

STERLING FINANCIAL CORP /WA/

Form DEF 14A

March 24, 2006

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

SCHEDULE 14A

Proxy Statement Pursuant To Section 14(a) of
 The Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant
 Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials

Sterling Financial Corporation

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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- Fee not required.
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**111 North Wall Street
Spokane, Washington 99201**

March 24, 2006

Dear Fellow Shareholder:

It is my pleasure to invite you to attend the Annual Meeting of Shareholders of Sterling Financial Corporation. The Annual Meeting will be held at the Cheney Cowles Center Building, 2316 West First Avenue in Spokane, Washington, on Tuesday, April 25, 2006, at 10:00 a.m., local time.

As set forth in the attached Notice of Annual Meeting of Shareholders and Proxy Statement, you will have an opportunity to vote on the election of Directors, the ratification of the independent registered public accounting firm, and any other matters properly brought before the meeting. We will also report on Sterling's operations and respond to questions of general interest to Shareholders.

It is very important that you be represented at the Annual Meeting regardless of the number of shares you own or whether you are able to attend the Annual Meeting in person. We urge you to complete, sign and date your proxy card today and promptly return it in the postage-paid envelope provided, even if you plan to attend the Annual Meeting. This will not prevent you from voting in person, but will ensure that your vote is counted if you are unable to attend.

Your continued support is sincerely appreciated.

Sincerely,

/s/ Harold B. Gilkey

Harold B. Gilkey
Chairman of the Board
and Chief Executive Officer

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**STERLING FINANCIAL CORPORATION
111 North Wall Street
Spokane, Washington 99201
NOTICE OF ANNUAL MEETING
OF SHAREHOLDERS**

The Annual Meeting of Shareholders of Sterling Financial Corporation (Sterling) will be held in the Eric A. Johnston Auditorium of the Cheney Cowles Center Building, 2316 West First Avenue, Spokane, Washington, on Tuesday, April 25, 2006, at 10:00 a.m., local time, for the following purposes:

1. To elect three Directors of Sterling for terms ending in the year 2009 and one Director of Sterling for a term ending in the year 2007;
2. To ratify the appointment of BDO Seidman, LLP as the independent registered public accounting firm for Sterling for the fiscal year ending December 31, 2006; and
3. To transact such other business as may properly come before the Annual Meeting or any adjournment or postponement thereof.

These matters are more fully described in the attached Proxy Statement. Only Shareholders of record at the close of business on March 1, 2006, the record date, will be entitled to vote at the Annual Meeting or any adjournment or postponement thereof.

YOUR VOTE IS IMPORTANT REGARDLESS OF THE NUMBER OF SHARES YOU OWN, OR WHETHER OR NOT YOU PLAN TO ATTEND THE ANNUAL MEETING. EVEN IF YOU EXPECT TO ATTEND THE ANNUAL MEETING, WE URGE YOU TO COMPLETE, SIGN AND DATE THE ENCLOSED PROXY CARD AND RETURN IT PROMPTLY IN THE ENCLOSED POSTAGE-PAID ENVELOPE.

By Order of the Board of Directors,

/s/ Andrew J. Schultheis

Andrew J. Schultheis
Secretary

Spokane, Washington
March 24, 2006

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**STERLING FINANCIAL CORPORATION
111 North Wall Street
Spokane, Washington 99201
PROXY STATEMENT
Annual Meeting of Shareholders
To be Held April 25, 2006**

Date, time, place and purpose of Sterling's Annual Meeting

The 2006 annual meeting of Shareholders of Sterling Financial Corporation (Sterling), including any postponements or adjournments thereof (the Annual Meeting), will be held at 10:00 a.m., local time, on Tuesday, April 25, 2006, in the Eric A. Johnston Auditorium of the Cheney Cowles Center Building, 2316 West First Avenue, Spokane, Washington. At the meeting, Sterling's Shareholders as of March 1, 2006 (the Record Date) will be asked to elect each of the nominees for the Board of Directors and to ratify the appointment of BDO Seidman, LLP (BDO) as the independent registered public accounting firm for Sterling for 2006. This Proxy Statement is first being sent to holders of Sterling common stock on or about March 24, 2006, and is accompanied by a proxy that is being solicited by the Sterling Board of Directors for use at the Annual Meeting.

Record date; outstanding shares; shares entitled to vote

Only holders of record of Sterling common stock at the close of business on the record date are entitled to notice of and to vote at the Annual Meeting. Each holder of Sterling common stock is entitled to one vote for each share of Sterling common stock owned as of the record date. As of the record date, there were 34,986,439 shares of Sterling common stock outstanding.

Quorum; vote required

Under Washington law, any Shareholder action at a meeting requires that a quorum exist with respect to that action. A quorum for the actions to be taken at the Annual Meeting will consist of a majority of the outstanding shares of Sterling common stock entitled to vote, present in person or by proxy at the Annual Meeting. Shareholders of record, including brokers holding customers' shares of record, who are present at the Annual Meeting in person or by proxy and who abstain from voting are considered present and entitled to vote, and will count toward a quorum.

If a quorum exists at the Annual Meeting, those nominees for election to the Board of Directors who receive the greatest number of affirmative votes cast for Directors will be elected as Directors. If a quorum exists, the ratification of the appointment of BDO as the independent

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registered public accounting firm for Sterling for the fiscal year ending December 31, 2006, and any interim periods, and all other matters that properly come before the Annual Meeting or any adjournment or postponement thereof, will be approved if the number of votes cast in favor of the proposed action exceeds the number of votes cast against it. Abstentions and broker non-votes will have no impact on the election of Directors or other proposals. Proxies and ballots will be received and tabulated by American Stock Transfer & Trust Company, Sterling's transfer agent and inspector of elections for the Annual Meeting.

Voting of proxies

The Board of Directors requests that you complete, date and sign the proxy card accompanying this Proxy Statement and promptly return the card in the enclosed postage-paid envelope. Unless contrary instructions are specified, all properly signed proxies received by Sterling and not revoked before the vote at the Annual Meeting will be voted: 1) FOR the election of the four Directors nominated by the Board of Directors; 2) FOR the ratification of the appointment of BDO as the independent registered public accounting firm for Sterling for 2006; and 3) in accordance with the best judgment of the proxy agents on any other matters properly brought before the Annual Meeting. If the Annual Meeting is postponed or adjourned, your proxy will still be effective and may be voted at the rescheduled meeting. You will still be able to change or revoke your proxy until it is voted.

If you own your shares in street name, that is, through a brokerage account or in another nominee form, you must provide instructions to the broker or nominee as to how your shares should be voted. Otherwise, your shares may not be voted and will be recorded as broker non-votes. Your broker or nominee will usually provide you with the appropriate instruction forms at the time you receive this Proxy Statement. If you own your shares in this manner, you cannot vote in person at the Annual Meeting unless you receive a proxy to do so from the broker or the nominee and you bring the proxy to the Annual Meeting.

If you are a participant in Sterling's 401(k) Employee Savings and Investment Plan and Trust, your completed proxy will serve as voting instructions to the plan trustee. However, your voting instructions must be received at least five days prior to the Annual Meeting to count. In accordance with the terms of the plan, if you fail to instruct the plan trustee how to vote your plan shares, the trustee will vote your plan shares in accordance with the recommendations of the 401(k) Advisory Committee.

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How to revoke your proxy

You may revoke your proxy at any time by taking any of the following actions before your proxy is voted at the Annual Meeting:

Deliver to Sterling a written notice bearing a date later than the date of the proxy card, stating that you revoke the proxy;

Sign and deliver to Sterling a proxy card relating to the same shares and bearing a later date; or

Attend the meeting and vote in person, although attendance at the meeting will not, by itself, revoke a proxy.

Also, please note that if you have voted through your broker, bank or other nominee and you wish to change your vote, you must follow the instructions received from such entity to change your vote.

Voting electronically via Internet or telephone

A large number of banks and brokerage firms provide Shareholders whose shares are registered in the name of such firms the opportunity to vote via the Internet or by telephone. The voting form sent to a beneficial owner will provide instructions if such options are available.

Expenses of proxy solicitation

The expense of preparing, printing and mailing this Proxy Statement and the proxies solicited hereby will be borne by Sterling. Proxies will be solicited by Sterling by mail and may also be solicited on behalf of Sterling by directors, officers and other employees of Sterling, without additional remuneration, in person or by telephone or facsimile transmission. Sterling will also request brokerage firms, banks, nominees, custodians and fiduciaries to forward proxy materials to the beneficial owners of shares of Sterling common stock as of the record date and will reimburse such entities for the cost of forwarding the proxy materials in accordance with customary practice.

Recommendation of the Board of Directors

The Board of Directors of Sterling believes the proposals described herein are in the best interests of Sterling and its Shareholders and, accordingly, recommends that the Shareholders vote **FOR** the proposals identified in the Notice.

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PROPOSAL 1: ELECTION OF DIRECTORS

The Board of Directors currently consists of nine Directors who are divided into three classes. The members of each class serve three-year terms, and one class is elected annually. The Board of Directors has nominated current Directors William Ike L. Eisenhart, Donald J. Lukes and William W. Zuppe for election at this year's Annual Meeting as Directors to serve terms of three years ending at the annual meeting of Shareholders of Sterling in the year 2009, or when their respective successors have been duly elected and qualified. In addition, the Board of Directors has nominated current Director Rodney W. Barnett to serve a term ending at the annual meeting of Shareholders in the year 2007, or when his respective successor has been duly elected and qualified.

Director Lukes was appointed to the Board in January 2006 to fill the vacancy created by the retirement of Director Ned M. Barnes from the Board and, pursuant to Washington law, his term expires at the Annual Meeting. He was recommended to the Board by the Chief Executive Officer.

Each nominee for election as a Director at the Annual Meeting has consented to serve if elected. Sterling has no reason to believe that any of the nominees will be unable to serve. Should any nominee become unable to serve as a Director for any reason, the Board of Directors shall designate a substitute nominee. Unless instructions to the contrary are specified on the proxy card, proxies will be voted in favor of the persons who have been nominated by the Board of Directors.

**The Board of Directors recommends that Shareholders
vote FOR the election of each of the nominees.**

BOARD OF DIRECTORS OF STERLING FINANCIAL CORPORATION

HAROLD B. GILKEY

Mr. Gilkey, 66, has served as Chairman of the Board and Chief Executive Officer (CEO) of Sterling since its inception in 1992, and served as Chairman of the Board and CEO of Sterling's wholly owned subsidiary, Sterling Savings Bank (Sterling Savings) from its inception in 1981 until October 2003, and continues to serve as a director of Sterling Savings. Mr. Gilkey co-founded Sterling Savings in 1981. Additionally, he is Chairman of the Board of INTERVEST-Mortgage Investment Company (INTERVEST), Action Mortgage Company (Action Mortgage) and Harbor Financial Services, Inc. (Harbor Financial), each of which are wholly owned subsidiaries of Sterling Savings. Mr. Gilkey brought to Sterling Savings over 20 years of commercial and mortgage banking experience. He served as President of Bancshares Mortgage Company of Spokane, Washington, and Senior Vice President of Old National Bank of Spokane, Washington. Prior to that, Mr. Gilkey was employed by Bank of America for 12 years. Mr. Gilkey serves on the Federal Home Loan Bank of Seattle Board of Directors. Mr. Gilkey is a past Director of the Washington Savings League and a member of the Savings Association Insurance Fund Industry Advisory Committee, an advisory committee of the Federal Deposit Insurance Corporation. Mr. Gilkey received a Bachelor's degree in Business Administration

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from the University of Montana in 1962 and a Master of Business Administration degree from the University of Southern California in 1970. His term will expire in 2008.

WILLIAM W. ZUPPE

Mr. Zuppe, 64, has served as Director, President and Chief Operating Officer of Sterling since its inception and served as Director, President and Chief Operating Officer of Sterling Savings from 1981 until October 2003, when he was promoted to lead Sterling Savings as Chairman of the Board and Chief Executive Officer. Mr. Zuppe co-founded Sterling Savings in 1981. Mr. Zuppe is also Vice President and serves as a Director of INTERVEST, Action Mortgage and Harbor Financial. Mr. Zuppe brought to Sterling Savings 18 years of mortgage lending experience as Vice President of Bancshares Mortgage Company and Manager of Loan Administration of Sherwood & Roberts, Inc. of Walla Walla, Washington, a mortgage banking company. Mr. Zuppe is past Chairman of the Board for America's Community Bankers, a national trade association. He is past Chairman of the Washington Savings League Board of Directors and past member of the Federal Reserve Board Thrift Institutions Advisory Council. If reelected, his term will expire in 2009.

RODNEY W. BARNETT

Mr. Barnett, 62, has served as a Director of Sterling since its inception and as a Director of Sterling Savings since its inception. He is President and General Manager of Carr Sales Company, an electrical supply firm in Spokane, Washington. Mr. Barnett is also a past Director of the National Association of Electrical Distributors. Mr. Barnett received a Bachelor's Degree from Gonzaga University in 1966 and a Juris Doctor degree from Gonzaga University in 1970. If reelected, his term will expire in 2007.

DONALD N. BAUHOFFER

Mr. Bauhofer, 54, has served as a Director of Sterling since his appointment in January 2004. He is Founder and President of the Pennbrook Company, a real estate development firm in Bend, Oregon, established in 1985. In addition, he is Founder and CEO of Pennbrook Homes, Inc., and Praxis Medical Group; co-owner of Arrowood Development, LLC; and co-owner and Director of Pacific Education Corporation. Mr. Bauhofer served on the Board of Directors of Klamath First Bancorp, Inc. (Klamath), from November 2002 until December 2003. Mr. Bauhofer was then appointed to Sterling's Board of Directors after Klamath was merged into Sterling in January 2004. Mr. Bauhofer received a Bachelor's degree and a Master of Business Administration degree from Stanford University and a Juris Doctor degree from the University of California at Davis. His term will expire in 2008.

WILLIAM IKE L. EISENHART

Mr. Eisenhart, 53, has served as a Director of Sterling since his appointment in January 2004. He serves as an independent financial advisor to privately held and publicly traded companies on investment banking matters. Previously, Mr. Eisenhart was a Managing Director at Dain Bosworth, Inc., in Seattle, Washington, a Partner in Corporate Finance for Cable Howse & Ragen in Seattle, Washington, and Vice President of Corporate Finance at Goldman, Sachs & Company in New York City. Currently, he serves as a member of the Finance Committee of the YMCA of Greater Seattle, as a member of the Board of Directors of Jumbo Foods, Inc., a

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privately held business serving convenience stores in western states, and is Co-Chair of Harvard College Schools and the Scholarship Committee of Western Washington. He has been a board member of Emerald Hills Coffee, Inc., a privately held coffee distributor, since 2002. Mr. Eisenhart received a Bachelor's degree from Harvard College and a Master of Business Administration degree from the University of Chicago. If reelected, his term will expire in 2009.

JAMES P. FUGATE

Dr. Fugate, 72, has served as a Director of Sterling since 1989. He is the retired Superintendent of Auburn School District No. 408. Dr. Fugate is a former Director of Central Evergreen Savings & Loan Association. He is on the Board of Governors of the Auburn Regional Medical Center and serves as the Chairman of the Board. Dr. Fugate received a Bachelor's degree from Central Washington State University. He received his Ph.D. from the University of Idaho in 1970. His term will expire in 2007.

ROBERT D. LARRABEE

Mr. Larrabee, 70, has served as a Director of Sterling since its inception and as a Director of Sterling Savings since 1983. Mr. Larrabee is the owner of Merchant Funeral Home in Clarkston, Washington. He is also a former Director of Laurentian Capital Corporation, a former Director of Lewis and Clark Savings & Loan Association and a past President of the Board of Regents of the University of Washington. Mr. Larrabee received a degree in Mortuary Science from The California College of Mortuary Science in 1958. His term will expire in 2007.

DONALD J. LUKES

Mr. Lukes, 57, has served as a Director of Sterling since January 2006. He retired in 2005 as a principal with the law firm of Witherspoon, Kelley, Davenport & Toole, P.S. Mr. Lukes joined Witherspoon Kelley in 1987 after having served as General Counsel and Senior Vice President of Citicorp's mortgage banking business. He has served as a Director and President of the Board of the Friends of Seven (Public Television); a Commissioner of the Chase Youth Commission; a Director of Goodwill Industries of the Inland Northwest; President of the Hamblen School Parent-Teacher Group and General Counsel to the Friends of the Centennial Trail. Mr. Lukes received a Bachelor's degree from the University of Montana and his Juris Doctor degree from St. John's University School of Law in June 1978. If elected, his term will expire in 2009.

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PROPOSAL 2: RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee of the Board of Directors has appointed BDO Seidman, LLP to serve as the independent registered public accounting firm for Sterling and its subsidiaries for the year ending December 31, 2006, and any interim periods. Shareholders are being asked to ratify such appointment. BDO has advised Sterling that it will have in attendance at the Annual Meeting one or more representatives who will be available to respond to appropriate questions presented at the Annual Meeting. Such representatives will have an opportunity to make a statement at the Annual Meeting if they desire to do so. If the appointment of BDO is not ratified by the required number of votes, the Board will review its future selection of independent registered public accounting firms.

The Board of Directors unanimously recommends that Shareholders vote FOR the ratification of the appointment of BDO as the independent registered public accounting firm for Sterling for 2006.
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM'S FEES

Audit Fees: The aggregate fees and expenses billed by BDO for professional services rendered for the audit of Sterling's annual financial statements, the reviews of the financial statements included in Sterling's periodic reports filed with the Securities and Exchange Commission (the SEC) on Forms 10-Q, SEC registration statement services, and the audits of the financial statements of Sterling's subsidiaries were \$604,400 and \$628,500 for the years ended December 31, 2004 and 2005, respectively. Fees for 2004 and 2005 include the integrated audit of Sterling's consolidated financial statements and management's assessment of internal controls over financial reporting as required by the Public Company Accounting Oversight Board and the SEC.

Audit Related Fees: The aggregate fees and expenses billed by BDO for audit related services rendered during 2004 and 2005 were \$29,250 and \$18,000, respectively. Types of services in this category were primarily audits of the employee benefit plans and consultation on accounting standards.

Tax Fees: The aggregate fees billed by BDO for tax services rendered during 2004 and 2005 were \$91,745 and \$55,490, respectively. Types of tax services provided by BDO primarily consisted of advice related to preparing Sterling's corporate tax returns and tax consulting projects.

All Other Fees: There were no other services provided by BDO during 2004 and 2005.

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PRE-APPROVAL OF AUDIT AND NON-AUDIT SERVICES

It is the responsibility of Sterling's Audit Committee to pre-approve all audit and non-audit services provided by BDO. The Audit Committee has adopted a policy authorizing certain permissible audit and non-audit services to be performed by BDO with subsequent reporting and oversight required by the Audit Committee. Permissible services, not pre-approved pursuant to this policy, require specific review and approval prior to the engagement by the Audit Committee, or a designated member. Specific pre-approval of such permissible services with estimated fees of \$2,500 or less may be waived via the *de minimis* exception rule. Procedures are in place to ensure the Audit Committee chairman is notified in the event the *de minimis* rule is used. All services rendered by and fees paid to BDO are reported to and monitored quarterly by the Audit Committee. The Audit Committee considers whether the provision of related audit services are compatible with maintaining the independent registered public accounting firm's independence. To assist the Audit Committee in its oversight responsibilities, the pre-approval policy identifies the three basic principles of independence with respect to services provided by the independent registered public accounting firm, as well as the non-audit services the independent registered public accounting firm is prohibited from providing. One hundred percent of all services provided by BDO in each of the last two fiscal years were pre-approved by the Audit Committee.

CORPORATE GOVERNANCE

Sterling has proactively taken steps to establish a corporate governance framework that affirms our high standards of business conduct, emphasizes the importance of integrity and honesty in the conduct of our business, and ensures the integrity of the controls and procedures implemented by our Directors, officers and employees, including our internal control over financial reporting. Actions we have taken to establish this corporate governance framework include: maintaining a Board composed of a majority of independent directors; adoption of charters for our Directors committees; adoption of a Code of Ethics for all of our Directors, officers and employees; and provision of a procedure for shareholders and employees to communicate with the Board. We believe that the ethical foundations outlined in our corporate governance framework are critical to our ongoing success and the maximization of shareholder value.

Board Composition

Our Board of Directors is responsible for the supervision of the overall affairs of Sterling. In fiscal 2005, the Board was initially comprised of Harold B. Gilkey, William W. Zuppe, Ned M. Barnes, Rodney W. Barnett, Donald N. Bauhofer, Thomas H. Boone, William Ike Eisenhart, James P. Fugate, and Robert D. Larrabee. In January 2006, Mr. Lukes was appointed to fill the vacancy created by the retirement of Mr. Barnes. In February 2006, Mr. Boone retired from the Sterling Board. Sterling is in the process of identifying candidates for the vacancy created by Mr. Boone's retirement.

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To assist in carrying out its duties, the Board has delegated authority to the Audit Committee, the Personnel Committee, and the Nominating Committee. For more information relating to the duties and composition of these committees, please see the sections below entitled Committees of the Board of Directors.

Following our 2006 Annual Meeting of Shareholders, the Board will consist of eight directors, with one vacancy as a result of Mr. Boone's retirement. In the interim period between Annual Meetings of Shareholders, the Board has the authority under Sterling's Bylaws to fill vacancies and may increase or decrease the size of the Board by amending the Bylaws. The directors are classified into three classes with staggered terms of three years.

Affirmative Determinations Regarding Director Independence

The Board of Directors has determined that each of the following Directors is an independent director as such term is defined by the rules of the National Association of Securities Dealers (NASD) and the Securities Exchange Commission (SEC):

Rodney W. Barnett
Donald N. Bauhofer
William Ike L. Eisenhart
James P. Fugate
Robert D. Larrabee

The Board of Directors has also determined that each member of the three committees of the Board meets the independence requirements applicable to those committees prescribed by the rules of the NASD and the SEC. These rules generally provide that an independent director is a person other than an officer or employee of Sterling or its subsidiaries or any other individual having a relationship that, in the opinion of the Board, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The NASDAQ Rules also provide specific criteria that, if met, disqualify a director from being independent.

Code of Ethics

The Board of Directors has adopted a Code of Ethics that applies to all Sterling employees and Directors, including Sterling's senior financial officers. The Code of Ethics is publicly available on Sterling's website at www.sterlingsavingsbank.com.

Communication with the Board of Directors

Shareholders may send communications to the Board of Directors of Sterling by addressing such correspondence to:

Harold B. Gilkey
Chairman of the Board
Sterling Financial Corporation

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111 North Wall Street
Spokane, WA 99201

As Chairman of the Board, Mr. Gilkey monitors Shareholder communications, forwards correspondence to the appropriate committee(s) or Director(s), and facilitates an appropriate response.

Compensation and Attendance of Directors

Directors of Sterling who are not employees of Sterling are paid an annual fee of \$10,000 plus a fee, which is currently \$2,000, for every meeting attended. Directors serving on committees of the Board also receive a fee of \$500 for every committee meeting attended unless they serve as the chair of such committee, in which case they receive a fee of \$1,000 for every committee meeting attended. Directors receive reimbursement for travel and other expenses incurred in connection with Board business.

Nonemployee Directors of Sterling also receive annual grants of non-qualified stock options. Such options have an exercise price equal to the fair market value of the Sterling common stock on the date of grant and generally expire ten years from the date of grant. In the event that a nonemployee Director is removed from office for cause, all options granted to such nonemployee Director pursuant to the automatic grants of non-qualified stock options described above will expire immediately upon such removal.

The Board of Directors of Sterling held 12 meetings during 2005 and acted by unanimous written consent one time. Each Director attended at least 75% of such meetings and those of the Board committees on which the Director served during the year. It is Sterling's policy that members of the Board of Directors should attend all annual meetings of Shareholders except for absences due to causes beyond the reasonable control of the Directors. At the 2005 annual meeting of Shareholders of Sterling Financial Corporation, all but one of the Directors were in attendance.

Committees of the Board of Directors

The Board of Directors of Sterling has established Audit, Personnel and Nominating Committees.

Audit Committee. The primary responsibilities of the Audit Committee are to oversee the integrity of Sterling's financial reporting process, including its financial statements and systems of internal controls, as well as its compliance with legal and regulatory requirements. The Audit Committee reviews the independent registered public accounting firm's qualifications, independence and performance, and oversees and monitors the performance of Sterling's internal audit function. The Audit Committee is responsible for the retention, supervision and termination of the independent registered public accounting firm and for resolving any disagreements between management and the independent registered public accounting firm. The independent registered public accounting firm reports directly to the Audit Committee. The Audit

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Committee is also responsible for reviewing the adequacy of the authority, responsibilities and functions of Sterling's internal audit department. The Audit Committee is not responsible for conducting reviews of auditing or accounting procedures. Management has primary responsibility for Sterling's financial reporting process and for preparing Sterling's financial statements. Sterling's independent registered public accounting firm is responsible for performing an independent audit of the consolidated financial statements in accordance with generally accepted auditing standards. The Audit Committee serves a board-level oversight role in which it provides advice, counsel and direction to management and the independent registered public accounting firm on the basis of the information it receives, discussions with the independent registered public accounting firm, and the experience of the Audit Committee's members in business, financial and accounting matters.

The Audit Committee held six meetings during 2005 and currently consists of Messrs. Eisenhart (Chairman), Barnett, Bauhofer and Fugate, each of whom has been determined by the Board to be independent and financially literate as required by the rules of the NASD and the SEC. Members of the Audit Committee have reviewed and discussed with management and the independent registered public accounting firm the periodic reports of Sterling prior to filing such reports with the SEC. No member of the Audit Committee has participated in the preparation of the financial statements of Sterling or its subsidiaries at any time during the past three years. The Board has determined that Mr. Barnett is an audit committee financial expert as defined by the SEC. The Audit Committee operates under a written charter reviewed and approved annually by Sterling's Board of Directors. Sterling's Audit Committee Charter is publicly available on Sterling's website at www.sterlingsavingsbank.com.

Personnel Committee. The Personnel Committee reviews and makes recommendations to the Board of Directors with respect to personnel policies that include, but are not limited to, officer and employee salaries and benefits. The Personnel Committee held two meetings during 2005 and currently consists of Messrs. Larrabee (Chairman), Fugate and Bauhofer, each of whom has been determined by the Board to be independent as that term is defined by the rules of the NASD and the SEC.

Nominating Committee. The Nominating Committee recommends to the Board of Directors a slate of nominees for election by the Shareholders at each annual meeting of Sterling. At the request of the Board, the Nominating Committee recommends, for approval by the Board, nominees to fill vacancies or new positions on the Board as they may occur or be created from time to time, all in accordance with Sterling's Bylaws. The Nominating Committee identifies potential nominees from various sources, including recommendations from Directors and officers of Sterling. The Nominating Committee will consider nominees recommended by Shareholders upon submission in writing to the Chairman of the Board of Directors the names of such nominees, together with their qualifications for service as Directors of Sterling. Individuals recommended by Shareholders are evaluated in the same manner as other potential nominees. The Nominating Committee reviews and discusses recommendations received for Director candidates and evaluates the qualifications of such candidates before selecting a slate of nominees to be recommended to the Board. Qualifications that the Nominating Committee will consider in evaluating Director candidates include contacts within Sterling's market area, skills,

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experience, time availability and such other criteria as the Nominating Committee shall determine to be relevant. The Nominating Committee held one meeting in 2005, and currently consists of Messrs. Fugate (Chairman), Larrabee and Bauhofer, each of whom has been determined by the Board to be independent as that term is defined by the rules of the NASD and the SEC. The Nominating Committee operates under a written charter approved by Sterling's Board of Directors. Sterling's Nominating Committee Charter is publicly available on Sterling's website at www.sterlingsavingsbank.com.

EXECUTIVE OFFICERS

In addition to Messrs. Gilkey and Zuppe, the Executive Officers of Sterling and its subsidiaries are Heidi B. Stanley, David P. Bobbitt, David A. Brukardt, Daniel G. Byrne, Thomas W. Colosimo, Ezra A. Eckhardt, John M. Harlow, James L. Kirschbaum, Nancy R. McDaniel, Stephen L. Page and Jeffery D. Schlenker. Each Executive Officer has held his or her present position for the past five years except as otherwise stated.

HEIDI B. STANLEY

Ms. Stanley, 49, has served as Vice Chair and Chief Operating Officer of Sterling Savings since October 2003. She joined Sterling in 1985. Prior to joining Sterling, Ms. Stanley was employed by IBM in San Francisco, California, and Tucson, Arizona. In 2004, she was named one of the 25 Women to Watch in Banking by U.S. Banker. She is currently on the Board of Directors of Avista Corporation and is Chair-Elect of the Spokane Chamber of Commerce. She is a past Chairman of the Board of the Association of Washington Business (AWB), past Chair of the Spokane area YMCA and Vice Chair of TVW (Washington Public Affairs Network). She is Vice-Chairman of America's Community Bankers (ACB) Membership Committee and member of the Government Affairs Steering Committee. She serves on the Board of Governors of the WSU Foundation. Ms. Stanley received a Bachelor's degree in Business Administration from Washington State University in 1979.

DAVID P. BOBBITT

Mr. Bobbitt, 58, is President and Chief Production Officer of Sterling Savings. Prior to joining Sterling Savings in early 1996, Mr. Bobbitt was Executive Vice President at West One Bank of Idaho. He is currently on the Board of Directors of Pacific Coast Banking School, an advisory board member of the College of Business and Economics at the University of Idaho, a board member of the North Idaho Fair and a board member of Habitat for Humanity of Spokane. He is also a board member of the Oregon Bankers Association and Vice Chair of the Commercial Banking Committee of America's Community Bankers, a national trade association. Mr. Bobbitt attended North Idaho College, and is a graduate of Harvard University's Advanced Management Program and the Pacific Coast Banking School.

DAVID A. BRUKARDT

Mr. Brukardt, 50, serves as Executive Vice President, Corporate Administrative Manager of Sterling Savings. He joined Sterling Savings in June 2004. Previously, Mr. Brukardt was employed by Avista Corporation as Vice President and Treasurer. He serves on the Executive

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Committee of the Board of the Association of Washington Business, is on the Executive Committee of the Board of Trustees of the Northwest Museum of Arts and Culture and is Chairman of the Spokane International Airport Board. Mr. Brukaradt received a Bachelor's degree from Marquette University.

DANIEL G. BYRNE

Mr. Byrne, 51, serves as Executive Vice President-Finance, Chief Financial Officer and Assistant Secretary of Sterling. He has served in these capacities with Sterling and Sterling Savings, which he joined in 1983. Mr. Byrne is also the Assistant Secretary and Treasurer of INTERVEST and Action Mortgage, and the Secretary and Treasurer of Harbor Financial. Before joining Sterling, Mr. Byrne was employed by the accounting firm of Coopers & Lybrand in Spokane, Washington. He is a past Lieutenant Governor of Kiwanis International. Mr. Byrne is a past member of the Board of Trustees, its Executive Committee and its Finance Committee for Gonzaga Preparatory School. He is a member of the Board of Directors of Spokane Community Mental Health and past Chairman of the Parish Council of St. Thomas More Church. He is also a board member and Audit Committee Chairman for Ambassadors Group, Inc., a publicly traded corporation. He serves as a member of the American Institute of Certified Public Accountants, the Washington Society of Certified Public Accountants, the Financial Managers Society and the American Community Bankers Association and its Accounting Committee. Mr. Byrne is a certified public accountant, and received a Bachelor's degree in Accounting from Gonzaga University in 1977.

THOMAS W. COLOSIMO

Mr. Colosimo, 54, serves as Senior Vice President, Chief Financial Officer of Sterling Savings Bank. He joined Sterling Savings in 2004. Prior to his work at Sterling from February 1998 through December 2003, Mr. Colosimo was employed by Regence BlueShield of Idaho and Regence BlueCross BlueShield of Utah as Vice President, Financial Services and Chief Financial Officer. He is an instructor for, and has served on the Board of Directors of Junior Achievement, of the Inland Northwest. He has also served on United Way allocation committees. Mr. Colosimo is a certified public accountant, and received a Bachelor's degree in Economics from the University of California, Davis in 1973 and a Master of Business Administration, Taxation degree from California State University, Hayword in 1978.

EZRA A. ECKHARDT

Mr. Eckhardt, 35, serves as Executive Vice President, Corporate Technical Services Manager of Sterling Savings. He joined Sterling in August 2004. Prior to joining Sterling, from November 2003 to August 2004, Mr. Eckhardt served as a Director of Process Improvement at Microsoft Corporation, and from October 1999 to November 2003 he served as Operations Leader at Honeywell Electronic Materials. Mr. Eckhardt is an Adjunct Professor at the Gonzaga University Graduate School of Business, member of the Board of Trustees for the Spokane Economic Development Council and a member of the Chamber of Commerce Higher Education Leadership Group. He received a Bachelor's degree from the United States Military Academy, a Master of Business Administration degree from Gonzaga University and advanced certification in Applied Statistics from the Rochester Institute of Technology.

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JOHN M. HARLOW

Mr. Harlow, 63, serves as Vice President of Sterling Savings and President and a Director of INTERVEST. He joined Sterling Savings in 1987. Mr. Harlow was formerly the President of the Mortgage Banking Division of Moore Financial Services of Portland, Oregon; Senior Vice President of Income Property Lending for Bancshares Mortgage Company of Spokane, Washington; and Vice President/Regional Manager for I.D.S. Mortgage Company in northern California. He is a Certified Mortgage Banker and is a past President of the Oregon Mortgage Bankers Association. Mr. Harlow received a Bachelor's degree from the University of Illinois in 1965.

JAMES L. KIRSCHBAUM

Mr. Kirschbaum, 65, serves as Vice President of Sterling Savings and President and Chief Operating Officer of Action Mortgage. He joined Sterling Savings in October 2001. Mr. Kirschbaum was formerly Executive Vice President of Source Capital Corporation in Spokane, Washington. He is a member of the Mortgage Bankers Association of America, a past President of the Seattle Mortgage Lenders Association, and a past President for the second time of the Washington State Mortgage Lenders Association. He is also a board member of the Pacific Real Estate Institute and a past President of the United Way of Spokane County. Mr. Kirschbaum is a graduate of the Stanford University Executive Program and the recipient of an Honorary Master's degree from Eastern Washington University's College of Business.

NANCY R. MCDANIEL

Ms. McDaniel, 46, serves as Executive Vice President, Portfolio Manager of Sterling Savings Bank. Ms. McDaniel joined Sterling in September 1994. Prior to joining Sterling, she held various management positions at U.S. Bank of Oregon and was a graduate of both their Management and Commercial Loan training programs. She serves as a member of Sterling's ALCO, Investment and Executive Credit Committees and acts as the Chairman of the Allowance for Loan Lease Losses Committee. She also serves on the Leadership Council and as a Legislative Ambassador for the American Cancer Society, and is a member of Risk Management Association. Ms. McDaniel attended the University of San Diego.

STEPHEN L. PAGE

Mr. Page, 57, serves as Executive Vice President, Chief Credit Officer of Sterling Savings. He joined Sterling Savings in 1983. Prior to 1983, Mr. Page was employed by Kiemle & Hagood Company of Spokane, Washington, as a Property Management Leasing Officer. He is a Director of the Educational Loan Foundation, Director of Lindbergh Lake Homeowners Association and serves as a mentor in the Big Brothers & Sisters of Spokane. Mr. Page received a Bachelor's degree from the University of Utah in 1970 and a Master of Business Administration degree from the University of New Mexico in 1973.

JEFFERY D. SCHLENKER

Mr. Schlenker, 38, has served as Vice-President of Harbor Financial since his appointment in January 2004. He was previously employed by Klamath First Financial Services, where he served as President for two years. Prior to his employment by Klamath, Mr. Schlenker was a financial advisor for approximately seven years. He received a Bachelor's degree in Business Administration from the University of Phoenix and has his Series 6, 63 and 7 licenses in the securities industry.

Table of Contents**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS**

The following table sets forth, as of January 31, 2006, information about the only known beneficial owners of more than five percent of Sterling's common stock. The following information is based solely on statements filed with the SEC or other information that Sterling believes to be reliable.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class⁽³⁾
Private Capital Management ⁽¹⁾ 8889 Pelican Bay Blvd., Suite 500 Naples, FL 34108	3,138,077	9.0%
Earnest Partners LLC ⁽²⁾ 75 Fourteenth Street, Suite 2300 Atlanta, GA 30309	2,118,655	6.1%

(1) Based on Schedule 13G/A filed on February 14, 2006, by Private Capital Management, which states that it has shared voting and dispositive power as to 3,138,077 shares.

(2) Based on Schedule 13G filed on February 14, 2006, by Earnest Partners LLC, which states that it has shared voting power as to 101,725 shares and sole voting and dispositive power as to 3,034,385 shares.

(3)

Based on shares
outstanding at
January 31,
2006, of
34,889,044.

Table of Contents**SECURITY OWNERSHIP OF MANAGEMENT**

The following table sets forth, as of January 31, 2006, information concerning the beneficial ownership of Sterling common stock by each Director, each Executive Officer named in the Summary Compensation Table and by all Directors and Executive Officers as a group.

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class
Rodney W. Barnett	65,300 ⁽¹⁾	*
Donald N. Bauhofer	42,228 ⁽²⁾	*
David P. Bobbitt	83,760 ⁽³⁾	*
Thomas H. Boone	84,046 ⁽⁴⁾	*
William Ike L. Eisenhart	17,450 ⁽⁵⁾	*
James P. Fugate	29,273 ⁽⁶⁾	*
Harold B. Gilkey	503,106 ⁽⁷⁾	1.43%
John M. Harlow	155,126 ⁽⁸⁾	*
Robert D. Larrabee	43,259 ⁽⁹⁾	*
Donald J. Lukes	5,622 ⁽¹⁰⁾	*
Heidi B. Stanley	265,182 ⁽¹¹⁾	*
William W. Zuppe	266,908 ⁽¹²⁾	*
All Directors and Executive Officers as a Group (28 persons)	2,150,059 ⁽¹³⁾	5.94%

* Less than 1%

(1) Includes 23,000 shares issuable pursuant to stock options exercisable within 60 days of January 31, 2006.

(2) Includes 34,846 shares issuable pursuant to stock options exercisable within 60 days of January 31, 2006.

(3) Includes 50,000 shares issuable pursuant to stock options exercisable

within 60 days of January 31, 2006. Excludes 10,645 shares held by Sterling's Deferred Compensation Plan and 3,348 shares (as of December 31, 2005) held by the 401(k) Plan for the benefit of Mr. Bobbitt, as to which shares Mr. Bobbitt disclaims beneficial ownership.

- (4) Includes 21,903 shares owned by a profit-sharing plan, as to which shares Mr. Boone disclaims beneficial ownership, and 20,000 shares issuable pursuant to stock options exercisable within 60 days of January 31, 2006.
- (5) Includes 12,500 shares issuable pursuant to stock options exercisable within 60 days of January 31, 2006.
- (6) Includes 20,000 shares issuable

pursuant to
stock options
exercisable
within 60 days
of January 31,
2006.

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- (7) Includes
200,000 shares
issuable
pursuant to
stock options
exercisable
within 60 days
of January 31,
2006, and
19,034 shares
held for
Mr. Gilkey's
individual
account under
the 401(k) Plan.
Excludes
268,045 shares
held by
Sterling's
Deferred
Compensation
Plan and 11,078
shares (as of
December 31,
2005) held by
the 401(k) Plan
for the benefit
of Mr. Gilkey,
as to which
shares
Mr. Gilkey
disclaims
beneficial
ownership.
- (8) Includes
112,750 shares
issuable
pursuant to
stock options
exercisable
within 60 days
of January 31,
2006. Excludes
48,825 shares
held by
Sterling's
Deferred
Compensation

Plan and 7,201 shares (as of December 31, 2005) held by the 401(k) Plan for the benefit of Mr. Harlow, as to which shares Mr. Harlow disclaims beneficial ownership.

(9) Includes 17,000 shares issuable pursuant to stock options exercisable within 60 days of January 31, 2006.

(10) Includes 5,000 shares issuable pursuant to stock options exercisable within 60 days of January 31, 2006.

(11) Includes 208,750 shares issuable pursuant to stock options exercisable within 60 days of January 31, 2006, and 7,581 shares held for Ms. Stanley's individual account under the 401(k) Plan. Excludes 48,237 shares held by Sterling's Deferred Compensation

Plan and 6,456 shares (as of December 31, 2005) held by the 401(k) Plan for the benefit of Ms. Stanley, as to which shares Ms. Stanley disclaims beneficial ownership.

- (12) Includes 200,000 shares issuable pursuant to stock options exercisable within 60 days of January 31, 2006, and 20,071 shares held for Mr. Zuppe's individual account under the 401(k) Plan. Excludes 184,392 shares held by Sterling's Deferred Compensation Plan and 10,462 shares (as of December 31, 2005) held by the 401(k) Plan for the benefit of Mr. Zuppe, as to which shares Mr. Zuppe disclaims beneficial ownership.

- (13) In addition to the information supplied in

footnotes 1-12,
includes
388,752 shares
issuable
pursuant to
stock options
exercisable
within 60 days
of January 31,
2006, and
38,303 shares
held in
individual
accounts under
the 401(k) Plan.
Excludes 57,844
shares held by
Sterling's
Deferred
Compensation
Plan and 19,032
shares (as of
December 31,
2005) held by
the 401(k) Plan
for the benefit
of members of
the group, as to
which shares
such members
disclaim
beneficial
ownership.

Table of Contents**EQUITY COMPENSATION PLAN INFORMATION**

The following table provides information about Sterling's common stock that may be issued upon the exercise of options, warrants and rights under Sterling's equity compensation plans as of December 31, 2005.

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by shareholders:			
Stock option plans	1,703,959	\$ 19.46	456,249
Equity compensation plans not approved by shareholders:	None	None	None
Total	1,703,959	\$ 19.46	456,249

PERSONNEL COMMITTEE REPORT ON EXECUTIVE COMPENSATION

During fiscal year 2005, Messrs. Larrabee, Bauhofer and Fugate served on the Personnel Committee, with Mr. Larrabee serving as Chairman.

Compensation Philosophy

Sterling seeks to promote a strong pay-for-performance culture by aligning compensation with Sterling's performance. Sterling's Board of Directors believes that compensation should:

relate to the value created for Shareholders by being directly tied to the financial performance and condition of Sterling and each Executive Officer's contribution thereto;

reward individuals who help Sterling achieve its short-term and long-term objectives and thereby contribute significantly to the success of Sterling;

help to attract and retain the most qualified individuals available by being competitive in terms of compensation paid to persons having similar responsibilities and duties in other companies in the same and closely-related industries; and

reflect the qualifications, skills, experience and responsibilities of each Executive Officer.

The Personnel Committee, which is composed of three nonemployee Directors, administers the compensation of the CEO and the other Executive Officers of Sterling and its

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subsidiaries (the Executive Officers), subject to review and appropriate approval of Sterling's Board of Directors.

In determining executive compensation, Sterling uses peer group comparisons as part of its overall analysis. The Personnel Committee believes that companies operating in the banking and financial services industries are appropriate to include in its compensation analysis. Additionally, the Personnel Committee is advised from time to time by outside compensation consultants on its compensation policies.

Several factors are used to measure the performance of Sterling and its Executive Officers. To measure corporate financial and operating results, the Personnel Committee examines Sterling's return on equity and its earnings per share as compared to the performance of Sterling's peers. Individual performance measures are designed to be reasonably attainable, under the immediate influence of the executive and related to the success of the individual.

Components of Compensation

At present, the executive compensation program is comprised of base salary, annual cash incentive compensation, long-term compensation in the form of deferred compensation and stock options, and benefits typically offered to executives of similar corporations.

Base Salary. In establishing the base salaries of the CEO and the other Executive Officers, the Personnel Committee examines competitive peer group surveys and data to determine whether compensation is competitive with that offered by other companies in the banking and financial services industries. The Personnel Committee looks primarily at companies that are similar in terms of their size and the complexity of their operations. The Personnel Committee also takes into account Sterling's financial and operating performance as compared with the industry as a whole, and considers the diverse skills required of its executive management to expand its operations while maintaining good performance. In addition, the Personnel Committee considers the particular executive's performance, responsibilities, qualifications and experience in the banking industry.

Annual Cash Incentive Compensation. Sterling maintains an Annual Cash Incentive Compensation Program. The annual component of this program is intended to encourage and reward the achievement of (1) growth in Sterling's reported earnings, and (2) targeted returns on equity. These criteria are deemed by the Personnel Committee to be critical in increasing Shareholder value. The program also is designed to assist in attracting and retaining qualified employees, to further link the financial interests and objectives of employees with those of Sterling and to foster accountability and teamwork throughout Sterling.

Long-Term Incentive Plans. The Personnel Committee believes that long-term incentive plans, such as the 2003 Long-Term Incentive Plan, provide a competitive incentive that links the achievement of financial goals and individual performance with greater Shareholder value. The purpose of these plans is to encourage the ownership of Sterling common stock, attract and retain

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qualified employees, develop and maintain strong management and employee loyalty, and give suitable recognition to an individual's material contributions to Sterling's success.

Supplemental Executive Retirement Plan. In January 2002, Sterling adopted a Supplemental Executive Retirement Plan (the SERP). The SERP is a non-qualified, unfunded plan that is designed to provide retirement benefits for certain key employees of Sterling. Depending on their classification under the Plan, participants will receive from 40% to 60% of their annual salary amount as of January 1, 2002, for 10 to 15 years, beginning at normal retirement age. Retirement benefits vest at the rate of 10% per year of service. Except for participants who have completed 25 years of service, benefits are reduced for early retirement. The present value of the retirement benefits becomes 100% vested if, within three years of a change in control of Sterling, either the Plan or the participant's employment are terminated.

Deferred Compensation Plan. Sterling maintains a non-qualified Deferred Compensation Plan. As of December 31, 2005, there were seven participants in the Deferred Compensation Plan. All amounts in a participant's account become 100% vested upon a change in control; when the participant attains normal retirement age; when the employment of the participant terminates due to death or disability; or upon termination of the Plan. Prior to such an event, amounts in a participant's account vest at the rate of 10% per year of service, provided that such vesting shall reach 100% when the participant reaches the age of 60. Payment of an account may be in a lump sum or in installments as determined by the Personnel Committee, and the Committee may accelerate installments. Payment must be commenced within one year of the termination of the participant's employment with Sterling. In February 2002, Sterling discontinued additional contributions to the Deferred Compensation Plan.

Klamath Plans. In connection with the Klamath acquisition, Sterling assumed Supplemental Executive Retirement Plans (the Klamath SERP Agreements) in place with certain former Klamath executives. Under the Klamath SERP Agreements, these executives are entitled to receive a normal retirement benefit at their normal retirement age that provides a continuation of salary for life, with annual increases of two percent. The amount of the normal retirement benefit is based on each executive's projected annual salary at the time of his normal retirement age. The Klamath SERP Agreements provide for full vesting of these normal retirement benefits if the executive's employment is terminated, without cause, within two years following a change in control. If termination occurs prior to the executive reaching his normal retirement age, an executive may elect to receive benefits prior to his normal retirement age, in which case such benefit will be reduced accordingly, based on the number of years that payments commence before normal retirement age.

Sterling also assumed director fee continuation agreements with the former Klamath directors, which entitle each director to retirement benefits upon termination of service, except for cause. Directors who were terminated subsequent to the transaction are initially entitled to normal retirement benefits of \$3,007 per month for directors who were at least age 65 on the effective date of the transaction and \$2,834 per month for directors who were under age 65, with annual increases of two percent. A director retiring before age 65 may elect to receive the retirement benefit prior to age 65, in which case the benefit will be reduced accordingly, based on

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the number of years that payments commence before normal retirement age. If the director dies before 60 monthly payments have been made, such payments will continue until a total of 60 monthly payments have been made, or until the death of the director's surviving spouse, whichever occurs earlier.

Sterling also assumed the Klamath ESOP to the extent necessary to maintain the Klamath ESOP until its termination. Approval for termination has been received from the Internal Revenue Service and the plan is in the process of liquidation. As of the effective date of the Klamath acquisition, the Klamath ESOP was frozen, such that no further contributions have been made to the Klamath ESOP and no further benefits are accruing to participants thereunder. When the Klamath ESOP was established, Klamath loaned funds to the plan to purchase shares of Klamath common stock, which represented the security for the loan. As Klamath made contributions to the Klamath ESOP each year to fund the benefits thereunder, these monies were used by the Klamath ESOP to pay down the loan and release shares from the collateral suspense account for allocation to participants. The Klamath ESOP provided that shares released from the Klamath ESOP suspense account in accordance with Klamath's annual contributions were allocated among participants on the basis of compensation in the year of allocation. Upon termination of the Klamath ESOP, the remaining unallocated shares that were not required to pay off the Klamath ESOP loan balance were allocated 50% on the basis of compensation and 50% on the basis of account balances. All account balances have been distributed to Klamath ESOP participants.

Compensation of CEO

During 2005, the compensation of Mr. Gilkey, Chairman of the Board and CEO, was based on the general principles of the executive compensation program and on Mr. Gilkey's Employment Agreement. In determining the salary and other forms of compensation for Mr. Gilkey, the Personnel Committee took into consideration Mr. Gilkey's substantial experience and standing in the industry in general and with Sterling in particular. The Personnel Committee also considered the increased responsibilities for Mr. Gilkey as a result of Sterling's diversification and growth in recent years. The Personnel Committee believes that Mr. Gilkey's compensation as CEO appropriately reflects Sterling's performance during 2005 and his contributions to that performance.

Personnel Committee Interlocks and Insider Participation

During 2005, there were no interlocking or cross-board memberships that are required to be disclosed under the rules of the SEC. For a general description of transactions and relationships Directors and Executive Officers and their associates may have had with Sterling and its affiliates during the year, see Interests of Directors and Executive Officers in Certain Transactions.

Submitted by the Personnel Committee of the Board of Directors of Sterling Financial Corporation.

Robert D. Larrabee, Chairman

Donald N. Bauhofer

James P. Fugate

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Table of Contents**EXECUTIVE COMPENSATION****Summary Compensation Table**

The following table sets forth information concerning compensation received from Sterling by the CEO of Sterling, the CFO of Sterling, and the four other most highly compensated executive officers who were serving as executive officers at the end of 2005 (together, the Named Executive Officers) for services in all capacities to Sterling and its subsidiaries for the last three years.

Name and Position	Year	Annual Compensation		Other Annual Comp. (\$) ⁽¹⁾	Long-Term Compensation Securities Underlying	All Other Comp. (\$)
		Salary (\$)	Bonus (\$)		Options (#)	
Harold B. Gilkey, Chairman and CEO of Sterling Financial Corp.	2005	500,000	500,000		50,000	418,237 ⁽²⁾
	2004	450,000	450,000		40,000	389,538
	2003	375,000	275,000	62,675	30,000	390,836
William W. Zuppe, Chairman and CEO of Sterling Savings	2005	375,000	300,000		50,000	212,449 ⁽³⁾
	2004	350,000	250,000		40,000	197,213
	2003	275,000	200,000	55,179	30,000	269,669
Heidi B. Stanley, Vice Chair and COO of Sterling Savings	2005	276,000	120,000		40,000	46,339 ⁽⁴⁾
	2004	252,000	85,000		25,000	45,022
	2003	198,000	60,000		25,000	43,972
David P. Bobbitt, President and CPO of Sterling Savings	2005	252,000	70,000		20,000	94,432 ⁽⁵⁾
	2004	240,000	70,000		20,000	86,580
	2003	195,000	60,000		20,000	79,636
John M. Harlow, Vice President of Sterling Savings; President of INTERVEST	2005	240,000	40,000		10,000	205,141 ⁽⁶⁾
	2004	216,000	40,000		10,000	180,124
	2003	206,000	40,000		10,000	159,913
Daniel G. Byrne, Executive Vice President and CFO of Sterling Financial Corp.	2005	180,000	50,000		25,000	39,084 ⁽⁷⁾
	2004	168,000	50,000		15,000	35,878
	2003	144,000	35,000		10,000	27,014

⁽¹⁾ Compensation amounts are not required to be provided where the aggregate amounts of perquisites and other personal benefits do not exceed the lesser of either

\$50,000 or 10% of the total of such officer's annual salary and bonus.

(2) Includes: a) \$6,300 vested contribution to the 401(k) Plan; b) \$403,577 vested in the SERP; and c) \$8,360 of income allocated to the individual by virtue of Sterling's payment of tax associated with the amount vested in the SERP.

(3) Includes: a) \$6,300 vested contribution to the 401(k) Plan; b) \$201,965 vested in the SERP; and c) \$4,184 of income allocated to the individual by virtue of Sterling's payment of tax associated with the amount vested in the SERP.

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- (4) Includes: a) \$4,900 vested contribution to the 401(k) Plan; b) \$26,245 vested in the SERP; c) \$544 of income allocated to the individual by virtue of Sterling's payment of tax associated with the amount vested in the SERP; and d) \$14,650 vested in the Deferred Compensation Plan.
- (5) Includes: a) \$4,900 vested contribution to the 401(k) Plan; b) \$68,921 vested in the SERP; c) \$1,428 of income allocated to the individual by virtue of Sterling's payment of tax associated with the amount vested in the SERP; and d) \$19,183 vested in the Deferred Compensation Plan.
- (6) Includes: a) \$4,900 vested contribution to the 401(k) Plan; b) \$196,177

vested in the SERP; and c) \$4,064 of income allocated to the individual by virtue of Sterling's payment of tax associated with the amount vested in the SERP.

- (7) Includes: a) \$4,900 vested contribution to the 401(k) Plan; b) \$33,642 vested in the SERP; and c) \$542 of income allocated to the individual by virtue of Sterling's payment of tax associated with the amount vested in the SERP.

Option Grants in 2005

The following table sets forth information with respect to stock options granted to the Named Executive Officers during 2005. Sterling has no outstanding stock appreciation rights. The amounts shown for each Named Executive Officer as potential realizable values are based entirely on hypothetical annualized rates of stock appreciation of five percent and ten percent compounded over the full ten-year terms of the options. These assumed rates of growth were selected by the SEC for illustration purposes only and are not intended to predict future stock prices, which will depend upon overall stock market conditions and Sterling's future performance and prospects. There can be no assurance that the Named Executive Officers will receive the potential realizable values shown in this table.

Name	Number of Securities Underlying Options Granted	Individual Grants		Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term	
		Percentage of Total Options Granted in Fiscal Year	Exercise or Base Price (\$/Sh) ⁽¹⁾		5% (\$)	10% (\$)
Harold B. Gilkey	50,000	12.47	25.71	12/18/2015	808,444	2,048,756

William W. Zuppe	50,000	12.47	25.71	12/18/2015	808,444	2,048,756
Heidi B. Stanley	40,000	9.98	25.71	12/18/2015	646,755	1,639,005
David P. Bobbitt	20,000	4.99	25.71	2/28/2012	174,877	396,737
John M. Harlow	10,000	2.49	25.71	2/28/2012	87,439	198,368
Daniel G. Byrne	25,000	6.23	25.71	2/28/2012	218,596	495,921

(1) The Exercise or Base Price is the fair market value of the Sterling common stock on the date of grant as listed on the NASDAQ National Market, as adjusted for stock dividends declared and/or paid.

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The following table sets forth information on the exercise of stock options during 2005 by each of the Named Executive Officers and the value of unexercised in-the-money options at December 31, 2005.

Name	Shares Acquired on Exercise (#)	Net Value Realized (\$)	Number of Securities Underlying Unexercised Options at Year-End		Value of Unexercised In-the-Money Options at Year-End (\$) ⁽¹⁾	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Harold B. Gilkey	75,000	1,386,000	200,000	0	4,237,700	0
William W. Zuppe	91,500	1,747,221	200,000	0	4,237,700	0
Heidi B. Stanley	10,500	212,520	208,750	0	3,323,824	0
David P. Bobbitt	66,822	885,879	50,000	0	1,315,599	0
John M. Harlow	10,500	210,210	112,750	0	1,453,670	0
Daniel G. Byrne	7,500	144,200	92,500	0	1,794,800	0

⁽¹⁾ Values are adjusted for Sterling common stock dividends declared and/or paid.

Employment and Change in Control Agreements

Sterling has entered into employment agreements (the "Agreements") with Messrs. Gilkey and Zuppe, which provide for annual fixed minimum salaries. The Agreements provide for incentive bonuses, long-term incentive compensation including stock options, certain perquisites, including payment for tax preparation and financial planning, payment for an annual physical examination, club membership fees and payment of an automobile allowance, and rights to participate in other benefit programs offered or maintained by Sterling. The Agreements with Messrs. Gilkey and Zuppe expire on December 31, 2009.

The Agreements provide for the payment of certain severance benefits to Messrs. Gilkey and Zuppe upon termination of their employment by Sterling without cause or following a constructive discharge or their permanent disability. If Messrs. Gilkey or Zuppe are not reelected to the Board of Directors, then they will be considered to have been constructively discharged under the terms of the Agreements. Pursuant to these provisions, Mr. Gilkey and Mr. Zuppe would be entitled to receive their base salary in effect at the time of termination until the later to occur of the expiration of their Agreements or the end of the three-year period following the date of such termination. In the event Messrs. Gilkey or Zuppe were discharged within eighteen months following a change in control of Sterling, they

would be entitled to their base salaries and incentive bonuses, at the highest annual rates during their employment, until the later to occur of the expiration of their Agreements or the end of the three-year period following the date of such discharge. In addition, in the event of any of these terminations of employment, earned but

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unpaid base salary and incentive bonus amounts and amounts held for Messrs. Gilkey and Zuppe in the deferred compensation plan and the supplemental executive retirement plan as of the date of termination would be payable in full. Medical, dental care, life or other insurance, including travel, accident and disability insurance and the perquisites detailed above would continue for the severance period. Stock options granted pursuant to the Agreements would become fully exercisable during the severance period.

The Agreements provide for the survival of certain benefits upon any termination of employment, including retirement, except for a termination for cause. The benefits that survive include medical, dental, disability, travel and accident insurance coverage for Messrs. Gilkey and Zuppe and their spouses, to the extent not offset by Medicare, and the continuation of certain perquisites, specifically tax preparation and financial planning, annual physical and club membership fees.

Sterling is the plaintiff in a lawsuit which is pending in the United States Court of Federal Claims (the Lawsuit). The Lawsuit is an action for damages arising out of the government s breach of its contracts with Sterling in connection with Sterling s past acquisitions of certain troubled thrift associations. In the event that a settlement or judgment amount is received by Sterling as a result of the Lawsuit, Messrs. Gilkey and Zuppe are entitled by the terms of the Agreements to receive three percent and two percent, respectively, of the gross amount received in recognition of their substantial contribution in bringing about the settlement or judgment. This provision is intended to survive the termination of the Agreements.

Sterling has also entered into employment agreements (the Executive Agreements) with each of the other Named Executive Officers. The term of each Executive Agreement continues until either the Board of Directors in its sole discretion or the executive in his or her sole discretion terminates the respective agreement in accordance with its terms.

Under the Executive Agreements, the Chairman and the President of Sterling determine the annual salary of the executive. Upon termination for any reason or resignation for Good Cause upon or within three years after a Change in Control (as Change in Control and Good Cause are defined in the Executive Agreements), certain executives will be paid three times and certain executives will be paid two times annual compensation, including the greater of salary and target bonus for the calendar year in which the termination occurs (if established before the termination) or salary and actual bonus for the prior calendar year (annualized if the executive was not employed by Sterling for the entire calendar year), but excluding the value of grants of stock options or restricted stock. In addition, all of the executive s outstanding, unvested options will immediately vest and become exercisable and, subject to prior approval of the Board, restrictions on all or certain grants of the executive s restricted stock will immediately lapse.

Under the terms of the Agreements and the Executive Agreements, if a Change in Control payment constitutes a parachute payment under Section 280G of the Internal Revenue Code of 1986, as amended (the Code), the executive is entitled to receive payment of an additional amount (the Gross-Up Payment) within a specified period of time. Any Gross-Up Payment would be equal to the amount necessary to cause the net amount retained by the executive, after

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subtracting the parachute excise tax imposed by Section 4999 of the Code (the Excise Tax) and any federal, state and local income taxes, FICA tax and excise tax on the Gross-Up Payment, to be equal to the net amount the executive would have retained had no Excise Tax been imposed and no Gross-Up Payments been paid.

Sterling establishes certain compensation arrangements with its executive officers at the time of hire. The arrangements include starting salary, bonus eligibility, initial stock option grants and relocation packages, where appropriate.

SHAREHOLDER RETURN COMPARISON

The following chart sets forth a five-year comparison of total Shareholder return on the common stock of Sterling compared to the NASDAQ Thrift Market Index and the Russell 2000 Index. The chart assumes an investment of \$100 on December 31, 2000, and the reinvestment of all dividends. The stock price performance shown on the following chart is provided as of year-end and may not be indicative of current stock price levels or future stock price performance.

**COMPARISON OF FIVE-YEAR CUMULATIVE TOTAL RETURN
AMONG STERLING FINANCIAL CORPORATION,
NASDAQ THRIFT MARKET INDEX AND RUSSELL 2000 INDEX**

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INTERESTS OF DIRECTORS, OFFICERS AND OTHERS IN CERTAIN TRANSACTIONS

Certain of the Directors and Executive Officers of Sterling and its subsidiaries were customers of and had transactions with Sterling Savings during 2005. In addition, certain Directors and Executive Officers are officers, Directors or Shareholders of corporations or members of partnerships that were customers of or had transactions with Sterling Savings during 2005. All such transactions were in the ordinary course of business, on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons, and did not involve more than the normal risk of collectibility or present other unfavorable features.

AUDIT COMMITTEE REPORT

During fiscal year 2005, Directors Barnett, Boone and Eisenhart served on the Audit Committee, with Director Barnett serving as Chairman. As more fully described in the Audit Committee Charter, the Audit Committee is responsible for overseeing Sterling's accounting and financial reporting processes, including the quarterly review and the annual audit of Sterling's consolidated financial statements by BDO, Sterling's independent registered public accounting firm. BDO currently serves as Sterling's independent registered public accounting firm and has conducted the audit of Sterling's financial statements for 2005. The Sarbanes-Oxley Act of 2002 requires the Audit Committee to be directly responsible for the appointment, compensation and oversight of the audit work of the independent registered public accounting firm. The Audit Committee has appointed BDO to serve as the independent registered public accounting firm to conduct an audit of Sterling's financial statements for the fiscal year ending December 31, 2006, and all interim periods. BDO has advised Sterling that it will have in attendance at the Annual Meeting one or more representatives who will have an opportunity to make a statement if they desire to do so and who will be available to respond to appropriate questions presented to the Secretary of Sterling in advance of the Annual Meeting. As part of fulfilling its responsibilities, the Audit Committee has reviewed and discussed Sterling's audited financial statements with management. The Audit Committee has also discussed with the independent registered public accounting firm the matters required to be discussed by Statement on Auditing Standards No. 61 (Communication with Audit Committees). Finally, the Audit Committee has received the written disclosures and the letter from the independent registered public accounting firm required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) and has discussed with the independent registered public accounting firm that firm's independence.

Based on its review and discussions, the Audit Committee recommended to the Board of Directors that the audited financial statements for 2005 be included in Sterling's 2005 Annual Report on Form 10-K filed with the SEC.

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Submitted by the Audit Committee of the Board of Directors of Sterling Financial Corporation.

Rodney W. Barnett, Chairman

Donald N. Bauhofer

William Ike L. Eisenhart

James P. Fugate

SHAREHOLDER PROPOSALS

It is presently anticipated that the 2007 Annual Meeting of Shareholders of Sterling will be held on Tuesday, April 24, 2007. In order for any Shareholder proposal to be considered for inclusion in the proxy materials of Sterling for the Annual Meeting on April 24, 2007, such proposal must be submitted, in accordance with the rules and regulations of the SEC, in writing to the Secretary of Sterling at Sterling's corporate offices by November 24, 2006.

Shareholders wishing to bring a proposal to be considered at the 2007 Annual Meeting of Shareholders (but not include it in Sterling's proxy materials) must provide written notice of such proposal to Sterling's Secretary at Sterling's principal executive offices no later than February 8, 2007 to be considered timely.

SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Under Section 16(a) of the Securities Exchange Act of 1934, as amended, and the regulations thereunder, Sterling's Directors, Executive Officers and beneficial owners of more than 10% of any registered class of Sterling equity securities are required to file reports of their ownership of Sterling's securities and any changes in that ownership with the SEC. Based solely on its review of copies of these reports and on written representations from such reporting persons, Sterling believes that during 2005 such filing requirements were complied with, except that Dr. Fugate had one filing on Form 4 that was not received by the SEC on a timely basis.

OTHER MATTERS

Sterling knows of no other business that will be presented for consideration at the Annual Meeting other than those items set forth herein. The enclosed proxy card, however, confers discretionary authority to the proxy agents to vote with respect to matters that may be presented at the Annual Meeting, including the election of any person as a Director in the event a nominee of the Board of Directors of Sterling is unable to serve. If any such matters come before the Annual Meeting, the proxy agents will vote according to their own best judgment.

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ANNUAL REPORT

A copy of Sterling's 2005 Annual Report on Form 10-K, including financial statements, is being mailed to Shareholders with this Proxy Statement. **Additional copies of the Annual Report on Form 10-K may be obtained without charge by writing to Shareholder Relations, Sterling Financial Corporation, 111 North Wall Street, Spokane, Washington 99201-0611.** This Proxy Statement, Sterling's 2005 Annual Report on Form 10-K and Sterling's other reports filed with the SEC are also available on Sterling's website at www.sterlingsavingsbank.com after the reports are filed with the SEC. The SEC maintains a website located at www.sec.gov that also contains this information. The information on Sterling's website and the SEC's website is not part of this Proxy Statement.

By Order of the Board of
Directors,

/s/ Andrew J. Schultheis

Andrew J. Schultheis
Secretary

Spokane, Washington
March 24, 2006

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**ANNUAL MEETING OF SHAREHOLDERS OF
STERLING FINANCIAL CORPORATION**

April 25, 2006

Please date, sign and mail
your proxy card in the envelope
provided as soon as possible.

ê Please detach along perforated line and mail in the envelope provided. ê

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE ELECTION OF THE NOMINEES AND
FOR PROPOSAL 2.**

**PLEASE SIGN, DATE AND RETURN PROMPTLY IN THE ENCLOSED ENVELOPE.
PLEASE MARK YOUR VOTE IN BLUE OR BLACK INK AS SHOWN HEREx**

	FOR	AGAINST	ABSTAIN
1. TO ELECT THE FOLLOWING DIRECTORS. IF ANY NOMINEE NAMED HEREIN BECOMES UNABLE OR UNWILLING TO SERVE THE PROXY WILL BE VOTED FOR THE ELECTION OF A PERSON RECOMMENDED BY THE BOARD OF DIRECTORS.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

2. TO RATIFY THE APPOINTMENT OF BDO SEIDMAN LLP AS THE INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE YEAR ENDING DECEMBER 31, 2006 AND ANY INTERIM PERIOD.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
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NOMINEES:
 m Rodney W. Barnett
 m William Ike L. Eisenhart
 m Donald J. Lukes
 m William W. Zuppe

FOR ALL NOMINEES

 WITHHOLD AUTHORITY
FOR ALL NOMINEES

FOR ALL EXCEPT
(See instructions below)

**THE BOARD OF DIRECTORS
RECOMMENDS A VOTE FOR ITEMS 1 AND 2
IN THE ABSENCE OF SPECIFIC
INSTRUCTIONS, PROXIES WILL BE VOTED
FOR ITEMS 1 AND 2 AT THE DISCRETION
OF THE PROXY AGENTS AS TO ANY
OTHER MATTERS THAT MAY PROPERLY
COME BEFORE THE ANNUAL MEETING OF
SHAREHOLDERS.
PLEASE SIGN, DATE AND RETURN
PROMPTLY.**

Shares represented by a properly executed proxies will be voted in accordance with instructions appearing on the proxy and in the discretion of the proxy agents as to any other matters that may properly come before the Annual Meeting of Shareholders.

INSTRUCTION: To withhold authority to vote for any individual nominee(s), mark **FOR ALL EXCEPT** and fill in the circle next to the nominee you wish to withhold, as shown here:

1

To change the address on your account, please check the box at right and indicate your new address in the address space above. Please note that changes to the registered name(s) on the account may not be submitted via this method.

Signature of Stockholder

Date:

Signature of Stockholder

Date:

Note: Please sign exactly as your name or names appear on this Proxy. When shares are held jointly, each holder should sign. When signing as executor, administrator, attorney, trustee or guardian, please give full title as such. If the signer is a corporation, please sign full corporate name by duly authorized officer, giving full title as such. If signer is a partnership, please sign in partnership name by authorized person.

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STERLING FINANCIAL CORPORATION

PROXY FOR THE APRIL 25, 2006 ANNUAL MEETING OF SHAREHOLDERS

THIS PROXY IS SOLICITED BY THE BOARD OF DIRECTORS

The undersigned hereby appoints Harold B. Gilkey and William W. Zuppe, and each of them, proxy agents of the undersigned, with full power of substitution, to represent and vote as directed herein all shares of Sterling Financial Corporation common stock held of record by the undersigned on March 1, 2006 at the annual meeting of Sterling shareholders to be held in the Eric A. Johnston Auditorium of the Cheney Cowles Center Building, 2316 West First Avenue, Spokane, Washington, on Tuesday, April 25, 2006, at 10:00 a.m. local time, and any adjournment or postponement thereof, with authority to vote upon the matter listed on the other side of this proxy card and with discretionary authority as to any other matters that may properly come before the meeting.

(Continued and to be dated and signed on the reverse side)

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