into an informal agreement with the Federal Reserve and the Idaho Department of Finance, which requires the Company to obtain advance approval from the Federal Reserve and the Idaho Department of Finance prior to paying any dividends. Payment of cash dividends by the Company will depend on sufficient earnings to support them and approval of appropriate bank regulatory authorities.

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-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 supervisory corrective actions. At each successively lower capital category, an insured bank is subject to increased restrictions on its operations. 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 schedule. The frequency of consumer compliance and 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

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.

As a publicly 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 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

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.

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.

The Emergency Economic Stabilization Act of 2008

Emergency Economic Stabilization Act of 2008. In response to market turmoil and financial crises affecting the overall banking system and financial markets in the United States, the Emergency Economic Stabilization Act of 2008 (EESA) was enacted on October 3, 2008. EESA 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.

Troubled Asset Relief Program

Under the EESA, the Treasury has authority, among other things, to purchase up to $700 billion in mortgage loans, mortgage-related securities and certain other financial instruments, including debt and equity securities issued by financial institutions pursuant to the Troubled Asset Relief Program (TARP). The purpose of TARP is to restore confidence and stability to the U.S. banking system and to encourage financial institutions to increase lending to customers and to each other. Pursuant to the EESA, the Treasury was initially authorized to use $350 billion for TARP. Of this amount, the Treasury allocated $250 billion to the TARP Capital Purchase Program (CPP), which funds were used to purchase preferred stock from qualifying financial institutions. The CPP provides direct equity investment of 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.

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). The Company entered into an informal agreement with the Federal Reserve and the Idaho Department of Finance, which requires the Company to obtain advance approval from the Federal Reserve and the Idaho Department of Finance prior to paying any dividends including dividends on the Preferred Stock. Under the CPP, if the Company fails to pay dividends on the Preferred Stock for 6 quarters, Treasury may appoint two members to the Company s board of directors.

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, including 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 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) restrictions 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, and (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. 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. Another program established pursuant to the EESA is the Temporary Liquidity Guarantee Program (TLGP), which (i) removed the limit on FDIC deposit insurance coverage for non-interest bearing transaction accounts through December 31, 2009, and (ii) provided FDIC backing for certain types of senior unsecured debt issued from October 14, 2008 through June 30, 2009. The end-date for issuing senior unsecured debt was later extended to October 31, 2009 and the FDIC also extended the Transaction Account Guarantee portion of the TLGP through December 31, 2010. Financial institutions that did not opt out of unlimited coverage for non-interest bearing accounts were initially charged an annualized 10 basis points on individual account balances exceeding $250,000, and those issuing FDIC-backed senior unsecured debt were initially charged an annualized 75 basis points on all such debt, although those rates were subsequently increased. We elected to fully participate in both parts of the TLGP.

Deposit Insurance

The Bank s deposits are insured under the Federal Deposit Insurance Act, up to the maximum applicable limits and are subject to deposit insurance assessments designed to tie what banks pay for deposit insurance more closely to the risks they pose. The Bank has prepaid its quarterly deposit insurance assessments for 2011 and 2012 pursuant to applicable FDIC regulations, but the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) in July 2010 required the FDIC to amend its regulations to redefine the assessment base used for calculating deposit insurance assessments. As a result, in February 2011, the FDIC approved new rules to, among other things, change the assessment base from one based on domestic deposits (as it has been since 1935) to one based on assets (average consolidated total assets minus average tangible equity). Since the new assessment base is larger than the base used under prior regulations, the rules also lower assessment rates, so that the total amount of revenue collected by the FDIC from the industry is not significantly altered. The rule also revises the deposit insurance assessment system for large financial institutions, defined as institutions with at least $10 billion in assets. The rules revise the assessment rate schedule, effective April 1, 2011, and adopt additional rate schedules that will go into effect when the Deposit Insurance Fund reserve ratio reaches various milestones.

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, 2010. On May 20, 2009, the temporary increase was extended through December 31, 2013. The Dodd-Frank Act permanently raises the current standard maximum deposit insurance amount to $250,000. The FDIC insurance coverage limit applies per depositor, per insured depository institution for each account ownership category. EESA also temporarily raised the limit on federal deposit insurance coverage to an unlimited amount for non-interest or low-interest bearing demand deposits. Pursuant to the Dodd-Frank Act, unlimited coverage for non-interest transaction accounts will continue upon expiration of the TLGP until December 31, 2012.

Recent Legislation

Dodd-Frank Wall Street Reform and Consumer Protection Act. As a result of the recent financial crises, on July 21, 2010 the Dodd-Frank Act was signed into law. The Dodd-Frank Act is expected to have a broad impact on the financial services industry, including significant regulatory and compliance changes and changes to corporate governance matters affecting public companies. Many of the requirements called for in the Dodd-Frank Act will be implemented over time and most will be subject to implementing regulations over the course of several years. Among other things, the legislation (i) centralizes responsibility for consumer financial protection by creating a new agency responsible for implementing, examining and enforcing compliance with federal consumer financial laws; (ii) applies the same leverage and risk-based capital requirements that apply to insured depository institutions to bank holding companies; (iii) requires the FDIC to seek to make its capital requirements for banks countercyclical so that the amount of capital required to be maintained increases in times of economic expansion and decreases in times of economic contraction; (iv) changes the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital; (v) requires the SEC to complete studies and develop rules or approve stock exchange rules regarding various investor protection issues, including shareholder access to the proxy process, and various matters pertaining to executive compensation and compensation committee oversight; (vi) makes permanent the $250,000 limit for federal deposit insurance and provides unlimited federal deposit insurance until December 31, 2012, for non-interest bearing transaction accounts; (vii) removes prior restrictions on interstate de novo branching; and (viii) repeals the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts. Many aspects of the

Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on the Company, the Bank and the financial services industry more generally. However, based on past experience with new legislation, it can be anticipated that the Dodd-Frank Act, directly and indirectly, will impact the business of the Company and the Bank and increase compliance costs.

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 through 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.

Overdrafts. On November 17, 2009, the Board of Governors of the Federal Reserve System promulgated the Electronic Fund Transfer rule with an effective date of January 19, 2010 and a mandatory compliance date of July 1, 2010. The rule, which applies to all FDIC-regulated institutions, prohibits financial institutions from assessing an overdraft fee for paying automated teller machine (ATM) and one-time point-of-sale debit card transactions, unless the customer affirmatively opts in to the overdraft service for those types of transactions. The opt-in provision establishes requirements for clear disclosure of fees and terms of overdraft services for ATM and one-time debit card transactions. Since a percentage of the Company s service charges on deposits are in the form of overdraft fees on point-of-sale transactions, this could have an adverse impact on our non-interest income.

Proposed Legislation

Proposed legislation is introduced in almost every legislative session. Certain of such legislation could dramatically affect the regulation of the banking industry. 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 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.

The continued challenging economic environment could have a material adverse effect on our future results of operations or market price of our stock.

The national economy and the financial services sector in particular, are still facing significant challenges. Substantially all of our loans are to businesses and individuals in northern, southwestern and south central Idaho, eastern Washington and southwestern Oregon, markets facing many of the same challenges as the national economy, including elevated unemployment and declines in commercial and residential real estate. Although some economic indicators are improving both nationally and in the markets we serve, unemployment remains high and there remains substantial uncertainty regarding when and how strongly a sustained economic recovery will occur. A further deterioration in economic conditions in the nation as a whole or in the markets 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, results of operations and prospects, and could also cause the market price of our stock to decline:

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.

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 loans with relatively large balances, 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, economic conditions or as a result of actual events turning out differently than forecasted in the assumptions we use to determine 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.

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 taken numerous 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. The Company is actively engaged in negotiations with potential investors for a significant capital raise. However, there can be no assurance that we will be successful in raising the required capital or satisfying all of the other conditions of the agreement within the specified timeframes.

We will pursue additional capital in the future, which likely would 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, if at all. Any such capital raising alternatives likely would 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 year ended December 31, 2010 we incurred a net loss applicable to common stockholders of $33.5 million, or a loss of $3.99 per share primarily due to an $11.7 million goodwill impairment charge, an $8.8 million deferred tax asset valuation allowance and a $24.0 million provision for loan losses. During the 2009 fiscal year, we incurred a net loss applicable to common stockholders 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 loan 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 in 2011, which would continue to have an adverse impact on our financial condition and results of operations and the market price 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.

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 current economic downturn and sluggish recovery is significantly affecting our market area. At December 31, 2010, 63.7% of our loans were secured with real estate as the primary collateral. Further deterioration or a slow recovery 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, 2010, our non-performing loans (which consist of non-accrual loans and loans that are 90 days or more past due) were 2.0% of the loan portfolio. At December 31, 2010, our non-performing assets (which also include OREO) were 1.6% 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 elevated levels of 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. The other primary sources of liquidity for the parent Company are capital or borrowings. 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 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 stockholders or principal and interest payments on our outstanding debt.

In this regard, we have 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 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.

With the suspension of payments on our trust preferred securities and preferred stock, management projects the parent Company s cash needs to be approximately $500,000 on an annualized basis, and that current resources will be sufficient to meet the parent Company s projected liabilities at least through April 2011. Management would expect to satisfy any liquidity needs through borrowings or offerings of equity securities, although there can be no assurance as to the availability or terms of such borrowings or equity capital.

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, 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.

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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.

In 2009, the FDIC imposed a special deposit insurance assessment of five basis points on all insured institutions, and also required insured institutions to prepay estimated quarterly risk-based assessments through 2012.

The Dodd-Frank Act established 1.35% as the minimum deposit insurance fund reserve ratio. The FDIC has determined that the fund reserve ratio should be 2.0% and has adopted a plan under which it will meet the statutory minimum fund reserve ratio of 1.35% by the statutory deadline of September 30, 2020. The Dodd-Frank Act requires the FDIC to offset the effect on institutions with assets less than $10 billion of the increase in the statutory minimum fund reserve ratio to 1.35% from the former statutory minimum of 1.15%. The FDIC has not announced how it will implement this offset or how larger institutions will be affected by it.

Despite the FDIC s actions to restore the deposit insurance fund, the fund will suffer additional losses in the future due to failures of insured institutions. 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 the Company s financial condition and results of operations.

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, 2010, two securities had been determined to be other than temporarily impaired, with the cumulative impairment totaling $3.2 million. Of this $3.2 million, $0.5 million was recognized as a credit loss through the Company s income statement for the twelve months ended December 31, 2009. For the twelve months ended December 31, 2010 an additional $0.8 million was recorded as a credit loss through the Company s income statement. The remaining $1.9 million was recognized in other comprehensive income in 2010 and 2009. 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, 2010, 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, 2010, 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.

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 three 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.

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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 of this Annual Report on Form 10-K, we are subject to extensive regulation, supervision and examination by federal and state banking authorities. In addition, as a publicly traded company, we 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, sweeping financial regulatory reform legislation was enacted in July 2010. Among other provisions, the new legislation (i) creates a new Bureau of Consumer Financial Protection with broad powers to regulate consumer financial products such as credit cards and mortgages, (ii) creates a Financial Stability Oversight Council comprised of the heads of other regulatory agencies, (iii) will lead to new capital requirements from federal banking agencies, (iv) places new limits on electronic debit card interchange fees, and (v) will require the Securities and Exchange Commission and national stock exchanges to adopt significant new corporate governance and executive compensation reforms. The new legislation and regulations are expected to 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.

We cannot predict the full effects of recent legislation or the various other 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 re-pricing 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 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 stockholder or a group of stockholders, 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 higher 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 may 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. In this regard, we established a valuation allowance for deferred income tax assets of $7.4 million at September 30, 2010. An additional $1.4 million valuation allowance was added in the fourth quarter of 2010. 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 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 stockholders and earnings per common share.

We have issued $27.0 million of Preferred Stock to the U.S. Treasury pursuant to the Troubled Asset Relief Program (TARP) Capital Purchase Program. The dividends accrued on the Preferred Stock reduce the net income available to common stockholders 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 stockholders, and the holders of the Preferred Stock may have interests different from our common stockholders.

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

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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 stockholders required by law or our Articles of Incorporation, the vote or consent of holders of at least 662/3% 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 affect the rights, preferences, privileges or voting power of the Preferred Stock; or

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 holder of the Preferred Stock, currently 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, except to the extent the 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.

Item 1B. *UNRESOLVED STAFF COMMENTS*

Not applicable.

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Item 2. ***PROPERTIES***

At December 31, 2010, 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)
Panhandle State Bank Branches				
IDAHO				
(Kootenai County)				
Coeur d Alene(1)	200 W. Neider Avenue Coeur d Alene, ID 83814	5,500	May 2005	Own building Lease land
Rathdrum	6878 Hwy 53 Rathdrum, ID 83858	3,410	March 2001	Own
Post Falls	3235 E. Mullan Avenue Post Falls, ID 83854	3,752	March 2003	Own
(Bonner County)				
Ponderay	300 Kootenai Cut-Off Road Ponderay, ID 83852	3,400	October 1996	Own
Priest River	301 E. Albeni Road Priest River, ID 83856	3,500	December 1996	Own
Sandpoint Center Branch(2)	414 Church Street Sandpoint, ID 83864	11,399	January 2006	Lease
Sandpoint (Drive up)(3)	231 N. Third Avenue Sandpoint, ID 83864	225	May 1981	Own
(Boundary County)				
Bonners Ferry	6750 Main Street Bonners Ferry, ID 83805	3,400	September 1993	Own
(Shoshone County)				
Kellogg	302 W. Cameron Avenue Kellogg, ID 83837	672	February 2006	Lease land, Own modular unit
Intermountain Community Bank Branches				
(Canyon County)				
Caldwell	506 South 10th Avenue Caldwell, ID 83605	6,480	March 2002	Own
Nampa	521 12th Avenue S. Nampa, ID 83653	5,000	July 2001	Own
Payette	175 North 16th Street Payette, ID 83661	5,000	September 1999	Own
Fruitland	1710 N. Whitley Dr., Ste A Fruitland, ID 83619	1,500	April 2006	Lease

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City and County	Address	Sq. Feet	Date Opened or Acquired	Occupancy Status (Own/Lease)
(Washington County)				
Weiser	440 E Main Street Weiser, ID 83672	3,500	June 2000	Own
Magic Valley Bank Branches				
(Twin Falls County)				
Twin Falls	113 Main Ave West Twin Falls, ID 83301	10,798	November 2004	Lease
Canyon Rim(4)	1715 Poleline Road East Twin Falls, ID 83301	6,975	September 2006	Lease
(Gooding County)				
Gooding(4)	746 Main Street Gooding, ID 83330	3,200	November 2004	Lease
OREGON				
(Malheur County)				
Ontario	98 South Oregon St. Ontario, OR 97914	10,272	January 2003	Lease
Intermountain Community Bank Washington Branches				
WASHINGTON				
(Spokane County)				
Spokane Downtown	801 W. Riverside, Ste 400 Spokane, WA 99201	4,818	April 2006	Lease
Spokane Valley	5211 E. Sprague Avenue Spokane Valley, WA 99212	16,000	Sept 2006	Own building Lease land
ADMINISTRATIVE				
(Bonner County)				
Sandpoint Center(3)	414 Church Street Sandpoint, ID 83864	26,725	January 2006	Lease
(Canyon County)				
Nampa Administrative Office	5680 E. Franklin Road, Suite 225 Nampa, ID 83687	2,795	April 2007	Lease
(Kootenai County)				
Coeur d Alene Branch and Administrative Services(1)	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.

2) In January 2006, the Company purchased land on an installment contract and subsequently began building the 86,100 square foot Sandpoint Center. The building contains the Sandpoint branch, corporate headquarters, administrative, technical and training facilities, an auditorium and community room and space for other professional tenants. The Company is currently pursuing tenants to occupy the other vacant leasable square footage in this building. 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.

3) 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 the remaining space.

4) 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.

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. *[REMOVED AND RESERVED.]*

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 February 28, 2011, 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

	2010		2009	
Quarter	**High**	**Low**	**High**	**Low**
1st	$ 2.60	$ 1.60	$ 5.20	$ 3.40
2nd	3.20	1.80	4.00	3.25
3rd	2.25	1.65	3.30	1.90
4th	2.00	1.40	3.50	2.06

At February 28, 2011 the Company had 8,406,578 shares of common stock outstanding held by approximately 2,040 shareholders. As a bulletin board stock, Intermountain s stock is relatively thinly traded, with daily average volumes totaling 2,413 in 2010 and 3,984 in 2009, respectively.

The Company historically has not paid cash dividends, but may do so in the 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.

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 2010.

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.

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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 the Company including the payment of quarterly cash dividends on the Company 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, the Company agreed that, while the U.S. Treasury owns the Preferred Stock, the Company 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. The following table sets forth information regarding shares reserved for issuance pursuant to outstanding awards:

Plan Category	**Number of Shares to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)**	**Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)**	**Number of Shares Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Shares Reflected in Column(a) (c))**
Equity compensation plans approved by shareholders	277,792	$ 6.28	

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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

	12/31/2005	12/31/2006	12/31/2007	12/31/2008	12/31/2009	12/31/2010
Intermountain Community Bancorp	$ 100	$ 154	$ 106	$ 31	$ 17	$ 10
SNL Index	$ 100	$ 112	$ 87	$ 54	$ 50	$ 54
Russell 2000	$ 100	$ 117	$ 114	$ 74	$ 93	$ 116

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.

	For the Year Ended December 31, (2)				
	2010(1)	2009(1)	2008(1)	2007(1)	2006(1)
INCOME STATEMENT DATA					
Total interest income	$ 46,049	$ 53,867	$ 63,809	$ 72,858	$ 59,580
Total interest expense	(10,785)	(16,170)	(20,811)	(26,337)	(17,533)
Net interest income	35,264	37,697	42,998	46,521	42,047
Provision for loan losses	(24,012)	(36,329)	(10,384)	(3,896)	(2,148)
Net interest income after provision for losses on loans	11,252	1,368	32,614	42,625	39,899
Total other income	11,024	11,991	13,932	13,199	10,838
Total other expense	(54,894)	(49,630)	(45,372)	(40,926)	(35,960)
Income (loss) before income taxes	(32,618)	(36,271)	1,174	14,898	14,777
Income tax (provision) benefit	882	14,360	80	(5,453)	(5,575)
Net income (loss)	(31,736)	(21,911)	1,254	9,445	9,202
Preferred stock dividend	1,716	1,662	45		
Net income (loss) applicable to common stockholders	$ (33,452)	$ (23,573)	$ 1,209	$ 9,445	$ 9,202
Net income (loss) per share(2)					
Basic	$ (3.99)	$ (2.82)	$ 0.15	$ 1.15	$ 1.15
Diluted	$ (3.99)	$ (2.82)	$ 0.14	$ 1.10	$ 1.07
Weighted average common shares outstanding(2)					
Basic	8,386	8,361	8,295	8,206	8,035
Diluted	8,386	8,361	8,515	8,605	8,586
Cash dividends per share					

	December 31, (1)				
	2010	2009	2008	2007	2006
BALANCE SHEET DATA					
Total assets	$ 1,005,109	$ 1,079,644	$ 1,105,555	$ 1,048,659	$ 920,348
Net loans(3)	563,228	655,602	752,615	756,549	664,885

Deposits	778,833	819,321	790,412	757,838	693,686
Securities sold subject to repurchase agreements	105,116	95,233	109,006	124,127	106,250
Advances from Federal Home Loan Bank	34,000	49,000	46,000	29,000	5,000
Other borrowings	16,527	16,527	40,613	36,998	22,602
Stockholders equity	59,353	88,627	110,485	90,119	78,080

(1) Certain prior period amounts have been reclassified to conform to the current period s presentation.

(2) Earnings per share and weighted average shares outstanding have been adjusted retroactively for the effect of stock splits and dividends, including the 10% common stock dividend effective May 31, 2007.

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(3) Net loans receivable have been adjusted for 2006 to move the allowance for unfunded commitments from the allowance for loan loss, a component of net loans, to other liabilities.

RETURNS ON AVERAGE ASSETS, COMMON SHAREHOLDERS EQUITY AND AVERAGE COMMON SHAREHOLDERS TO AVERAGE ASSETS

For the Years Ended December 31,	**2010**	**2009**	**2008**
	(Dollars in thousands)		
Return on Average Assets:			
Net earnings (loss) available to common shareholders	(3.04)%	(2.01)%	0.12%
Adjusted net earnings (loss) available to common shareholders(1)	(1.21)%		
Return on Average Common Stockholders Equity:			
Net earnings (loss) available to common shareholders	(67.35)%	(31.17)%	1.35%
Adjusted net earnings (loss) available to common shareholders(1)	(28.97)%		
Average Tangible Common Stockholders Equity to Average Tangible Assets	7.22%	9.28%	8.97%
Average Common Stockholders Equity to Average Assets(2)	4.76%	6.95%	8.49%

(1) Non-GAAP ratios adjusted for Goodwill Impairment charge of $11,662,000 and Deferred Tax Asset Valuation charge of $7,400,000.

(2) Average common tangible equity is average common stockholders equity less average net goodwill and other intangible assets.

Management believes that adjusted return on average assets and return on average equity are meaningful measures of performance. The exclusion of the goodwill impairment of $11.6 million and the deferred tax asset valuation of $7.4 million are relevant as they represent non-cash expenses that are nonrecurring in the normal course of operations. Additionally, management believes tangible common equity and the tangible common equity ratio are meaningful measures of capital adequacy. Management believes the exclusion of certain intangible assets in the computation of tangible common equity and tangible common equity ratio provides a meaningful base for period-to-period and company-to-company comparisons, which management believes will assist investors in analyzing the operating results and capital of the Company. Tangible common equity is calculated as total shareholders equity less preferred stock and less goodwill and other intangible assets. In addition, tangible assets are total assets less goodwill and other intangible assets. The tangible common equity ratio is calculated as tangible common shareholders equity divided by tangible assets. The tangible common equity and tangible common equity ratio is considered a non-GAAP financial measure and should be viewed in conjunction with the total shareholders equity and the total shareholders equity ratio.

The adjusted return on average assets, adjusted return on average equity, tangible common equity and tangible common equity ratio are considered non-GAAP financial measures and should be viewed in conjunction with the return on average assets, return on average equity, total shareholders equity and the total shareholders equity ratio.

ITEM 7. *MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS*

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes thereto presented elsewhere in this report. This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. For a discussion of the risks and uncertainties inherent in such statements, see Forward-Looking Statements and Risk Factors in Part 1 of this report.

Overview

The Company operates a multi-branch banking system and continues to plan long-term to operate as a community bank in both existing and potentially new markets. Given current economic conditions and short-term market uncertainties, the Company scaled back its expansion plans in 2008, and is currently focused on managing and growing its existing asset portfolio, preserving its capital and liquidity positions, improving operating efficiency and capitalizing on opportunities to selectively grow its core low-cost deposit base.

Longer term, based on opportunities available in the future, the Company plans expansion in markets generally located within the states where it currently operates, and has identified its primary short-term growth markets as Ada County in Idaho, Spokane County, Washington, and counties contiguous to its existing Idaho and eastern Washington markets. However, Intermountain currently has branches in Idaho, Oregon and Washington, which would allow for future expansion in any of these states without the purchase of another financial institution. As economic conditions improve, the Company will pursue a balance of asset and earnings growth by focusing on increasing its market share in its present locations, expanding services sold to existing customers, building new branches and merging and/or acquiring community banks that fit closely with the Bank s strategic direction.

Management and the Board of Directors remain committed to building a fiscally strong, locally focused community banking organization and further increasing the level of service we provide our targeted customers and communities. Our long-term strategic plan calls for focused earnings growth through maximizing its operating efficiency and resuming managed balance sheet growth. We expect to achieve these goals by employing experienced, knowledgeable and dedicated people and supporting them with strong technology and training. Please see the Business Strategy and Opportunities Subsection of Item 1 on page 5 above for a more detailed discussion on the Company s strengths and potential opportunities.

Recent History

In June 2005, the Company entered the Washington State market by opening a branch in Spokane Valley, Washington. This branch allowed the Company to enter into the eastern Washington banking market and to also better serve its existing customer base. It added a downtown Spokane location in April 2006 after the Bank was able to attract a seasoned team of commercial and private bankers. The Company now offers full service banking and residential and commercial lending from its Spokane Valley branch and Spokane downtown offices, which it operates under the name of Intermountain Community Bank Washington. In August 2007, the Spokane Valley branch was moved to a larger facility in a growing small business and retail area. It also houses a mortgage loan center and some administrative offices.

Also in 2005, the Company relocated the Coeur d Alene branch and administrative office to a combined administrative and branch office building located on Neider Avenue between Highway 95 and Government Way in Coeur d Alene. This facility serves as our primary Coeur d Alene office and accommodates the Home Loan Center, our centralized real estate mortgage processing department, various administrative support departments and our SBA Loan Production Center. The SBA center was initiated in 2003 to enhance the service, delivery and efficiency of the Small Business Administration lending process.

In March 2006, the Company opened a branch in Kellogg, Idaho under the Panhandle State Bank name. In April 2006, the Company opened a branch in Fruitland, Idaho which operates as Intermountain Community Bank. In April 2006, the Company also opened a Trust & Wealth Management division, and began offering these services to its customers. In September 2006, the Company opened a second branch in Twin Falls, Idaho, which operates as Magic Valley Bank. These new branches and divisions allowed the Company to expand geographically and better serve its existing customer base.

In September 2006, the Company acquired a small investment company with which it had maintained a close relationship for many years, and subsequently renamed the department, Intermountain Community Investment Services (ICI). Despite difficult market conditions, ICI has served the needs of its customers and increased its customer base since the acquisition. In 2009, the Company combined its Trust and ICI functions into one unit, now known as Trust and Investment Services to further integrate the services and offer customers a more comprehensive investment and wealth management program.

In August 2006, the Company began construction of new headquarters building in Sandpoint, Idaho, now known as the Sandpoint Center. The Company relocated its Sandpoint main branch, corporate headquarters and administrative offices to this building in 2008, with the Company occupying approximately 47,000 square feet. The remaining rentable space is being marketed to prospective tenants who provide complementary services to those of the Bank. In connection with the building, the Company borrowed $23.1 million from an unaffiliated bank. This loan was paid off in August 2009, through the sale of the Sandpoint Center to an unaffiliated third party. The Bank holds the master lease on the Sandpoint Center. Because the Company provided the financing for the purchase of the building on a non-recourse basis, the transaction was accounted for using the financing method.

As economic conditions and the Company s credit portfolio stabilizes, its near-term focus is beginning to shift. It has spent the past several years overcoming the challenges created by the significant downturn in its markets. In 2009 and 2010, it responded proactively to the challenging economy in a number of different ways. In lending, it tightened loan underwriting standards, actively reduced concentrations of riskier loan types, significantly enhanced its credit administration and credit resolution functions, and more aggressively pursued government-guaranteed and other lower risk lending opportunities. On the deposit side, it maintained its core deposit base while simultaneously reducing its cost of funds through a disciplined approach focused on attracting and retaining low-cost transactional deposits. Intermountain also made significant efficiency gains in many areas, including reducing its workforce by 23% since 2007, and centralizing and automating more of its core deposit and lending functions. These cost reduction gains were more than offset in the past couple years by significantly increased credit costs, but as these abate, the Company s non-interest expense should reduce significantly.

As 2011 begins, the Company continues to proactively manage its current credit portfolio, but is now more aggressively seeking new quality lending relationships, particularly in the agriculture, commercial and commercial real estate sectors. Management is maintaining its focus on increasing the core deposit base, but at lower pricing. It is also accelerating its cost management efforts, as management believes that strong efficiency gains are critical in the projected slow-growth environment of the near future. Responding to additional regulatory pressure on traditional income sources such as overdraft and debit card fees, management is increasing its focus on enhancing its alternative fee income activities, including trust and investment, cash management and other service fees. It is also evaluating a number of new fee income initiatives.

Longer-term, the Company will continue its focus on expanding market share of targeted customers in its existing markets, and entering new markets in which it can attract and retain strong employees, subject to capital adequacy levels and regulatory approval. Management believes that the economy arising out of the current downturn will present a number of new opportunities for fewer, but stronger, community banks. Its efforts are focused on positioning Intermountain to take advantage of these opportunities, particularly through the acquisition of desirable employees and customers from distressed banks and non-bank institutions. It will also look for opportunities to acquire other community banks in both FDIC- and non-FDIC assisted transactions. The Company has employed these competitive tools to grow market share over the past ten years, since it began expanding beyond its Sandpoint base. During this time period, the Company has grown from eighth overall in market share in the core Idaho and Oregon markets it serves to second, with a consolidated market share of 12.6%. The Company is the market share leader in deposits in five of the eleven counties in which it operates (Source: June 2010 FDIC Survey of Banking Institutions). 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 other markets. The Company has a relatively small, but growing presence in Spokane County with strong local market talent. The Bank 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, which would allow for potential entry and expansion into this market in the future. Please see the Business Strategy and Opportunities, Primary Market Area and Competition Subsections of Item 1 beginning on page 5 above for a more detailed discussion on the Company s strengths, market position and potential opportunities.

Results of Operations

Overview. Intermountain recorded a net loss applicable to common stockholders of $33.5 million, or $3.99 per diluted share, for the twelve months ended December 31, 2010, compared with net loss applicable to common stockholders of $23.6 million, or $2.82 per diluted share, for the twelve months ended December 31, 2009. The increased loss for 2010 primarily reflected the impacts of an $11.7 goodwill impairment charge and a $7.4 million deferred tax asset valuation allowance charge taken by the Company in the third quarter. Net interest income and other income were down modestly for the year, but were offset by larger reductions in the provision for loan losses and other non-interest expenses. Fourth quarter 2010 results showed significant improvement over the prior quarter

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and the same period last year. Intermountain recorded a net loss applicable to common stockholders of $1.1 million, or $0.13 per diluted share for the three months ended December 31, 2010, compared with a net loss applicable to common stockholders of $24.7 million or $2.95 per diluted share for the third quarter of 2010 (impacted by the non-cash charges noted above) and a net loss applicable to common stockholders of $9.0 million or $1.07 per diluted share, for the three months ended December 31, 2009.

The annualized return on average assets (ROAA) was -3.04% for 2010, but excluding the goodwill impairment charge and the deferred tax asset valuation charge, it was -1.21% for the twelve months ended December 31, 2010. For 2009, the ROAA was -2.01%. The annualized return on average common equity (ROAE) was -67.35% and -31.16% for the twelve months ended December 31, 2010 and 2009, respectively. The annualized return on average common equity (ROAE), excluding the goodwill impairment charge and the deferred tax asset valuation charge was -28.97% for the twelve months ended December 31, 2010. See Item 6, Selected Financial Data for discussion of non-GAAP financial measures.

The annualized return on average assets (ROAA) was -0.25%, -9.37%, and -3.17% for the three months ended December 31, 2010, September 30, 2010 and December 31, 2009, respectively. The annualized return on average common equity (ROAE) was -12.39, -212.06%, and -52.55%, for the three months ended December 31, 2010, September 30, 2010 and December 31, 2009, respectively.

The goodwill impairment and the deferred tax asset adjustments noted above total $19.1 million and are non-cash adjustments that do not impact the Company s current liquidity or underlying operating results. The adjustments also have no impact on the Company s regulatory capital ratios, as they are both already excluded from the Company s regulatory capital calculations. The goodwill impairment charge is based upon the results of the goodwill impairment analysis it completed in the third quarter of 2010. Although the lost earnings from the goodwill impairment cannot be reclaimed in future periods, the charge eliminated all of the Company s remaining goodwill on its balance sheet, so that no further charges are possible unless the Company records goodwill as part of a future transaction. The establishment of the non-cash valuation allowance against the Company s deferred tax assets (DTA) reflected the Company s decision under applicable accounting rules to recognize uncertainty in its ability to generate certain levels of future taxable income, given the challenging economic times and its prior losses. The Company analyzes the deferred tax asset on a quarterly basis and may recapture all or a portion of this allowance depending on future profitability.

The following tables set forth reconciliations of non-GAAP financial measures discussed in this report (dollars in thousands):

	Twelve Months Ended December 31		**Three Months Ended December 31**	
	2010	**2009**	**2010**	**2009**
Net income (loss)	$ (31,736)	$ (21,911)	$ (626)	$ (8,548)
Less tax benefit	(882)	(14,360)		(5,217)
Less goodwill impairment	11,662			
Less deferred tax asset valuation	7,400			
Total loss before income tax benefit, excluding Goodwill Impairment	$ (13,556)	$ (36,271)	$ (626)	$ (13,765)

Both interest expense and other operating expense, excluding the goodwill impairment, decreased significantly from 2009. Interest income also declined, reflecting a more conservative asset mix emphasizing safety and liquidity and the impact of lower interest rates, particularly on the Company s marketable securities portfolio. Other income was down from 2009 as a result of smaller gains on the sale of securities than was recorded in 2009. Excluding the impact of these sales, the Company generally had higher fee and other non-interest income revenue than in 2009. See Item 6, Selected Financial Data for discussion of non-GAAP financial measures.

Most asset quality metrics continued to improve with lower levels of non-performing assets and reduced concentrations in the riskiest loan segments. The Company has been proactive in identifying and resolving its problem credits, taking write-downs early in the process and initiating dialogue with borrowers at the first sign of trouble. As a result, its loan losses over the past two years have been significant, but are projected to decline substantially in future periods.

As of December 31, 2010, assets totaled $1.01 billion, a decrease of $74.5 million or 6.9% from the prior year, reflecting conservative balance sheet management in light of the weak economy. In 2009, assets totaled $1.08 billion, a 2.3% decrease from $1.11 billion at December 31, 2008. The Company decreased net loans receivable by $92.4 million or 14.1% in 2010, and by $97.0 million in 2009. Loan balance decreases reflect a combination of lower borrowing demand, tighter underwriting standards and aggressive management and disposition of problem assets. Total deposits also decreased by $40.5 million or 4.9% in 2010, following a $28.9 million increase in 2009, as the Company allowed higher rate brokered and other non-relationship deposits to roll off, given the high levels of liquidity on the balance sheet.

Net Interest Income

The Company s net interest income for the year ended December 31, 2010 was $35.3 million, a decrease of $2.4 million from the prior year. The decrease in net interest income resulted from a combination of a shift in the mix of the Company s assets to more conservative, lower-yielding assets and lower yields on its securities portfolio. Most of the negative impact on interest income from these sources was offset by decreases in interest expense on the Company s interest bearing liabilities. The net interest margin for the year ended December 31, 2010 was 3.77%, as compared to 3.81% for 2009 and 4.50% for 2008. A volatile interest rate environment, in which rates on interest earning assets declined more rapidly and further than rates on interest-bearing liabilities produced most of the decrease in the Company s margin during 2009 and 2008.

The following table provides information on net interest income for the past three years, setting forth average balances of interest-earning assets and interest-bearing liabilities, the interest income earned and interest expense recorded thereon and the resulting average yield-cost ratios.

Average Balance Sheets and Analysis of Net Interest Income

	For the Year Ended December 31, 2010		
	Average Balance	Interest Income/ Expense	Average Yield
	(Dollars in thousands)		
Loans receivable, net(1)	$ 632,761	$ 38,020	6.01%
Securities(2)	199,819	7,793	3.90
Federal funds sold	102,109	236	0.23
Total earning assets	934,689	46,049	4.93%
Cash and cash equivalents	18,691		
Office property and equipment, net	41,293		
Other assets	47,897		
Total assets	$ 1,042,570		
Time deposits of $100,000 or more	$ 127,173	$ 3,065	2.41%
Other interest-bearing deposits	517,438	4,681	0.90
Short-term borrowings	69,232	2,005	2.90
Other borrowed funds	79,060	1,034	1.31

Total interest-bearing liabilities	792,903		10,785	1.36%
Noninterest-bearing deposits	161,877			
Other liabilities	9,238			
Stockholders equity	78,552			
Total liabilities and stockholders equity	$ 1,042,570			
Net interest income		$	35,264	
Net interest margin				3.77%

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Average Balance Sheets and Analysis of Net Interest Income

	For the Year Ended December 31, 2009		
	Average Balance	Interest Income/ Expense	Average Yield
	(Dollars in thousands)		
Loans receivable, net(1)	$ 736,568	$ 43,611	5.92%
Securities(2)	201,709	10,079	5.00
Federal funds sold	50,387	177	0.35
Total earning assets	988,664	53,867	5.45%
Cash and cash equivalents	18,904		
Office property and equipment, net	43,238		
Other assets	29,769		
Total assets	$ 1,080,575		
Time deposits of $100,000 or more	$ 142,831	$ 4,338	3.04%
Other interest-bearing deposits	524,901	8,001	1.52
Short-term borrowings	92,507	2,347	2.54
Other borrowed funds	62,900	1,484	2.36
Total interest-bearing liabilities	823,139	16,170	1.96%
Noninterest-bearing deposits	151,640		
Other liabilities	3,011		
Stockholders equity	102,785		
Total liabilities and stockholders equity	$ 1,080,575		
Net interest income		$ 37,697	
Net interest margin			3.81%

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Average Balance Sheets and Analysis of Net Interest Income

	For the Year Ended December 31, 2008		
	Average Balance	Interest Income/ Expense	Average Yield
	(Dollars in thousands)		
Loans receivable, net(1)	$ 779,854	$ 55,614	7.13%
Securities(2)	155,025	7,998	5.16
Federal funds sold	19,937	197	0.99
Total earning assets	954,816	63,809	6.68%
Cash and cash equivalents	22,591		
Office property and equipment, net	44,372		
Other assets	19,295		
Total assets	$ 1,041,074		
Time deposits of $100,000 or more	$ 130,729	$ 5,176	3.96%
Other interest-bearing deposits	475,990	9,464	1.99
Short-term borrowings	121,055	4,385	3.62
Other borrowed funds	70,374	1,786	2.54
Total interest-bearing liabilities	798,148	20,811	2.61%
Noninterest-bearing deposits	145,924		
Other liabilities	6,706		
Stockholders equity	90,296		
Total liabilities and stockholders equity	$ 1,041,074		
Net interest income		$ 42,998	
Net interest margin			4.50%

(1) Non-accrual loans are included in the average balance, but interest on such loans is not recognized in interest income.

(2) Municipal interest income is not presented on a tax-equivalent basis, and represents a small portion of total interest income.

The following rate/volume analysis depicts the increase (decrease) in net interest income attributable to (1) interest rate fluctuations (change in rate multiplied by prior period average balance), (2) volume fluctuations (change in average balance multiplied by prior period rate) and (3) volume/rate (changes in rate multiplied by changes in volume) when compared to the preceding year.

Changes Due to Volume and Rate 2010 versus 2009

	Volume	Rate	Volume/Rate	Total
	(Dollars in thousands)			
Loans receivable, net	$ (6,146)	$ 646	$ (91)	$ (5,591)
Securities	(94)	(2,212)	20	(2,286)
Federal funds sold	182	(61)	(62)	59
Total interest income	(6,058)	(1,627)	(133)	(7,818)
Time deposits of $100,000 or more	(476)	(896)	99	(1,273)
Other interest-bearing deposits	(114)	(3,252)	46	(3,320)
Borrowings	(210)	(329)	(253)	(792)
Total interest expense	(800)	(4,477)	(108)	(5,385)
Net interest income	$ (5,258)	$ 2,850	$ (25)	$ (2,433)

Changes Due to Volume and Rate 2009 versus 2008

	Volume	Rate	Volume/Rate	Total
	(Dollars in thousands)			
Loans receivable, net	$ (3,087)	$ (9,440)	$ 524	$ (12,003)
Securities	2,408	(252)	(75)	2,081
Federal funds sold	301	(127)	(194)	(20)
Total interest income	(378)	(9,819)	255	(9,942)
Time deposits of $100,000 or more	479	(1,206)	(111)	(838)
Other interest-earning deposits	972	(2,209)	(226)	(1,463)
Borrowings	(1,224)	(1,440)	324	(2,340)
Total interest expense	227	(4,855)	(13)	(4,641)
Net interest income	$ (605)	$ (4,964)	$ 268	$ (5,301)

Net Interest Income 2010 Compared to 2009

The Company s net interest income decreased to $35.3 million in 2010 from $37.7 million in 2009. The net interest income change attributable to volume changes was an unfavorable $5.3 million from 2009 as the volume of higher yielding assets, particularly loans, decreased significantly, overwhelming positive volume changes in Fed Funds Sold on the asset side and in all interest-bearing liabilities. Overall, rate changes had a $2.9 million favorable impact on net interest income in 2010, as rate reductions on all interest-bearing liabilities and positive rate impacts on the loan portfolio from lower non-accrual loans offset rate reductions in the Company s securities portfolio. The separate volume and rate changes along with a $25,000 decrease due to the interplay between rate and volume factors created the $2.4 million overall decrease in net interest income for 2010.

The yield on interest-earning assets decreased 0.52% in 2010 from 2009, while the cost of interest-bearing liabilities decreased 0.53% during the same period. The earning-asset yield was significantly impacted by the shift in the mix of Company assets from the higher-yielding loan portfolio to lower-yielding fixed income securities and Fed Funds Sold, as a result of conservative liquidity management, lower loan demand, and aggressive problem asset resolution. Rates paid on Fed Funds Sold remained between 0.00% and 0.25% throughout 2010, meaning that the $101.1 million in average Fed Funds Sold balances earned only minimal income.

The yield on the Company s loans, at 6.01%, was up modestly from the prior year, primarily as a result of lower interest reversals on non-accrual and other problem loans than it experienced in 2009. The Bank maintained about 56% of its portfolio as variable rate loans, which were stable but at relatively low rates as market rates remained very low all year. The Bank sought to moderate this impact by continuing to maintain floors on its variable rate loans, and

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emphasizing the higher yielding commercial, agricultural and commercial real estate segments of its loan portfolio. Non-accrual loans were down from 2009, but still had an impact on net interest income, as the Company reversed $794,000 in interest income on loans placed on non-accrual status and problem loans. Problem loans include loans charged off directly or transferred to OREO. This resulted in an 0.08% decrease in loan yield over what would have been experienced without the non-accrual loans. The investment securities portfolio experienced a 1.10% decrease in yield in 2010 as spreads tightened on most fixed income securities, prepayments on mortgage-backed securities increased, and the Company maintained a short duration in its investment portfolio to position it for anticipated future higher market rates.

The Company lowered its interest expense by $5.4 million or 33% during 2010. Active management strategies, low market rates, and decreased competition reduced the average cost on its interest-bearing liabilities from 1.66% to 1.13% of average earning assets, while maintaining its solid relationship-based deposit base. Management focused on eliminating or reducing funding costs on wholesale sources and non-relationship deposits during 2010, while protecting its local core deposit franchise. Its cost of deposits decreased from 1.51% to 0.96% and the cost of other borrowings and FHLB advances decreased from 2.47% to 2.05%. The Company maintains 20% of its average total deposits a relatively high percentage as compared to its peer group, in non-interest bearing demand deposits, which provide a low-cost funding source in low interest rate environments but holds even more value in higher interest rate environments.

Net Interest Income 2009 Compared to 2008

The Company s net interest income decreased to $37.7 million in 2009 from $43.0 million in 2008. The net interest income change attributable to volume changes was an unfavorable $605,000 from 2008 as the volume of higher yielding assets, particularly loans, decreased significantly, overwhelming positive volume changes in securities, Fed Funds Sold, and borrowings. During 2009, interest rates decreased both on interest earning assets and interest bearing liabilities; however, rates continued to decrease more significantly on the asset side than the liability side. This created a $5.0 million decrease in net interest income attributable to rate variances. The separate volume and rate changes along with a $268,000 increase due to the interplay between rate and volume factors created a $5.3 million overall decrease in net interest income for 2009.

The yield on interest-earning assets decreased 1.23% in 2009 from 2008, while the cost of interest-bearing liabilities decreased 0.65% during the same period. The earning-asset yield was significantly impacted by management s shift in the mix of Company assets from the higher-yielding loan portfolio to lower-yielding fixed income securities and Fed Funds Sold to enhance Company liquidity. Rates paid on Fed Funds Sold remained between 0.00% and 0.25% throughout 2009, meaning that the $43.9 million in average Fed Funds Sold balances earned only minimal income.

The yield on the Company s loans, at 5.92%, was also down from the prior year, although the drop was less significant than in 2008. The Bank maintained about 58% of its portfolio as variable rate loans, which continued to drop as market rates remained very low all year. The Bank sought to moderate this impact by continuing to maintain floors on its variable rate loans, and emphasizing the higher yielding commercial loan component of its loan portfolio. High levels of non-accrual loans also significantly impacted net interest income, as the Company reversed $1.9 million in interest income on loans placed on non-accrual status and problem loans. This resulted in an additional 0.26% decrease in the yield on loans. The investment securities portfolio experienced a 0.16% decrease in yield in 2009 as spreads tightened on most fixed income securities and the Company shortened the duration of its investment portfolio to position it better for anticipated future higher market rates.

While the significant market rate declines in 2008 and early 2009 also reduced the Company s interest-bearing liability costs, liability rate decreases lagged behind asset yield changes. The Company experienced pressure on its deposit rates from some distressed and deposit-starved competitors, which continued to offer higher than market rates. These market conditions particularly impacted time and higher-balance money market rates, which resulted in both smaller and later declines than in the rates earned on loans and Fed Funds Sold. The overall result was a drop of 0.65% in the interest expense rate during the year.

Provision for Losses on Loans & Credit Quality.

Management s policy is to establish valuation allowances for estimated losses by charging corresponding provisions against income. This evaluation is based upon management s assessment of various factors including, but not limited to, current and anticipated future economic trends, historical loan losses, delinquencies, and underlying collateral values, as well as current and potential risks identified in the portfolio. See the Loan Portfolio discussion in the Item 1- Business section beginning on page 11 of this report for additional information on asset quality, loan portfolio trends and provision for loan loss trends.

The provision for losses on loans totaled $24.0 million for the year ended December 31, 2010, compared to a provision of $36.3 million for the year ended December 31, 2009. Net chargeoffs in 2010 totaled $28.2 million compared to $36.2 million for 2009. The following table summarizes provision and loan loss allowance activity for the periods indicated.

Trend Analysis of the Allowance for Loan Losses

	December 31,				
	2010	**2009**	**2008**	**2007(1)**	**2006(1)(2)**
	(Dollars in thousands)				
Balance Beginning January 1	$ (16,608)	$ (16,433)	$ (11,761)	$ (9,837)	$ (8,100)
Charge-Offs					
Commercial loans	10,603	5,037	1,486	886	283
Commercial real estate loans	5,610	3,194	186	8	
Commercial construction loans	1,393	4,982	663		
Land and land development loans	8,622	19,817	2,820	580	
Agriculture loans	1,055	988	162	50	
Multifamily loans	16	53			
Residential loans	2,019	1,598	173		9
Residential construction loans	101	241			
Consumer Loans	490	1,001	703	520	501
Municipal Loans					
Total Charge-offs	29,909	36,911	6,193	2,044	793
Recoveries					
Commercial Loans	(628)	(144)	(53)	(34)	(8)
Commercial real estate loans	(311)		(1)		
Commercial construction loans	(391)	(1)			
Land and land development loans	(175)	(347)	(198)		
Agriculture loans	(31)			(1)	
Multifamily loans					
Residential Loans	(50)	(9)		(10)	(4)
Residential construction loans					
Consumer Loans	(158)	(256)	(229)	(30)	(435)
Municipal Loans					
Total Recoveries	(1,744)	(757)	(481)	(75)	(447)
Net charge-offs	28,165	36,154	5,712	1,969	346

Transfers				3	65
Provision for losses on loans	(24,012)	(36,329)	(10,384)	(3,896)	(2,148)
Sale of loans					
Balance at end of period	$ (12,455)	$ (16,608)	$ (16,433)	$ (11,761)	$ (9,837)
Ratio of net charge-offs to loans outstanding	4.89%	5.38%	0.75%	0.26%	0.06%
Allowance Unfunded Commitments					
Balance Beginning January 1	$ (11)	$ (13)	$ (18)	$ (482)	$ (417)
Adjustment	(6)	2	5	467	
Transfers				(3)	(65)
Allowance Unfunded Commitments at end of period	$ (17)	$ (11)	$ (13)	$ (18)	$ (482)

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(1) The allowance analysis has been adjusted for the periods 2007 and 2006 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.

The decrease in the loan loss allowance is due primarily to the reduction in the loan portfolio and the level of classified and non-performing loans over the same period. Chargeoffs outpaced the loan loss provision in 2010 due to management s aggressive reduction of problem credits during 2010. In addition, in the third quarter of 2010, one large commercial credit was charged off in the amount of $4.5 million for which some recovery is anticipated in future periods.

The weak local and national economy continued to have significant negative impacts on the Company s loan portfolio in 2010. Credit losses were lower than in 2009, but were still at levels far higher than the Company has experienced in the past. While still elevated, losses in construction and development loans subsided in 2010, as the Company worked aggressively in 2010 and prior years to reduce the exposure in this portfolio. Reflecting national and regional trends, the Company experienced higher losses in both commercial and commercial real estate loans in 2010, as the impacts of the prolonged economic downturn cycled into these sectors during the year. Commercial loan losses were also heavily impacted by one significant relationship which was restructured in 2010, and for which the Company anticipates some recovery in future years. Losses in most other loan segments were either stable or down from the prior year.

Geographically, the concentration of losses migrated from southern Idaho to northern Idaho as 2010 progressed. Southern Idaho felt the impact of the recession and real estate downturn earlier and more deeply, as it had more excess real estate inventory than other areas. Northern Idaho economic impacts were tied more closely to the prolonged downturn and high unemployment rates. Real estate inventory levels are not as high in northern Idaho and eastern Washington, and the borrowers are generally more stable, longer-term residents of the area. As a result, the Company experienced lower overall default rates and lower loss rates on those loans that defaulted in the north than it did in its southern markets.

The Company responded to the volatile credit environment by adjusting its allowance for loan losses throughout 2009 and 2010. Generally the allowance decreased throughout 2010 as the volume of problem assets declined, and ended the year at $12.5 million or 2.16% of total loans, as compared to 2.47% at the end of 2009. At December 31, 2010, the allowance for loan losses totaled 108.1% of non-performing loans (NPLs), up from 87.2% at year end 2009. The higher coverage of NPLs reflects a considerable reduction in NPLs during the course of 2010 as the Company moved aggressively to resolve or liquidate these loans. After peaking at $25.1 million, or 3.43% of total loans in July 2009, the allowance declined to $16.6 million or 2.47% of total loans at the end of 2009. The 2010 ending allowance still reflected higher levels of problem assets and heightened concerns about current economic and market conditions. However, management believes that it has already incurred the most significant losses and reduced its concentrations in riskier assets, particularly its residential land and construction portfolio.

Given the current distressed and volatile credit environment, management continues to evaluate and adjust the loan loss allowance carefully and frequently to reflect the most current information available concerning the Company s markets and loan portfolio. In its evaluation, management considers current economic and borrower conditions in both the pool of loans subject to specific impairment (FAS 114 pool), and the pool subject to a more generalized allowance based on historical and other factors (FAS 5 pool). The following table includes this information, (dollars in thousands):

	December 31	
	2010	2009
FAS 5 Allocation	$ 8,235	$ 10,234
Impaired Allocation	4,220	6,374
Allowances for Loan Loss	$ 12,455	$ 16,608

The reduction in the reserve from 2009 to 2010 reflects reductions in both the amount allocated to the impaired loan pool and the FAS 5 allocation. The Company has proactively managed its problem loans to lower the total number and volume of loans that are impaired. When a loan is characterized as impaired, the Company performs a specific evaluation of the loan, focusing on potential future cash flows likely to be generated by the loan, current collateral values underlying the loan, and other factors such as government guarantees or guarantor support that may impact repayment. Based on this evaluation, it sets aside a specific reserve for this loan and/or charges down the loan to its net realizable value (selling price of collateral less estimated closing costs) if it is unlikely that the Company will receive any cash flow beyond the amount obtained from liquidation of the collateral. If the loan continues to be impaired, management periodically re-evaluates the loan for additional potential impairment, and charges it down or adds to reserves if appropriate. On the pool of loans not subject to specific impairment, management evaluates both regional and loan-specific historical loss trends to develop its base reserve level on a loan-by-loan basis. It then modifies those reserves by considering the risk grade of the loan, current economic conditions, the recent trend of defaults, trends in collateral values, underwriting and other loan management considerations, and unique market-specific factors such as water shortages or other natural phenomena. Given the continuing high level of problem assets, uncertain economic conditions, and regulatory pressure, it is reasonably likely that the Company s reserve levels will remain higher than those it maintained prior to 2008 for a sustained period of time.

General trending information with respect to non-performing loans, non-performing assets, and other key portfolio metrics is as follows (dollars in thousands):

Credit Quality Trending

	At December 31,				
	2010	**2009**	**2008**	**2007**	**2006**
			(In thousands)		
Loans past due in excess of 90 days and still accruing	$ 66	$ 586	$ 913	$ 797	$ 87
Non-accrual loans	11,451	18,468	26,365	5,569	1,201
Total non-performing loans	11,517	19,054	27,278	6,366	1,288
OREO	4,429	11,538	4,541	1,682	795
Total non-performing assets (NPAs)	$ 15,946	$ 30,592	$ 31,819	$ 8,048	$ 2,083
Classified loans(1)	$ 54,085	$ 77,175	$ 53,847	$ 18,643	$ 10,165
Troubled debt restructured loans(2)	$ 4,838	$ 4,604	$ 13,424	$	$
Total allowance related to non-accrual loans	$ 1,192	$ 965	$ 6,856	$ 585	$ 531
Interest income recorded on non-accrual loans	$ 848	$ 1,126	$ 1,193	$ 270	$ 230
Non-accrual loans as a percentage of net loans receivable	2.03%	2.82%	3.50%	0.74%	0.18%
Total non-performing loans as a % of net loans receivable	2.04%	2.91%	3.62%	0.84%	0.19%
Allowance for loan losses (ALLL) as a % of non-performing loans	108.1%	87.2%	60.2%	184.7%	763.7%
Total NPA as a % of total assets(3)	1.59%	2.83%	2.88%	0.77%	0.23%
Total NPA as a % of tangible capital + ALLL (Texas Ratio)(3)	22.30%	32.85%	27.75%	8.99%	2.76%

Loan Delinquency Ratio (30 days and over)	0.55%	1.06%	0.90%	0.40%	0.15%

(1) Classified loan totals are inclusive of non-performing loans and may also include troubled debt restructured loans, depending on the grading of these restructured loans.

(2) 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. No other funds are available for disbursement on restructured loans.

(3) NPAs include both nonperforming loans and OREO.

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The $7.0 million decrease in non-accrual loans from December 31, 2009 to December 31, 2010 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 migrate 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 regional investors, and a limited number of bulk sales and auctions of like properties. NPAs fell $14.6 million from December 31, 2009, and totaled 1.59% of total assets at December 31, 2010, down from 2.83% at the preceding year end. NPAs reached their peak of $47.7 million in May 2009 and have trended down since then. 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. Loan delinquencies (30 days or more past due) also declined to 0.55% from 1.06% of total loans at the end of December 31, 2009, reflecting stronger performance in the general loan portfolio. Loan delinquencies (30 days or more past due) reached their peak in April 2009 at a rate of 3.10%.

The following tables provide additional trending and geographical information on the Company s NPAs:

Nonperforming Asset Trending By Category

	December 31, 2010	September 30, 2010	June 30, 2010	March 31, 2010	December 31, 2009
	(Dollars in thousands)				
Commercial loans	$ 3,859	$ 4,394	$ 3,364	$ 5,282	$ 2,653
Commercial real estate loans	4,354	4,882	4,760	6,766	5,235
Commercial construction loans	69	1,662	1,931	3,858	3,133
Land and land development loans	3,368	7,266	11,625	12,989	14,055
Agriculture loans	582	934	524	250	834
Multifamily loans		112	112		135
Residential real estate loans	3,213	3,524	3,982	4,040	3,195
Residential construction loans	112	2	193	1,173	1,264
Consumer loans	389	12	28	21	88
Total NPAs by Categories	$ 15,946	$ 22,788	$ 26,519	$ 34,379	$ 30,592

NPAs by location December 31, 2010	North Idaho Eastern Washington	Magic Valley Idaho	Greater Boise Area	E. Oregon, SW Idaho Excluding Boise	Other	Total	% of Loan Type to Total Non-Performing Assets
	(Dollars in thousands)						
Commercial loans	$ 2,927	$ 415	$ 135	$ 352	$ 30	$ 3,859	24.2%
	1,714	46	453	413	1,728	4,354	27.3%

Commercial real estate loans							
Commercial construction loans	69					69	0.4%
Land and land development loans	2,600	49	250	269	200	3,368	21.1%
Agriculture loans			157	22	403	582	3.7%
Multifamily loans							0.0%
Residential real estate loans	2,013	102	652	259	187	3,213	20.2%
Residential construction loans	112					112	0.7%
Consumer loans	386	3				389	2.4%
Total	$ 9,821	$ 615	$ 1,647	$ 1,315	$ 2,548	$ 15,946	100.0%
Percent of total NPAs	61.6%	3.9%	10.3%	8.2%	16.0%	100.0%	
Percent of NPAs to total loans in each region(1)	3.0%	1.3%	2.5%	1.2%	9.7%	2.8%	

NPA by location 12/31/2009	North Idaho Eastern Washington	Magic Valley Idaho	Greater Boise Area	E. Oregon, SW Idaho Excluding Boise	Other	Total	% of Loan Type to Total Non-Performing Assets
	(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 NPAs	60.5%	9.1%	12.1%	7.5%	10.8%	100.0%	
Percent of NPAs to total loans in each region(1)	5.0%	5.19%	4.5%	1.7%	9.5%	4.6%	

(1) NPAs include both nonperforming loans and OREO

The volume of non-performing residential land and construction assets has declined rapidly since December 2009 and no longer comprises the majority of NPAs. This reflects the Company s aggressive effort in resolving or liquidating these assets quickly to reduce future exposure in this portfolio. NPAs are now relatively evenly split between commercial, commercial real estate, construction and development, and residential real estate loan segments, reflecting the ongoing impacts on all loan types of the challenging economy. Commercial and residential real estate NPAs increased moderately since the end of 2009, but were offset by decreases in commercial real estate and agricultural NPAs. The top 10 non-performing loans totaled $4.7 million, or 41% of total non-performing loans and the top 10 OREO properties accounted for 50% 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 and Magic Valley regions are lower. This reflects generally stronger economic conditions in the Southwest Idaho market outside Boise as a result of its agricultural base. It also reflects aggressive efforts to reduce exposure in the Greater Boise area region in 2008 and 2009. The Other NPAs total is largely comprised of one commercial property in Nevada.

All NPAs are reported at the Company s best estimate of net realizable value. The Company has evaluated the borrowers and the collateral underlying these loans and determined the probability of recovery of the loans principal balance. Given the volatility in the current market, the Company continues to monitor these assets closely and revalue the collateral on a frequent and periodic basis. This re-evaluation may create the need for additional write-downs or additional loss reserves on these assets.

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At December 31, 2010 and 2009, classified loans (loans with risk grades 6, 7 or 8) by loan type are as follows (dollars in thousands):

Classified Loans	December 31, 2010	December 31, 2009
Commercial loans	$ 14,069	$ 11,685
Commercial real estate loans	15,807	12,409
Commercial construction loans	7,832	15,554
Land and land development loans	8,040	20,136
Agriculture loans	2,380	9,637
Multifamily loans		695
Residential real estate loans	4,477	5,433
Residential construction loans	277	1,165
Consumer loans	1,203	461
Municipal loans		
Total classified loans	$ 54,085	$ 77,175

Classified loans are loans for which management believes it may experience some problems in obtaining repayment under the contractual terms of the loan, and are inclusive of the Company s non-accrual loans. However, categorizing a loan as classified does not necessarily mean that the Company will experience any or significant loss of expected principal or interest.

While still elevated, classified loans dropped by $23 million, or 29.9% in 2010. The total balance of classified loans reached a peak of $96.2 million in July 2009, and has been reduced by 43.8% since then, as a result of the workout and disposition efforts of the Company s special assets team. As a percentage of the Company s net loans, classified loans reached a peak of 13.9% in November 2009, dropped to 11.8% of net loans at the end of 2009, and totaled 9.6% at the end of 2010.

The decrease in classified loans from 2009 to 2010 largely reflects decreases in the construction and land development loan segments. These segments represented the highest loss exposure for the Company, and were a priority to resolve and liquidate rapidly. The reductions were a combination of loan sales, movement to OREO and subsequent liquidation, and writedowns. The Company also experienced decreases in classified agricultural and residential real estate loans, primarily through either upgrade of the loans or liquidation with very limited losses. 2010 was a strong year for agribusiness, creating strong performance and lowering exposure risk in this segment of the Company s portfolio. In contrast, commercial and commercial real estate classified loans increased moderately during the year. The increase in these segments reflects the impact of the prolonged economic downturn and challenging real estate conditions throughout the Company s market area. Unemployment rates continued at high levels, placing additional stress on businesses. This resulted in more borrowers experiencing difficulties in maintaining their ability to service the Company s debts. At the same time, real estate and other collateral valuations remained depressed, 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.

As with NPAs, the geographical distribution of the Company s classified loans reflects the distribution of the Company s loan portfolio, with higher distributions in the North Idaho/Eastern Washington region, and decreased levels in southern Idaho. As noted above, the Company worked rapidly to reduce its exposure in the Greater Boise area, and the other southern Idaho regions have strong agri-business components. In general, the Company believes that its loss exposure to classified loans in northern Idaho and eastern Washington will be less, because of stronger, local borrower relationships and generally higher real estate and other collateral values.

Local economies and real estate valuations appeared to stabilize in the latter part of 2010. However, significant improvement is not forecast for at least the balance of 2011. Based on local forecasts, full recovery is likely to occur slowly and over a multi-year period. As such, management believes that classified loans, non-performing assets, and credit losses will likely continue to decline in 2011, but remain at historically high levels as compared to the years prior to 2008. If this holds true, the Company s allowance for loan losses would likely remain at higher levels than its historical experience prior to 2008 as well. Given market volatility and future uncertainties, management cannot assure nor guarantee the accuracy of these future forecasts.

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 and again in early 2011, 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 reviews 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 reviews was to provide an independent assessment of the potential imbedded risks and dollar exposure within the Bank s loan portfolio. The scope of the original review included 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 review in 2011 was slightly smaller in scope, but still comprised almost 80% of the total 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 and a comparison of the 2010 internal and external loss projections against actual losses, 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.

Other Income

The following table details dollar amount and percentage changes of certain categories of other income for the three years ended December 31.

Other Income	2010 Amount	% of Total	Percent Change Prev. Yr	2009 Amount	% of Total	Percent Change Prev. Yr.	2008 Amount	% of Total
				(Dollars in thousands)				
Fees and service charges	$ 7,133	65%	3%	$ 6,948	58%	(6)%	$ 7,394	53%
Loan related fee income	3,061	28	5	2,913	24	(4)	3,029	22
BOLI income	368	3	2	360	3	11	324	2
Other-than-temporary credit impairment on investment securities	(828)	(8)	(57)	(526)	(4)			
Net gain (loss) on sale of securities	349	3	(81)	1,795	15	(18)	2,182	16
Other income	941	9	88	501	4	(50)	1,011	7
Total	$ 11,024	100%	(8)%	$ 11,991	100%	(14)%	$ 13,940	100%

Total other income was $11.0 million and $12.0 million for the twelve months ended December 31, 2010 and 2009, respectively, with the decrease largely resulting from a $1.4 million reduction in gains on the sale of investment securities.

Fees and service charges earned on deposit, trust and investment accounts continue to be the Company s primary sources of other income. Fees and service charges for the twelve month period ended December 31, 2010 totaled $7.1 million versus $6.9 million for the same period last year, reflecting additional trust, investment services, and debit card income. Increases in these fees offset a 17.2% decrease in overdraft charges, as the Company implemented new federal regulations on overdraft charges that came into effect in July 2010. The Company anticipates that further regulations arising from the Dodd-Frank Act may continue to negatively impact fee income, particularly income earned on overdraft and debit card activity. The Company is evaluating new fee structures, and implementing additional training and marketing programs to further enhance fee income through reduced waivers, increased pricing and additional cross-selling of other services to offset these potential impacts. Amidst the

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changing regulatory environment, it also continues to evaluate fees for all of its services to identify new opportunities that may arise.

Loan related fee income increased by $148,000, or 5.1%, for the twelve months ended December 31, 2010 compared to one year ago as a result of additional servicing income and higher mortgage lending fees. The Company has restructured its mortgage banking function to enhance origination volume and income, and continues to build its servicing portfolio to improve customer service and provide a more stable source of fee income in the future.

For the twelve-month period, gains on sales of securities totaled $349,000 in 2010 versus $1.8 million in the same period of 2009. The credit loss on impaired securities increased from $526,000 for the twelve months ended December 31, 2009 to $828,000 for the twelve months ended December 31, 2010, as the Company continued to experience impairments on two non-government-guaranteed mortgage backed securities.

Bank-owned life insurance (BOLI) income was relatively flat from the prior year as yields were stable and the Company did not purchase or liquidate BOLI assets. Other non-interest income increased $440,000, reflecting higher secured credit card contract income and lower loss on sales of assets in 2010. Income from the secured credit card contract is expected to increase over the next quarter based on higher pricing, then level off before potentially terminating at the end of 2012. The Company is evaluating various alternatives, including partnering with other card providers, to replace this income source in future years.

The decrease in other income from 2008 to 2009 of $1.9 million reflected lower fees and service charges, reduced gains on security sales and decreased secured credit card contract income in 2009, as well as $526,000 in credit loss impairment on securities.

Operating Expenses

The following table details dollar amount and percentage changes of certain categories of other expense for the three years ended December 31, 2010.

Other Expense	2010 Amount	% of Total	Percent Change Prev. Yr.	2009 Amount	% of Total	Percent Change Prev. Yr.	2008 Amount	% of Total
				(Dollars in thousands)				
Salaries and employee benefits	$ 20,950	38%	(7)%	$ 22,512	45%	(11)%	$ 25,301	55%
Occupancy expense	7,240	13	(4)	7,515	15	0	7,496	17
Advertising	1,010	2	(25)	1,351	3	(8)	1,474	3
Fees and service charges	2,666	5	(9)	2,940	6	48	1,990	4
Printing, postage and supplies	1,346	2	0	1,352	3	(6)	1,442	3
Legal and accounting	1,244	2	(28)	1,734	3	(1)	1,758	4
FDIC assessment	1,892	3	(20)	2,373	5	364	511	1
OREO operations(1)	3,472	6	(35)	5,389	11	445	988	3
Goodwill Impairment	11,662	22	100					
Other expense	3,412	7	(24)	4,464	9	1	4,412	10

Total	$	54,894	100%	11%	$ 49,630	100%	9%	$ 45,372	100%

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

Operating expense for the twelve months ended December 31, 2010 totaled $54.9 million, an increase of $5.3 million over the same period one year ago. However, operating expense excluding the goodwill impairment charge for the twelve months ended December 31, 2010 totaled $43.2 million, a decrease of $6.4 million, or 12.9% over the same period one year ago. See Item 6, Selected Financial Data for discussion of non-GAAP financial measures.

Salaries and employee benefits expense for the twelve months ended December 31, 2010 decreased $1.6 million, or 6.9% compared to the same period one year ago. During 2010, the Company implemented a restructuring plan resulting in an 8% reduction in staff by the end of April and continuing reductions for the rest of the year. Severance costs paid as part of this staff reduction totaled $561,000 for 2010. Future expense savings from the original restructuring are estimated to be approximately $600,000 per quarter, with additional compensation expense savings forecasted. Ongoing efforts to control compensation expense include centralizing and automating additional functions, reducing administrative overhead, and revamping our credit management process. At December 31, 2010, full-time-equivalent employees (FTE) totaled 349, compared with 406 at December 31, 2009 and 418 at December 31, 2008. The reductions in compensation and other benefits expense were partially offset by a $190,000, or 95.0%, increase in unemployment insurance expense from 2009.

Occupancy expenses were $7.2 million for the twelve months ended December 31, 2010, a 3.7% decrease compared to December 31, 2009. The decrease from last year reflects reduced rent expense and lower hardware, software, and equipment purchasing activity, as previous infrastructure investments have enhanced efficiency and reduced the need for additional purchasing activity. The Company also consolidated administrative functions during the second quarter, which allowed it to terminate leases on two formerly leased properties. Continued centralization and outsourcing efforts are anticipated to bring further improvement to this area in the near future.

The advertising expense decrease of $341,000 for the twelve month period compared to the same period one year ago is a result of reductions in general advertising and media expenses, as the need for broad advertising in the current market has been limited. The $274,000 decrease in fees and service charges for the twelve month period ended December 31, 2010 compared to the same period one year ago is primarily comprised of decreases in loan collection, repossession and liquidation expenses, with particularly large reductions in the latter part of this year. These expenses are expected to decline further as the Company s credit quality continues to improve. Printing, postage and supplies remained static for the twelve month period in comparison to last year s total, with a $6,000 decrease from a year ago. Additional outsourcing activities are expected to result in improvements in these areas over the next several months. Legal and accounting fees decreased by $490,000 in comparison to the same twelve month period in 2010 as the Company reduced expenditures on outside legal and consulting services related to loan collection and regulatory compliance. Legal fees may continue to remain high, given Company credit resolution efforts and increasing regulatory requirements, but are likely to be offset by lower consulting fees over the near term.

At $1.9 million, FDIC expense was down $481,000 or 20.0% from the twelve months ended December 31, 2010. Higher regular premium costs in 2010 were more than offset by the absence of any special assessments. In September 2009, the Company accrued $475,000 to pay a special assessment to the FDIC to help recapitalize the insurance fund. Given the challenged state of the banking industry, future assessments are likely to remain high, but may be partially offset by improving Company conditions.

OREO operations, related valuation adjustments and gain/loss on sale of OREO decreased by $1.9 million for the twelve month period over the same period last year. OREO volumes have been reduced substantially and property valuation adjustments and losses on sale are significantly lower. OREO expenses and adjustments should continue to decline from the peak reached in late 2009 as the Company reduces its OREO balances and liquidation activity subsides.

As noted earlier, the Company recorded an $11.7 million goodwill impairment during 2010, reducing the balance of goodwill to zero, as compared to the December 31, 2009 balance of $11.7 million. Goodwill represents the difference between the value of consideration paid and the fair value of the net assets received in a business combination. Intermountain records impairment losses as charges to noninterest expense and adjustments to the carrying value of goodwill. Goodwill is tested for impairment on an annual basis, or more frequently as events occur, or as current circumstances and conditions warrant. The Company engaged an independent consultant at December 31, 2009 to assist management in evaluating the carrying value of goodwill. The evaluation followed the two-step process for evaluating impairment required by accounting guidance. In Step 1, the Company evaluated whether an impairment of goodwill might exist at December 31, 2009. Since the Company operates in a single segment this evaluation was based on a comparison of the estimated fair value of the Company in comparison to the book value of the Company s common equity at December 31, 2009. The results of Step 1 indicated that a potential for impairment did exist at the end of 2009, requiring the Company to engage in Step 2 to determine the amount of the impairment, if any.

The Step 2 evaluation required the Company to calculate the implied fair value of its goodwill. The implied fair value of goodwill is determined in the same manner as goodwill recognized in a business combination. The estimated fair value of the Company is allocated to all of the Company s assets and liabilities, including any unrecognized identifiable assets, as if the Company had been acquired in a business combination and the estimated fair value of the Company is the price paid to acquire it. The Step 2 analysis indicated that the Company s fair value at December 31, 2009 exceeded the net fair value of its assets by an amount greater than the carrying value of its goodwill. As a result, the Company determined that no impairment existed in 2009.

At September 30, 2010, the Company concluded there was a triggering event related to continuing depressed economic conditions and ongoing losses incurred by the Company. As a result, Intermountain performed a goodwill impairment evaluation using current information. In completing its goodwill impairment analysis, the Company used tangible common equity multiples and core deposit metrics from recent transactions to estimate the fair value of the Company at September 30, 2010. For Step 1, the fair value of the Company was less than the common book value of the Company prior to any goodwill adjustments, indicating a potential impairment. As such, under accounting guidance, a Step 2 analysis was required. In the Step 2 analysis, the fair value of the Company s assets and liabilities was determined, using discounted cash flows based on the cash flow characteristics of the assets and liabilities and prevailing market interest rates. The fair value of the liabilities was subtracted from the fair value of the assets resulting in the fair value of the net assets. This was then reduced by the value of the preferred stock to derive the sum of the fair value of net assets supported by common equity. Since this number was higher at September 30, 2010 than the fair value of the Company calculated in Step 1, there was no excess company value that could be allocated to goodwill, resulting in a full impairment of the Company s goodwill. Intermountain recorded this impairment loss as a charge to noninterest expense and an adjustment to the carrying value of goodwill.

The Company s efficiency ratio was 93.4% (excluding the goodwill impairment of $11.7 million) for the twelve months ended December 31, 2010, compared to 99.9% for the twelve months ended December 31, 2009. However, the quarter by quarter comparison shows continued improvement in this ratio over the past year. The ratio was 86.3% for the three months ended December 31, 2010, compared to the adjusted ratio of 86.6% for the sequential quarter and 125.0% for the three months ended December 31, 2009. The Company has been and continues to execute strategies to reduce controllable expenses to improve efficiency. However, flat asset growth, net interest margin compression and substantially higher credit-related expenses and FDIC insurance premiums have hampered efficiency gains. With economic conditions likely to remain challenging in the near future, the Company continues to lower its interest expense and is implementing additional efficiency and cost-cutting efforts. Management anticipates that as it completes the action plans developed under prior initiatives and undertakes its new plans, the efficiency and expense ratios will improve. Stabilization and improvement in economic conditions in the future should also improve efficiency, as net interest income rebounds and credit-related costs subside.

Income Tax Provision. Federal and state income tax benefits totaled $882,000 and $14.4 million for the twelve months ended December 31, 2010 and 2009, respectively. The effective tax rates used to calculate the tax benefit were (2.7%) and (39.6%) for the twelve months ended December 31, 2010 and 2009, respectively. During the third quarter of 2010, Intermountain determined that the negative evidence associated with three-year cumulative loss and continued depressed economic conditions outweighed the existing positive evidence. Therefore, during the third quarter of 2010, Intermountain established a valuation allowance of $7.4 million against its deferred tax asset. Results for fourth quarter 2010 were materially consistent with expectations and as a result, the Company made no change to the net deferred tax asset of approximately $15.3 million that it expects to utilize over the next few years. As a result, due to the increase in its deferred tax assets (from operations) during the fourth quarter 2010, the Company increased its valuation allowance correspondingly by approximately $1.4 million. The fourth quarter increase in the deferred tax assets and corresponding increase to the valuation allowance resulted in no provision or benefit for quarter. The Company analyzes the deferred tax asset on a quarterly basis and may recapture a portion or all of this allowance depending on future profitability. At December 31, 2010, the net deferred tax asset totaled $15.3 million, net of a deferred tax asset valuation of $8.8 million, compared to a net deferred tax asset of $16.9 million, net of a deferred tax asset valuation of $0 at December 31, 2009. Excluding the original deferred tax asset valuation charge of $7.4 million, the effective tax rate was 20.0% for 2010.

Intermountain uses an estimate of future earnings and tax planning strategies to determine whether it is more likely than not that the benefit of its net deferred tax asset will be realized. In developing its estimate of future earnings, two different scenarios were used and the results of the two were probability weighted and averaged together to determine both the need for a valuation allowance and the size of the allowance. In conducting this analysis, management has assumed economic conditions will continue to be very challenging in 2011, followed by gradual improvement in the ensuing years. These assumptions are in line with both national and regional economic forecasts. As such, its estimates include elevated credit losses in 2011, but at lower levels than those experienced in 2009 and 2010, followed by improvement in ensuing years as the economy improves and the Company s loan portfolio turns over. It also assumes improving net interest margins beginning in late 2011, as it is able to convert some of its cash position to higher yielding instruments, and reductions in operating expenses as credit costs abate and its other cost reduction strategies continue

Financial Position

Assets. At December 31, 2010, Intermountain s assets were $1.01 billion, down $74.5 million from $1.08 billion at December 31, 2009. During this period, increases in investments available-for-sale and cash and cash equivalents were offset by a decrease in loans receivable. Given the challenging economic climate and the lack of quality borrowing demand, the Company continued to manage its balance sheet cautiously, limiting asset growth, reducing problem loans and shifting the mix from loans to more conservative and liquid investments.

Investments. Intermountain s total investment portfolio, including investments available for sale, investments held to maturity and FHLB stock, at December 31, 2010 was $207.6 million, an increase of $8.3 million from the December 31, 2009 balance of $199.3 million. The increase was primarily due to the net purchase of high-quality taxable municipal bonds. During the twelve months ended December 31, 2010, the Company sold $15.3 million in investment securities resulting in a $349,000 net pre-tax gain, and experienced higher prepayments on its MBS related to FNMA and FHLMC accelerating payments on guaranteed mortgages that had defaulted. The Company continued to position the portfolio to perform better in unchanged or rising rate environments by holding mostly agency-guaranteed mortgage-backed securities with strong cash flows and short durations. As of December 31, 2010, the balance of the unrealized loss on investment securities (including cumulative OTTI recognized through other comprehensive income), net of federal income taxes, was $797,000, compared to an unrealized loss at December 31, 2009 of $4.9 million. The unrealized loss for both periods was caused by the impacts of illiquid markets on the pricing of some of the Company s non-agency backed mortgage backed securities, but was mostly offset in the recent period by unrecognized gains on many of the agency-guaranteed securities.

The Company currently holds two residential MBS, with an unpaid balance totaling $10.4 million that are determined to have other than temporary impairments (OTTI), as detailed in the table below:

Security Issuer	Principal Balance	Fair Value	Unrealized (Loss) Gain	Cumulative OTTI Credit Loss Recorded in Income	Cumulative OTTI Impairment Loss Recorded in OCI
Security 1	$ 3,201	$ 2,066	$ 526	$ (947)	$ (805)
Security 2	7,241	5,854	200	(407)	(1,122)

Total	$ 10,442	$ 7,920	$ 726	$ (1,354)	$ (1,927)

In March, 2009, residential mortgage-backed securities included a security comprised of a pool of mortgages with a remaining unpaid principal balance of $4.2 million. In the year ended December 31, 2009, 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 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 (loss). The Company has recorded additional credit loss impairments totaling $947,000, including $421,000 in 2010. However, the overall estimated market value on the security improved during this time, reducing the net non-credit value impairment to $805,000. In June 2010, the Company identified an additional residential mortgage-backed security comprised of a pool of mortgages with a remaining unpaid principal balance of $7.5 million. At June 30, 2010, its fair value was determined to be $6.0 million based on similar analytical modeling. Of the $1.5 million original OTTI on this security, based on an analysis of projected cash flows, $407,000 was charged to earnings as a credit loss for the twelve months ended December 31, 2010, leaving a net non-credit value impairment of $1.1 million at December 31, 2010. At this time, the Company anticipates holding the two securities until their value is recovered or until maturity, and will continue to adjust its net income and other comprehensive income (loss) 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 securities from their amortized cost at the end of each period.

Loans Receivable. At December 31, 2010 net loans receivable totaled $563.2 million, down $92.4 million or 14.1% from $655.6 million at December 31, 2009. During the twelve months ended December 31, 2010, total loan originations were $267.4 million compared to $411.3 million for the prior year s comparable period. The decrease in total loan originations reflected difficult economic conditions, muted borrowing demand in the Company s markets, and tighter underwriting standards. As part of its ***Powered By Community*** initiative, the Company continues to market residential and commercial lending programs to help ensure the credit needs of its communities are met. In particular, it is pursuing attractive small and mid-market commercial credits, originating commercial real estate loans to strong borrowers at lower real estate prices, originating mortgage loans to strong borrowers at conservative loan-to-values, diversifying its agricultural portfolio, and expanding its already strong government-guaranteed loan marketing efforts. These efforts have been reasonably successful, but have not been sufficient to offset the substantial and intentional reduction in the Company s land development and construction portfolios. The Company also recently introduced new SBA and mortgage lending initiatives to spur additional production in its markets, which appear to be gaining some traction.

The following table sets forth the composition of Intermountain s loan portfolio at the dates indicated.

	December 31, 2010		December 31, 2009		December 31, 2008	
	Amount	%	Amount	%	Amount	%
			(Dollars in thousands)			
Commercial loans	$ 122,656	21.31	$ 131,562	19.57	$ 139,443	18.13
Commercial real estate loans	175,559	30.50	172,726	25.69	161,628	21.00
Commercial construction loans	17,951	3.12	45,581	6.78	60,057	7.81
Land and land development loans	60,962	10.59	88,604	13.18	136,514	17.75
Agriculture loans	87,364	15.18	110,256	16.40	112,358	14.61
Multifamily loans	26,417	4.59	18,067	2.69	18,617	2.42
Residential real estate loans	60,872	10.58	65,544	9.75	72,301	9.40
Residential construction loans	3,219	0.56	16,626	2.47	40,001	5.20
Consumer loans	14,095	2.45	18,287	2.72	23,245	3.02
Municipal loans	6,528	1.12	5,061	0.75	5,109	0.66
Total loans receivable	575,623	100.00	672,314	100.00	769,273	100.00
Net deferred origination fees	60		(104)		(225)	
Allowance for losses on loans	(12,455)		(16,608)		(16,433)	
Loans receivable, net	$ 563,228		$ 655,602		$ 752,615	

Weighted average yield at end of period	6.04%	6.15%	6.38%

As a result of the Company s continued efforts to reduce construction and land development exposure, these loan categories declined an additional $68.7 million during 2010. They now represent 14.3% of the Company s total loan portfolio and only about 30.8% of the exposure in 2008, based on dollar volumes. Commercial loans decreased as several larger problem loans were resolved in 2010 and slow demand by area businesses reduced new origination activity. Commercial real estate loans increased slightly, largely as a result of the conversion of commercial construction loans into term notes. Decreasing agricultural loans reflected very strong agricultural markets, reducing the need for farmers to borrow and allowing them to pay down additional debt. Most other categories were unchanged or slightly lower, continuing to reflect slow economic conditions.

The rapid reduction in the construction and land development portfolio has reduced the future potential loss exposure in this segment significantly. The mix of this segment has changed considerably as well, with a substantial reduction in residential subdivision loans, leaving a lower-risk portfolio of commercial land and construction loans, smaller lots owned by individual consumers, and a small number of remaining lower-priced subdivision projects.

The commercial portfolio is diversified by industry with a variety of small business customers that have held up relatively well during this economic downturn. As slow economic conditions continue, however, the Company has experienced a moderate increase in stress in this portfolio, including the large chargeoff on a commercial borrower discussed in the Provision for Loan Losses section above. Most of the commercial credits are smaller, however, and Intermountain carries a higher proportion of SBA and USDA guaranteed loans than many of its peers, reducing the overall risk in this portfolio.

Difficult economic conditions continue to create risk in the non-residential component of the commercial real estate portfolio. However, in comparison to peers, the Company believes it 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. 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 (19%), industrial (13%), multifamily (13%), health care (6%), and retail (5%). The other 44% 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 1% of the commercial real estate portfolio, although there are also several unfinished condo projects in the construction and development portfolio.

The following table provides additional information on the Company s commercial real estate portfolio:

Commercial Real Estate by Property Types	**December 31, 2010**		**December 31, 2009**	
	(Dollars in thousands)			
Condominiums	$ 2,321	1.1%	$ 4,504	2.4%
Office	38,528	19.1%	32,265	16.9%
Industrial warehouse	25,911	12.8%	29,206	15.3%
Storage units	6,782	3.4%	6,984	3.7%
Retail	10,722	5.3%	12,177	6.4%
Restaurants	6,114	3.0%	6,028	3.2%
Land and land development	7,859	3.9%	10,281	5.4%
Other commercial	16,562	8.2%	19,560	10.3%
Health care	12,486	6.2%	11,345	5.9%
Religious facilities	1,758	0.9%	2,538	1.3%
Gas stations & convenience stores	5,818	2.9%	2,712	1.4%
Auto R/E (car lot, wash, repair)	2,290	1.1%	2,554	1.3%
Hotel/Motel	2,546	1.3%	3,351	1.8%
Miscellaneous	35,862	17.7%	29,221	15.2%
Total Commercial real estate loans	175,559	86.9%	172,726	90.5%
Multifamily	26,417	13.1%	18,067	9.5%

Total Commercial real estate and Multifamily Loans	$ 201,976	100.0%	$ 190,793	100.0%

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 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 102.35%, 151.86%, and 183.26% for 2010, 2009 and 2008, 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 254.93% in 2008 to 214.29% at the end of 2009 and up slightly to 216.52% at the end of 2010. As a result, Intermountain remains below this regulatory guideline. Most agricultural markets continue to perform very well, and the Company has very limited exposure to the severely impacted dairy market. In fact, the sector has performed so well that many of its best borrowing customers are using excess cash generated over the past couple of years to reduce their overall borrowing position. Intermountain has also experienced challenges with a couple of larger cattle operations, and moved aggressively to resolve or liquidate these credits.

The residential and consumer portfolios consist primarily of first and second mortgage loans, unsecured loans to individuals, and auto, boat and RV loans. These portfolios have performed well with limited delinquencies and defaults, given the difficult economic conditions. These loans have generally been underwritten with relatively conservative loan to values, reasonable debt-to-income ratios and required income verification.

High unemployment and decreased asset values continue to challenge Intermountain s customers and its loan portfolios. However it appears that economic conditions may be stabilizing in most of the Company s markets, and management believes that its underwriting standards and aggressive identification and management of credit problems are having a positive impact on its credit portfolios. Losses are likely to remain elevated in 2011, but at lower levels than in 2009 and 2010, with continued improvement in subsequent years.

Geographic Distribution

As of December 31, 2010, the Bank s loan portfolio by loan type and geographical market area was:

Loan Portfolio by Location	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	$ 81,916	$ 9,572	$ 10,747	$ 18,865	$ 1,556	$ 122,656	21.3%
Commercial real estate loans	115,721	14,536	18,295	17,465	9,542	175,559	30.5%
Commercial construction loans	6,738	3,070	8,143			17,951	3.1%
Land and land development loans	47,197	4,421	5,944	1,904	1,496	60,962	10.6%
Agriculture loans	1,609	7,302	16,754	59,575	2,124	87,364	15.2%
Multifamily loans	18,205		725		7,487	26,417	4.6%
Residential real estate loans	39,482	5,795	3,582	8,248	3,765	60,872	10.6%
Residential construction loans	2,594	287	7	331		3,219	0.6%
Consumer loans	7,802	1,580	1,318	2,960	435	14,095	2.4%
Municipal loans	4,955	1,573				6,528	1.1%

Total	$ 326,219	$ 48,136	$ 65,515	$ 109,348	$ 26,405	$ 575,623	100.0%
Percent of total loans in geographic area	56.4%	8.4%	11.5%	19.1%	4.6%	100.0%	
Percent of total loans where real estate is the primary collateral	70.6%	64.5%	59.5%	40.2%	85.4%	63.7%	

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

an 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)				
mmercial loans	$ 86,682	$ 11,057	$ 14,067	$ 18,090	$ 1,666	$ 131,562	19.6
mmercial real estate loans	106,913	17,051	20,063	15,564	13,135	172,726	25.7
mmercial construction loans	35,335	187	9,105	180	774	45,581	6.8
nd and land development loans	61,329	7,434	11,403	7,342	1,096	88,604	13.2
riculture loans	2,145	8,883	19,618	74,730	4,880	110,256	16.4
ltifamily loans	9,133	135	1,078		7,721	18,067	2.6
sidential real estate loans	41,614	6,904	4,136	8,399	4,491	65,544	9.7
sidential construction loans	11,698	795	1,141	2,884	108	16,626	2.5
nsumer loans	9,629	2,140	1,449	4,377	692	18,287	2.7
nicipal loans	4,766	295				5,061	0.8
al	$ 369,244	$ 54,881	$ 82,060	$ 131,566	$ 34,563	$ 672,314	100.0
cent of total loans in geographic a	54.9%	8.2%	12.2%	19.6%	5.1%	100.00%	
cent of total loans where real estate he primary collateral	72.1%	63.9%	60.1%	41.0%	79.1%	64.2%	

As illustrated, 76% 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, portfolio loss rates have been lower than in the Boise area or other areas of the country. This reflects the differing economies in these areas, generally more conservative lending and borrowing norms, longer-term customers, 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 levels of price appreciation or depreciation as steep as other areas over the last few years. Through aggressive loan workout efforts, the Company has reduced its exposure to the Boise market significantly, particularly its residential construction and land development loans in this area. 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 36% of this total or 1.6% of the total loan portfolio.

Participation loans where Intermountain purchased part of the loan and was not the lead bank totaled $19.0 million at December 31, 2010. $7.1 million of the total is a condominium project in Boise that is currently classified, but is being managed very closely, and for which no loss is expected. The remaining loans are all within the Company s footprint and management believes they do not present significant risk at this time.

The following table sets forth the composition of Intermountain s loan originations for the periods indicated.

	Twelve Months Ended December 31, 2010	2009	% Change
	(Dollars in thousands)		
Commercial loans	$ 75,873	$ 98,549	(23.0)
Commercial real estate loans	24,006	33,512	(28.4)
Commercial construction loans	9,960	30,711	(67.6)
Land and land development loans	4,851	16,200	(70.1)
Agriculture loans	65,459	89,932	(27.2)
Multifamily loans	52	375	(86.1)
Residential real estate loans	71,757	128,466	(44.1)
Residential construction loans	5,843	3,528	65.6
Consumer	6,961	9,033	(22.9)
Municipal	2,660	1,033	157.5
Total loans originated	$ 267,422	$ 411,339	(35.0)

2010 origination results reflect reductions in virtually all areas, as high unemployment, depressed real estate prices, and cautious borrowers reduced borrowing demand significantly. The construction and development, and commercial and residential real estate reductions reflect a combination of minimal loan demand for these types of loans and tight underwriting conditions. Potential borrowers remain very cautious about pursuing new real estate purchase, expansion or construction activities. The Company anticipates commercial, commercial real estate and residential real estate origination activity to slowly increase as the economy improves, borrowing demand returns, and customers from distressed banks seek new credit from Intermountain. Residential construction and land development originations are likely to remain constricted, given a substantial backlog of properties in its markets.

Office Properties and Equipment. Office properties and equipment decreased 5.1% to $40.2 million from $42.4 million at December 31, 2009 due primarily to depreciation recorded for 2010. Reflecting efficiencies gained from prior infrastructure investments, the Company has been able to reduce its hardware, software and equipment purchases.

Per its original plan, the Company sold the Sandpoint Center, its Company headquarters, in August 2009 to a third party in order to reduce debt and increase the Company s future flexibility. The building was sold for $24.8 million with financing provided by Panhandle State Bank. Because of the non-recourse financing terms offered by Panhandle State Bank, the lease is treated as an operating lease utilizing the financing method for accounting purposes. Consequently, there was no gain recognized at the time of the transaction and the building will remain on the consolidated financial statements with depreciation and interest expense recognized over the life of the lease. Panhandle State Bank executed an agreement to lease the building from the purchaser with an initial term of 20 years with three successive options to extend the lease for an additional 10 years each.

Other Real Estate Owned. Other real estate owned decreased to $4.4 million at December 31, 2010 from $11.5 million at December 31, 2009. The Company continues to actively market and liquidate its OREO properties, selling seventy-five properties for $13.4 million in 2010. This more than offset the seventy-two properties totaling $8.9 million that entered OREO during the period.

The following tables provide additional trending information about the OREO portfolio.

Other Real Estate Owned Activity

	2010	2009	2008	2007
		(Dollars in thousands)		
Balance, beginning of period, January 1	$ 11,538	$ 4,541	$ 1,682	$ 795
Additions to OREO	8,946	20,789	4,092	896
Proceeds from sale of OREO	(13,442)	(9,830)	(474)	(9)
OREO valuation adjustments in the period(1)	(2,613)	(3,962)	(759)	
Balance, end of period, December 31	$ 4,429	$ 11,538	$ 4,541	$ 1,682

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

The remaining OREO portfolio consists of 47 properties totaling $4.4 million. At year end, OREO assets consisted of single family residences (49%), developed residential lots (23%), commercial buildings (18%), and raw land (10%). Given still elevated levels of problem loans, the Company anticipates continued migration in and liquidation out of the OREO portfolio over the next year, but has found more active markets to sell properties, reducing the anticipated loss on OREO property significantly.

Other Real Estate Owned Quarterly Activity

	Dec 10	Sep 10	Jun 10	Mar 10	Dec 09
			(Dollars in thousands)		
Balance, beginning of period	$ 6,424	$ 8,754	$ 11,538	$ 11,538	$ 14,395
Additions to OREO	2,365	1,653	2,467	2,461	5,785
Proceeds from sale of OREO	(4,042)	(3,584)	(4,133)	(1,684)	(6,992)
OREO valuation adjustments in the period(1)	(318)	(399)	(1,118)	(777)	(1,650)
Balance, end of period	$ 4,429	$ 6,424	$ 8,754	$ 11,538	$ 11,538

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

Intangible Assets. As discussed in the Operating Expense section above, intangible assets decreased as a result of the $11.7 million goodwill impairment recorded in the quarter ended September 30, 2010 and the continuing amortization of the core deposit intangible. The Company concluded there was a triggering event that occurred in the quarter ended September 30, 2010 which required a goodwill evaluation as of September 30, 2010. This evaluation resulted in a full impairment of the Company s goodwill during 2010.

Deferred Tax Asset. At December 31, 2010, the Company s net deferred tax asset totaled $15.3 million. The deferred tax asset included $17.0 million in net operating loss carry forwards and $7.0 million in temporary timing differences. At September 30, 2010, Intermountain assessed whether it was more-likely-than-not that it would realize the benefits of its deferred tax asset. Intermountain determined that the negative evidence associated with a projected three-year cumulative loss for the period ending December 31, 2010, and the continued depressed economic conditions outweighed the positive evidence. Therefore, Intermountain established a valuation allowance of $7.4 million against its deferred tax asset. During the fourth quarter of 2010, Intermountain reserved the full tax benefit in the amount of $1.4 million due to continuing uncertain economic conditions. See the Income Tax Provision section above for more information.

BOLI and All Other Assets. Bank-owned life insurance (BOLI) and other assets totaled $22.4 million at December 31, 2010, down from $29.5 million at December 31, 2009.

Deposits. Total deposits decreased $40.5 million to $778.8 million at December 31, 2010 from $819.3 million at December 31, 2009. The decrease in 2010 largely reflects management s decision to allow wholesale and

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higher-rate, non-relationship deposits to run off during the year. Given its strong liquidity position, the Company focused on lowering the cost of its deposit base while maintaining its strong core relationship deposit base, and was successful in achieving this goal.

The following table sets forth the composition of Intermountain s deposits at the dates indicated.

	December 31, 2010		December 31, 2009	
	Amount	%	Amount	%
	(Dollars in thousands)			
Demand	$ 168,519	21.6	$ 168,244	20.5
NOW and money market 0.0% to 4.65%	327,891	42.1	340,070	41.6
Savings and IRA 0.0% to 5.75%	75,387	9.7	77,623	9.5
Certificate of deposit accounts (CDs)	79,533	10.2	86,381	10.5
Jumbo CDs (CDs $100,000 and over)	77,685	10.0	82,249	10.0
Brokered CDs	40,899	5.3	54,428	6.6
CDARS CDs to local customers	8,919	1.1	10,326	1.3
Total deposits	$ 778,833	100.0	$ 819,321	100.0
Weighted average interest rate on certificates of deposit		1.66%		2.52%
Core Deposits as a percentage of total deposits(1)		83.2%		81.6%
Deposits generated from the Company s market area as a % of total deposits		94.8%		93.4%

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

Non-interest bearing demand deposits were stable during the year and totaled $168.5 million, or 21.6% of the total deposit base, NOW and money market deposits totaled $327.9 million or 42.1% of the deposit base, up from 41.6% in the prior year. The 3.6% reduction in NOW and money market balances from the prior year end reflects planned collateralized deposit runoff and the movement of public deposits into either repurchase agreements or other investment alternatives as a result of FDIC coverage changes at year end. Transaction deposits represent the bulk of the deposit base at 63.7% of total deposits at December 31, 2010 compared to 62.1% a year ago. Jumbo and brokered deposits continued to decline both in absolute terms and as a percent of the overall portfolio reflecting the ongoing strategy to build core deposits.

The Company s strong local, core funding base, high percentage of checking, money market and savings balances and careful management of its brokered CD funding provide lower-cost, more reliable funding to the Company than most of its peers and add to the liquidity strength of the Bank. Maintaining the local funding base at a reasonable cost remains a critical priority for the Company s management and production staff. The Company uses a combination of proactive branch staff efforts and a dedicated team of deposit sales specialists to target low-cost deposit balances. It emphasizes personalized service, local community involvement and targeted campaigns to generate deposits, rather than media campaigns or advertised rate specials. The introduction of new sales platform technology, mobile banking technology, electronic statements and other online banking enhancements should spur additional low cost deposit growth when the Company needs it in the future.

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Deposits by location are as follows (dollars in thousands):

Deposits by Location	December 31, 2010	% of total deposits	December 31, 2009	% of total deposits
North Idaho Eastern Washington	$ 374,173	48.0	$ 402,620	49.1
Magic Valley Idaho	68,870	8.8	69,430	8.5
Greater Boise Area	79,697	10.2	77,291	9.4
Southwest Idaho Oregon, excluding Boise	165,505	21.3	158,919	19.4
Administration, Secured Savings	90,588	11.7	111,061	13.6
Total	$ 778,833			