STERLING FINANCIAL CORP /WA/
Form 10-Q
August 07, 2013
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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 JUNE 30, 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	91-1572822
(State or other jurisdiction of incorporation or organization)	(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 þ 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 þ 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	þ
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 þ

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 July 31, 2013
Common Stock	62,314,862

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

	June 30, 2013	December 31, 2012
ASSETS:		
Cash and cash equivalents:		
Interest bearing	$221,192	$173,962
Noninterest bearing	87,870	125,916
Total cash and cash equivalents	309,062	299,878
Restricted cash	16,648	31,672
Investments and mortgage-backed securities ("MBS"):		
Available for sale	1,538,880	1,513,157
Held to maturity	185	206
Loans held for sale, at fair value	307,511	465,983
Loans receivable, net ($36,338 and $23,177 at fair value)	6,868,866	6,101,749
Accrued interest receivable	31,013	28,019
Other real estate owned, net ("OREO")	26,511	25,042
Properties and equipment, net	98,483	93,850
Bank-owned life insurance ("BOLI")	188,178	179,828
Goodwill	36,633	22,577
Other intangible assets, net	17,830	19,072
Mortgage servicing rights, net	52,430	32,420
Deferred tax asset, net	290,377	292,082
Other assets, net	156,966	131,375
Total assets	$9,939,573	$9,236,910
LIABILITIES:		
Deposits:		
Noninterest bearing	$1,702,022	$1,702,740
Interest bearing	4,926,437	4,733,377
Total deposits	6,628,459	6,436,117
Advances from Federal Home Loan Bank ("FHLB")	1,197,857	605,330
Securities sold under repurchase agreements	527,925	586,867
Junior subordinated debentures	245,297	245,294
Accrued interest payable	4,084	4,229
Accrued expenses and other liabilities	129,615	141,150
Total liabilities	8,733,237	8,018,987
SHAREHOLDERS' EQUITY:		
Preferred stock, 10,000,000 shares authorized; no shares outstanding	0	0
Common stock, 151,515,151 shares authorized; 62,297,712 and 62,207,529 shares outstanding, respectively	1,970,229	1,968,025
Accumulated other comprehensive income	30,751	60,712
Accumulated deficit	(794,644)	(810,814)
Total shareholders' equity	1,206,336	1,217,923
Total liabilities and shareholders' equity	$9,939,573	$9,236,910

See notes to consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Interest income:				
Loans	$84,436	$85,537	$165,623	$165,378
MBS	7,333	12,936	14,630	28,271
Investments and cash equivalents	2,248	2,517	4,521	5,306
Total interest income	94,017	100,990	184,774	198,955
Interest expense:				
Deposits	6,038	9,921	12,345	21,023
Short-term borrowings	288	1,825	734	4,031
Long-term borrowings	7,277	10,334	14,387	20,638
Total interest expense	13,603	22,080	27,466	45,692
Net interest income	80,414	78,910	157,308	153,263
Provision for credit losses	0	4,000	0	8,000
Net interest income after provision for credit losses	80,414	74,910	157,308	145,263
Noninterest income:				
Fees and service charges	15,618	14,131	29,748	26,871
Mortgage banking operations	23,180	24,181	36,974	42,725
BOLI	1,424	3,769	2,981	5,515
Gains on sales of securities	0	9,321	0	9,463
Other-than-temporary impairment credit losses on securities (1)	0	(6,819)	0	(6,819)
Charge on prepayment of debt	0	(2,664)	0	(2,664)
Gains on other loan sales	1,194	2,811	1,219	3,411
Other	587	11	8,647	(2,174)
Total noninterest income	42,003	44,741	79,569	76,328
Noninterest expense	81,678	87,607	163,607	176,256
Income before income taxes	40,739	32,044	73,270	45,335
Income tax (provision) benefit	(12,978)	288,842	(22,831)	288,842
Net income	$27,761	$320,886	$50,439	$334,177
Earnings per share - basic	$0.45	$5.17	$0.81	$5.38
Earnings per share - diluted	$0.44	$5.13	$0.80	$5.33
Dividends declared per share	$0.55	$0.00	$0.55	$0.00
Weighted average shares outstanding - basic	62,289,437	62,112,936	62,265,941	62,095,670
Weighted average shares outstanding - diluted	63,107,913	62,610,054	63,076,481	62,648,152

(1) The other-than-temporary impairment recognized in earnings during the second quarter of 2012 did not have a portion recognized in accumulated other comprehensive income. See Note 3.

See notes to consolidated financial statements.

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

	Three Months Ended June 30, 2013		2012	
Net income		$27,761		$320,886
Beginning balance, accumulated other comprehensive income	$56,076		$65,571	
Other comprehensive (loss) income:				
Change in unrealized gains on investments and MBS available for sale		(40,198)		7,714
Realized net gains reclassified from other comprehensive income		0		(2,502)
Less deferred income tax benefit (provision)		14,873		(3,681)
Net other comprehensive (loss) income		(25,325)		1,531
Ending balance, accumulated other comprehensive income	$30,751		$67,102	
Comprehensive income		$2,436		$322,417

	Six Months Ended June 30, 2013		2012	
Net income		$50,439		$334,177
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		(47,557)		12,312
Realized net gains reclassified from other comprehensive income		0		(2,644)
Less deferred income tax benefit (provision)		17,596		(3,681)
Net other comprehensive (loss) income		(29,961)		5,987
Ending balance, accumulated other comprehensive income	$30,751		$67,102	
Comprehensive income		$20,478		$340,164

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 and other-than-temporary impairment.

See notes to consolidated financial statements.

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

	Six Months Ended June 30, 2013	2012
Cash flows from operating activities:		
Net income	$50,439	$334,177
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	0	8,000
Net gain on sales of loans	(30,621)	(42,969)
Net gain on sales of investments and MBS	0	(9,463)
Net gain on mortgage servicing rights	(5,614)	(1,143)
Other-than-temporary impairment credit losses on securities	0	6,819
Stock based compensation	1,791	1,837
Loss (gain) on OREO	241	(1,605)
Release of DTA valuation allowance	0	(288,842)
Increase in cash surrender value of BOLI	(2,920)	(5,390)
Depreciation and amortization	21,740	22,192
Bargain purchase gain	(7,544)	0
Change in:		
Accrued interest receivable	(2,184)	5,050
Prepaid expenses and other assets	(9,060)	(32,479)
Accrued interest payable	(185)	(16,728)
Accrued expenses and other liabilities	(40,262)	7,276
Proceeds from sales of loans originated for sale	1,601,564	1,205,473
Loans originated for sale	(1,417,216)	(1,158,269)
Net cash provided by operating activities	160,169	33,936
Cash flows from investing activities:		
Change in restricted cash	15,024	(17,431)
Net change in loans	(428,774)	(243,657)
Proceeds from sales of loans	22,170	20,515
Purchase of investment securities	0	(2,534)
Proceeds from maturities of investment securities	1,176	17,505
Proceeds from sale of investment securities	0	179,235
Purchase of MBS	(280,490)	(72,032)
Principal payments received on MBS	200,823	314,414
Proceeds from sales of MBS	0	183,636
Office properties and equipment, net	(9,125)	(4,647)
Improvements and other changes to OREO	(776)	(1,250)
Proceeds from sales of OREO	18,318	51,515
Net change in cash and cash equivalents from acquisitions	(115,768)	121,098
Net cash (used in) provided by investing activities	$(577,422)	$546,367

See notes to consolidated financial statements.

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

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Cash flows from financing activities:		
Net change in deposits	$(94,126)	$(384,963)
Advances from FHLB	1,060,000	0
Repayment of advances from FHLB	(468,440)	(200,104)
Net change in short term repurchase agreements	(8,942)	561
Payments under structured repurchase agreements	(50,000)	(50,000)
Proceeds from stock issuance, net	413	236
Cash dividend paid	(12,468)	0
Net cash provided by (used in) financing activities	426,437	(634,270)
Net change in cash and cash equivalents	9,184	(53,967)
Cash and cash equivalents, beginning of period	299,878	470,599
Cash and cash equivalents, end of period	$309,062	$416,632
Supplemental disclosures:		
Cash paid during the period for:		
Interest	$27,611	$62,287
Income taxes, net	692	56
Noncash financing and investing activities:		
Foreclosed real estate acquired in settlement of loans	14,847	22,551
Common stock cash dividend accrued	21,801	0

See notes to consolidated financial statements.

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STERLING FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 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 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.

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

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("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.

In July 2013, the FASB issued ASU 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists." ASU 2013-11 provides guidance on the presentation of unrecognized tax benefits related to any disallowed portion of net operating loss carryforwards, similar tax losses, or tax credit carryforwards, if they exist. ASU 2013-11 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.

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2. Business Combinations:

Boston Private Bank and Trust Company. On May 10, 2013, Sterling paid $123.0 million in cash to acquire the Puget Sound operations of Boston Private Bank & Trust Company ("Boston Private"), a wholly owned subsidiary of Boston Private Financial Holdings, Inc. The Boston Private Puget Sound offices are located in Seattle, Bellevue and Redmond, Washington. The following table summarizes the amounts recorded at closing:

	May 10, 2013
	(in thousands)
Cash and cash equivalents	$340
Loans receivable, net	273,353
Goodwill	14,056
Core deposit intangible	1,674
Other assets	2,721
Total assets acquired	$292,144
Deposits	$168,246
Other liabilities	913
Total liabilities assumed	169,159
Net assets acquired	$122,985

The recorded goodwill represents the inherent value of the Boston Private transaction, which expands Sterling's presence in the Puget Sound market through the addition of two branch offices and the associated customer relationships. The additional branches are along the I-5 corridor, which has been identified by Sterling as its primary focus for future growth. The amount of goodwill deductible for income tax purposes is approximately equivalent to the recorded book value. The core deposit intangible has an amortization period of approximately ten years and will be amortized on an accelerated basis.

As of May 10, 2013, the unpaid principal balance and contractual interest ("contractual cash flows") on purchased loans was $280.7 million. Sterling estimated that $3.5 million of these cash flows would be uncollectable, resulting in a combined credit and interest rate discount of $5.1 million being recorded on these loans. As of the acquisition date, none of the loans purchased from Boston Private exhibited evidence of credit deterioration.

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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

Sterling 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 a limited market for Borrego's assets, as well as Borrego's regulatory and capital constraints. The bargain purchase gain is included in other noninterest income on the income statement for the six months ended June 30, 2013. The core deposit intangible has an amortization period of 11 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 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.

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First Independent Bank. On February 29, 2012, Sterling Bank completed its acquisition of the operations of First Independent Bank ("First Independent") of Vancouver, Washington, 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. During the six months ended June 30, 2013, the first of two scheduled contingent payments was made in the amount of $6.8 million. At June 30, 2013, the fair value estimate of the remaining contingent consideration was $9.9 million. See Note 13. 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 First Independent transaction expands Sterling's presence in the Vancouver and Portland markets, which are also within the I-5 corridor. 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	
	Three Months Ended	Six Months Ended	Three Months Ended	Six Months Ended
	June 30, 2012			
	(in thousands, except per share data)			
Net interest income	$7,859	$11,100	$78,910	$159,744
Noninterest income	1,678	2,181	44,741	77,333
Net income	3,901	6,008	320,886	338,391
Earnings per share - basic	0.06	0.10	5.17	5.45
Earnings per share - diluted	$0.06	$0.10	$5.13	$5.40

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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)			
June 30, 2013				
Available for sale				
MBS	$1,337,908	$18,264	$(12,991)	$1,343,181
Municipal bonds	187,468	9,139	(1,077)	195,530
Other	162	7	0	169
Total	$1,525,538	$27,410	$(14,068)	$1,538,880
Held to maturity				
Tax credits	$185	$0	$0	$185
Total	$185	$0	$0	$185
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 June 30, 2013 and 2012 are summarized as follows:

	Proceeds from Sales	Gross Realized Gains	Gross Realized Losses
	(in thousands)		
Six Months Ended:			
June 30, 2013	$0	$0	$0
June 30, 2012	362,871	9,537	(74)

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The following table summarizes Sterling's investments and MBS that had a market value below their amortized cost as of June 30, 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)					
June 30, 2013						
MBS	$505,378	$(12,991)	$0	$0	$505,378	$(12,991)
Municipal bonds	1,550	(11)	14,551	(1,066)	16,101	(1,077)
Other	0	0	0	0	0	0
Total	$506,928	$(13,002)	$14,551	$(1,066)	$521,479	$(14,068)
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 six months ended June 30, 2013, no securities were determined to be other-than-temporarily impaired, while during the comparative 2012 period, $6.8 million of OTTI was recognized on a single issuer trust preferred security. The security is no longer owned by Sterling.

The following table presents the amortized cost and fair value of available for sale and held to maturity securities as of June 30, 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	Fair Value	Amortized Cost	Fair Value
	(in thousands)			
Due within one year	$0	$0	$0	$0
Due after one year through five years	0	0	9,907	10,539
Due after five years through ten years	0	0	74,756	74,895
Due after ten years	185	185	1,440,875	1,453,446
Total	$185	$185	$1,525,538	$1,538,880

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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:

	June 30, 2013	December 31, 2012
	(in thousands)	
Residential real estate	$964,872	$806,722
Commercial real estate ("CRE"):		
Investor CRE	1,172,433	1,219,847
Multifamily	1,962,919	1,580,289
Construction	69,796	74,665
Total CRE	3,205,148	2,874,801
Commercial:		
Owner occupied CRE	1,411,576	1,276,591
Commercial & Industrial ("C&I")	636,727	540,499
Total commercial	2,048,303	1,817,090
Consumer	783,601	754,621
Gross loans receivable	7,001,924	6,253,234
Deferred loan costs (fees), net	8,891	2,860
Allowance for loan losses	(141,949)	(154,345)
Net loans receivable	$6,868,866	$6,101,749

As of June 30, 2013 and December 31, 2012, loans pledged as collateral for borrowings from the FHLB and the Federal Reserve were $4.82 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 updated quarterly for changes in the loans' cash flow expectations, and reflected in interest income over the life of the loans as accretable yield. As of June 30, 2013 and December 31, 2012, 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 $32.5 million and $19.9 million, respectively. The following table presents a roll-forward of accretable yield over the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands)			
Beginning balance	$3,061	$1,909	$1,332	$0
Additions	0	0	1,774	1,923
Accretion to interest income	(497)	(308)	(702)	(322)
Reclassifications	184	730	344	730
Ending balance	$2,748	$2,331	$2,748	$2,331

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As of June 30, 2013 and December 31, 2012, net loans receivable included unamortized discounts on acquired loans of $28.2 million and $21.3 million, respectively. The following table presents, as of June 30, 2013, the five-year projected loan discount accretion to be recognized as interest income:

	Amount (in thousands)
Remainder of 2013	$3,463
Years ended December 31,	
2014	4,589
2015	2,982
2016	1,856
2017	1,284
2018	924

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
June 30, 2013						
Loans receivable, gross:						
Individually evaluated for impairment	$0	$62,018	$43,336	$0	$0	$105,354
Collectively evaluated for impairment	964,872	3,143,130	2,004,967	783,601	0	6,896,570
Total loans receivable, gross	$964,872	$3,205,148	$2,048,303	$783,601	$0	$7,001,924
Allowance for loan losses:						
Individually evaluated for impairment	$0	$1,793	$2,739	$0	$0	$4,532
Collectively evaluated for impairment	18,989	39,794	36,785	27,744	14,105	137,417
Total allowance for loan losses	$18,989	$41,587	$39,524	$27,744	$14,105	$141,949
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

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Loans collectively evaluated for impairment include purchased credit impaired loans, which were $19.9 million as of June 30, 2013, and $11.2 million as of December 31, 2012.

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 second quarter activity						
Allowance for loan losses:						
Beginning balance, April 1	$19,968	$45,135	$39,596	$25,817	$19,157	$149,673
Provisions	(214)	(2,198)	1,819	3,045	(5,052)	(2,600)
Charge-offs	(1,107)	(2,636)	(2,512)	(1,503)	0	(7,758)
Recoveries	342	1,286	621	385	0	2,634
Ending balance, June 30	18,989	41,587	39,524	27,744	14,105	141,949
Reserve for unfunded credit commitments:						
Beginning balance, April 1	1,909	355	2,433	2,722	571	7,990
Provisions	2,318	152	119	525	(514)	2,600
Charge-offs	(1,085)	0	0	0	0	(1,085)
Recoveries	0	0	0	0	0	0
Ending balance, June 30	3,142	507	2,552	3,247	57	9,505
Total credit allowance	$22,131	$42,094	$42,076	$30,991	$14,162	$151,454
2012 second quarter activity						
Allowance for loan losses:						
Beginning balance, April 1	$12,242	$80,614	$34,483	$14,160	$19,774	$161,273
Provisions	(377)	(9,905)	6,222	4,052	2,008	2,000
Charge-offs	(157)	(9,481)	(3,606)	(1,643)	0	(14,887)
Recoveries	673	5,624	3,171	390	0	9,858
Ending balance, June 30	12,381	66,852	40,270	16,959	21,782	158,244
Reserve for unfunded credit commitments:						
Beginning balance, April 1	3,802	1,608	2,461	1,282	875	10,028
Provisions	2,595	(910)	889	228	(802)	2,000
Charge-offs	(4,076)	0	0	0	0	(4,076)
Recoveries	0	0	0	0	0	0
Ending balance, June 30	2,321	698	3,350	1,510	73	7,952
Total credit allowance	$14,702	$67,550	$43,620	$18,469	$21,855	$166,196

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	Residential Real Estate (in thousands)	Commercial Real Estate	Commercial	Consumer	Unallocated	Total
2013 year to date						
Allowance for loan losses:						
Beginning balance, January 1	$19,847	$48,094	$41,874	$25,602	$18,928	$154,345
Provisions	746	(3,289)	209	4,557	(4,823)	(2,600)
Charge-offs	(2,126)	(5,559)	(4,100)	(3,147)	0	(14,932)
Recoveries	522	2,341	1,541	732	0	5,136
Ending balance, June 30	18,989	41,587	39,524	27,744	14,105	141,949
Reserve for unfunded credit commitments:						
Beginning balance, January 1	2,230	405	2,806	2,118	443	8,002
Provisions	2,009	102	(254)	1,129	(386)	2,600
Charge-offs	(1,097)	0	0	0	0	(1,097)
Recoveries	0	0	0	0	0	0
Ending balance, June 30	3,142	507	2,552	3,247	57	9,505
Total credit allowance	$22,131	$42,094	$42,076	$30,991	$14,162	$151,454
2012 year to date						
Allowance for loan losses:						
Beginning balance, January 1	$15,197	$91,722	$38,046	$13,427	$19,066	$177,458
Provisions	(1,357)	(12,729)	10,680	6,690	2,716	6,000
Charge-offs	(2,344)	(20,999)	(13,139)	(4,095)	0	(40,577)
Recoveries	885	8,858	4,683	937	0	15,363
Ending balance, June 30	12,381	66,852	40,270	16,959	21,782	158,244
Reserve for unfunded credit commitments:						
Beginning balance, January 1	3,828	2,321	1,796	1,787	297	10,029
Provisions	2,570	(1,623)	1,554	(277)	(224)	2,000
Charge-offs	(4,077)	0	0	0	0	(4,077)
Recoveries	0	0	0	0	0	0
Ending balance, June 30	2,321	698	3,350	1,510	73	7,952
Total credit allowance	$14,702	$67,550	$43,620	$18,469	$21,855	$166,196

In establishing the allowance for loan losses, Sterling groups its loan portfolio into classes 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. This 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 either the actual one or three year loss rates, then the expected loss rate may be set at the greater of the actual one or three year loss rates. Sterling evaluates the results of this analysis, and based on qualitative factors, the highest of the three loss rates may be used to better reflect the inherent losses for those loan classes.

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 would determine the need to record a charge-off or establish a specific reserve.

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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.

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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)								
June 30, 2013									
Pass	$875,419	$652,127	$1,880,798	$13,785	$659,774	$420,985	$754,887	$5,257,775	75 %
Marginal	55,340	421,988	68,210	43,640	629,299	193,252	16,337	1,428,066	20 %
Special mention	8,764	66,836	9,077	2,979	73,522	16,661	4,712	182,551	3 %
Substandard	25,053	30,174	4,615	9,126	46,304	5,817	7,665	128,754	2 %
Doubtful/Loss	296	1,308	219	266	2,677	12	0	4,778	0 %
Total	$964,872	$1,172,433	$1,962,919	$69,796	$1,411,576	$636,727	$783,601	$7,001,924	100 %
Restructured	$23,290	$7,429	$1,225	$8,814	$20,266	$1,225	$95	$62,344	1 %
Nonaccrual	17,205	17,843	840	6,050	30,792	2,538	5,119	80,387	1 %
Nonperforming	40,495	25,272	2,065	14,864	51,058	3,763	5,214	142,731	2 %
Performing	924,377	1,147,161	1,960,854	54,932	1,360,518	632,964	778,387	6,859,193	98 %
Total	$964,872	$1,172,433	$1,962,919	$69,796	$1,411,576	$636,727	$783,601	$7,001,924	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 June 30, 2013, and $2.1 million as of December 31, 2012, are included in the nonaccrual loans.

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Aging by class for Sterling's loan portfolio as of June 30, 2013 and December 31, 2012 was as follows:

	Residential Real Estate	Commercial Real Estate Investor CRE	Multifamily	Construction	Commercial Owner Occupied CRE	Commercial & Industrial	Consumer	Total	% of Total
	(in thousands)								
June 30, 2013									
30 - 59 days past due	$1,829	$6,947	$651	$ 2,692	$4,828	$1,395	$4,162	$22,504	0 %
60 - 89 days past due	2,118	424	0	0	2,135	395	1,217	6,289	0 %
> 90 days past due	19,054	9,316	704	6,050	17,987	1,634	3,221	57,966	1 %
Total past due	23,001	16,687	1,355	8,742	24,950	3,424	8,600	86,759	1 %
Current	941,871	1,155,746	1,961,564	61,054	1,386,626	633,303	775,001	6,915,165	99 %
Total Loans	$964,872	$1,172,433	$1,962,919	$ 69,796	$1,411,576	$636,727	$783,601	$7,001,924	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 %

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Sterling considers its nonperforming loans to be impaired loans. The following table summarizes impaired loans by class as of June 30, 2013 and December 31, 2012:

	Unpaid Principal Balance	Charge-Offs	Book Balance Without Specific Reserve	Book Balance With Specific Reserve	Specific Reserve
	(in thousands)				
June 30, 2013					
Residential real estate	$45,620	$5,125	$40,199	$296	$296
CRE:					
Investor CRE	28,527	3,255	20,774	4,498	1,308
Multifamily	2,802	737	840	1,225	219
Construction	29,323	14,459	13,596	1,268	266
Total CRE	60,652	18,451	35,210	6,991	1,793
Commercial:					
Owner Occupied CRE	55,838	4,780	38,166	12,892	2,740
C&I	3,764	0	3,764	0	0
Total commercial	59,602	4,780	41,930	12,892	2,740
Consumer	5,530	316	5,214	0	0
Total	$171,404	$28,672	$122,553	$20,179	$4,829

	Unpaid Principal Balance	Charge-Offs	Book Balance Without Specific Reserve	Book Balance 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

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

	Three Months Ended June 30,			
	2013		2012	
	Average Book Balance	Interest Income Recognized	Average Book Balance	Interest Income Recognized
	(in thousands)			
Residential real estate	$41,662	$165	$46,485	$174
Investor CRE	34,760	109	60,793	421
Multifamily	3,445	4	16,839	255
Construction	16,035	470	58,289	21
Owner Occupied CRE	56,890	195	73,688	628
C&I	4,488	24	11,530	6
Consumer	5,653	0	4,897	0
Total	$162,933	$967	$272,521	$1,505

	Six Months Ended June 30,			
	2013		2012	
	Average Book Balance	Interest Income Recognized	Average Book Balance	Interest Income Recognized
	(in thousands)			
Residential real estate	$41,960	$317	$43,231	$418
Investor CRE	38,003	456	63,283	1,003
Multifamily	5,106	39	16,188	350
Construction	15,779	2,171	64,030	873
Owner Occupied CRE	52,953	589	73,188	1,406
C&I	3,999	58	11,122	35
Consumer	6,229	5	5,209	0
Total	$164,029	$3,635	$276,251	$4,085

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

	Three Months Ended June 30,					
	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	1	$ 184	$ 186	8	$ 1,193	$ 1,188
Investor CRE	1	263	262	0	0	0
Multifamily	0	0	0	1	767	763
Construction	0	0	0	1	3,252	3,261
Owner Occupied CRE	4	1,616	759	6	8,809	8,766
C&I	4	449	454	5	1,494	1,500
Consumer	0	0	0	2	296	299
Total (1)	10	$ 2,512	$ 1,661	23	$ 15,811	$ 15,777

	Six Months Ended June 30,					
	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	10	$ 2,318	$ 2,115	12	$ 2,234	$ 2,228
Investor CRE	4	1,745	1,442	1	1,302	1,302
Multifamily	0	0	0	2	2,379	2,374
Construction	0	0	0	2	5,944	5,953
Owner Occupied CRE	7	4,048	3,173	9	15,441	15,390
C&I	4	449	454	9	3,482	2,206
Consumer	0	0	0	2	296	299
Total (1)	25	$ 8,560	$ 7,184	37	$ 31,078	$ 29,752

(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 June 30, 2013, Sterling had specific reserves of $691,000 on TDRs which were restructured during the previous six months. There were nine loans totaling $6.7 million that were removed from TDR status during the three and six months ended June 30, 2013, as they had met the conditions for removal by achieving twelve consecutive months of performance at market equivalent rates of interest.

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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
Six Months Ended June 30, 2013	(in thousands)				
Residential Real Estate	$0	$1,581	$203	$331	