

STERLING FINANCIAL CORP /WA/

Form S-4/A

May 05, 2006

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As filed with the Securities and Exchange Commission on May 5, 2006.

Registration No. 333-133404

**SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Amendment No. 1
to
FORM S-4
REGISTRATION STATEMENT
UNDER THE SECURITIES ACT OF 1933
STERLING FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)**

WASHINGTON
*(State or other jurisdiction of
incorporation or organization)*

6719
*(Primary Standard Industrial
Classification Code Number)*

91-1572822
*(I.R.S. Employer
Identification No.)*

**111 North Wall Street
Spokane, Washington 99201
(509) 227-5389**
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

**Andrew J. Schultheis, Secretary
Sterling Financial Corporation
111 North Wall Street
Spokane, Washington 99201
(509) 227-5389**

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies of communications to:

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Approximate date of commencement of the proposed sale of the securities to the public: As soon as practicable after the effective date of this Registration Statement and upon consummation of the transactions described herein.

If the securities being registered on this Form are being offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement

for the same offering. o

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment that specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until this registration statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

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The information in this document is not complete and may be changed. We may not issue the securities offered by this document until the registration statement filed with the Securities and Exchange Commission is effective. This document is not an offer to sell these securities, and we are not soliciting an offer to buy these securities, in any state where the offer or sale is not permitted.

PRELIMINARY SUBJECT TO COMPLETION DATED MAY 5, 2006

Lynnwood Financial Group, Inc.

6505 218th Avenue SW #9

Mountlake Terrace, Washington 98043

To the Shareholders of Lynnwood Financial Group, Inc. (Lynnwood):

The board of directors of Lynnwood has approved the agreement and plan of merger that provides for the merger of Lynnwood with and into Sterling Financial Corporation (Sterling) with Sterling being the surviving entity in the merger. We are seeking your vote on this important transaction.

If the merger is completed, Sterling will issue \$15,750,000 in cash and 1,800,000 shares of Sterling common stock for all outstanding Lynnwood shares. Lynnwood founder Charles Ainslie and his wife, Lynette, will receive all of the cash consideration, plus a portion of the shares of Sterling common stock, for the shares of Lynnwood common stock that they own, and all other Lynnwood shareholders will receive Sterling common stock for the shares of Lynnwood common stock that they own, in either case having an equivalent value per share. Sterling s common stock is traded on the Nasdaq Stock Market under the symbol STSA. Based on the closing sales price of Sterling s common stock of \$32.04 per share on May 4, 2006, each Lynnwood shareholder would receive cash and/or stock valued at approximately \$70.67 per share of Lynnwood common stock, with Lynnwood s founder, Charles Ainslie, and his wife Lynette receiving \$15,750,000 in cash and 724,217 shares of Sterling common stock in the merger. The actual allocation of the 1,800,000 shares of Sterling common stock among holders of Lynnwood common stock, including Charles and Lynette Ainslie, will depend on the average closing price of Sterling s common stock for the twenty trading days up to and including the fifth business day prior to the closing of the merger.

We cannot complete the merger unless Lynnwood shareholders approve the plan of merger. Your vote is very important. There will be a special meeting of Lynnwood shareholders held for the purpose of voting on the plan of merger. Whether or not you plan to attend the special meeting, please take the time to vote on the proposal to approve the plan of merger by completing and mailing the enclosed proxy card to us. **Please vote as soon as possible to make sure that your shares are represented at the special meeting. If you do not vote, it will have the same effect as voting against the plan of merger.**

The Lynnwood board of directors unanimously recommends that you vote **FOR** approval of the plan of merger.

The special meeting of Lynnwood shareholders will be held on June 14, 2006 at 23515 Timberlane Road, Woodway, Washington, 98020 at 3:00 p.m., local time.

We encourage you to read carefully the detailed information about the merger contained in this proxy statement/ prospectus, including the section entitled Risk Factors beginning on page 18. The proxy statement/ prospectus incorporates important business and financial information and risk factors about Sterling that are not included in or delivered with this document. See the section entitled Where You Can Find More Information on page 78.

/s/ Robert B. Fuller

Robert B. Fuller

Chief Financial Officer

and Secretary

Lynnwood Financial Group, Inc.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the shares to be issued under this proxy statement/ prospectus or passed upon the adequacy or accuracy of this proxy statement/ prospectus. Any representation to the contrary is a criminal offense.

You should rely only on the information provided or incorporated by reference in this proxy statement/ prospectus. We have not authorized anyone to provide you with different information. We are not making an offer of these securities in any state where the offer is not permitted. You should not assume that the information in this proxy statement/ prospectus is accurate as of any date other than the date on the front of the document.

**This proxy statement/ prospectus is dated May 5, 2006 and was first mailed to
Lynnwood shareholders on or about May 9, 2006.**

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REFERENCES TO ADDITIONAL INFORMATION

This proxy statement/ prospectus incorporates important business and financial information about Sterling from other documents that are not included in or delivered with this document. This information is available to you without charge upon written or oral request. You can obtain documents relating to Sterling that are incorporated by reference in this document through the Securities and Exchange Commission's website at www.sec.gov or by requesting them in writing or by telephone from Sterling at the following address:

Sterling Financial Corporation
111 North Wall Street
Spokane, Washington 99201
Attn: Investor Relations
(509) 227-5389

Requests for documents related to Lynnwood should be directed to:

Lynnwood Financial Group, Inc.
6505 218th Avenue SW #9
Mountlake Terrace, Washington 98043
Attn: Robert B. Fuller
(425) 775-9968

All website addresses given in this document are for information only and are not intended to be an active link or to incorporate any website information into this document.

Please note that copies of the documents provided to you will not include exhibits, unless the exhibits are specifically incorporated by reference into the documents or this document.

If you would like to request documents, please do so by June 7, 2006, in order to receive them before Lynnwood's special meeting of shareholders. See the section entitled "Where You Can Find More Information" on page 78.

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**Lynnwood Financial Group, Inc.
6505 218th Avenue SW #9
Mountlake Terrace, Washington 98042
NOTICE OF SPECIAL MEETING OF SHAREHOLDERS
TO BE HELD JUNE 14, 2006**

TO OUR SHAREHOLDERS:

A Special Meeting of Shareholders of Lynnwood Financial Group, Inc. will be held at 23515 Timberlane Road, Woodway, Washington, 98020, on June 14, 2006, at 3:00 p.m. local time.

At the meeting, we will ask you to act on the following matters:

1. **Approval of the Plan of Merger.** To consider and vote on a proposal to approve the plan of merger by and between Lynnwood and Sterling, pursuant to which you will receive cash and/or shares of Sterling common stock for each share of Lynnwood common stock you own, as described in the accompanying proxy statement/prospectus.

2. **Adjournments.** To consider and act upon a proposal to approve, if necessary, an adjournment of the special meeting to solicit additional proxies in favor of the plan of merger.

No other business may be transacted at the special meeting.

YOUR BOARD OF DIRECTORS HAS DETERMINED THAT THE MERGER IS IN THE BEST INTERESTS OF LYNNWOOD FINANCIAL GROUP, INC. AND ITS SHAREHOLDERS AND UNANIMOUSLY RECOMMENDS THAT YOU VOTE FOR APPROVAL OF THE PLAN OF MERGER.

The board of directors of Lynnwood has fixed the close of business on May 5, 2006 as the record date for determination of shareholders entitled to notice of, and the right to vote at, the special meeting. If you were a shareholder of record at the close of business on May 5, 2006, you may vote at the meeting or at any postponement or adjournment of the meeting.

Pursuant to Washington law, approval of the plan of merger requires the affirmative vote of two-thirds of the shares of Lynnwood common stock outstanding on the record date. In addition, under the terms of the agreement and plan of merger, approval of the plan of merger requires the affirmative vote of two-thirds of the shares of Lynnwood common stock issued and outstanding on the record date that are not held by Charles and Lynette Ainslie. Approval to adjourn the special meeting to solicit additional proxies, if necessary, requires the affirmative vote of a majority of the shares represented and voting at the special meeting.

In connection with the proposed merger, you may exercise dissenters' rights as provided under the Revised Code of Washington. If you meet all of the requirements under applicable Washington law, and follow all of its required procedures, you may receive cash in the amount equal to the fair value of your shares of common stock. The procedure for exercising your dissenters' rights is summarized under the heading "Dissenters' Rights" in the attached proxy statement/prospectus. The relevant Washington statutory provisions regarding dissenters' rights are attached to this document as Appendix B.

BY ORDER OF THE BOARD OF DIRECTORS

/s/ Robert B. Fuller

Robert B. Fuller, Secretary

May 5, 2006

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QUESTIONS AND ANSWERS ABOUT THE MERGER

The following are some of the questions that you, as a shareholder of Lynnwood, may have and answers to those questions. These questions and answers, as well as the following summary, are not meant to be a substitute for the information contained in the remainder of this document, and this information is qualified in its entirety by the more detailed descriptions and explanations contained elsewhere in this document. We urge you to read this document in its entirety prior to making any decision as to your Lynnwood common stock and the plan of merger.

Q1: Why are these proxy materials being sent to Lynnwood shareholders?

A1: This document is being provided by, and the enclosed proxy is solicited by and on behalf of, the Lynnwood board of directors for use at the special meeting of Lynnwood shareholders.

Q2: When and where is the Lynnwood special meeting?

A2: The Lynnwood special meeting is scheduled to be held at 3:00 p.m., local time, on June 14, 2006 at 23515 Timberlane Road, Woodway, Washington 98020, unless it is postponed.

Q3: What is the purpose of the Lynnwood special meeting? What am I voting on?

A3: The purpose of the special meeting is to consider and vote upon: approval of the plan of merger by and between Lynnwood and Sterling, as provided in the Agreement and Plan of Merger, dated as of February 12, 2006, by and between Sterling and Lynnwood, and, if necessary, approval of an adjournment of the special meeting to solicit additional proxies in favor of the plan of merger.

Q4: Who is entitled to vote at the Lynnwood special meeting?

A4: Lynnwood shareholders of record at the close of business on May 5, 2006, the record date for the Lynnwood special meeting, are entitled to receive notice of and to vote on matters that come before the special meeting and any adjournments or postponements of the special meeting. However, a Lynnwood shareholder may only vote his or her shares if he or she is present in person or is represented by proxy at the Lynnwood special meeting.

Q5: How do I vote?

A5: After carefully reading and considering the information contained in this document, please fill out, sign and date the proxy card, and then mail your signed proxy card in the enclosed envelope as soon as possible so that your shares may be voted at the special meeting. Lynnwood shareholders may attend the Lynnwood special meeting and vote in person. Even if you are planning to attend the special meeting, we request that you fill out, sign and return your proxy card. For more detailed information, please see the section entitled "The Special Meeting of Lynnwood Shareholders" beginning on page 26.

Q6: How many votes do I have?

A6: Each share of Lynnwood common stock that you own as of the record date entitles you to one vote. As of the close of business on May 5, 2006, there were 1,038,921 outstanding shares of Lynnwood common stock. As of that date, 80.46% of the outstanding shares of Lynnwood common stock was held by directors and executive officers of Lynnwood and their respective affiliates.

Q7: What constitutes a quorum at the Lynnwood special meeting?

A7: The presence of the holders of a majority of the shares entitled to vote at the Lynnwood special meeting constitutes a quorum. Presence may be in person or by proxy. You will be considered part of the quorum if you return a signed and dated proxy card, or if you vote in person at the special meeting.

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Q8: What vote is required to approve the plan of merger? What is the effect of not voting?

A8: The affirmative vote of the holders of at least two-thirds of all outstanding shares of Lynnwood common stock not held by Charles and Lynette Ainslie is required under the terms of the agreement and plan of merger. No vote of the shareholders of Sterling is required to approve the plan of merger.

Because the affirmative vote required to approve the plan of merger is based upon the total number of outstanding shares of Lynnwood common stock, the failure to submit a proxy card (or to vote in person at the special meeting) or the abstention from voting by a shareholder will have the same effect as a vote against approval of the plan of merger.

Q9: What is the recommendation of the Lynnwood board of directors?

A9: The Lynnwood board of directors unanimously recommends a vote FOR approval of the plan of merger.

Q10: What if I return my proxy but do not mark it to show how I am voting?

A10: If your proxy card is signed and returned without specifying your choice, your shares will be voted according to the recommendation of the Lynnwood board of directors.

Q11: Can I change my vote after I have mailed my signed proxy card?

A11: Yes. You can change your vote by revoking your proxy at any time before it is exercised at the Lynnwood special meeting. You can revoke your proxy in one of three ways:

notify Lynnwood's corporate secretary in writing before the special meeting that you are revoking your proxy,

submit another proxy with a later date prior to the special meeting, or

vote in person at the special meeting.

Q12: As a holder of Lynnwood common stock, what will I receive in the merger?

A12: Lynnwood's founder, Charles Ainslie, and his wife Lynette, will receive a combination of cash and Sterling common stock for the Lynnwood common stock they own. All other Lynnwood shareholders will receive Sterling common stock for the shares of Lynnwood common stock they own.

Q13: Why are Lynnwood's founder, Charles Ainslie, and his wife Lynette, receiving all of the cash consideration to be paid in the merger?

A13: Sterling and Lynnwood determined that all of the cash to be paid in the merger would be paid to Lynnwood's founder, Charles Ainslie, and his wife Lynette, for a number of reasons. Under federal securities law, because Charles Ainslie would be a former officer and director of Lynnwood, Mr. and Mrs. Ainslie would be subject to restrictions on trading in their Sterling common stock, which would limit their ability to obtain liquidity—a limitation not likely to be faced by any of the other Lynnwood shareholders because no other Lynnwood shareholder is likely to acquire enough shares of Sterling so as to be subject to the trading volume limitations. In addition, Sterling was also concerned with the potential impact that a sale by Mr. and Mrs. Ainslie of a large amount of Sterling stock might have on the price of Sterling's common stock, even if Mr. and Mrs. Ainslie received less shares and all of the cash consideration. To address this concern, Sterling required that Mr. and Mrs. Ainslie agree to additional restrictions on the sale of their Sterling shares. Sterling and Lynnwood were also aware that the receipt of cash consideration would generally result in immediate recognition of gain for the recipient and that Lynnwood shareholders receiving only stock consideration would not be expected to experience a taxable event as a result of the merger, except for any cash received in lieu of fractional shares.

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Q14: What regulatory approvals are required to complete the merger?

A14: In order to complete the merger, Sterling must first obtain the prior approval of the Board of Governors of the Federal Reserve System, or FRB. Moreover, the acquisition of Golf Savings Bank and Golf Escrow Corporation is subject to the receipt of prior approval from the Federal Deposit Insurance Corporation, or FDIC, and the Washington Department of Financial Institutions, or WDFI. An application with the FRB was filed on or about April 20, 2006. An application with the FDIC was filed on or about April 20, 2006. An application with the WDFI was filed on or about April 20, 2006.

Q15: Do I have dissenter s or appraisal rights with respect to the merger?

A15: Yes. Under Washington law, you have the right to dissent from the merger. To exercise dissenters rights of appraisal you must strictly follow the procedures prescribed by the Washington Business Corporation Act, or the WBCA. To review these procedures in more detail, see the section entitled Dissenters Rights beginning on page 77, and Appendix B of this proxy statement/ prospectus.

Q15: What are the material U.S. Federal income tax consequences of the merger to me?

A15: The merger will qualify for U.S. Federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended, referred to as the Code. As a result, we expect that, for U.S. federal income tax purposes, Lynnwood shareholders receiving only Sterling common stock generally will not recognize any gain or loss in their Lynnwood common stock as a result of the merger (except with respect to cash for fractional shares).

For further information concerning U.S. federal income tax consequences of the merger, please see the section entitled The Merger Material United States Federal Income Tax Considerations of the Merger beginning on page 34 of this proxy statement/ prospectus.

Q16: What risks should I consider before I vote on the merger?

A16: We encourage you to read carefully the detailed information about the merger contained in this document, including the section entitled Risk Factors beginning on page 18.

Q17: When do you expect to complete the merger?

A17: We are working to complete the merger in the third quarter of 2006. We must first obtain the necessary regulatory approvals and the approval of Lynnwood s shareholders at the special meeting. In the event of delays, the date for completing the merger can occur as late as November 30, 2006, after which Lynnwood and Sterling would need to mutually agree to extend the closing date of the merger. We cannot assure you as to if and when all the conditions to the merger will be met nor can we predict the exact timing. It is possible we will not complete the merger.

Q18: Whom should I contact with questions or to obtain additional copies of this document?

A18: Sterling Financial Corporation
111 North Wall Street
Spokane, Washington 99201
Attn: Investor Relations
(509) 227-5389
Lynnwood Financial Group, Inc.
6505 218th Avenue SW #9

Mountlake Terrace, Washington 98043

Attn: Robert B. Fuller

(425) 775-9968

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SUMMARY

This summary highlights selected information about the merger but may not contain all of the information that may be important to you. You should carefully read this entire document and the other documents to which this document refers for a more complete understanding of the matter being considered at the special meeting. See the section entitled "Where You Can Find More Information" beginning on page 78. Unless we have stated otherwise, all references in this document to Sterling are to Sterling Financial Corporation, all references to Lynnwood are to Lynnwood Financial Group, Inc., and all references to the plan of merger or the merger agreement are to the Agreement and Plan of Merger, dated as of February 12, 2006, between Sterling and Lynnwood, a copy of which is attached as Appendix A to this document. In this document, we often refer to the combined company, which means, following the merger, Sterling and its subsidiaries, including Lynnwood's subsidiaries. References to we, us and our in this document mean Sterling and Lynnwood together.

The Companies

Sterling Financial Corporation
111 North Wall
Spokane, Washington 99201
Attn: Investor Relations
(509) 227-5389

Sterling is a Washington corporation registered as a bank holding company under the Bank Holding Company Act of 1956. Sterling is headquartered in Spokane, Washington. Sterling's principal business is to serve as a holding company for Sterling Savings Bank, a Washington State-chartered bank with branches in Washington, Oregon, Idaho and Montana. Sterling originates loans through its branch offices, as well as through residential loan production offices of its subsidiary, Action Mortgage, in the four-state area and Utah, and through commercial real estate lending offices of its subsidiary, INTERVEST-Mortgage Investment Company, which operates in Washington, Oregon, Arizona and California. Sterling also markets fixed income and equity products, mutual funds, fixed and variable annuities and other financial products through service representatives of its subsidiary, Harbor Financial Services, located throughout Sterling's financial service center network. At December 31, 2005, Sterling had total assets of approximately \$7.56 billion, net loans receivable of approximately \$4.89 billion, deposits of approximately \$4.81 billion and shareholders' equity of approximately \$506.7 million. Sterling Savings Bank was founded in 1983. Sterling trades on Nasdaq under the symbol of STSA.

Lynnwood Financial Group, Inc.
6505 218th Avenue SW #9
Mountlake Terrace, Washington 98043
Attn: Robert B. Fuller
(425) 775-9968

Lynnwood is a Washington corporation registered as a unitary thrift savings and loan holding company under the Home Owners Loan Act of 1994. Lynnwood was formed in November 1999 for the purpose of becoming the holding company for Golf Savings Bank and Golf Escrow Corporation. Lynnwood is primarily engaged in the business of planning, directing, and coordinating the business activities of two wholly owned subsidiaries, Golf Savings Bank and Golf Escrow Corporation. As of December 31, 2005, Lynnwood had total assets of approximately \$497.4 million, net loans receivable of approximately \$428.7 million, deposits of approximately \$417.7 million and shareholders' equity of approximately \$34.8 million.

Golf Savings Bank is a Washington State-chartered and FDIC insured savings bank. Golf Savings Bank's primary focus is residential mortgage origination of single-family permanent loans and residential construction financing. Golf Savings Bank's primary market area is the greater Puget Sound area of Washington State and its business is conducted from its headquarters in Mountlake Terrace, Washington. Golf Savings Bank originates loans through a mortgage origination office in Kennewick, Washington, as

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well as eight retail mortgage loan production offices throughout the Puget Sound area. Golf Escrow Corporation offers a full range of escrow closing services from two locations, one in Mountlake Terrace and one in the Northgate area of Seattle.

The Merger (Page 29)

We propose a merger in which Lynnwood will merge with and into Sterling. As a result of the merger, Lynnwood will cease to exist as a separate corporation. After the merger, Golf Savings Bank and Golf Escrow Corporation, as well as Lynnwood's special purpose subsidiaries, Lynnwood Statutory Trust I and Lynnwood Statutory Trust II, will become wholly owned subsidiaries of Sterling.

Immediately after the merger, based on shares of Sterling common stock outstanding as of March 31, 2006, former Lynnwood shareholders are expected to own approximately 5.1% of the outstanding shares of Sterling common stock as a result of the issuance of shares of Sterling common stock to the former Lynnwood shareholders. We expect the merger of Lynnwood with and into Sterling to be completed during the third quarter of 2006, although the merger could be delayed to as late as November 30, 2006, after which Lynnwood or Sterling would need to mutually agree to extend the closing date of the merger.

After careful consideration, the Lynnwood board of directors unanimously approved and adopted the plan of merger. The Lynnwood board of directors unanimously recommends that holders of Lynnwood common stock vote FOR approval of the plan of merger.

Under the terms of the merger agreement, the approval of the plan of merger requires the affirmative vote, in person or by proxy, of two-thirds of the outstanding shares of Lynnwood common stock not held by Charles and Lynette Ainslie. No vote of Sterling shareholders is required (or will be sought) in connection with the merger. See the section entitled The Merger Agreement Voting Agreements.

In approving and adopting the plan of merger and making its recommendation, the Lynnwood board of directors consulted with Lynnwood senior management and Lynnwood's financial and legal advisors and considered a number of strategic, financial and other considerations referred to under the section entitled The Merger Recommendation of the Lynnwood Board of Directors and Reasons of Lynnwood for the Merger.

Recommendation of the Lynnwood Board of Directors and Reasons of Lynnwood for the Merger (Page 31)

The Lynnwood board of directors believes the merger is in the best interests of Lynnwood and the Lynnwood shareholders. The Lynnwood board of directors unanimously recommends that Lynnwood shareholders vote FOR the approval of the plan of merger and the consummation of the transactions contemplated by the agreement and plan of merger. See the section entitled The Merger Recommendation of the Lynnwood Board of Directors and Reasons of Lynnwood for the Merger.

Consideration to be received in the merger (Page 32)

At the effective time, by virtue of the merger and without any action on your part, the shares of Lynnwood common stock that are issued and outstanding immediately prior to the effective time will be converted into the right to receive an aggregate of 1,800,000 shares of Sterling common stock and \$15,750,000 of cash consideration. The merger agreement provides that Lynnwood's founder, Charles Ainslie, and his wife Lynette, will receive all of the cash consideration and a portion of the stock consideration. All other holders of Lynnwood common stock will be entitled to receive a number of shares of Sterling common stock that is determined to be equal in value per share to the per share value of the combined cash and stock consideration received by Charles and Lynette Ainslie. Furthermore, at the effective date of the merger, Lynnwood options to purchase Lynnwood common stock held by Lynnwood employees will be converted into options to purchase Sterling common stock. See the section entitled Interests of Certain Persons in the Merger Stock Options. The shares of Sterling common stock to be received by Charles and Lynette Ainslie, and by Donn Costa and Dennis O'Leary, will be subject to

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certain sale and transfer restrictions. See the section entitled "The Merger Agreement - Shareholder Agreements." Sterling common stock received by all other Lynnwood shareholders will be unrestricted, publicly tradable stock.

See the section entitled "The Merger - Consideration to be Received in the Merger."

Lynnwood's directors and executive officers have interests in the merger that differ from, or are in addition to, your interests in the merger (Page 38)

You should be aware that some of the directors and executive officers of Lynnwood have interests in the merger that are different from, or are in addition to, the interests of Lynnwood shareholders. These interests include, but are not limited to, the receipt by Charles and Lynette Ainslie of all of the cash consideration provided pursuant to the merger agreement, the continued employment of and retention benefits payable to certain executive officers after the merger, severance benefits payable to certain executive officers whose employment is not continued after the merger, and the indemnification of former Lynnwood officers and directors by Sterling.

Material United States federal income tax considerations of the merger (Page 34)

The merger will qualify for U.S. Federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended, referred to as the Code. As a result, we expect that, for U.S. federal income tax purposes, Lynnwood shareholders receiving only Sterling common stock generally will not recognize any of the gain or loss in their Lynnwood common stock as a result of the merger (except with respect to cash for fractional shares), and Lynnwood shareholders receiving part cash and part Sterling common stock generally will recognize gain, but not loss, equal to the lesser of (1) the excess, if any, of the fair market value of the Sterling common stock and the amount of cash received over the adjusted tax basis in the Lynnwood common stock exchanged in the merger or (2) the amount of cash received in the merger.

For further information concerning U.S. federal income tax consequences of the merger, please see the section entitled "The Merger - Material United States Federal Income Tax Considerations of the Merger" beginning on page 34 of this proxy statement/prospectus.

Tax matters are very complicated and the consequences of the merger to any particular Lynnwood shareholder will depend on that shareholder's particular facts and circumstances. Lynnwood shareholders are urged to consult their own tax advisors to determine their own tax consequences from the merger.

Following the merger, you will be entitled to receive dividends, if any, that Sterling pays on Sterling common stock (Page 16)

After the merger, you will receive dividends, if any, that Sterling pays on its common stock. Sterling paid a quarterly cash dividend of \$0.055 on January 13, 2006 and has announced a quarterly dividend of \$0.06 per share payable on April 13, 2006 to shareholders of record of Sterling common stock as of March 31, 2006.

Accounting treatment (Page 37)

The merger will be accounted for as an acquisition of Lynnwood by Sterling under the purchase method of accounting in accordance with U.S. generally accepted accounting principles.

In order to complete the merger, we must first obtain certain regulatory approvals (Page 34)

In order to complete the merger, Sterling must first obtain the prior written approval of the Federal Reserve Bank of San Francisco under the Bank Holding Company Act. An application for approval of the merger with the FRB was filed on or about April 20, 2006. The acquisition of Golf Savings Bank and Golf Escrow Corporation is also subject to the receipt of prior approval from the FDIC and the WDFI. An

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application with the FDIC was filed on or about April 20, 2006. An application with the WDFI was filed on or about April 20, 2006.

Lynnwood shareholders have dissenters' rights (Page 77)

Lynnwood shareholders have the right under Washington law to dissent from the merger, obtain an appraisal of the fair value of their Lynnwood common stock, and receive cash equal to the appraised fair value of their Lynnwood common stock (without giving effect to the merger) instead of receiving the merger consideration. To exercise dissenters' rights, among other things, a Lynnwood shareholder must (i) provide notice to Lynnwood that complies with the requirements of Washington law prior to the vote of its shareholders on the transaction of the shareholder's intent to demand payment for the shareholder's shares, and (ii) not vote in favor of the plan of merger. Submitting a properly signed proxy card that is received prior to the vote at the special meeting (and is not properly revoked) that does not direct how the shares of Lynnwood common stock represented by proxy are to be voted will constitute a vote in favor of the plan of merger and a waiver of such shareholder's statutory dissenters' rights.

If you dissent from the plan of merger and the conditions outlined above are met, then your shares of Lynnwood will not be exchanged for shares of Sterling common stock or cash or a combination thereof in the merger, and your only right will be to receive the fair value of your common stock as determined by mutual agreement between you and Sterling or by appraisal if you are unable to agree. The appraised value may be more or less than the consideration you would receive under the terms of the merger agreement, and will be based upon the value of shares of Lynnwood common stock without giving effect to the merger. If you exercise dissenters' rights, any cash you receive for your Lynnwood shares that results in a gain or loss will be immediately recognizable for federal income tax purposes. You should be aware that submitting a signed proxy card without indicating a vote with respect to the merger will be deemed a vote FOR the plan of merger and a waiver of your dissenters' rights. A vote AGAINST the plan of merger does not dispense with the other requirements to request an appraisal under Washington law.

A shareholder electing to dissent from the plan of merger must strictly comply with all procedures required under Washington law. These procedures are described more fully beginning on page 77 of this proxy statement/ prospectus, and a copy of the relevant Washington statutory provisions regarding dissenters' rights is included as Appendix B to this proxy statement/ prospectus.

The merger agreement (Page 42)

The merger agreement is described beginning on page 42. The merger agreement also is attached as Appendix A to this document. We urge you to read the merger agreement in its entirety because it contains important provisions governing the terms and conditions of the merger.

Conditions to consummation of the merger (Page 48)

The consummation of the merger depends on a number of conditions being met, including, among others:
approval of the principal terms of the merger by two-thirds of all outstanding shares of Lynnwood common stock not held by Charles and Lynette Ainslie;

authorization of the shares of Sterling common stock to be issued in the merger for quotation on the NASDAQ stock market;

receipt of required regulatory approvals for the merger;

the filing and effectiveness of a registration statement on Form S-4 with the Securities and Exchange Commission, or SEC in connection with the issuance of Sterling common stock in the merger;

absence of any order, injunction, or regulatory prohibition to completion of the merger;

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receipt by each party of an opinion from such party's tax counsel that the merger will qualify as a tax-free reorganization;

accuracy of the representations and warranties of Lynnwood and Sterling, except those that would not have or be reasonably likely to have a material adverse effect on Lynnwood or Sterling;

performance in all material respects by Lynnwood and Sterling of all obligations required to be performed by either of them under the merger agreement;

there will not have been any material adverse change in Lynnwood or Sterling;

Sterling's receipt, and the continued effectiveness, of voting agreements from three Lynnwood shareholders, Charles J. Ainslie, Donn C. Costa and Dennis V. O'Leary, in which they agree to vote all or a portion of their shares for the merger;

receipt by Sterling of shareholder agreements from Messrs. Ainslie, Costa and O'Leary;

the execution and continued effectiveness of employment agreements between Sterling and certain employees of Lynnwood;

the execution by Charles J. Ainslie of an amendment to his employment agreement with Lynnwood, terminating such agreement immediately prior to the effective time, and the execution of a consulting agreement with Sterling; and

receipt by Sterling of resignations from each director of Lynnwood and each of its subsidiaries.

Where the law permits, a party to the merger agreement could elect to waive a condition to its obligation to complete the merger although that condition has not been satisfied. We cannot be certain when (or if) the conditions to the merger will be satisfied or waived or that the merger will be completed.

We may decide not to complete the merger (Page 50)

Lynnwood and Sterling, by mutual consent, can agree at any time not to complete the merger, even if the shareholders of Lynnwood have voted to approve the principal terms of the merger. Also, either party can decide, without the consent of the other, not to complete the merger in a number of other situations, including:

if any governmental entity that must grant a required regulatory approval has denied such approval and such denial has become final and nonappealable;

if any governmental entity of competent jurisdiction shall have issued a final nonappealable order enjoining or otherwise prohibiting the consummation of the transactions contemplated by the merger agreement, unless such denial or order shall be due to the failure of the party seeking to terminate the merger agreement to perform or observe the covenants and agreements of such party set forth in the merger agreement;

failure to complete the merger by November 30, 2006, unless the failure of the closing to occur by such date shall be due to the failure of the party seeking to terminate the merger agreement (i) to perform or observe the covenants and agreements of such party or (ii) to fulfill the other party's conditions to closing;

if the merger has not occurred by the closing date, and the conditions to closing to be performed by the other party have not been satisfied or waived, and the party seeking to terminate (A) is not then in material breach of any representation, warranty, covenant or other agreement contained in the merger agreement and (B) has not failed to materially satisfy the other party's conditions to closing (that have not been waived) that are due to be performed or satisfied as of the date of the event giving rise to the right to terminate;

if the other party shall have materially breached any of the covenants, agreements, representations or warranties contained in the merger agreement and such breach is not cured within 30 days

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following written notice to the party committing such breach, or which breach, by its nature, cannot be cured prior to the closing date; and

if the approval of the shareholders of Lynnwood contemplated by the merger agreement shall not have been obtained by reason of the failure to obtain the vote required under the WBCA at the Lynnwood special meeting, unless such failure was caused by Lynnwood or a party to a voting agreement entered into in connection with the merger agreement.

Sterling, without the consent of Lynnwood, can terminate if:

the board of directors of Lynnwood shall have failed to recommend to its shareholders the approval of the merger, or shall have changed, or publicly announced its intention to change such recommendation, or

Lynnwood shall have breached its covenant not to solicit other acquisition proposals.

Lynnwood, without the consent of Sterling, can terminate if:

the average closing price of Sterling's common stock during a specified period just prior to the closing date is less than \$22.56 and the Sterling common stock price has also declined from a price of \$26.54 per share by 15% or more relative to a weighted average index of a certain group of financial institution holding companies. Sterling, however, would then have the option to avoid the termination by increasing the consideration paid to Lynnwood shareholders, as provided in the merger agreement.

Under some circumstances, either Lynnwood or Sterling will be required to pay a termination fee to the other if the merger agreement is terminated (Page 51)

Lynnwood must pay Sterling a termination fee of \$2.5 million if Sterling terminates the merger agreement and elects to receive such fee as a result of: (i) the Lynnwood shareholders failing to approve the merger; (ii) the Lynnwood board of directors failing to recommend the approval of the merger, or changing or publicly announcing its intention to change, such recommendation; or (iii) Lynnwood breaching its covenant not to solicit other acquisition proposals;

Lynnwood must pay Sterling a termination fee of \$1.0 million if Sterling terminates the merger agreement and elects to receive such fee as a result of Lynnwood (i) failing to perform its closing conditions by the closing date or (ii) materially breaching any of the covenants, agreements, representations or warranties it made in the merger agreement, and such breach is not cured within 30 days following written notice to Lynnwood, or which breach, by its nature, cannot be cured prior to the closing date; and

Sterling must pay Lynnwood a termination fee of \$1.0 million if Lynnwood terminates the merger agreement and elects to receive such fee as a result of Sterling (i) failing to perform its closing conditions by the closing date or (ii) materially breaching any of the covenants, agreements, representations or warranties it made in the merger agreement, and such breach is not cured within 30 days following written notice to Sterling, or which breach, by its nature, cannot be cured prior to the closing date.

Comparison of Shareholder Rights (Page 74)

The conversion of your shares of Lynnwood common stock into the right to receive shares of Sterling common stock in the merger will result in differences between your rights as a Lynnwood shareholder, which are governed by the WBCA and Lynnwood's amended articles of incorporation and amended bylaws, and your rights as a Sterling shareholder, which are governed by the WBCA and Sterling's amended and restated articles of incorporation and bylaws.

Table of Contents**SELECTED CONSOLIDATED FINANCIAL INFORMATION OF STERLING**

Sterling is providing the following information to aid you in your analysis of the financial aspects of the merger. Sterling derived the information as of and for the years ended December 31, 2001 through December 31, 2005 from its historical audited consolidated financial statements for these fiscal years. The audited consolidated financial information contained herein is the same historical information that Sterling has presented in its prior filings with the SEC.

The operating results for the years ended December 31, 2001 through 2005 are not necessarily indicative of the operating results that may be expected for the year ended December 31, 2006. This information is only a summary, and you should read it in conjunction with Sterling's consolidated financial statements and notes thereto contained in Sterling's 2005 Annual Report on Form 10-K, which has been incorporated by reference into this document. See the sections entitled "Where You Can Find More Information" and "Incorporation of Certain Documents by Reference" on pages 78 and 79, respectively.

Years Ended December 31,

	2005	2004	2003	2002	2001
(Dollars in thousands, except per share amounts)					
Income Statement Data:					
Interest income	\$ 387,811	\$ 319,761	\$ 214,727	\$ 197,313	\$ 201,385
Interest expense	(171,276)	(122,945)	(89,807)	(96,965)	(116,516)
Net interest income	216,535	196,816	124,920	100,348	84,869
Provision for losses on loans	(15,200)	(12,150)	(10,500)	(11,867)	(8,000)
Net interest income after provision for losses on loans	201,335	184,666	114,420	88,481	76,869
Non-interest income	59,569	47,799	33,735	29,080	21,021
Merger and acquisition costs	0	(4,835)	(792)	0	(283)
Amortization of goodwill and core deposit intangibles	(2,222)	(2,222)	(262)	(644)	(5,377)
Goodwill litigation	(179)	(141)	(600)	(1,100)	(890)
Non-interest expenses	(167,880)	(141,172)	(92,910)	(79,199)	(66,743)
Income before income taxes	90,623	84,095	53,591	36,618	24,597
Income tax provision	(29,404)	(27,790)	(18,678)	(11,031)	(8,409)
Net income	\$ 61,219	\$ 56,305	\$ 34,913	\$ 25,587	\$ 16,188
Earnings per share:					
Basic(1)	\$ 1.77	\$ 1.66	\$ 1.45	\$ 1.19	\$ 0.81
Diluted(1)	\$ 1.75	\$ 1.62	\$ 1.42	\$ 1.16	\$ 0.79
Cash dividends declared per share	\$ 0.105	\$ 0.000	\$ 0.000	\$ 0.000	\$ 0.000
Weighted average shares outstanding:					
Basic(1)	34,633,952	33,931,509	23,980,113	21,496,008	19,974,152
Diluted(1)	35,035,029	34,708,794	24,590,172	22,115,723	20,372,423

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2005 2004 2003 2002 2001

(Dollars in thousands, except per share amounts)

Financial Ratios:

Book value per share(1)	\$ 14.54	\$ 13.65	\$ 10.21	\$ 9.38	\$ 7.87
Return on average assets	0.87%	0.88%	0.88%	0.80%	0.58%
Return on average shareholders equity	12.4%	13.2%	14.4%	13.9%	10.5%
Shareholders equity to total assets	6.7%	6.8%	5.9%	5.8%	5.5%
Operating efficiency	61.7%	60.7%	59.6%	62.5%	69.2%
Net interest margin	3.28%	3.32%	3.35%	3.37%	3.27%
Nonperforming assets to total assets	0.11%	0.20%	0.50%	0.59%	0.82%

Statistical Data:

Number of:

Employees (full-time equivalents)	1,789	1,624	1,121	953	890
Full service branches	140	135	86	79	77

Reported net income	\$61,219	\$56,305	\$34,913	\$25,587	\$16,188
Add back: goodwill amortization net of tax(2)	0	0	0	0	2,538
Total	\$ 61,219	\$ 56,305	\$ 34,913	\$ 25,587	\$ 18,726

Basic earnings per share:

Reported net income	\$ 1.77	\$ 1.66	\$ 1.45	\$ 1.19	\$ 0.81
Goodwill amortization	0.00	0.00	0.00	0.00	0.13
Adjusted net income	\$ 1.77	\$ 1.66	\$ 1.45	\$ 1.19	\$ 0.94

Diluted earnings per share:

Reported net income	\$ 1.75	\$ 1.62	\$ 1.42	\$ 1.16	\$ 0.79
Goodwill amortization	0.00	0.00	0.00	0.00	0.13
Adjusted net income	\$ 1.75	\$ 1.62	\$ 1.42	\$ 1.16	\$ 0.92

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	December 31,				
	2005	2004	2003	2002	2001
	(Dollars in thousands)				
Balance Sheet Data:					
Total assets	\$ 7,558,928	\$ 6,942,224	\$ 4,279,321	\$ 3,507,021	\$ 3,038,593
Loans receivable, net	4,885,916	4,251,877	2,906,426	2,390,422	2,109,479
Mortgage-backed securities	1,960,582	2,036,920	983,736	743,610	617,569
Investments	167,957	167,665	89,448	86,558	76,479
Deposits	4,806,301	3,863,296	2,455,076	2,014,096	1,853,536
FHLB Seattle advances	1,443,462	1,635,933	1,026,031	874,515	633,054
Reverse repurchase agreements and funds purchased	611,676	780,012	363,137	249,769	218,549
Other borrowings	110,688	131,822	137,998	127,682	127,500
Shareholders equity	506,685	469,844	250,348	203,656	165,690
Capital Ratios:(3)					
Total capital to risk-weighted assets					
Sterling	10.5%	N/A	N/A	N/A	N/A
Sterling Savings Bank	10.2%	10.7%	10.9%	11.0%	11.7%
Tier I capital to risk-weighted assets					
Sterling	9.5%	N/A	N/A	N/A	N/A
Sterling Savings Bank	9.2%	9.7%	9.9%	10.0%	10.8%
Tier I capital to average assets					
Sterling	7.4%	N/A	N/A	N/A	N/A
Sterling Savings Bank	7.2%	6.6%	7.4%	7.6%	8.0%

- (1) All prior period per share and weighted average share amounts have been restated to reflect the 3 for 2 stock split that was effected August 31, 2005.
- (2) Sterling adopted SFAS No. 142 Goodwill and Intangible Assets on January 1, 2002. The tabular presentation reflects retroactive application of SFAS No. 142, even though SFAS No. 142 by its terms applies prospectively.
- (3) Sterling Financial Corporation did not have regulatory capital ratio requirements prior to its conversion to a bank holding company.

Table of Contents**SELECTED CONSOLIDATED FINANCIAL INFORMATION OF LYNNWOOD**

The following selected financial data with respect to Lynnwood's balance sheet and its statements of income for the fiscal years ended December 31, 2001 through December 31, 2005 have been derived from its historical audited financial statements for those fiscal years. The audited financial statements for the fiscal years ended December 31, 2005 and December 31, 2004 have been included as Appendix C to this proxy statement/prospectus. This selected financial information should be read in conjunction with such financial statements and the notes thereto.

Lynnwood Financial Group and Subsidiaries
Selected Consolidated and Other Financial Data

	Years Ended December 31				
	2005	2004	2003	2002	2001
(Dollars in thousands, except per share data)					
Income Statement Data:					
Interest income	\$ 42,362	\$ 22,838	\$ 22,295	\$ 18,823	\$ 19,888
Interest expense	(12,797)	(4,570)	(4,058)	(4,568)	(7,066)
Net interest income	29,565	18,268	18,237	14,255	12,822
Provision for losses on loans	(896)	(897)	(305)	(319)	(146)
Net interest income after provision for losses on loans	28,669	17,371	17,932	13,936	12,676
Non-interest income	21,767	18,776	23,603	16,136	12,652
Non-interest expenses	(36,239)	(27,318)	(30,447)	(23,569)	(21,651)
Income before income taxes	14,197	8,829	11,088	6,503	3,677
Income tax provision	(4,733)	(2,483)	(3,898)	(2,350)	(1,458)
Net income	\$ 9,464	\$ 6,346	\$ 7,190	\$ 4,153	\$ 2,219
Per Share Data:					
Earnings per share:					
Basic	\$ 9.38	\$ 7.36	\$ 9.53	\$ 5.52	\$ 2.95
Diluted	\$ 9.27	\$ 6.84	\$ 7.20	\$ 4.19	\$ 2.24
Book value per share	\$ 33.53	\$ 28.47	\$ 29.49	\$ 21.28	\$ 15.45
Performance Ratios:					
Net interest spread	7.06%	7.60%	9.52%	8.94%	9.38%
Efficiency ratio	70.60%	73.74%	72.77%	77.55%	84.99%
Return on average assets	2.35%	2.66%	3.63%	2.47%	1.53%
Return on average equity	30.73%	25.87%	35.95%	30.93%	20.30%
Average equity to average assets	7.64%	10.30%	9.67%	8.23%	7.51%
Asset Quality Ratios:					
Non-performing assets to total loans	0.00%	0.04%	0.17%	0.00%	0.44%
Net charge-offs to average loans	0.00%	0.01%	0.07%	0.00%	0.00%
Allowance for losses to total loans	0.72%	0.84%	0.80%	0.82%	0.77%
Non-performing assets to total assets	0.00%	0.04%	0.14%	0.00%	0.30%

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	December 31,				
	2005	2004	2003	2002	2001
Balance Sheet Data:					
Total assets	\$ 497,371	\$ 286,491	\$ 191,406	\$ 202,922	\$ 145,736
Loans held for sale	\$ 40,204	\$ 23,439	\$ 23,444	\$ 62,075	\$ 40,970
Loans receivable, net	\$ 428,681	\$ 250,758	\$ 155,997	\$ 131,437	\$ 98,436
Deposits	\$ 417,699	\$ 234,137	\$ 127,196	\$ 129,604	\$ 91,221
Other borrowings	\$ 39,867	\$ 22,419	\$ 37,509	\$ 53,782	\$ 40,781
Shareholders' equity	\$ 34,833	\$ 26,761	\$ 22,297	\$ 16,000	\$ 11,614
Common shares outstanding	1,038,921	939,954	756,084	751,745	751,745

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FOR THE YEAR ENDED DECEMBER 31, 2005**

The following table summarizes unaudited per share information for Sterling and Lynnwood on a historical basis and a pro forma combined basis for Sterling. It has been assumed for purposes of the pro forma financial information provided below for the year ended December 31, 2005, the merger was completed on January 1, 2005 for income statement purposes, and on December 31, 2005 for balance sheet purposes. The following information should be read in conjunction with the audited consolidated financial statements of Sterling as of and for the year ended December 31, 2005, which are incorporated by reference into this document and the audited consolidated financial statements of Lynnwood as of and for the year ended December 31, 2005, which are included in Appendix C of this document. The following pro forma information has been prepared in accordance with the rules and regulations of the SEC and accordingly includes the effects of purchase accounting. It does not reflect cost savings, synergies or certain other adjustments that may result from the merger with Lynnwood. This information is presented for illustrative purposes only and is not necessarily indicative of the operating results or financial position that would have occurred if the merger had been completed as of the dates indicated, nor is it necessarily indicative of the future operating results or financial position of the combined company.

The historical book value per share is computed by dividing total shareholders' equity by the number of shares of common stock outstanding at the end of the period. The pro forma income per share of the combined company is computed by dividing the pro forma net income available to holders of the combined company's common stock by the pro forma weighted average number of shares outstanding for the periods presented. The pro forma combined book value per share is computed by dividing total pro forma shareholders' equity by the pro forma number of common stock outstanding at the end of the period presented.

	Sterling Historical	Lynnwood Historical	Pro Forma Combined
Earnings for fiscal year 2005:			
Basic	\$ 1.77	\$ 9.38	\$ 1.94
Diluted	1.75	9.27	\$ 1.92
Cash dividends declared:			
For fiscal year 2005	\$ 0.105	\$ 2.99	\$ 0.18
Book value:			
As of December 31, 2005	\$ 14.54	\$ 33.53	\$ 15.13

Table of Contents**MARKET PRICE DATA AND DIVIDEND INFORMATION****Comparative Market Price Information**

The following table presents trading information for Sterling common stock on the Nasdaq National Market System on February 10, 2006, the last trading day prior to the announcement of the signing of the merger agreement and on May 4, 2006, the last practical trading day for which information was available prior to the date of the printing of this proxy statement/ prospectus. The table also presents, for illustrative purposes only, the value of per share consideration to be received by Lynnwood shareholders in comparison to the price of Sterling common stock, as indicated.

	Closing Sales Price		
	Sterling	Lynnwood(1)	Lynnwood Equivalent(2)
Price per share:			
February 10, 2006	\$ 26.70	N/A	\$ 61.42
May 4, 2006	32.04	N/A	70.67

- (1) There are no publicly available quotations of Lynnwood common stock. Lynnwood's board of directors approved a sale of Lynnwood common stock on October 31, 2005 at a price of \$55 per share, which was the last sale of Lynnwood common stock prior to February 10, 2006.
- (2) The equivalent price per share data for Lynnwood common stock have been determined by dividing (1) the sum of (a) the product obtained by multiplying the last reported sale price of a share of Sterling common stock on February 10, 2006 and May 4, 2006, respectively, by 1,800,000, the number of Sterling shares to be issued in the merger, and (b) \$15,750,000, the amount of cash to be paid by Sterling in the merger, by (2) 1,038,921, the number of outstanding shares of Lynnwood common stock. The actual value of the consideration to be received by Lynnwood shareholders will be based on the average closing price of Sterling common stock over the 20 trading days ending on the fifth business day immediately prior to the Closing Date.

You should obtain current market quotations for Sterling common stock. The market price of Sterling common stock will probably fluctuate between the date of this document and the date on which the merger is completed and after the merger. Because the market price of Sterling common stock is subject to fluctuation, the value and number of the shares of Sterling common stock that you may receive in the merger may increase or decrease prior to and after the merger.

Historical Market Prices and Dividend Information***Sterling.***

Sterling common stock is listed on the Nasdaq National Market System under the symbol STSA. The following table sets forth, for the calendar quarters indicated, the high and low sales prices per share of Sterling common stock as reported on the Nasdaq National Market System.

As of March 31, 2006, there were 35,066,735 outstanding shares of Sterling common stock held by approximately 1,874 shareholders of record.

On July 26, 2005, Sterling announced a quarterly cash dividend of \$0.05 per share of common stock, which resulted in a payment of \$1.7 million on October 14, 2005 to shareholders of record as of September 30, 2005. On October 25, 2005, Sterling announced a quarterly cash dividend of \$0.055 per share of common stock, which resulted in a payment of \$1.9 million on January 13, 2006 to shareholders of record as of December 30, 2005. On February 28, 2006, Sterling announced a quarterly cash dividend of \$0.06 per share of common stock, payable on April 13, 2006 to shareholders of record as of March 31, 2006. The board of directors of Sterling from time to time evaluates the payment of cash dividends. The timing and amount of any future dividends will depend upon earnings, cash

requirements, capital requirements, the financial condition of Sterling and its subsidiaries, applicable government regulations and other factors deemed relevant by Sterling's board of directors.

Table of Contents***Lynnwood.***

Lynnwood common stock is not publicly traded on Nasdaq or any other exchange. Lynnwood common stock has occasionally been sold or transferred in private transactions. Due to the limited information available and the absence of any trading market, such transactions may not accurately reflect the actual market value of Lynnwood common stock.

As of January 31, 2006, there were 1,038,921 outstanding shares of Lynnwood common stock held by approximately 60 holders of record.

Lynnwood has paid dividends to shareholders of record for each of the following years in the following amounts:

Year	Total Dividends
2005	\$ 2,999,000
2004	\$ 1,998,000
2003	\$ 946,000
2002	0

Lynnwood is restricted in its ability to make future dividend payments. See Lynnwood's Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Management, and The Merger Agreement—Conduct of Lynnwood Pending the Merger—Dividends and Capital Stock.

Sterling and Lynnwood Quarterly Stock Price and Dividend Information.

The following table sets forth, for the calendar quarters indicated, the high and low sales prices per share of Lynnwood common stock in such transactions known to Lynnwood management.

	Sterling Common Stock			Lynnwood Common Stock		
	High	Low	Dividends	High	Low	Dividends
2005						
Quarter ended December 31	\$ 26.78	\$ 21.86	\$ 0.055	\$ 55.00	\$ 55.00	\$ 0.000
Quarter ended September 30	27.39	21.66	0.050	None	None	0.000
Quarter ended June 30	25.12	21.69	0.000	None	None	0.000
Quarter ended March 31	26.75	23.36	0.000	\$ 30.00	\$ 30.00	2.99
2004						
Quarter ended December 31	\$ 27.50	\$ 23.26	\$ 0.000	\$ 30.00	\$ 30.00	\$ 0.000
Quarter ended September 30	23.87	20.45	0.000	\$ 21.66	\$ 21.66	0.000
Quarter ended June 30	22.57	19.05	0.000	None	None	2.13
Quarter ended March 31	23.61	20.12	0.000	None	None	0.000
2003						
Quarter ended December 31	\$ 21.70	\$ 16.89	\$ 0.000	None	None	\$ 0.000
Quarter ended September 30	17.69	14.55	0.000	None	None	1.250
Quarter ended June 30	15.00	11.46	0.000	\$ 21.66	\$ 21.66	0.000
Quarter ended March 31	11.70	10.31	0.000	None	None	0.000
2002						
Quarter ended December 31	\$ 11.32	\$ 9.23	\$ 0.000	None	None	\$ 0.000
Quarter ended September 30	11.18	8.75	0.000	None	None	0.000
Quarter ended June 30	12.73	10.22	0.000	None	None	0.000
Quarter ended March 31	11.39	7.39	0.000	None	None	0.000

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RISK FACTORS

By voting in favor of the merger, you will be choosing to invest in the common stock of Sterling and Lynnwood as a combined company to the extent you receive Sterling common stock in exchange for your shares of Lynnwood common stock. An investment in the combined company's common stock contains a high degree of risk. In addition to the other information included in this proxy statement/prospectus, including the matters addressed in the section entitled "Cautionary Statement Regarding Forward-Looking Statements" on page 25, you should carefully consider the matters described below in determining whether to approve the principal terms of the plan of merger.

Risks Related to the Merger

The merger consideration formula will not be determined until the time of the merger because the Sterling average price used to calculate the merger consideration formula will not be determined until five business days prior to the effective date.

The merger consideration formula depends on the average closing price of Sterling common stock over a 20 consecutive trading-day period ending on the fifth business day prior to the closing of the merger, referred to as the average price, which will not be known until after the special meeting of Lynnwood shareholders. As a result, you will not know the number of shares of Sterling common stock you will receive in the merger at the time you vote on the proposal to approve the merger agreement.

If Sterling is unable to integrate the combined operations successfully, its business and earnings may be negatively affected.

The merger involves the integration of companies that have previously operated independently. Successful integration of Lynnwood's operations will depend primarily on Sterling's ability to consolidate operations, systems and procedures and to eliminate redundancies and costs. No assurance can be given that Sterling will be able to integrate its post-merger operations without encountering difficulties including, without limitation, the loss of key employees and customers, the disruption of its respective ongoing businesses or possible inconsistencies in standards, controls, procedures and policies. Estimated cost savings and revenue enhancements are projected to come from various areas that Sterling's management has identified through the due diligence and integration planning process. The elimination and consolidation of duplicate tasks are projected to result in annual cost savings. If Sterling has difficulties with the integration, it might not fully achieve the economic benefits it expects to result from the merger. In addition, Sterling may experience greater than expected costs or difficulties relating to the integration of the business of Lynnwood, and/or may not realize expected cost savings from the merger within the expected time frame.

Shares eligible for future sale could have a dilutive effect.

Shares of Sterling common stock eligible for future sale, including those that may be issued in the acquisition of Lynnwood and any other offering of Sterling common stock for cash, could have a dilutive effect on the market for Sterling common stock and could adversely affect its market price.

As of December 31, 2005, there were 60,000,000 shares of Sterling common stock authorized, of which 34,855,549 shares were outstanding. As a result of the merger, 1,800,000 shares of Sterling common stock will be issued to Lynnwood shareholders.

Lynnwood's directors and executive officers might have additional interests in the merger.

In deciding how to vote on the proposal to approve the merger agreement, you should be aware that Lynnwood's directors and executive officers might have interests in the merger that are different from, or in addition to, the interests of Lynnwood shareholders generally. See the section entitled "The Merger - Interests of Certain Persons in the Merger." Lynnwood's board of directors was aware of these interests and considered them when it recommended approval of the merger agreement.

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Risks Related to Sterling Following Completion of the Merger

Unless otherwise specified, references to we, our and us in this subsection means Sterling and its subsidiaries on a consolidated basis.

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

Sterling is a legal entity separate and distinct from Sterling Savings Bank, although the principal source of Sterling's cash is dividends from Sterling Savings Bank. Our right to participate in the assets of any subsidiary upon such subsidiary's liquidation, reorganization or otherwise will be subject to the claims of the subsidiary's creditors, which will take priority except to the extent that we may be a creditor with a recognized claim.

Sterling Savings Bank is also subject to restrictions under federal law which limit the transfer of funds to us or to other affiliates, whether in the form of loans, extensions of credit, investments, asset purchases or otherwise. Such transfers by Sterling Savings Bank to us or any other affiliate are limited in amount to 10% of Sterling Savings Bank's capital and surplus. Furthermore, such loans and extensions of credit are required to be collateralized.

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

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

A downturn in the local economies or real estate markets could negatively impact our banking business. Because we primarily serve individuals and businesses located in the Pacific Northwest, a significant portion of our total loan portfolio is originated in the Pacific Northwest or secured by Pacific Northwest real estate or other assets. As a result of this geographic concentration the ability of customers to repay their loans, and consequently our results, are impacted by the economic and business conditions in the Pacific Northwest, in particular in the metropolitan areas of Seattle, Washington, Portland, Oregon, Boise, Idaho, Sacramento, California and Phoenix, Arizona. Any adverse economic or business developments or natural disasters in these areas could cause uninsured damage and other loss of value to real estate that secures our loans or could negatively affect the ability of borrowers to make payments of principal and interest on the underlying loans. In the event of such adverse development or natural disaster, our results of operations or financial condition could be adversely affected.

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

We have shifted our focus to community banking.

We are increasing our business banking, consumer and construction lending, while placing an increased emphasis on attracting greater volumes of retail deposits. Business banking, consumer and construction loans generally produce higher yields than residential mortgage loans. Such loans, however, generally involve a higher degree of risk than the financing of residential real estate, primarily because the collateral may be difficult to obtain or liquidate in the event of default. Construction lending is subject to risks such as construction delays, cost overruns, insufficient collateral and the inability to obtain permanent financing in a timely manner. Business banking and construction loans are more expensive to originate

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than residential mortgage loans. As a result, our operating expenses are likely to increase as we increase our lending in these areas. Additionally, we are likely to experience higher levels of loan losses than we would on residential mortgage loans. There can be no assurance that our emphasis on community banking will be successful or that any increase in the yields on business banking, consumer and construction loans will offset higher levels of expense and losses on such loans.

Our loan originations are highly concentrated in certain types of loans.

Our loans, with limited exceptions, are secured by either real estate, marketable securities or corporate assets. A significant portion of our loans are residential construction loans. In addition, the majority of the loans in Lynnwood's portfolio prior to the merger are residential construction loans. Our ability to continue to originate such loans may be impaired by adverse changes in local and regional economic conditions in the real estate markets, or by acts of nature. Due to the concentration of real estate collateral, these events could have a material adverse impact on the value of the collateral, resulting in losses or delinquencies. Our residential mortgage and home equity loans are primarily secured by residential property in the Pacific Northwest. As a result, conditions in the real estate markets specifically, and the Pacific Northwest economy generally, can materially impact the ability of our borrowers to repay their loans and affect the value of the collateral securing these loans. Customer demand for loans secured by real estate could be reduced by a weaker economy, an increase in unemployment, a decrease in real estate values or an increase in interest rates.

At December 31, 2005, approximately 21% of Sterling Savings Bank's total loan portfolio consisted of construction loans, approximately 23% of which were for speculative endeavors. Additionally, 23% of Sterling Savings Bank's loan portfolio consisted of multifamily residential and commercial property loans at December 31, 2005. A reduction in the demand for new construction or multifamily residential and commercial property loans could have a negative impact on the bank and therefore on us.

Our earnings are significantly affected by the fiscal and monetary policies of the federal government and the governments of the states in which it operates.

The Board of Governors of the Federal Reserve System, also known as the Federal Reserve Board, regulates the supply of money and credit in the United States. Its policies determine in large part our cost of funds for lending and investing and the return we earn on those loans and investments, both of which impact net interest margin, and can materially affect the value of financial instruments such as debt securities and mortgage servicing rights. Its policies also can affect our borrowers, potentially increasing the risk that they may fail to repay their loans. Changes in Federal Reserve Board policies are beyond our control and hard to predict or anticipate.

The amount of income taxes that we are required to pay on our earnings is based on federal and state legislation and regulations. We provided for current and deferred taxes in our financial statements, based on our results of operations, business activity, legal structure and interpretation of tax statutes. We may take filing positions or follow tax strategies that may be subject to challenge. Our net income and earnings per share may be reduced if a federal, state, or local authority assessed charges for taxes that have not been provided for in our consolidated financial statements. There can be no assurance that we will achieve our effective tax rate or that taxing authorities will not change tax legislation, challenge filing positions, or assess taxes and interest charges.

Changes in market interest rates could adversely affect our earnings.

Our earnings are impacted by changing market interest rates. Changes in market interest rates impact the level of loans, deposits and investments, the credit profile of existing loans and the rates received on loans and investment securities and the rates paid on deposits and borrowings. One of our primary sources of income from operations is net interest income, which is equal to the difference between the interest income received on interest-earning assets (usually, loans and investment securities) and the interest expense incurred in connection with interest-bearing liabilities (usually, deposits and borrowings). These

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rates are highly sensitive to many factors beyond our control, including general economic conditions, both domestic and foreign, and the monetary and fiscal policies of various governmental and regulatory authorities. Net interest income can be affected significantly by changes in market interest rates. Changes in relative interest rates may reduce net interest income as the difference between interest income and interest expenses decreases.

Interest rates are currently rising, and if interest rates continue to rise, the amount of interest we pay on deposits and borrowings could increase more quickly than the amount of interest we receive on our loans, mortgage-related securities and investment securities. This could cause our profits to decrease. Rising interest rates would likely reduce the value of our mortgage-related securities and investment securities and may decrease demand for loans and make it more difficult for borrowers to repay their loans. Increasing market interest rates may also depress property values, which could affect the value of collateral securing our loans.

An increase in interest rates could also have a negative impact on our results of operations by reducing the ability of borrowers to repay their current loan obligations. These circumstances could not only result in increased loan defaults, foreclosures and write-offs, but also necessitate further increases to the allowances for loan losses. In addition, fluctuations in interest rates may result in disintermediation, which is the flow of funds away from depository institutions into direct investments that pay a higher rate of return and may affect the value of our investment securities and other interest-earning assets.

Our cost of funds may increase as a result of general economic conditions, interest rates or competitive pressures.

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

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

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

In particular, our competitors include major financial companies whose greater resources may provide them a marketplace advantage. Areas of competition include interest rates for loans and deposits, efforts to obtain deposits and the range and quality of services provided. Because we have fewer financial and other resources than larger institutions with which we compete, we may be limited in our ability to attract customers. In addition, some of the current commercial banking customers may seek alternative banking sources as they develop needs for credit facilities larger than we can accommodate. If we are unable to attract and retain customers, we may be unable to continue our loan and deposit growth, and our results of operations and financial condition may otherwise be negatively impacted.

We may not be able to successfully implement our internal growth strategy.

We have pursued and intend to continue to pursue an internal growth strategy, the success of which will depend primarily on generating an increasing level of loans and deposits at acceptable risk levels and

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terms without proportionate increases in non-interest expenses. There can be no assurance that we will be successful in implementing our internal growth strategy. Furthermore, the success of our growth strategy will depend on maintaining sufficient regulatory capital levels and on continued favorable economic conditions in the Pacific Northwest.

There are risks associated with potential acquisitions.

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

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

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

Defaults may negatively impact our business.

Increased delinquencies or loan defaults by our customers may negatively impact business. A borrower's default on its obligations under one or more loans may result in lost principal and interest income and increased operating expenses as a result of the allocation of management time and resources to the collection and workout of the loan.

If collection efforts are unsuccessful or acceptable workout arrangements cannot be reached, we may have to charge-off all or a part of the loan. In such situations, we may acquire any real estate or other assets, if any, that secure the loan through foreclosure or other similar available remedies. The amount owed under the defaulted loan may exceed the value of the assets acquired.

Our allowance for loan losses may be inadequate.

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

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

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management determines that additional increases in the allowance for loan losses are necessary, we may incur additional expenses.

Our loans are primarily secured by real estate, including a concentration of properties located in the Pacific Northwest. If an earthquake, volcano eruption or other natural disaster were to occur in one of the major market areas, loan losses could occur that are not incorporated in the existing allowance for loan losses.

We are expanding our lending activities in riskier areas.

We have identified commercial real estate, commercial business and consumer loans as areas for increased lending emphasis. While increased lending diversification is expected to increase interest income, non-residential loans carry greater risk of payment default than residential real estate loans. As the volume of these loans increase, credit risk increases. In the event of substantial borrower defaults, our provision for loan losses would increase and therefore, earnings would be reduced.

Our operations could be interrupted if our third-party service providers experience difficulty, terminate their services or fail to comply with banking regulations.

We depend, and will continue to depend, to a significant extent, on a number of relationships with third-party service providers. Specifically, we receive core systems processing, essential web hosting and other Internet systems and deposit and other processing services from third-party service providers. If these third-party service providers experience difficulties or terminate their services and we are unable to replace them with other service providers, our operations could be interrupted. If an interruption were to continue for a significant period of time, business, financial condition and results of operations could be materially adversely affected.

Our internal control systems could fail to detect certain events.

We are subject to certain operations risks, including but not limited to data processing system failures and errors and customer or employee fraud. We maintain a system of internal controls to mitigate against such occurrences and maintain insurance coverage for such risks, but should such an event occur that is not prevented or detected by our internal controls, uninsured or in excess of applicable insurance limits, it could have a significant adverse impact on our business, financial condition or results of operations.

The network and computer systems on which we depend could fail or experience a security breach.

Our computer systems could be vulnerable to unforeseen problems. Because we conduct part of our business over the Internet and outsource several critical functions to third parties, operations will depend on the ability, as well as that of third-party service providers, to protect computer systems and network infrastructure against damage from fire, power loss, telecommunications failure, physical break-ins or similar catastrophic events. Any damage or failure that causes interruptions in operations could have a material adverse effect on business, financial condition and results of operations.

In addition, a significant barrier to online financial transactions is the secure transmission of confidential information over public networks. Our Internet banking system relies on encryption and authentication technology to provide the security and authentication necessary to effect secure transmission of confidential information. Advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms our third-party service providers use to protect customer transaction data. If any such compromise of security were to occur, it could have a material adverse effect on our business, financial condition and results of operations.

We could be held responsible for environmental liabilities of properties acquired through foreclosure.

If we are forced to foreclose on a defaulted mortgage loan to recover our investment, we may be subject to environmental liabilities related to the underlying real property. Hazardous substances or wastes,

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contaminants, pollutants or sources thereof may be discovered on properties during its ownership or after a sale to a third party. The amount of environmental liability could exceed the value of real property. There can be no assurance that we would not be fully liable for the entire cost of any removal and clean-up on an acquired property, that the cost of removal and clean-up would not exceed the value of the property, or that costs could be recovered from any third party. In addition, we may find it difficult or impossible to sell the property prior to or following any environmental remediation.

Our banking business is highly regulated.

State-chartered banks operate in a highly regulated environment and are subject to supervision and examination by federal and state regulatory agencies. As a Washington State-chartered commercial bank, our subsidiary Sterling Savings Bank is subject to regulation and supervision by the FDIC and the WDFI. Federal and state laws and regulations govern numerous matters, including changes in the ownership or control of banks, maintenance of adequate capital and the financial condition of a financial institution, permissible types, amounts, and terms of extensions of credit and investments, maintenance of permissible non-banking activities, maintenance of deposit insurance, protection of financial privacy the level of reserves against deposits, and restrictions on dividend payments.

The FDIC, the Federal Reserve Board and the DFI possess cease and desist powers to prevent or remedy unsafe or unsound practices or violations of law by banks subject to their regulations. These and other restrictions limit the manner in which we may conduct business and obtain capital or financing.

Our stock price can be volatile.

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

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

No assurance can be given that dividends payable on Sterling common stock, including the stock to be received by Lynnwood shareholders in the merger, will continue at historical levels, or at all.

Future legislation could change our competitive position.

Various legislation, including proposals to change substantially the financial institution regulatory system and to expand or contract the powers of banking institutions and bank holding companies, is from time to time introduced in the Congress. This legislation may change banking statutes and our operating environment in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. We cannot predict whether any of this potential legislation will be enacted, and if enacted, the effect that it, or any implementing regulations, would have on our financial condition or results of operations.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This document, including information included or incorporated by reference in this document may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act of 1934, as amended, and Sterling and Lynnwood intend for such forward-looking statements to be covered by the safe harbor provisions for forward looking statements contained in the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, (i) statements about the benefits of the merger, including future financial and operating results, cost savings, enhancements to revenue and accretion to reported earnings that may be realized from the merger; (ii) statements about our respective plans, objectives, expectations and intentions and other statements that are not historical facts; (iii) statements about expectations regarding the timing of the closing of the merger and the ability to obtain regulatory approvals on a timely basis; and (iv) other statements identified by words such as expects, anticipates, intends, plans, believes, seeks, estimates, or words of similar meaning. These forward-looking statements are based on current beliefs and expectations of Sterling's and Lynnwood's respective management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are difficult to predict and beyond Sterling's and Lynnwood's control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

our businesses may not be combined successfully, or such combination may take longer to accomplish than expected;

the growth opportunities and cost savings from the merger may not be fully realized or may take longer to realize than expected;

operating costs, customer losses and business disruption following the merger, including adverse effects of relationships with employees, may be greater than expected;

adverse governmental or regulatory policies may be enacted;

the interest rate environment may change, causing margins to compress and adversely affecting net interest income;

the global financial markets may experience increased volatility;

we may experience adverse changes in our credit rating;

we may experience competition from other financial services companies in our markets; and

the risk of an economic slowdown that may adversely affect credit quality and loan originations.

Additional factors that could cause actual results to differ materially from those expressed in the forward-looking statements are discussed under "Risk Factors" beginning on page 18 and in Sterling's reports filed with the SEC.

All subsequent written and oral forward-looking statements concerning the proposed transaction or other matters attributable to Sterling or Lynnwood or any person acting on behalf of Sterling or Lynnwood are expressly qualified in their entirety by the cautionary statements above. Neither Sterling nor Lynnwood undertake any obligation to update any forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made.

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THE SPECIAL MEETING OF LYNNWOOD SHAREHOLDERS

This proxy statement/prospectus constitutes the proxy statement of Lynnwood Financial Group, Inc., which we refer to as Lynnwood, for use at the special meeting of Lynnwood's shareholders to be held on June 14, 2006, at 23515 Timberlane Road, Woodway, Washington, 98020, at 3:00 p.m., local time, and any adjournments thereof.

At the special meeting, the shareholders of Lynnwood will consider and vote upon a proposal to approve the principal terms of the plan of merger, as provided in the Agreement and Plan of Merger dated as of February 12, 2006, which is included as Appendix A.

Pursuant to the merger agreement, Lynnwood will merge with and into Sterling, and Lynnwood's subsidiaries, Golf Savings Bank, Golf Escrow Corporation, Lynnwood Statutory Trust I and Lynnwood Statutory Trust II, will become independently operating wholly owned subsidiaries of Sterling. We expect to complete the merger of Lynnwood with and into Sterling during the third quarter of 2006.

When we complete the merger, Lynnwood founder Charles Ainslie and his wife, Lynette, will receive a combination of cash and shares of Sterling common stock as merger consideration for each share of Lynnwood common stock they own, and all other Lynnwood shareholders will receive merger consideration in the form of shares of Sterling common stock for each share of Lynnwood common stock they own, subject to proration and adjustments as described in "The Merger - Consideration to be Received in the Merger." Sterling common stock received by Charles and Lynette Ainslie, and by Donn Costa and Dennis O'Leary, will be subject to certain sale and transfer restrictions as described in "The Merger - Shareholder Agreements." Sterling common stock received by all other Lynnwood shareholders will be unrestricted publicly traded stock.

All information contained in this proxy statement/prospectus with respect to Lynnwood has been supplied by Lynnwood. All information contained in this proxy statement/prospectus with respect to Sterling has been supplied by Sterling.

This proxy statement/prospectus is first being mailed to shareholders of Lynnwood on or about May 9, 2006.

Record Date

The close of business on May 5, 2006 was the record date for determining Lynnwood shareholders entitled to receive notice of and to vote at the special meeting.

Voting

On the record date, there were 1,038,921 shares of Lynnwood common stock outstanding held by 60 holders of record. Each holder of Lynnwood common stock is entitled to one vote for each share of Lynnwood common stock in that holder's name on Lynnwood's books as of the record date on any matter submitted to the vote of the Lynnwood shareholders at the special meeting. Under the terms of the merger agreement, the approval of the plan of merger will require the affirmative vote, in person or by proxy, of two-thirds of the outstanding shares of Lynnwood common stock not held by Charles and Lynette Ainslie. Authorization to adjourn the special meeting, if necessary, to solicit additional proxies requires the favorable vote of a majority of the shares represented at the special meeting. The directors and executive officers of Lynnwood and their affiliates hold 80.46% of the outstanding shares entitled to vote. Three of Lynnwood's shareholders, Charles Ainslie, Donn Costa and Dennis O'Leary, have agreed to vote an aggregate of 64.60% of Lynnwood's outstanding common stock in favor of the plan of merger. See the section entitled "The Merger Agreement - Voting Agreements."

Shares of Lynnwood common stock that are not represented in person or by proxy at the special meeting shall not be counted in determining whether a quorum is present and shall not be deemed present at the special meeting. Proxies submitted by any shareholder that are unmarked as to any matter shall be voted in favor of the merger in accordance with the recommendation of the board of directors of

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Lynnwood. Abstentions are counted towards a quorum, but abstentions are the equivalent of **AGAINST** votes with respect to the approvals of the merger and authority to vote for adjournments to solicit additional proxies.

Adjournments

Although it is not anticipated, the special meeting may be adjourned for the purpose of soliciting additional proxies in favor of the plan of merger. Any adjournment of the special meeting may be made without notice, other than by an announcement made at the special meeting, by approval of the holders a majority of the shares of Lynnwood common stock present in person or represented by proxy at the special meeting, whether or not a quorum exists. Any adjournment of the special meeting for the purpose of soliciting additional proxies will allow Lynnwood's shareholders who have already sent in their proxies to revoke them at any time prior to their use.

Revocation of Proxies

Any proxy in the form enclosed for Lynnwood shareholders that is properly completed and returned in time for voting with a choice specified thereon will be voted in accordance with that specification.

Lynnwood shareholders may revoke a proxy at any time by: (i) sending written notice of revocation to the Corporate Secretary of Lynnwood prior to the special meeting; (ii) executing and delivering a proxy for the special meeting bearing a later date; or (iii) attending the special meeting and voting in person.

Proxies which do not provide the proxy holders with direction in voting on the merger or with respect to adjournments will be voted in favor of the merger and in favor of granting authority to adjourn the special meeting, in accordance with the recommendation of the board of directors of Lynnwood, and Lynnwood shareholders who have provided such proxies will not be eligible to assert their dissenters' rights.

Proxy Solicitation

The accompanying proxy is being solicited by the board of directors of Lynnwood. Lynnwood will bear the entire cost of solicitation of proxies from holders of its shares. In addition to the solicitation of proxies by mail, certain officers, directors and employees of Lynnwood, without extra remuneration, may also solicit proxies in person, by telephone, facsimile or otherwise. Lynnwood will pay printing, postage and mailing costs for preparation and mailing of the proxy statement/ prospectus. All other costs, including legal and accounting fees, shall be borne by the party incurring such costs.

Outstanding Voting Securities

Lynnwood has only one class of voting securities outstanding, Lynnwood common stock. Shareholders of record entitled to notice of and to vote at the special meeting have been determined as of the record date, May 5, 2006, and, as of such date, 1,038,921 shares of Lynnwood common stock were outstanding, all of which are entitled to vote at the special meeting.

Table of Contents**Security Ownership of Management and Certain Beneficial Owners**

The following table sets forth information as of December 31, 2005, regarding the shares of Lynnwood common stock beneficially owned (including all vested and unvested options) by (i) each person (other than executive officer or directors whose stock ownership is listed below) known by Lynnwood to own beneficially more than 5% of Lynnwood's common stock; (ii) each director of Lynnwood (including Lynnwood's President and CEO); (iii) each executive officer of Lynnwood; and (iv) all directors and executive officers of Lynnwood. Except as noted below, each holder has sole voting and investment power with respect to shares of Lynnwood common stock listed as owned by such person. There are no shareholders with ownership of 5% or greater, other than the directors and executive officers indicated below.

Beneficial Stock Ownership of Directors and Executive Officers as a Group (10 Individuals)

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class
Charles J Ainslie President & CEO Lynette Ainslie (included in above)	551,198	53.05%
Dennis V. O Leary EVP & Director	123,637	11.9%
Donn C. Costa EVP & Director	125,715	12.1%
Robert B. Fuller EVP & Director(1)	39,662	3.73%(3)
David E. A. Holmstrom SVP & Director	1,428	*
Gerald R. Zachary Director	2,338	*
William Tindall Director	3,768	*
Nicole A. Galipeau Director(2)	15,058	1.45%
Jennifer Clark Director	1,000	*
All directors and executive officers as a group	863,804	81.22%(3)

* Less than 1%.

(1) Includes 24,662 shares issuable pursuant to vested stock options.

(2) Includes 3,000 shares held of record by Ms. Galipeau as trustee of the William Jay Ainslie Galipeau Irrevocable Trust and 6,200 shares held for the benefit of Ms. Galipeau's children.

(3) Based on 1,038,921 shares outstanding as of December 31, 2005, together with 24,662 shares issuable pursuant to vested stock options.

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THE MERGER

General

The boards of directors of Sterling and Lynnwood have unanimously approved the plan of merger providing for the merger of Lynnwood with and into Sterling with Sterling being the surviving entity and Lynnwood's wholly owned subsidiaries, Golf Savings Bank and Golf Escrow Corporation, becoming wholly owned and independent operating subsidiaries of Sterling. Lynnwood Statutory Trust I and Lynnwood Statutory Trust II, two special purpose subsidiaries of Lynnwood formed for the sole purpose of providing capital to Golf Savings Bank, will also become wholly owned subsidiaries of Sterling. We expect to complete the merger of Lynnwood with and into Sterling during the third quarter of 2006.

Background of the Merger

In June of 2000, Lynnwood Mortgage Corporation, a successful residential mortgage company headquartered in Mountlake Terrace Washington, and owned by Charles and Lynette Ainslie, received all necessary regulatory approval to convert to a Washington State stock savings bank. At the same time, Lynnwood, a Washington corporation formed in November 1999 in anticipation of the bank conversion, received approval to become a savings and loan holding company pursuant to the Home Owners Loan Act of 1994. As a part of the bank conversion transaction, Lynnwood Mortgage Corporation reorganized as Golf Savings Bank and became a wholly owned subsidiary of Lynnwood. Golf Escrow Corporation (formerly known as Lynnwood Escrow Corporation), which had been a wholly owned subsidiary of Lynnwood Mortgage Corporation, also became a wholly owned subsidiary of Lynnwood as part of the conversion transaction. In connection with the bank conversion process, Lynnwood sold approximately 200,000 shares of its common stock to qualified investors raising approximately \$3,500,000 in capital. Most of the original subscribers of the initial private stock offering continue to be shareholders of Lynnwood. In June of 2000, Golf Savings Bank opened its doors for business as a wholly owned subsidiary of Lynnwood.

During the normal course of its business, the board of directors of Lynnwood periodically reviewed and assessed its business plan and strategic options. Over the course of the last three years, Lynnwood has considered various internal and external strategies to grow and enhance Lynnwood's and Golf Savings Bank's business for the purpose of enhancing shareholder value and achieving shareholder liquidity. Those discussions have included analysis of the financial institution merger market on a national and regional basis, and analysis of access to both private and public capital markets. While the rapid growth and success of the bank's mortgage lending was gratifying and profitable, the Lynnwood board of directors recognized that additional capital would be needed in order for the bank to be able to continue to grow its core business and diversify its product offerings consistent with its business plan. As a result of the inherent risks and volatility of mortgage interest rates and residential construction warehousing lines, as well potential impacts from the eventual retirement of Lynnwood's founder, Charles Ainslie, the Lynnwood board of directors determined in 2002 to consider growth strategies involving merger partners that could provide enhanced value and liquidity to Lynnwood's shareholders.

During 2002 and 2003, Lynnwood, together with its investment banking advisors, explored potential merger and acquisition opportunities. During that period, no acceptable opportunities were found and Lynnwood's executive management and board of directors determined that further efforts would not be in the best interests of Lynnwood and its shareholders. Instead, Lynnwood focused on internal growth strategies for the next 12 to 24 months. Operationally, Golf Savings Bank continued to have impressive results, and in 2003 the bank generated over \$1 billion in mortgages for the first time.

In May 2005, Lynnwood's executive management determined that prevailing market conditions again favored a search for potential merger partners. By July of 2005, executive management determined that the best approach would be to jointly engage the investment banking firms of Sandler O'Neill & Partners, L.P. and D.A. Davidson & Co. to serve as financial advisors to Lynnwood. On August 9, 2005, the Lynnwood board of directors approved the concept of a joint investment banking engagement. The engagement of both investment banking firms was finalized and approved by the Lynnwood board of

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directors on September 22, 2005. During October and November 2005, the investment banks performed their due diligence review of Lynnwood and prepared information regarding Lynnwood to be provided to targeted parties. In November 2005, five confidentiality agreements were executed with various interested parties, including Sterling.

Preliminary merger discussions between Lynnwood and Sterling began in December of 2005, and a meeting was held between the two companies' executives and financial advisors. Later in December, Charles Ainslie and Lynnwood board member Bill Tindall met with Harold Gilkey to further evaluate the potential fit of the two organizations.

On December 19, 2005, Sterling delivered to Lynnwood a letter of intent, including a nonbinding term sheet, to formalize its interest in acquiring Lynnwood, subject among other things, to the satisfactory completion of Sterling's due diligence investigation of Lynnwood. From December 19, 2005 to December 23, 2005, Lynnwood's executive management, together with Lynnwood's legal counsel and financial advisors, analyzed and revised the letter of intent and nonbinding term sheet.

On the morning of December 23, 2005, Messrs. Gilkey and Ainslie met, along with a representative of Sandler O'Neill & Partners, L.P., to discuss the letter of intent and nonbinding term sheet, including the consideration to be received in the merger. During negotiations it became clear that Sterling would require Mr. Ainslie and his wife Lynette to agree to restrictions on their ability to sell the Sterling shares received in the merger, in order to minimize the potential impact that a sale of a large block of Sterling shares might have on the market. These restrictions would be in addition to the restrictions imposed on Mr. and Mrs. Ainslie under federal securities laws that limit trading volumes for former officers and directors of Lynnwood. These volume restrictions would not likely apply to any of the other Lynnwood officers or directors, as they would not receive sufficient Sterling shares to be affected by the volume limits. To lessen the adverse impact of these restrictions on Mr. and Mrs. Ainslie's ability to obtain liquidity, Lynnwood proposed that all of the cash offered as consideration in the merger would be paid to Mr. and Mrs. Ainslie, noting that structuring the payment of the merger consideration in this way was permissible under Washington law. Sterling agreed to the proposal. That afternoon, Lynnwood, with the assistance of its legal counsel and financial advisors, provided comments to the letter of intent and nonbinding term sheet. Mr. Gilkey then discussed the comments with Daniel G. Byrne, Sterling's Chief Financial Officer, and a representative of Witherspoon, Kelley, Davenport & Toole, P.S., Sterling's counsel, who revised the letter of intent and nonbinding term sheet and delivered it to Lynnwood. Mr. Byrne, representatives of Witherspoon, Kelley, Davenport & Toole, P.S., and representatives of Williams, Kastner & Gibbs PLLC, Lynnwood's counsel, then held a call to discuss the revised letter of intent and nonbinding term sheet. Sterling then prepared and delivered to Lynnwood a revised letter of intent and nonbinding term sheet that incorporated the changes discussed and agreed to by the parties. Thereafter, on the same day, on behalf of Lynnwood, Charles Ainslie executed the letter of intent. On January 19, 2006, the Lynnwood board of directors unanimously ratified and approved the letter of intent and nonbinding term sheet and authorized Charles Ainslie to proceed with negotiations consistent with the general terms of the term sheet. During January 2006, both Sterling and Lynnwood conducted mutual due diligence, including on-site visits.

Following the January 19, 2006 Lynnwood board of directors approval of the letter of intent and nonbinding term sheet, and concurrent with the ongoing due diligence, Lynnwood and Sterling, with assistance from both parties' legal counsel and Lynnwood's financial advisors, extensively negotiated the terms of a definitive merger agreement. These negotiations occurred during the last two weeks of January and the first two weeks of February, 2006.

On February 12, 2006, the Lynnwood board of directors unanimously approved the definitive merger agreement. Prior to approval, the board of directors discussed their fiduciary duties to Lynnwood and its shareholders, questions about the merger agreement, the form of consideration to be received by the Lynnwood shareholders and its allocation among the Lynnwood shareholders, the termination fees, the current stock price of Sterling and its dividend history, and the implications to Lynnwood, its shareholders, employees, and customers. Also discussed were the reasons for completing the merger and the implications

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to Lynnwood if Golf Savings Bank continued without an affiliation with Sterling. The board of directors also considered extensive information provided by its investment banker regarding the market, Sterling, the merger consideration and value.

On February 12, 2006, immediately following the Lynnwood board meeting, the Sterling board of directors held a meeting to consider the approval of the proposed transaction. During this meeting, Mr. Gilkey summarized the material terms of the proposed transaction, and led Sterling's board of directors in a discussion of the merits, risks and the strategic reasons for and against the transaction. Following this discussion, Sterling's board of directors unanimously approved the definitive merger agreement. At the conclusion of the arm's length negotiations between representatives of Sterling and Lynnwood, and pursuant to the resolutions adopted by each company's board of directors, Sterling and Lynnwood entered into the merger agreement, dated as of February 12, 2006.

Recommendation of the Lynnwood Board of Directors and Reasons of Lynnwood for the Merger

The Lynnwood board of directors unanimously determined that the merger is in the best interests of Lynnwood and the Lynnwood shareholders and unanimously recommends that Lynnwood shareholders vote for the approval of the plan of merger and the consummation of the transactions contemplated by the merger agreement.

In reaching its determination to approve the plan of merger, the Lynnwood board of directors consulted with Lynnwood's management and its financial and legal advisors, and considered a number of factors. The material factors that the Lynnwood board of directors believes favor the merger include, but are not limited to, the following:

Terms of the Merger. The terms of the merger, including the consideration being paid and various other documents related to the merger and the structure of the merger.

Capital Constraints. Lynnwood's growth rate during 2005 expanded its balance sheet to a level near regulatory limits and future growth cannot continue at such a pace without additional capital.

Liquidity. The historical stock price performance and liquidity of Sterling common stock should provide greater liquidity for Lynnwood shareholders, especially for the minority shareholders, because there is no public market for Lynnwood's common stock.

Value. The value to be received by holders of Lynnwood common stock pursuant to the merger agreement in relation to the historical trading prices of Lynnwood common stock, as compared to other similar transactions of a comparable nature in the view of the board of directors' financial advisors.

Dividends. Sterling's common stock pays dividends, and Lynnwood may have limited ability to pay future dividends due to regulatory capital limitations.

Products & Services. Lynnwood customers would be afforded new or enhanced products and services not previously available. Examples of these enhancements include larger credit relationships, more advanced cash management services, a broader array of commercial real estate conduits, and all-in-one residential construction loans.

Competitive Issues. Competition in Lynnwood's market has increased in the past few years, especially in pricing of commercial real estate financing and the competition for single-family mortgage financing, and is expected to increase in the future as other larger banks enter the market.

Financial Advisors. The advice of Sandler O'Neill & Partners, L.P. and D.A. Davidson & Co., Lynnwood's financial advisors, as to the financial terms of the merger.

Future Prospects. The Lynnwood board of directors believes that future earnings prospects will be stronger on a combined basis. In addition, affiliation with Sterling should offer expansion opportunities not currently available

because Lynnwood has nearly reached its regulatory limits and capital is required for future growth.

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Other Strategies. Other alternatives to the merger for raising capital and for achieving shareholder value and liquidity were not likely to be successful in the near term or at all.

Employee Matters. The expectation that the merger will generally expand the career opportunities and employee benefits available to many Lynnwood employees.

Risks of Remaining Independent. The Lynnwood board of directors considered the risks and costs associated with remaining an independent bank given the increasing level of regulation and competition.

Approvals. The likelihood of receiving regulatory approvals in a timely fashion and the likelihood that the merger would be completed.

Corporate Values. The Lynnwood board of directors' belief that the two companies share a common vision of the importance of customer service and that management and employees of Lynnwood and Sterling possess complementary skills and expertise.

Reorganization. The expectation that the merger will constitute a reorganization under section 368(a) of the Internal Revenue Code (see the section entitled "Material United States Federal Income Tax Considerations of the Merger" on page 34).

In the course of its deliberations regarding the merger, the Lynnwood board of directors also considered the following factors, which the board of directors determined did not outweigh the benefits to Lynnwood and its shareholders expected to be generated by the merger:

Amount of Consideration Unknown until Closing. Because the market price of Sterling stock will fluctuate, and because the merger consideration consists of 1,800,000 shares of Sterling common stock, Lynnwood shareholders cannot be sure of the exact dollar value of the consideration they will receive for their shares of Lynnwood common stock.

Business Interruption. The possible disruption to Lynnwood's business that may result from the announcement of the merger and the resulting distraction of its management's attention from the day-to-day operation of Lynnwood's business.

Integration Issues. The difficulty inherent in integrating two businesses and the risk that the cost efficiencies, synergies and other benefits expected to be obtained in the merger may not be fully realized.

Operational Restrictions. The restrictions contained in the merger agreement on the operation of Lynnwood's business during the period between the signing of the merger agreement and completion of the merger.

Termination, No-Approval, and Break-up Fees. Under certain circumstances, Sterling may terminate the merger agreement and require Lynnwood to pay a termination fee of either \$1,000,000 or \$2,500,000, depending on the circumstances of the termination. In certain circumstances, Lynnwood may terminate the merger agreement and require Sterling to pay a termination fee of \$1,000,000. In particular, in certain instances in which the merger agreement is terminated following the receipt of a superior proposal prior to the consummation of the merger and such a superior proposal is accepted, Lynnwood may be required to pay a termination fee of \$2,500,000 and the board of directors considered the risk that this termination fee may discourage third parties from offering to acquire Lynnwood by increasing the cost of a third-party acquisition.

Risk of Termination. The possibility that the merger might not be completed and the effect of the resulting public announcement of the termination of the merger agreement on, among other things, the market price of Lynnwood common stock and Lynnwood operating results, particularly in light of the costs incurred in connection with the

transaction.

The foregoing discussion of the factors considered by the Lynnwood board of directors is not intended to be exhaustive but includes all of the material factors considered by the board of directors. In reaching

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its determination to approve and recommend the merger, the Lynnwood board of directors did not assign any relative or specific weights to the factors considered in reaching that determination and individual directors may have given differing weights to different factors.

After carefully evaluating the above factors, Lynnwood's board of directors has determined that the merger is fair to and in the best interests of Lynnwood and its shareholders. Lynnwood's board of directors unanimously recommends that Lynnwood shareholders vote FOR approval of the plan of merger.

Consideration to be Received in the Merger

At the effective time of the merger, Sterling will issue 1,800,000 shares of Sterling common stock and \$15,750,000 in cash for all outstanding shares of Lynnwood common stock. Lynnwood's founder, Charles Ainslie and his wife, Lynette, will receive all of the cash and a portion of the Sterling common stock to be issued in the merger. All other Lynnwood shareholders will receive Sterling common stock only, except that a Lynnwood shareholder may receive cash in lieu of a fractional share of common stock of Sterling. The shares will be allocated so that each share of Lynnwood common stock receives the same value in the merger. Under the terms of the merger agreement, the value of the shares of Sterling common stock for purposes of this allocation will be the average closing price of Sterling common stock on the Nasdaq Stock Market for the twenty (20) trading days ending on (and inclusive of) the fifth business day immediately prior to the closing date of the merger. Except for the shares to be received by Charles and Lynette Ainslie, Dennis O'Leary and Donn Costa, which will have certain sale restrictions as described below in

The Merger Agreement Shareholder Agreements, the Sterling shares of common stock received by all other shareholders will be unrestricted publicly tradable shares.

Following is an example that illustrates how the merger consideration will be allocated among the Lynnwood shareholders in a manner that provides the same consideration value for each share of Lynnwood common stock:

Assume the average closing price of Sterling common stock on the Nasdaq Stock Market for the twenty (20) trading days ending on (and inclusive of) the fifth business day immediately prior to the closing date of the merger is \$25.00.

The aggregate merger consideration value to be received by all Lynnwood shareholders would be \$60,750,000.00 $((1,800,000 \times \$25.00) + \$15,750,000.00)$.

Assume that 1,038,921 shares of Lynnwood common stock are outstanding. The per share merger consideration value to be received by all Lynnwood shareholders would be \$58.4741 $(\$60,750,000.00 \div 1,038,921)$.

Assume Charles and Lynette Ainslie hold 551,198 Lynnwood Shares. Their consideration value would be \$32,230,806.97 $(\$58.4741 \times 551,198)$.

The value of the Sterling common stock to be received by Charles and Lynette Ainslie would be \$16,480,806.97 $(\$32,230,806.97 - \$15,750,000.00)$.

The number of shares of Sterling common stock that they would receive would be 659,232.2788 shares of Sterling common stock $(\$16,480,806.97 \div \$25.00)$.

The cash and stock to be received by Charles and Lynette Ainslie therefore would be \$15,750,000.00 in cash and 659,232.2788 shares of Sterling Common Stock.

The aggregate number of shares of Sterling common stock to be received by all other Lynnwood shareholders would be 1,140,767.7212 shares $(1,800,000 - 659,232.2788)$.

Assume that all other Lynnwood shareholders hold 487,723 shares of Lynnwood Common Stock. Their per share consideration therefore would be 2.3390 shares of Sterling Common Stock for each share of Lynnwood Common

Stock held by the Other Holders (1,140,767.7212 ÷ 487,723).

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Conversion of Shares; Exchange of Certificates;

As soon as reasonably practicable after the effective time of the merger, each holder of a certificate formerly representing shares of Lynnwood common stock who surrenders such certificate, and upon receipt and acceptance of such certificate together with duly executed transmittal materials by American Stock Transfer & Trust Company, as exchange agent, shall be entitled to a certificate representing Sterling common stock and/or cash as merger consideration.

Reasons of Sterling for the Merger

The merger will enable Sterling to expand and strengthen its community banking presence in the Pacific Northwest, in particular in the Puget Sound region. During its deliberation regarding the approval of the merger agreement, the board of directors of Sterling considered a number of factors, including, but not limited to, the following:

- Lynnwood's strong existing customer base and reputation for providing mortgage banking and financial services;
- the compatibility of the merger with Sterling's long-term community banking strategy;
- Golf Savings Bank's construction lending prowess along the I-5 corridor north of Seattle complements Sterling's existing Puget Sound franchise;
- the ability of the combined company to offer a broader array of products and services to Lynnwood's customers;
- Lynnwood's financial performance would make the transaction immediately accretive to earnings;
- potential opportunities to reduce operating costs and enhance revenue; and

Sterling management's prior record of integrating acquired financial institutions.

Sterling based these assumptions on its present assessment of where savings could be realized based upon the present independent operations of Lynnwood. Actual savings in some or all of these areas could be higher or lower than currently expected.

In reaching its decision to approve the merger agreement, Sterling's board of directors also considered the risks associated with the transaction, and, after due consideration, concluded that the potential benefits of the proposed transaction outweighed the risks associated with the proposed transaction.

The foregoing information and factors considered by Sterling's board of directors are not intended to be exhaustive. In view of the variety of factors and the amount of information considered, Sterling's board of directors did not find it practicable to, and did not, quantify, rank or otherwise assign relative weights to the specific factors it considered in approving the transaction. In addition, individual members of Sterling's board of directors may have given different weights to different factors. Sterling's board of directors considered all of these factors as a whole, and overall considered them to be favorable to and to support its determination.

Regulatory Approvals Required for the Merger

The closing of the merger is conditioned upon the receipt of all approvals of regulatory authorities required for the merger without the imposition of any restrictions or conditions that would have a material adverse effect on Sterling or any of its subsidiaries or reduce the benefit of the merger to Sterling to the extent that it would not have entered into the merger agreement had it known such restrictions or conditions would be imposed prior to entering into the merger agreement. Under the terms of the merger agreement, Sterling and Lynnwood have agreed to use their reasonable best efforts to obtain all necessary permits, consents, approvals and authorizations from any governmental authority necessary, proper or advisable to consummate the merger.

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The merger of Sterling and Lynnwood is subject to prior approval by the Federal Reserve Board, or the FRB, under the Bank Holding Company Act of 1956, as amended, or the BHCA. An application for approval of the merger with the FRB was filed on or about April 20, 2006. The acquisition of Golf Savings Bank and Golf Escrow Corporation is also subject to the receipt of prior approval from the Federal Deposit Insurance Corporation, or FDIC, and the Washington Department of Financial Institutions, or WDFI. An application with the FDIC was filed on or about April 20, 2006. An application with the WDFI was filed on or about April 20, 2006.

Material United States Federal Income Tax Considerations of the Merger

The following is a discussion of the material U.S. federal income tax consequences of the merger to Lynnwood shareholders whose shares of Lynnwood common stock are exchanged solely for shares of Sterling common stock in the merger. This discussion addresses only Lynnwood shareholders who hold their shares of Lynnwood common stock as capital assets. This discussion does not address all of the U.S. federal income tax consequences that may be relevant to a particular Lynnwood shareholder in light of that shareholder's individual circumstances or to a Lynnwood shareholder who is subject to special rules, such as, without limitation:

- a partnership, subchapter S corporation or other pass through entity;
- a foreign person, foreign entity or U.S. expatriate;
- a mutual fund, bank, thrift or other financial institution;
- a tax-exempt organization or pension fund;
- an insurance company;
- a trader in securities that elects mark-to-market;
- a dealer in securities or foreign currencies;
- a shareholder who received his or her shares of Lynnwood common stock through a benefit plan or a tax-qualified retirement plan or through the exercise of employee stock options or similar derivative securities or otherwise as compensation;
- a shareholder who may be subject to the alternative minimum tax provisions of the Code;
- a shareholder whose functional currency is not the U.S. dollar;
- a shareholder who exercises dissenters' rights; and
- a shareholder who holds Lynnwood common stock as part of a hedge, appreciated financial position, straddle, synthetic security, conversion transaction or other integrated investment.

The following discussion is based on the Code, applicable Treasury regulations, administrative interpretations and court decisions, each as in effect as of the date of this proxy statement/prospectus and all of which are subject to change, possibly with retroactive effect. It is not binding on the Internal Revenue Service, referred to as the IRS. In addition, this discussion does not address any tax consequences arising under the laws of any state, locality or foreign jurisdiction.

Lynnwood shareholders should consult their own tax advisors as to the specific tax consequences to them of the merger in light of their particular circumstances, including the applicability and effect of U.S. federal, state, local, foreign and other tax laws.

In the opinion of Witherspoon, Kelley, Davenport & Toole, P.S., counsel to Sterling, and Williams, Kastner & Gibbs PLLC, counsel to Lynnwood, the merger will qualify as a reorganization within the meaning of Section 368(a) of the Code and each of Sterling and Lynnwood will be a party to the

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reorganization within the meaning of Section 368(b) of the Code. The resulting tax consequences, subject to the reservations noted above, are as follows:

Exchange of Lynnwood Common Stock for Sterling Common Stock.

A Lynnwood shareholder who receives shares of Sterling common stock in exchange for shares of Lynnwood common stock will not recognize gain or loss as a result of the merger, except with respect to any cash received instead of fractional share interests in Sterling common stock;

the aggregate tax basis of the Sterling common stock received in the merger will be the same as the aggregate tax basis of the Lynnwood common stock for which it is exchanged, less any tax basis attributable to fractional share interests in Sterling common stock for which cash is received; and

the holding period of Sterling common stock received in exchange for shares of Lynnwood common stock will include the holding period of the Lynnwood common stock for which it is exchanged.

Charles and Lynette Ainslie will be subject to different tax consequences as a result of their receipt of a portion of their consideration in cash. A description of these consequences follows:

Exchange of Lynnwood Common Stock for Sterling Common Stock and Cash.

A Lynnwood shareholder who receives part cash and part Sterling common stock in exchange for shares of Lynnwood common stock generally will recognize gain, but not loss, equal to the lesser of (1) the excess, if any, of the fair market value of the Sterling common stock and the amount of cash received by the shareholder (excluding cash received in lieu of a fractional share, which would be taxed as discussed below) over that shareholder's adjusted tax basis in the Lynnwood common stock exchanged in the merger or (2) the amount of cash received by the shareholder in the merger (excluding cash received in lieu of fractional shares, which will be taxed as discussed below);

the gain recognized by a Lynnwood shareholder in the merger generally will constitute capital gain, unless, as discussed below, the shareholder's receipt of cash has the effect of a distribution of a dividend for U.S. federal income tax purposes, in which case the shareholder's gain will be treated as ordinary dividend income to the extent of the shareholder's ratable share of current and accumulated earnings and profits as calculated for U.S. federal income tax purposes;

any capital gain recognized by a Lynnwood shareholder generally will constitute long-term capital gain (taxed at a maximum rate of 15% in the case of an individual) if the shareholder's holding period for the Lynnwood common stock exchanged in the merger is more than one year as of the date of the merger, and otherwise will constitute short-term capital gain;

the aggregate tax basis of the shares of Sterling common stock received by a Lynnwood shareholder in exchange for Lynnwood common stock in the merger will be the same as the aggregate tax basis of the shareholder's Lynnwood common stock exchanged therefor (less any tax basis attributable to a fractional share for which cash is received), decreased by the amount of cash received by the shareholder in the merger (excluding any cash received in lieu of a fractional share) and increased by the amount of gain recognized by the shareholder in the merger (including any portion of the gain that is treated as a dividend and excluding any gain recognized as a result of cash received in lieu of a fractional share); and

the holding period of the shares of Sterling common stock received by a Lynnwood shareholder in the merger will include the holding period of the shareholder's Lynnwood common stock exchanged in the merger.

Potential Treatment of Cash as a Dividend.

In general, the determination of whether gain recognized by a Lynnwood shareholder will be treated as capital gain or a dividend distribution will depend upon whether, and to what extent, the merger reduces

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the Lynnwood shareholder's deemed percentage stock ownership interest in Sterling. For purposes of this determination, a Lynnwood shareholder will be treated as if the shareholder first exchanged all of its Lynnwood common stock solely for Sterling common stock (instead of the combination of Sterling common stock and cash actually received) and then Sterling immediately redeemed a portion of that Sterling common stock in exchange for the cash the shareholder received in the merger. The gain recognized in the exchange followed by the deemed redemption will be treated as capital gain if, with respect to the Lynnwood shareholder, the deemed redemption is substantially disproportionate or not essentially equivalent to a dividend.

In general, the deemed redemption will be substantially disproportionate with respect to a Lynnwood shareholder if the percentage described in (2) below is less than 80% of the percentage described in (1) below. Whether the deemed redemption is not essentially equivalent to a dividend with respect to a Lynnwood shareholder will depend on the shareholder's particular circumstances. In order for the deemed redemption to be not essentially equivalent to a dividend, the deemed redemption must result in a meaningful reduction in the Lynnwood shareholder's deemed percentage stock ownership of Sterling common stock. In general, that determination requires a comparison of (1) the percentage of the outstanding voting stock of Sterling that the Lynnwood shareholder is deemed actually and constructively to have owned immediately before the deemed redemption by Sterling and (2) the percentage of the outstanding voting stock of Sterling actually and constructively owned by the shareholder immediately after the deemed redemption by Sterling. In applying the foregoing tests, a shareholder may, under constructive ownership rules, be deemed to own stock in addition to stock actually owned by the shareholder, including stock owned by other persons and stock subject to an option held by such shareholder or by other persons. Because the constructive ownership rules are complex, each Lynnwood shareholder should consult his or her own tax advisor as to the applicability of these rules. The IRS has indicated that a minority shareholder in a publicly traded corporation whose relative stock interest is minimal and who exercises no control with respect to corporate affairs is considered to have a meaningful reduction if that shareholder has any reduction in its percentage stock ownership under the foregoing analysis.

Cash Received in Lieu of a Fractional Share.

To the extent that a Lynnwood shareholder receives cash in lieu of a fractional share of common stock of Sterling, the shareholder will be deemed to have received that fractional share in the merger and then to have received the cash in redemption of that fractional share. The shareholder generally will recognize gain or loss equal to the difference between the cash received and the portion of the shareholder's tax basis in the shares of Lynnwood common stock surrendered allocable to that fractional share. This gain or loss generally will be long-term capital gain or loss if the holding period for those shares of Lynnwood common stock is more than one year as of the date of the merger.

Backup Withholding.

Backup withholding at the applicable rate may apply with respect to certain payments, including cash received in the merger, unless a Lynnwood shareholder: (1) is a corporation or is within certain other exempt categories and, when required, demonstrates this fact; or (2) provides a correct taxpayer identification number, certifies as to no loss of exemption from backup withholding, and otherwise complies with applicable requirements of the backup withholding rules. A Lynnwood shareholder who does not provide its correct taxpayer identification number may be subject to penalties imposed by the IRS. Any amounts withheld under the backup withholding rules may be allowed as a refund or a credit against the shareholder's U.S. federal income tax liability, provided the shareholder furnishes certain required information to the IRS.

Reporting Requirements.

A Lynnwood shareholder will be required to retain records pertaining to the merger and will be required to file with such Lynnwood shareholder's U.S. federal income tax return for the year in which the merger takes place a statement setting forth certain facts relating to the merger.

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TAX MATTERS REGARDING THE MERGER ARE VERY COMPLICATED, AND THE TAX CONSEQUENCES OF THE MERGER TO ANY PARTICULAR LYNNWOOD SHAREHOLDER WILL DEPEND ON THAT SHAREHOLDER'S PARTICULAR SITUATION. LYNNWOOD SHAREHOLDERS ARE STRONGLY URGED TO CONSULT THEIR OWN TAX ADVISORS REGARDING THE SPECIFIC TAX CONSEQUENCES OF THE MERGER, INCLUDING TAX RETURN REPORTING REQUIREMENTS, THE APPLICABILITY OF FEDERAL, STATE, LOCAL AND FOREIGN TAX LAWS AND THE EFFECT OF ANY PROPOSED CHANGE IN THE TAX LAWS TO THEM.

Accounting Treatment

The costs related to the merger are expected to be approximately \$7.3 million and the merger will be accounted for as a purchase for financial accounting purposes in accordance with accounting principles generally accepted in the United States. For purposes of preparing Sterling's consolidated financial statements, Sterling will establish a new accounting basis for Lynnwood's assets and liabilities based upon their fair values, the merger consideration and the costs of the merger as of the acquisition date. Sterling will record any excess of cost over the fair value of the net assets, including any intangible assets with definite lives, of Lynnwood as goodwill. A final determination of the intangible asset values and required purchase accounting adjustments, including the allocation of the purchase price to the assets acquired and liabilities assumed based on their respective fair values, has not yet been made. Sterling will determine the fair value of Lynnwood's assets and liabilities and will make appropriate purchase accounting adjustments including the calculation of any intangible assets with definite lives, upon completion of the acquisition. Goodwill will be periodically reviewed for impairment. Other intangible assets will be amortized against the combined company's earnings following completion of the merger.

Interests of Certain Persons in the Merger

In considering the recommendation of the Lynnwood board of directors, you should be aware that some members of Lynnwood management have certain interests in the transactions contemplated by the merger agreement, as described below, that are different from or in addition to the interests of shareholders generally and that may create potential conflicts of interest. The Lynnwood board of directors was aware of these interests and considered them, among other matters, in approving the merger agreement and the transactions contemplated thereby.

Stock Ownership.

At the date hereof, the directors, executive officers and principal shareholders (holders of at least 5%) of Lynnwood, together with their affiliates, beneficially owned (assuming the exercise of their outstanding options) a total of 863,804 shares of Lynnwood common stock representing 81.22% of all outstanding shares of Lynnwood common stock and shares issuable under options to purchase Lynnwood common stock which would be immediately exercisable on the effective date of the merger. Charles and Lynette Ainslie own a total of 551,198 shares of Lynnwood stock representing 53.05% of all such outstanding shares. The directors and executive officers of Lynnwood will receive the same consideration in the merger for their shares as the other shareholders of Lynnwood, plus Sterling common stock with respect to their options, with the exception of Charles and Lynette Ainslie, who will receive \$15,750,000 of their consideration in cash in addition to a number of shares of Sterling common stock such that the value per share received by them will be equivalent to the value per share received by all other Lynnwood shareholders.

Stock Options.

At the effective date of the merger, Lynnwood options to purchase Lynnwood common stock held by Lynnwood employees will be converted into options to purchase Sterling common stock. As of the date of the merger agreement, two employees of Lynnwood held options to acquire a total of 34,662 shares of Lynnwood common stock. The options will become fully vested as a result of merger. If the Lynnwood

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employees exercise their options prior to the merger, their shares of Lynnwood common stock will be converted into shares of Sterling common stock on the same basis as other Lynnwood shareholders in the merger, but the shares issuable to the Lynnwood employees would be in addition to the 1,800,000 shares to be issued as merger consideration. The total value of stock payable with respect to such options (net of the exercise prices payable by the optionholders) is estimated at \$883,540 based on an assumed Sterling common stock price of \$25.00 per share.

Lynnwood Change in Control Obligations.

Lynnwood is a party to an employment agreement with its chief executive officer, Charles J. Ainslie, which generally provides that in the event a change in control occurs (such as the merger) and Mr. Ainslie is terminated without cause or resigns after a material reduction in compensation or responsibility, a change in control payment in an amount equal to five years of Mr. Ainslie's base salary will be paid to Mr. Ainslie within 30 days after termination or resignation following the change in control. Due to Mr. Ainslie's significant experience and knowledge of Lynnwood's and Golf Savings Bank's business, Sterling wishes to retain Mr. Ainslie's services as a consultant and Mr. Ainslie has agreed to forego any change in control payment that might become due to him in exchange for a five-year consulting agreement. At the effective time, Mr. Ainslie will become fully vested in the fees payable pursuant to the consulting agreement. The consulting fees payable to Mr. Ainslie under the consulting agreement are less than the payment Mr. Ainslie would have received under the change in control payment provisions of his Lynnwood employment agreement. The consulting agreement also contains a noncompete provision which lasts for the duration of the agreement; however, Sterling has agreed to allow Mr. Ainslie to participate in certain permitted activities in the context of a small construction and development lending business.

Lynnwood is also a party to employment agreements with Donn C. Costa, Dennis V. O'Leary and Robert F. Fuller, which generally provide that in the event a change in control occurs, and they are terminated without cause or resign after a material reduction in compensation or responsibility, they would be entitled to receive in a lump sum a change in control payment in an amount equal to two times their base salary. Each of the employment agreements contains a noncompete provision of two years following termination of employment. Messrs. Costa, O'Leary and Fuller have each entered into new employment agreements with Sterling, which provide for their continued employment as of the effective time of the merger, such that the change in control payments under their agreements with Lynnwood will not be triggered. In lieu of any change in control payments, Sterling has agreed to contribute an aggregate total of \$825,000 into a deferred compensation plan on behalf of Messrs. Costa, O'Leary and Fuller. It is expected that Messrs. Costa, O'Leary and Fuller will become fully vested in such deferred compensation plan 30 months from the closing date. If they are terminated by Sterling without cause or if they resign for good cause, the employment agreements provide for a severance payment equal to a multiple of two-times base salary. Mark Milan also has an employment agreement providing that in the event a change in control occurs and Mr. Milan's employment is terminated without cause or Mr. Milan resigns after a material reduction in compensation or responsibility, Mr. Milan will receive a change in control payment equal to a multiple of one times base salary if such termination or resignation occurs within 36 months from the effective date of the merger or a multiple of one-half his base salary if such termination or resignation occurs between 37 months and 60 months after the effective date of the merger. Sterling anticipates that Mr. Milan will be employed by Sterling at a comparable salary and position of responsibility following the merger. Although it is contemplated that no change in control payment will be due, if all potential change in control obligations were paid upon completion of the merger (including Messrs. Ainslie, Costa, Fuller, O'Leary and Milan), the estimated cash payment would be approximately \$7,479,500.

Nonqualified Deferred Compensation Plan.

Golf Savings Bank maintains a nonqualified deferred compensation plan for a select group of management and highly compensated employees, which provides that all benefits thereunder will be

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distributed upon a change in control. The nonqualified deferred compensation plan provides that all benefits deferred thereunder shall be distributed upon the occurrence of a change in control. As of March 31, 2006, approximately \$1,206,000 was accrued under the plan. The plan will be terminated in conjunction with the merger, and the entire balance in the plan will be distributed to the participants.

Employee Benefits.

Sterling has agreed to provide those employees of Lynnwood who continue as employees of Sterling or any of its subsidiaries with employee benefit plans substantially comparable in the aggregate to those provided to similarly situated employees of Sterling and its subsidiaries.

Restrictions on Resales by Affiliates

The shares of Sterling common stock to be issued to Lynnwood shareholders in the merger will be registered under the Securities Act of 1933, or the Securities Act. These shares may be traded freely and without restriction by those shareholders not deemed to be affiliates of Lynnwood. An affiliate of a corporation, as defined by the Securities Act, is a person who directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with, that corporation and generally may include Lynnwood directors, executive officers and major shareholders. Any subsequent transfer of Sterling common stock by an affiliate of Lynnwood must be either permitted by the resale provisions of Rule 145 promulgated under the Securities Act or otherwise permitted under the Securities Act.

Method of Effecting the Acquisition

Sterling may at any time change the method of effecting the acquisition of Lynnwood and its subsidiaries. However, no change may: (i) alter or change the amount or kind of consideration to be issued to holders of the common stock of Lynnwood, as provided for in the merger agreement; (ii) have a material adverse effect on the tax treatment of Lynnwood's shareholders as a result of receiving the merger consideration; (iii) prevent or materially impede or delay completion of the transactions contemplated by the merger agreement; or (iv) otherwise be prejudicial to the interests of Lynnwood shareholders.

Effective Time

The effective time of the merger will be the time and date when the merger becomes effective, as set forth in the articles of merger that will be filed with the Washington Secretary of State on the closing date of the merger. The closing date will occur on a date to be specified by Sterling and Lynnwood. Subject to applicable law, this date will be no later than the tenth day after the satisfaction or waiver of the latest to occur of: (a) receipt of all required regulatory approvals; or (b) the approval of the merger by the shareholders of Lynnwood; provided, however that in no event shall such date be earlier than July 5, 2006, with such date to be specified in writing by Sterling to Lynnwood at least five business days prior to such closing, or such other date, place and time as the parties may agree. Sterling and Lynnwood shall each use their reasonable best efforts to cause all conditions to the closing to be satisfied (unless waived) on or before June 27, 2006.

We anticipate that the merger of Lynnwood with and into Sterling will be completed during the third quarter of 2006. However, completion of the merger could be delayed if there is a delay in obtaining the required regulatory approvals or in satisfying other conditions to the merger. The date for completing the merger can occur as late as November 30, 2006, after which Lynnwood or Sterling would need to mutually agree to extend the closing date of the merger. See the sections entitled "The Merger - Regulatory Approvals Required for the Merger" and "The Merger Agreement - Conditions to Consummation of the Merger."

Treatment of Options

Lynnwood's stock option plans provide for acceleration of vesting for outstanding options, effective upon shareholder approval of the merger. Upon approval of the principal terms of the merger at the special

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meeting of shareholders, any outstanding options, whether vested or unvested immediately prior to the special meeting of shareholders, will become fully vested and exercisable at the effective time. Prior to the effective time, any vested option holder exercising his or her options will thereafter participate in the merger on the same basis as other Lynnwood shareholders in the merger, but the Sterling shares issuable for shares issued on exercise of the Lynnwood options would be in addition to the 1,800,000 shares to be issued as merger consideration.

At the effective time, Lynnwood's stock options then outstanding will be converted into a fully vested option to acquire a number of shares of Sterling's common stock equal to the product of (x) the number of shares of Lynnwood common stock subject to the stock option and (y) the Stock Consideration (as that term is defined in the merger agreement), at an exercise price per share equal to (A) the exercise price of the stock option divided by (B) the Stock Consideration.

Declaration and Payment of Dividends

Holders of Lynnwood common stock will accrue but will not be paid dividends or other distributions declared after the effective time with respect to Sterling common stock into which their shares have been converted until they surrender their Lynnwood stock certificates for exchange after the effective time. Upon surrender of those certificates after the effective time, the combined company will pay any unpaid dividends or other distributions, without interest. After the effective time, there will be no transfers on the stock transfer books of Lynnwood of shares of Lynnwood common stock issued and outstanding immediately prior to the effective time. If certificates representing shares of Lynnwood common stock are presented for transfer after the effective time, they will be cancelled and exchanged for certificates representing the applicable number of shares of Sterling common stock.

No Fractional Shares

No fractional shares of Sterling common stock will be issued to any shareholder of Lynnwood upon completion of the merger. For each fractional share that would otherwise be issued, Sterling will pay cash in an amount equal to the fraction of a share of Sterling common stock which the holder would otherwise be entitled to receive, multiplied by the average closing price of Sterling common stock over a twenty trading-day period ending on the fifth business day prior to the closing of the merger. No interest will be paid or accrued on cash payable to holders of those certificates in lieu of fractional shares.

None of Sterling, Lynnwood, the exchange agent or any other person will be liable to any former shareholder of Lynnwood for any amount delivered in good faith to a public official pursuant to applicable abandoned property, escheat or similar laws.

If a certificate for Lynnwood stock has been lost, stolen or destroyed, the exchange agent will issue the consideration properly payable under the merger agreement upon the making of an affidavit by the person claiming that loss, theft or destruction and the posting of a bond in an amount reasonably necessary as indemnity against any claim that may be made against Sterling with respect to that lost certificate.

For a description of Sterling common stock and a description of the differences between the rights of the holders of Lynnwood common stock compared to the rights of the holders of Sterling common stock, see the sections entitled Description of Sterling Capital Stock and Comparison of Rights of Lynnwood Common Stock and Sterling Common Stock.

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THE MERGER AGREEMENT

The following summary of the material terms and provisions of the merger agreement is qualified in its entirety by reference to the merger agreement by and between Sterling and Lynnwood, which is dated as of February 12, 2006. The merger agreement is attached as Appendix A to this proxy statement/prospectus and is incorporated by reference herein.

Representations and Warranties

The merger agreement contains substantially similar representations and warranties of Sterling and Lynnwood as to, among other things:

corporate organization and existence;

the corporate organization and existence of any subsidiaries;

capitalization;

corporate power and authority;

governmental and third-party approvals required to complete the merger;

timely filing of required regulatory reports and absence of regulatory investigations or restrictive agreements with regulators;

availability, accuracy and compliance with generally accepted accounting principles of financial reports, in the case of Lynnwood, and of reports and filings with the Securities and Exchange Commission, in the case of Sterling, and absence of material adverse effect since the date of the last amended financial statements;

absence of broker's fees;

absence of certain changes or events;

payment of taxes and filing of tax returns;

compliance with applicable laws; and

tax treatment of the merger.

In addition, the merger agreement contains further representations and warranties of Lynnwood as to, among other things:

absence of material litigation;

employee benefit matters;

validity of, and the absence of defaults under, certain material contracts;

regulatory agreements;

state takeover laws;

environmental matters;

allowances for losses;

properties and assets;

insurance coverage;

loans;

undisclosed material liabilities;

intellectual property rights;

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indemnification

insiders' interests; and

information to be contained in securities filings or other documents filed with governmental entities.

Conduct of Sterling Pending the Merger

Prior to the effective time of the merger, except as expressly contemplated by the merger agreement, Sterling has agreed that it will not:

take any action that will result in: Sterling's representations and warranties set forth in the merger agreement being or becoming untrue; any of the conditions to the consummation of the merger not being satisfied; or, a violation of the merger agreement, except, in each case, as may be required by applicable law;

take any action, or amend the Sterling Articles of Incorporation or Bylaws, the effect of which would be to materially and adversely affect the rights or powers of shareholders generally;

take or omit to take any other action that would materially adversely affect or materially delay the ability of Sterling to obtain the required regulatory approvals or otherwise materially adversely affect Sterling's ability to consummate the transactions contemplated by the merger agreement; or

agree or commit to take any such prohibited action.

Conduct of Lynnwood Pending the Merger

Prior to the effective time, except as expressly contemplated by the merger agreement, Lynnwood has agreed that it and each of its subsidiaries shall, among other things:

Ordinary Course of Business.

conduct business in the usual, regular and ordinary course in substantially the same manner as previously conducted;

pay all debts, taxes and other obligations when due,

use its commercially reasonable efforts to preserve intact its present business organizations, keep available the services of its present officers and key employees and preserve relationships with customers, suppliers, distributors, licensors, licensees, and other business contacts;

promptly notify Sterling of any change, occurrence or event not in the ordinary course of its or any subsidiary's business, and of any change, occurrence or event which, individually or in the aggregate with any other changes, occurrences and events, would reasonably be expected to cause any of the conditions to closing set forth in the merger agreement not to be satisfied;

use its commercially reasonable efforts to assure that each of its contracts entered into after February 12, 2006 will not require the procurement of any consent, waiver or novation or provide for any change in the obligations of any party in connection with, or terminate as a result of the consummation of, the merger, and to give reasonable advance notice to Sterling prior to allowing any material contract or right thereunder to lapse or terminate by its terms; and

maintain each of its leased premises in accordance with the terms of the applicable lease.

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In addition, prior to the effective time, except as expressly contemplated by the merger agreement, Lynnwood has agreed that it shall not, and shall not permit its subsidiaries to, among other things:

Dividends and Capital Stock.

declare or pay any dividends on, or make other distributions in respect of, any capital stock, except cash dividends from Lynnwood subsidiaries to Lynnwood or to other Lynnwood subsidiaries, in conformity with past practice and applicable law;

split, combine or reclassify any shares of capital stock or issue, authorize or propose the issuance of any other securities for shares of its capital stock, except upon the exercise or fulfillment of options issued and outstanding as of February 12, 2006 pursuant to the Lynnwood Stock Option Plan;

repurchase, redeem or otherwise acquire any shares of the capital stock of Lynnwood or Golf Savings Bank, or any securities convertible into or exercisable for any shares of the capital stock of Lynnwood or Golf Savings Bank; or

issue, allocate, deliver or sell, or authorize or propose the issuance, delivery or sale of, any shares of its capital stock or any securities convertible into or exercisable for, or any rights, warrants or options to acquire, any such shares, or enter into any agreement with respect to any of the foregoing, other than the issuance of Lynnwood common stock pursuant to stock options or similar rights to acquire Lynnwood common stock granted pursuant to the Lynnwood Stock Option Plan and outstanding prior to February 12, 2006.

Amendments to Governing Documents.

amend its articles of incorporation, bylaws or other similar governing documents unless required to do so by applicable law or regulation or by regulatory directive.

Capital Expenditures.

make capital expenditures aggregating in excess of \$35,000, except as provided in the merger agreement.

Other Business.

enter into any new line of business;

acquire or agree to acquire, by merging or consolidating with, or by purchasing an equity interest in or the assets of, or by any other manner, any business or any corporation, partnership, association or other business organization or division thereof or otherwise acquire any assets, other than in connection with foreclosures, settlements in lieu of foreclosure or troubled loan or debt restructurings, or in the ordinary course of business; and

make any investment, or incur deposit liabilities, other than in the ordinary course of business consistent with past practices.

Representations and Warranties.

take any action that is intended or may reasonably be expected to result in: any of its representations and warranties set forth in the merger agreement being or becoming untrue; any of the conditions to the merger not being satisfied; or a violation of any provision of the merger agreement, except, in each case as may be required by applicable law.

Accounting Methods.

change its methods of accounting in effect at September 30, 2005 except as required by changes in GAAP or regulatory accounting principles as concurred to by Lynnwood's independent auditors.

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Compensation and Benefits.

except as required by applicable law or the merger agreement or to maintain qualification pursuant to the Code, adopt, amend, renew or terminate any benefit plan or any agreement, arrangement, plan or policy between Lynnwood or Golf Savings Bank and one or more of its current or former directors, officers or employees;

other than normal annual increases in pay, consistent with past practice, for employees not subject to an employment, change in control or severance agreement, increase in any manner the compensation of any employee or director or pay any benefit not required by any plan or agreement as in effect as on February 12, 2006;

enter into, modify or renew any contract, agreement, commitment or arrangement providing for the payment to any director, officer or employee of compensation or benefits, other than normal annual increases in pay, consistent with past practice, for employees not subject to an employment, change in control or severance agreement;

hire any new employee at an annual compensation in excess of \$65,000;

pay aggregate expenses of more than \$3,000 of employees or directors who attend conventions or similar meetings after the date of the merger agreement;

promote any employee to a rank of vice president or more senior; or

except as provided in the merger agreement, pay any retention or other bonuses in excess of \$25,000 to any employees.

Indebtedness.

incur any indebtedness, with a term greater than one year, for borrowed money, or assume, guarantee, endorse or otherwise as an accommodation become responsible for the obligations of any other individual, corporation or other entity, in each case other than in the ordinary course of business;

sell, purchase, enter into a lease, relocate, open or close any banking or other loan production office or other real estate, or file an application pertaining to such action with any governmental entity, except as provided in the merger agreement; and

make any equity investment or commitment to make such an investment in real estate or in any real estate development project, other than in connection with foreclosure, settlements in lieu of foreclosure, or troubled loan or debt restructuring, in the ordinary course of business.

Loans.

make any new loans to, modify the terms of any existing loan to, or engage in any other transactions with, any officer, director or greater than five-percent shareholder of Lynnwood or Golf Savings Bank (or any of their affiliates), or to or with any of their employees, other than loans to employees that are in the ordinary course of business and that are qualified to be sold in the secondary market; and

purchase or originate: (a) any loans except in accordance with existing Golf Savings Bank lending policies; (b) unsecured consumer loans in excess of \$50,000; (c) residential permanent or construction loans in excess of \$2,000,000; (d) non-mortgage commercial loans in excess of \$250,000; or (e) income property (permanent and construction) loans, excluding multi-family, in excess of \$750,000, except in each case, as provided in the merger agreement.

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Investments.

make any investments in any equity or derivative securities or engage in any forward commitment, futures transaction, financial options transaction, hedging or arbitrage transaction or covered asset trading activities or make any investment in any investment security with an average life greater than one year at the time of purchase;

sell any held for investment loans or servicing rights related thereto or purchase any mortgage loan servicing rights; or

take or omit to take any other action that would have a material adverse effect on, or materially delay, the ability of Lynnwood and Sterling to obtain any required regulatory approvals or otherwise have a material adverse effect on Lynnwood's and Golf Savings Bank's ability to consummate the transactions contemplated by the merger agreement.

Commitments.

take or omit to take any other action that would materially adversely affect or materially delay the ability of Sterling to obtain the required regulatory approvals or otherwise materially adversely affect Sterling's or Sterling Savings Bank's ability to consummate the transactions contemplated by the merger agreement.

Prior Shareholder Agreements.

cause its prior agreements with shareholders to be terminated, effective as of the effective time, in accordance with their respective terms, and cause the shareholders who are parties to prior shareholder agreements to waive all of their respective rights thereunder, effective as of the effective time.

Benefit Plans.

use its reasonable best efforts to (i) merge the Golf Savings Bank 401(k) Plan into Sterling's 401(k) Plan and (ii) terminate or withdraw from the Golf Savings Bank Deferred Compensation Plan and the Golf Savings Bank Benefits Plan, and all other plans, except for the Golf Savings Bank 401(k) Plan and the Lynnwood Stock Option Plan, at or as soon as reasonably practicable after the effective time, in accordance with the applicable plan documents and laws; unless Sterling chooses to merge one or more of the plans into a corresponding Sterling plan.

Additional Covenants

Lynnwood and Sterling have agreed to:

promptly cause a registration statement and applicable state filings for the merger to be prepared and filed with the SEC and to use their reasonable best efforts to have the registration statement declared effective by the SEC as soon as possible after the filing thereof. The parties have also agreed to cooperate in responding to any questions or comments from the SEC and in amending the registration statement and such filings as necessary;

cooperate and consult with each other and use their best efforts to promptly prepare and file all necessary documentation, to effect all applications, notices, petitions and filings, and to obtain as promptly as practicable all permits, consents, approvals and authorizations of all third parties and governmental entities which are necessary or advisable to consummate the transactions contemplated by the merger agreement and to keep the other apprised of the status of matters relating to such transactions;

furnish each other all information concerning each other and their directors, officers and shareholders and such other matters as may be reasonably necessary or advisable in connection with the registration statement, this proxy statement/ prospectus or any other statement, filing, notice or

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application made by or on behalf of Sterling or Lynnwood to any governmental entity in connection with the merger or the other transactions contemplated by the merger agreement;

promptly advise each other upon receiving any communication from any governmental entity whose consent or approval is required for consummation of the transactions contemplated by the merger agreement which causes such party to believe that there is a reasonable likelihood that any required regulatory approval will not be obtained or that the receipt of any such approval will be materially delayed;

use reasonable efforts to have the merger qualify as a reorganization under section 368(a) of the Internal Revenue Code, or the Code;

pursuant to a Confidentiality Agreement dated November 17, 2005, keep confidential information they provide each other pursuant to the merger agreement;

use their reasonable best efforts (a) to comply with all legal requirements which may be imposed on them with respect to the merger; and (b) obtain (and cooperate with each other to obtain) any consent, authorization, order or approval of, or any exemption by, any governmental entity and any other third party which is required to be obtained in connection with the merger;

promptly advise each other of any change or event that, individually or in the aggregate, has had or would be reasonably likely to have a material adverse effect on us or cause or constitute a material breach of any of its representations, warranties or covenants contained herein; and

promptly notify each other of any material change in the normal course of business or in the operation of their properties and of any governmental complaints, investigations or hearings, or the institution or the threat of litigation involving either of them or any of their subsidiaries.

Lynnwood and Sterling also agree that:

Sterling may elect to modify the structure of the transactions contemplated by the merger agreement so long as: (i) there are no material adverse consequences to Lynnwood, Lynnwood's directors or the Lynnwood shareholders; (ii) the consideration paid to Lynnwood's shareholders is not changed or reduced; and (iii) such modification will not delay or jeopardize receipt of any required regulatory approvals.

Lynnwood has further agreed to:

accord to the representatives of Sterling, access, during normal business hours throughout the period prior to the effective time, to all of its and its subsidiaries' properties, books, contracts, commitments and records and, during such period, and to give Sterling notice of all meetings of its board of directors and any committees thereof, and of any management committees, so that a Sterling representative may attend such meeting if Sterling chooses;

take all steps necessary to duly call, give notice of, convene and hold a special meeting of shareholders within 40 days after this proxy statement/ prospectus becomes effective for the purpose of voting upon the adoption or approval of the merger agreement and the merger, and that the board of directors of Lynnwood shall recommend approval of the merger unless a change of recommendation is permitted as provided in the merger agreement;

provide to Sterling the audited consolidated balance sheet of Lynnwood and its subsidiaries as of the end of Lynnwood's fiscal year and each month and the related audited consolidated statements of income, shareholders equity and comprehensive income and cash flows for the relevant periods;

take any further action that is necessary or desirable to effect the purposes of the merger, or to vest Sterling with full title to all properties, assets, rights, approvals, immunities and franchises of any of the parties to the merger;

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cause one or more of its designated representatives to confer on a regular and frequent basis (not less than monthly) with representatives of Sterling and to report the general status of the ongoing operations of Lynnwood;

provide to Sterling an estimate of the expenses Lynnwood expects to incur in connection with the merger, and to keep Sterling reasonably informed of material changes in such estimate.

Sterling has further agreed that it or its subsidiaries, as appropriate, will:

afford to the representatives of Lynnwood such access, during normal business hours during the period prior to the effective time, to Sterling's representatives as Lynnwood shall reasonably request, and shall make available to Lynnwood a copy of each report, schedule, and other document filed by it (including by its subsidiaries) during such period pursuant to the requirements of federal securities laws or federal or state banking laws;

use its reasonable best efforts to cause Sterling's shares of common stock to be issued pursuant to the merger agreement to be approved for quotation on Nasdaq prior to or at the effective time;

credit employees of Lynnwood or any Lynnwood subsidiary with periods of service with Lynnwood or the applicable Lynnwood subsidiary before the effective time as if such service had been with Sterling or a Sterling subsidiary, as applicable;

give credit to employees of Lynnwood and its subsidiaries, with respect to the satisfaction of the waiting periods for participation and coverage which are applicable under the welfare benefit plans of Sterling or its applicable subsidiary, equal to the credit that any such employee had received as of the effective time towards the satisfaction of any such limitations and waiting periods under the comparable welfare benefit plans of Lynnwood and its subsidiaries;

provide each employee of Lynnwood and its subsidiaries with credit for any co-payment and deductibles paid prior to the effective time in satisfying any deductible or out-of-pocket requirements;

allow each employee of Lynnwood and its subsidiaries to have credit for all unused sick leave as of the effective time;

provide coverage for all pre-existing conditions that were covered under any welfare plan of Lynnwood or the applicable Lynnwood subsidiary;

give Lynnwood employees credit for prior service for vacation accruals after the effective time;

provide severance benefits to those employees of Lynnwood and its subsidiaries whose employment is involuntarily terminated without cause at or within 180 days of the effective time unless such employees are entitled to receive severance payments under employment or similar agreements;

indemnify and hold harmless the officers, directors and employees of Lynnwood and its subsidiaries for any liabilities incurred in connection with any matters arising prior to the merger out of their service as an officer, director or employee of Lynnwood or its subsidiaries or the merger agreement for a period of six years after the merger; and

obtain the release of Charles and Lynnette Ainslie from all personal guarantees of, and all personal liability under or for, extensions of credit for which Lynnwood or its subsidiaries is the borrower.

Conditions to Consummation of the Merger

Each party's obligation to effect the merger is subject to the satisfaction or waiver, where permissible, of the following conditions:

approval of the principal terms of the merger by two-thirds of all outstanding shares of Lynnwood common stock not held by Charles and Lynette Ainslie;

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approval for quotation on Nasdaq of the shares of Sterling common stock that are to be issued to Lynnwood shareholders upon completion of the merger;

receipt of required regulatory approvals for the merger and the related transactions and the expiration of all statutory waiting periods in respect thereof;

effectiveness of the registration statement, of which this proxy statement/ prospectus forms a part, under the Securities Act, with no stop order suspending the effectiveness of the registration statement having been issued and no proceedings for that purpose having been initiated by the SEC and not withdrawn;

absence of any order, injunction or decree issued or enacted by any court or agency of competent jurisdiction or other legal restraint or prohibition preventing the completion of the merger or any of the other transactions contemplated by the merger agreement;

receipt by each party of the opinion of its counsel in form and substance reasonably satisfactory to it, dated as of the effective time, that the merger will be treated for U.S. federal income tax purposes as a reorganization under Section 368(a) of the Code;

accuracy of the representations and warranties of the other party in all material respects as of the closing date, as defined in the merger agreement, and, to the extent representations and warranties speak as of some other date, then those representations and warranties shall be true and correct as of such date, provided, however, that the representations and warranties will be deemed to be true and correct, unless the failure or failures of the representations and warranties to be true and correct would have or would be reasonably likely to have a material adverse effect on the party making the representation or on the combined company;

performance by each party in all material respects of all covenants and agreements required to be performed by it under the merger agreement at or prior to the closing date; and

absence of any material adverse change in the other party, whether or not resulting from a breach in any representation, warranty or covenant contained in the merger agreement and the receipt by each party of a certificate to that effect from the designated executive officers of the other party.

Sterling's obligation to effect the merger is also subject to satisfaction, or waiver, of the following conditions: The merger agreement and the merger shall have been duly and validly approved and adopted, as required by the WBCA and Lynnwood's Articles of Incorporation and Bylaws, each as currently in effect, and by the valid and affirmative vote or written consent of at least two-thirds of the outstanding shares of Lynnwood common stock not held by Charles and Lynette Ainslie;

Receipt by Sterling of voting agreements from Charles Ainslie, Donn Costa and Dennis O'Leary, which were executed concurrently with the merger agreement;

Receipt by Sterling of shareholder agreements from each of Charles Ainslie, Donn Costa and Dennis O'Leary, which were executed concurrently with the merger agreement, restricting the transferability of the Sterling common stock following the merger, and no action shall have been taken by any such individual to rescind such shareholder agreement;

Sterling shall have entered into employment agreements with individuals specified in the merger agreement, which were executed concurrently with the merger agreement, and as of the closing date, each of such individuals shall have remained continuously employed with Lynnwood or its subsidiaries and no action shall have been taken by any such individual to rescind such employment agreement;

Charles Ainslie shall have entered into an amendment to his employment agreement with Lynnwood, terminating such agreement immediately prior to the effective time, and shall have entered into a consulting agreement with Sterling, both of which were executed concurrently with

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the merger agreement, and no action shall have been taken by Mr. Ainslie to rescind such agreements; and

Sterling shall have received resignations from each director of Lynnwood and each of its subsidiaries.

We cannot assure you if, or when, the required regulatory approvals necessary to consummate the merger will be obtained, or whether all of the other conditions precedent to the merger will be satisfied or waived by the party permitted to do so. If the merger is not completed on or before November 30, 2006, either Sterling or Lynnwood may terminate the merger agreement, unless the failure to effect the merger by that date is due to the failure of the party seeking to terminate the merger agreement to perform or observe covenants and agreements of that party set forth in the merger agreement.

Nonsolicitation

Under the terms of the merger agreement, Lynnwood has agreed that it shall not authorize or permit its officers, directors, employees, agents, advisors and affiliates to, and that it shall direct the employees, agents and representatives of its subsidiaries to not, directly or indirectly solicit, initiate or encourage any takeover proposals or other forms of business combination with a third party. In addition, Lynnwood has agreed that it shall not, and that it shall direct the employees, agents and representatives of its subsidiaries to not, negotiate, furnish information or otherwise cooperate in any way in connection with any competing takeover proposals by third parties, unless Lynnwood's board of directors determines in good faith that (i) the takeover proposal, if consummated, would result in a transaction more favorable to holders of Lynnwood common stock than the merger, and (ii) considering the advice of counsel, it has a fiduciary duty to act on the competing proposal.

Termination of the Merger Agreement

Lynnwood and Sterling, by mutual consent, can agree at any time not to complete the merger, even if the shareholders of Lynnwood have voted to approve the principal terms of the merger. Also, either party can decide, without the consent of the other, not to complete the merger in a number of other situations, including:

any governmental entity which must grant a required regulatory approval has denied such approval and such denial has become final and nonappealable;

any governmental entity of competent jurisdiction shall have issued a final nonappealable order enjoining or otherwise prohibiting the consummation of the transactions contemplated by the merger agreement, unless such denial or order shall be due to the failure of the party seeking to terminate the merger agreement to perform or observe the covenants and agreements of such party set forth in the merger agreement;

failure to complete the merger by November 30, 2006, unless the failure of the closing to occur by such date shall be due to the failure of the party seeking to terminate the merger agreement (i) to perform or observe the covenants and agreements of such party or (ii) to fulfill the other party's conditions to closing, in each case as set forth herein;

if the merger has not occurred by the closing date, and the conditions to closing to be performed by the other party have not been satisfied or waived, and the party seeking to terminate (A) is not then in material breach of any representation, warranty, covenant or other agreement contained in the merger agreement and (B) has not failed to materially satisfy the other party's conditions to closing (that have not been waived) due to be performed or satisfied as of the date of the event giving rise to the right to terminate;

if the other party shall have materially breached (i) any of the covenants, agreements, representations or warranties contained in the merger agreement and such breach is not cured

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within 30 days following written notice to the party committing such breach, or which breach, by its nature, cannot be cured prior to the closing date; and

if the approval of the shareholders of Lynnwood contemplated by the merger agreement shall not have been obtained by reason of the failure to obtain the vote required under the WBCA at the Lynnwood special meeting, unless such failure was caused by Lynnwood or a party to a voting agreement as provided by the merger agreement.

Sterling, without the consent of Lynnwood, can terminate:

if: (i) the board of directors of Lynnwood shall have failed to recommend to its shareholders the approval of the merger, or shall have changed, or publicly announced its intention to change such recommendation, or (ii) Lynnwood shall have breached its covenant not to solicit other acquisition proposals;

Lynnwood, without the consent of Sterling, can terminate:

if the average closing price of Sterling's common stock during a specified period just prior to the closing date is less than \$22.56 per share and the Sterling common stock price has also declined from a price of \$26.54 per share, the average closing price of Sterling common stock on the Nasdaq National Market for the twenty (20) trading days ending on (and inclusive of) February 10, 2006, by 15% or more relative to a weighted average index of a certain group of financial institution holding companies. Sterling, however, will then have the option to avoid the termination by increasing the consideration paid to Lynnwood shareholders, as provided in the merger agreement.

Waiver and Amendment to the Merger Agreement

At any time prior to the effective time, Sterling and Lynnwood, by action taken or authorized by their respective boards of directors, may, to the extent legally allowed, waive compliance with any provision in the merger agreement that benefits the waiving party. Any agreement to any such extension or waiver shall be valid only if set forth in a written instrument signed on behalf of such party.

Termination Fee

Sterling and Lynnwood have agreed to pay termination fees in certain events.

Lynnwood must pay Sterling a termination fee of \$2.5 million if Sterling terminates the merger agreement and elects to receive such fee as a result of: (i) the Lynnwood shareholders failing to approve the merger; (ii) the Lynnwood board of directors failing to recommend the approval of the merger or changing, or publicly announcing its intention to change such recommendation; or (iii) Lynnwood breaching its covenant not to solicit other acquisition proposals;

Lynnwood must pay Sterling a termination fee of \$1.0 million if Sterling terminates the merger agreement and elects to receive such fee as a result of Lynnwood (i) failing to perform its closing conditions by the closing date or (ii) materially breaching any of the covenants, agreements, representations or warranties it made in the merger agreement, and such breach is not cured within 30 days following written notice to Lynnwood, or which breach, by its nature, cannot be cured prior to the closing date; and

Sterling must pay Lynnwood a termination fee of \$1.0 million if Lynnwood terminates the merger agreement and elects to receive such fee as a result of Sterling (i) failing to perform its closing conditions by the closing date or (ii) materially breaching any of the covenants, agreements, representations or warranties it made in the merger agreement, and such breach is not cured within 30 days following written notice to Sterling, or which breach, by its nature, cannot be cured prior to the closing date.

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Nasdaq Listing

The approval for quotation on Nasdaq of the shares of Sterling common stock to be issued in the merger is a condition to the parties' obligation to complete the merger.

Expenses

The merger agreement provides that, unless specifically provided otherwise, each of Sterling and Lynnwood will pay its own costs and expenses incurred in connection with the merger agreement and the transactions contemplated by the merger agreement.

Voting Agreements

Charles J. Ainslie, in his capacity as a shareholder of Lynnwood, has separately entered into a voting agreement with Sterling in which he has agreed to vote all shares of Lynnwood common stock that he owned or exercised voting power over as of the record date of the Lynnwood special meeting, in favor of the approval and adoption of the merger agreement and the approval of the merger and the other actions contemplated by the merger agreement. As of the record date, he owned, in the aggregate, 551,198 shares of the common stock of Lynnwood, allowing him to exercise approximately 53.05% of the voting power of Lynnwood common stock. In addition, Donn J. Costa and Dennis V. O'Leary in their capacities as shareholders of Lynnwood, have separately entered into voting agreements with Sterling in which they have each agreed to vote 60,000 shares of Lynnwood common stock, representing approximately 11.55% of the voting power of Lynnwood common stock, that they owned or exercised voting power over as of the record date of the Lynnwood special meeting, in favor of the approval and adoption of the merger agreement and the approval of the merger and the other actions contemplated by the merger agreement.

Shareholder Agreements

Charles J. Ainslie, in his capacity as a shareholder of Lynnwood, has separately entered into a shareholder agreement with Sterling in which he has agreed to certain restrictions on the transferability of the shares of Sterling common stock that he is to receive in the merger. These restrictions include, among others, his agreement not to transfer any shares of Sterling common stock prior to the later of November 15, 2006 or the effective time of the merger, and that for a period of two years after the merger he will transfer no more than 10% of his shares of Sterling common stock in any calendar quarter.

In addition, Donn J. Costa and Dennis V. O'Leary, in their capacities as shareholders of Lynnwood, have separately entered into shareholder agreements with Sterling in which they have each agreed to certain restrictions on the transferability of the shares of Sterling common stock that they are to receive in the merger. These restrictions include, among others, their agreement not to transfer any shares of Sterling common stock until three days after Sterling's earnings for the quarter during which the merger occurs are reported and that for a period of two years after the merger they will transfer no more than 15% of their shares of Sterling common stock in any calendar quarter.

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INFORMATION ABOUT LYNNWOOD

Lynnwood is a Washington corporation registered as a unitary thrift savings and loan holding company under the Home Owners Loan Act of 1994. Lynnwood was formed in November 1999 for the purpose of becoming the holding company for Golf Savings Bank and Golf Escrow Corporation. Lynnwood is primarily engaged in the business of planning, directing, and coordinating the business activities of its wholly owned subsidiaries, Golf Savings Bank, Golf Escrow Corporation, Lynnwood Statutory Trust I and Lynnwood Statutory Trust II. Lynnwood's operating business activities are conducted by and through Golf Savings Bank and Golf Escrow Corporation.

Golf Savings Bank is a Washington State-chartered and FDIC insured savings bank. Golf Savings Bank's primary focus is residential mortgage origination of single-family permanent loans and residential construction financing. Golf Savings Bank's primary market area is the greater Puget Sound area of Washington State and its business is conducted from its headquarters in Mountlake Terrace, Washington. Golf Savings Bank originates loans through a mortgage origination office in Kennewick, Washington, as well as eight retail mortgage loan production offices, throughout the Puget Sound area. Golf Escrow Corporation offers a full range of escrow closing services from two locations, one in Mountlake Terrace and one in the Northgate area of Seattle.

Lynnwood Statutory Trust I is a Connecticut statutory trust formed to facilitate the issuance of approximately \$9,000,000 in trust preferred securities, and Lynnwood Statutory Trust II is a Delaware statutory trust formed to facilitate the issuance of \$10,000,000 of trust preferred securities. The proceeds generated by the trust preferred offerings were distributed to Golf Savings Bank for use as regulatory capital.

As of December 31, 2005, Lynnwood had total assets of approximately \$497.4 million, total net loans receivable of approximately \$428.7 million, total deposits of approximately \$417.7 million and shareholders' equity of approximately \$34.8 million.

Business of Lynnwood

In June of 2000, Lynnwood Mortgage Corporation, a successful residential mortgage company headquartered in Mountlake Terrace Washington, and owned by Charles and Lynette Ainslie, received all necessary regulatory approval to convert to a Washington State stock savings bank. At the same time, Lynnwood, a Washington corporation formed in November 1999 in anticipation of the bank conversion, received approval to become a savings and loan holding company pursuant to the Home Owners Loan Act of 1994. As a part of the bank conversion transaction, Lynnwood Mortgage Corporation reorganized as Golf Savings Bank and became a wholly owned subsidiary of Lynnwood Financial Corporation. Golf Escrow Corporation, which provides escrow services for residential real estate closings, and had been a wholly owned subsidiary of Lynnwood Mortgage Corporation, also became a wholly owned subsidiary of Lynnwood as part of the conversion transaction. In connection with the bank conversion process, Lynnwood sold approximately 200,000 shares of its common stock to qualified investors raising approximately \$3,500,000 in capital. Most of the original subscribers of the initial private stock offering continue to be shareholders of Lynnwood.

Golf Savings Bank originates financing to a broad range of consumers offering home mortgages that are sold in the secondary market or brokers home mortgage loans. Golf Savings Bank also provides loans to predominately small and mid sized residential builders and loans to predominately small to mid sized commercial real estate investors. Both in-house and brokered single family permanent mortgages are offered by Golf Savings Bank. Approximately 99% of in-house mortgage loans are sold to the secondary market. In addition to mortgage lending, Golf Savings Bank has a strong presence in the residential construction lending market.

Golf Savings Bank also has an emerging commercial real estate division providing financing for construction on both a full-term and intermediate-term basis. Golf Savings Bank's deposit mix is 40% retail certificates of deposit and 48% certificates of deposit purchased in the national market and the

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balance is in interest-bearing accounts, savings accounts, and money market accounts. Golf Savings Bank operates eight retail mortgage loan production offices located throughout the Puget Sound region, one loan production office in the Tri-Cities, one retail depository located in Mountlake Terrace, and residential and commercial real estate lending divisions located at its Mountlake Terrace headquarters. Deposit services are offered through the Mountlake Terrace branch, as well as through the mail and on-line.

Lending Products and Services

Residential Mortgage products. Golf Savings Bank offers a broad array of residential mortgage products. Terms and rates vary widely, depending on consumer preference and secondary market considerations. Primary risks to these types of loans are falling real estate values and general economic downturns which affect employment levels.

Residential construction loans. Terms of residential construction loans are generally nine to fifteen months. These loans are secured by first deed of trust positions. The loans are generally prime-based. The credit risks include builder performance, falling real estate values, and the marketability of the finished product.

Commercial real estate loans. These loans include various types of loans for which Golf Savings Bank holds real property as collateral. These include owner-occupied real estate loans, real estate investment loans, real estate development loans and commercial construction loans. Terms vary depending upon many factors, including location, type of project and financial condition of the borrower. The primary risks of commercial real estate loans include the borrower's inability to pay and deterioration in value of real estate that is held as collateral.

The board of directors of Golf Savings Bank and Lynnwood have approved specific lending policies and procedures for the companies and is responsible for implementation of the policies. The lending policies and procedures include guidelines for loan term, loan-to-value ratios, collateral appraisals and interest rates. The loan policies also vest varying levels of loan authority in management and Golf Savings Bank's board of directors. Management of the companies monitors lending activities through monthly reporting and periodic review of loans.

Deposit Products and Services

Golf Savings Bank also offers a range of personal and commercial banking services, including the following: checking accounts, checking accounts with interest, savings accounts, money market accounts, various types of certificates of deposit, NOW accounts, Individual Retirement Accounts, internet banking, direct deposit, night deposit and ATM cards. The transaction accounts and certificates of deposit are tailored to Golf Savings Bank's primary market area at rates competitive with those offered in the area. All deposit accounts are insured by the FDIC to the maximum amount permitted by law.

Competition

Golf Savings Bank faces a high degree of competition because there are numerous small banks and several larger national and regional financial banking groups in the same market. Golf Savings Bank also competes with mortgage companies, savings and loan associations, credit unions, and other financial service providers. Many of these competitors have capital resources and legal lending limits substantially in excess of Lynnwood's capital resources and legal lending limits.

Golf Savings Bank competes for loans and deposits principally based on the availability and quality of services provided, responsiveness to customers, interest rates, loan fees and office locations.

Golf Savings Bank actively solicits deposit customers and competes by offering them high quality customer service and a complete product line. Golf Savings Bank believes its personalized customer service, competitive rates, and community banking philosophy enable it to compete effectively in its market area.

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The adoption of the Gramm-Leach-Bliley Act of 1999 (the Financial Services Modernization Act) eliminated many of the barriers to affiliation among providers of financial services and further opened the door to business combinations involving banks, insurance companies, securities or brokerage firms, and others. This regulatory change has led to further consolidation in the financial services industry and the creation of financial conglomerates which frequently offer multiple financial services, including deposit services, brokerage and others. When combined with technological developments such as the Internet that have reduced barriers to entry faced by companies physically located outside Golf Savings Bank's market area, changes in the market have resulted in increased competition and can be expected to result in further increases in competition in the future.

Facilities

Lynnwood, Golf Savings Bank and Golf Escrow Corporation are headquartered in Mountlake Terrace, Washington. A banking facility, the commercial real estate division, the construction lending division and all corporate functions are housed in the headquarters location. Golf Savings Bank also has eight mortgage loan production offices.

The following is a summary of selected information about the facilities:

Location	SF	Date of Lease	Lease/ Own
6505 218th St SW, Mountlake Terrace, WA 98043	20,400	06/05/01	Lease
3312 Rosedale Street NW #203, Gig Harbor, WA 98335	1,895	01/10/05	Lease
11871 Silverdale Way NW Ste 111, Silverdale, WA 98383	2,545	03/23/04	Lease
115 NE 100th Ste 110, Seattle, WA 98125	5,087	02/26/01	Lease
1730 Minor Ste 1100, Seattle, WA 98101	6,280	09/17/04	Lease
410 Neel #A Kennewick, WA 98336	2,000	06/21/01	Lease
10230 NE Pointe Dr. Suite 530, Kirkland, WA 98033	7,966	10/01/03	Lease
6100 219th St SW #480 and #440, Mountlake Terrace, WA 98043	11,132	05/09/03	Lease

Employees

As of December 31, 2005 Lynnwood had 254 employees. None of the employees are covered by a collective bargaining agreement. Management considers its relationship with employees to be satisfactory.

Legal Proceedings

From time to time, Lynnwood and/or its subsidiaries may be a party to routine litigation incidental to their businesses. Neither Lynnwood nor any of its subsidiaries is a party to any litigation, the adverse determination of which would be likely to have a material adverse effect upon their business operations or assets.

Table of Contents**Lynnwood's Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis describes the financial condition and changes to financial condition and results of operations for Lynnwood and its subsidiaries for the years ended December 31, 2005, 2004 and 2003. It should be read in conjunction with Lynnwood's audited financial statements and notes thereto, and the other financial information appearing elsewhere in this joint proxy statement/prospectus.

Selected Quarterly Financial Data
(Unaudited)
(Dollars in thousands)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Year Ended December 31, 2005					
Interest income	\$ 7,712	\$ 10,004	\$ 11,727	\$ 12,919	\$ 42,362
Interest expense	(2,021)	(2,817)	(3,785)	(4,174)	(12,797)
Net interest income	5,691	7,187	7,942	8,745	29,565
Provision for loan losses	(210)	(220)	(223)	(243)	(896)
Net interest income after provision for loan losses	5,481	6,967	7,719	8,502	28,669
Non-interest income	4,399	5,561	6,607	5,200	21,767
Non-interest expense	(7,086)	(8,736)	(10,162)	(10,255)	(36,239)
Income before provision for income taxes	2,794	3,792	4,164	3,447	14,197
Provision for income taxes	(761)	(1,328)	(1,453)	(1,191)	(4,733)
Net income	\$ 2,033	\$ 2,464	\$ 2,711	\$ 2,256	\$ 9,464

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Year Ended December 31, 2004					
Interest income	\$ 4,641	\$ 5,454	\$ 6,016	\$ 6,727	\$ 22,838
Interest expense	(860)	(946)	(1,250)	(1,514)	(4,570)
Net interest income	3,781	4,508	4,766	5,213	18,268
Provision for loan losses	(15)	(32)	(135)	(715)	(897)
Net interest income after provision for loan losses	3,766	4,476	4,631	4,498	17,371
Non-interest income	3,833	5,366	4,483	5,094	18,776
Non-interest expense	(5,829)	(6,965)	(6,775)	(7,749)	(27,318)
Income before provision for income taxes	1,770	2,877	2,339	1,843	8,829
Provision for income taxes	(619)	(365)	(856)	(643)	(2,483)
Net income	\$ 1,151	\$ 2,512	\$ 1,483	\$ 1,200	\$ 6,346

Critical Accounting Policies

Lynnwood's accounting policies are integral to understanding the financial results reported. Lynnwood's most complex accounting policies require management's judgment to ascertain the valuation of assets, liabilities, commitments and contingencies. Lynnwood has established detailed policies and control procedures that are intended to ensure that valuation methods are well controlled and applied consistently from period to period. In addition, the policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. The following is a brief description of Lynnwood's current critical accounting policies involving significant management valuation judgments.

Table of Contents***Allowance for Loan Losses.***

The allowance for loan losses represents Lynnwood's best estimate of the probable losses inherent in the existing loan portfolio. The allowance for loan losses is increased by the provision for loan losses charged to expense and reduced by loans charged off, net of recoveries.

Lynnwood evaluates its allowance for loan losses on a quarterly basis. Lynnwood believes that the allowance for loan losses is a critical accounting estimate because it is based upon management's assessment of various factors affecting the collectibility of the loans, including current economic conditions, past credit experience, delinquency status, the value of the underlying collateral, if any, and a continuing review of the portfolio of loans. For a discussion of the allowance and our methodology, see the section entitled *Credit Risk Management and Allowance for Loan Losses*.

Like all financial institutions, Lynnwood maintains an allowance for loan losses based on a number of quantitative and qualitative factors, including levels and trends of past due and non-accrual loans, asset classifications, loan grades, change in volume and mix of loans, collateral value, historical loss experience, peer group loss experience, size and complexity of individual credits and economic conditions. Provisions for loan losses are provided on both a specific and general basis. Specific allowances are provided for impaired credits for which the expected/anticipated loss is measurable. General valuation allowances are based on a portfolio segmentation based on risk grading, with a further evaluation of various quantitative and qualitative factors noted above.

Lynnwood closely examines each credit graded *Special Mention* and below to individually assess the appropriate loan loss reserve for the particular credit. Lynnwood periodically reviews the assumptions and formulas by which additions are made to the specific and general valuation allowances for losses in an effort to refine such allowances in light of the current status of the factors described above.

Although Lynnwood believes the levels of the allowance as of December 31, 2005 and 2004, were adequate to absorb probable losses in the loan portfolio, a decline in local economic, or other factors, could result in increasing losses that cannot be reasonably predicted at this time.

Income Recognition.

Lynnwood recognizes interest income by methods that conform to general accounting practices within the banking industry. In the event management believes collection of all or a portion of contractual interest on a loan has become doubtful, which generally occurs after the loan is 90 days past due, Lynnwood discontinues the accrual of interest, and any previously accrued interest recognized in income deemed uncollectible is reversed. Interest received on nonperforming loans is included in income only if principal recovery is reasonably assured. A nonperforming loan is restored to accrual status when it is brought current, has performed in accordance with contractual terms for a reasonable period of time, and the collectibility of the total contractual principal and interest is no longer in doubt. Mortgage broker fees are recognized upon receipt based upon the broker's loan settlement date. Service release premiums and gains on sale of loans are recognized at the date of settlement and based on the difference between the selling price and the carrying value of the related loans and servicing asset sold.

Mortgage Banking Activities.

Mortgage loans originated and intended for sale in the secondary market are reported as loans held for sale and are carried at the lower of cost or estimated market value in the aggregate. Net unrealized losses are recognized in a valuation allowance by charges to income.

Income Taxes.

Deferred tax assets and liabilities result from differences between the financial statement carrying amounts and the tax basis of assets and liabilities, and are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. Deferred tax assets are reduced by a valuation allowance when management determines that it is more

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likely than not that some portion or all of the deferred tax assets will not be realized. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Golf Savings Bank and Golf Escrow Corporation provide for income taxes on a separate basis and remit amounts currently due to Lynnwood.

Results of Operations***For the years ended December 31, 2005 and December 31, 2004.***

For the year ended December 31, 2005, Lynnwood had net income of \$9.46 million or \$9.38 per share of common stock, compared to net income of \$6.35 million or \$7.36 per share of common stock for the year ended December 31, 2004. Lynnwood's annualized returns on average assets and average equity for 2005 were 2.35% and 30.73% compared to 2.66% and 25.87% for 2004.

Interest income totaled \$42.36 million in 2005, compared to \$22.84 million in 2004, an increase of 85.5%. Lynnwood enjoyed 75% growth in average outstanding loans, which was the primary driver of interest income. Lynnwood also had a growing percentage of prime-plus based residential construction loans compared to fixed-rate mortgages in 2005, a year in which the rates for long-term mortgages did not rise as high as the rates for short-term mortgages. Residential construction fees are a large driver of interest income. These fees totaled \$6.07 million in 2005, a 41% increase over 2004. Also, origination fees on single-family permanent loans were \$6.92 million in 2005, a 46% increase over 2004.

Interest expense was 180% higher in 2005 compared to 2004, totaling \$12.8 million and \$4.57 million, respectively. Both funding cost and volume contributed to the increase. Rising rates in the short end of the market drove up deposit and borrowing rates. Deposit volume increased in support of asset growth and was focused primarily in time deposits. Additionally, there was more reliance on bank lines and a new trust preferred offering to fund growth. Net interest income before provision for credit losses totaled \$29.6 million in 2005 and \$18.27 million in 2004, a 62% increase. Net interest spread was 7.06% compared to 7.60% for 2005 and 2004, respectively.

The provision for loan losses for 2005 and 2004 totaled \$896,000 and \$897,000 respectively. No additional credits were deemed uncollectible, reflecting continued high credit quality. Net interest income after loan loss provision totaled \$28.67 million in 2005 and \$17.37 million in 2004.

Non-interest income rose 15.9% to \$21.77 million in 2005, compared to \$18.78 million for 2004. Mortgage origination volume was the primary driver, as Lynnwood closed a company record \$1.2 billion in broker and in-house mortgages, up 31% from the prior year of \$928 million.

A breakdown of non-interest income components is shown below:

	2005	2004
	(Dollars in thousands)	
Loan brokerage fees and servicing release premiums	\$ 13,346	\$ 12,726
Gain on loan sales	5,795	3,821
Escrow	1,818	1,577
Other	808	652
Total non-interest income	\$ 21,767	\$ 18,776
Total loans originated and brokered	\$ 1,215,000	\$ 928,000

Golf Escrow Corporation also enjoyed a 15.3% increase in closing volume for 2005. Much of Golf Escrow Corporation's volume is driven by referrals from Golf Savings Bank's loan production staff.

Salaries and employee benefits for Lynnwood and its subsidiaries rose 33.4% to \$26.77 million in 2005, compared to \$20.06 million during the same period in 2004. The increase was driven primarily by mortgage and commercial real estate volume, as commissions and incentive pay are volume based. Additionally, staffing increased to support asset

growth, with headcount rising 10.4% to 254 employees.

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Occupancy and equipment expenses rose by 26% to \$2.84 million in 2005, compared with \$2.25 million in 2004. This reflects a full year of rent at the Seattle loan production office and the lease of additional new space at the Mountlake Terrace mortgage loan production office.

In 2005, other operating expenses totaled \$6.63 million, compared with \$5.0 million in 2004, a 32.6% increase. This increase is in line with asset growth and mortgage volume increases.

For the years ended December 31, 2004 and December 31, 2003.

For the year ended December 31, 2004, Lynnwood had net income of \$6.35 million or \$7.36 per share of common stock, compared to net income of \$7.19 million or \$9.53 per share of common stock for the year ending December 31, 2003. Lynnwood's annualized returns on average assets and average equity for 2004 were 2.66% and 25.87% compared to 3.63% and 35.95% for 2003.

Interest income totaled \$22.84 million in 2004, compared to \$22.30 million in 2003, an increase of 2.44%. Lynnwood enjoyed 20.66% growth in average outstanding loans, which was the primary driver of interest income. Lynnwood also had a growing percentage of prime-plus based residential construction loans compared to fixed-rate mortgages in 2003. Residential construction fees are a large driver of interest income. These fees totaled \$4.30 million in 2004, a 34.32% increase over 2003. An off-setting affect on interest income growth was origination fees on single-family permanent loans. These fees were \$4.74 million in 2004, a 35.27% decrease from 2003.

Interest expense was 12.62% higher in 2004 compared to 2003, totaling \$4.57 million and \$4.06 million, respectively. Volume contributed to the increase. Deposit volume increased in support of asset growth and was focused primarily in time deposits. Overall funding rates declined marginally from 2003 as higher cost borrowings were replaced with lower cost deposits. Net interest income before provision for credit losses totaled \$18.27 million in 2004 and \$18.24 million in 2003, a 0.17% increase. Net interest spread was 7.60% compared to 9.52% for 2004 and 2003, respectively.

The provision for loan losses for 2004 and 2003 totaled \$897,000 and \$305,000 respectively. No additional credits were deemed uncollectible, reflecting continued high credit quality. Net interest income after loan loss provision totaled \$17.37 million in 2004 and \$17.93 million in 2003.

Non-interest income declined 20.45% to \$18.78 million in 2004, compared to \$23.60 million for 2003. A decline in mortgage origination volume was the primary driver. Lynnwood enjoyed record volume in 2003 fueled by 40 year lows in 30 year fixed rate mortgage rates and the accompanying refinancing boom. Lynnwood closed \$928 million in broker and in-house mortgages, down 17.11% from the prior year of \$1,121 million.

A breakdown of non-interest income components is shown below:

	2004	2003
	(Dollars in thousands)	
Loan brokerage fees and servicing release premiums	\$ 12,726	\$ 18,043
Gain on loan sales	3,821	3,235
Escrow	1,577	1,762
Other	652	563
Total non-interest income	18,766	23,603
Total loans originated and brokered	\$ 928,000	\$ 1,121,000

Salaries and employee benefits for Lynnwood and its subsidiaries declined 14.32% to \$20.06 million in 2004, compared to \$23.42 million during the same period in 2003. The decrease was driven primarily by mortgage and commercial real estate volume, as commissions and incentive pay are volume based.

Occupancy and equipment expenses rose by 28.65% to \$2.25 million in 2004, compared with \$1.75 million in 2003. This reflects the opening of a new mortgage office in Kennewick, Washington, additional rental expense at Lynnwood's headquarters, and computer infrastructure upgrade costs.

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In 2004, other operating expenses totaled \$5.0 million, compared with \$5.28 million in 2003, a 5.25% decrease. This decrease is in line with mortgage volume decreases.

Loan Portfolio.

Total net loans (including loans held for sale) were \$468.89 million, \$274.20 million and \$179.44 million at December 31, 2005, 2004 and 2003, respectively.

The following table sets forth a summary of the composition of Lynnwood's loan portfolio at December 31, 2005, 2004, and 2003.

	December 31, 2005		December 31, 2004		December 31, 2003	
	Amounts	Percent of Total Loans	Amounts	Percent of Total Loans	Amounts	Percent of Total Loans
(Dollars in thousands)						
Mortgage Permanent						
One to Four Family Residential	\$ 73,679	15.6%	\$ 50,067	18.2%	\$ 37,706	20.9%
Multi Family Residential	16,525	3.5%	10,210	3.7%	2,316	1.3%
Commercial Real Estate	40,814	8.6%	3,647	1.3%	0	0.0%
Mortgage Construction						
One to Four Family Residential	309,246	65.5%	209,279	75.7%	139,412	77.1%
Multi Family Residential	22,031	4.7%	2,324	0.8%	0	0.0%
Commercial Real Estate	6,174	1.3%	0	0.0%	0	0.0%
Total Mortgages	\$ 468,469	99.2%	\$ 275,527	99.7%	\$ 179,434	99.3%
Commercial and Consumer						
Consumer	421	0.1%	437	0.2%	630	0.3%
Commercial	3,698	0.8%	615	0.2%	650	0.4%
Total Commercial and Consumer	\$ 4,119	0.9%	\$ 1,052	0.4%	\$ 1,280	0.7%
Total Loans Receivable*	472,588	100.1%	276,579	100.1%	180,714	100.0%
Deferred loan origination fees, net of costs	(601)	-0.1%	(256)	-0.1%	(12)	0.0%
Gross Loans Receivable	\$ 471,987	100.0%	\$ 276,323	100.0%	\$ 180,702	100.0%
Allowance for Loan Losses	(3,102)	0.66%*	(2,126)	0.77%*	(1,261)	0.70%*
Loans Receivable, net and held for sale	\$ 468,885		\$ 274,197		\$ 179,441	

* Total loans includes loans held for sale.

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The following table sets forth a summary of the maturities and interest sensitivities of Lynnwood's loan portfolio as of December 31, 2005:

		Balance Outstanding as of December 31, 2005	Principal Payments Contractually Due in Fiscal Years		
			2006	2007-2010	Thereafter
(Dollars in thousands)					
Mortgage	Permanent				
	Fixed rate	\$ 37,731	\$ 0	\$ 0	\$ 37,731
	Variable rate	93,244	12,112	12,310	68,822
Mortgage	Construction	336,909	310,640	26,269	0
Consumer		421	143	278	0
Commercial		3,682	2,780	902	0
		\$ 471,987	\$ 325,675	\$ 39,759	\$ 106,553

Lynnwood's real estate loan portfolio is secured by office buildings, land for development, single family homes and other real property located primarily within the Puget Sound region in Washington State. Substantially all of these loans are secured by first liens with initial loan to value ratios ranging from 70% to 90%, depending on the type of real property securing the loans.

There were no impaired loans at December 31, 2005, 2004 and 2003. The average investment in impaired loans was \$0, \$96,000 and \$193,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

Asset and Liability Management.

The results of operations for all financial institutions continue to be materially and potentially adversely affected by changes in prevailing economic conditions, including rapid changes in interest rates, changes in real estate market values, and the monetary and fiscal policies of the federal government. Similar to all financial institutions, the net income of Lynnwood and its principal subsidiary, Golf Savings Bank, is subject to fluctuations in market conditions including interest rates changes. For example, a primary driver of net income at Golf Savings Bank is mortgage production, which is highly dependent upon economic factors such as interest rates, local employment and housing affordability. Although Lynnwood maintains a short-term mix of assets and liabilities, fee income associated with loan production from the real estate market in the Pacific Northwest is a primary driver of net income. This production driver for fee income is the principal reason Lynnwood uses a net income model to simulate expected future fee income as well as net interest income spread.

Currently, 72% of Lynnwood's assets are prime-based loans that re-price daily. When including the loans held for sale (held for less than 30 days) as a short-term asset, this ratio increases to 80% of assets. Of the \$57 million in term commercial real estate loans held, 79% are match funded to a brokered CD of similar duration. Approximately 80% of all liabilities are time certificates of deposit with a weighted average maturity of 10 months. Of the remaining liabilities, 9% are money market accounts, 3% are demand and escrow deposits, 4% are variable-rate notes payable to other banks and 4% are variable-rate trust preferred securities. Given the short-term nature of Lynnwood's balance sheet, spread compression from liabilities that price independently from the prime index and a slowdown in production due to weaknesses in the real estate market in the Pacific Northwest are the primary market risks. As the housing market is contingent on lower interest rates, any increase in interest rates is projected to slow production and lower net income.

Lynnwood maintains an asset and liability management program intended to manage net income through various interest rate cycles. Lynnwood uses a simulation model designed to measure the sensitivity of spread compression, mortgage production and fee income to changes in interest rates. This modeling is designed to provide management with a forecasting tool to analyze and interpret the affects of market changes on net income and create alternative strategies for addressing profitability shortfalls. Lynnwood s

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modeling incorporates various mortgage-banking production changes associated with variable interest rate environments and their impact on demand. In addition, Lynnwood's modeling attempts to predict expected fee income from residential construction, commercial construction and commercial term loans. Because Lynnwood maintains a relatively matched balance sheet, the Net Present Value effects are minimal and not used to manage market risks.

The total measurements of Lynnwood's modeling exposure to interest rate risks are presented in the table below and may not be representative of the actual values that may result from a higher or lower interest rate environment. A higher or lower interest rate environment may prompt management to alter lending strategies to focus on segments that present stronger returns and/or lower risk profiles. Higher interest rates may also slow real estate production, which would have a detrimental impact on residential construction lending, mortgage banking income, and potentially commercial mortgage production. Fee income derived from this production may be significantly impacted, resulting in lower net income from rising interest rates.

Lynnwood continues to pursue a strategy of managing interest rate risk exposure by maintaining short-term assets and liabilities and matching longer term assets to brokered CDs with a fixed interest spread. Net interest income is managed through a strategy of funding prime-based construction with shorter term time deposit products. The following scenarios indicate the typical spread to prime for Lynnwood's prime-based products:

construction residential lending at prime plus 1.25 percent;

construction commercial lending at prime plus 1.10 percent; and

consumer lending (home equity loans and short-term bridge financing) of prime plus 1 percent.

Fee income for all lending products is based upon a 1 percent fee of outstanding commitment at origination plus an expected fee of 50-100 basis points for all short-term construction loans renewed beyond the initial 1-2 year commitment. For clarification, all Lynnwood residential construction loans are committed for a 1 year period, although two 6-month extensions are common if construction is ongoing. Residential construction lending in the Seattle area provides a natural hedge for rising interest rates, as prime-based construction loans on highly desirable/affordable infill town home projects produce more interest income during periods of lower fee income from mortgage production.

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The following table indicates the projected net income of Lynnwood one year forward from December 31, 2005 in a base case scenario that assumes no changes in interest rates, shock scenarios of +1 percent, +2 percent, -1 percent, and -2 percent that use the same growth assumptions in the base case scenario with parallel shocks to interest rates, and no growth shocked scenarios of +1 percent, +2 percent, -1 percent, and -2 percent that assume all expected growth will not materialize. The no growth model is a static balance sheet model that assumes standard amortizing of deferred fee income and a 50 percent reduction in fee income for other construction lending. These final shocked scenarios are highly subjective, technical, and relative measurements of market risks, and do not reflect any expected movements in interest rates.

Consolidated Interest Rate Risk Report as of December 31, 2005

	Projected 2006 Net Income	Change from Base	Return on Equity	Return on Assets	Projected Capital Ratio
Probable					
Projected Shock to Growth Scenario					
Base case	\$ 11,032	0%	24%	2.04%	8.71%
Shock up 1%	\$ 10,007	-9%	23%	1.86%	8.64%
Shock up 2%	\$ 9,006	-18%	21%	1.69%	8.55%
Shock down 1%	\$ 12,747	16%	27%	2.33%	8.87%
Shock down 2%	\$ 14,903	35%	30%	2.70%	9.13%
Worst Case					
Shock to No Growth Scenario					
Base case	\$ 11,032	0%	24%	2.04%	8.71%
Shock 1% up-no growth	\$ 7,616	-31%	18%	1.45%	8.56%
Shock 2% up-no growth	\$ 6,558	-41%	16%	1.23%	8.33%
Shock 1% down-no growth	\$ 10,413	-6%	23%	2.03%	9.16%
Shock 2% down-no growth	\$ 12,291	-11%	26%	2.41%	9.54%

Lynnwood does not use traditional gap analysis, as gap analysis does not have the ability to project the impact of mortgage banking and fee-based activities. As the balance sheet of Lynnwood is short-term for both assets and liabilities, a gap analysis only indicates a minimal impact from interest rate risk. The simulation above has proven to be useful and appropriate in both a rising and falling interest rate environment. Management believes that Lynnwood's income will remain strong based upon the economic strength of the Pacific Northwest, and specifically the economic strength of the real estate market in the Puget Sound corridor.

Assets.

Total assets were \$497.37 million at December 31, 2005, an increase of 73.6%, compared to total assets of \$286.49 million as of December 31, 2004. Total average assets for the year 2005 were \$402.93 million.

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Management of Lynnwood considers many criteria in managing assets, including credit-worthiness, diversification and structural characteristics, maturity and interest rate sensitivity. The following table sets forth a summary of Lynnwood's interest earning assets by category:

	Within One Year		One to Five Years		Over Five Years		Grand Total	
	Total	% Earning Assets	Total	% Earning Assets	Total	% Earning Assets	Total	% Earning Assets
Rate sensitive assets:								
Loan Portfolio, including held for sale*	\$ 380,187	97%	\$ 47,635	100%	\$ 44,766	92%	\$ 472,588	97%
Investments	0	0%	0		3,649	8%	3,649	1%
Fed funds sold and interest-bearing deposits	11,178	3%	0		0		11,178	2%
	391,365	100%	47,635	100%	48,415	100%	487,415	100%
Rate sensitive liabilities:								
Saving, NOW, and interest-bearing checking	39,914		0		0		39,914	
Time deposits	324,911		33,937		5,472		364,320	
Other borrowings	39,867		0		0		39,867	
	404,692		33,937		5,472		444,101	
Interest sensitive gap	(13,327)		13,698		42,943			
Cumulative gap	\$ (13,327)		\$ 371		\$ 43,314			
Cumulative gap to Total Assets	-2.68%		0.07%		8.71%			
Total Assets	\$ 497,371							

* Excludes deferred fees and includes the allowance for loan losses

Investment Policy.

The objective of Lynnwood's investment policy is to invest funds not otherwise needed to meet the loan demand of its market area to earn the maximum return for Lynnwood, yet still maintain sufficient liquidity to meet fluctuations in Golf Savings Bank's loan demand and deposit structure. In doing so, Lynnwood balances market and credit risks against potential investment return, makes investments compatible with the pledge requirements of Golf Savings Bank's deposits of public funds, maintains compliance with regulatory investment requirements, and assists various public entities with their financing needs. The chief executive officer and the executive vice president/ chief financial officer are authorized to execute security transactions for the investment portfolio, subject to Golf Savings Bank's investment policy and monthly review by Golf Savings Bank's board of directors.

The investment policy is reviewed annually by Golf Savings Bank's board of directors. Lynnwood focuses on the following attributes for its investments: safety of principal, liquidity, yield, price appreciation and pledgeability.

Table of Contents**Yield Analysis.**

The following tables set forth weighted average yields earned by Lynnwood on its earning assets and the weighted average yields paid on its average deposits and other interest-bearing liabilities for the periods indicated. The table also presents a summary of changes in interest income, interest expense, and the interest rate differential aggregated by the changes in volumes and rates.

	Years Ended December 31,								
	2005			2004			2003		
	Average Balance	Interest Earned or Paid	Average Yield or Cost	Average Balance	Interest Earned or Paid	Average Yield or Cost	Average Balance	Interest Earned or Paid	Average Yield or Cost
(Dollars in thousands)									
Loans	\$ 391,086	\$ 42,211	10.79%	\$ 223,518	\$ 22,788	10.20%	\$ 185,246	\$ 22,168	11.97%
Investment and cash equivalents	14,765	151	1.02%	10,701	50	0.47%	3,138	127	4.05%
Total interest-earning assets	\$ 405,851	\$ 42,362	10.44%	\$ 234,219	\$ 22,838	9.75%	\$ 188,384	\$ 22,295	11.83%
Interest-bearing liabilities:									
Time deposits	\$ 285,820	\$ 9,821	3.44%	\$ 131,795	\$ 2,906	2.20%	\$ 81,959	\$ 989	1.21%
Regular savings and MMDA	28,488	738	2.59%	28,131	457	1.62%	26,166	480	1.83%
Interest-bearing demand accounts	23,138	71	0.31%	18,945	64	0.31%	16,287	65	0.40%
Total interest-bearing deposits	\$ 337,446	\$ 10,630	3.15%	\$ 178,871	\$ 3,427	1.91%	124,412	1,534	1.23%
FHLB Seattle advances	8,152	292	3.58%	7,870	137	1.74%	15,781	250	1.58%
All other borrowings	18,362	987	5.38%	15,937	572	3.58%	28,121	1,970	7.01%
Trust Preferred Securities	14,928	888	5.95%	9,279	434	4.68%	7,144	304	4.26%
Total interest-bearing liabilities	378,888	\$ 12,797	3.38%	211,957	\$ 4,570	2.15%	175,458	\$ 4,058	2.31%
Net interest spread		\$ 29,565	7.06%		\$ 18,268	7.60%		\$ 18,237	9.52%

Net interest margin	7.28%	7.80%	9.68%
Ratio of average interest-earning assets to average interest-bearing liabilities	107.12%	110.50%	107.37%

Deposits.

The following table summarizes Lynnwood's deposit mix and average funding rates.

	Year Ended December 31, 2005				Year Ended December 31, 2004				Year Ended December 31, 2003			
	Period		% of Avg. Deposits	Avg. Rate Paid	Period		% of Avg. Deposits	Avg. Rate Paid	Period		% of Avg. Deposits	Avg. Rate Paid
	End Deposits	Average Deposits			End Deposits	Average Deposits			End Deposits	Average Deposits		
	(Dollars in thousands)											
Net interest margin	\$ 13,465	\$ 19,495	5.78%	0.00%	\$ 13,262	\$ 15,506	8.67%	0.00%	\$ 12,082	\$ 13,845	11.13%	0.00%
Time deposits, & IRAs, & CDs	39,914	32,130	9.52%	2.55%	30,274	31,570	17.65%	1.66%	31,222	28,608	22.99%	1.91%
Certificates of deposit	364,320	285,820	84.70%	3.33%	190,601	131,795	73.68%	2.20%	84,104	81,959	65.88%	1.20%
Maturity in:												
12 months or less	109,016				40,848				28,907			
Greater than 12 months	99,478				54,325				22,093			
2 months or less	116,417				83,700				21,853			
Greater than 2 months	39,409				11,728				11,251			
Total deposits	\$ 417,699	\$ 337,445		3.15%	\$ 234,137	\$ 178,871		1.91%	127,408	124,412		1.20%

Table of Contents***Borrowings.***

The following table summarizes Lynnwood's borrowing mix.

	2005	%	2004	%	2003	%
(Dollars in thousands)						
Federal Home Loan Bank Borrowings	\$ 0		\$ 1,200	5.35%	\$ 6,000	16.00%
Fed Fund Purchases	0		0		5,000	13.33%
Lines of Credit	20,278	50.86%	11,940	53.26%	17,230	45.94%
Trust Preferred Offerings	19,589	49.14%	9,279	41.39%	9,279	24.73%
Total Borrowings	\$ 39,867	100.00%	\$ 22,419	100.00%	\$ 37,509	100.00%

Credit Risk Management and Allowance for Loan Losses.

Credit risk and exposure to loss are inherent parts of the banking business. Lynnwood's management seeks to manage and minimize these risks through its loan and investment policies and loan review procedures. Lynnwood's management establishes and continually reviews lending and investment criteria and approval procedures that it believes reflect the risk sensitive nature of banking. The loan review procedures are set to monitor adherence to the established criteria and to ensure that on a continuing basis such standards are enforced and maintained.

Lynnwood's objective in establishing lending and investment standards is to manage the risk of loss and provide for income generation through pricing policies. To effectuate this policy, Lynnwood prices its loan products at a margin above prime rate, the FHLB intermediate advance rates and other indices that it regularly monitors.

The loan portfolio is reviewed quarterly and management determines the amount of loans to be charged off on a monthly basis. In addition, such factors as Lynnwood's previous loan loss experience, prevailing and anticipated economic conditions, industry concentrations and the overall quality of the loan portfolio are considered. While management uses available information to recognize losses on loans and real estate owned, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowances for losses on loans and real estate owned. Such agencies may require Lynnwood to recognize additions to the allowances based on their judgments about information available at the time of their examinations. In addition, any loan or portion thereof that is classified as a loss by regulatory examiners is charged-off. For the year ended December 31, 2005, Lynnwood had loan charge-offs of approximately \$13,000.

The allowance for loan losses is maintained at a level that management considers adequate to provide for estimated losses based on evaluating known and inherent risks in the loan portfolio. The allowance for loan losses is increased by charging operating expense. The allowance is reduced by loans charged off and is increased by provisions charged to earnings and recoveries on loans previously charged off. Lynnwood grades and classifies loans according to collateral type and assigns a reserve allocation based upon historical and industry experience. Golf Savings Bank further evaluates specific loans for impairment and, as necessary, establishes reserves for those loans that are specifically reviewed. The evaluation is inherently subjective, because it requires estimates that are susceptible to significant revision as more information becomes available.

When information confirms that specific loans are uncollectible, these amounts are charged off against the allowance for loan losses. The existence of some or all of the following criteria will generally confirm that a loss has occurred: the loan is significantly delinquent and the borrower has not evidenced the ability or intent to bring the loan current; Lynnwood has no recourse to the borrower, or if it does, the borrower has insufficient assets to pay the debt; the estimated fair market value of the collateral is significantly below the loan balance; and there is little or no near-term prospect for improvement.

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The allowance for loan losses at December 31, 2005 was \$3.10 million, or 0.66% of loans outstanding (including loans held-for-sale). The allowance for loan losses at December 31, 2004 was \$2.13 million, or 0.77% of loans outstanding. The allowance for loan losses at December 31, 2003 was \$1.26 million, or 0.70% of loans outstanding. The following tables present data related to Golf Savings Bank's allowance for loan losses for the years ended December 31, 2005, 2004 and 2003.

Summary of Loan Loss Experience and Related Information

	December 31, 2005	December 31, 2004	December 31, 2003
(Dollars in thousands)			
Balance at beginning of period	\$ 2,126	\$ 1,261	\$ 1,084
Charge-offs:			
Mortgage Permanent	13	67	130
Mortgage Construction	0	0	0
Consumer	0	1	0
Commercial	0	0	0
Total charge-offs	\$ 13	\$ 68	\$ 130
Recoveries:			
Mortgage Permanent	93	36	2
Mortgage Construction	0	0	0
Consumer	0	0	0
Commercial	0	0	0
Total recoveries	93	36	2
Net charge-offs/recoveries	(80)	32	128
Provision charged to operations	896	897	305
Balance at end of period	\$ 3,102	\$ 2,126	\$ 1,261
Loans Outstanding (including loans held-for-sale):			
End of period	\$ 471,987	\$ 276,323	\$ 180,702
Average during the period	391,087	223,518	185,246
Ratio of allowance for loan losses at end of period to:			
Loans outstanding at end of period	0.66%	0.77%	0.70%
Ratio of net charge offs during the period to average loans outstanding during the period	0.02%	0.01%	0.07%

Loan Loss Reserves Allocation

	December 31, 2005		December 31, 2004		December 31, 2003	
	Allocation	Percentage	Allocation	Percentage	Allocation	Percentage
(Dollars in thousands)						
Mortgage Permanent	\$ 861	27.76%	\$ 492	23.14%	\$ 279	22.13%
Mortgage Construction	2,218	71.50%	1,628	76.58%	973	77.16%
Consumer	3	0.10%	3	0.14%	4	0.32%

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Commercial	24	0.77%	5	0.24%	5	0.40%
Unallocated	(4)	-0.13%	(2)	-0.09%	(0)	-0.01%
Total	\$ 3,102	100.00%	\$ 2,126	100.00%	\$ 1,261	100.00%
TOTAL LOANS(1)	\$ 471,987		\$ 276,323		\$ 180,702	

(1) Includes loans held for sale.

Table of Contents***Risk Elements for Nonaccrual, Past Due and Restructured Loans.***

Golf Savings Bank and Lynnwood had zero past due over 90 days, nonaccrual, restructured, or lost interest loans as of December 31, 2005 and December 31, 2004.

Accrual of interest is discontinued when there is reasonable doubt as to the full, timely collection of interest or principal. When a loan becomes contractually past due 90 days with respect to interest or principal, it is reviewed and a determination is made as to whether it should be placed on nonaccrual status. When a loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans only when they are brought fully current with respect to principal and interest and when, in the judgment of management, the loans are estimated to be fully collectible as to principal and interest.

Restructured loans are those loans on which concessions in terms have been granted because of a borrower's financial difficulty. Interest is generally accrued on such loans in accordance with the new terms.

Impact of Inflation and Changing Prices.

The Lynnwood financial statements and related financial data presented in this document have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time and due to inflation. The impact of inflation on operations is reflected in increased operating costs. Unlike most industrial companies, virtually all of the assets and liabilities of Golf Savings Bank are monetary in nature. As a result, interest rates have a more significant impact on Lynnwood's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the price of goods and services.

Contractual Obligations and Off-Balance Sheet Arrangements.

Lynnwood and Golf Savings Bank routinely enter into contracts in the ordinary course of business to meet various business needs. These contractual obligations, including operating lease commitments and borrowings from the Federal Home Loan Bank of Seattle, may require payment for services to be provided in the future and may also contain penalty clauses for the early termination of the contracts. Lynnwood and Golf Savings Bank are also parties to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of their customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized on the consolidated balance sheets. See the notes to Lynnwood's consolidated financial statements at December 31, 2005 for annual information.

The following table sets forth Lynnwood's significant contractual obligations as of December 31, 2005:

	Total	<1 Yr	1 - 3 Yrs	3 - 5 Yrs	over 5 Yrs
(Dollars in thousands)					
Federal Home Loan Bank Borrowings	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Fed Fund Purchases	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Warehouse Lines of Credit	\$ 20,278	\$ 20,278	\$ 0	\$ 0	\$ 0
Trust Preferred Offerings	\$ 19,589	\$ 0	\$ 0	\$ 0	\$ 19,589
Total Borrowings	\$ 39,867	\$ 20,278	\$ 0	\$ 0	\$ 19,589
Lease obligations	\$ 3,178	\$ 882	\$ 2,151	\$ 145	\$ 0
Total	\$ 43,045	\$ 21,160	\$ 2,151	\$ 145	\$ 19,589

Table of Contents***Liquidity and Capital Management.***

Liquidity and capital management involves the ability to meet the cash-flow requirements of customers who are depositors desiring to withdraw funds and borrowers requiring assurance that sufficient funds will be available to meet their credit needs.

Lynnwood's liquidity management focuses on the ability to generate cash within a reasonable time frame and at a reasonable cost. Golf Savings Bank's primary sources of liquidity are total cash, cash due from banks, and federal funds sold. Lynnwood's investment portfolio is relatively short term in nature and insignificant in amount. Lynnwood also maintains credit lines with its correspondent banking relationships.

In order to ensure that adequate funds are available at all times, Lynnwood has policies and procedures in place to monitor liquidity levels on a regular basis. Lynnwood is not subject to any specific liquidity requirements imposed by regulatory orders. Lynnwood is subject to general FDIC safety and soundness guidelines. Lynnwood's management believes that its current liquidity levels are adequate.

Lynnwood is a legal entity separate and distinct from its subsidiary bank and other subsidiaries. Its principal source of funds to pay dividends on its common stock and principal and interest on its debt is dividends from its subsidiaries. Various federal and state statutory provisions and regulations limit the amount of dividends Golf Savings Bank and certain other subsidiaries may pay without regulatory approval.

Lynnwood is also subject to oversight by various bank regulatory agencies that have the authority to prohibit Lynnwood from paying dividends if Lynnwood's capital is deemed to be inadequate. Depending on Lynnwood's financial condition, the payment of dividends could be deemed an unsafe or unsound practice. The ability of Lynnwood to pay dividends in the future therefore is currently, and could be further, influenced by bank regulatory policies and capital guidelines.

Lynnwood's and Golf Savings Bank's capital amounts and ratios are summarized in the following table:

December 31, 2005	Actual Amount	Ratio	Capital Adequacy Amount	Ratio	Well Capitalized Amount	Ratio
(Dollars in thousands)						
Tier 1 capital (average assets)						
Consolidated	\$ 46,444	9.79%	\$ 18,984	4.00%	\$ N/A	N/A
Bank	47,328	10.48%	18,069	4.00%	22,587	5.00%
Tier 1 capital (risk-weighted assets)						
Consolidated	46,444	10.09%	18,410	4.00%	N/A	N/A
Bank	47,328	10.86%	17,426	4.00%	26,139	6.00%
Total 1 capital (risk-weighted assets)						
Consolidated	49,546	10.76%	36,821	8.00%	N/A	N/A
Bank	50,240	11.53%	34,852	8.00%	43,565	10.00%

December 31, 2004	Actual Amount	Ratio	Capital Adequacy Amount	Ratio	Well Capitalized Amount	Ratio
(Dollars in thousands)						
Tier 1 capital (average assets)						
Consolidated	\$ 35,681	12.76%	\$ 11,188	4.00%	\$ N/A	N/A
Bank	30,839	11.85%	10,412	4.00%	13,015	5.00%
Tier 1 capital (risk-weighted assets)						
Consolidated	35,681	12.27%	11,634	4.00%	N/A	N/A

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Bank	30,839	11.21%	11,001	4.00%	16,502	6.00%
Total 1 capital (risk-weighted assets)						
Consolidated	37,807	13.00%	23,268	8.00%	N/A	N/A
Bank	32,820	11.93%	22,003	8.00%	27,503	10.00%

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December 31, 2003	Actual Amount	Ratio	Adequacy Amount	Ratio	Capitalized Amount	Ratio
Tier 1 Capital (average assets)						
Consolidated	\$ 29,729	15.20%	\$ 7,821	4.00%	N/A	N/A
Bank	25,935	15.67%	6,620	4.00%	\$ 8,275	5.00%
Tier 1 Capital (risk-weighted assets)						
Consolidated	29,729	16.74%	7,102	4.00%	N/A	N/A
Bank	25,935	16.72%	6,203	4.00%	9,304	6.00%
Total Capital (risk-weighted assets)						
Consolidated	30,990	17.45%	14,204	8.00%	N/A	N/A
Bank	26,996	17.41%	12,406	8.00%	15,507	10.00%

REGULATION AND SUPERVISION

The following is not intended to be a complete discussion but is intended to be a summary of some of the more significant provisions of laws applicable to Sterling, Lynnwood and their subsidiaries. This regulatory framework is intended to protect depositors, federal deposit insurance funds and the banking system as a whole, and not to protect security holders. To the extent that the information describes statutory and regulatory provisions, it is qualified in its entirety by reference to those provisions and any amendments thereto.

General

The banking and financial services business in which Lynnwood and Sterling engage is highly regulated. Such regulation is intended, among other things, to protect depositors insured by the FDIC, and the entire banking system. The commercial banking business is also influenced by the monetary and fiscal policies of the federal government and the policies of the Federal Reserve Board, or the FRB. The FRB implements national monetary policies (with objectives such as curbing inflation and combating recession) by its open-market operations in United States Government securities, by adjusting the required level of reserves for financial intermediaries subject to its reserve requirements and by varying the discount rates applicable to borrowings by depository institutions. The actions of the FRB in these areas influence the growth of bank loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. Indirectly, such actions may also impact the ability of non-bank financial institutions to compete with the banks. The nature and impact of any future changes in monetary policies cannot be predicted.

The laws, regulations and policies affecting financial services businesses are continuously under review by Congress, state legislatures and federal and state regulatory agencies. From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial intermediaries. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial intermediaries are frequently made in Congress, in the Washington legislature and by various bank regulatory agencies and other professional agencies. Changes in the laws, regulations or policies that impact Lynnwood and Sterling cannot necessarily be predicted, but they may have a material effect on Lynnwood's and Sterling's business and earnings.

Bank Holding Company Regulation

As a bank holding company, Sterling is registered with and subject to regulation by the FRB under the Bank Holding Company Act, or BHCA. In accordance with FRB policy, Sterling is expected to act as a source of financial strength to its subsidiary bank, Sterling Savings Bank, and to commit resources to support the bank in circumstances where it might not otherwise do so. Similarly, under the cross-guarantee provisions of the Federal Deposit Insurance Act, the FDIC can hold any FDIC-insured depository institution liable for any loss suffered or anticipated by the FDIC in connection with: (i) the default of a commonly controlled FDIC-insured depository institution; or (ii) any assistance provided by the FDIC to

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such a commonly controlled institution. Under the BHCA, Sterling is subject to periodic examination by the FRB. Sterling is also required to file with the FRB periodic reports of its operations and such additional information regarding Sterling and its subsidiaries as the FRB may require. Pursuant to the BHCA, Sterling is required to obtain the prior approval of the FRB before it acquires all or substantially all of the assets of any bank or ownership or control of voting shares of any bank if, after giving effect to such acquisition, it would own or control, directly or indirectly, more than 5 percent of such bank.

Under the BHCA, Sterling may not engage in any business other than managing or controlling banks or furnishing services to its subsidiaries that the FRB deems to be so closely related to banking as to be a proper incident thereto. Sterling is also prohibited, with certain exceptions, from acquiring direct or indirect ownership or control of more than 5 percent of the voting shares of any company unless the company is engaged in banking activities or the FRB determines that the activity is so closely related to banking as to be a proper incident to banking. The FRB's approval must be obtained before the shares of any such company can be acquired and, in certain cases, before any approved company can open new offices. Additionally, bank holding companies that meet certain eligibility requirements prescribed by the BHCA and elect to operate as financial holding companies may engage in, or own shares in, businesses or companies engaged in a wider range of non-banking activities, including securities and insurance activities and any other activity that the FRB, in consultation with the Secretary of the Treasury, determines by regulation or order is financial in nature, incidental to any such financial activity or complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. The BHCA generally does not place territorial restrictions on the domestic activities of non-bank subsidiaries of bank holding companies. As of the date of this filing, Sterling does not operate as a financial holding company.

The BHCA and regulations of the FRB also impose certain constraints on the redemption or purchase by a bank holding company of its own shares of stock.

Sterling's earnings and activities are affected by legislation, by regulations and by local legislative and administrative bodies and decisions of courts in the jurisdictions in which Sterling and Sterling Savings Bank conduct business. For example, these include limitations on the ability of Sterling Savings Bank to pay dividends to Sterling and Sterling's ability to pay dividends to its shareholders. It is the policy of the FRB that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiaries. Various federal and state statutory provisions limit the amount of dividends that subsidiary banks and savings associations can pay to their holding companies without regulatory approval. In addition to these explicit limitations, the federal regulatory agencies have general authority to prohibit a banking subsidiary or bank holding company from engaging in an unsafe or unsound banking practice. Depending upon the circumstances, the agencies could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

In addition, banking subsidiaries of bank holding companies are subject to certain restrictions imposed by federal law in dealings with their holding companies and other affiliates. Subject to certain exceptions set forth in the Federal Reserve Act, a bank can make a loan or extend credit to an affiliate, purchase or invest in the securities of an affiliate, purchase assets from an affiliate, accept securities of an affiliate as collateral for a loan or extension of credit to any person or company, issue a guarantee or accept letters of credit on behalf of an affiliate only if the aggregate amount of the above transactions of such subsidiary does not exceed 10 percent of such subsidiary's capital stock and surplus on an individual basis or 20 percent of such subsidiary's capital stock and surplus on an aggregate basis. Such transactions must be on terms and conditions that are consistent with safe and sound banking practices. A bank and its subsidiaries generally may not purchase a low-quality asset, as that term is defined in the Federal Reserve Act, from an affiliate. Such restrictions also prevent a holding company and its other affiliates from borrowing from a banking subsidiary of the holding company unless the loans are secured by collateral.

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The FRB has cease and desist powers over parent bank holding companies and non-banking subsidiaries where the action of a parent bank holding company or its non-financial institutions represent an unsafe or unsound practice or violation of law. The FRB has the authority to regulate debt obligations, other than commercial paper, issued by bank holding companies by imposing interest ceilings and reserve requirements on such debt obligations.

As a unitary thrift savings and loan holding company, Lynnwood is subject to supervision and regulation by the Office of Thrift Supervision, or OTS. Because FRB must approve the merger as described above, additional approval of the merger by OTS is not required.

As a Washington corporation, Sterling is subject to certain limitations and restrictions under applicable Washington corporate law. For example, state law restrictions in Washington include limitations and restrictions relating to indemnification of directors, distributions to shareholders, transactions involving directors, officers or interested shareholders, maintenance of books, records, and minutes, and observance of certain corporate formalities.

Bank Regulation

Golf Savings Bank and Sterling Savings Bank are extensively regulated under both federal and state law.

As a Washington State-chartered bank with deposits insured by the FDIC, each bank is subject to the supervision and regulation of the WDFI and the FDIC. These agencies have the authority to prohibit banks from engaging in what they believe to be unsafe or unsound banking practices. Each bank's deposits are insured to a maximum of \$100,000 per depositor by the FDIC, and each bank pays semiannual deposit insurance premium assessments to the FDIC.

Prompt Corrective Action

The Federal Deposit Insurance Corporation Improvement Act, or FDICIA, requires each federal banking agency to take prompt corrective action to resolve the problems of insured depository institutions, including but not limited to those that fall below one or more prescribed minimum capital ratios. Pursuant to FDICIA, the Office of the Comptroller of the Currency, or OCC, the FDIC and the FRB promulgated regulations defining the following five categories in which an insured depository institution will be placed, based on the level of its capital ratios: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. Under the prompt corrective action provisions of FDICIA, an insured depository institution generally will be classified as undercapitalized if its total risk-based capital is less than 8% or its Tier 1 risk-based capital or leverage ratio is less than 4%. An institution that, based upon its capital levels, is classified as well capitalized, adequately capitalized or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that