STERLING FINANCIAL CORP /WA/
Form 10-Q
May 07, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended MARCH 31, 2013

OR

¨ 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.....001-34696

STERLING FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Washington (State or other jurisdiction of incorporation or organization)	91-1572822 (I.R.S. Employer Identification No.)

111 North Wall Street, Spokane, Washington 99201
(Address of principal executive offices) (Zip Code)
(509) 358-8097
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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 ý No ¨

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

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.

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

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock as of the latest practicable date:

Class	Outstanding as of April 30, 2013
Common Stock	62,296,704

Table of Contents

TABLE OF CONTENTS
March 31, 2013

Table of Contents

STERLING FINANCIAL CORPORATION
CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(in thousands, except shares)

	March 31, 2013	December 31, 2012
ASSETS:		
Cash and cash equivalents:		
Interest bearing	$213,390	$173,962
Noninterest bearing	68,974	125,916
Total cash and cash equivalents	282,364	299,878
Restricted cash	14,846	31,672
Investments and mortgage-backed securities (“MBS”):		
Available for sale	1,471,563	1,513,157
Held to maturity	195	206
Loans held for sale	295,505	465,983
Loans receivable, net	6,334,560	6,101,749
Accrued interest receivable	30,705	28,019
Other real estate owned, net (“OREO”)	29,056	25,042
Properties and equipment, net	96,594	93,850
Bank-owned life insurance (“BOLI”)	185,953	179,828
Goodwill	22,577	22,577
Other intangible assets, net	17,866	19,072
Mortgage servicing rights, net	45,061	32,420
Deferred tax asset, net	288,764	292,082
Other assets, net	140,827	131,375
Total assets	$9,256,436	$9,236,910
LIABILITIES:		
Deposits:		
Noninterest bearing	$1,705,835	$1,702,740
Interest bearing	4,892,003	4,733,377
Total deposits	6,597,838	6,436,117
Advances from Federal Home Loan Bank (“FHLB”)	541,259	605,330
Securities sold under repurchase agreements	531,066	586,867
Junior subordinated debentures	245,295	245,294
Accrued interest payable	3,845	4,229
Accrued expenses and other liabilities	100,128	141,150
Total liabilities	8,019,431	8,018,987
SHAREHOLDERS’ EQUITY:		
Preferred stock, 10,000,000 shares authorized; no shares outstanding	0	0
Common stock, 151,515,151 shares authorized; 62,275,581 and 62,207,529 shares outstanding, respectively	1,969,070	1,968,025
Accumulated other comprehensive income	56,076	60,712
Accumulated deficit	(788,141)	(810,814)
Total shareholders’ equity	1,237,005	1,217,923
Total liabilities and shareholders’ equity	$9,256,436	$9,236,910

See notes to consolidated financial statements.

Table of Contents

STERLING FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(in thousands, except share amounts)

	Three Months Ended March 31, 2013	2012
Interest income:		
Loans	$81,187	$79,841
MBS	7,297	15,335
Investments and cash equivalents	2,273	2,789
Total interest income	90,757	97,965
Interest expense:		
Deposits	6,307	11,102
Short-term borrowings	446	2,206
Long-term borrowings	7,110	10,304
Total interest expense	13,863	23,612
Net interest income	76,894	74,353
Provision for credit losses	0	4,000
Net interest income after provision for credit losses	76,894	70,353
Noninterest income:		
Fees and service charges	14,130	12,740
Mortgage banking operations	13,794	18,544
BOLI	1,557	1,746
Gains on sales of securities	0	142
Gains on other loan sales	25	600
Other	8,060	(2,185)
Total noninterest income	37,566	31,587
Noninterest expense	81,929	88,649
Income before income taxes	32,531	13,291
Income tax (provision) benefit	(9,853)	0
Net income	$22,678	$13,291
Earnings per share - basic	$0.36	$0.21
Earnings per share - diluted	$0.36	$0.21
Dividends declared per share	$0.00	$0.00
Weighted average shares outstanding - basic	62,242,183	62,078,404
Weighted average shares outstanding - diluted	63,004,784	62,682,987

See notes to consolidated financial statements.

Table of Contents

STERLING FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
(in thousands)

	Three Months Ended March 31, 2013	2012
Net income	$22,678	$13,291
Beginning balance, accumulated other comprehensive income	$60,712	$61,115
Other comprehensive (loss) income:		
Change in unrealized gains on investments and MBS available for sale	(7,359)	4,598
Realized net gains reclassified from other comprehensive income	0	(142)
Less deferred income tax provision	2,723	0
Net other comprehensive (loss) income	(4,636)	4,456
Ending balance, accumulated other comprehensive income	$56,076	$65,571
Comprehensive income	$18,042	$17,747

For the periods presented, accumulated other comprehensive income was comprised solely of unrealized market value adjustments on available for sale securities. The realized portion reclassified out of other comprehensive income is reflected on the income statement in gains on sales of securities.

See notes to consolidated financial statements.

Table of Contents

STERLING FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(in thousands)

	Three Months Ended March 31,	
	2013	2012
Cash flows from operating activities:		
Net income	$22,678	$13,291
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	0	4,000
Net gain on sales of loans	(10,614)	(13,939)
Net gain on sales of investments and MBS	0	(142)
Net gain on mortgage servicing rights	(2,834)	(2,216)
Stock based compensation	632	990
Loss (gain) on OREO	214	(752)
Increase in cash surrender value of BOLI	(1,461)	(1,486)
Depreciation and amortization	10,692	10,921
Bargain purchase gain	(7,544)	0
Change in:		
Accrued interest receivable	(2,253)	2,085
Prepaid expenses and other assets	2,148	(11,321)
Accrued interest payable	(419)	1,556
Accrued expenses and other liabilities	(47,044)	2,308
Proceeds from sales of loans originated for sale	797,735	578,189
Loans originated for sale	(631,632)	(577,405)
Net cash provided by operating activities	130,298	6,079
Cash flows from investing activities:		
Change in restricted cash	16,826	(17,003)
Net change in loans	(129,515)	(125,173)
Proceeds from sales of loans	2,190	1,718
Purchase of investment securities	0	(2,530)
Proceeds from maturities of investment securities	169	13,484
Proceeds from sale of investment securities	0	178,380
Purchase of MBS	(76,590)	(72,032)
Principal payments received on MBS	108,098	158,133
Proceeds from sales of MBS	0	283
Office properties and equipment, net	(5,537)	(1,814)
Improvements and other changes to OREO	(125)	(760)
Proceeds from sales of OREO	6,738	22,424
Net change in cash and cash equivalents from acquisitions	6,877	121,098
Net cash (used in) provided by investing activities	$(70,869)	$276,208

See notes to consolidated financial statements.
6

Table of Contents

STERLING FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)—cont.
(in thousands)

	Three Months Ended March 31,	
	2013	2012
Cash flows from financing activities:		
Net change in deposits	$43,499	$(231,869)
Advances from FHLB	225,000	0
Repayment of advances from FHLB	(290,054)	(200,052)
Net change in short term repurchase agreements	(5,801)	10,032
Payments under structured repurchase agreements	(50,000)	0
Proceeds from stock issuance, net	413	319
Net cash used in financing activities	(76,943)	(421,570)
Net change in cash and cash equivalents	(17,514)	(139,283)
Cash and cash equivalents, beginning of period	299,878	470,599
Cash and cash equivalents, end of period	$282,364	$331,316
Supplemental disclosures:		
Cash paid during the period for:		
Interest	$14,247	$21,923
Income taxes, net	687	31
Noncash financing and investing activities:		
Foreclosed real estate acquired in settlement of loans	6,764	9,385

See notes to consolidated financial statements.

Table of Contents

STERLING FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2013

1. Basis of Presentation:

The foregoing unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the Securities and Exchange Commission. Accordingly, these financial statements do not include all of the disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. These unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements as disclosed in the annual report on Form 10-K for the year ended December 31, 2012. References to “Sterling,” in this report are to Sterling Financial Corporation, a Washington corporation, and its consolidated subsidiaries on a combined basis, unless otherwise specified or the context otherwise requires. References to “Sterling Bank” refer to our subsidiary Sterling Savings Bank, a Washington state-chartered commercial bank.
In the opinion of management, the unaudited interim consolidated financial statements furnished herein include all adjustments, all of which are of a normal recurring nature, necessary for a fair statement of the results for the interim periods presented.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities known to exist as of the date the financial statements are published, and the reported amounts of revenues and expenses during the reporting period. Uncertainties with respect to such estimates and assumptions are inherent in the preparation of Sterling’s consolidated financial statements; accordingly, it is possible that the actual results could differ from these estimates and assumptions, which could have a material effect on the reported amounts of Sterling’s consolidated financial position and results of operations.

During 2012, Sterling identified an error related to the classification of the loss on foreclosure amounts reported in the Consolidated Statement of Cash Flows for the quarter ended March 31, 2012, and for the years ended December 31, 2011 and 2010, and the interim periods therein. The loss on foreclosure amounts were previously included in the cash flows from operating activities in the "Loss on OREO" line item, instead of the cash flows from investing activities in the "Net change in loans" line item. In accordance with the SEC Staff Accounting Bulletin (SAB) No. 99, "Materiality," and SAB No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," management evaluated the materiality of the error from qualitative and quantitative perspectives and concluded that the error was immaterial to prior periods. Consequently, the Consolidated Statement of Cash Flows contained in this Report has been revised for the three months ended March 31, 2012. This change resulted in a decrease of $5.3 million to cash flows from operating activities and an increase of the same amount to cash flows from investing activities for the three months ended March 31, 2012. This change did not affect net income, the balance sheet, or shareholders' equity for any period.

In addition to other established accounting policies, the following is a discussion of recent accounting pronouncements:

In December 2011, the FASB issued ASU 2011-11, “Disclosures about Offsetting Assets and Liabilities,” as amended by ASU 2013-01, "Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities." The guidance adds certain additional disclosure requirements about financial instruments and derivatives instruments that are subject to netting arrangements. ASU 2011-11 became effective for Sterling on January 1, 2013, and did not have a material impact on its consolidated financial statements.

In July 2012, the FASB issued ASU 2012-02, "Testing Indefinite-Lived Intangible Assets for Impairment." ASU 2012-02,
similar to ASU 2011-08, provided a qualitative assessment of determining if it is more likely than not that impairment has
occurred, to establish the extent to which further testing is required. ASU 2012-02 became effective for Sterling on January 1, 2013, and did not have a material impact on its consolidated financial statements.

In February 2013, the FASB issued ASU 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." The amendment requires an entity to provide additional information about reclassifications out of accumulated other comprehensive income. ASU 2013-02 became effective for Sterling on January 1, 2013, and did not have a material impact on its consolidated financial statements.

Table of Contents

In February 2013, the FASB issued ASU 2013-04, "Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date." ASU 2013-04 provides guidance for the recognition, measurement, and disclosure of such obligations. ASU 2013-04 is effective for fiscal years beginning after December 15, 2013, and is not expected to have a material impact on Sterling's consolidated financial statements.

2. Business Combinations:

American Heritage Holdings. On February 28, 2013, Sterling paid $6.5 million in cash and paid off an existing note payable of $2.2 million for a total of $8.7 million in consideration to acquire American Heritage Holdings, the holding company for Borrego Springs Bank, N.A. ("Borrego"). Immediately following the acquisition, Borrego was merged with and into Sterling's principal operating subsidiary, Sterling Bank, with Borrego's operations continuing under the registered trade name of Borrego Springs Bank. As a result of this transaction, Sterling has expanded its SBA lending platform and added depository branches in Southern California. The following table summarizes the amounts recorded at closing:

	February 28, 2013 (in thousands)
Cash and cash equivalents	15,626
Investments and MBS	1,030
Loans receivable, net	97,262
Core deposit intangible	453
Other assets	27,197
Total assets acquired	$141,568
Deposits	$118,221
Other liabilities	7,054
Total liabilities assumed	125,275
Net assets acquired	16,293
Consideration paid	8,749
Bargain purchase gain	$7,544

We recognized a bargain purchase gain of $7.5 million in the transaction for the net assets acquired in excess of the purchase price, primarily due to limited market for Borrego's assets, in addition to Borrego's regulatory and capital constraints. The bargain purchase gain is included in other noninterest income on the income statement for the three months ended March 31, 2013. The core deposit intangible has a weighted average amortization period of ten years and will be amortized on an accelerated basis. On the acquisition date of February 28, 2013, the contractual cash flows of purchased impaired loans, which are described in Note 4, from Borrego were $16.1 million, cash flows expected to be collected $13.6 million, and the fair value of the loans $11.9 million, with $9.8 million of these loans being guaranteed by government agencies.

As of February 28, 2013, the unpaid principal balance and contractual interest ("contractual cash flows") on purchased loans that had not exhibited evidence of credit deterioration was $83.3 million. Sterling estimated that $3.9 million of these cash flows would be uncollectable, resulting in a combined credit and interest rate discount of $4.5 million being recorded on these loans.

Table of Contents

First Independent Bank. On February 29, 2012, Sterling Bank completed its acquisition of the operations of First Independent Bank ("First Independent") of Vancouver, WA, by acquiring certain assets and assuming certain liabilities, including all deposits for a net purchase price of $40.6 million, comprised of $28.9 million of cash paid at closing and contingent consideration with a fair value of $11.7 million at acquisition date. Due to favorable performance, the full value of the contingent consideration of $17 million may be recognized. During the first quarter 2013, a payment of $6.8 million was made for this contingent consideration, resulting in a remaining estimated fair value of $9.2 million. The following table summarizes the amounts recorded at closing:

	February 29, 2012
	(in thousands)
Cash and cash equivalents	$150,045
Investments and MBS	187,465
Loans receivable, net	349,990
Goodwill	22,577
Core deposit intangible	11,974
Fixed assets	4,038
Other assets	10,886
Total assets acquired	$736,975
Deposits	$695,919
Other liabilities	409
Total liabilities assumed	696,328
Net assets acquired	$40,647

The recorded goodwill of $22.6 million represents the inherent long-term value anticipated from synergies expected to be achieved as a result of the transaction. The amount recorded for goodwill includes subsequent adjustments, primarily from updated appraisals on fixed assets. The amount of goodwill deductible for income tax purposes is approximately equivalent to the recorded book value. The core deposit intangible has a weighted average amortization period of ten years and will be amortized on an accelerated basis. On the acquisition date of February 29, 2012, the contractual cash flows of purchased impaired loans from First Independent were $24.4 million, cash flows expected to be collected $17.2 million, and the fair value of the loans $15.3 million.

As of February 29, 2012, the contractual cash flows on purchased loans that had not exhibited evidence of credit deterioration was $403.8 million. Sterling estimated that $12.7 million of these cash flows would be uncollectable, resulting in a discount of $21.8 million being recorded on these loans.

The following table presents certain First Independent stand alone amounts and pro forma Sterling and First Independent combined amounts as if the transaction had occurred on January 1, 2012. Cost savings estimates are not included in the pro forma combined results, nor are certain credit impaired loans and associated losses excluded from the purchase and assumption transaction.

	First Independent (stand alone)	Pro Forma Combined
	One Months Ended	Three Months Ended
	March 31, 2012	
	(in thousands, except per share data)	
Net interest income	$3,241	$80,834
Noninterest income	503	32,592
Net income	2,107	17,505
Earnings per share - basic	0.03	0.28
Earnings per share - diluted	$0.03	$0.28

10

Table of Contents

3. Investments and MBS:

The carrying and fair values of investments and MBS are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
March 31, 2013				
Available for sale				
MBS	$1,229,428	$39,074	$(172)	$1,268,330
Municipal bonds	188,434	15,219	(590)	203,063
Other	162	8	0	170
Total	$1,418,024	$54,301	$(762)	$1,471,563
Held to maturity				
Tax credits	$195	$0	$0	$195
Total	$195	$0	$0	$195
December 31, 2012				
Available for sale				
MBS	$1,263,786	$45,052	$0	$1,308,838
Municipal bonds	188,467	16,452	(613)	204,306
Other	5	8	0	13
Total	$1,452,258	$61,512	$(613)	$1,513,157
Held to maturity				
Tax credits	$206	$0	$0	$206
Total	$206	$0	$0	$206

Sterling’s MBS portfolio is comprised primarily of residential agency securities. Total sales of Sterling’s securities during the periods ended March 31, 2013 and 2012 are summarized as follows:

	Proceeds from Sales	Gross Realized Gains	Gross Realized Losses
	(in thousands)		
Three Months Ended:			
March 31, 2013	$0	$0	$0
March 31, 2012	178,663	142	0

Table of Contents

The following table summarizes Sterling’s investments and MBS that had a market value below their amortized cost as of March 31, 2013 and December 31, 2012, segregated by those investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer:

	Less than 12 months		12 months or longer		Total	
	Market Value	Unrealized Losses	Market Value	Unrealized Losses	Market Value	Unrealized Losses
	(in thousands)					
March 31, 2013						
MBS	$32,685	$(172)	$0	$0	$32,685	$(172)
Municipal bonds	0	0	14,047	(590)	14,047	(590)
Other	0	0	0	0	0	0
Total	$32,685	$(172)	$14,047	$(590)	$46,732	$(762)
December 31, 2012						
MBS	$0	$0	$0	$0	$0	$0
Municipal bonds	0	0	12,921	(613)	12,921	(613)
Other	0	0	0	0	0	0
Total	$0	$0	$12,921	$(613)	$12,921	$(613)

Management evaluates investment securities for other-than-temporary declines in fair value each quarter. If the fair value of investment securities falls below the amortized cost and the decline is deemed to be other-than temporary, the securities are written down to current market value, resulting in the recognition of an other-than-temporary impairment ("OTTI"). During the three months ended March 31, 2013 and 2012, no securities were determined to be other-than-temporarily impaired.

The following table presents the amortized cost and fair value of available for sale and held to maturity securities as of March 31, 2013, grouped by contractual maturity. Actual maturities for MBS will differ from contractual maturities as a result of the level of prepayments experienced on the underlying mortgages.

	Held to maturity		Available for sale	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	(in thousands)			
Due within one year	$0	$0	$0	$0
Due after one year through five years	0	0	2,720	2,917
Due after five years through ten years	0	0	72,378	75,451
Due after ten years	195	195	1,342,926	1,393,195
Total	$195	$195	$1,418,024	$1,471,563

Table of Contents

4. Loans Receivable and Allowance for Credit Losses:

The following table presents the composition of Sterling’s loan portfolio as of the balance sheet dates:

	March 31, 2013	December 31, 2012
	(in thousands)	
Residential real estate	$857,864	$806,722
Commercial real estate ("CRE"):		
Investor CRE	1,163,821	1,219,847
Multifamily	1,725,403	1,580,289
Construction	71,213	74,665
Total CRE	2,960,437	2,874,801
Commercial:		
Owner occupied CRE	1,372,949	1,276,591
Commercial & Industrial ("C&I")	533,955	540,499
Total commercial	1,906,904	1,817,090
Consumer	752,292	754,621
Gross loans receivable	6,477,497	6,253,234
Deferred loan costs (fees), net	6,736	2,860
Allowance for loan losses	(149,673)	(154,345)
Net loans receivable	$6,334,560	$6,101,749

As of March 31, 2013 and December 31, 2012, loans pledged as collateral for borrowings from the FHLB and the Federal Reserve were $4.28 billion and $4.15 billion, respectively. Loans receivable include purchased impaired loans, which are loans acquired that are deemed to exhibit evidence of credit deterioration since origination and therefore, are classified as impaired.

The accounting for purchased impaired loans is periodically updated for changes in the loans' cash flow expectations, and reflected in interest income over the life of the loans as accretable yield. As of March 31, 2013, no allowance for credit losses was recorded in connection with purchased impaired loans, and the unpaid principal balance and carrying amount of these loans were $37.0 million and $22.5 million, respectively. The following table presents a roll-forward of accretable yield over the periods presented:

	Three Months Ended March 31,	
	2013	2012
	(in thousands)	
Beginning balance	$1,332	$0
Additions	1,774	1,923
Accretion to interest income	(205)	(14)
Reclassifications	160	0
Ending balance	$3,061	$1,909

13

Table of Contents

As of March 31, 2013 and December 31, 2012, net loans receivable included unamortized discounts on acquired loans of $27.0 million and $21.3 million, respectively. The following table presents, as of March 31, 2013, the five-year projected loan discount accretion to be recognized as an increase to interest income:

	Amount (in thousands)
Remainder of 2013	$2,938
Years ended December 31,	
2014	2,796
2015	1,724
2016	1,032
2017	679
2018	434

The following table sets forth details by segment for Sterling's loan portfolio and related allowance as of the balance sheet dates:

	Residential Real Estate (in thousands)	Commercial Real Estate	Commercial	Consumer	Unallocated	Total
March 31, 2013						
Loans receivable, gross:						
Individually evaluated for impairment	$0	$83,454	$48,342	$0	$0	$131,796
Collectively evaluated for impairment	857,864	2,876,983	1,858,562	752,292	0	6,345,701
Total loans receivable, gross	$857,864	$2,960,437	$1,906,904	$752,292	$0	$6,477,497
Allowance for loan losses:						
Individually evaluated for impairment	$0	$4,308	$5,106	$0	$0	$9,414
Collectively evaluated for impairment	19,968	40,827	34,490	25,817	19,157	140,259
Total allowance for loan losses	$19,968	$45,135	$39,596	$25,817	$19,157	$149,673
December 31, 2012						
Loans receivable, gross:						
Individually evaluated for impairment	$9,134	$68,317	$48,312	$494	$0	$126,257
Collectively evaluated for impairment	797,588	2,806,484	1,768,778	754,127	0	6,126,977
Total loans receivable, gross	$806,722	$2,874,801	$1,817,090	$754,621	$0	$6,253,234
Allowance for loan losses:						
Individually evaluated for impairment	$365	$3,182	$4,916	$0	$0	$8,463
Collectively evaluated for impairment	19,482	44,912	36,958	25,602	18,928	145,882
Total allowance for loan losses	$19,847	$48,094	$41,874	$25,602	$18,928	$154,345

Purchased credit impaired loans included in loans collectively evaluated for impairment as of March 31, 2013 are $22.5 million and as of December 31, 2012 are $11.2 million.

Table of Contents

The following tables present a roll-forward by segment of the allowance for credit losses for the periods presented:

	Residential Real Estate (in thousands)	Commercial Real Estate	Commercial	Consumer	Unallocated	Total
2013 first quarter activity						
Allowance for loan losses:						
Beginning balance, Jan 1	$19,847	$48,094	$41,874	$25,602	$18,928	$154,345
Provisions	960	(1,091)	(1,610)	1,512	229	0
Charge-offs	(1,019)	(2,923)	(1,588)	(1,644)	0	(7,174)
Recoveries	180	1,055	920	347	0	2,502
Ending balance, March 31	19,968	45,135	39,596	25,817	19,157	149,673
Reserve for unfunded credit commitments:						
Beginning balance, Jan 1	2,230	405	2,806	2,118	443	8,002
Provisions	(309)	(50)	(373)	604	128	0
Charge-offs	(12)	0	0	0	0	(12)
Recoveries	0	0	0	0	0	0
Ending balance, March 31	1,909	355	2,433	2,722	571	7,990
Total credit allowance	$21,877	$45,490	$42,029	$28,539	$19,728	$157,663
2012 first quarter activity						
Allowance for loan losses:						
Beginning balance, Jan 1	$15,197	$91,722	$38,046	$13,427	$19,066	$177,458
Provisions	(980)	(2,824)	4,458	2,638	708	4,000
Charge-offs	(2,187)	(11,518)	(9,533)	(2,452)	0	(25,690)
Recoveries	212	3,234	1,512	547	0	5,505
Ending balance, March 31	12,242	80,614	34,483	14,160	19,774	161,273
Reserve for unfunded credit commitments:						
Beginning balance, Jan 1	3,828	2,321	1,796	1,787	297	10,029
Provisions	(25)	(713)	665	(505)	578	0
Charge-offs	(1)	0	0	0	0	(1)
Recoveries	0	0	0	0	0	0
Ending balance, March 31	3,802	1,608	2,461	1,282	875	10,028
Total credit allowance	$16,044	$82,222	$36,944	$15,442	$20,649	$171,301

In establishing the allowance for loan losses, Sterling groups its loan portfolio into segments for loans collectively evaluated for impairment. The groups are further segregated based on internal risk ratings. Both qualitative and quantitative data are considered in determining the probability of default and loss given default for each group of loans. The probability of default and loss given default are used to calculate an expected loss rate. The calculated expected loss for each loan class is compared to the actual one-year and three-year (annualized) losses. If the calculated expected loss rate is less than the actual one and

Table of Contents

three year loss rates, then the expected loss rate would be set at the greater of the actual one or three year loss rate. If a loan is determined to be impaired, Sterling prepares an individual evaluation of the loan. The individual evaluation compares the present value of the expected future cash flows or the fair value of the underlying collateral to the recorded investment in the loan. The results of the individual impairment evaluation could determine the need to record a charge-off or establish a specific reserve.

Sterling assigns risk rating classifications to its loans. These risk ratings are divided into the following groups:

Pass - the asset is considered of sufficient quality to preclude a Marginal rating. Pass assets generally are well protected by the current net worth and paying capacity of the obligor or by the value of the asset or underlying collateral.
Marginal - the asset is susceptible to deterioration if stressed from a cash flow or earnings shock, with liquidity and leverage possibly below industry norms. The borrower may have few reserves to cover debt service, besides current income. A business generating cash flows that service the debt may be dependent on the successful reception of new products in the marketplace.
Special Mention - the asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or of Sterling's credit position at some future date. Special Mention assets are not adversely classified and do not expose Sterling to sufficient risk to warrant adverse classification.
Substandard - the asset is inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. Assets so classified have well-defined weaknesses. They are characterized by the distinct possibility that Sterling may sustain some loss if the deficiencies are not corrected.
Doubtful/Loss - the Doubtful asset has the weaknesses of those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. An asset classified Loss is the portion of the asset that is considered uncollectible and/or of such little value that its continuance as an asset, without a charge-off or establishment of a specific reserve, is not warranted. This classification does not necessarily mean that an asset has absolutely no recovery or salvage value; but rather, it is not practical or desirable to defer writing off an asset that is no longer deemed to have financial value, even though partial recovery may be recognized in the future.

Table of Contents

The following table presents credit quality indicators for Sterling's loan portfolio grouped according to internally assigned risk ratings and performance status:

	Residential Real Estate	Commercial Real Estate Investor CRE	Multifamily	Construction	Commercial Owner Occupied CRE	Commercial & Industrial	Consumer	Total	% of Total
	(in thousands)								
March 31, 2013									
Pass	$766,136	$571,102	$1,640,373	$11,362	$733,524	$346,956	$722,180	$4,791,633	74 %
Marginal	52,250	453,064	69,576	41,995	499,192	149,595	15,901	1,281,573	20 %
Special mention	11,542	81,649	10,568	4,585	76,629	29,485	5,425	219,883	3 %
Substandard	27,625	55,001	4,667	12,187	58,560	7,894	8,786	174,720	3 %
Doubtful/Loss	311	3,005	219	1,084	5,044	25	0	9,688	0 %
Total	$857,864	$1,163,821	$1,725,403	$71,213	$1,372,949	$533,955	$752,292	$6,477,497	100 %
Restructured	$24,407	$8,482	$3,504	$9,718	$22,263	$806	$304	$69,484	1 %
Nonaccrual	18,421	35,765	1,321	7,488	40,458	4,407	5,787	113,647	2 %
Nonperforming	42,828	44,247	4,825	17,206	62,721	5,213	6,091	183,131	3 %
Performing	815,036	1,119,574	1,720,578	54,007	1,310,228	528,742	746,201	6,294,366	97 %
Total	$857,864	$1,163,821	$1,725,403	$71,213	$1,372,949	$533,955	$752,292	$6,477,497	100 %
December 31, 2012									
Pass	$714,346	$599,660	$1,486,824	$10,946	$678,916	$349,674	$723,698	$4,564,064	73 %
Marginal	53,722	472,801	74,379	42,518	454,348	146,554	17,255	1,261,577	20 %
Special mention	11,739	77,342	10,122	3,401	85,228	38,874	4,864	231,570	4 %
Substandard	26,550	67,347	8,745	17,534	53,183	5,397	8,804	187,560	3 %
Doubtful/Loss	365	2,697	219	266	4,916	0	0	8,463	0 %
Total	$806,722	$1,219,847	$1,580,289	$74,665	$1,276,591	$540,499	$754,621	$6,253,234	100 %
Restructured	$22,968	$4,334	$4,094	$8,551	$23,152	$810	$307	$64,216	1 %
Nonaccrual	20,457	46,399	4,055	8,144	31,696	3,424	6,938	121,113	2 %
Nonperforming	43,425	50,733	8,149	16,695	54,848	4,234	7,245	185,329	3 %
Performing	763,297	1,169,114	1,572,140	57,970	1,221,743	536,265	747,376	6,067,905	97 %
Total	$806,722	$1,219,847	$1,580,289	$74,665	$1,276,591	$540,499	$754,621	$6,253,234	100 %

Purchased credit impaired loans of $15.7 million as of March 31, 2013, and $2.1 million as of December 31, 2012, are included in the nonaccrual loans.

Table of Contents

Aging by class for Sterling's loan portfolio as of March 31, 2013 and December 31, 2012 was as follows:

	Residential Real Estate	Commercial Real Estate Investor CRE	Commercial Real Estate Multifamily	Construction	Commercial Owner Occupied CRE	Commercial & Industrial	Consumer	Total	% of Total
	(in thousands)								
March 31, 2013									
30 - 59 days past due	$5,884	$6,004	$168	$219	$7,666	$1,048	$4,810	$25,799	0 %
60 - 89 days past due	2,587	5,329	0	3,661	5,522	414	1,281	18,794	0 %
> 90 days past due	19,542	23,404	1,184	7,488	27,780	2,096	4,034	85,528	2 %
Total past due	28,013	34,737	1,352	11,368	40,968	3,558	10,125	130,121	2 %
Current	829,851	1,129,084	1,724,051	59,845	1,331,981	530,397	742,167	6,347,376	98 %
Total Loans	$857,864	$1,163,821	$1,725,403	$71,213	$1,372,949	$533,955	$752,292	$6,477,497	100 %
> 90 days and accruing	$0	$0	$0	$0	$0	$0	$0	$0	0 %
December 31, 2012									
30 - 59 days past due	$5,800	$10,565	$707	$611	$10,543	$2,690	$4,028	$34,944	1 %
60 - 89 days past due	1,576	1,042	479	0	3,300	376	1,796	8,569	0 %
> 90 days past due	20,507	34,196	3,436	8,243	20,883	1,954	4,717	93,936	2 %
Total past due	27,883	45,803	4,622	8,854	34,726	5,020	10,541	137,449	3 %
Current	778,839	1,174,044	1,575,667	65,811	1,241,865	535,479	744,080	6,115,785	97 %
Total Loans	$806,722	$1,219,847	$1,580,289	$74,665	$1,276,591	$540,499	$754,621	$6,253,234	100 %
> 90 days and accruing	$0	$0	$0	$0	$0	$0	$0	$0	0 %

Table of Contents

Sterling considers its nonperforming loans to be impaired loans. The following table summarizes impaired loans by class as of March 31, 2013 and December 31, 2012:

	Unpaid Principal Balance	Charge-Offs	Book Balance Without Specific Reserve	With Specific Reserve	Specific Reserve
	(in thousands)				
March 31, 2013					
Residential real estate	$47,967	$5,139	$42,517	$311	$311
CRE:					
Investor CRE	50,451	6,204	34,451	9,796	3,005
Multifamily	5,562	737	3,575	1,250	219
Construction	31,541	14,335	11,584	5,622	1,084
Total CRE	87,554	21,276	49,610	16,668	4,308
Commercial:					
Owner Occupied CRE	71,229	8,508	44,935	17,786	5,107
C&I	17,223	12,010	5,213	0	0
Total commercial	88,452	20,518	50,148	17,786	5,107
Consumer	6,509	418	6,091	0	0
Total	$230,482	$47,351	$148,366	$34,765	$9,726

	Unpaid Principal Balance	Charge-Offs	Book Balance Without Specific Reserve	With Specific Reserve	Specific Reserve
	(in thousands)				
December 31, 2012					
Residential real estate	$49,816	$6,391	$43,060	$365	$365
CRE:					
Investor CRE	59,099	8,366	33,540	17,193	2,697
Multifamily	9,554	1,405	6,873	1,276	219
Construction	31,040	14,345	15,421	1,274	266
Total CRE	99,693	24,116	55,834	19,743	3,182
Commercial:					
Owner Occupied CRE	61,300	6,452	42,075	12,773	4,916
C&I	16,959	12,725	4,234	0	0
Total commercial	78,259	19,177	46,309	12,773	4,916
Consumer	7,671	426	7,245	0	0
Total	$235,439	$50,110	$152,448	$32,881	$8,463

Table of Contents

The following table presents the average book balance and interest income recognized for impaired loans by class for the periods presented:

	Three Months Ended March 31,			
	2013		2012	
	Average Book Balance	Interest Income Recognized	Average Book Balance	Interest Income Recognized
	(in thousands)			
Residential real estate	$43,127	$152	$46,157	$244
Investor CRE	47,490	347	49,703	582
Multifamily	6,487	35	6,519	95
Construction	16,951	1,701	89,477	852
Owner Occupied CRE	58,785	394	73,771	778
C&I	4,723	34	12,288	29
Consumer	6,668	5	5,517	0
Total	$184,231	$2,668	$283,432	$2,580

The following tables present loans that were modified and recorded as troubled debt restructurings ("TDR's") during the following period:

	Three Months Ended March 31,					
	2013			2012		
	Number of Contracts	Pre-Modification Recorded Investment	Post-Modification Recorded Investment	Number of Contracts	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
	(in thousands, except number of contracts)					
Residential real estate	9	$ 2,134	$ 1,929	4	1,041	1,040
Investor CRE	3	1,482	1,180	1	1,302	1,302
Multifamily	0	0	0	1	1,612	1,611
Construction	0	0	0	1	2,692	2,692
Owner Occupied CRE	3	2,432	2,414	3	6,632	6,624
C&I	0	0	0	4	1,988	706
Consumer	0	0	0	0	0	0
Total (1)	15	$ 6,048	$ 5,523	14	15,267	13,975

(1) Amounts exclude specific loan loss reserves.

Substantially all TDRs are determined to be impaired prior to being restructured. As such, they are individually evaluated for impairment, unless they are considered homogeneous loans in which case they are collectively evaluated for impairment. As of March 31, 2013, Sterling had specific reserves of $706,000 on TDRs which were restructured during the previous three months. There were no loans that were removed from TDR status during this period.

Table of Contents

The following table shows the post-modification recorded investment by class for TDRs restructured during the periods presented by the primary type of concession granted:

	Principal Deferral	Rate Reduction	Extension of Terms	Forgiveness of Principal and/or Interest	Total
Three Months Ended March 31, 2013	(in thousands)				
Residential Real Estate	$0	$1,395	$203	$331	$1,929
Investor CRE	0	1,139	0	41	1,180
Multifamily	0	0	0	0	0
Construction	0	0	0	0	0
Owner CRE	730	1,684	0	0	2,414
C&I	0	0	0	0	0
Consumer	0	0	0	0	0
Total	$730	$4,218	$203	$372	$5,523
Three Months Ended March 31, 2012					
Residential Real Estate	$407	$633	$0	$0	$1,040
Investor CRE	0	1,302	0	0	1,302
Multifamily	0	1,611	0	0	1,611
Construction	0	0	2,692	0	2,692
Owner CRE	0	6,624	0	0	6,624
C&I	0	0	0	706	706
Consumer	0	0	0	0	0
Total	$407	$10,170	$2,692	$706	$13,975

Restructurings that result in the forgiveness of principal or interest are typically part of a bankruptcy settlement. There were no TDR’s completed during the twelve month period ended March 31, 2013 that subsequently defaulted during the period.

5. Goodwill and Other Intangible Assets:

Goodwill represents the excess of a purchase price over the net assets acquired. The following table presents a roll-forward of Sterling's goodwill:

	2013	2012
	(in thousands)	
Beginning balance, January 1	$22,577	$0
Acquired	0	21,730
Ending balance, March 31	$22,577	$21,730

Table of Contents

Goodwill acquired during the three months ended March 31, 2012 was related to the First Independent transaction and has been allocated to the Community Banking segment. Goodwill is not amortized, but is reviewed for impairment at least annually. Other intangible assets at March 31, 2013 and December 31, 2012 were comprised of core deposit intangibles from various acquisitions, and other identifiable intangibles related to First Independent's trust and wealth management business. The following table provides details of other intangible assets:

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
March 31, 2013	(in thousands)		
Core deposit intangibles	$55,873	$39,644	$16,229
Other	1,800	163	1,637
December 31, 2012			
Core deposit intangibles	55,420	38,029	17,391
Other	1,800	119	1,681

The following table provides the projected core deposit and other intangibles amortization expense for the remainder of 2013 and the next five years:

	Amount
Remainder of 2013	$4,853
Years ended December 31,	
2014	3,406
2015	2,416
2016	1,316
2017	1,215
2018	1,126

Table of Contents

6. Junior Subordinated Debentures:

Sterling has raised regulatory capital through the formation of trust subsidiaries and has assumed similar obligations through mergers with other financial institutions. The trusts are business trusts in which Sterling owns all of the common equity. The proceeds from the sale of the securities were used to purchase junior subordinated debentures issued by Sterling. Sterling’s obligations under the junior subordinated debentures and related documents, taken together, constitute a full and unconditional guarantee by Sterling of the trusts’ obligations. The junior subordinated debentures are treated as debt of Sterling. The junior subordinated debentures mature 30 years after issuance, and are redeemable, subject to certain conditions. As of March 31, 2013, all of Sterling's junior subordinated debentures were redeemable at par, at their ap