INTERMOUNTAIN COMMUNITY BANCORP
Form 10-K
March 16, 2007

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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, 2006

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.)*

231 N. Third Avenue, 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 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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer on Rule 12b-2 of the Exchange Act.

o Large Accelerated filer   þ Accelerated filer   o Non Accelerated filer

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, 2006, 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 $120,267,000.

The number of shares outstanding of the registrant s Common Stock, no par value per share, as of March 2, 2007 was 7,415,585.

DOCUMENTS INCORPORATED BY REFERENCE

Specific portions of the registrant s Proxy Statement dated March 23, 2007 are incorporated by reference into Part III hereof.

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PART I

The discussion following below and elsewhere in this Form 10-K contains forward-looking statements, which are subject to safe harbors under the Securities Act of 1933 and the Securities Exchange Act of 1934. When used in this discussion and elsewhere in this Form 10-K, the words or phrases will likely result, are expected to, will continue, is anticipated, estimate, project or similar expressions are intended to identify forward-looking statements. In addition, statements that refer to projections of the Company s future financial performance, anticipated growth and trends in the Company s businesses and in the financial services industry, including statements regarding the Company s plans to expand, expected growth in Other income services, and expectations regarding operating expense levels during 2007, are forward-looking statements. Readers are cautioned to not place undue reliance on any such forward-looking statements, which speak only as of the date of this Form 10-K, and readers are advised that various factors, including regional and national economic conditions, unfavorable judicial decisions, substantial changes in levels of market interest rates, credit and other risks of lending and investment activities and competitive and regulatory factors and other factors listed under Risk Factors in Item 1A could affect the Company s financial performance and could cause actual results for future periods to differ materially from those anticipated or projected. The Company does not undertake and specifically disclaim any obligation to update any forward-looking statements to reflect occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

Item 1. *BUSINESS*

Forward-Looking Statements

Intermountain Community Bancorp (Intermountain or the Company) is a financial 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 (the 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 (Department), 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. During 1999, the Bank opened its first branch under the name of Intermountain Community Bank, a division of Panhandle State Bank, in Payette, Idaho. In 2000, the second branch under that name was opened in Weiser, Idaho. Three additional branches were opened during 2001, one in Coeur d Alene, another in Nampa and the third in Rathdrum. In 2002, a branch was started in Caldwell and during 2003 a branch was opened in Post Falls. In January 2003, the Bank acquired a branch office from Household Bank F.S.B. located in Ontario, Oregon, its first and only out-of-state branch at the time. Also, in 2003, the Company changed the names of the Coeur d Alene, Post Falls, and Rathdrum branches from Intermountain Community Bank to Panhandle State Bank, because the Panhandle State Bank name had more brand recognition in the northern part of the state. In November 2004, Intermountain acquired Snake River Bancorp, Inc. (Snake River) and its subsidiary bank, Magic Valley Bank, which consisted of three branches. The branches were located in south central Idaho in the cities of Twin Falls, Gooding and Jerome. In June 2005, the Company opened a branch in Spokane Valley, Washington. In August 2005, the Company closed its Jerome, Idaho branch and consolidated the branch operations into its Twin Falls branch.

In March 2006, the Company opened a branch in Kellogg, Idaho. In April 2006, the Company opened a branch in Fruitland, Idaho and a branch in downtown Spokane, Washington. It also opened a Trust & Wealth division, offering trust & wealth management services to its customers. In September 2006, the Company opened a second branch in Twin Falls, Idaho, and purchased a small investment company, which now operates as Intermountain Community Investment Services (ICI), providing investment advisory services to its customers.

The Bank s primary service area covers three 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. The north Idaho region is heavily forested and contains 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. Both Kootenai and Bonner County have also experienced additional light industrial, high-tech, commercial, retail and medical development over the past ten years. Shoshone County is experiencing residential development relating to the outdoor recreation industry in the area. The Spokane County economy is the most diverse in eastern Washington. There is an emergence of new high tech industries, as well as an established base of mature businesses in manufacturing, health care and service industries.

The second region served by the Bank encompasses three counties in southwestern Idaho (Canyon, 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 and pigs, are also raised. Because of its proximity to Boise, Canyon County has expanding residential and retail development, and a more diversified light manufacturing and commercial base.

The third region served by the Bank encompasses two counties in south central Idaho (Twin Falls and Gooding). 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 prevalent. Twin Falls County has experienced significant growth over the past 10 years and as a result, residential and commercial construction is a much larger driver of the local economy. The area is also experiencing growth in light manufacturing and retail development.

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 million in preferred securities, the purchasers of which are entitled to receive cumulative cash distributions from the Trusts. The Company has issued junior subordinated debentures to the Trusts, and payments from these debentures are used to make the cash distributions to the holders of the Trusts preferred securities.

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 and Weiser, one branch is located in Spokane Valley, Washington, one branch is located in Spokane, Washington and one branch is 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. On December 31, 2006, the Company had total consolidated assets of $919.9 million.

Competition

Based on total asset size as of December 31, 2006, 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, and 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 decision-making. 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 both market share and profitability over the past several years.

The Company s principal market area is divided into three separate regions based upon population and the presence of banking offices. In the northern part of Idaho and eastern Washington, the delineated communities are Boundary, Bonner, Kootenai and Shoshone Counties in Idaho and Spokane County in Washington. Primary competitors in this northern region include US Bank, Wells Fargo, Key Bank, Washington Trust Bank, Sterling Savings Bank and Bank of America, all large international or regional banks, and Idaho Independent Bank and Mountain West Bank, both community banks.

In southwestern and south central Idaho and eastern Oregon, the Bank has delineated Washington, Payette, Canyon, Malheur, Twin Falls and Gooding Counties. Primary competitors in the southern region include international or regional banks, US Bank, Wells Fargo, Key Bank, Bank of America and Zions Bank, and community banks, Farmers & Merchants State Bank, Idaho Independent Bank, DL Evans Bank and Farmers National Bank.

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, legal impediments, 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 USDA financing programs. Operating loans or lines of credit typically carry annual maturities. Straight maturity notes are also available, in which the maturities match the anticipated receipt of specifically identified repayment sources. Term loans for purposes such as equipment purchases, expansion, term working capital, and other purposes generally carry terms that match the borrower s cash flow capacity, typically with maturities of three years or longer. Risk is controlled by applying sound, consistent underwriting guidelines, concentrating on relationship loans as opposed to transaction type loans, and establishing sound alternative repayment sources. Government guaranty programs are also utilized when appropriate.

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. Sound underwriting is applied, as with other business loans, by a staff of lending and credit personnel seasoned in this line of lending. 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.

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 1st mortgage loans are offered with up to 30-year maturities, while typical maturities for 2nd mortgages (home improvement and home equity loans and lines) are as stated below under Consumer Loans. Lot acquisition and construction loans are also offered to consumers with typical terms up to 36 months (interest only loans are also available) and up to 12 months (with six months extension), respectively. Loans for purchase, construction, rehabilitation or repurchase of commercial and industrial properties are also available through the Bank, as are property development loans, with up to two-year terms typical for construction and development loans, and up to 10 years for term loans (generally with re-pricing after three, five or seven years). Risk is mitigated by selling the conventional residential mortgage loans (currently 100% are sold) and underwriting 2nd mortgage products for potential sale. Commercial real estate loans are generally confined to owner-occupied properties unless there is a strong customer relationship justifying otherwise. All commercial real estate loans are restricted to borrowers with established track records and financial wherewithal. Project due diligence is conducted by the Bank, to help provide for adequate contingencies, collateral and/or government guaranties.

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. Loans for the purchase of new autos typically range up to 72 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 generally reviewed by the Bank periodically. Relationship lending is emphasized, which, along with credit control practices, minimizes risk in this type of lending.

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

Deposit Services

The Bank offers the full range of 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 non-FDIC insured alternatives on a limited basis to customers, in the form of reverse repurchase agreements and sweep accounts.

Investment Services

The Bank provides alternative investment services through its division, Intermountain Community Investments (ICI). Products offered by ICI include annuities, equity and fixed income securities, mutual funds, insurance products and brokerage services to its customers. 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.

Trust & Wealth Management Services

The Bank also provides trust and wealth management services to its higher net worth customers to assist them in investment, tax and estate planning. 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 s assets and providing trust services.

Other Services

These services include automated teller machines (ATMs), debit and credit cards, safe deposit boxes, merchant credit card acceptance services, travelers cheques, savings bonds, direct deposit, night deposit, cash management services, internet and phone banking services, VISA/Mastercard credit cards and ACH origination services. The Bank is a member of the Star, Plus, Exchange, Interlink and Accell ATM networks. New products and

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services introduced in 2006 include remote deposit capture and positive pay services for businesses, and gift and travel cards for consumers.

Loan Portfolio

The loan portfolio continues to be the largest component of earning assets. In 2006, the Company increased total gross loans by 20%, or $111.3 million, resulting in a favorable increase in earnings for the Company. Commercial loans contributed the highest percentage growth in 2006, increasing $102.3 million or 24% over 2005.

During 2006, with a rising short-term interest rate environment and a slowdown in construction lending, loan competition increased, as lenders continued to aggressively pursue new loan originations and refinancings. As short-term interest rates increase, pressure is put on borrowers to pay more of their business income in interest to the Company. While the Company did not experience negative impacts from this in 2006, it may result in a higher rate of loan defaults in the future. If loan interest rates continue to increase, the Company s future earnings could be adversely affected. The Bank continues to pursue quality loans using conservative underwriting and control practices and to monitor existing loans carefully for increased default risk. The Bank also expanded its expertise and use of relationship pricing models and techniques during the year.

In 2005, the total loan portfolio increased 33%, with commercial loans contributing the highest percentage growth, 39% over 2004. In November 2004, the Bank acquired Snake River Bancorp, Inc. and its subsidiary bank, Magic Valley Bank, which contributed $65.5 million in net loans receivable at the acquisition date.

The following tables contain information related to the Company s loan portfolio for the five-year period ended December 31, 2006 (dollars in thousands).

			December 31,		
	2006	2005	2004	2003	2002
Commercial loans	$ 527,345	$ 425,005	$ 304,783	$ 215,396	$ 144,872
Residential loans	112,569	107,554	94,170	58,728	36,832
Consumer loans	31,800	29,109	24,245	16,552	13,854
Municipal loans	4,082	2,856	2,598	1,751	2,679
Total loans	675,796	564,524	425,796	292,427	198,237
Allowance for loan losses	(10,319)	(8,517)	(6,902)	(5,118)	(3,259)
Deferred loan fees, net of direct origination costs	(1,074)	(971)	(234)	(53)	(204)
Loans receivable, net	$ 664,403	$ 555,036	$ 418,660	$ 287,256	$ 194,774
Weighted average rate	8.65%	7.90%	6.81%	6.60%	6.94%

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. 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.

Non-accrual loans are those that have become delinquent for more than 90 days (unless well-secured and in the process of collection). Placement of loans on non-accrual status does not necessarily mean that the outstanding loan principal will not be collected, but rather that timely collection of principal and interest is in question. When a loan is placed on non-accrual status, interest accrued but not received is reversed. The amount of interest income which

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would have been recorded in fiscal 2006, 2005, 2004, 2003 and 2002 on non-accrual loans was approximately $21,000, $95,000, $55,000, $7,000 and $104,000, respectively. A non-accrual loan may be restored to accrual status when principal and interest payments are brought current or when brought to 90 days or less delinquent and continuing payment of principal and interest is expected.

As of December 31, 2006, there were no identified loans, other than those represented in the following table, which were not in compliance with the stated terms of the loan or otherwise presented additional credit risk to the Company.

Information with respect to non-accrual loans is as follows (dollars in thousands):

	December 31,				
	2006	2005	2004	2003	2002
Non-accrual loans	$ 1,201	$ 807	$ 1,218	$ 174	$ 609
Non-accrual loans as a percentage of total loans	0.18%	0.14%	0.29%	0.06%	0.31%
Total allowance related to these loans	$ 531	$ 341	$ 413	$ 47	$ 249
Interest income recorded on these loans	$ 230	$ 8	$ 10	$ 3	$ 11

Allowance for Loan Losses

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, 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. It is calculated by applying specified allocation factors to the various portfolio totals segmented by risk grades and loan types. The specific allocation factor is reviewed and determined annually, based on a historical migration analysis of charge-offs relative to the various risk grade categories. An allocation is also included for unfunded commitments.

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

	December 31, 2006			
	Percent of Loans to Total Loans	Gross Loans	Allowance	Non-Accrual Loans
Commercial loans	78.03%	$ 527,345	$ 8,406	$ 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	$ 10,319	$ 1,201

	December 31, 2005			
	Percent of Loans to Total Loans	Gross Loans	Allowance	Non-Accrual Loans
Commercial loans	75.28%	$ 425,005	$ 6,210	$ 671
Residential loans	19.05%	107,554	1,827	10
Consumer loans	5.16%	29,109	450	126
Municipal loans	0.51%	2,856	30	
Totals	100.00%	$ 564,524	$ 8,517	$ 807

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	December 31, 2004			
	Percent of Loans to Total Loans	Gross Loans	Allowance	Non-Accrual Loans
Commercial loans	71.58%	$ 304,783	$ 4,844	$ 1,036
Residential loans	22.11%	94,170	1,710	175
Consumer loans	5.70%	24,245	307	7
Municipal loans	0.61%	2,598	41	
Totals	100.00%	$ 425,796	$ 6,902	$ 1,218

	December 31, 2003			
	Percent of Loans to Total Loans	Gross Loans	Allowance	Non-Accrual Loans
Commercial loans	73.66%	$ 215,396	$ 3,804	$ 121
Residential loans	20.08%	58,728	1,102	37
Consumer loans	5.66%	16,552	189	16
Municipal loans	0.60%	1,751	23	
Totals	100.00%	$ 292,427	$ 5,118	$ 174

	December 31, 2002			
	Percent of Loans to Total Loans	Gross Loans	Allowance	Non-Accrual Loans
Commercial loans	73.08%	$ 144,872	$ 2,572	$ 161
Residential loans	18.58%	36,832	485	445
Consumer loans	6.99%	13,854	184	3
Municipal loans	1.35%	2,679	18	
Totals	100.00%	$ 198,237	$ 3,259	$ 609

The Bank s allocation was determined in prior years by applying a factor to loan totals based on risk grade, plus any specifically determined amount for individual loans deemed to have greater risk tendency. The allocation factors ranged from 0.5% for cash equivalent secured loans (Risk Grade 1) to 100% for loans with doubtful (Risk Grade 6) repayment status.

Other factors were 1% for Risk Grade 2 (Better than average net worth and repayment capacity), 1.65% for Risk Grade 3 (Satisfactory), 4% for Risk Grade 4 (Special mention), and 15% for Risk Grade 5 (Substandard). All for individual loans with specific (dollar) identification was determined by management s best estimate of probable loss, based on collateral liquidation value.

Beginning in February 2002, the Bank began using an alternative methodology for calculating the Allowance for Loan Losses, along with its traditional method of allocating percentages based on risk grading. The alternative method was based more on the Bank s portfolio and performance relative to a designated peer group. The Bank began establishing its allowance based on the greater of the two alternative calculations. At that time the traditional method had not undergone a validation analysis. In August 2002, a loan loss migration analysis was performed covering the prior 18 months of data. In July 2003, another year of data was analyzed, providing the Bank with 30 months of supporting data for the validity of the traditional methodology. Therefore, in July 2003, the Bank eliminated the alternative methodology in favor of the previously utilized traditional methodology. Also considered in this decision was the fact that peer group data used in the alternative method appeared to provide some skewed data in attempting to arrive at comparable measurement. Management decided its own migration history was more representative of its performance relative to the makeup of its loan portfolio.

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During 2005, the Company modified its risk grade allocation factors to better reflect varying loss experiences in different types of loans. As of December 31, 2006, the allocation factors range from 0.25% for cash equivalent secured loans to 100% of doubtful/loss (Risk Grade 7). Risk Grades 3 , 5 , 6 and 7 closely reflect the FDIC s for Satisfactory, Special Mention, Substandard and Doubtful/Loss respectively. Risk Grade 4 is an internally designated Watch category. At December 31, 2006, the Company had $9.3 million in the Special Mention and $839,000 in the substandard loan categories.

The Bank s total allowance for loan losses was 1.53% and 1.51% of total loans at December 31, 2006 and December 31, 2005, respectively. The following table provides additional detail on the allowance.

Analysis of the Allowance for Loan Losses

	December 31,				
	2006	2005	2004	2003	2002
	(Dollars in thousands)				
Balance Beginning December 31	$ (8,517)	$ (6,902)	$ (5,118)	$ (3,259)	$ (2,574)
Charge Offs					
Commercial Loans	283	307	535	785	740
Residential Loans	9	21	44	195	217
Consumer Loans	501	464	164	137	46
Municipal Loans					
Total Charge-offs	793	792	743	1,117	1,003
Recoveries					
Commercial Loans	(8)	(187)	(131)	(357)	(57)
Residential Loans	(4)	(19)	(23)	(35)	(24)
Consumer Loans	(435)	(68)	(40)	(5)	
Municipal Loans					
Total Recoveries	(447)	(274)	(194)	(397)	(81)
Net charge offs	346	518	549	720	922
Provision for loan loss	(2,148)	(2,229)	(1,438)	(955)	(1,607)
Addition from acquisition			(1,108)	(1,624)	
Sale of loans		96	213		
Balance at end of period	$ (10,319)	$ (8,517)	$ (6,902)	$ (5,118)	$ (3,259)
Ratio of net charge-offs to loans outstanding	0.06%	0.09%	0.13%	0.25%	0.47%

In November 2004, the Bank acquired Snake River Bancorp, Inc, and its subsidiary bank, Magic Valley Bank. Total loans of approximately $65.5 million were acquired which was net of a $1.1 million allowance for loan losses. The loan portfolio acquired from Magic Valley Bank is similar to the Bank s existing loan portfolio. Therefore, the Bank s current process for assessing the allowance for loan loss was applied to the Magic Valley Bank portfolio at December 31, 2006 and December 31, 2005.

In January 2003, the Company acquired the loan portfolio of the Ontario branch of Household FSB (Ontario Branch Portfolio). Total loans of approximately $39.4 million were acquired which was net of a $1.6 million allowance for loan losses. Of the total $1.1 million in charge-offs during 2003, $0.2 million related to the Ontario Branch Portfolio.

The allowance for loan losses related to the acquisition of the Ontario Branch Portfolio was initially determined by reviewing each loan (except the consumer loan and real estate contract portfolios), assigning a risk grade commensurate with the Bank s prevailing grading system, and applying the allowance factor appropriate to the respective grade by the Bank. A representative percentage of the consumer loan portfolio was reviewed and the allowance for this portfolio was also computed based on grade assignment. For the real estate contract portfolio, all loans over $100,000 and all loans considered to have higher than moderate risk were reviewed. An allowance of the difference between the loan balance and 50% of the originally determined collateral value was established for these loans. This (specific identification) calculation was determined from an analysis of prior losses from the real estate contract portfolio. The allowance for the remainder of the real estate contract portfolio was calculated based on the respective risk grade allocation. The allowance for the total Ontario Branch portfolio amounted to approximately 4%. Beginning in July 2003, the allowance for the real estate contract portfolio was modified to approximately 4% on all loans not carrying a specifically identified allowance. The balance of the Ontario Branch portfolio is allocated based on the respective risk grades of each loan. The balance of the Ontario Branch portfolio has decreased substantially as a result of loan sales totaling approximately $1.3 million in 2005 and $2.7 million in 2004, along with large prepayments since the purchase of the portfolio in 2003. There were no sales of these loans in 2006. The balance of the real estate contract portfolio at December 31, 2006 was $6.8 million.

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

Maturity and Repricing for the Bank s
Loan Portfolio at December 31, 2006

Loan Repricing	**Fixed Rate**	**Variable Rate**	**Total Loans**
		(Dollars in thousands)	
0-90 days	$ 24,788	$ 175,418	$ 200,206
91-365 days	61,495	123,123	184,618
1 year-5 years	114,214	123,876	238,090
5 years or more	46,397	6,485	52,882
Total	$ 246,894	$ 428,902	$ 675,796

Loan Portfolio Concentrations

The Bank continuously monitors concentrations of loan categories in regards to industries and loan types. Due to the makeup of the Bank s marketplace, it expects to have significant concentrations in certain industries and with specific loan types. Concentration guidelines are established and then approved by the Board of Directors at least annually, and are reviewed by management and the Board monthly. Detrimental circumstances affecting industries involved in loan concentrations are reviewed as to their impact as they occur, and appropriate action is determined regarding the loan portfolio and/or lending strategies and practices.

As of December 31, 2006, the Bank s loan portfolio was concentrated, by loan type, as follows:

Commercial	78.03%
Residential	16.66%
Consumer	4.71%
Municipal	0.60%

These concentrations are typical for the markets served by the Bank, and management believes that they are comparable with those of the Banks peer group (banks of similar size and operating in the same geographic areas).

Management does not consider the overall commercial portfolio total to present a concentration risk, and feels that there is adequate diversification by type, industry, and geography to further mitigate risk. The agricultural portfolio, which is included in commercial loans, presents a somewhat greater risk, in that it represents a large percentage of the loans in the Bank s southern Idaho region. At December 31, 2006, agricultural loans and agricultural real estate loans represent approximately 12.4% and 3.0% of the total loan portfolio, respectively. The agricultural portfolio consists of loans secured by crops, real estate and livestock.

To mitigate credit risk, specific underwriting is applied to retain only borrowers that have proven track records in the agricultural industry. 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 real estate loan portfolio appears to pose the greatest overall risk of loan-type concentration. However, experienced lenders and consistently applied underwriting standards help to mitigate credit risk. Although real estate values tend to fluctuate somewhat with economic conditions, over time, real estate collateral is generally considered one of the safest forms of collateral in regards to maintaining value.

The Bank lends to contractors and developers, and is also active in custom construction lending. The Bank has established concentration limits to include residential construction, commercial construction and development loans not to exceed 125%, total commercial real estate loans not to exceed 325% and other real estate (agricultural and land) loans not to exceed 25% of the Bank s capital, surplus and capital notes. In addition, total real estate loans with maturities exceeding 2 years were limited to 350% of the Bank s capital, surplus and capital notes. Accordingly, at December 31, 2006, residential construction, commercial construction and development loans represented 122.8%, commercial real estate loans and other real estate loans represented 311.5% and other real estate loans represented 27.6% of Bank s capital, surplus and capital notes, respectively. Total real estate loans with maturities exceeding 2 years represented 208.3% of the Bank s capital, surplus and capital notes. In response to the combined banking agencies recently adopted Commercial Real Estate Lending Guidelines, the Bank plans to establish revised measurements and expanded categories for monitoring in 2007.

In addition to the higher loan loss allowance for the contract segment of the real estate loan portfolio, the methodology of determining the Bank s overall allowance provides for specific allocation for individual loans or components of the loan portfolio. This could include any segment. However, all components deemed to represent significant concentrations are especially scrutinized for credit quality and appropriate allowance. Allocations are reviewed and determined by senior management monthly and reported to the Board of Directors.

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 recorded at market 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 41.3% to $118.5 million at December 31, 2006 from $83.8 million at December 31, 2005. The carrying value of the held-to-maturity securities portfolio remained constant at $6.7 million for both December 31, 2006 and December 31, 2005. During 2006, the Company utilized funds from repurchase agreements and new deposits to fund the growth in the investment portfolio. In general, the Company sought to extend the duration of its investment portfolio in 2006 to offset the short duration of the loan portfolio, improve yield and limit interest rate risk in a down-rate environment. The U.S. agency debentures and mortgage-backed securities investments have allowed the Bank to maintain a shorter duration in the total investment portfolio to limit extension risk and position the Bank for a rising interest rate market. The municipal bond portfolio remained static during 2006 and saw a substantial increase during 2005 due to bonds acquired in the Snake River Bancorp merger and a greater supply of attractive Idaho municipal bonds. The average duration of the available-for-sale and the held-to-maturity portfolios was approximately 3.6 years and 5.2 years, respectively on December 31, 2006, compared to 2.4 years and 5.1 years, respectively on December 31, 2005.

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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,

Carrying Value as of December 31,	2006 Amount	Percent Change Prev. Yr.	2005 Amount	Percent Change Prev. Yr.	2004 Amount
	(Dollars in thousands)				
U.S. treasury securities and obligations of government agencies	$ 78,629	51.81%	$ 51,796	(14.09)%	$ 60,290
Mortgage-backed securities	39,559	28.53%	30,777	(23.36)%	40,156
Corporate Bonds		(100.00)%	969	(51.55)%	2,000
State and municipal bonds	7,021	(0.47)%	7,054	23.30%	5,721
Total	$ 125,209	38.21%	$ 90,596	(16.24)%	$ 108,167
Available-for-Sale	118,490	41.32%	83,847	(18.40)%	102,758
Held-to-Maturity	6,719	(0.45)%	6,749	24.77%	5,409
Total	$ 125,209	38.21%	$ 90,596	(16.24)%	$ 108,167

Investments held as of December 31, 2006
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	Y
	(Dollars in thousands)									
easury securities and ions of government es	$ 15,031	4.86%	$ 30,909	3.65%	$ 32,689	5.87%	$	%	$ 78,629	
ate bonds		%		%		%		%		
ge-backed securities	225	4.05%	8,675	4.02%	445	4.56%	30,214	5.67%	39,559	
nd municipal bonds equivalent)	145	6.97%	3,968	4.41%	593	5.50%	2,315	6.44%	7,021	
	$ 15,401	4.87%	$ 43,552	3.79%	$ 33,727	5.85%	$ 32,529	5.72%	$ 125,209	

Deposits

Deposits represent approximately 82.4% of the Bank s liabilities at December 31, 2006. The Bank gathers its deposit base from a combination of small business and retail sources. The retail and small business base continues to grow with new and improved product offerings. However, management recognizes that customer service, not a vast retail branch network, is going to be the key to the Bank s customer growth. In 2006, the Bank experienced increased competition for deposits, but successfully grew lower-cost transaction deposits, including demand and money market balances, at a relatively strong rate. Total deposits grew 16.1% in 2006 with non-interest bearing deposits growing 6.9% and interest-bearing deposits growing 18.7% over 2005 balances. NOW and money market accounts (personal, business and public) grew 34.9% to $291.4 million at December 31, 2006 from $216.0 million at December 31, 2005. Demand accounts grew 6.9% to $141.6 million at December 31, 2006 from $132.4 million at December 31, 2005. Certificate of deposit accounts grew $3.4 million, from $175.3 million at December 31, 2005 to $178.7 million at December 31, 2006, an overall increase of 2.0%.

The rise in short-term interest rates during 2006 continued to place additional pressure on banks to raise rates paid on deposits and to grow deposit balances simultaneously, especially during the latter half of the year. The Bank has responded by focusing on growing core customer relationships through targeting high deposit balance customers and prospects, providing high-touch personal service to these customers, pursuing referrals from existing customers, competitively pricing its traditional deposit products and enhancing services offered to its business customers.

The following table details repricing information for the Bank s time deposits with minimum balance of $100,000 at December 31, 2006 (in thousands):

Maturities	
Less than three months	$ 40,038
Three to six months	18,663
Six to twelve months	25,085
Over twelve months	9,511
	$ 93,297

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, 2006 there were no short-term borrowing balances outstanding and the Bank had unsecured credit lines of $55.0 million available. For 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 subject to collateralization requirements and a blanket pledge agreement. At December 31, 2006, the Bank had outstanding notes with the FHLB of $5.0 million and the ability to borrow an additional $66.0 million. In January 2006, the Company entered into an additional borrowing agreement with US Bank in the amount of $5.0 million and in September 2006 increased the amount to $10.0 million. The borrowing agreement is a revolving line of credit with a variable rate of interest tied to LIBOR. In January 2006, the Company purchased land to build a 94,000 square foot Financial and Technical Center in Sandpoint, Idaho. It entered into a Note Payable with the sellers of the property in the amount of $1,130,000. The note has a fixed rate of 6.65% and had an outstanding balance of $1,014,933 at December 31, 2006.

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. These agreements had a weighted average interest rate of 5.03%, 3.60% and 1.75% at December 31, 2006, 2005 and 2004, respectively. The average balances of securities sold subject to repurchase agreements were $59.7 million, $31.6 million and $14.6 million during the years ended December 31, 2006, 2005 and 2004, respectively. The maximum amount outstanding at any month end during these same periods was $106.2 million, $47.6 million and $24.5 million, respectively. The increase in the peak in 2006 reflected the issuance of repurchase agreements primarily to municipal customers during the year and the issuance of one institutional repurchase agreement in July 2006. The institutional repurchase agreement was entered into to reduce interest rate risk in a down-rate environment. The weighted average interest rates during 2006, 2005 and 2004 were 4.72%, 2.86% and 1.09%, respectively. The majority of the repurchase agreements mature on a daily basis, with the institutional repurchase agreement in the amount of $30.0 million maturing in July 2011. At December 31, 2006, 2005 and 2004, the Company pledged as collateral, certain investment securities with aggregate amortized costs of $109.0 million, $37.9 million and $20.3 million, respectively. These investment securities had market values of

$109.0 million, $37.1 million and $20.2 million at December 31, 2006, 2005 and 2004, 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 at 6.75% with interest payable quarterly. The debt is callable by the Company in March 2008 and matures in March 2033.

In March 2004, the Company issued $8.0 million of additional Trust Preferred securities through a second subsidiary, Intermountain Statutory Trust II. This debt is callable by the Company in April 2009, bears interest on a variable basis tied to the 90-day LIBOR index plus 2.8%, and matures in April 2034. The rate at Decem