INTERMOUNTAIN COMMUNITY BANCORP
Form 10-K
March 17, 2008

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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, 2007

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, 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):

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

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, 2007, 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 $113,597,000.

The number of shares outstanding of the registrant s Common Stock, no par value per share, as of March 2, 2008 was 8,273,578.

DOCUMENTS INCORPORATED BY REFERENCE

Specific portions of the registrant s Proxy Statement dated March 24, 2008 are incorporated by reference into Part III hereof.

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PART I

Forward-Looking Statements

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 2008, 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 made, 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*

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, 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. Over the next four years, the Bank opened branches in Weiser, Coeur d Alene, Nampa, Rathdrum, Caldwell and Post Falls, Idaho. 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 are 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 2006, the Company opened branches in Kellogg and 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, Premier Alliance, which now operates as Intermountain Community Investment Services (ICI), providing investment advisory services to its customers. In January 2007, the Company opened a loan

production and administrative office in Nampa, Idaho, and in August of 2007, it relocated its Spokane Valley branch to a new larger facility.

The Bank has filed an application with its bank regulators to move its main office location. Pending final approval, the Bank will move its main office to a newly built structure in Sandpoint and will retain the current Sandpoint office as a drive-up banking facility.

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 the 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 and one branch is located in 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. On December 31, 2007, the Company had total consolidated assets of $1.05 billion.

Competition

Based on total asset size as of December 31, 2007, 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 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. Based on the June 2007 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 discussed above, 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, 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, Bank of the Cascades, 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. As with other business loans, sound underwriting is applied 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 nearly 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 or sound business project 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 non-FDIC insured 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 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

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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 cards, safe deposit boxes, merchant credit card acceptance services, savings bonds, remote deposit capture, 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 services introduced in 2007 include check collect for businesses, enhanced internet cash management services and portfolio checking for professionals.

Loan Portfolio

The loan portfolio is the largest component of earning assets. In 2007, the Company increased total gross loans by 14% or $93.2 million. Commercial loans contributed the highest dollar growth in 2007, increasing $96.1 million or 18% over 2006.

During 2007, with a volatile short-term interest rate environment and a slowdown in lending, loan competition increased, as lenders continued to aggressively pursue new loan originations and refinancings. With market interest rates flattening in early 2007 and then declining in the later months, yields on the loan portfolio increased only slightly over the prior year. 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 continues to utilize relationship pricing models and techniques to increase customer profitability.

In 2006, the Company increased total gross loans by 20%, or $111.3 million. Commercial loans contributed the highest percentage growth in 2006, increasing $102.3 million or 24% over 2005.

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 table contains information related to the Company s loan portfolio for the five-year period ended December 31, 2007 (dollars in thousands).

	December 31,				
	2007	**2006**	**2005**	**2004**	**2003**
Commercial loans	$ 623,439	$ 527,345	$ 425,005	$ 304,783	$ 215,396
Residential loans	114,010	112,569	107,554	94,170	58,728
Consumer loans	26,285	31,800	29,109	24,245	16,552
Municipal loans	5,222	4,082	2,856	2,598	1,751
Total loans	768,956	675,796	564,524	425,796	292,427
Allowance for loan losses	(11,761)	(9,837)	(8,100)	(6,902)	(5,118)
Deferred loan fees, net of direct origination costs	(646)	(1,074)	(971)	(234)	(53)

Loans receivable, net	$ 756,549	$ 664,885	$ 555,453	$ 418,660	$ 287,256
Weighted average rate	8.16%	8.65%	7.90%	6.81%	6.60%

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.

During 2007, the Company modified its risk grade allocation factors to better reflect varying loss experiences in different types of loans. As of December 31, 2007, the risk factors range from cash equivalent secured loans (Risk Grade 1) to doubtful/loss (Risk Grade 8). Risk Grades 3 , 5 , 6 , 7 and 8 closely reflect the FDIC s defini Satisfactory, Special Mention, Substandard , Doubtful and Loss , respectively. Risk Grade 4 is an internally de Watch category. At December 31, 2007, the Company had $4.7 million in the Special Mention, $18.2 million in the substandard, $423,000 in the Doubtful and $0 in the Loss loan categories. The majority of the classified loans were real-estate related, reflecting the slowdown in the real estate sector of the economy, particularly in the land development and residential construction sectors.

Non-accrual loans are those loans that have become delinquent for more than 90 days (unless well-secured and in the process of collection). Placement of loans on non-accrual status does not necessarily mean that the outstanding loan principal will not be collected, but rather that timely collection of principal and interest is in question. When a loan is placed on non-accrual status, interest accrued but not received is reversed. The amount of interest income which would have been recorded in fiscal 2007, 2006, 2005, 2004 and 2003 on non-accrual loans was approximately $161,000, $21,000, $95,000, $55,000 and $7,000, 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, 2007, there were a total of $6.4 million in identified loans which were not in compliance with the stated terms of the loan or otherwise presented additional credit risk to the Company. Of these loans $800,000 were loans past due 90 days and still accruing interest and $5.6 million were non-accrual loans.

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

	December 31,				
	2007	**2006**	**2005**	**2004**	**2003**
Non-accrual loans	$ 5,569	$ 1,201	$ 807	$ 1,218	$ 174
Non-accrual loans as a percentage of total loans	0.74%	0.18%	0.14%	0.29%	0.06%
Total allowance related to these loans	$ 585	$ 531	$ 341	$ 413	$ 47
Interest income recorded on these loans	$ 270	$ 230	$ 8	$ 10	$ 3

The $4.4 million increase in non-accrual loans from December 31, 2006 to December 31, 2007 is primarily comprised of several larger residential construction and land loans where repayment is primarily reliant on selling the asset. The Company has evaluated the borrowers and the collateral underlying these loans and determined that the probability of recovery of the loans principal balance is high.

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. The methodology for calculating the allowance is discussed in more detail below. An allocation is also included for unfunded commitments, however this allocation is recorded as a liability, as required by new bank regulatory guidance issued in early 2007.

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

	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

	December 31, 2005			
	Percent of Loans to Total Loans	Gross Loans	Allowance	Non-Accrual Loans
Commercial loans	75.28%	$ 425,005	$ 5,793	$ 671
Residential loans	19.05	107,554	1,827	10
Consumer loans	5.16	29,109	450	126
Municipal loans	0.51	2,856	30	

Totals	100.00%	$ 564,524	$ 8,100	$ 807

	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

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During 2007, the company changed its method of calculating its loan loss allowance, in line with new bank regulatory guidance issued in early 2007. Under the new methodology, 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 appropriate 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 and industry experience. This base reserve allocation is then modified by management considering factors such as the current economic environment, portfolio delinquency trends, collateral valuation trends, quality of underwriting and quality of collection activities. The reserves derived from the model are modified by management, then added to the reserve for specifically identified loans to produce the total reserve. Management believes that this methodology provides a more accurate, reliable and verifiable reserve calculation and closely follows recent regulatory guidance. The Bank s total allowance for loan losses was 1.53% of total loans at December 31, 2007 and 1.46% of total loans at December 31, 2006. The following table provides additional detail on the allowance.

Analysis of the Allowance for Loan Losses

	December 31,				
	2007(1)	2006(1)	2005(1)	2004	2003
	(Dollars in thousands)				
Balance Beginning December 31	$ (9,837)	$ (8,100)	$ (6,309)	$ (5,118)	$ (3,259)
Charge-Offs					
Commercial Loans	1,523	283	307	535	785
Residential Loans		9	21	44	195
Consumer Loans	521	501	464	164	137
Municipal Loans					
Total Charge-offs	2,044	793	792	743	1,117
Recoveries					
Commercial Loans	(34)	(8)	(187)	(131)	(357)
Residential Loans	(9)	(4)	(19)	(23)	(35)
Consumer Loans	(32)	(435)	(68)	(40)	(5)
Municipal Loans					
Total Recoveries	(75)	(447)	(274)	(194)	(397)
Net charge-offs	1,969	346	518	549	720
Transfers	3	65	(176)		
Provision for loan loss	(3,896)	(2,148)	(2,229)	(1,438)	(955)
Addition from acquisition				(1,108)	(1,624)
Sale of loans			96	213	
Balance at end of period	$ (11,761)	$ (9,837)	$ (8,100)	$ (6,902)	$ (5,118)
Ratio of net charge-offs to loans outstanding	0.26%	0.06%	0.09%	0.13%	0.25%
Allowance Unfunded Commitments					
Balance Beginning December 31	$ (482)	$ (417)	$ (593)	N/A	N/A
Adjustment	467			N/A	N/A

Transfers	(3)	(65)	176	N/A	N/A
Allowance Unfunded Commitments at end of period	(18)	(482)	(417)	N/A	N/A

(1) The allowance analysis has been adjusted for the periods 2007, 2006 and 2005 to segregate the allowance for loan losses from an allowance for unfunded commitments, per new bank regulatory guidance issued in 2007. Information to accurately segregate the unfunded commitments was not considered material prior to 2005.

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, 2007, 2006 and 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 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, 2007

Loan Repricing	Fixed Rate	Variable Rate	Total Loans
	(Dollars in thousands)		
0-90 days	$ 55,593	$ 253,685	$ 309,278
91-365 days	50,421	126,548	176,969
1 year-5 years	119,440	97,620	217,060
5 years or more	54,910	10,739	65,649
Total	$ 280,364	$ 488,592	$ 768,956

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, 2007, the Bank s loan portfolio by loan type was:

Commercial	31.26%
Commercial real estate	49.81%
Residential real estate	14.83%
Consumer	3.42%
Municipal	0.68%

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

December 31, 2007, approximately 65% of the total loan portfolio was secured by real estate.

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, 2007, agricultural loans and agricultural real estate loans represent approximately 11.0% and 3.1% 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 residential land and construction loan portfolio currently appears to pose the greatest overall risk of loan-type concentration. However, experienced lenders and consistently applied underwriting standards help to mitigate credit risk. Real estate values tend to fluctuate somewhat with economic conditions. Currently, valuations are static or falling in many of the Bank s markets, although the rate of decline is smaller than current national average rates of decline. Over longer periods, real estate collateral is generally considered one of the more stable 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 as measured against Tier 1 capital (generally, Tier 1 capital is the Company s tangible net worth). These concentration limits include residential and commercial construction loans not to exceed 175% and, combined with development loans, not to exceed 325% of Tier 1 capital. The guidelines further specify that total commercial real estate loans are not to exceed 400% and other real estate (agricultural and land) loans are not to exceed 230% of the Bank s Tier 1 capital. Accordingly, at December 31, 2007, residential and commercial construction loans represented 128.2% and, combined with development loans, represented 295.6% of Tier 1 capital. Total commercial real estate loans represented 380.5%, and other real estate loans represented 147.7% of the Bank s Tier 1 capital, respectively. In response to the combined banking agencies recently adopted Commercial Real Estate Lending Guidelines, the Bank revised measurements and expanded categories for monitoring in 2007.

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 34.0% to $158.8 million at December 31, 2007 from $118.5 million at December 31, 2006. The carrying value of the held-to-maturity securities portfolio increased 68.5% to $11.3 million at December 31, 2007 from $6.7 million at December 31, 2006. During 2007, the Company utilized funds from repurchase agreements and new deposits to fund the growth in the investment portfolio. In general, the Company sought to increase the yield and use the investment portfolio to limit the Bank s overall interest rate risk position during the year. In doing so, the Company extended the duration of its portfolio and re-positioned it to perform better in a down-rate environment, to offset the weaker performance expected from the loan portfolio in such an environment. The Company used a combination of U.S agency debentures, highly rated whole loan collateralized mortgage obligations (CMOs), and municipal bonds to accomplish this re-positioning. The average duration of the available-for-sale and the held-to-maturity portfolios was approximately 4.4 years and 6.4 years, respectively on December 31, 2007, compared to 3.6 years and 5.2 years, respectively on December 31, 2006.

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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,	2007 Amount	Percent Change Prev. Yr.	2006 Amount	Percent Change Prev. Yr.	2005 Amount
	(Dollars in thousands)				
U.S. treasury securities and obligations of government agencies	$ 62,952	(19.94)%	$ 78,629	51.81%	$ 51,796
Mortgage-backed securities	95,739	142.02	39,559	28.53	30,777
Corporate Bonds		00.00		(100.00)	969
State and municipal bonds	11,424	62.71	7,021	(0.47)	7,054
Total	$ 170,115	35.87%	$ 125,209	38.21%	$ 90,596
Available-for-Sale	158,791	34.01	118,490	41.32	83,847
Held-to-Maturity	11,324	68.54	6,719	(0.45)	6,749
Total	$ 170,115	35.87%	$ 125,209	38.21%	$ 90,596

Investments held as of December 31, 2007
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
	(Dollars in thousands)								
easury securities and ions of government es	$ 12,691	3.53%	$ 16,949	3.96%	$ 33,312	5.87%	$	%	$ 62,952
ge-backed securities	120	4.92	7,103	4.03	15,056	5.28	73,460	5.92	95,739
nd municipal bonds equivalent)	1,376	4.83	2,324	4.25	1,910	5.86	5,814	2.82	11,424
	$ 14,187	3.66%	$ 26,376	4.00%	$ 50,278	5.69%	$ 79,274	5.69%	$ 170,115

Deposits

Deposits represent approximately 79.1% of the Bank s liabilities at December 31, 2007. 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, targeted marketing and attractive product offerings, not a vast retail branch network, are going to be the key to the Bank s future customer and deposit growth. In 2007, the Bank experienced strong competition for deposits, but successfully grew lower-cost transaction deposits, including demand, NOW and money market balances, at a relatively strong rate. Total deposits grew 9.3% in 2007 with non-interest bearing deposits growing 12.3% and interest-bearing deposits growing 8.5% over 2006 balances. NOW and money market accounts (personal, business and public) grew 5.99% to $308.9 million at December 31, 2007 from $291.4 million at December 31, 2006. Demand accounts grew 12.3% to $159.1 million at December 31, 2007 from $141.6 million at December 31, 2006. Certificate of deposit accounts grew $24.1 million, from $178.7 million at December 31, 2006 to $202.8 million at December 31, 2007, an overall increase of 13.5%.

The rise in short-term interest rates during 2006 placed pressure on banks to raise rates paid on deposits during the first nine months of 2007, placing pressure on the Bank s cost of funds and net interest margin. The Bank

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 decrease in short-term interest rates during the latter part of 2007 will likely have the lagged effect of decreasing deposit rates during 2008, but may simultaneously decrease demand for deposits as well. Volatility in the equity markets and other customer investment alternatives may counterbalance this pressure, however.

The following table details repricing information for the Bank s time deposits with minimum balance of $100,000 at December 31, 2007 (in thousands):

Maturities	
Less than three months	$ 55,059
Three to six months	25,708
Six to twelve months	7,988
Over twelve months	27,880
	$ 116,635

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, the Bank had overnight unsecured credit lines of $50.0 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 subject to collateralization requirements and a blanket pledge agreement. At December 31, 2007 the Bank had a $5.0 million FHLB advance that matures in June 2008, a $14.0 million FHLB advance that matures in September 2009 and a $10.0 million FHLB advance that matures in September 2010. These notes totaled $29.0 million, and the Bank had the ability to borrow an additional $59.5 million.

In March 2007, the Company entered into an additional borrowing agreement with Pacific Coast Bankers Bank in the amount of $18.0 million and in December 2007 increased the amount to $25.0 million. The borrowing agreement is a revolving line of credit with a variable rate of interest tied to LIBOR and is collateralized by Bank stock and the Sandpoint Center. This line is currently being used primarily to fund the construction of the Company s new headquarters building in Sandpoint, with pay down likely in late 2008 from the building s anticipated sale or refinancing into a longer-term instrument. 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 has a fixed rate of 6.65%, matures in February 2026 and had an outstanding balance of $982,000 at December 31, 2007.

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 4.69%, 5.03% and 3.60% at December 31, 2007, 2006 and 2005, respectively. The average balances of securities sold subject to repurchase agreements were $104.2 million, $59.7 million and $31.6 million during the years ended December 31, 2007, 2006 and 2005, respectively. The maximum amount outstanding at any month end during

these same periods was $124.1 million, $106.2 million and $47.6 million, respectively. The increase in the peak in 2007 reflected the issuance of repurchase agreements primarily to municipal customers during the year. In 2006, the Company entered into an institutional repurchase agreement to reduce interest rate risk in a down-rate environment. 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, 2007, 2006 and 2005, the Company pledged as collateral, certain investment securities with aggregate amortized costs of $122.2 million,

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$109.0 million and $37.9 million, respectively. These investment securities had market values of $123.7 million, $109.0 million and $37.1 million at December 31, 2007, 2006 and 2005, 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 December 31, 2007 was 8.04%. Funds received from this borrowing were used to support planned expansion activities during 2004, including the Snake River Bancorp acquisition.

Employees

The Bank employed 450 full-time equivalent employees at December 31, 2007. None of the employees are represented by a collective bargaining unit and the Company believes it has good relations with its employees.

Supervision and Regulation

General

The following discussion describes elements of the extensive regulatory framework applicable to Intermountain Community Bancorp (the Company) and Panhandle State (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 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 in its entirety 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 interpretation or implementation thereof, could have a material effect on our business or operations.

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 upon banks certain non-capital safety and soundness standards. These standards cover internal controls, information systems and internal audit systems, loan

documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, such other operational and managerial standards as the agency determines to be appropriate, and standards for asset quality, earnings and stock valuation. An institution that fails to meet these standards must develop a plan acceptable to its 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.

Consumer Protection and Disclosure Regulations. Federal and state law requires banks to adhere to a number of regulations designed to protect consumers and businesses from inadequate disclosure, unfair treatment, excessive fees and other similar abuses. An institution that fails to comply with these regulations must develop a plan acceptable to its regulators, specifying the steps that the institution will take to adhere to the regulations. Failure to submit or implement such a plan may subject the institution to regulatory sanctions. As new regulations have been added in the last few years with more expected in the near future, the costs to the institution of complying with these regulations has increased.

Interstate Banking And Branching

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Interstate Act) relaxed prior interstate branching restrictions under federal law by permitting nationwide interstate banking and branching under certain circumstances. Generally, bank holding companies may purchase banks in any state, and states may not prohibit these purchases. Additionally, banks are permitted to merge with banks in other states, as long as the home state of neither merging bank has opted out under the legislation. The Interstate Act requires regulators to consult with community organizations before permitting an interstate institution to close a branch in a low-income area.

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

Deposit Insurance

In 2006, federal deposit insurance reform legislation was enacted that (i) required the FDIC to merge the Bank Insurance Fund and the Savings Association Insurance Fund into a newly created Deposit Insurance Fund; (ii) increases the amount of deposit insurance coverage for retirement accounts; (iii) allows for deposit insurance coverage on individual accounts to be indexed for inflation starting in 2010; (iv) provides the FDIC more flexibility in setting and imposing deposit insurance assessments; and (v) provides eligible institutions credits on future assessments.

The Bank s deposits are currently insured to the maximum allowed per depositor through the Deposit Insurance Fund. The Bank is required to pay deposit insurance premiums, which are assessed and paid regularly. The premium amount is based upon a risk classification system established by the FDIC. Banks with higher levels of capital and a low degree of supervisory concern are assessed lower premiums than banks with lower levels of capital or a higher degree of supervisory concern.

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.

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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 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.

In 2007, the federal banking agencies, including the FDIC and the Federal Reserve, approved final rules to implement new risk-based capital requirements. Presently, this new advanced capital adequacy framework, called Basel II, is applicable only to large and internationally active banking organizations. Basel II changes the existing risk-based capital framework by enhancing its risk sensitivity. Whether Basel II will be expanded to apply to banking organizations that are the size of the Company or the Bank is unclear at this time, and what effect such regulations would have on us cannot be predicted, but we do not expect our operations would be significantly impacted.

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 Legislation

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

To deter wrongdoing, the Act (i) subjects bonuses issued to top executives to disgorgement if a restatement of a company s financial statements was due to corporate misconduct; (ii) prohibits an officer or director misleading or coercing an auditor; (iii) prohibits insider trades during pension fund blackout periods ; (iv) imposes new criminal penalties for fraud and other wrongful acts; and (v) extends the period during which certain securities fraud lawsuits can be brought against a company or its officers.

As 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 activities.

Anti-terrorism Legislation

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

Financial Services Modernization

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

with respect to insurance and securities underwriting activities.

Recent Legislation

Financial Services Regulatory Relief Act of 2006. In 2006, the President signed the *Financial Services Regulatory Relief Act of 2006* into law (the Relief Act). The Relief Act amends several existing banking laws and

regulations, eliminates some unnecessary and overly burdensome regulations of depository institutions and clarifies several existing regulations. The Relief Act, among other things, (i) authorizes the Federal Reserve Board to set reserve ratios; (ii) amends regulations of national banks relating to shareholder voting and granting of dividends; (iii) amends several provisions relating to loans to insiders, regulatory applications, privacy notices, and golden parachute payments; and (iv) expands and clarifies the enforcement authority of federal banking regulators. Our business, expenses, and operations have not been significantly impacted by this legislation.

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, such as the recent lowering of the Federal Reserve s discount and federal funds target rate, and their impact on us cannot be predicted with certainty.

Forward-Looking Statements

From time to time, Intermountain and its senior managers have made and will make forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements may be contained in this report and in other documents that Intermountain files with the Securities and Exchange Commission. Such statements may also be made by Intermountain and its senior managers in oral or written presentations to analysts, investors, the media and others. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. Also, forward-looking statements can generally be identified by words such as may, could, should, would, believe, anticipate, estimate, seek, expect, intend, plan and similar expressions.

Forward-looking statements provide management s expectations or predictions of future conditions, events or results. They are not guarantees of future performance. By their nature, forward-looking statements are subject to risks and uncertainties. These statements speak only as of the date they are made. Intermountain does not undertake to update forward-looking statements to reflect the impact of circumstances or events that arise after the date the forward-looking statements were made. There are a number of factors, many of which are beyond Intermountain s control that could cause actual conditions, events or results to differ significantly from those described in the forward-looking statements. These factors, some of which are discussed elsewhere in this report, include:

- the inflation and interest rate levels, and market and monetary fluctuations;
- trade, monetary and fiscal policies and laws, including interest rate policies of the federal government;
- applicable laws and regulations and legislative or regulatory changes;
- the timely development and acceptance of new products and services of Intermountain;
- the willingness of customers to substitute competitors products and services for Intermountain s products and services;
- Intermountain s success in gaining regulatory approvals, when required;

technological and management changes;

growth and acquisition strategies;

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

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; and

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

Where you can find more information

The periodic reports Intermountain files with the SEC are available on Intermountain s website athttp://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
231 N. Third Avenue
Sandpoint, Idaho 83864
(208) 263-0505

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

As a financial holding company, our earnings are dependent upon the performance of our bank as well as by business, economic and political conditions.

Intermountain is a legal entity separate and distinct from the Bank. Our right to participate in the assets of the Bank upon the Bank s liquidation, reorganization or otherwise will be subject to the claims of the Bank s creditors, which will take priority except to the extent that we may be a creditor with a recognized claim.

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.

Earnings are impacted by business and economic conditions in the United States and abroad. These conditions include short-term and long-term interest rates, inflation, monetary supply, fluctuations in both debt and equity capital markets, and the strength of the U.S. economy and the local economies in which we operate. Business and economic conditions that negatively impact household or corporate incomes could decrease the demand for our products and increase the number of customers who fail to pay their loans.

A downturn in the local economies or real estate markets could negatively impact our banking business.

The Company has a high concentration in the real estate market and a downturn in the local economies or real estate markets could negatively impact our banking business. Because we primarily serve individuals and businesses located in northern, southwestern and southcentral Idaho, eastern Washington and southeastern Oregon, a significant portion of our total loan portfolio is originated in these areas or secured by real estate or other assets located in these areas. As a result of this geographic concentration, the ability of customers to repay their loans, and consequently our results, are impacted by the economic and business conditions in our market areas. Any adverse economic or business developments or natural disasters in these areas could cause uninsured damage and other loss of value to real estate that secures our loans or could negatively affect the ability of borrowers to make payments of principal and interest on the underlying loans. In the event of such adverse development or natural disaster, our results of operations or

financial condition could be adversely affected. Our ability to recover on defaulted loans by foreclosing and selling the real estate collateral would then be diminished and we would more likely suffer losses on defaulted loans.

Furthermore, current uncertain geopolitical trends and variable economic trends, including uncertainty regarding economic growth, inflation and unemployment, may negatively impact businesses in our markets. While the short-term and long-term effects of these events remain uncertain, they could adversely affect general economic conditions, consumer confidence, market liquidity or result in changes in interest rates, any of which could have a negative impact on the banking business.

Changes in market interest rates could adversely affect our earnings.

Our earnings are impacted by changing market interest rates. Changes in market interest rates impact the level of loans, deposits and investments, the credit profile of existing loans and the rates received on loans and investment securities and the rates paid on deposits and borrowings. One of our primary sources of income from operations is net interest income, which is equal to the difference between the interest income received on interest-earning assets (usually, loans and investment securities) and the interest expense incurred in connection with interest-bearing liabilities (usually, deposits and borrowings). These rates are highly sensitive to many factors beyond our control, including general economic conditions, both domestic and foreign, and the monetary and fiscal policies of various governmental and regulatory authorities. Net interest income can be affected significantly by changes in market interest rates. Changes in relative interest rates may reduce net interest income as the difference between interest income and interest expense decreases.

Market interest rates have shown considerable volatility over the past several years. After rising through much of 2005 and the first half of 2006, short-term market rates flattened and the yield curve inverted through the latter half of 2006 and the first half of 2007. In this environment, short-term market rates were higher than long-term market rates, and the amount of interest we paid on deposits and borrowings increased more quickly than the amount of interest we received on our loans, mortgage-related securities and investment securities. In the latter half of 2007 and early 2008, short-term market rates declined significantly, causing asset yields to decline. If this trend continues, it could cause our net interest margin to decline and profits to decrease.

Should rates start rising again, interest rates would likely reduce the value of our investment securities and may decrease demand for loans and make it more difficult for borrowers to repay their loans. Increasing market interest rates may also depress property values, which could affect the value of collateral securing our loans.

An increase in interest rates could also have a negative impact on our results of operations by reducing the ability of borrowers to repay their current loan obligations. These circumstances could not only result in increased loan defaults, foreclosures and write-offs, but also necessitate further increases to the allowances for loan losses.

Should market rates fall further, rates on our assets may fall faster than rates on our liabilities, resulting in decreased income for the bank. Fluctuations in interest rates may also result in disintermediation, which is the flow of funds away from depository institutions into direct investments that pay a higher rate of return and may affect the value of our investment securities and other interest-earning assets.

Our cost of funds may increase because of general economic conditions, unfavorable conditions in the capital markets, interest rates and competitive pressures. We have traditionally obtained funds principally through deposits and borrowings. As a general matter, deposits are a cheaper source of funds than borrowings, because interest rates paid for deposits are typically less than interest rates charged for borrowings. If, as a result of general economic conditions, market interest rates, competitive pressures, or other factors, our level of deposits decreases relative to our overall banking operation, we may have to rely more heavily on borrowings as a source of funds in the future, which may negatively impact net interest margin.

Competition may adversely affect our ability to attract and retain customers at current levels.

The banking and financial services businesses in our market areas are highly competitive. Competition in the banking, mortgage and finance industries may limit our ability to attract and retain customers. We face competition from other banking institutions, savings banks, credit unions and other financial institutions. We also compete with non-bank financial service companies within the states that we serve and out of state financial intermediaries that have opened loan production offices or that solicit deposits in our market areas. There has also been a general consolidation of

financial institutions in recent years, which results in new competitors and larger competitors in our market areas.

In particular, our competitors include major financial companies whose greater resources may provide them a marketplace advantage. Areas of competition include interest rates for loans and deposits, efforts to obtain deposits and the range and quality of services provided. Because we have fewer financial and other resources than larger institutions with which we compete, we may be limited in our ability to attract customers. In addition, some of the current commercial banking customers may seek alternative banking sources as they develop needs for credit

facilities larger than we can accommodate. If we are unable to attract and retain customers, we may be unable to continue our loan and deposit growth, and our results of operations and financial condition may otherwise be negatively impacted.

Additional market concern over investment securities backed by mortgage loans could create losses in the Company s investment portfolio

A majority of the Company s investment portfolio is comprised of securities where mortgages are the underlying collateral. These securities include agency-guaranteed mortgage backed securities and collateralized mortgage obligations and triple AAA rated non- agency mortgage-backed securities and collateralized mortgage obligations. With the recent national downturn in real estate markets and the rising mortgage delinquency and foreclosure rates, investors are increasingly concerned about these types of securities. The potential for subsequent discounting, if continuing for a long period of time, could lead to permanent impairment in the value of these investments. This impairment could negatively impact earnings and the Company s capital position.

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 continued favorable economic conditions in our market areas.

There are risks associated with potential acquisitions.

We may make opportunistic acquisitions of other banks or financial institutions from time to time that further our business strategy. These acquisitions could involve numerous risks including lower than expected performance or higher than expected costs, difficulties in the integration of operations, services, products and personnel, the diversion of management s attention from other business concerns, changes in relationships with customers and the potential loss of key employees. Any acquisitions will be subject to regulatory approval, and there can be no assurance that we will be able to obtain such approvals. We may not be successful in identifying further acquisition candidates, integrating acquired institutions or preventing deposit erosion or loan quality deterioration at acquired institutions. Competition for acquisitions in our market area is highly competitive, and we may not be able to acquire other institutions on attractive terms. There can be no assurance that we will be successful in completing future acquisitions, or if such transactions are completed, that we will be successful in integrating acquired businesses into our operations. Our ability to grow may be limited if we are unable to successfully make future acquisitions.

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

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

The allowance for loan losses may be inadequate.

Our loan customers may not repay their loans according to the terms of the loans, and the collateral securing the payment of these loans may be insufficient to pay any remaining loan balance. We therefore may experience significant loan losses, which could have a material adverse effect on our operating results.

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We make various assumptions and judgments about the collectibility of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. We rely on our loan quality reviews, our experience and our evaluation of economic conditions, among other factors, in determining the amount of the allowance for loan losses. If our assumptions prove to be incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in additions to our allowance. Increases in this allowance result in an expense for the period. If, as a result of general economic conditions or a decrease in asset quality, management determines that additional increases in the allowance for loan losses are necessary, we may incur additional expenses.

Our loans are primarily secured by real estate, including a concentration of properties located in northern, southwestern and southcentral Idaho, eastern Washington and southeastern Oregon. If an earthquake, volcanic eruption or other natural disaster were to occur in one of our major market areas, loan losses could occur that are not incorporated in the existing allowance for loan losses.

We are expanding our lending activities in riskier areas.

We have identified commercial real estate and commercial business loans as areas for increased lending emphasis. While increased lending diversification is expected to increase interest income, non-residential loans carry greater historical risk of payment default than residential real estate loans. As the volume of these loans increase, credit risk increases. In the event of substantial borrower defaults, our provision for loan losses would increase and therefore, earnings would be reduced. As the Company lends in diversified areas such as commercial real estate, commercial, agricultural, real estate, commercial construction and residential construction, the Company may be incur additional risk if one lending area experienced difficulties due to economic conditions.

Our stock price can be volatile.

Our stock price can fluctuate widely in response to a variety of factors, including actual or anticipated variations in quarterly operating results, recommendations by securities analysts and news reports relating to trends, concerns and other issues in the financial services industry. Other factors include new technology used or services offered by our competitors, operating and stock price performance of other companies that investors deem comparable to us, and changes in government regulations.

General market fluctuations, industry factors and general economic and political conditions and events, such as future terrorist attacks and activities, economic slowdowns or recessions, interest rate changes or credit loss trends, also could cause our stock price to decrease regardless of our operating results.

Item 1B. *UNRESOLVED STAFF COMMENTS*

Not applicable.

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Item 2. ***PROPERTIES***

At December 31, 2007, 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	231 N. Third Avenue Sandpoint, ID 83864	10,000	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
Nampa Loan Production Office	5660 E. Franklin Road, Suite 100. Nampa, ID 83687	2,380	February 2007	Lease
(Payette County)				
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

(Washington County)				
Weiser	440 E Main Street Weiser, ID 83672	3,500	June 2000	Own

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City and County	Address	Sq. Feet	Date Opened or Acquired	Occupancy Status (Own/Lease)
Magic Valley Bank Branches				
(Twin Falls County)				
Twin Falls	113 Main Ave West Twin Falls, ID 83301	10,798	November 2004	Lease
Canyon Rim(2)	1715 Poleline Road East Twin Falls, ID 83301	6,975	September 2006	Lease
(Gooding County)				
Gooding(2)	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 Private Banking	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 Data Center	218 Main Street Sandpoint, ID 83864	1,900	March 1999	Lease
Sandpoint Management Services	110 Main Street Sandpoint, ID 83864	6,669	June 2002	Lease
Sandpoint Administrative	307 N. Second Avenue Sandpoint, ID 83864	4,848	March 2006	Lease
ICI Brokerage Dept	102 10th & Hwy 2, Ste A Priest River, ID 83856	665	September 2006	Lease
Sandpoint Center(3)	414 Church Street Sandpoint, ID 83864		January 2006	Own
(Kootenai County)				
Coeur d Alene Branch and Administrative Services(1)	200 W. Neider Avenue Coeur d Alene, ID 83814	17,600	May 2005	land lease own building

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 December 2006, the Company entered in agreements to sell the Gooding and Canyon Rim branches, and subsequently lease them back. The sales were completed in January 2007 and the leases commenced in January

2007.

3) In January 2006, the Company purchased land on an installment contract and subsequently began building the 94,000 square foot Sandpoint Center, which will house the Sandpoint branch, corporate headquarters and administrative functions. The building will also contain technical and training facilities, an auditorium and community room and space for other professional tenants. Pending receipt of regulatory approval, the Company anticipates relocating the Sandpoint Branch, corporate headquarters and administrative functions during the second quarter of 2008. The Company anticipates selling the building upon or near completion and leasing back approximately 47,000 square feet.

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Item 3. ***LEGAL PROCEEDINGS***

The Company and the Bank are parties to various claims, legal actions and complaints in the ordinary course of their businesses. In the Company 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, cash flows or results of operations of the Company.

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

There were no matters submitted to security holders for a vote during the fourth quarter of 2007.

PART II

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

Market Price and Dividend Information

Bid and ask prices for the Company s Common Stock are quoted in the Pink Sheets and on the OTC Bulletin Board under the symbol IMCB.OB As of March 2, 2008, there were 13 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 (1)

	2007		2006	
Quarter	**High**	**Low**	**High**	**Low**
1st	$ 22.18	$ 20.01	$ 18.18	$ 14.09
2nd	20.68	17.13	20.50	17.02
3rd	17.90	14.49	21.82	18.73
4th	16.75	13.10	22.73	20.36

(1) This table reflects the range of high and low closing prices for the Company s Common Stock during the indicated periods. Prices have been retroactively adjusted to reflect all stock splits and stock dividends, including a 10% common stock dividend that was effective May 31, 2007. Prices do not include retail markup, markdown or commissions.

The approximate number of record holders of the Company s common stock as of March 2, 2008 was 961, representing 8,273,578 shares outstanding.

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

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 2007.

Equity Compensation Plan Information

The Company currently maintains four compensation plans that provide for the issuance of Intermountain s common stock to officers and other employees, directors and consultants. These consist of the 1988 Employee Stock Option Plan, the 1999 Employee Stock Plan, the 1999 Director Stock Option Plan, and the 2006-2008 Executive Long Term Incentive Plan, each of which have been approved by the Company s shareholders. The

following table sets forth information regarding outstanding options and shares reserved for future issuance under the foregoing plans as of December 31, 2007:

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	551,624(1)	$	5.48	247,399(1)
	90,750(2)			90,750(2)
Equity compensation plans not approved by shareholders	31,453(3)			31,453(3)
Total	673,827	$	5.48	369,602

(1) Under the company s Employee Stock Option and Restricted Stock Plan, as amended (the Stock Plan), we may issue Restricted Stock Awards, as that term is defined in the Stock Plan.

(2) For purposes of this table, we have listed the target shares that could be used under the 2006-2008 Long Term Incentive Plan to eligible executive officers, provided the company meets specific performance goals at the end of the three-year period. In the event the company exceeds the performance targets, more shares could be issued.

(3) We issue securities under the 2003-2005 Long Term Incentive Plan to eligible executive officers, provided the company has met specific performance goals at the end of the three-year period. Under the terms of the plan, the executive must have been continuously employed by the company during the three-year period and to receive the award, must be employed at the time the stock award vests. The award vests equally over a three-period and is payable in restricted stock. The number of shares set forth in the table are the shares that may be issued under the 2003-2005 Long Term Incentive Plan, for which a Registration Statement on Form S-8 has been filed.

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.

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Total Return Performance

	Period Ending					
Index	**December 31, 2002**	**December 31, 2003**	**December 31, 2004**	**December 31, 2005**	**December 31, 2006**	**December 31, 2007**
Intermountain Community Bancorp	$ 100	$ 197	$ 275	$ 256	$ 396	$ 272
SNL Index	100	141	157	159	178	139
Russell 2000	100	145	170	176	206	200

Item 6. ***SELECTED FINANCIAL DATA***

The following selected financial data (in thousands except per share data) of the Company is derived from the Company s historical audited consolidated financial statements and related footnotes. The information set forth below should be read in conjunction with Management s Discussion and Analysis of Financial Condition and

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Results of Operations and the consolidated financial statements and related footnotes contained elsewhere in this Form 10-K.

	For the Year Ended December 31, (2)				
	2007(1)(5)	2006(1)(5)	2005(1)	2004(1)	2003
STATEMENTS OF INCOME DATA					
Total interest income	$ 72,858	$ 59,580	$ 41,648	$ 25,355	$ 20,983
Total interest expense	(26,337)	(17,533)	(10,717)	(5,712)	(4,970)
Net interest income	46,521	42,047	30,931	19,643	16,013
Provision for loan losses	(3,896)	(2,148)	(2,229)	(1,438)	(955)
Net interest income after provision for losses on loans	42,625	39,899	28,702	18,205	15,058
Total other income	13,199	10,838	9,620	7,197	5,985
Total other expense	(40,926)	(35,960)	(26,532)	(18,884)	(15,476)
Income before income taxes	14,898	14,777	11,790	6,518	5,567
Income taxes	(5,453)	(5,575)	(4,308)	(2,172)	(1,906)
Net income	$ 9,445	$ 9,202	$ 7,482	$ 4,346	$ 3,661
Net income per share(3)					
Basic	$ 1.15	$ 1.15	$ 1.06	$ 0.73	$ 0.64
Diluted	$ 1.10	$ 1.07	$ 0.97	$ 0.66	$ 0.59
Weighted average common shares outstanding(3)					
Basic	8,206	8,035	7,078	5,991	5,730
Diluted	8,605	8,586	7,684	6,604	6,154
Cash dividends per share					

	December 31, (2)				
	2007(1)	2006(1)	2005(1)	2004(1)	2003
BALANCE SHEET DATA					
Total assets	$ 1,048,659	$ 920,348	$ 734,099	$ 597,680	$ 409,760
Net loans(4)	756,549	664,885	555,453	418,660	287,256
Deposits	757,838	693,686	597,519	500,923	344,866
Securities sold subject to repurchase agreements	124,127	106,250	37,799	20,901	17,156
Advances from Federal Home Loan Bank	29,000	5,000	5,000	5,000	5,000
Other borrowings	36,998	22,602	16,527	16,527	8,279
Shareholders equity	90,119	78,080	64,273	44,564	27,078

(1) Comparability is affected by the acquisition of Snake River Bancorp in November 2004 and a branch in 2003.

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

(3) 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

(4) Net loans receivable have been adjusted for 2006 and 2005 to move the allowance for unfunded commitments from the allowance for loan loss, a component of net loans, to other liabilities.

(5) Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*, was adopted as of January 1, 2006. During 2007 and 2006, stock based compensation expense was $486,000 and $848,000, respectively.

Key Financial Ratios	Years Ended December 31, 2007	2006	2005
Return on Average Assets	0.96%	1.13%	1.11%
Return on Average Equity	11.30%	12.90%	14.80%
Average Equity to Average Assets	8.50%	8.76%	7.53%

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 Business Forward-Looking Statements.

Overview

The Company operates a multi-branch banking system and is executing plans for the formation and acquisition of banks and bank branches that can operate under a decentralized community bank structure. Based on opportunities available in the future, the Company plans expansion in markets generally located within the states where it currently operates or in contiguous states, including Idaho, Oregon, Washington and Montana, or in other areas that may provide significant opportunity for targeted customer growth. The Company is pursuing 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.

The Company continues to make significant investments in human resources and technology to support its growth initiatives. Asset growth is expected to keep pace or exceed earnings growth over the next several years while the Company pursues its expansion and customer acquisition goals. Further, the Company continues to leverage its capital which, in addition to retained earnings, has been supplemented by two trust preferred debentures totaling approximately $16.5 million, and a $12.0 million common stock offering in December 2005, both executed in anticipation of expansion into new markets.

Management and the Board of Directors remain committed to building a decentralized community banking organization and further increasing the level of service we provide our targeted customers and our communities. Our strategic plan calls for a balanced yet aggressive set of asset growth and shareholder return goals. We expect to achieve these goals by employing experienced, knowledgeable and dedicated people and supporting them with strong technology and training.

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). This acquisition allows the Company to offer non-FDIC insured investment alternatives to its customers, including mutual funds, insurance, brokerage services and annuities.

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 now also houses a mortgage loan center and some administrative offices.

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 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 August 2006, the Company began construction of a 94,000 square foot financial and technical center office building in Sandpoint, Idaho. The Company plans to relocate both its Sandpoint main branch and headquarters to this building, with the Company occupying approximately 47,000 square feet. Pending regulatory approval, the Company anticipates moving into the facility during the second quarter of 2008.

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. It will also look for opportunities to acquire other community banks that believe in the strategy of community banking and desire to build on the Company s culture, employee capital, technology and operational efficiency. Based on the June 2007 FDIC survey of banking institutions, the Company is the market share leader in deposits in five of the eleven counties in which it operates, and has experienced share growth in virtually all of its markets over the past year.

2007 represented a challenging year for the banking industry, as slowing economic growth combined with rising loan defaults, particularly in the real estate sector, to place pressure on bank earnings. Large banking institutions were also hurt by significant investment exposure to sub-prime and similar collateralized debt obligations. As delinquencies in the collateral underlying these investments increased and investors pulled money from the market, many large commercial and investment banks experienced significant write-downs.

While smaller banks did not generally have direct exposure to the subprime market, the effects of the subprime meltdown increased pressure on their local real estate loans, causing rising defaults and chargeoffs. As the Fed sought to control the situation by adding liquidity and lowering interest rates in the latter half of the year, many smaller banks also faced compression in their net interest margin, as they were unable to reprice liabilities as quickly as assets were repricing.

Worsening economic and real estate conditions are likely in 2008, as the US economy continues to struggle with slower growth, a weak dollar, and higher inflation, particularly in gas and food prices, With this backdrop, the Federal Reserve is likely to continue to push short-term market rates down to spur higher economic growth.

The northwest economy in which the Company operates held up better than much of the rest of the nation in 2007, and is likely to do so again in 2008. Relatively strong exports, continued in-migration and lower-cost, business-friendly governments may help bolster these markets against some of the national difficulties. Still, the northwest economy is likely to feel the impacts in terms of slowing growth and rising prices.

In this environment, the most significant perceived risks to the Company are credit quality, interest rate risk, operational/execution risk, and human resources risk. Poor credit quality can create significant earnings, capital and liquidity pressures more quickly than other types of risk faced by the Bank. During 2007, the financial stability of the Company s customers weakened in response to the weakening national economy, although our local markets generally held up better.. Total loans receivable in 2007 increased 13.9% while our net loan charge-off rate increased to 0.26% of total loans from 0.06% in 2006. Non-accrual loans increased approximately $4.4 million in 2007 to 0.74% of total

loans. Loan delinquencies over 30-days at fiscal year end 2007 increased to 0.40% at December 31, 2007 from 0.24% at December 31, 2006. The delinquency ratios reflected strong collection efforts by the Company s officers, and trended with the increased non-accrual and loss percentages. Softening credit conditions and particularly a slowdown in the real estate sector of the economy placed additional pressure on the loan portfolio during 2007. The economic environment is expected to deteriorate further in 2008, creating more risk in the loan portfolio. Management is responding by actively managing its underwriting, monitoring and collection efforts.

Interest rate risk for the Company can create earnings and liquidity pressure as market rate changes may adversely impact net interest income and net earnings. To address this risk, management closely monitors changing market rate conditions and bank portfolios and responds accordingly through both portfolio mix and pricing decisions. In addition, the Company engages in certain hedging activities to protect itself against changes in market rates. Market rates were inverted through much of 2007, meaning that short-term rates were higher than longer-term rates. In this environment, it became more difficult to maintain the Company s net interest margin, because deposits continued to reprice upward as loan rates remained static. In the latter half of 2007 and early 2008, the Federal Reserve aggressively cut short-term target rates, leading to a significant decline in overall short-term market rates, including the Bank s prime lending rate. These movements are anticipated to create additional pressure on the Company s net interest margin, as loans reprice down more quickly than its deposit portfolio. Management anticipated these movements, and responded by repricing its deposit portfolio down, aggressively seeking lower-cost funding sources, including non-interest and low-interest bearing deposits, and engaging in additional hedging transactions to offset declining asset yields. The Company also actively employs a customer profitability system and pricing model to ensure that loans and deposits are priced appropriately.

The growth in the Bank has increased the risk of operational problems. These are being addressed through the recruitment and hiring of additional experienced staff in key administrative support positions, significant increases in our training budget and programs, implementation of new monitoring and control technology and the expansion of our internal compliance and audit staff.

In addressing human resources risk, management focuses a great deal of its efforts on developing a culture that promotes, retains and attracts high quality individuals. Our compensation and reward systems contribute directly to maintaining and enhancing this culture, and we encourage strong participation among all employees in establishing and implementing the bank s business plans.

Management believes that its efforts in managing these and other risks have been successful, but that continued diligence is required.

To summarize the Company s financial performance in 2007, net income increased 2.6% over 2006 while assets increased 14.0% over the same time period. The Company realized record net income of $9.4 million or $1.10 per share (diluted). This is a 2.8% increase in diluted earnings per share over the 2006 figure of $1.07 per share (diluted). Return on average equity (ROAE) and return on average assets (ROAA), common measures of bank performance, totaled 11.3% and 0.96%, respectively, compared to 12.9% and 1.13% in 2006. Assets increased at a stronger pace than net income in 2007, which resulted in the decrease in ROAA for the year ended December 31, 2006. Net income increased only slightly in 2007, while equity increased due to the retention of net income and the reversal of an unrealized loss to an unrealized gain position on the investment portfolio.

In 2005 the Company successfully raised $12 million in equity capital through a common stock offering. In this common stock offering, the Company issued 705,882 common shares and added $11.9 million to stockholders equity. Other equity events over the past few years include 10% common stock dividends effective May 31, 2007, and May 31, 2006, and a 3-for-2 stock split effective March 10, 2005. All per-share data computations are calculated after giving retroactive effect to stock dividends and stock splits.

Total assets reached $1.05 billion, a 14.0% increase from $920.3 million at December 31, 2006. Net loans experienced 13.8% growth to $756.5 million at December 31, 2007 from $664.9 million at the end of 2006. Total deposits grew from $693.7 million to $757.8 million during 2007, representing a 9.3% increase. Both loans receivable and deposit growth reflect strong organic growth in the Bank s existing markets, as well as increasing contributions from the newer markets. Growth over the past four years has been largely driven by the Company s continued commitment to attracting, motivating and retaining high quality employees, maintaining high levels of customer service and

community involvement, pursuing an aggressive branch expansion and acquisition plan and successful face-to-face business development efforts.

The Company s net interest margin for the year ended December 31, 2007 was 5.21%, as compared to 5.66% for 2006 and 5.01% for 2005. A volatile interest rate environment, in which interest rates on interest-costing liabilities generally rose more than on interest earning assets during 2007 created the decrease in the Company s margin in 2007.

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Results of Operations

Net Interest Income

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, 2007		
	Average Balance	Interest Income/ Expense	Average Yield
	(Dollars in thousands)		
Loans receivable, net(1)	$ 742,310	$ 65,362	8.81%
Securities(2)	133,275	6,585	4.93
Federal funds sold	17,631	911	5.17
Total earning assets	893,216	72,858	8.16
Cash and cash equivalents	21,690		
Office properties and equipment, net	32,734		
Other assets	19,181		
Total assets	$ 966,821		
Time deposits of $100,000 or more	$ 91,960	$ 4,467	4.86%
Other interest-bearing deposits	488,075	14,302	2.93
Short-term borrowings	96,563	3,498	3.62
Other borrowed funds	50,961	4,070	7.99
Total interest-bearing liabilities	727,559	26,337	3.62%
Noninterest-bearing deposits	148,586		
Other liabilities	7,066		
Shareholders equity	83,610		
Total liabilities and shareholders equity	$ 966,821		
Net interest income		$ 46,521	
Net interest margin			5.21%

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Average Balance Sheets and Analysis of Net Interest Income

	For the Year Ended December 31, 2006		
	Average Balance	Interest Income/ Expense	Average Yield
	(Dollars in thousands)		
Loans receivable, net(1)	$ 623,861	$ 54,393	8.72%
Securities(2)	101,896	4,378	4.30
Federal funds sold	16,880	809	4.79
Total earning assets	742,637	59,580	8.02%
Cash and cash equivalents	21,729		
Office properties and equipment, net	19,523		
Other assets	21,643		
Total assets	$ 805,532		
Time deposits of $100,000 or more	$ 92,933	$ 3,997	4.30%
Other interest-bearing deposits	412,009	9,195	2.23
Short-term borrowings	48,086	2,109	4.39
Other borrowed funds	36,718	2,232	6.08
Total interest-bearing liabilities	589,746	17,533	2.97%
Noninterest-bearing deposits	133,052		
Other liabilities	11,478		
Shareholders equity	71,256		
Total liabilities and shareholders equity	$ 805,532		
Net interest income		$ 42,047	
Net interest margin			5.66%

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Average Balance Sheets and Analysis of Net Interest Income

	For the Year Ended December 31, 2005		
	Average Balance	Interest Income/ Expense	Average Yield
	(Dollars in thousands)		
Loans receivable, net(1)	$ 505,701	$ 37,897	7.49%
Securities(2)	108,620	3,672	3.38
Federal funds sold	2,790	79	2.83
Total earning assets	$ 617,111	$ 41,648	6.75%
Cash and cash equivalents	21,730		
Office property and equipment, net	14,869		
Other assets	18,344		
Total assets	$ 672,054		
Time deposits of $100,000 or more	$ 83,175	$ 2,842	3.42%
Other interest-bearing deposits	345,309	5,408	1.57
Short term borrowings	42,407	1,290	3.04
Other borrowed funds	21,527	1,177	5.47
Total interest-bearing liabilities	492,418	10,717	2.18%
Noninterest-bearing deposits	119,831		
Other liabilities	9,747		
Shareholders equity	50,058		
Total liabilities and shareholders equity	$ 672,054		
Net interest income		$ 30,931	
Net interest margin			5.01%

(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 tax equalized, 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 2007 versus 2006

	Volume	Rate	Volume/Rate	Total
		(Dollars in thousands)		
Loans receivable, net	$ 10,327	$ 539	$ 103	$ 10,969
Securities	1,357	648	202	2,207
Federal funds sold	26	74	2	102
Total interest income	11,710	1,261	307	13,278
Time deposits of $100,000 or more	(42)	517	(5)	470
Other interest-earning deposits	1,698	2,878	531	5,107
Borrowings	3,068	334	(175)	3,227
Total interest expense	4,724	3,729	351	8,804
Net interest income	$ 6,986	$ (2,468)	$ (44)	$ 4,474

Changes Due to Volume and Rate 2006 versus 2005

	Volume	Rate	Volume/Rate	Total
		(Dollars in thousands)		
Loans receivable, net	$ 8,855	$ 6,194	$ 1,447	$ 16,496
Securities	(227)	995	(62)	706
Federal funds sold	399	55	276	730
Total interest income	9,027	7,244	1,661	17,932
Time deposits of $100,000 or more	333	735	87	1,155
Other interest-bearing deposits	1,045	2,298	444	3,787
Borrowings	1,004	737	133	1,874
Total interest expense	2,382	3,770	664	6,816
Net interest income	$ 6,645	$ 3,474	$ 997	$ 11,116

Net Interest Income 2007 Compared to 2006

The Company s net interest income increased to $46.5 million in 2007 from $42.0 million in 2006. The net interest income increase attributable to volume increases was a favorable $7.0 million over 2006 as average interest earning assets increased by $150.6 million and average interest costing liabilities increased by $137.8 million. During 2007, interest rates increased both on the interest earning assets and interest costing liabilities; however, rates increased more significantly on the liability side than the assets. This created a $2.5 million decrease attributable to rate variances. The separate volume and rate changes along with a $44,000 decrease due to the interplay between rate and volume factors created a $4.5 million overall increase in net interest income for 2007.

The yield on interest-earning assets increased 0.14% in 2007 from 2006, while the cost of interest-bearing liabilities increased 0.65% during the same period. At 0.09%, the loan yield increase was relatively modest over the prior year. The prime lending rate was stable during the first half of 2007, but was generally higher than during 2006. However, it dropped by 1.00% during the final four months of the year, resulting in a relatively small annual increase in the overall average loan yield. Approximately 64% of the Bank s loan portfolio is variable rate, so it responds relatively quickly to both rising and falling market rates. The Bank sought to moderate this impact by increasing the higher yielding commercial loan component of its loan portfolio and emphasizing more fixed rate loans in 2007.

The investment securities portfolio experienced an increase in yield of 0.63% as the Company extended the duration of its investment portfolio and bought higher-yielding securities to increase yield and offset some of the volatility in the loan portfolio yield.

The volatile interest rate environment also impacted the Company s interest-bearing liability costs. During the first eight months of 2007, market rates stabilized and deposit costs generally rose in response to market rate increases in 2006. Over the final four months, market rates dropped significantly and liability costs began to decline, but at a slower rate than market rate and asset yield declines. As a result, the overall cost of interest-bearing liabilities increased by 0.65% during the year.

Net Interest Income 2006 Compared to 2005

The Company s net interest income increased to $42.0 million in 2006 from $30.9 million in 2005. The net interest income increase attributable to volume increases was a favorable $6.6 million over 2005 as interest earning assets increased by $125.5 million and interest costing liabilities increased by $110.4 million. During 2006, interest rates increased both on the interest earning assets and interest costing liabilities; however, rates increased more significantly on the asset side than the liabilities. This created a $3.5 million increase attributable to rate variances. The separate volume and rate increases along with a $957,000 increase due to the interplay between rate and volume factors created an $11.1 million overall increase in net interest income for 2006.

The yield on interest-earning assets increased 1.27% in 2006 versus 2005. The cost of interest-bearing liabilities increased 0.79%. The loan yield increase of 1.23% represented the largest combined impact to net yield. The increase by 1.00% in the prime lending rate during 2006 directly affected the Bank s variable rate loan portfolio, which comprised approximately 63% of the total loan portfolio at December 31, 2006. The Bank has increased the higher yielding commercial loan component of the loan portfolio, which contributed to the increase in loan yield. The investment securities portfolio experienced an increase in yield of 0.92% as the Company swapped a number of lower yielding investment securities for higher yielding ones during the year. The yield on federal funds sold rose during 2006 by 1.96%, which is in line with the short-term investment market. The increases in earning asset yields were partially offset by increases in the cost of interest-bearing sources of funding. The cost of other borrowings increased by 1.32% as the Bank partially funded loan and other asset growth with borrowings. This represented the most drastic rate change from 2005. The cost of interest bearing deposits increased 0.66% as the Bank raised interest rates on small certificate of deposits and money market accounts in a rising interest rate environment. The Company was generally asset-sensitive in 2006, resulting in improved net interest income during the year, as its earning assets repriced more quickly and to a higher degree than its interest costing liabilities.

Provision for Loan Losses

Management continually evaluates allowances for estimated loan losses and based on this evaluation, charges a corresponding provision against income. While the Bank generally maintained its sound credit quality position in 2007, the softening economy and real estate downturn impacted its results. The allowance for loan losses as a percentage of total loans receivable was 1.53% at December 31, 2007 and 1.46% at December 31, 2006. The provision for loan losses increased from $2.1 million in 2006 to $3.9 million in 2007. Net chargeoffs in 2007 totaled $2.0 million versus only $347 thousand in 2006. Much of the additional net chargeoff volume consisted of write-downs on non-performing construction and land loans to lowered collateral values, as the Company reevaluated its collateral positions on its real estate portfolio. At December 31, 2007, the total allowance for loan losses was $11.8 million compared to $9.8 million at the end of the prior year.

With the strong growth in the loan portfolio and its concentration in real estate loans, management continues to focus on enhancing its credit quality efforts by recruiting individuals with strong credit experience, providing additional training for our lending officers, and refining its credit approval, management and review process. During the year, the company also credit-shocked its real estate portfolio and revised its method of calculating its loan loss allowance, in line with new bank regulatory guidance issued in early 2007. The credit shock testing provided management with better information about the potential impact of different economic scenarios on the Company s real estate loan portfolio. The ALLL methodology change provides more detailed and granular information to management in its consideration of appropriate allowance levels. While both national and local credit markets experienced a downturn, the local economy remains relatively stable. Given local credit conditions and the stability of the bank s loan portfolio, management believes that the loan loss allowance is adequate at December 31, 2007.

Other Income

The following table details dollar amount and percentage changes of certain categories of other income for the three years ended December 31, 2007.

Other Income	2007 Amount	% of Total	Percent Change Prev. Yr	2006 Amount	% of Total	Percent Change Prev. Yr.	2005 Amount	% of Total
				(Dollars in thousands)				

Fees and service charges	$	8,646	65%	29%	$	6,726	62%	17%	$	5,754	60%
Mortgage Banking Operations		2,749	21	(17)		3,300	30	37		2,411	25
BOLI income		314	2	3		305	3	2		300	3
Net gain (loss) on sale of securities		(38)	0	(96)		(987)	(9)	2,195		(43)	0
Other income		1,528	12	2		1,494	14	25		1,198	12
Total	$	13,199	100%	22%	$	10,838	100%	13%	$	9,620	100%

Fees earned from loans sold and a variety of fees and service charges earned on deposit accounts continue to be the Bank s primary sources of other income. Fees and service charges increased significantly during 2007 as a result of increasing investment, trust, debit card and business services income during the year. The Trust division, established in 2006, picked up customer volume and grew to approximately $48.5 million in assets under management at the end of 2007. Intermountain Community Investments, purchased in September 2006, had a strong year in 2007, contributing over $700,000 in fee income, and debit card activity expanded rapidly as customers continued to migrate to electronic banking. Increasing customer accounts, pricing changes on some services and stronger cross-selling activity also contributed to the improvement. The Company expects further growth in income from all of these sources in 2008 and future years.

Mortgage banking income, which had been expanding rapidly in prior years, slowed in 2007 as a result of the downturn in the real estate economy. 2008 is likely to remain a slow year, as residential real estate activity continues to soften. BOLI income reflected slightly higher yields in the BOLI portfolio, while the net loss on securities decreased significantly. In 2006, the Company swapped some very low-yielding securities resulting in a significant loss, which was not repeated in 2007. The yield pickup from this investment swap offset the loss taken within nine months of the swap date. The other income subcategory largely consists of fees earned on the Company s contract to provide deposit accounts used to secure credit card portfolios. This program continued to expand volumes during the year, but at a slower pace than prior years, as national credit card activity slowed in 2007. The Company forecasts continued growth in this contract income, but at slower rates as the slower economy begins to weigh on credit card borrowing.

Overall, the Bank continues to rank near the top of its peer group in terms of other income as a percentage of average assets. To maintain this position and expand the percentage of revenue contributed by non-interest income, the Company will continue to aggressively seek account growth in its local markets, adjust pricing, cross-sell its investment, trust and business solutions, and seek further opportunities to diversify its non-interest income sources.

Operating Expenses

The following table details dollar amount and percentage changes of certain categories of other expense for the three years ended December 31, 2007.

Other Expense	2007 Amount	% of Total	Percent Change Prev. Yr.	2006 Amount	% of Total	Percent Change Prev. Yr.	2005 Amount	% of Total
				(Dollars in thousands)				
Salaries and employee benefits	$ 25,394	62%	16%	$ 21,859	61%	42%	$ 15,356	58%
Occupancy expense	6,089	15	27	4,789	13	22	3,927	15
Advertising	1,330	3	13	1,172	3	53	767	3
Fees and service charges	1,404	4	18	1,193	4	22	974	3
Printing, postage and supplies	1,466	4	3	1,430	4	14	1,257	5
Legal and accounting	1,377	3	(3)	1,418	4	23	1,153	4
Other expense	3,866	9	(6)	4,099	11	32	3,098	12
Total	$ 40,926	100%	14%	$ 35,960	100%	36%	$ 26,532	100%

Similar to 2006 and 2005, salaries and employee benefits continued to be the majority of non-interest expense in 2007. The pace of growth in salaries and employee benefits expense slowed significantly in 2007, as compared to 2006 and 2005 as the Company did not expand into new markets or open new branches during the year.

The number of full-time equivalent employees (FTE) at the Bank grew in 2007, but at a slower pace than prior years. The Company added 35 net FTE in 2007, an 8% increase, versus 83, a 25% increase in 2006. The 2007 FTE growth resulted from expanding existing branches and increasing administrative staff to support growth and comply with increasing regulatory requirements. This increase in FTE, along with normal cost-of-living and promotional increases added approximately $3.5 million to salary and benefits expense during the year. The bank s incentive plans, driven by a combination of asset growth, net income and return on equity, paid at a lower rate as the

Company s asset and income growth slowed and the return on equity worsened. Recruitment costs totaled $219 thousand in 2007, down from $604,000 the year before. Stock based compensation expense decreased to $486,000 in 2007 from $848,000 in 2006. Prior to the adoption of FAS123 (R) stock based compensation expense in 2005 totaled $79,000. Benefits costs continued to rise, however as health insurance premiums increased.

As the economy shifts, the Company expects to further stabilize its staffing levels in 2008 and pursue its short-term objectives through the retention and motivation of its existing high-quality staff. The rate of personnel expense growth is expected to decline further as the company implements cost saving strategies, including revising business processes to more effectively utilize existing bank staff. However, benefits expenses are expected to increase at a rate higher than salary expenses as health insurance premiums continue to rise.

The 2006 personnel expense and FTE growth resulted from expanding existing branches and opening new branches in Fruitland, Kellogg, Twin Falls and downtown Spokane during the year. In addition, the Company established the Trust and Wealth Management division, purchased Intermountain Community Investments, and added administrative staff to support the company growth and comply with increased regulatory requirements related to lending compliance, the US Patriot Act and the Sarbanes Oxley Act. The 2006 increase also reflects introduction of new incentive compensation plans and changes in accounting for stock option expense resulting from the introduction of FAS123 (R), which required the expensing of stock options for the first time in 2006.

Consistent with the Company s growth strategy, occupancy and equipment expense grew significantly in 2007 and 2006. The expense increase was primarily caused by the full-year effect of operational costs of the branches and divisions opened in 2006. It also reflects increasing technology expense, as the Bank continues to improve its infrastructure to support growth, security and product development initiatives. This expense is anticipated to increase again in 2008 as the Company completes and moves into the Sandpoint Center, but it will mitigate some of this impact by reducing its lease expense and implementing cost saving measures in other areas.

Public relations and advertising expense totaled $1.3 million for 2007, a 13% increase over the $1.2 million expense in 2006. Continued market development, the need to market in more geographic areas and new target marketing initiatives caused the increases over 2006 and 2005. Management expects costs to remain stable in this category in 2008 as the Bank anticipates improving the efficiency of its marketing efforts during the year.

The increase in fees and service charges during 2007 was caused primarily by increasing volumes of business and the entry into new product lines where third party vendors were required. In addition, the Bank chose to pay service fees to its correspondent banks and sweep balances into interest-bearing accounts, rather than maintaining sufficient balances in non-interest bearing accounts to offset correspondent banking fees. We expect moderation in this area, as efficiencies allow us to spread our vendor costs, and new technology initiatives reduce some of our volume-related expenses. Printing, postage and supplies remained stable from 2006 to 2007 as the Company controlled costs in this area. It is expected that this expense will remain stable in 2008.

Legal and accounting expense decreased in 2007 as the Company reduced expenditures on Sarbanes Oxley compliance and legal fees on the collection of problem loans. In 2006, the Company incurred substantial additional accounting expense to comply with the requirements of Section 404 of Sarbanes Oxley for the first time, as well as other new accounting regulations. The Company also incurred significant legal expense to collect a large loan in southern Idaho, some of which is anticipated to be recovered in 2008. It is anticipated that legal and accounting expense will moderate in 2008, but at a slower pace as the Company continues its compliance with Sarbanes Oxley and other legal, regulatory and accounting pronouncements.

Other expenses decreased in 2007, as the Company trimmed expenses in training, travel, professional consulting, telecommunications and other operational expenses during the year. It also experienced lower operational losses than

in the prior year. This category is expected to be stable for 2008, as the Company continues to focus on cost-saving initiatives.

Cost management is a more critical priority for management in 2008, as the economy slows and credit losses potentially increase. While 2006 presented unique growth opportunities and challenges, management began actively targeting higher efficiency as a significant goal in 2007 and expects to continue this focus in 2008. It will seek to leverage the investments made over the past couple years in personnel, compensation systems, fixed assets, training and marketing expenses to generate additional growth without corresponding increases in these expenses.

In 2008, it will also engage in significant business process revisions to improve workflows, efficiency and the quality of the customer experience. As a result, it will be centralizing certain processes and employing additional technology to slow the growth in salary and other expenses.

Financial Position

Assets increased by $128.3 million or 14% during 2007. This increase was driven largely by organic growth in the loans receivable portfolio, particularly commercial loans. Loans receivable increased by $91.7 million or 14% compared to 2006. Continued strong loan demand in both new and existing markets and continued progress on relationship banking initiatives within the Bank created the significant increase in 2007.

Assets increased in 2006 by $186.2 million, or 25%. This increase primarily resulted from organic loan growth of $109.4 million, or 20% over 2005, as well as expansion in the investment portfolio. Loan and asset growth is expected to moderate in 2008, as local economies respond to the slowdown in the national economy, and particularly in the real estate sector. Growth rates in the Company s market areas, however, are anticipated to exceed national growth rates.

Investments in available for sale securities increased by 34% from 2006, totaling $158.8 million at December 31, 2007, compared to $118.5 million at December 31, 2006. Available for sale investments increased to 15% of total assets compared to 13% for the previous year. Held-to-maturity investments also increased, from $6.7 million in 2006 to $11.3 million in 2007. Management expanded the investment portfolio again in 2007 to improve its interest rate risk position, particularly in a down-rate environment. Management continues to manage the investment portfolio to achieve reasonable yield and manage interest rate risk exposure, while maintaining the liquidity necessary to support the rapidly growing loan portfolio. Changes in the investment portfolio along with changes in market rates converted an unrealized loss of $111,000 in the investment portfolio at the end of 2006 into an unrealized gain of $1.3 million at the end of 2007. The Company also drew its Fed Funds Sold position down by $28.8 million during 2007 and reinvested the funds in the higher-yielding loan portfolio.

Office properties and equipment increased $16.6 million or 65% at December 31, 2007 compared to December 31, 2006. Continued construction on the new Sandpoint headquarters building and the new Spokane Valley office produced much of the increase. Investment in additional technology also added to the change. It is anticipated that the total construction and land cost of the Sandpoint building will be approximately $24.4 million. The Company currently plans to sell the building upon completion and full occupancy in late 2008. It will then lease back the branch and headquarters space. After 2008, occupancy expense is expected to moderate, as the Company s future growth initiatives will likely involve fewer fixed asset expenditures.

Goodwill and other intangible assets decreased to $12.4 million at December 31, 2007, from $12.5 million at December 31, 2006. The Company had goodwill and core deposit intangible assets of approximately $10.9 million related to the November 2004 Snake River acquisition, and goodwill and other intangible assets of approximately $1.9 million as a result of the January 2003 purchase of the Ontario branch of Household FSB. The September 2006 purchase of a small investment company, Premier Alliance, added $263,000 in goodwill to this total in 2006. No new acquisitions occurred in 2007. Goodwill and other intangible assets equaled 1.2% of total assets at December 31, 2007. The decrease in the balance of goodwill and other intangible assets in 2007 relates to the amortization of the core deposit intangibles related to the Snake River acquisition and the Household FSB purchase.

To fund the asset growth, liabilities increased by $116.3 million, or 14% over 2006. Most of the increase was in traditional customer deposits, which grew $64.2 million or 9% from 2006 balances. The increase in deposits was split between non-interest bearing deposit accounts ($17.5 million growth), NOW and money market accounts ($17.5 million growth), and certificates of deposit ($24.1 million growth) from the previous year. Over the last several years, strong penetration in our existing markets and rapid growth in new branches have combined with market forces,

including volatile equity markets, to produce the increases. Declining interest rates and increasing competition from other banks who are facing significant funding pressures will create additional challenges in growing deposits in 2008. To combat this, the Bank is specifically targeting customers and expanding in areas with high deposit concentrations, changing compensation structures to encourage branch staff to seek deposit growth, and providing additional training, target marketing and technology support for our staff. Management will also emphasize new product development and the use of other funding alternatives.

Deposits as of December 31, 2006 increased by $96.2 million over December 31, 2005, or 16%. NOW and money market accounts grew $75.4 million, or 35% from December 31, 2005. Demand deposit accounts increased $9.2 million over December 31, 2005, or 7%. Savings and IRA accounts increased by $8.2 million from December 31, 2005, or 11%.

Repurchase agreements increased $17.9 million, or 17% as the Bank utilized repurchase agreements to partially fund the strong loan and investment growth that occurred during 2007. Much of the growth in 2007 was used to fund the Company s purchase of certain investment securities to protect against lower market rates. The Bank continues to rely on repurchase agreements as an alternate source of funding to support its asset growth. The $24 million increase in Federal Home Loan Bank advances was also used to fund the Company s investment transactions. The 64% increase over 2006 in other borrowings to $37.0 million reflects the use of a credit line to fund construction of the Sandpoint Center. The outstanding balance of this credit line at December 31, 2007 was $19.5 million.

Total shareholders equity increased by $12.0 million from $78.1 million at December 31, 2006 to $90.1 million at December 31, 2007. This increase is due to the retention of the Company s earnings and the after-tax increase in the market value of the available-for-sale investment portfolio. Total shares outstanding increased to 8.2 million shares. Total shareholders equity grew by $13.8 million from $64.3 million at December 31, 2005 to $78.1 million at December 31, 2006. This increase was due primarily to the retention of the Company s earnings. Both the Bank s and the Company s regulatory capital ratios remain well above the percentages required by the FDIC to qualify as a well capitalized institution. Management is closely monitoring current capital levels in line with its long-term capital plan to maintain sufficient protection against risk and provide flexibility to capitalize on future opportunities.

Capital

Capital is the shareholders investment in the Company. Capital grows through the retention of earnings, the issuance of new stock, and through the exercise of stock options. Capital formation allows the Company to grow assets and provides flexibility and protection in times of adversity. Total equity on December 31, 2007 was 8.6% of total assets. The largest component of equity is common stock representing 85% of total equity. Retained earnings amount to 13% and the remaining 2% is accumulated other comprehensive income.

Banking regulations require the Company to maintain minimum levels of capital. The Company manages its capital to maintain a well capitalized designation (the FDIC s highest rating). Regulatory capital calculations include some of the trust preferred securities as a component of capital. At December 31, 2007, the Company s Total capital to risk weighted assets was 11.61%, compared to 11.62% at December 31, 2006. At December 31, 2007, the Company s Tier I capital to risk weighted assets was 10.36%, compared to 10.37% at December 31, 2006. At December 31, 2007, the Company s Tier I capital to average assets was 8.90%, compared to 9.13% at December 31, 2006. The decrease in these capital ratios at December 31, 2007 compared to December 31, 2006 is primarily a result of asset growth outpacing the growth of equity during 2007. It is anticipated that in the future, the Company will build capital through the retention of earnings and other sources. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios of 10%, 6%, and 5%, respectively. Based on the established regulatory ratios, the Company continues to maintain a well-capitalized designation.

In February 2005, the Company approved a 3-for-2 stock split, payable on March 15, 2005 to shareholders of record on March 10, 2005. In December 2005, the Company successfully completed a $12.0 million common stock offering to its existing shareholders and customers. This resulted in the issuance of an additional 705,882 shares of common stock. In April 2006, the Company approved a 10% stock dividend to all shareholders of record as of May 15, 2006. In April 2007, the Company approved an additional 10% stock dividend to all shareholders of record as of May 15, 2007.

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The following table sets forth the Company s actual regulatory capital ratios for 2007 and 2006 as well as the quantitative measures established by regulatory authorities.

	Actual		Capital Requirements		Well-Capitalized Requirements	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
As of December 31, 2007						
Total capital (to risk-weighted assets):						
The Company	$ 102,927	11.61%	$ 70,900	8%	$ 88,626	10%
Panhandle State Bank	102,898	11.61%	70,902	8%	88,627	10%
Tier I capital (to risk-weighted assets):						
The Company	91,840	10.36%	35,450	4%	53,175	6%
Panhandle State Bank	91,811	10.36%	35,451	4%	53,176	6%
Tier I capital (to average assets):						
The Company	91,840	8.90%	41,297	4%	51,621	5%
Panhandle State Bank	91,811	9.13%	40,225	4%	50,281	5%
As of December 31, 2006						
Total capital (to risk-weighted assets):						
The Company	$ 90,937	11.62%	$ 62,611	8%	$ 78,264	10%
Panhandle State Bank	89,898	11.49%	62,611	8%	78,264	10%
Tier I capital (to risk-weighted assets):						
The Company	81,147	10.37%	31,306	4%	46,958	6%
Panhandle State Bank	80,108	10.24%	31,306	4%	46,958	6%
Tier I capital (to average assets):						
The Company	81,147	9.13%	35,540	4%	44,425	5%
Panhandle State Bank	80,108	9.18%	34,915	4%	43,643	5%

Liquidity

Liquidity is the term used to define the Company s ability to meet its financial commitments. The Company maintains sufficient liquidity to ensure funds are available for both lending needs and the withdrawal of deposit funds. The Company derives liquidity primarily through core deposit growth, repurchase agreements and other borrowing arrangements, loan payments and the maturity of investment securities.

At December 31, 2007, the available-for-sale investment portfolio had gross unrealized gains in the amount of $2.2 million, compared to $183,000 at December 31, 2006. Management believes that all unrealized losses as of December 31, 2007 and 2006 are market driven, with no permanent sector or issuer credit concerns or impairments.

Core deposits include demand, interest checking, money market, savings, and local time deposits. Additional liquidity and funding sources are provided through the sale of loans, sales of securities, access to national certificate of deposit (CD) markets, and both secured and unsecured borrowings.

Core deposits, (total deposits less public deposits and brokered certificates of deposit), at December 31, 2007 were 95.7% of total deposits, compared to 97.1% at December 31, 2006. During 2007, the Company experienced a $45.3 million or 6.7% increase in its core deposit base. Deposit growth of $64 million lagged loan growth of

$87 million in 2007, but was offset by strong increases in repurchase agreements and the use of a large Federal Funds Sold position at the beginning of 2007. As a result, the Company did not significantly utilize other higher-cost funding sources, such as wholesale certificates of deposit and other borrowings. In the future, management anticipates continued competition for deposits which will require stronger core deposit-gathering efforts and the use of other funding alternatives. The company utilized other repurchase agreements, wholesale certificates of deposit and Federal Home Loan Bank advances during the year to purchase additional investment securities that would provide interest rate risk protection in a declining rate environment.

Overnight-unsecured borrowing lines have been established at US Bank, Wells Fargo, Pacific Coast Bankers Bank the Federal Home Loan Bank of Seattle (FHLB) and the Federal Reserve Bank of San Francisco. At December 31, 2007, the Company had approximately $50.0 million of overnight funding available from its unsecured sources and no overnight fed funds borrowed. In addition, $2 to $5 million in funding is available on a semiannual basis from the State of Idaho in the form of negotiated certificates of deposit. In March 2007, the Company entered into an additional borrowing agreement with Pacific Coast Bankers Bank in the amount of $18.0 million, with the amount being increased to $25.0 million in December 2007. The borrowing agreement is a revolving line of credit with a variable rate of interest tied to LIBOR and is being used to support construction of the new Sandpoint headquarters facility. Management has also sold whole loans or participated portions of loans with other lenders as an additional source of liquidity.

While asset growth is expected to moderate in 2008, the competitive environment for deposits continues to be difficult in the short-term. As a result, management may utilize these alternative funding sources to a greater extent in 2008. As such, management is improving its access to these sources and upgrading its asset and liability management process, expertise and technology to effectively control potential future risks in this area.

Related Party Transactions

The Bank has executed certain loans and deposits with its directors, officers and their affiliates. All loans and deposits made are in conformance with regulatory requirements for banks and on substantially the same terms and conditions as other similarly qualified borrowers. The aggregate amount of loans outstanding to such related parties at December 31, 2007 and 2006 was approximately $1,024,000 and $638,000, respectively.

Directors fees of approximately $296,000, $314,000, and $310,000 were paid during the years ended December 31, 2007, 2006, and 2005, respectively.

Two of the Company s Board of Directors are principals in law firms that provide legal services to Intermountain. During the years ended December 31, 2007, 2006 and 2005 the Company incurred legal fees of approximately $9,000, $11,000, and $7,000, respectively, related to services provided by these firms.

Two directors of Intermountain who joined the boards of Intermountain and Panhandle State Bank in connection with the Snake River Bancorp, Inc. acquisition and one former employee of Magic Valley Bank, who is now an employee of the Company, are all members of a partnership which owned the branch office building of Magic Valley Bank in Twin Falls, Idaho. The lease requires monthly rent of $13,165 and expires on February 28, 2018. The Company has an option to renew the lease for three consecutive five-year terms at current market rates. In connection with the Snake River Bancorp acquisition, the lease was amended to grant the Company a two-year option to acquire the property for $2.5 million. In December 2006, the Company sold the option to acquire the property to an unrelated party and executed a lease agreement to lease the building. The property was sold in January 2007 and the lease commenced in January 2007.

Off-Balance Sheet Arrangements

The Company, in the conduct of ordinary business operations routinely enters into contracts for services. These contracts may require payment for services to be provided in the future and may also contain penalty clauses for the early termination of the contracts. The Company is also party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Management does not believe that these off-balance sheet arrangements have a material current effect on the Company s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources, but there is no

assurance that such arrangements will not have a future effect. See Note 14 of Notes to Consolidated Financial Statements.

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Tabular Disclosure of Contractual Obligations

The following table represents the Company s on-and-off balance sheet aggregate contractual obligations to make future payments as of December 31, 2007.

	Payments Due by Period				
	Total	**Less than 1 Year**	**1 to 3 Years**	**Over 3 to 5 Years**	**More than 5 Years**
	(Dollars in thousands)				
Long-term debt(1)	$ 112,678	$ 4,300	$ 31,579	$ 33,601	$ 43,198
Short-term debt	120,063	100,513	19,550		
Capital lease obligations					
Operating lease obligations(2)	14,667	991	1,520	1,321	10,835
Purchase obligations(3)	4,042	4,042			
Other long-term liabilities reflected on the registrant s balance sheet under GAAP					
Total	$ 251,450	$ 109,846	$ 52,649	$ 34,922	$ 54,033

(1) Includes interest payments related to long-term debt agreements.

(2) Excludes recurring accounts payable, accrued expenses and other liabilities, repurchase agreements and customer deposits, all of which are recorded on the registrant s balance sheet. See Notes 5 and 6 of Notes to Consolidated Financial Statements . Includes operating lease payments for new leases executed in December 2006 for the sale leaseback transactions for previously owned Canyon Rim and Gooding branches. The sale transaction was completed in January 2007 and the leases commenced in January 2007.

(3) The Company is constructing a 94,000 square foot Sandpoint Center to relocate its Sandpoint branch and corporate headquarters.

Inflation

Substantially all of the assets and liabilities of the Company are monetary. Therefore, inflation has a less significant impact on the Company than does fluctuation in market interest rates. Inflation can lead to accelerated growth in noninterest expenses and may be a contributor to interest rate changes, both of which may impact net earnings. During the last two years, inflation, as measured by the Consumer Price Index, has not increased significantly, although current inflationary trends are higher. The effects of inflation have not had a material impact on the Company.

Interest Rate Management

See discussion under Item 7A of this Form 10-K.

Critical Accounting Policies

The accounting and reporting policies of the Company conform to Generally Accepted Accounting Principles (GAAP) and to general practices within the banking industry. The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The Company s management has identified the accounting policies described below as those that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of the Company s Consolidated Financial Statements and Management s Discussion and Analysis of Financial Condition and Results of Operations.

Income Recognition. The Company recognizes interest income by methods that conform to general accounting practices within the banking industry. In the event management believes collection of all or a portion of contractual interest on a loan has become doubtful, which generally occurs after the loan is 90 days past due, the

Company discontinues the accrual of interest and any previously accrued interest recognized in income deemed uncollectible is reversed. Interest received on nonperforming loans is included in income only if recovery of the principal is reasonably assured. A nonperforming loan is restored to accrual status when it is brought current or when brought to 90 days or less delinquent, has performed in accordance with contractual terms for a reasonable period of time, and the collectibility of the total contractual principal and interest is no longer in doubt.

Allowance For Loan Losses. In general, determining the amount of the allowance for loan losses requires significant judgment and the use of estimates by management. This analysis is designed to determine an appropriate level and allocation of the allowance for losses among loan types and loan classifications by considering factors affecting loan losses, including: specific losses; levels and trends in impaired and nonperforming loans; historical bank and industry loan loss experience; current national and local economic conditions; volume, growth and composition of the portfolio; regulatory guidance; and other relevant factors. Management monitors the loan portfolio to evaluate the adequacy of the allowance. The allowance can increase or decrease based upon the results of management s analysis.

The amount of the allowance for the various loan types represents management s estimate of probable incurred losses inherent in the existing loan portfolio based upon historical bank and industry loan loss experience for each loan type. The allowance for loan losses related to impaired loans usually is based on the fair value of the collateral for certain collateral dependent loans. This evaluation requires management to make estimates of the value of the collateral and any associated holding and selling costs.

Individual loan reviews are based upon specific quantitative and qualitative criteria, including the size of the loan, loan quality classifications, value of collateral, repayment ability of borrowers, and historical experience factors. The historical experience factors utilized are based upon past loss experience, trends in losses and delinquencies, the growth of loans in particular markets and industries, and known changes in economic conditions in the particular lending markets. Allowances for homogeneous loans (such as residential mortgage loans, personal loans, etc.) are collectively evaluated based upon historical bank and industry loan loss experience, trends in losses and delinquencies, growth of loans in particular markets, and known changes in economic conditions in each particular lending market. The Allowance for Loan Losses is presented to the Audit Committee for review.

Management believes the allowance for loan losses was adequate at December 31, 2007. While management uses available information to provide for loan losses, the ultimate collectibility of a substantial portion of the loan portfolio and the need for future additions to the allowance will be based on changes in economic conditions and other relevant factors. A slowdown in economic activity could adversely affect cash flows for both commercial and individual borrowers, as a result of which the Company could experience increases in nonperforming assets, delinquencies and losses on loans.

A reserve for unfunded commitments is maintained at a level that, in the opinion of management, is adequate to absorb probable losses associated with the Bank s commitment to lend funds under existing agreements such as letters or lines of credit. Management determines the adequacy of the reserve for unfunded commitments based upon reviews of individual credit facilities, current economic conditions, the risk characteristics of the various categories of commitments and other relevant factors. The reserve is based on estimates, and ultimate losses may vary from the current estimates. These estimates are evaluated on a regular basis and, as adjustments become necessary, they are recognized in earnings in the periods in which they become known through charges to other non-interest expense. Draws on unfunded commitments that are considered uncollectible at the time funds are advanced are charged to the reserve for unfunded commitments. Provisions for unfunded commitment losses, and recoveries on commitment advances previously charged-off, are added to the reserve for unfunded commitments, which is included in the Other Liabilities section of the Consolidated Statements of Financial Condition.

Investments. Assets in the investment portfolios are initially recorded at cost, which includes any premiums and discounts. The Company amortizes premiums and discounts as an adjustment to interest income using the interest yield method over the term of the security. The cost of investment securities sold, and any resulting gain or loss, is based on the specific identification method.

Management determines the appropriate classification of investment securities at the time of purchase. Held-to-maturity securities are those securities that the Company has the positive intent and ability to hold to

maturity, and are recorded at amortized cost. Available-for-sale securities are those securities that would be available to be sold in the future in response to liquidity needs, changes in market interest rates, and asset-liability management strategies, among others. Available-for-sale securities are reported at fair value, with unrealized holding gains and losses that are considered to be temporary reported in shareholders equity as a separate component of other comprehensive income, net of applicable deferred income taxes.

Management evaluates investment securities for other than temporary declines in fair value on a periodic basis. If the fair value of investment securities falls below their amortized cost and the decline is deemed to be other than temporary, the securities will be written down to current market value and the write down will be deducted from earnings. There were no investment securities which management identified to be other-than-temporarily impaired for the year ended December 31, 2007. Charges to income could occur in future periods due to a change in management s intent to hold the investments to maturity, a change in management s assessment of credit risk, or a change in regulatory or accounting requirements.

Goodwill and Other Intangible Assets. Goodwill arising from business combinations represents the value attributable to unidentifiable intangible elements in the business acquired. The Company s goodwill relates to value inherent in the banking business and the value is dependent upon the Company s ability to provide quality, cost-effective services in a competitive market place. As such, goodwill value is supported ultimately by revenue that is driven by the volume of business transacted. A decline in earnings as a result of a lack of growth or the inability to deliver cost effective services over sustained periods can lead to impairment of goodwill that could adversely impact earnings in future periods. Goodwill is not amortized, but is subjected to impairment analysis at least annually. The last impairment analysis was performed in December 2007. No impairment was considered necessary during the year ended December 31, 2007. However, future events could cause management to conclude that the Company s goodwill is impaired, which would result in the Company recording an impairment loss. Any resulting impairment loss could have a material adverse impact on the Company s financial condition and results of operations.

Other intangible assets consisting of core-deposit intangibles with definite lives are amortized over the estimated life of the acquired depositor relationships. These intangible assets are also subject to impairment analysis. No impairment was considered necessary during the year ended December 31, 2007.

Real Estate Owned (REO). Property acquired through foreclosure of defaulted mortgage loans is carried at the lower of cost or fair value less estimated costs to sell. Development and improvement costs relating to the property are capitalized to the extent they are deemed to be recoverable.

An allowance for losses on REO is designed to include amounts for estimated losses as a result of impairment in value of the real property after repossession. The Company reviews its REO for impairment in value whenever events or circumstances indicate that the carrying value of the property may not be recoverable. In performing the review, if expected future undiscounted cash flows from the use of the property or the fair value, less selling costs, from the disposition of the property are less than its carrying value, an allowance for loss is recognized. As a result of changes in the real estate markets in which these properties are located, it is reasonably possible that the carrying values could be reduced in the near term.

Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 141 (R), Business Combinations (SFAS No. 141 (R)). SFAS No. 141 (R) establishes principles and requirements for how the acquirer: 1) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; 2) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; 3) determines what information to disclose to enable users of the financial

statements to evaluate the nature and financial effects of the business combination. SFAS No. 141 (R) applies prospectively to business combinations entered into by the Company after January 1, 2009. The Company intends to continue to pursue a long term growth strategy, which may include acquiring other financial institutions. As such, SFAS No. 141 (R) may have a material effect on the Company, mainly in regards to the valuation of loans, and the treatment for acquisition costs.

In November 2007, the SEC issued Staff Accounting Bulletin 109 (SAB 109) regarding the valuation of loan commitments. SAB 109 supersedes SAB 105, and states that in measuring the fair value of a derivative loan commitment, the expected net future cash flows related to the associated servicing of the loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. SAB 109 will be effective for the Company as of January 1, 2008. The Company is currently evaluating the impact, if any, of SAB 109 on future periods.

In February 2007, FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159). SFAS No. 159 provides a fair value measurement election for many financial instruments, on an instrument by instrument basis. SFAS No. 159 will be effective for the Company as of January 1, 2008. The Company is currently evaluating whether to make the SFAS No. 159 fair value election on any of its financial instruments.

In September 2006, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. EITF Issue No. 06-4 will be effective for the Company as of January 1, 2008. The Company has evaluated the impact of EITF Issue No. 06-4 on future periods and has determined the amount to be immaterial.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 will be effective for the Company as of January 1, 2008. The Company is currently assessing the impact of this standard and does not expect SFAS No. 157 to have a material effect on its consolidated financial statements.

Item 7A. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

Interest Rate Sensitivity Management

The largest component of the Company s earnings is net interest income, which can fluctuate widely when interest rate movements occur. The Bank s management is responsible for minimizing the Company s exposure to interest rate risk. This is accomplished by developing objectives, goals and strategies designed to enhance profitability and performance, while managing risk within specified control parameters. The ongoing management of the Company s interest rate sensitivity limits interest rate risk by controlling the mix and maturity of assets and liabilities. Management continually reviews the Bank s position and evaluates alternative sources and uses of funds. This includes any changes in external factors. Various methods are used to achieve and maintain the desired rate sensitive position, including the sale or purchase of assets and product pricing.

The Company views any asset or liability which matures, or is subject to repricing within one year to be interest sensitive even though an analysis is performed for all other time intervals as well. The difference between interest-sensitive assets and interest sensitive liabilities for a defined period of time is known as the interest sensitivity gap , and may be either positive or negative. When the gap is positive, interest sensitive assets reprice quicker than interest sensitive liabilities. When negative, the reverse occurs. Non-interest assets and liabilities have been positioned based on management s evaluation of the general sensitivity of these balances to migrate into rate-sensitive products. This analysis provides a general measure of interest rate risk but does not address complexities such as prepayment risk, basis risk and the Bank s customer responses to interest rate changes.

At December 31, 2007, the Company s one-year interest sensitive gap is negative $299.4 million, or negative 28.55% which falls within the risk tolerance levels established by the Company s Board. The current gap position indicates that if interest rates were to change and affect assets and liabilities equally, rising rates would decrease the Bank s net interest income. The reverse is true when rates fall. The primary cause for the negative gap is the large block of

deposits with no stated maturity, including NOW, money market and savings accounts that can be repriced at any time. However, changes in rates offered on these types of deposits tend to lag changes in market interest rates, thereby potentially reducing or eliminating the impact of the negative gap position. As such, this measure is only a small part of a larger Interest Rate Risk assessment or analysis.

The Asset/Liability Management Committee of the Company also periodically reviews the results of a detailed and dynamic simulation model to quantify the estimated exposure of net interest income (NII) and the estimated economic value of the Company to changes in interest rates. The simulation model, which has been compared to and validated with an independent third-party model, illustrates the estimated impact of changing interest rates on the interest income received and interest expense paid on all interest bearing assets and liabilities reflected on the Company s statement of financial condition. This interest sensitivity analysis is compared to policy limits for risk tolerance levels of net interest income exposure over a one-year time horizon, given a 300 and 100 basis point movement in interest rates. Trends in out-of-tolerance conditions are then addressed by the committee, resulting in the implementation of strategic management intervention designed to bring interest rate risk within policy targets. A parallel shift in interest rates over a one-year period is assumed as a benchmark, with reasonable assumptions made regarding the timing and extent to which each interest-bearing asset and liability responds to the changes in market rates. The original assumptions were made based on industry averages and the company s own experience, and have been modified based on the company s continuing analysis of its actual versus expected performance, and after consultations with an outside consultant. The following table represents the estimated sensitivity of the Company s net interest income as of December 31, 2007 and 2006 compared to the established policy limits:

12 Month Cumulative % effect on NII	Policy Limit %	12-31-07	12-31-06
+100bp	+8.0 to - 8.0	3.81	0.25
+300bp	+15.0 to -15.0	10.06	5.75
−100bp	+8.0 to - 8.0	0.73	−1.81
−300bp	+15.0 to -15.0	−17.8	−6.28

The model results for both years fall within the risk tolerance guidelines established by the committee, with the exception of the minus 300 basis point scenario in 2007. Given that market rates have declined 2.25% over the past six months, management considers an additional 3.0% drop highly unlikely.

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The following table displays the Bank s balance sheet based on the repricing schedule of 3 months, 3 months to 1 year, 1 year to 5 years and over 5 years.

Asset/Liability Maturity Repricing Schedule
December 31, 2007

	Within Three Months	After Three Months but within One Year	After One Year but within Five Years	After Five Years	Total
	(Dollars in thousands)				
Loans receivable and held for sale	$ 313,479	$ 176,969	$ 217,060	$ 65,649	$ 773,157
Securities	66,360	8,166	35,753	61,614	171,893
Federal funds sold	6,565				6,565
Time certificates and interest-bearing cash	149				149
Total earning assets	386,553	185,135	252,813	127,263	951,764
Allowance for loan losses	(3,528)	(3,176)	(4,116)	(941)	(11,761)
Total earning assets, net	$ 383,025	$ 181,959	$ 248,697	$ 126,322	$ 940,003
Interest-bearing demand deposits(1)	$ 308,857	$	$	$	$ 308,857
Savings deposits and IRA(1)	76,112	4,413	6,623		87,148
Time certificates of deposit accounts	113,219	52,727	36,747	71	202,764
Total deposits	498,188	57,140	43,370	71	598,769
Repurchase agreements	124,127				124,127
FHLB advances		5,000	24,000		29,000
Other borrowed funds	36,015			982	36,997
Total interest-bearing liabilities	$ 658,330	$ 62,140	$ 67,370	$ 1,053	$ 788,893
Net interest rate sensitivity gap	$ (275,305)	$ 119,819	$ 181,327	$ 125,269	$ 151,110
Cumulative gap	$ (275,305)	$ (155,486)	$ 25,841	$ 151,110	

(1) Includes deposits with no stated maturity.

The following table displays expected maturity information and corresponding interest rates for all interest-sensitive assets and liabilities at December 31, 2007.

Expected Maturity Date at December 31, 2007

	2008	**2009-10**	**2011-12**	**Thereafter**	**Total**
			(Dollars in thousands)		
Interest-sensitive assets:					
Commercial loans	$ 366,005	$ 87,167	$ 58,082	$ 112,184	$ 623,438
Average interest rate	8.47%	8.09%	8.36%	8.30%	
Residential loans(1)	48,238	21,406	10,635	33,731	114,010
Average interest rate	8.69%	8.37%	9.00%	8.30%	
Consumer loans	11,101	6,419	6,222	2,544	26,286
Average interest rate	7.83%	9.18%	9.08%	11.06%	
Municipal loans	1,461	337	1,514	1,910	5,222
Average interest rate	6.65%	5.35%	5.62%	5.11%	
Investments	74,527	20,859	14,893	61,615	171,894
Average interest rate	4.29%	5.03%	5.75%	5.53%	
Federal funds sold	6,565				6,565
Average interest rate	3.90%	0.00%	0.00%	0.00%	
Certificates and interest bearing cash	149				149
Average interest rate	3.65%	0.00%	0.00%	0.00%	
Total interest-sensitive assets	$ 508,046	$ 136,188	$ 91,346	$ 211,984	$ 947,564
Deposits:					
Savings deposits and IRA	$ 80,560	$ 3,981	$ 2,608	$	$ 87,149
Average interest rate	0.78%	4.05%	4.72%	0.00%	
NOW and money market	308,857				308,857
Average interest rate	2.59%	0.00%	0.00%	0.00%	
Certificates of deposit accounts	165,945	33,894	2,853	71	202,763
Average interest rate	4.57%	4.71%	4.63%	4.24%	
Repurchase agreements	94,127		30,000		124,127
Average interest rate	4.44%	0.00%	5.85%	0.00%	
Other borrowed funds	5,000	$ 43,488		17,509	65,998
Average interest rate	2.71%	5.77%	0.00%	7.35%	
Total interest-sensitive liabilities	$ 654,489	$ 81,364	$ 35,461	$ 17,580	$ 788,894

(1) Includes loans held for sale.

Management will continue to refine its interest rate risk management by performing ongoing validity testing of the current model, expanding the number of scenarios tested, and enhancing its modeling techniques. Because of the importance of effective interest-rate risk management to the Company s performance, the committee will also continue

to seek review and advice from independent external consultants.

Item 8. ***FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA***

The required information is contained on pages F-1 through F-37 of this Form 10-K.

Item 9. ***CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE***

There have been no changes in or disagreements with Intermountain s independent accountants on accounting and financial statement disclosures.

Item 9A. ***CONTROLS AND PROCEDURES***

Disclosure Controls and Procedures

Intermountain s management, with the participation of Intermountain s principal executive officer and principal financial officer, has evaluated the effectiveness of Intermountain s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based on such evaluation, Intermountain s principal executive officer and principal financial officer have concluded that, as of the end of such period, Intermountain s disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by Intermountain in the reports that it files or submits under the Exchange Act.

Management s Report on Internal Control Over Financial Reporting

Intermountain s management, including the principal executive officer and principal financial officer, is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of Intermountain s management, Intermountain conducted an evaluation of the effectiveness of its internal control over financial reporting based on the framework described in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO Framework). Based on management s evaluation under the COSO Framework, Intermountain s management has concluded that Intermountain s internal control over financial reporting was effective as of December 31, 2007.

The effectiveness of Intermountain s internal control over financial reporting as of December 31, 2007 has been attested to by BDO Seidman, LLP, the independent registered public accounting firm that audited the financial statements included in Intermountain s annual report on 10-K, as stated in their report which is included herein.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Intermountain Community Bancorp
Sandpoint, Idaho

We have audited Intermountain Community Bancorp s (Company) internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Intermountain Community Bancorp s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Intermountain Community Bancorp maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Intermountain Community Bancorp as of December 31, 2007 and 2006, and the related consolidated statements of income, comprehensive income, changes in stockholders equity, and cash flows for each of the three years in the period ended December 31, 2007 and our report dated March 17, 2008, expressed an unqualified opinion on those consolidated financial statements.

Spokane, Washington
March 17, 2008

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Changes in Internal Control over Financial Reporting

There were no changes in internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)), during our fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. *OTHER INFORMATION*

None.

PART III

Item 10. *DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE*

In response to this Item, the information set forth in Intermountain s Proxy Statement dated March 24, 2008 (2008 Proxy Statement) under the headings Information with Respect to Nominees and Other Directors, Meetings and Committees of the Board of Directors, Executive Compensation, and Security Ownership of Certain Beneficial Owners and Management and Compliance with Section 16(a) filing requirements are incorporated herein by reference.

Information concerning Intermountain s Audit Committee financial expert is set forth under the caption Meetings and Committees of the Board of Directors in Intermountain s 2008 Proxy Statement and is incorporated herein by reference.

Intermountain has adopted a Code of Ethics that applies to all Intermountain employees and directors, including Intermountain s senior financial officers. The Code of Ethics is publicly available on Intermountain s website at http://www.Intermountainbank.com.

Item 11. *EXECUTIVE COMPENSATION*

In response to this Item, the information set forth in Intermountain s Proxy Statement dated March 24, 2008 under the heading Directors Compensation and Executive Compensation is incorporated herein.

Item 12. *SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS*

In response to this Item, the information set forth in Intermountain s 2008 Proxy Statement under the heading Security Ownership of Certain Beneficial Owners and Management is incorporated herein.

Item 13. *CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS*

In response to this Item, the information set forth in Intermountain s 2008 Proxy Statement under the heading Certain Relationships and Related Transactions is incorporated herein.

Item 14. *PRINCIPAL ACCOUNTING FEES AND SERVICES*

In response to this Item, the information set forth in Intermountain s 2008 Proxy Statement under the headings Ratification of Appointment of Independent Auditors and Independent Registered Public Accounting Firm is incorporated herein.

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PART IV

Item 15. *EXHIBITS AND FINANCIAL STATEMENT SCHEDULES*

(a)(1) Audited Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets at December 31, 2007 and 2006

Consolidated Statements of Income for the years ended December 31, 2007, 2006 and 2005

Consolidated Statements of Comprehensive Income for the years ended December 31, 2007, 2006 and 2005

Consolidated Statements of Changes in Stockholders Equity for the years ended December 31, 2007, 2006 and 2005

Consolidated Statements of Cash Flows for the years ended December 31, 2007, 2006 and 2005

Summary of Accounting Policies

Notes to Consolidated Financial Statements

(a)(2) Financial Statement Schedules have been omitted as they are not applicable or the information is included in the Consolidated Financial Statements

(b) Exhibits: See Exhibit Index

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

INTERMOUNTAIN COMMUNITY BANCORP
(Registrant)

/s/ Curt Hecker
Curt Hecker
President and Chief Executive Officer

March 17, 2008

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Curt Hecker Curt Hecker	President and Chief Executive Officer, Principal Executive Officer, Director	March 17, 2008
/s/ John B. Parker John B. Parker	Chairman of the Board, Director	March 17, 2008
/s/ Douglas Wright Douglas Wright	Executive Vice President and Chief Financial Officer, Principal Financial Officer	March 17, 2008
/s/ Charles L. Bauer Charles L. Bauer	Director	March 17, 2008
/s/ James T. Diehl James T. Diehl	Director	March 17, 2008
/s/ Ford Elsaesser Ford Elsaesser	Director	March 17, 2008
/s/ Ronald Jones	Director	March 17, 2008

Ronald Jones		
/s/ Maggie Y. Lyons	Director	March 17, 2008
Maggie Y. Lyons		
/s/ Jim Patrick	Director	March 17, 2008
Jim Patrick		
/s/ Michael J. Romine	Director	March 17, 2008
Michael J. Romine		

Signature	Title	Date
/s/ Jerrold Smith Jerrold Smith	Executive Vice President and Director	March 17, 2008
/s/ Barbara Strickfaden Barbara Strickfaden	Director	March 17, 2008
/s/ Douglas P. Ward Douglas P. Ward	Director	March 17, 2008

EXHIBIT INDEX

Exhibit No.	Description
3.1	Amended and Restated Articles of Incorporation(1)
3.2	Amended and Restated Bylaws(2)
4.1	Form of Stock Certificate(3)
10.1	Second Amended and Restated 1999 Employee Stock Option and Restricted Stock Plan(3)
10.2	Form of Employee Option Agreement(3)
10.3	Form of Restricted Stock Award Agreement
10.4	Amended and Restated Director Stock Option Plan(4)
10.5	Form of Nonqualified Stock Option Agreement(3)
10.6	Form of Director Restricted Stock Award Agreement
10.7	Form of Stock Purchase Bonus Agreement
10.8	Amended and Restated Employment Agreement with Curt Hecker dated January 1, 2008
10.9	Amended and Restated Salary Continuation and Split Dollar Agreement for Curt Hecker dated January 1, 2008
10.10	Amended and Restated Employment Agreement with Jerry Smith dated January 1, 2008
10.11	Amended and Restated Salary Continuation and Split Dollar Agreement with Jerry Smith dated January 1, 2008
10.12	Amended and Restated Executive Severance Agreement with Douglas Wright dated January 1, 2008
10.13	Amended and Restated Executive Severance Agreement with John Nagel dated December 27, 2007
10.14	Amended and Restated Executive Severance Agreement with Pam Rasmussen dated December 28, 2007
10.15	Amended and Restated 2006-2008 Long Term Incentive Plan(5)
10.16	2003 2005 Long-Term Incentive Plan, as amended, and Restricted Stock Award Agreement(6)
10.17	Executive Incentive Plan(7)
14	Code of Ethics(7)
21	Subsidiaries of the Registrant
23	Consent of BDO Seidman, LLP
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002

(1) Incorporated by reference to the Registrant s Quarterly Report on Form 10-Q for the quarter ended September 30, 2007

(2) Incorporated by reference to the Registrant s Current Report on Form 8-K, filed September 8, 2004

(3) Incorporated by reference to the Registrant s Form 10, as amended on July 1, 2004

(4) Incorporated by reference to the Registrant s Quarterly Report on Form 10-Q for the quarter ended March 31, 2005

(5) Incorporated by reference to the Registrant s Quarterly Report on Form 10-Q for the quarter ended March 31, 2006

(6) Incorporated by reference to the S-8 Registration Statement filed by the Registrant on March 30, 2006 (File No. 333-132835)

(7) Incorporated by reference to the Registrant s Annual Report on Form 10-K for the fiscal year ended December 31, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Intermountain Community Bancorp
Sandpoint, Idaho

We have audited the accompanying consolidated balance sheets of Intermountain Community Bancorp as of December 31, 2007 and 2006 and the related consolidated statements of income, comprehensive income, changes in stockholders equity, and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Intermountain Community Bancorp at December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2007**,** in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 10 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*, as of January 1, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Intermountain Community Bancorp s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 17, 2008, expressed an unqualified opinion thereon.

/s/ BDO Seidman, LLP

Spokane, Washington
March 17, 2008

INTERMOUNTAIN COMMUNITY BANCORP

CONSOLIDATED BALANCE SHEETS

	December 31, 2007	December 31, 2006
	(Dollars in thousands, except per share data)	
ASSETS		
Cash and cash equivalents:		
Interest-bearing	$ 149	$ 72
Non-interest bearing and vault	26,851	24,305
Restricted cash	4,527	888
Federal funds sold	6,565	35,385
Available-for-sale securities, at fair value	158,791	118,490
Held-to-maturity securities, at amortized cost	11,324	6,719
Federal Home Loan Bank of Seattle stock, at cost	1,779	1,779
Loans held for sale	4,201	8,945
Loans receivable, net	756,549	664,885
Accrued interest receivable	8,207	7,329
Office properties and equipment, net	42,090	25,444
Bank-owned life insurance	7,713	7,400
Goodwill	11,662	11,662
Other intangibles	723	881
Prepaid expenses and other assets	7,528	6,164
Total assets	$ 1,048,659	$ 920,348
LIABILITIES		
Deposits	$ 757,838	$ 693,686
Securities sold subject to repurchase agreements	124,127	106,250
Advances from Federal Home Loan Bank	29,000	5,000
Cashier checks issued and payable	1,509	6,501
Accrued interest payable	3,027	1,909
Other borrowings	36,998	22,602
Accrued expenses and other liabilities	6,041	6,320
Total liabilities	958,540	842,268
Commitments and contingent liabilities (Notes 14 and 15)		
STOCKHOLDERS EQUITY		
Common stock 29,040,000 shares authorized; 8,313,005 and 7,423,904 shares issued and 8,248,710 and 6,577,290 shares outstanding	76,746	60,395
Accumulated other comprehensive income (loss), net of tax	1,327	(111)
Retained earnings	12,046	17,796

Total stockholders equity	90,119	78,080
Total liabilities and stockholders equity	$ 1,048,659	$ 920,348

See accompanying summary of accounting policies and notes to consolidated financial statements.

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INTERMOUNTAIN COMMUNITY BANCORP

CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31,		
	2007	2006	2005
	(Dollars in thousands, except per share amounts)		
Interest income:			
Loans	$ 65,362	$ 54,393	$ 37,897
Investments	7,496	5,187	3,751
Total interest income	72,858	59,580	41,648
Interest expense:			
Deposits	18,769	13,192	8,250
Other borrowings	3,498	2,109	1,177
Short-term borrowings	4,070	2,232	1,290
Total interest expense	26,337	17,533	10,717
Net interest income	46,521	42,047	30,931
Provision for losses on loans	(3,896)	(2,148)	(2,229)
Net interest income after provision for losses on loans	42,625	39,899	28,702
Other income:			
Fees and service charges	8,646	6,726	5,754
Mortgage banking operations	2,749	3,300	2,411
Bank-owned life insurance	314	305	300
Net (loss) on sale of securities	(38)	(987)	(43)
Other income	1,528	1,494	1,198
Total other income	13,199	10,838	9,620
Operating expenses:			
Salaries and employee benefits	25,394	21,859	15,356
Occupancy expense	6,089	4,789	3,927
Advertising	1,330	1,172	767
Fees and service charges	1,404	1,193	974
Printing, postage and supplies	1,466	1,430	1,257
Legal and accounting	1,377	1,418	1,153
Other expenses	3,866	4,099	3,098
Total operating expenses	40,926	35,960	26,532
Income before income taxes	14,898	14,777	11,790

Income tax provision	5,453	5,575	4,308
Net income	$ 9,445	$ 9,202	$ 7,482
Earnings per share basic	$ 1.15	$ 1.15	$ 1.06
Earnings per share diluted	$ 1.10	$ 1.07	$ 0.97
Weighted-average shares outstanding basic	8,206,341	8,035,401	7,078,037
Weighted-average shares outstanding diluted	8,604,737	8,585,687	7,683,813

See accompanying summary of accounting policies and notes to consolidated financial statements.

INTERMOUNTAIN COMMUNITY BANCORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31,		
	2007	2006	2005
	(Dollars in thousands)		
Net income	$ 9,445	$ 9,202	$ 7,482
Other comprehensive income (loss):			
Change in unrealized (losses) gains on investments, net of reclassification adjustments	2,380	2,018	(1,362)
Less deferred income tax benefit (expense)	(942)	(792)	534
Net other comprehensive income (loss)	1,438	1,226	(828)
Comprehensive income	$ 10,883	$ 10,428	$ 6,654

See accompanying summary of accounting policies and notes to consolidated financial statements.

INTERMOUNTAIN COMMUNITY BANCORP

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
Years Ended December 31, 2007, 2006, and 2005

	Common Stock		Accumulated Other Comprehensive Income (loss)	Retained Earnings	Total Stockholders Equity
	Shares	Amount			
	(Dollars in thousands, except per share data)				
Balance, January 1, 2005	3,784,180	$ 30,314	$ (509)	$ 14,759	$ 44,564
Net income				7,482	7,482
Equity based compensation		79			79
Restricted Stock Grant	21,520				
Shares issued upon exercise of stock options	172,419	901			901
Net unrealized loss on investments			(828)		(828)
Stock split, three-for-two	1,914,911				
Fractional share redemption	(102)			(1)	(1)
Common stock issued, net of costs	705,882	11,861			11,861
Tax benefit associated with stock options		215			215
Balance, December 31, 2005	6,598,810	$ 43,370	$ (1,337)	$ 22,240	$ 64,273

See accompanying summary of accounting policies and notes to consolidated financial statements.

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INTERMOUNTAIN COMMUNITY BANCORP

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
Years Ended December 31, 2007, 2006, and 2005

	Common Stock		Accumulated Other Comprehensive Income	Retained	Total Stockholders
	Shares	Amount	(Loss)	Earnings	Equity
	(Dollars in thousands, except per share data)				
Balance, December 31, 2005	6,598,810	$ 43,370	$ (1,337)	$ 22,240	$ 64,273
Net income				9,202	9,202
Equity based compensation		848			848
Restricted Stock Grant	19,877				
Shares issued upon exercise of stock options	101,245	476			476
Vesting of stock-based compensation awards	26,002				
Reclassification of liability associated with stock-based compensation plans upon adoption of SFAS 123 (R)		1,333			1,333
Net unrealized gain on investments			1,226		1,226
10% common stock dividend	666,840	13,637		(13,637)	
Fractional share redemption	(32)			(9)	(9)
Shares issued for business purchase	11,162	255			255
Tax benefit associated with stock options		476			476
Balance, December 31, 2006	7,423,904	$ 60,395	$ (111)	$ 17,796	$ 78,080

See accompanying summary of accounting policies and notes to consolidated financial statements.

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INTERMOUNTAIN COMMUNITY BANCORP

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
Years Ended December 31, 2007, 2006 and 2005

	Common Stock		Accumulated Other Comprehensive Income	Retained	Total Stockholders
	Shares	Amount	(Loss)	Earnings	Equity
		(Dollars in thousands, except per share data)			
Balance, December 31, 2006	7,423,904	$ 60,395	$ (111)	$ 17,796	$ 78,080
Net income				9,445	9,445
Equity based compensation		486			486
Restricted Stock Grant	26,177				
Shares issued upon exercise of stock options	83,664	395			395
Vesting of stock-based compensation awards	28,604				
Net unrealized gain on investments			1,438		1,438
10% common stock dividend	750,671	15,186		(15,186)	
Fractional share redemption	(15)			(9)	(9)
Tax benefit associated with stock options		284			284
Balance, December 31, 2007	8,313,005	$ 76,746	$ 1,327	$ 12,046	$ 90,119

See accompanying summary of accounting policies and notes to consolidated financial statements.

INTERMOUNTAIN COMMUNITY BANCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2007	**2006**	**2005**
	(Dollars in thousands)		
Cash flows from operating activities:			
Net income	$ 9,445	$ 9,202	$ 7,482
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity based compensation expense	486	848	79
Excess tax benefit related to stock-based compensation	(226)	(382)	
Depreciation	2,632	2,095	1,697
Net amortization of premiums on securities	(508)	115	163
Stock dividends on Federal Home Loan Bank of Seattle stock		(5)	
Provisions for losses on loans	3,896	2,148	2,229
Amortization of core deposit intangibles	158	170	186
Net accretion of loan discount	(56)	(89)	(146)
Accretion of deferred gain on sale of branch property	(16)		
Gain (loss) on sale of loans, investments, property and equipment	(350)	243	64
Gain on sale of real estate owned			(79)
Deferred income tax benefit	(835)	(1,182)	(832)
Increase in cash surrender value of bank-owned life insurance	(314)	(305)	(300)
Change in (net of acquisition of business):			
Loans held for sale	4,744	(3,056)	(203)
Accrued interest receivable	(878)	(2,337)	(1,270)
Prepaid expenses and other assets	(1,816)	(2,424)	(455)
Accrued interest payable	1,118	835	321
Accrued expenses and other liabilities	(4,795)	2,659	2,694
Net cash provided by operating activities	12,685	8,535	11,630
Cash flows from investing activities:			
Net change in certificates of deposit with other institutions			
Purchases of available-for-sale securities	(168,065)	(73,278)	(39,159)
Proceeds from calls, maturities or sales of available-for-sale securities	121,627	32,138	43,401
Principal payments on mortgage-backed securities	9,042	7,456	13,248
Purchases of held-to-maturity securities	(5,071)	(649)	(1,929)
Proceeds from calls or maturities of held-to-maturity securities	412	637	541
Purchase of Federal Home Loan Bank of Seattle stock			(564)
Net increase in loans receivable	(105,432)	(125,777)	(139,693)
Proceeds from sale of loans receivable	8,317	15,541	1,278
Purchase of office properties and equipment	(19,078)	(10,871)	(4,332)
Purchase of business		(42)	
Proceeds from sales of office properties and equipment	2,248	22	38

Improvements and other changes in real estate owned	(280)	776	(242)
Proceeds from sale of other real estate owned	9	47	1,163
Net change in federal funds sold	28,820	(24,305)	(2,750)
Net (increase) decrease in restricted cash	(3,639)	(114)	860
Net cash used in investing activities	(131,090)	(178,419)	(128,140)

See accompanying summary of accounting policies and notes to consolidated financial statements.

INTERMOUNTAIN COMMUNITY BANCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2007	**2006**	**2005**
	(Dollars in thousands)		
Cash flows from financing activities:			
Net increase in demand, money market and savings deposits	40,107	92,731	80,024
Net increase in certificates of deposit	24,036	3,412	16,500
Proceeds from other borrowings	14,428	5,059	
Proceeds from Federal Home Loan Bank advances	34,000		48,000
Repayments of Federal Home Loan Bank advances	(10,000)		(48,000)
Net change in repurchase agreements	17,877	68,451	16,898
Principal reduction of note payable	(33)	(116)	
Excess tax benefit related to stock based compensation	226	382	
Proceeds from exercise of stock options	396	476	901
Proceeds from common stock offering, net of expenses			11,861
Redemption of fractional shares of common stock	(9)	(9)	(1)
Net cash provided by financing activities	121,028	170,386	126,183
Net increase in cash and cash equivalents	2,623	502	9,673
Cash and cash equivalents, beginning of year	24,377	23,875	14,202
Cash and cash equivalents, end of year	$ 27,000	$ 24,377	$ 23,875
Supplemental disclosure of cash flow information:			
Cash paid during the period for:			
Interest	$ 27,152	$ 16,674	$ 10,325
Income taxes	$ 5,858	$ 6,620	$ 4,468
Noncash investing and financing activities:			
Common stock dividends	$ 15,186	$ 13,637	$
Restricted shares issued	$ 719	$ 491	$ 344
Deferred gain on sale/leaseback of branch property	$ 307	$	$
Purchase of land	$	$ 1,130	$
Loans converted to Other Real Estate Owned	$ 616	$ 398	$
Common stock issued upon business combination	$	$ 255	$

See accompanying summary of accounting policies and notes to consolidated financial statements.

INTERMOUNTAIN COMMUNITY BANCORP

SUMMARY OF ACCOUNTING POLICIES

Organization

Intermountain Community Bancorp (Intermountain or the Company) is a financial holding company whose principal activity is the ownership and management of its wholly owned subsidiary, Panhandle State Bank (the Bank). The Bank is a state chartered commercial bank under the laws of the state of Idaho. At December 31, 2007, the Bank had eight branch offices in northern Idaho, five in southwestern Idaho, three in southcentral Idaho, two branches in eastern Washington and one branch in eastern Oregon operating under the names of Panhandle State Bank, Intermountain Community Bank and Magic Valley Bank. It also had a loan production office operating under the name Intermountain Community Bank in southwestern Idaho.

Intermountain provides customized quality financial services and banking products to its customers through experienced, highly trained staff who are long-time residents of its local markets. Intermountain believes this philosophy has allowed it to grow rapidly in its market areas. With $1.05 billion in total assets as of December 31, 2007, Intermountain originates loans and attracts Federal Deposit Insurance Corporation (FDIC) insured deposits from the general public through 19 branches and one loan production office located in Washington, Oregon, and Idaho. In addition, Intermountain also markets trust and wealth management services through its Trust Division and fixed income and equity products, mutual funds, fixed and variable annuities and other financial products through Intermountain Community Investments.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiary. All significant intercompany accounts and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

Cash equivalents are any highly liquid debt instruments with a remaining maturity of three months or less at the date of purchase. Cash and cash equivalents are on deposit with other banks and financial institutions in amounts that periodically exceed the federal insurance limit. Intermountain evaluates the credit quality of these banks and financial institutions to mitigate its credit risk.

Restricted Cash

Restricted cash represents the required reserve balances maintained to comply with Federal Reserve Bank requirements.

Investments

Intermountain classifies debt and equity investments as follows:

> *Available-for-Sale.* Debt and equity investments that will be held for indefinite periods of time are classified as available-for-sale and are carried at market value. Market value is determined using published quotes or other indicators of value as of the close of business. Unrealized gains and losses that are considered temporary are reported, net of deferred income taxes, as a component of accumulated other comprehensive income or loss in stockholders equity until realized.

Federal Home Loan Bank of Seattle Stock. Federal Home Loan Bank (FHLB) of Seattle stock may only be redeemed by FHLB Seattle or sold to another member institution at par. Therefore, this investment is carried at cost.

Held-to-Maturity. Investments in debt securities that management has the intent and ability to hold until maturity are classified as held-to-maturity and are carried at their remaining unpaid principal balance, net of unamortized premiums or unaccreted discounts.

INTERMOUNTAIN COMMUNITY BANCORP

SUMMARY OF ACCOUNTING POLICIES (Continued)

Premiums are amortized and discounts are accreted using the level-interest-yield method over the estimated remaining term of the underlying security. Realized gains and losses on sales of investments and mortgage-backed securities are recognized in the statement of income in the period sold using the specific identification method.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value. Net unrealized losses are recognized through a valuation allowance by charges to income. Gains or losses on sales of mortgage loans are recognized based on the differences between the selling price and the carrying value of the mortgage loans sold.

The Company records a transfer of financial assets as a sale when it surrenders control over those financial assets to the extent that consideration other than beneficial interests in the transferred assets is received in exchange. The Company considers control surrendered when all conditions prescribed by Statement of Financial Accounting Standards (SFAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities are met. Those conditions focus on whether the transferred assets are isolated beyond the reach of the Company and its creditors, the constraints on the transferee or beneficial interest holders, and the Company s rights or obligations to reacquire transferred financial assets.

Loans Receivable

Loans receivable that management of Intermountain has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal balance less any unearned income, premiums or discounts and an associated allowance for losses on loans. Unearned income includes deferred loan origination fees reduced by loan origination costs.

Loans are classified as impaired when, based on current information and events, it is probable the Bank will be unable to collect all amounts as scheduled under the contractual terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan s effective interest rate or the fair value of the collateral, if the loan is collateral dependent. Changes in these values are reflected in income through charges to the provision for loan losses.

Interest income is recognized over the term of the loans receivable based on the unpaid principal balance. The accrual of interest on impaired loans is discontinued when, in management s opinion, the borrower may be unable to make payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is then subsequently recognized only to the extent cash payments are received in excess of principal due.

Allowance for Losses on Loans

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses is evaluated on a regular basis by management and is based upon management s periodic

review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

A reserve for unfunded commitments is maintained at a level that, in the opinion of management, is adequate to absorb probable losses associated with the Bank s commitment to lend funds under existing agreements such as letters or lines of credit. Management determines the adequacy of the reserve for unfunded commitments based upon reviews of individual credit facilities, current economic conditions, the risk characteristics of the various

INTERMOUNTAIN COMMUNITY BANCORP

SUMMARY OF ACCOUNTING POLICIES (Continued)

categories of commitments and other relevant factors. The reserve is based on estimates, and ultimate losses may vary from the current estimates. These estimates are evaluated on a regular basis and, as adjustments become necessary, they are recognized in earnings in the periods in which they become known through charges to other non-interest expense. Draws on unfunded commitments that are considered uncollectible at the time funds are advanced are charged to the reserve for unfunded commitments. Provisions for unfunded commitment losses, and recoveries on commitment advances previously charged-off, are added to the reserve for unfunded commitments, which is included in the Other Liabilities section of the Consolidated Statements of Financial Condition.

Loan Origination and Commitment Fees

Loan origination fees, net of direct origination costs, are deferred and recognized as interest income using the level interest yield method over the contractual term of each loan adjusted for actual loan prepayment experience.

Loan commitment fees are deferred until the expiration of the commitment period unless management believes there is a remote likelihood that the underlying commitment will be exercised, in which case the fees are amortized to fee income using the straight-line method over the commitment period. If a loan commitment is exercised, the deferred commitment fee is accounted for in the same manner as a loan origination fee. Deferred commitment fees associated with expired commitments are recognized as fee income.

Other Real Estate Owned

Properties acquired through, or in lieu of, foreclosure of defaulted real estate loans are carried at the lower of cost or fair value (less estimated costs to sell). Development and improvement costs related to the property are capitalized to the extent they are deemed to be recoverable. Subsequent to foreclosure, management periodically performs valuations and the assets are carried at the lower of carrying amount or fair value less costs to sell. Expenses for maintenance and changes in the valuation are charged to earnings. Other real estate owned is included with prepaid expenses and other assets on the consolidated balance sheet.

Office Properties and Equipment

Office properties and equipment are carried at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, ranging from two to thirty years. Expenditures for new properties and equipment and major renewals or betterments are capitalized. In the case where the Company constructs a facility and the construction period is lengthy, interest expense will be capitalized and added to the cost of the facility. Expenditures for repairs and maintenance are charged to expense as incurred. Upon sale or retirement, the cost and related accumulated depreciation are removed from the respective property or equipment accounts, and the resulting gains or losses are reflected in operations.

Bank-Owned Life Insurance

Bank-owned life insurance (BOLI) is carried at the initial premium paid for the policies plus the increase in the cash surrender value.

Goodwill and Other Intangibles

In accordance with SFAS No. 142, Goodwill and Other Intangible Assets , goodwill and intangible assets with indefinite lives are not amortized, but are subject to impairment tests at least annually. Intangible assets with finite lives, including core deposit intangibles, are amortized over the estimated life of the depositor relationships acquired.

INTERMOUNTAIN COMMUNITY BANCORP

SUMMARY OF ACCOUNTING POLICIES (Continued)

Advertising and Promotion

The Company expenses all costs associated with its advertising and promotional efforts as incurred. Those costs are included with operating expenses on the consolidated statements of income.

Income Taxes

Intermountain accounts for income taxes using the liability method, which requires that deferred tax assets and liabilities be determined based on the temporary differences between the financial statement carrying amounts and tax basis of assets and liabilities and tax attributes using enacted tax rates in effect in the years in which the temporary differences are expected to reverse.

Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares outstanding increased by the additional common shares that would have been outstanding if the potentially dilutive common shares had been issued.

Equity Compensation Plans

The Company maintains an Equity Participation Plan under which the Company has granted non-qualified and incentive stock options and restricted stock to employees and non-employee directors. Effective January 1, 2006, the Company adopted FASB Statement No. 123(R), Share-Based Payments , using the modified prospective method, and the fair value recognition provision of the Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards (FSP 123R)). Using the alternative transition method, the Company elected to adopt the alternative transition method provided in FSP 123R-3 for calculating the tax effects of stock-based compensation. The alternative transition method includes simplified methods to establish the beginning balance of the additional-paid-in-capital pool (APIC pool) related to the tax effects of stock-based compensation, and for determining the subsequent impact on the APIC pool and consolidated statements of cash flows of the tax effects of stock-based compensation awards that are outstanding upon adoption of SFAS 123 (R).

Prior to 2006, the Company applied the disclosure-only provision of SFAS No. 123 as amended by SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure. The Company measured compensation cost for stock-based employee compensation plans using the intrinsic value method of accounting prescribed by Accounting Principals Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees. All of the stock options are granted at market value on the date of grant. Accordingly, no compensation expense was recognized in 2005 for options related to the stock option plan. Restricted stock grants, however, are subject to a five-year vesting period, and the fair values on issuance date of these grants were expensed on a straight line basis over the life of the grant.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets

and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan losses, valuation of investments, deferred tax assets and liabilities and valuation and recoverability of goodwill and intangible assets.

INTERMOUNTAIN COMMUNITY BANCORP

SUMMARY OF ACCOUNTING POLICIES (Continued)

Business Combinations

Pursuant to SFAS No. 141 Business Combinations , Intermountain s mergers and acquisitions are accounted for under the purchase method of accounting. Accordingly, the assets and liabilities of the acquired entities are recorded by Intermountain at their respective fair values at the date of the acquisition and the results of operations are included with those of Intermountain commencing with the date of acquisition. The excess of the purchase price over the fair value of the assets acquired and liabilities assumed, including identifiable intangible assets, is recorded as goodwill.

Reclassifications

Certain amounts in the 2006 financial statements have been reclassified to conform with the current year s presentation. These reclassifications had no effect on total stockholders equity or net income as previously reported.

Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 141 (R), Business Combinations (SFAS No. 141 (R)). SFAS No. 141 (R) establishes principles and requirements for how the acquirer: 1) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; 2) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; 3) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141 (R) applies prospectively to business combinations entered into by the Company after January 1, 2009. The Company intends to continue to pursue a long term growth strategy, which may include acquiring other financial institutions. As such, SFAS No. 141 (R) may have a material effect on the Company, mainly in regards to the valuation of loans, and the treatment for acquisition costs.

In November 2007, the SEC issued Staff Accounting Bulletin 109 (SAB 109) regarding the valuation of loan commitments. SAB 109 supersedes SAB 105, and states that in measuring the fair value of a derivative loan commitment, the expected net future cash flows related to the associated servicing of the loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. SAB 109 will be effective for the Company as of January 1, 2008. The Company is currently evaluating the impact, if any, of SAB 109 on future periods.

In February 2007, FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159). SFAS No. 159 provides a fair value measurement election for many financial instruments, on an instrument by instrument basis. SFAS No. 159 will be effective for the Company as of January 1, 2008. The Company is currently evaluating whether to make the SFAS No. 159 fair value election on any of its financial instruments.

In September 2006, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. EITF Issue No. 06-4 will be effective for the Company as of January 1, 2008. The Company has evaluated the impact of EITF Issue No. 06-4 on future periods and has determined the amount to be immaterial.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 will be effective for the Company as of January 1, 2008. The Company is currently assessing the impact of this standard and does not expect SFAS No. 157 to have a material effect on its consolidated financial statements.

INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Investments

The amortized cost and fair values of investments are as follows (in thousands):

	Available-for-Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value/ Carrying Value
December 31, 2007				
U.S. treasury securities and obligations of U.S. government agencies	$ 61,740	$ 1,313	$ (101)	$ 62,952
Mortgage-backed securities	94,754	1,518	(533)	95,739
State and municipal securities	100			100
	$ 156,594	$ 2,831	$ (634)	$ 158,791
December 31, 2006				
U.S. treasury securities and obligations of U.S. government agencies	$ 78,754	$ 701	$ (826)	$ 78,629
Mortgage-backed securities	39,616	308	(365)	39,559
State and municipal securities	303		(1)	302
	$ 118,673	$ 1,009	$ (1,192)	$ 118,490

	Held-to-Maturity			
	Carrying Value/ Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2007				
State and municipal securities	$ 11,324	$ 49	$ (117)	$ 11,256
December 31, 2006				
State and municipal securities	$ 6,719	$ 4	$ (88)	$ 6,635

For the years ended December 31, 2007, 2006, and 2005 gross realized gains on sales of available-for-sale securities were $0, $0, and $6,670 with gross realized losses amounting to $37,547, $986,854, and $49,966 respectively. Proceeds from sales of available-for-sale securities were $17,722,306, $25,637,465 and $20,266,440 for the years ended December 31, 2007, 2006 and 2005, respectively.

Securities with a fair value of approximately $122.2 million and $118.1 million at December 31, 2007 and 2006, respectively, were pledged to secure public deposits, repurchase agreements and other purposes required and/or permitted by law.

INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

At December 31, 2007, the amortized cost and fair value of available-for-sale and held-to-maturity debt securities, by contractual maturity, follows (in thousands):

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
One year or less	$ 12,846	$ 12,791	$ 1,276	$ 1,275
After one year through five years	16,994	16,949	2,324	2,295
After five years through ten years	32,000	33,312	1,910	1,952
After ten years			5,814	5,734
	61,840	63,052	11,324	11,256
Mortgage-backed securities	94,754	95,739		
	$ 156,594	$ 158,791	$ 11,324	$ 11,256

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.

The following table summarizes the duration of Intermountain s unrealized losses on available-for-sale and held-to-maturity securities as of the dates indicated (in thousands).

	Less Than 12 Months		12 Months or Longer		Total	
December 31, 2007	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. treasury securities and obligations of U.S. government agencies	$	$	$ 27,639	$ 101	$ 27,639	$ 101
State and municipal securities	3,459	85	3,469	32	6,928	117
Mortgage-backed securities	24,461	418	9,779	115	34,240	533
Total	$ 27,920	$ 503	$ 40,887	$ 248	$ 68,807	$ 751

	Less Than 12 Months		12 Months or Longer		Total	
		Unrealized		Unrealized		Unrealized

December 31, 2006	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
U.S. treasury securities and obligations of U.S. government agencies	$ 15,020	$ 2	$ 30,910	$ 824	$ 45,930	$ 826
State and municipal securities	15		5,270	89	5,285	89
Mortgage-backed securities	225	1	13,926	364	14,151	365
Total	$ 15,260	$ 3	$ 50,106	$ 1,277	$ 65,366	$ 1,280

Intermountain s investment portfolios are managed to provide and maintain liquidity; to maintain a balance of high quality, diversified investments to minimize risk; to provide collateral for pledging; and to maximize returns. Management believes that all unrealized losses as of December 31, 2007 and 2006 to be market driven, with no permanent sector or issuer credit concerns or impairments. The Company has the ability to retain these securities until recovery of loss occurs.

INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Loans Receivable

The components of loans receivable are as follows (in thousands):

	December 31, 2007	December 31, 2006
Commercial	$ 623,439	$ 527,345
Residential	114,010	112,569
Consumer	26,285	31,800
Municipal	5,222	4,082
Total loans receivable	768,956	675,796
Allowance for loan losses	(11,761)	(9,837)
Deferred loan fees, net of direct origination costs	(646)	(1,074)
Loans receivable, net	$ 756,549	$ 664,885
Weighted average interest rate	8.16%	8.65%

An analysis of the changes in the allowance for losses on loans is as follows (in thousands):

	Years Ended December 31, 2007	2006	2005
Allowance for loan losses, beginning of year	$ 9,837	$ 8,100	$ 6,309
Acquired reserve from business combination			
Loans charged off	(2,044)	(793)	(792)
Recoveries	75	447	274
Allowance related to loan sales	0		(96)
Transfers	(3)	(65)	176
Provision for losses on loans	3,896	2,148	2,229
Allowance for loan losses, end of year	$ 11,761	$ 9,837	$ 8,100
Allowance Unfunded Commitments Balance Beginning December 31	$ 482	$ 417	$ 593
Adjustment	(467)		
Transfers	3	65	(176)
Allowance Unfunded Commitments at end of period	18	482	417

As required by bank regulatory guidance issued in 2007, the allowance for unfunded commitments was removed from the allowance for loan loss and reclassified to other liabilities. This change had a small impact on the consolidated balance sheets, increasing 2007 and 2006 net loans receivable and other liabilities by $18,000 and $482,000 respectively.

Loans that are not performing in accordance with their original contractual terms at December 31, 2007 and 2006 were approximately $6,366,000 and $1,288,000, respectively. The total allowance for losses related to these loans at December 31, 2007 and 2006 was $585,000 and $534,000, respectively.

For loans on non-accrual status, interest income of approximately $270,000, $230,000, and $8,000 was recorded for the years ended December 31, 2007, 2006, and 2005, respectively. If these non-accrual loans had

INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

performed in accordance with their original contract terms, additional income of approximately $161,000, $21,000, and $95,000 would have been recorded for the years ended December 31, 2007, 2006, and 2005, respectively.

The Company s investment in impaired loans for December 31, 2007 and December 31, 2006 was $6,492,000 and $4,762,000, respectively. The Company s investment in other real estate owned for December 31, 2007 and December 31, 2006 was $1,682,000 and $795,000, respectively.

At December 31, 2007, the contractual principal payments due on outstanding loans receivable are shown below (in thousands). Actual payments may differ from expected payments because borrowers have the right to prepay loans, with or without prepayment penalties.

Year Ending December 31,	**Amount**
2008	$ 426,805
2009	75,707
2010	39,622
2011	34,571
2012	41,882
Thereafter	150,369
	$ 768,956

The Company sells mortgage loans and Small Business Administration Loans in the secondary market. For the years ended December 31. 2007, 2006 and 2005, the gains on sale of loans and the volumes of loans sold were $2,749,000 and $116,871,000, $3,300,000 and $133,314,000 and $2,411,000 and $102,248,000, respectively.

3. Office Properties and Equipment

The components of office properties and equipment as of December 31, 2007 and 2006, are as follows (in thousands):

	December 31,	
	2007	**2006**
Land	$ 5,220	$ 5,121
Buildings and improvements	14,619	11,991
Construction in progress	18,478	6,056
Furniture and equipment	15,453	11,580
	53,770	34,748
Less accumulated depreciation	(11,680)	(9,304)

	$ 42,090	$ 25,444

The construction in progress balance is related to the building of the 94,000 square foot Sandpoint Center. The Company anticipates the Sandpoint Center will cost approximately $8.0 million more to complete and furnish the building, which is scheduled to be completed in the second quarter 2008. The Company anticipates selling the Sandpoint Center and leasing approximately 47,000 square feet from the ultimate owner. The Spokane Valley branch, which opened in August 2007, cost approximately $4.4 million to complete and furnish. During the year ended December 31, 2007 the Company capitalized $530,000 in interest and applied this amount to construction in progress. Depreciation expense for the years ended December 31, 2007, 2006, and 2005 was approximately $2,632,000, $2,095,000 and $1,697,000, respectively.

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INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Goodwill and Other Intangible Assets

Intermountain has goodwill and core deposit intangible assets which were recorded in connection with business combinations (see Note 21). The value of the core deposit intangibles is amortized over the estimated life of the depositor relationships. At December 31, 2007 and 2006, the net carrying value of core deposit intangibles was approximately $723,000 and $881,000, respectively. Accumulated amortization at December 31, 2007 and 2006 was approximately $674,000 and $516,000, respectively. Amortization expense related to core deposit intangibles for the years ended December 31, 2007, 2006 and 2005 was approximately $158,000, $170,000 and $186,000, respectively. Intangible amortization for each of the next five years is estimated to be as follows (in thousands):

Year Ending December 31,	Amount
2008	$ 146
2009	137
2010	129
2011	122
2012	116
	$ 650

The changes in carrying value of goodwill for the years ended December 31, 2007 and 2006 are as follows (in thousands):

	Amount
Balance as of January 1, 2006	$ 11,399
Goodwill acquired during the year	263
Balance as of December 31, 2006	11,662
Goodwill acquired during the year	0
Balance as of December 31, 2007	$ 11,662

The Company evaluates its goodwill for impairment at least annually. There was no impairment in 2007 and 2006.

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INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Deposits

The components of deposits and applicable yields as of December 31, 2007 and 2006, are as follows (in thousands):

	December 31,	
	2007	**2006**
Demand	$ 159,069	$ 141,601
NOW and money market 0.0% to 5.50%	308,857	291,412
Savings and IRA 0.0% to 5.75%	87,149	81,955
	555,075	514,968
Certificate of deposit accounts:		
Up to 1.99%	1	35
2.00% to 2.99%	788	1,397
3.00% to 3.99%	30,181	38,651
4.00% to 4.99%	104,940	95,538
5.00% to 5.99%	66,831	43,097
6.00% to 6.99%	22	
	202,763	178,718
Total deposits	$ 757,838	$ 693,686

The weighted average interest rate paid on certificate of deposit accounts was 4.57% and 4.47% at December 31, 2007 and 2006, respectively.

At December 31, 2007, the scheduled maturities of certificate of deposit accounts are as follows (in thousands):

Year Ending December 31,	**Weighted Average Interest Rate**	**Amounts**
2008	4.57%	$ 165,949
2009	4.03%	8,312
2010	4.94%	25,582
2011	4.74%	1,544
2012	4.51%	1,309
Thereafter	4.48%	67
		$ 202,763

At December 31, 2007, the remaining maturities of certificate of deposit accounts with a minimum balance of $100,000 were as follows (in thousands):

	Amounts
Less than three months	$ 55,059
Three to six months	25,708
Six to twelve months	7,988
Over twelve months	27,880
	$ 116,635

INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The components of interest expense associated with deposits are as follows (in thousands):

	Years Ended December 31,		
	2007	**2006**	**2005**
NOW and money market accounts	$ 9,277	$ 4,927	$ 2,129
Savings and IRA accounts	1,038	911	690
Certificate of deposit accounts	8,454	7,354	5,431
	$ 18,769	$ 13,192	$ 8,250

6. Securities Sold Subject To Repurchase Agreements

Securities sold under agreements to repurchase, which are classified as 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 have a weighted average interest rate of 4.69% and 5.03% at December 31, 2007 and 2006, respectively. Approximately $94.1 million of the repurchase agreements mature on a daily basis, while the remaining balance of $30.0 million has a variable interest rate of 5.87% and matures in July 2011. The interest rate reindexes quarterly and is based on 90 Day LIBOR. At December 31, 2007 and 2006, the Company pledged as collateral, certain investment securities with aggregate amortized costs of $120.8 million and $118.2 million, respectively. These investments securities had market values of $122.2 million and $118.1 million at December 31, 2007 and 2006, respectively.

7. Advances From Federal Home Loan Bank

During June of 2003 the Bank obtained an advance from the Federal Home Loan Bank of Seattle (FHLB Seattle) in the amount of $5,000,000. The note is due in 2008 with interest only payable monthly at 2.71%. During September 2007, the Bank obtained two advances from the FHLB Seattle in the amounts of $10,000,000 and $14,000,000 with interest payable at 4.96% and 4.90% and maturities in September 2010 and September 2009, respectively.

Advances from FHLB Seattle are collateralized by certain qualifying loans with a carrying value of approximately $29,000,000 at December 31, 2007. The Bank s credit line with FHLB Seattle is limited to a percentage of its total regulatory assets subject to collateralization requirements. At December 31, 2007, Intermountain had the ability to borrow an additional $59,477,000 from FHLB Seattle. Intermountain would be able to borrow amounts in excess of this total from the FHLB Seattle with the placement of additional available collateral.

8. Other Borrowings

In January 2003, the Company issued $8.0 million of Trust Preferred securities through its subsidiary, Intermountain Statutory Trust I. The debt associated with these securities bears a fixed interest rate of 6.75%, with interest only paid quarterly starting in June 2003. 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 Trust Preferred securities through its subsidiary, Intermountain Statutory Trust II. The debt is callable by the Company after five years, requires quarterly interest only payments, bears interest on a variable basis tied to the 90 day LIBOR (London Inter-Bank Offering Rate) index plus 2.8% and matures in April 2034. The rate on this borrowing was 8.04% at December 31, 2007.

Overnight-unsecured borrowing lines have been established at US Bank, Wells Fargo, Pacific Coast Bankers Bank, the Federal Home Loan Bank of Seattle and with the Federal Reserve Bank of San Francisco. At December 31, 2007, the Company had approximately $50.0 million of overnight funding available from the unsecured sources and $59.5 million from the FHLB Seattle. The Company had no fed funds purchased. In addition,

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

$2 to $5 million in funding is available on a semi-annual basis from the State of Idaho in the form of negotiated certificates of deposit.

In March 2007, the Company entered into an additional borrowing agreement with Pacific Coast Bankers Bank in the amount of $18.0 million which was raised to $25.0 million in December 2007. The borrowing agreement is a revolving line of credit with a variable rate of interest tied to LIBOR with a maturity of January 18, 2009. The collateral for the credit line is all of the Bank stock and the Sandpoint Center, which is currently under construction. Under the restrictive covenants of this borrowing agreement, Intermountain cannot incur additional debt over $5.0 million without Pacific Coast Bankers Bank s consent, and Intermountain is obligated to provide information regarding the loan portfolio on a regular basis. At December 31, 2007, the balance outstanding was $19,488,000 at 6.73%.

In January 2006, the Company purchased land to build the 94,000 square foot Sandpoint 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%, matures on February 23, 2026 and had an outstanding balance of $982,206 at December 31, 2007.

9. Income Taxes

The tax effects of the principal temporary differences giving rise to deferred tax assets and liabilities as of December 31, 2007 and 2006 were as follows (in thousands):

	2007		2006	
	Assets	**Liabilities**	**Assets**	**Liabilities**
Allowance for losses on loans	$ 4,373	$	$ 3,644	$
Investments		(870)	73	
FHLB stock		(74)		(74)
Office properties and equipment		(462)		(554)
Deferred compensation	612		779	
Core deposit intangible		(101)		(145)
Other		(209)		(151)
Total deferred income taxes	$ 4,985	$ (1,716)	$ 4,496	$ (924)

A valuation allowance against deferred tax assets has not been established as it is more likely than not that these assets will be realized through the refund of prior years taxes or the generation of future taxable income. Net deferred tax assets of approximately $3,269,000 and $3,572,000 as of December 31, 2007 and 2006, respectively, are included in prepaid expenses and other assets on the consolidated balance sheets.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The components of Intermountain s income tax provision are as follows (in thousands):

	Year Ended December 31,		
	2007	**2006**	**2005**
Current income taxes:			
Federal	$ 5,346	$ 5,682	$ 4,307
State	942	1,075	833
Deferred income taxes:	6,288	6,757	5,140
Federal	(526)	(1,138)	(943)
State	(309)	(44)	111
Total deferred income tax benefit	(835)	(1,182)	(832)
Total income tax provision	$ 5,453	$ 5,575	$ 4,308

A reconciliation of the income tax provision and the amount of income taxes computed by applying the statutory federal corporate income tax rate to income before income taxes for the years ended December 31, 2007, 2006 and 2005, is as follows (in thousands):

	2007		2006		2005	
	Amount	**%**	**Amount**	**%**	**Amount**	**%**
Income tax provision at federal statutory rate	$ 5,215	35.0%	$ 5,073	34.3%	$ 4,009	34.0%
Tax effect of:						
State taxes (net of federal tax benefit)	510	3.4%	550	3.7%	444	3.8%
Tax exempt income and other, net	(272)	(1.8)%	(48)	(0.3)%	(145)	(1.3)%
	$ 5,453	36.6%	$ 5,575	37.7%	$ 4,308	36.5%

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN No. 48). This pronouncement requires a certain methodology for measuring and reporting uncertain tax positions, as well as disclosures regarding such tax positions. FIN No. 48 became effective for Intermountain as of January 1, 2007. Intermountain has performed an analysis of its uncertain tax positions and has not recorded any potential penalties, interest or additional tax in its financial statements as of December 31, 2007. Intermountain s tax positions for the years 2003 through 2006 remain subject to review by the Internal Revenue Service. Intermountain does not expect unrecognized tax benefits to significantly change within the next twelve months.

10. Stock-Based Compensation Plans

On August 18, 1999, the shareholders of Intermountain approved two stock option plans, one for certain key employees of the Bank (the 1999 Employee Stock Option Plan) and another for the Directors of Intermountain (the Director Stock Option Plan). The 1999 Employee Stock Option Plan replaced a 10-year plan that expired in February 1998.

In December 2003, the Board of Directors amended the 1999 Employee Stock Option Plan to provide for 291,100 shares of common stock in Intermountain to be granted as either qualified or nonqualified incentive stock options at a price not less than the greater of (1) the fair market value of the common stock, or (2) the net book value of the common stock at the time of the grant. Additionally, if the grant is an incentive option to an employee owning 10 percent or more of common stock, then the issue price cannot be less than 110 percent of the fair market value of the common stock at the time of issue. These options vest over a period up to five years and expire in 10 years.

At a shareholder meeting held on December 17, 2003, amendments were approved to allow the issuance of restricted shares and to increase the number of shares allocated to the 1999 Employee Stock Option Plan to 582,200

INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

subject to a 2-for-1 stock split which was effective December 29, 2003. Under the amended 1999 Employee Stock Option Plan, 185,166 options remain available for grant as either stock options or restricted shares as of December 31, 2007.

The Directors Stock Option Plan was adopted to provide incentives to Directors of Intermountain thereby helping to attract and retain the best available individuals for positions as directors of the corporation. In April 2005, the plan was amended to allow for the issuance of restricted shares. The plan provides for a total of 161,051 common stock options at a price not less than the greater of (1) the fair market value of the common stock, or (2) the net book value of the common stock at the time of the grant. These options vest over a five-year term and expire in 10 years. At December 31, 2007, 62,233 options remain available for grant as either stock options or restricted shares under this Plan.

During 2007, 2006 and 2005, the Company granted restricted stock to its directors and employees from the Director Option Plan and the 1999 Employee Stock Option Plan. These restricted stock grants vest evenly over a five-year period. The Company did not grant stock options during 2007, 2006 or 2005.

The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The Black-Scholes option-pricing model was developed for use in estimating the fair value of options. In addition, option valuation models require the input of highly subjective assumptions, particularly for the expected term and stock price volatility. The employee stock options do not trade on a secondary exchange, therefore employees do not derive a benefit from holding stock options unless there is an appreciation in the market price of the stock above the grant price. Such an increase in stock price would benefit all shareholders commensurately. The assumptions used to calculate the fair value of options granted are evaluated and revised, as necessary, to reflect market conditions and our experience. The fair value of each restricted share is based on the fair market value at the date of grant. The Company records compensation expense based on the determined fair value.

Prior to 2006, we adopted disclosure-only provisions of SFAS No. 123, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure*. The company chose to measure compensation cost for stock-based employee compensation plans using the intrinsic value method of accounting prescribed by APB Opinion No. 25, *Accounting for Stock Issued to Employees*. All stock options were granted at market value on the date of grant. Accordingly, no compensation expense was recognized in 2005 for options related to the stock option plans. The company adopted the provisions of SFAS 123 (R), Share Based Payment on January 1, 2006, using the modified prospective method of adoption.

Total stock-based compensation expense recognized in the consolidated statement of operations for the years ended December 31, 2007 and 2006 was $486,000 and $848,000 before income taxes, respectively. Of the total stock-based compensation expense during the years ended December 31, 2007 and 2006, stock option expense was $196,000 and $141,000, restricted stock expense was $244,000 and $661,000 and other expense related to stock options issued below market price at issue date totaled $46,000 and $46,000, respectively. The Company has approximately $135,000 remaining to expense related to the non-vested stock options outstanding at December 31, 2007. This expense will be recorded over a weighted average remaining period of 12 months.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Had compensation cost for the stock option plans been determined based on fair value at the grant dates under the Plan consistent with the method of SFAS 123 (R) , net income and net income per share amounts for the year ended 2005 would have been changed to the pro-forma amount indicated below (in thousands except per share data). Disclosures for 2007 and 2006 are not presented as the amounts are recognized in the consolidated financial statements.

	Year Ended December 31, 2005	
Reported net income	$	7,482
Add back: Stock-based employee compensation expense, net of related tax effects		48
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects		(158)
Pro forma net income	$	7,372
Basic earnings per share(1):		
Reported earnings per share	$	1.06
Stock-based employee compensation, fair value		(0.02)
Pro forma earnings per share	$	1.04
Dilutive earnings per share(1):		
Reported earnings per share	$	0.97
Stock-based employee compensation, fair value		(0.02)
Pro forma earnings per share	$	0.95

(1) Basic and Dilutive earnings per share have been adjusted for the 10% common stock dividend payable May 31, 2007 to shareholders of record on May 15, 2007.

Prior to the adoption of SFAS 123 (R), the Company presented all tax benefits resulting from the exercise of stock options as operating cash inflows in the consolidated statements of cash flows, in accordance with the provisions of the Emerging Issues Tax Force (EITF) Issue No. 00-15, *Classification in the Statement of Cash Flows of the Income Tax Benefit Received by a Company upon Exercise of a Nonqualified Employee Stock Option*. SFAS 123 (R) requires the benefits of tax deductions in excess of the compensation cost recognized for those options to be classified as financing cash inflows rather than operating cash inflows, on a prospective basis. This amount is shown as Excess tax benefit from stock-based compensation on the consolidated statement of cash flows.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock option transactions for all of the above described plans are summarized as follows:

	Number of Shares(1)	Weighted Average Exercise Price(1)	Exercise Price Per Share		Weighted Average Remaining life (Years)	Aggregate Intrinsic Value(2) (Dollars in (thousands)
Balance, December 31, 2004	972,329	$ 4.87	$ 1.56	13.20		
Options granted						
Options exercised	(238,513)	3.91	1.55	13.20		$ 2,489
Options forfeited and canceled	(35,716)	6.46	3.72	13.20		
Outstanding, December 31, 2005	698,100	5.17	2.68	13.20	4.79	3,606
Options granted						
Options exercised	(114,352)	4.16	2.68	13.20		1,833
Options forfeited and canceled	(7,821)	6.44	0.00	12.95		
Outstanding, December 31, 2006	575,927	5.35	2.68	13.20	4.04	3,085
Options granted						
Options exercised	(86,726)	4.55	2.68	13.20		1,192
Options forfeited and canceled	(1,872)	11.09	7.99	13.20		
Outstanding, December 31, 2007	487,329	$ 5.48	$ 2.79	13.20	3.12	$ 4,640

(1) Shares and Weighted-Average Exercise Price have been adjusted for the 10% common stock dividend payable May 31, 2007 to shareholders of record on May 15, 2007.

(2) The aggregate intrinsic value is before applicable income taxes, based on the Company s $15.00 closing stock price at December 31, 2007, which would have been received by the optionees had all options been exercised on that date.

The following table presents information about the options as of December 31, 2007:

	Total Outstanding			Exercisable	
Range of Exercise Price	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Life (Years)	Number of Shares	Weighted Average Exercise Price
$ 2.64 - $ 3.92	75,942	$ 3.71	3.1	75,942	$ 3.71
$ 3.92 - $ 4.54	230,698	4.40	1.3	230,698	4.40
$ 4.54 - $ 5.16	44,663	4.79	5.2	33,410	4.79
$ 5.16 - $ 5.78	66,362	5.51	5.0	57,755	5.51
$ 5.78 - $ 6.40	15,641	6.11	5.0	12,653	6.06
$ 8.62 - $12.75	7,987	12.38	6.2	5,445	12.38
$12.75 - $13.38	46,036	12.99	6.4	26,330	12.99
	487,329	$ 5.48	3.0	442,233	$ 5.12

INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The number of shares and exercise prices have been adjusted for the 10% common stock dividend effective May 31, 2007.

As of December 31, 2007, total unrecognized stock-based compensation expense related to non-vested stock options and restricted stock grants was approximately $1.3 million, which was expected to be recognized over a period of approximately 3.3 years. During the year ended December 31, 2007, 2006 and 2005, the intrinsic value of stock options exercised was $1.2 million, $1.8 million and $2.5 million, and the total fair value of the options vested was $161,000, $284,000 and $333,000, respectively

Restricted Stock transactions are summarized as follows:

	Number of Shares(1)	Weighted Average Grant Date Fair Value(1)
Nonvested shares		
Balance, December 31, 2004		
Shares granted	26,039	$ 14.58
Shares vested		
Shares forfeited and canceled	(828)	14.24
Balance, December 31, 2005	25,211	14.59
Shares granted	27,322	17.66
Shares vested	(5,037)	14.59
Shares forfeited and canceled	(2,405)	16.80
Balance, December 31, 2006	45,091	17.23
Shares granted	33,524	21.44
Shares vested	(9,718)	17.97
Shares forfeited and canceled	(4,602)	16.53
Balance, December 31, 2007	64,295	$ 19.53

(1) Shares and Weighted-Average Grant-Date Fair Value have been adjusted for the 10% common stock dividend, payable May 31, 2007 to shareholders of record on May 15, 2007.

INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Earnings per Share

The following table (dollars in thousands, except per share amounts) presents a reconciliation of the numerators and denominators used in the basic and diluted earnings per share computations for the years ended December 31 2007, 2006, and 2005. Weighted average shares outstanding have been adjusted for the 10% common stock dividend effective May 2007.

	Years Ended December 31,		
	2007	2006	2005
Numerator:			
Net income basic and diluted	$ 9,445	$ 9,202	$ 7,482
Denominator:			
Weighted average shares outstanding basic	8,206,341	8,035,401	7,078,036
Dilutive effect of common stock options, restricted stock awards	398,396	550,286	605,777
Weighted average shares outstanding diluted	8,604,737	8,585,687	7,698,813
Earnings per share basic and diluted:			
Earnings per share basic	$ 1.15	$ 1.15	$ 1.06
Effect of dilutive common stock options	(0.05)	(0.08)	(0.09)
Earnings per share diluted	$ 1.10	$ 1.07	$ 0.97

At December 31, 2007, 2006 and 2005 there were no options outstanding that were not included in the dilutive calculations above. For the year ended December 31, 2007 and December 31, 2006, 32,000 and 92,745 shared performance stock awards have been included in the dilutive shares. These are related to the 2006-2008 Long Term Incentive Plan and the 2003-2005 Long Term Incentive Plan.

12. Stockholders Equity

On May 31, 2007 and 2006, Intermountain distributed a Board of Directors approved 10% stock dividend to shareholders of record on May 15, 2007 and 2006, respectively.

Effective December 1, 2005, Intermountain completed a $12.0 million common stock offering, issued 705,882 shares of common stock and added $11.9 million to stockholders equity.

On April 30, 2005, at the annual meeting of shareholders of Intermountain Community Bancorp, shareholders approved increasing the number of authorized common shares of stock from 7,084,000 to 24,000,000. This subsequently increased to 26,400,000 shares upon the declaration of the stock dividend, effective May 31, 2006, and to 29,040,000 upon the declaration of the stock dividend, effective May 31, 2007.

As of February 24, 2005, the Board of Directors approved a 3-for-2 stock split which was effective March 10, 2005. Intermountain issued 1,914,809 common shares, net of fractional shares.

13. Regulatory Matters

The Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval. At December 31, 2007 and 2006, approximately $9.4 million and $9.2 million of retained earnings were available for dividend declaration without prior regulatory approval.

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by state and federal banking agencies. Failure to meet minimum capital requirements can initiate

INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct, material effect on the Company s financial statements.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of total and Tier I capital to risk-weighted assets, and of Tier I capital to average assets. Management believes, as of December 31, 2007, that the Company and the Bank meet all capital adequacy requirements to which it is subject.

As of December 31, 2007, the most recent notification from the Federal Deposit Insurance Corporation (FDIC) and the State of Idaho Department of Finance categorized the Company and the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the Company s or the Bank s category.

The following table sets forth the amounts and ratios regarding actual and minimum core Tier 1 risk-based and total risk-based capital requirements, together with the amounts and ratios required in order to meet the definition of a well-capitalized institution (in thousands). For all periods, both the Company and Panhandle State Bank met the requirements for a well-capitalized institution

	Actual		**Capital Requirements**		**Well-Capitalized Requirements**	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
As of December 31, 2007						
Total capital (to risk-weighted assets):						
The Company	$ 102,927	11.61%	$ 70,900	8%	$ 88,626	10%
Panhandle State Bank	102,898	11.61%	70,902	8%	88,627	10%
Tier I capital (to risk-weighted assets):						
The Company	91,840	10.36%	35,450	4%	53,175	6%
Panhandle State Bank	91,811	10.36%	35,451	4%	53,176	6%
Tier I capital (to average assets):						
The Company	91,840	8.90%	41,297	4%	51,621	5%
Panhandle State Bank	91,811	9.13%	40,225	4%	50,281	5%
As of December 31, 2006						
Total capital (to risk-weighted assets):						

The Company	$ 90,937	11.62%	$ 62,611	8%	$ 78,264	10%
Panhandle State Bank	89,898	11.49%	62,611	8%	78,264	10%
Tier I capital (to risk-weighted assets):						
The Company	81,147	10.37%	31,306	4%	46,958	6%
Panhandle State Bank	80,108	10.24%	31,306	4%	46,958	6%
Tier I capital (to average assets):						
The Company	81,147	9.13%	35,540	4%	44,425	5%
Panhandle State Bank	80,108	9.18%	34,915	4%	43,643	5%

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. Commitments and Contingent Liabilities

The Company is engaged in lending activities with borrowers in a variety of industries. A substantial portion of lending is concentrated in the regions in which the Company is located. Collateral on loans, loan commitments and standby letters of credit vary and may include accounts receivable, inventories, investment securities, real estate, equipment and vehicles. The amount and nature of collateral required is based on credit evaluations of the individual customers.

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its banking customers. These financial instruments generally include commitments to extend credit, credit card arrangements, standby letters of credit and financial guarantees. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank s exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, credit card arrangements, standby letters of credit and financial guarantees written is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The contractual amounts of these financial instruments representing credit risk at December 31, 2007, were as follows (in thousands):

Commitments to extend credit	$ 171,482
Credit card arrangements	$ 10,272
Standby letters of credit	$ 11,803

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit typically expire during the next 12 months.

Intermountain leases office space and equipment. As of December 31, 2007, future minimum payments under all of the Company s non-cancelable operating leases that have initial terms in excess of one year are due as follow (in thousands):

Year Ending December 31,	**Amount**
2008	$ 991
2009	839
2010	681

2011	686
2012	635
Thereafter	10,835
	$ 14,667

Rent expense under these agreements for the years ended December 31, 2007, 2006, and 2005 totaled approximately $1,195,000, $801,000, and $635,000, respectively. The operating lease obligations outlined above include lease obligations for the Canyon Rim and Gooding branches in the amount of $112,500 per year and $63,750 per year, respectively. Intermountain owned these buildings and executed a purchase and sale agreement to sell these buildings in December 2006. Intermountain also executed lease agreements in December 2006 which became effective in January 2007 to lease the same buildings. The sale-leaseback agreements do not require any

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

future commitments, obligations, provisions or circumstances that would require or result in the Company s continuing involvement.

At December 31, 2007, Intermountain had an outstanding commitment to fund the completion of the Sandpoint Center totaling $4.0 million. The Company expects to pay this amount within 2008 as the Sandpoint Center is completed.

15. Employee Benefits Plans

The Company sponsors a 401(k) profit sharing plan covering employees meeting minimum eligibility requirements. Employee contributions are voluntary, and the Company may make elective contributions to match up to 50% of the employee s contribution up to 8% of eligible compensation. The Company s contributions to the plan for the years ended December 31, 2007, 2006, and 2005 totaled approximately $589,000, $410,000, and $310,000, respectively.

During 2003, the Company entered into a split dollar life insurance agreement on behalf of certain key executives. The policies were fully funded at purchase. The Company and the employee s estate are co-beneficiaries, with each receiving a certain amount upon death of the employee. Also, as a result of the Snake River Bancorp, Inc. acquisition in November 2004, the Company also assumed a split dollar life insurance agreement with Snake River directors and key executives.

The Company has various compensation plans for employees. Contributions to the plan are at the discretion of the Board of Directors. Deferred compensation expense for the plans described below for the years ended December 31, 2007, 2006, and 2005 was approximately $3,251,000, $3,961,000, and $2,890,000, respectively. These various compensation plans are discussed in detail below.

The Company has annual incentive plans for key employees. Amounts are paid annually within 75 days after each year end. The accrued balance at December 31, 2007 and 2006 for these plans was approximately $2,558,000 and $2,874,000, respectively.

In 2003, the Company adopted a Supplemental Executive Retirement Plan (SERP). The SERP is a non-qualified unfunded plan designed to provide retirement benefits for two key employees of Intermountain. Participants will receive approximately $258,620 in annual payments for 10 years beginning at normal retirement age. Retirement benefits vest after ten years of continued service and benefits are reduced for early retirement. The disability benefit is similar to the reduced benefit for early retirement without any vesting requirements. The plan provides for a change in control benefit if, within one year of a change in control, the participant s employment is terminated. Total amount accrued under the plan as of December 31, 2007 and 2006, was approximately $254,000 and $190,000, respectively.

In April 2006, the Company implemented a long-term executive incentive plan, based on long-term corporate goals, to provide compensation in the form of stock grants to key executive officers. Participants are required to remain employed through the vesting period to receive any accrued benefits under the plan. For this stock-based compensation plan, the total adjustment to equity per SFAS 123 (R) at December 31, 2007 was $597,000 and the compensation expense recorded for the year ended December 31, 2007 was $66,000.

The Company approved stock purchase agreements for certain key officers. Participants must remain employed to receive payments annually in December. The total amount paid under these agreements for 2007 and 2006 was approximately $562,000 and $500,000, respectively. Approximately $2,057,000 remained available to be awarded at December 31, 2007.

INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

16. Interest Rate Risk

The results of operations for financial institutions may be materially and adversely affected by changes in prevailing economic conditions, including rapid changes in interest rates, declines in real estate market values and the monetary and fiscal policies of the federal government. Like all financial institutions, Intermountain s net interest income and its NPV (the net present value of financial assets, liabilities and off-balance sheet contracts) are subject to fluctuations in interest rates. Currently, Intermountain s interest- earning assets, consisting primarily of loans receivable and investments, mature or reprice more rapidly, or on different terms, than do its interest-bearing liabilities, consisting primarily of deposits. The fact that assets mature or reprice more frequently on average than liabilities may be beneficial in times of rising interest rates; however, such an asset/liability structure may result in declining net interest income during periods of falling interest rates. The use of the Bank s pricing strategies, along with other asset-liability strategies, helps to mitigate the negative impact in a falling interest rate environment.

To minimize the impact of fluctuating interest rates on net interest income, Intermountain promotes a loan pricing policy consisting of both fixed and variable rate structures. Deposit pricing strategies are also employed to help distribute funding repricing between both short and long term sources. Additionally, Intermountain maintains an asset and liability management program intended to manage net interest income through interest rate cycles and to protect its NPV by controlling its exposure to changing interest rates.

Intermountain uses an internal simulation model designed to measure the sensitivity of net interest income, net income and NPV to changes in interest rates. This simulation model is designed to enable Intermountain to generate a forecast of net interest income, net income and NPV given various interest rate forecasts and alternative strategies. The model also is designed to measure the anticipated impact that prepayment risk, basis risk, customer maturity preferences, volumes of new business and changes in the relationship between long and short-term interest rates have on the performance of Intermountain. Validation of this model is achieved through backtesting and the use of a third party model. Consultants from this vendor run an independent model which is then used to compare and validate internal results as well as providing critical information for asset-liability decision making.

Another monitoring tool used by Intermountain to assess interest rate risk is gap analysis. The matching of repricing characteristics of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are interest sensitive and by monitoring Intermountain s interest sensitivity gap. Management is aware of the sources of interest rate risk and endeavors to actively monitor and manage its interest rate risk although there can be no assurance regarding the management of interest rate risk in future periods.

17. Related-Party Transactions

The Bank has executed certain loans and deposits with its directors, officers and their affiliates. Related party loans and deposits are transacted as part of the Company s normal course of business, and are not subject to preferential terms or conditions. The aggregate amount of loans outstanding to such related parties at December 31, 2007 and 2006 was approximately $1,244,000 and $638,000, respectively.

During the year, the balance of loans outstanding to directors and executive officers changed as follows (dollars in thousands):

		2007
Balance, January 1,	$	638
New		1,080
Repayment		(474)
Balance, December 31,	$	1,244

Directors fees of approximately $296,000, $314,000, and $310,000 were paid during the years ended December 31, 2007, 2006, and 2005, respectively.

INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Two of the Company s Board of Directors are principals in law firms that provide legal services to Intermountain. During the years ended December 31, 2007, 2006 and 2005 the Company incurred legal fees of approximately $9,000, $11,000, and $7,000, respectively, related to services provided by these firms.

Two directors of Intermountain who joined the boards of Intermountain and Panhandle State Bank in connection with the Snake River Bancorp, Inc. acquisition and two former employees of Magic Valley Bank, who are now employees of the Company, are all members of a partnership which owned the branch office building of Magic Valley Bank in Twin Falls, Idaho. The lease requires monthly rent of $13,165 and expires on February 28, 2018. The Company has an option to renew the lease for three consecutive five-year terms at current market rates. In connection with the Snake River Bancorp acquisition, the lease was amended to grant the Company a two-year option to acquire the property for $2.5 million. In December 2006, the Company sold the option to acquire the property to an unrelated party and executed a lease agreement to lease the building. The property was sold in January 2007 and the lease commenced in January 2007.

18. Fair Value of Financial Instruments

Fair value estimates are determined as of a specific date in time utilizing quoted market prices, where available, or various assumptions and estimates. As the assumptions underlying these estimates change, the fair value of the financial instruments will change. The use of assumptions and various valuation techniques will likely reduce the comparability of fair value disclosures between financial institutions. Accordingly, the aggregate fair value amounts presented do not represent and should not be construed to represent the full underlying value of Intermountain.

The methods and assumptions used to estimate the fair values of each class of financial instruments are as follows:

Cash, Cash Equivalents, Federal Funds and Certificates of Deposit

The carrying value of cash, cash equivalents, federal funds sold and certificates of deposit approximates fair value due to the relatively short-term nature of these instruments.

Investments and BOLI

The fair value of investments is based on quoted market prices. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. The fair value of BOLI is equal to the cash surrender value of the life insurance policies.

Loans Receivable and Loans Held For Sale

The fair value of performing mortgage loans, commercial real estate construction, permanent financing, consumer and commercial loans is estimated by discounting the cash flows using interest rates that consider the interest rate risk inherent in the loans and current economic and lending conditions. Non-accrual loans are assumed to be carried at their current fair value and therefore are not adjusted.

Deposits

The fair values for deposits subject to immediate withdrawal such as interest and non-interest bearing checking, savings and money market deposit accounts, are discounted using market rates for replacement dollars and using industry statistics for decay/maturity dates. The carrying amounts for variable-rate certificates of deposit and other time deposits approximate their fair value at the reporting date. Fair values for fixed-rate certificates of deposit are estimated by discounting future cash flows using interest rates currently offered on time deposits with similar remaining maturities.

INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Borrowings

The carrying amounts of short-term borrowings under repurchase agreements approximate their fair values due to the relatively short period of time between the origination of the instruments and their expected payment. The fair value of long-term FHLB Seattle advances and other long-term borrowings is estimated using discounted cash flow analyses based on the Company s current incremental borrowing rates for similar types of borrowing arrangements with similar remaining terms.

Accrued Interest

The carrying amounts of accrued interest payable and receivable approximate their fair value.

The estimated fair value of the financial instruments as of December 31, 2007 and 2006, are as follows (in thousands):

	2007		2006	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Financial assets:				
Cash, cash equivalents, restricted cash and federal funds sold	$ 38,092	$ 38,092	$ 60,650	$ 60,650
Interest bearing certificates of deposit				
Available-for-sale securities	158,791	158,791	118,490	118,490
Held-to-maturity securities	11,324	11,256	6,719	6,635
Loans held for sale	4,201	4,201	8,945	8,945
Loans receivable, net	756,549	768,427	664,403	664,850
Accrued interest receivable	8,207	8,207	7,329	7,329
BOLI	7,713	7,713	7,400	7,400
Financial liabilities:				
Deposit liabilities	757,838	721,974	693,686	635,064
Other borrowed funds	190,124	217,682	133,852	132,697
Accrued interest payable	3,027	3,027	1,909	1,909

INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

19. Quarterly Financial Data (Unaudited)

The following tables present Intermountain s condensed operations on a quarterly basis for the years ended December 31, 2007 and 2006 (dollars in thousands, except per share amounts):

	Year Ended December 31, 2007			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest income	$ 17,056	$ 17,952	$ 19,084	$ 18,766
Interest expense	(6,208)	(6,482)	(6,721)	(6,926)
Provision for losses on loans	(834)	(1,172)	(1,221)	(669)
Net interest income after provision for losses on loans	10,014	10,298	11,142	11,171
Other income	3,041	3,197	3,584	3,377
Operating expenses	(9,677)	(9,957)	(10,718)	(10,574)
Income before income taxes	3,378	3,538	4,008	3,974
Income tax provision	(1,285)	(1,354)	(1,590)	(1,224)
Net income	$ 2,093	$ 2,184	$ 2,418	$ 2,750
Earnings per share basic(1)	$ 0.26	$ 0.27	$ 0.29	$ 0.33
Earnings per share diluted(1)	$ 0.24	$ 0.25	$ 0.28	$ 0.33
Weighted average shares outstanding basic(1)	8,161,310	8,194,522	8,223,257	8,245,133
Weighted average shares outstanding diluted(1)	8,615,307	8,605,032	8,592,975	8,582,943

	Year Ended December 31, 2006			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest income	$ 12,628	$ 13,913	$ 16,030	$ 17,009
Interest expense	(3,337)	(3,670)	(4,924)	(5,602)
Provision for losses on loans	96	(762)	(910)	(572)
Net interest income after provision for losses on loans	9,387	9,481	10,196	10,835
Other income	2,440	2,364	2,973	3,061
Operating expenses	(7,704)	(8,889)	(9,221)	(10,146)
Income before income taxes	4,123	2,956	3,948	3,750
Income tax provision	(1,561)	(1,117)	(1,423)	(1,474)
Net income	$ 2,562	$ 1,839	$ 2,525	$ 2,276
Earnings per share basic(1)	$ 0.33	$ 0.23	$ 0.31	$ 0.28
Earnings per share diluted(1)	$ 0.30	$ 0.21	$ 0.29	$ 0.27
Weighted average shares outstanding basic(1)	7,967,573	8,023,276	8,054,527	8,094,757
Weighted average shares outstanding diluted(1)	8,455,114	8,448,791	8,558,530	8,641,019

(1) Earnings per share and weighted average shares outstanding have been adjusted to reflect the 10% common stock dividend effective May 31, 2007.

INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

20. Parent Company-Only Financial Information

Intermountain Community Bancorp became the holding company for Panhandle State Bank on January 27, 1998. The following Intermountain Community Bancorp parent company-only financial information should be read in conjunction with the other notes to the consolidated financial statements. The accounting policies for the parent company-only financial statements are the same as those used in the presentation of the consolidated financial statements other than the parent company-only financial statements account for the parent company s investments in its subsidiaries under the equity method (in thousands).

Condensed Balance Sheets

	December 31, 2007	December 31, 2006
Assets:		
Cash	$ 357	$ 236
Construction in progress	18,413	5,695
Land	2,099	1,802
Investment in subsidiaries	106,617	93,567
Prepaid expenses and other assets	190	197
Total assets	$ 127,676	$ 101,497
Liabilities:		
Other borrowings	$ 36,998	$ 22,602
Other liabilities	559	815
Total liabilities	$ 37,557	$ 23,417
Stockholders Equity	90,119	78,080
Total liabilities and stockholders equity	$ 127,676	$ 101,497

Condensed Statements of Income

	Years Ended December 31, 2007	2006	2005
Interest income	$	$	$
Interest expense	(1,587)	(1,326)	(1,042)

Net interest income (expense)	(1,587)	(1,326)	(1,042)
Equity in net earnings of subsidiary	11,545	11,058	8,931
Other income	5		
Operating expenses	(518)	(530)	(407)
Net income	$ 9,445	$ 9,202	$ 7,482

INTERMOUNTAIN COMMUNITY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Condensed Statements of Cash Flows

Cash flows from operating activities:			
Net income	$ 9,445	$ 9,202	$ 7,482
Equity income from subsidiary	(11,545)	(11,058)	(8,931)
Other	170	793	338
Net cash used in operating activities	(1,930)	(1,063)	(1,111)
Cash flows from investing activities:			
Investments in and advances to subsidiaries			(14,712)
Purchase of office properties	(13,015)	(6,367)	
Acquisition of Snake River Bancorp, Inc.			
Net decrease in notes and contracts receivable			
Net cash provided by (used in) investing activities	(13,015)	(6,367)	(14,712)
Cash flows from financing activities:			
Payments to repurchase stock			
Proceeds from other borrowings	14,428	5,060	
Proceeds from common stock offering, net of expenses			11,861
Proceeds from exercise of stock options	679	1,396	901
Repayment of borrowings	(32)	(115)	
Redemption of fractional shares of common stock	(9)	(9)	(1)
Net cash provided by financing activities	15,066	6,332	12,761
Net change in cash and cash equivalents	121	(1,098)	(3,062)
Cash and cash equivalents, beginning of year	236	1,334	4,396
Cash and cash equivalents, end of year	$ 357	$ 236	$ 1,334

21. Business Combinations

In September 2006, the Company purchased a small investment company. The company, Premier Financial Services, had a previous business relationship with this company whereby the investment company employees provided investment advisory services to the Bank s customers. The Company issued 11,162 shares of common stock with a market value of $255,000, purchased $8,300 in fixed assets, paid a non-compete agreement and recorded $263,000 in goodwill. The employees of the acquired company became employees of the Bank and continue to provide investment advisory services to the Bank s customers through a division of the Bank called Intermountain Community Investment Services.

22. Subsequent Events

None.