First California Financial Group, Inc.
Form 10-Q
November 09, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2012

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 000-52498

FIRST CALIFORNIA FINANCIAL GROUP, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	38-3737811 (I.R.S. Employer Identification Number)
3027 Townsgate Road, Suite 300 Westlake Village, California (Address of Principal Executive Offices)	91361 (Zip Code)

Registrant's telephone number, including area code: (805) 322-9655

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

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

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

29,220,271 shares of Common Stock, $0.01 par value, as of November 6, 2012

FIRST CALIFORNIA FINANCIAL GROUP, INC.
QUARTERLY REPORT ON
FORM 10-Q

For the Quarterly Period Ended September 30, 2012

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets (unaudited)

(in thousands, except share and per share data)		September 30, 2012		December 31, 2011
Cash and due from banks	$	42,387	$	40,202
Interest bearing deposits with other banks		34,095		21,230
Securities available-for-sale, at fair value		549,373		453,735
Non-covered loans, net		1,049,642		918,356
Covered loans		106,144		135,412
Premises and equipment, net		18,184		18,480
Non-covered foreclosed property		15,201		20,349
Covered foreclosed property		5,218		14,616
Goodwill		60,720		60,720
Other intangibles, net		12,205		13,887
FDIC shared-loss receivable		50,471		68,083
Cash surrender value of life insurance		12,991		12,670
Accrued interest receivable and other assets		34,173		34,924
Total assets	$	1,990,804	$	1,812,664
Non-interest checking	$	675,488	$	482,156
Interest checking		112,895		107,077
Money market and savings		483,293		486,000
Certificates of deposit, under $100,000		62,176		74,861
Certificates of deposit, $100,000 and over		266,040		275,175
Total deposits		1,599,892		1,425,269
Securities sold under agreements to repurchase		30,000		30,000
Federal Home Loan Bank advances		84,583		87,719
Junior subordinated debentures		26,805		26,805
Deferred tax liabilities, net		2,261		7,370
FDIC shared-loss liability		3,827		3,757
Accrued interest payable and other liabilities		6,873		8,637
Total liabilities		1,754,241		1,589,557
Commitments and Contingencies (Note 12)				
Perpetual preferred stock; authorized 2,500,000 shares				
Series A - $0.01 par value, 1,000 shares issued and outstanding as of September 30, 2012 and December 31, 2011		1,000		1,000
Series C - $0.01 par value, 25,000 shares issued and outstanding as of September 30, 2012 and December 31, 2011		25,000		25,000
Common stock, $0.01 par value; authorized 100,000,000 shares; 29,266,050 shares issued at September 30, 2012 and		292		292

29,220,079 shares issued at December 31, 2011; 29,220,271 and 29,220,079 shares outstanding at September 30, 2012 and December 31, 2011, respectively				
Additional paid-in capital		174,796		173,062
Treasury stock, 45,779 shares at cost at September 30, 2012 and no shares at December 31, 2011		(255)		—
Retained earnings		33,724		25,427
Accumulated other comprehensive income (loss)		2,006		(1,674)
Total shareholders' equity		236,563		223,107
Total liabilities and shareholders' equity	$	1,990,804	$	1,812,664

See accompanying notes to consolidated financial statements.

FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Income (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands, except per share data)	2012	2011	2012	2011
Interest and fees on loans	$ 17,555	$ 16,896	$ 52,346	$ 49,264
Interest on securities	1,704	1,720	5,301	4,712
Interest on federal funds sold and interest bearing deposits	51	90	154	270
Total interest income	19,310	18,706	57,801	54,246
Interest on deposits	1,258	1,836	4,028	6,494
Interest on borrowings	887	916	2,739	2,853
Interest on junior subordinated debentures	159	336	628	1,001
Total interest expense	2,304	3,088	7,395	10,348
Net interest income before provision for loan losses	17,006	15,618	50,406	43,898
Provision for non-covered loan losses	500	1,550	1,500	4,550
Net interest income after provision for loan losses	16,506	14,068	48,906	39,348
Service charges on deposit accounts	735	878	2,335	2,633
Gain on loan sales and commissions	29	—	274	—
Net gain on sale of securities	510	209	1,104	699
Impairment loss on securities	(449)	—	(477)	(1,066)
Loss on non-hedged derivatives	(99)	(24)	(506)	(24)
(Amortization)accretion of FDIC shared-loss asset	(135)	48	131	143
Gain on acquisitions	—	—	—	35,202
Other income	1,519	1,189	5,063	2,812
Total noninterest income	2,110	2,300	7,924	40,399
Salaries and employee benefits	6,592	6,675	21,254	19,315
Premises and equipment	1,629	1,567	4,845	4,708
Data processing	910	810	2,531	2,685
Legal, audit, and other professional services	1,905	1,071	4,480	4,299
Printing, stationery and supplies	63	79	229	288
Telephone	193	218	637	592
Directors’ expense	122	135	374	342
Advertising, marketing and business development	340	272	1,221	1,069
Postage	57	50	170	171
	553	364	1,633	1,777

Insurance and regulatory assessments				
(Gain)loss on and expense of foreclosed property	(701)	(672)	(108)	5,066
Amortization of intangible assets	539	624	1,682	1,665
Other expenses	664	840	2,513	2,387
Total noninterest expense	12,866	12,033	41,461	44,364
Income before provision for income taxes	5,750	4,335	15,369	35,383
Provision for income taxes	2,286	1,819	6,135	14,862
Net income	$ 3,464	$ 2,516	$ 9,234	$ 20,521
Preferred stock dividends	$ (313)	$ (1,616)	$ (938)	$ (2,241)
Net income available to common stockholders	$ 3,151	$ 900	$ 8,296	$ 18,280
Net income per common share:				
Basic	$ 0.11	$ 0.03	$ 0.28	$ 0.64
Diluted	$ 0.11	$ 0.03	$ 0.28	$ 0.64

See accompanying notes to consolidated financial statements.

FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Comprehensive Income (unaudited)

	Three months ended September 30,		Nine months ended September 30,	
(dollars in thousands)	2012	2011	2012	2011
Other comprehensive income:				
Unrealized loss on interest rate cap	$(26)	$(288)	$(140)	$(510)
Unrealized gain on securities available-for-sale	4,572	2,219	7,034	5,098
Reclassification adjustment for net (gains) losses included in net income	(61)	(209)	(627)	367
Other comprehensive income, before tax	4,485	1,722	6,267	4,955
Income tax expense related to items of other comprehensive income	(2,570)	(721)	(2,587)	(2,069)
Other comprehensive income	1,915	1,001	3,680	2,886
Net income	3,464	2,516	9,234	20,521
Comprehensive income	$5,379	$3,517	$12,914	$23,407

See accompanying notes to consolidated financial statements.

FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows (unaudited)

(in thousands)	Nine Months Ended September 30, 2012	2011
Net income	$ 9,234	$ 20,521
Adjustments to reconcile net income to net cash from operating activities:		
Provision for non-covered loan losses	1,500	4,550
Stock-based compensation costs	1,530	832
Gain on acquisition	—	(35,202)
Gain on sales of securities	(1,104)	(699)
Gain on sales of loans	(274)	—
Net loss on sale and valuation adjustments of non-covered foreclosed property	1,753	4,371
Net gain on sale and valuation adjustments of covered foreclosed property	(2,126)	—
Impairment loss on securities	477	1,066
Amortization of net premiums on securities available-for-sale	4,846	2,672
Depreciation and amortization of premises and equipment	1,598	1,526
Amortization of intangible assets	1,682	1,665
Accretion of FDIC shared-loss asset	(131)	(143)
Loss(gain) on disposal of premises and equipment	40	(149)
Increase in cash surrender value of life insurance	(321)	(330)
Change in deferred taxes	(5,109)	2,298
Increase in accrued interest receivable and other assets, net of effects of acquisition	(20)	(12,123)
Decrease in accrued interest payable and other liabilities, net of effects of acquisition	(1,695)	(1,356)
Net cash provided (used) by operating activities	11,880	(10,501)
Purchases of securities available-for-sale, net of effects from acquisition	(348,380)	(146,184)
Proceeds from repayments and maturities of securities available-for-sale	145,923	102,943
Proceeds from sales of securities available-for-sale	108,380	26,344
Purchases of Federal Home Loan Bank and other stock	—	(5)
Net change in federal funds sold and interest bearing deposits, net of effects from acquisition	(12,865)	(3,664)
Loan originations, purchases and principal collections, net of effects of acquisition	(111,889)	71,542
Purchases of premises and equipment, net of effects of acquisition	(1,487)	(1,828)
Proceeds from sale of premises and equipment	6	1,267
Proceeds from redemption of Federal Home Loan Bank and other stock	748	1,459
Net proceeds from FDIC shared-loss asset	17,743	9,405

Proceeds from sale of non-covered foreclosed property		3,392			2,587	
Proceeds from sale of covered foreclosed property		18,439			15,562	
Net cash acquired in acquisition		—			122,119	
Net cash (used) provided by investing activities		(179,990	)		201,547	
Net increase in noninterest-bearing deposits, net of effects of acquisition		193,333			40,160	
Net decrease in interest-bearing deposits, net of effects of acquisition		(18,709	)		(139,013	)
Net decrease in FHLB advances and other borrowings, net of effects of acquisition		(3,136	)		(75,267	)
Dividends paid on preferred stock		(938	)		(831	)
Purchases of treasury stock		(255	)		—	
Net cash provided (used) by financing activities		170,295			(174,951	)
Change in cash and due from banks		2,185			16,095	
Cash and due from banks, beginning of period		40,202			25,487	
Cash and due from banks, end of period	$	42,387		$	41,582	
Supplemental cash flow information:						
Cash paid for interest	$	7,499		$	10,222	
Cash paid for income taxes	$	11,725		$	7,520	
Supplemental disclosure of noncash items:						
Net change in fair value of securities available-for-sale, net of tax	$	3,712		$	3,575	
Net change in fair value of cash flow hedges, net of tax	$	(32	)	$	(177	)
Non-covered loans transferred to non-covered foreclosed property	$	—		$	328	
Covered loans transferred to covered foreclosed property	$	6,721		$	15,657	
Acquisitions:						
Assets acquired	$	—		$	456,922	
Liabilities assumed	$	—		$	436,498	

See accompanying notes to consolidated financial statements.

NOTE 1 – NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Organization and nature of operations – First California Financial Group, Inc., or First California, or the Company, is a bank holding company incorporated under the laws of the State of Delaware and headquartered in Westlake Village, California. The principal asset of the Company is the capital stock of First California Bank, or the Bank. The Bank is a full-service commercial bank headquartered in Westlake Village, California, chartered under the laws of the State of California and subject to supervision by the California Department of Financial Institutions and the Federal Deposit Insurance Corporation, or the FDIC. The FDIC insures the Bank's deposits up to the maximum legal limit.

On February 18, 2011, the Bank assumed certain liabilities and acquired certain assets and substantially all of the operations of San Luis Trust Bank, or SLTB, located in San Luis Obispo, California, from the FDIC. The Bank acquired, received and recognized certain assets with an estimated fair value of approximately $367 million, including $139 million of loans, $99 million of cash and federal funds sold, $70 million of a FDIC shared-loss asset, $41 million of securities, $13 million of foreclosed property and $5 million of other assets. Liabilities with an estimated fair value of approximately $346 million were also assumed and recognized, including $266 million of deposits, $62 million of Federal Home Loan Bank advances, $15 million in a deferred tax liability, $3 million of a FDIC shared-loss liability and $0.4 million of other liabilities. The Bank recorded a pre-tax bargain purchase gain of $36.5 million in connection with this transaction. This transaction increased the number of the Bank's full-service branch locations to 19 and the Bank fully integrated the former SLTB branch location into its full-service branch network in June 2011.

On April 8, 2011, the Bank completed the acquisition of the Electronic Banking Solutions division of Palm Desert National Bank. The transaction included the division's customer base, core deposits, and employees. The Electronic Payment Services Division, or the EPS division, its new name under the Bank, issues prepaid cards and sponsors merchant acquiring services for all national and regional networks, including Visa, MasterCard, and Discover throughout all 50 states and U.S. territories. The Bank acquired cash of $85.4 million, recognized intangible assets of $6.0 million, assumed $91 million of deposits and recognized a pre-tax bargain purchase gain of $0.5 million in connection with this transaction.

On February 28, 2012, the Bank entered into a definitive agreement and plan of merger to acquire Premier Service Bank, a state-chartered commercial bank headquartered in Riverside, California for $2.0 million. As part of the merger, the Bank will acquire certain assets and assume certain liabilities and substantially all of the operations, including two full-service branches located in Riverside and Corona, California, of Premier Service Bank. The Bank will acquire approximately $140 million of assets, including $104 million of loans related to the transaction. The Bank will assume approximately $112 million of deposits related to the transaction. The transaction is pending the receipt of the required regulatory and shareholder approvals.

The Bank serves the comprehensive financial needs of businesses and consumers in Los Angeles, Orange, Riverside, San Diego, San Bernardino, San Luis Obispo and Ventura counties through 15 full-service branch locations.

Consolidation – The accompanying condensed consolidated financial statements include, in conformity with generally accepted accounting principles in the United States of America, the accounts of the Company, the Bank, Wendy Road Office Development LLC, a subsidiary of the Bank which manages and disposes of real estate, and SC Financial, an inactive subsidiary of First California. The Company does not consolidate the accounts of FCB Statutory Trust I and First California Statutory Trust I, or the Trusts, in the consolidated financial statements. The Company does include, however, the junior subordinated debentures issued by the Company to the Trusts on the consolidated balance sheets. Results of operations for the three and nine months ended September 30, 2011 include the effects of the FDIC-assisted SLTB transaction and the EPS division acquisition from the date of the acquisitions. All material intercompany transactions have been eliminated.

Basis of presentation – The unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q as promulgated by the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnote disclosures normally required by generally accepted accounting principles for complete financial statements. In our opinion, all normal recurring adjustments necessary for a fair presentation are reflected in the unaudited condensed consolidated financial statements. Operating results for the period ended September 30, 2012 are not necessarily indicative of the results of operations that may be expected for any other interim period or for the year ending December 31, 2012. In preparing these financial statements, the Company has evaluated events and transactions subsequent to September 30, 2012 for potential recognition or disclosure. The unaudited condensed consolidated financial statements should be read in conjunction with the audited condensed consolidated financial statements and notes thereto included in the Company's 2011 Annual Report on Form 10-K.

Reclassifications – Certain reclassifications have been made to the 2011 consolidated financial statements to conform to the current year presentation. The effects of reclassification adjustments had no effect upon previously reported net income or net income per common share calculations.

Management's estimates and assumptions – The preparation of the consolidated financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported revenues and expenses for the reporting periods. Actual results could differ significantly from those estimates. Significant estimations made by management primarily involve the calculation of the allowance for loan losses, the carrying amount of deferred tax assets, the carrying amount of covered loans, the carrying amount of foreclosed property, the carrying amount of the FDIC shared-loss receivable and liability, the assessments for impairment related to goodwill and securities, the estimated fair value of financial instruments and the effectiveness of derivative instruments in offsetting changes in fair value or cash flows of hedged items.

Allowance for loan losses – The allowance for loan losses is established through a provision charged to expense. Loans are charged against the allowance when management believes that the collectability of principal is unlikely. The allowance is an amount that management believes will be adequate to absorb estimated probable losses on existing loans that may become uncollectable, based on evaluations of the collectability of loans and prior loan loss experience. The evaluation includes an assessment of the following factors: any external loan review and any regulatory examination, estimated probable loss exposure on each pool of loans, concentrations of credit, value of collateral, the level of delinquent and nonaccrual loans, trends in the portfolio volume, effects of any changes in the lending policies and procedures, changes in lending personnel, present economic conditions at the local, state and national levels, the amount of undisbursed off-balance sheet commitments, and a migration analysis of historical losses and recoveries for the prior twenty-two quarters. Individual loans are also evaluated for impairment and if a portion of a loan is impaired, the impaired amount is charged-off or a specific reserve is allocated for that loan. Various regulatory agencies, as a regular part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgment of information available to them at the time of their examinations. The allowance for loan losses was $18.2 million at September 30, 2012 and $17.8 million at December 31, 2011.

Non-covered foreclosed property - We acquire, through foreclosure or through full or partial satisfaction of a loan, real or personal property. At the time of foreclosure, the Company obtains an appraisal of the property and records the property at its estimated fair value less costs to sell. We charge the allowance for loan losses for the loan amount in excess of the fair value of the foreclosed property received; we credit recoveries, up to the amount of previous charge-offs, if any, and then earnings for the fair value amount of the foreclosed property in excess of the loan due. Subsequent to foreclosure, the Company periodically assesses our disposition efforts and the estimated fair value of the foreclosed property. The Company establishes a valuation allowance through a charge to earnings for estimated declines in fair value subsequent to foreclosure. Operating income and operating expense related to foreclosed property is included in earnings as are any ultimate gains or losses on the sale of the foreclosed property. Our recognition of gain is however dependent on the buyer's initial investment in the purchase of foreclosed property meeting certain criteria. The estimated fair value of non-covered foreclosed property was $15.2 million at September 30, 2012 and $20.3 million at December 31, 2011.

Covered foreclosed property - All foreclosed property acquired in FDIC-assisted acquisitions that are subject to a FDIC shared-loss agreement are referred to as "covered foreclosed property" and reported separately in our consolidated balance sheets. Covered foreclosed property is reported exclusive of expected reimbursement cash flows from the FDIC. Foreclosed covered loan collateral is transferred into covered foreclosed property at the collateral's net realizable value, less estimated selling costs.

Covered foreclosed property was initially recorded at its estimated fair value on the acquisition date based on similar market comparable valuations less estimated selling costs. Any subsequent valuation adjustments due to declines in fair value will be charged to non-interest expense, and will be mostly offset by non-interest income representing the corresponding increase to the FDIC shared-loss asset for the offsetting loss reimbursement amount. Any recoveries of previous valuation adjustments will be credited to non-interest expense with a corresponding charge to non-interest income for the portion of the recovery that is due to the FDIC. The estimated fair value of covered foreclosed property was $5.2 million at September 30, 2012 and $14.6 million at December 31, 2011.

Deferred income taxes – The Company recognizes deferred tax assets subject to our judgment that realization of such assets are more-likely-than-not. A valuation allowance is established when the Company determines that the realization of income tax benefits may not occur in future years. There was no valuation allowance at September 30, 2012 or December 31, 2011. There were net deferred tax liabilities of $2.3 million at September 30, 2012 and $7.4 million at December 31, 2011.

FDIC shared-loss asset – The FDIC shared-loss asset is initially recorded at fair value, based on the discounted value of expected future cash flows under the shared-loss agreements. The difference between the present value and the undiscounted cash flows the Company expects to collect from the FDIC will be accreted or amortized into non-interest income over the life of the FDIC shared-loss asset. Subsequent to initial recognition, the FDIC shared-loss asset is reviewed quarterly and adjusted for any changes in expected cash flows based on recent performance and expectations for future performance of the covered portfolio. These adjustments are measured on the same basis as the related covered loans, at a pool level, and covered foreclosed property. Generally, any increases in cash flow of the covered assets over those previously expected will result in prospective increases in the loan pool yield and amortization of the FDIC shared-loss asset. Any decreases in cash flow of the covered assets under those previously expected will trigger impairments on the underlying loan pools and will result in a corresponding gain on the FDIC shared-loss asset. Increases and decreases to the FDIC shared-loss asset are recorded as adjustments to non-interest income.

FDIC shared-loss liability – Forty-five days following the tenth anniversary of the Western Commercial Bank, or WCB, and SLTB acquisition dates, the Company will be required to perform a calculation and determine if a payment to the FDIC is necessary. The payment amount will be 50 percent of the excess, if any, of (i) 20 percent of the intrinsic loss estimate minus (ii) the sum of (a) 20 percent of the net loss amount, plus (b) 25 percent of the asset discount bid, plus (c) 3.5 percent of total loss share assets at acquisition. The Company’s estimate for the present value of this liability was $3.8 million at both September 30, 2012 and December 31, 2011.

Derivative instruments and hedging – For derivative instruments designated in cash flow hedging relationships, we assess the effectiveness of the instruments in offsetting changes in the overall cash flows of designated hedged transactions on a quarterly basis. The Company recognizes the unrealized gains or losses of derivative instruments directly in current period earnings to the extent these instruments are not effective. At September 30, 2012, the Company had $37.1 million notional interest rate caps to limit the variable interest rate payments on our $26.8 million junior subordinated debentures. Our 2012 third quarter effectiveness assessment indicated that these instruments were effective.

At September 30, 2012, the Bank had $240 million notional interest rate caps that do not meet the criteria for hedge accounting to manage the interest rate risk associated with its fixed rate securities and loans. The Company may enter into derivative contracts that are intended to economically hedge certain of its risks, even though hedge accounting does not apply or the Company elects not to apply hedge accounting. Derivatives not designated as hedges are marked-to-market each period through earnings.

Assessments of impairment – Goodwill is assessed for impairment on an annual basis or at interim periods if an event occurs or circumstances change which may indicate a change in the implied fair value of the goodwill. The implied fair value of goodwill is estimated by comparing the estimated fair value of the Company to the estimated fair value of the Company’s individual assets, liabilities, and identifiable intangible assets. Impairment exists when the carrying amount of goodwill exceeds this implied fair value.

First California uses independent data where possible in determining the fair value of the Company and in determining appropriate market factors used in the fair value calculations. At December 31, 2011, the annual assessment resulted in the conclusion that goodwill was not impaired. No events occurred or circumstances changed since December 31, 2011 which indicated there was a material change in the implied fair value of goodwill.

An impairment assessment is performed quarterly on the securities available-for-sale portfolio in accordance with Financial Accounting Standards Board, or FASB, accounting standards codification guidance related to the consideration of impairment related to certain debt and equity securities. All of the securities classified as available-for-sale are debt securities.

If the Company does not intend to sell, and it is more likely than not that the Company is not required to sell a debt security before recovery of its cost basis, other-than-temporary impairment is separated into (a) the amount representing credit loss and (b) the amount related to other factors. The amount of the other-than-temporary impairment related to credit loss is recognized in earnings and other-than-temporary impairment related to other factors is recognized in other comprehensive income (loss). Other-than-temporary declines in fair value are assessed based on the duration the security has been in a continuous unrealized loss position, the severity of the decline in value, the rating of the security, the long-term financial outlook of the issuer, the expected future cash flows from the security and the Company's ability and intent to hold the security until the fair value recovers. Please see the "Securities" section of Management's Discussion and Analysis in this document for a detailed explanation of the impairment analysis process. The Company will continue to evaluate the securities portfolio for other-than-temporary impairment at each reporting date and can provide no assurance there will not be an other-than-temporary impairment in future periods.

For the three months ended September 30, 2012, we recognized an other-than-temporary impairment loss of $449,000 on a private-label CMO security which was sold in the third quarter. There was no other-than-temporary impairment loss for the three months ended September 30, 2011. For the nine months ended September 30, 2012, we recognized impairment losses of $477,000 - an other-than-temporary impairment loss on a private-label CMO security of

$449,000 and a permanent impairment loss of $28,000 on a $1.0 million community development-related equity investment. For the nine months ended September 30, 2011, we recognized an other-than-temporary impairment loss of $1.1 million related to two private-label CMO securities.

NOTE 2 – RECENTLY ISSUED AND ADOPTED ACCOUNTING PRONOUNCEMENTS

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurements (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. ASU 2011-04 was issued concurrently with IFRS 13, Fair Value Measurements, to provide mainly identical guidance about fair value measurement and disclosure requirements. For U.S. GAAP, most of the changes are clarifications of existing guidance or wording changes to align with IFRS 13. ASU 2011-04 is effective during interim and annual periods beginning after December 15, 2011. Early adoption is not permitted. The adoption of this ASU did not have a material effect on our consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. ASU 2011-05 will require companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. This standard eliminates the option to present components of comprehensive income as part of the statement of changes in stockholders' equity. This standard does not change the items which must be reported in other comprehensive income, how such items are measured, or when they must be reclassified to net income. This standard is effective for interim and annual periods beginning after December 15, 2011. Early adoption is permitted. A portion of this ASU was deferred with the issuance of ASU 2011-12 discussed below.

In September 2011, the FASB issued ASU 2011-08, Intangibles – Goodwill and Other – Testing Goodwill for Impairment. ASU 2011-08 provides guidance on the application of a qualitative assessment of impairment indicators in the review of goodwill impairment. The ASU provides that in the event that the qualitative review indicates that it is more likely than not that no impairment has occurred, the Company would not be required to perform a quantitative review. The provisions of ASU 2011-08 will be effective for years beginning after December 15, 2011 for both public and nonpublic entities, although earlier adoption is allowed. The adoption of this standard did not have a significant impact on our consolidated financial statements.

In December 2011, the FASB issued ASU 2011-11, Disclosures about Offsetting Assets and Liabilities. ASU 2011-11 provides convergence to International Financial Reporting Standards, or IFRS, to provide common disclosure requirements for the offsetting of financial instruments. Existing GAAP guidance allowing balance sheet offsetting, including industry-specific guidance, remains unchanged. The new guidance is effective on a retrospective basis, including all prior periods presented, for interim and annual periods beginning on or after January 1, 2013. The Company does not expect that adoption of this standard will have a material impact on the Company's consolidated financial statements.

In December 2011, the FASB issued ASU 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. ASU 2011-12 defers the requirements of ASU 2011-05 to display reclassification adjustments for each component of other comprehensive income in both net income and other comprehensive income and to present the components of other comprehensive income in interim financial statements. During 2012, the FASB will reconsider the reclassification requirements and the timing of their implementation. Management is currently evaluating the impact both of these ASU's will have on the disclosures in the Company's consolidated financial statements.

In July 2012, the FASB issued ASU 2012-02, Intangibles – Goodwill and Other. ASU 2012-02 provides guidance on the application of a qualitative assessment of impairment indicators in the review of impairment of indefinite-lived intangible assets. The ASU provides that in the event that the qualitative review indicates that it is more likely than not that no impairment has occurred, the Company would not be required to perform a quantitative review. The provisions of ASU 2012-02 will be effective for interim and annual impairment tests performed for fiscal years beginning after September 15, 2012 for both public and nonpublic entities, although earlier adoption is permitted. The adoption of this standard is not expected to have a material impact on our consolidated financial statements.

In October 2012, the FASB issued ASU 2012-06, Business Combinations – Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution. ASU 2012-06 requires that when a reporting entity recognizes an indemnification asset as a result of a government-assisted acquisition of a financial institution and subsequently a change in the cash flows expected to be collected on the indemnification asset occurs, the reporting entity should subsequently account for the change in the measurement of the indemnification asset on the same basis as the change in the assets subject to indemnification. This standard is effective for fiscal years, and interim periods within those years, beginning on or after December 15, 2012. Early adoption is permitted. The amendments should be applied prospectively to any new indemnification assets acquired after the date of adoption and to indemnification assets existing as of the date of adoption arising from a government-assisted acquisition of a financial institution. Certain transition disclosures are required. The adoption of ASU 2012-06 is not expected to have a material impact on our consolidated financial statements.

NOTE 3 – ACQUISITION

On April 8, 2011, or the EPS Transaction Date, the Bank completed the acquisition of the Electronic Banking Solutions division of Palm Desert National Bank. The transaction included the division's customer base, core deposits, and employees. The Bank paid cash consideration of $5.5 million to purchase the EPS division. The Bank acquired cash of $85.4 million, recognized intangible assets of $6.0 million, assumed $91 million of deposits and recognized a pre-tax bargain purchase gain of $0.5 million in connection with this transaction. The Bank desired this transaction to expand its product and service offerings and diversify its sources of revenue.

Under the acquisition method of accounting, the Bank recorded the assets acquired and liabilities assumed based on their estimated fair values as of the EPS Transaction Date. Results of operations for the year ended December 31, 2011 included the effects of the EPS acquisition from the EPS Transaction Date.

The following table summarizes the estimated fair values of the assets acquired, received and recognized and the liabilities assumed and recognized as of the EPS Transaction Date.

		(Dollars in thousands)
Assets Acquired:		
Cash	$	85,389
Intangible assets		6,005
Other assets		89
Total assets acquired	$	91,483
Liabilities Assumed:		
Deposits	$	91,018
Deferred taxes		195
Total liabilities assumed		91,213
Net assets acquired (after-tax bargain purchase gain)		270
Total liabilities and net assets acquired	$	91,483

The Bank based the allocation of the purchase price above on the fair values of the assets acquired and the liabilities assumed. The net gain represents the excess of the estimated fair value of the assets acquired over the estimated fair value of the liabilities assumed. The gain was recognized as non-interest income in the Company's Condensed Consolidated Statements of Operations. Non-interest expense for the second quarter of 2011 included integration and conversion expenses related to the EPS division acquisition of approximately $350,000. The "Salaries and employee benefits", "Data processing" and "Legal, audit, and other professional services" categories were affected on the Company's Condensed Consolidated Statements of Income.

On February 18, 2011, or the SLTB Transaction Date, the Bank assumed certain liabilities and acquired certain assets and substantially all of the operations of SLTB from the FDIC, acting in its capacity as receiver of SLTB, pursuant to the terms of a purchase and assumption agreement entered into by the Bank and the FDIC, or the Purchase Agreement. The Bank acquired, received, and recognized certain assets with a fair value of approximately $367 million, including $139 million in loans, $99 million of cash and cash equivalents, $41 million of securities and $13 million of foreclosed property related to the transaction. These acquired assets represented approximately 20 percent of consolidated total assets at March 31, 2011. The Bank also assumed approximately $266 million of deposits and

$62 million of FHLB advances related to the transaction. The Bank also recorded an FDIC shared-loss asset of $70 million, a core deposit intangible of $0.3 million, deferred tax liabilities of $15 million, a FDIC shared-loss liability of $2.6 million and a premium on time deposits acquired of $0.8 million related to the transaction. The Bank continues to operate the one former SLTB branch location as part of the Bank's 15 branch locations. The Bank desired this transaction to expand its footprint into the California central coast region.

As part of the Purchase Agreement, the Bank and the FDIC entered into shared-loss agreements, whereby the FDIC will cover a substantial portion of any future losses on loans (and related unfunded loan commitments), foreclosed property and accrued interest on loans for up to 90 days. We refer to the acquired assets subject to the shared-loss agreements collectively as covered assets. Under the terms of the shared-loss agreements, the FDIC will absorb 80 percent of losses and share in 80 percent of loss recoveries. The shared-loss agreements for commercial and residential mortgage loans are in effect for 5 years and 10 years, respectively, from the SLTB Transaction Date and the loss recovery provisions are in effect for 8 years and 10 years, respectively, from the SLTB Transaction Date.

In March 2021, approximately ten years following the SLTB Transaction Date, the Bank is required to perform a calculation and determine if a payment to the FDIC is necessary. The payment amount will be 50 percent of the excess, if any, of (i) 20 percent of the intrinsic loss estimate ($99.0 million) minus (ii) the sum of (a) 20 percent of the net loss amount, plus (b) 25 percent of the asset discount bid ($58.0 million), plus (c) 3.5 percent of total loss share assets at acquisition. At the SLTB Transaction Date, the Bank estimated a liability, on a present value basis, of $2.6 million under this provision.

Under the acquisition method of accounting, the Bank recorded the assets acquired and liabilities assumed based on their estimated fair values as of the SLTB Transaction Date. Results of operations for the year ended December 31, 2011 included the effects of the SLTB acquisition from the SLTB Transaction Date.

The following table summarizes the estimated fair values of the assets acquired, received and recognized and the liabilities assumed and recognized as of the SLTB Transaction Date.

		(Dollars in thousands)
Assets Acquired:		
Cash and cash equivalents	$	98,820
Securities		40,972
Covered loans		138,792
Covered foreclosed property		12,772
FDIC shared-loss asset		70,293
Other assets		5,510
Total assets acquired	$	367,159
Liabilities Assumed:		
Deposits	$	266,149
FHLB advances		61,541
FDIC shared-loss liability		2,564
Deferred taxes		15,316
Other liabilities		437
Total liabilities assumed		346,007
Net assets acquired (after-tax bargain purchase gain)		21,152
Total liabilities and net assets acquired	$	367,159

The Bank based the allocation of the purchase price above on the fair values of the assets acquired and the liabilities assumed. The net gain represents the excess of the estimated fair value of the assets acquired over the estimated fair value of the liabilities assumed and is influenced significantly by the FDIC-assisted transaction process. Under the FDIC-assisted transaction process, only certain assets and liabilities are transferred to the acquirer and, depending on the nature and amount of the acquirer's bid, the FDIC may be required to make a cash payment to the acquirer. The Bank received a cash payment from the FDIC for $34.4 million. The book value of net assets transferred to the Bank was $23.6 million (i.e., the cost basis). The pre-tax gain of $36.5 million or the after-tax gain of $21.1 million recognized by the Company is considered a bargain purchase transaction under ASC 805 "Business Combinations" since the total acquisition-date fair value of the identifiable net assets acquired exceeded the fair value of the consideration transferred. The gain was recognized as non-interest income in the Company's Condensed Consolidated Statements of Operations. Non-interest expense for the first quarter of 2011 included integration and conversion expenses related to the SLTB acquisition of approximately $515,000. The "Salaries and employee benefits", "Data processing" and "Legal, audit, and other professional services" categories were affected on the Company's Condensed Consolidated Statements of Income.

In August 2011, the Bank exercised its option to purchase at fair value approximately $100,000 of furniture, fixtures and equipment related to the one SLTB branch location from the FDIC. The Bank also negotiated and executed a new five-year lease approximating current market rent for the one branch location.

The acquisition of assets and liabilities of SLTB were significant at a level to require disclosure of one year of historical financial information and related pro forma disclosure. However, given the pervasive nature of the shared-loss agreements entered into with the FDIC, the historical information of SLTB are much less relevant for purposes of assessing the future operations of the combined entity. In addition, prior to closure, SLTB had not completed an audit of their financial statements, and the Company determined that audited financial statements are not and will not be reasonably available for the year ended December 31, 2010. Given these considerations, the Company requested, and received, relief from the Securities and Exchange Commission from submitting certain historical and pro forma financial information of SLTB.

NOTE 4 – SECURITIES

Securities have been classified in the consolidated balance sheets according to management’s intent and ability as available-for-sale. The amortized cost, gross unrealized gains, gross unrealized losses and estimated fair values of securities available-for-sale at September 30, 2012 and December 31, 2011 are summarized as follows:

	September 30, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. Treasury notes/bills	$19,037	$2	$—	$19,039
U.S. government agency notes	45,530	169	(30)	45,669
U.S. government agency mortgage-backed securities	226,915	4,921	—	231,836
U.S. government agency collateralized mortgage obligations	206,830	682	(815)	206,697
Private label collateralized mortgage obligations	5,763	—	(638)	5,125
Municipal securities	36,820	1,621	(113)	38,328
Other domestic debt securities	4,574	—	(1,895)	2,679
Securities available-for-sale	$545,469	$7,395	$(3,491)	$549,373

	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. Treasury notes/bills	$45,151	$14	$(4)	$45,161
U.S. government agency notes	59,212	257	(23)	59,446
U.S. government agency mortgage-backed securities	132,141	1,616	(82)	133,675
U.S. government agency collateralized mortgage obligations	168,158	384	(368)	168,174
Private label collateralized mortgage obligations	15,853	—	(2,811)	13,042
Municipal securities	28,572	813	(60)	29,325
Other domestic debt securities	7,151	—	(2,239)	4,912
Securities available-for-sale	$456,238	$3,084	$(5,587)	$453,735

As of September 30, 2012, securities available-for-sale with a fair value of $48.6 million were pledged as collateral for borrowings, public deposits and other purposes as required by various statutes and agreements.

The following table shows the gross unrealized losses and amortized cost of the Company’s securities aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2012 and December 31, 2011.

	At September 30, 2012	
Less Than 12 Months	Greater Than 12 Months	Total

	Amortized Cost	Unrealized Losses	Amortized Cost	Unrealized Losses	Amortized Cost	Unrealized Losses
			(in thousands)			
U.S. government agency notes	$3,999	$(30)	$—	$—	$3,999	$(30)
U.S. government agency collateralized mortgage obligations	120,020	(764)	7,175	(51)	127,195	(815)
Private-label collateralized mortgage obligations	—	—	5,763	(638)	5,763	(638)
Municipal securities	7,525	(113)	—	—	7,525	(113)
Other domestic debt securities	—	—	4,574	(1,895)	4,574	(1,895)
	$131,544	$(907)	$17,512	$(2,584)	$149,056	$(3,491)

	At December 31, 2011					
	Less Than 12 Months		Greater Than 12 Months		Total	
	Amortized Cost	Unrealized Losses	Amortized Cost	Unrealized Losses	Amortized Cost	Unrealized Losses
	(in thousands)					
U.S. Treasury notes/bills	$10,029	$(4)	$—	$—	$10,029	$(4)
U.S. government agency notes	10,000	(23)	—	—	10,000	(23)
U.S. government agency mortgage-backed securities	40,889	(82)	—	—	40,889	(82)
U.S. government agency collateralized mortgage obligations	99,894	(368)	—	—	99,894	(368)
Private-label collateralized mortgage obligations	—	—	15,853	(2,811)	15,853	(2,811)
Municipal securities	4,039	(60)	—	—	4,039	(60)
Other domestic debt securities	—	—	7,151	(2,239)	7,151	(2,239)
	$164,851	$(537)	$23,004	$(5,050)	$187,855	$(5,587)

Net unrealized holding gains were $3.9 million at September 30, 2012 and net unrealized holding losses were $2.5 million at December 31, 2011. As a percentage of securities, at amortized cost, net unrealized holding gains were 0.72 percent and net unrealized holding losses were 0.55 percent at the end of each respective period. Securities are comprised largely of U.S. Treasury bills and notes, and U.S. government agency notes, mortgage-backed securities and collateralized mortgage obligations. On a quarterly basis, we evaluate our individual available-for-sale securities in an unrealized loss position for other-than-temporary impairment. As part of this evaluation, we consider whether we intend to sell each security and whether it is more-likely-than-not that we will be required to sell the security before the anticipated recovery of the security's amortized cost basis. Should a security meet either of these conditions, we recognize an impairment charge to earnings equal to the entire difference between the security's amortized cost basis and its fair value at the balance sheet date. For securities in an unrealized loss position that meet neither of these conditions, we consider whether we expect to recover the entire amortized cost basis of the security by comparing our best estimate, on a present value basis, of the expected future cash flows from the security with the amortized cost basis of the security. If our best estimate of expected future cash flows is less than the amortized cost basis of the security, we recognize an impairment charge to earnings for this estimated credit loss.

The Company will continue to evaluate the securities portfolio for other-than-temporary impairment at each reporting date and can provide no assurance there will not be further other-than-temporary impairments in future periods.

The following table presents the other-than-temporary impairment activity related to credit loss, which is recognized in earnings, and the other-than-temporary impairment activity related to all other factors, which are recognized in other comprehensive income.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Beginning balance	$3,008	$3,322	$3,643	$2,256
Reduction for securities sold	(1,061)	—	(1,724)	—
Additional increases to the amount related to the credit loss for which an other-than-temporary impairment was previously recognized	449	—	477	1,066
Ending balance	$2,396	$3,322	$2,396	$3,322

The Company owns one pooled trust preferred security, rated triple-A at purchase, with an amortized cost basis of $4.6 million and an unrealized loss of $1.9 million at September 30, 2012. The gross unrealized loss is mainly due to extraordinarily high investor yield requirements resulting from an illiquid market, causing this security to be valued at a discount to its acquisition cost. One credit rating agency has recently upgraded the security to investment grade. The senior tranche owned by the Company has a collateral balance well in excess of the amortized cost basis of the tranche at September 30, 2012. Eighteen of the fifty-six issuers in the security have deferred or defaulted on their interest payments as of September 30, 2012. The Company's analysis determined that approximately half of the issuers would need to default on their interest payments before the senior tranche owned by the Company would be at risk of loss. As the Company's estimated present value of expected cash flows to be collected is in excess of the amortized cost basis, the Company considers the gross unrealized loss on this security to be temporary.

The Company owns one mortgage-backed security also known as a private-label CMO. As of September 30, 2012, the par value of this security was $6.7 million and the amortized cost basis, net of other-than-temporary impairment charges, was $5.8 million. At September 30, 2012, the fair value of this security was $5.1 million, representing 1 percent of our securities portfolio. Gross unrealized losses related to this private-label CMO was $0.6 million, or 11 percent of the amortized cost basis of this security as of September 30, 2012.

The gross unrealized losses associated with this security were primarily due to extraordinarily high investor yield requirements resulting from an extremely illiquid market, significant uncertainty about the future condition of the mortgage market and the economy, and continued deterioration in the credit performance of loan collateral underlying these securities, causing these securities to be valued at significant discounts to their acquisition cost. This private-label CMO had credit agency ratings of less than investment grade at September 30, 2012. We performed a discounted cash flow analysis for this security using the current month, last three month and last twelve month historical prepayment speed, the cumulative default rate and the loss severity rate to determine if there was other-than-temporary impairment as of September 30, 2012. Based upon this analysis, we determined that there was no further other-than-temporary impairment than what had been previously recognized. We had previously recognized an other-than-temporary loss of $1.0 million on this security in prior periods. We do not intend to sell these securities and we do not believe it likely that we will be required to sell these securities before the anticipated recovery of the remaining amortized cost basis. If current conditions in the mortgage markets and general business conditions continue to deteriorate, the fair value of our private-label CMO may decline further and we may experience further impairment losses. For the three months ended September 30, 2012, we recognized an other-than-temporary impairment loss of $449,000 on a private-label CMO security which was sold in the third quarter. There was no other-than-temporary impairment loss for the three months ended September 30, 2011. For the nine months ended September 30, 2012, we recognized impairment losses of $477,000 - an other-than-temporary impairment loss on a private-label CMO security of $449,000 and a permanent impairment loss of $28,000 on a $1.0 million community development-related equity investment. For the nine months ended September 30, 2011, we recognized a credit loss of $1.1 million related to two private-label CMO securities.

The amortized cost and estimated fair value of securities by contractual maturities are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	At September 30, 2012	
	Amortized Cost	Fair Value
	(in thousands)	
Due in one year or less	$ 19,037	$ 19,039
Due after one year through five years	45,530	45,669
Due after five years through ten years	152,115	155,030
Due after ten years	328,787	329,635
Total	$ 545,469	$ 549,373

NOTE 5 – NON-COVERED LOANS AND ALLOWANCE FOR NON-COVERED LOAN LOSSES

The loans not acquired in the SLTB and WCB acquisitions and which are not covered by the related shared-loss agreements with the FDIC are referred to as non-covered loans. The non-covered loan portfolio by type consists of the following:

(in thousands)		At September 30, 2012			At December 31, 2011	
Commercial mortgage	$	453,137		$	393,376	
Multifamily		214,962			187,333	
Commercial loans and lines		168,513			180,421	
Home mortgage		152,710			106,350	
Home equity loans and lines of credit		42,483			28,645	
Construction and land		33,021			35,082	
Installment and credit card		3,055			4,896	
Total loans		1,067,881			936,103	
Allowance for loan losses		(18,239	)		(17,747	)
Loans, net	$	1,049,642		$	918,356	

At September 30, 2012, loans with a balance of $803.6 million were pledged as security for Federal Home Loan Bank, or FHLB, advances. Loan balances include net deferred loan costs of $6.6 million and $3.4 million at September 30, 2012 and December 31, 2011, respectively.

Most of the Company's lending activity is with customers located in Los Angeles, Orange, Ventura, Riverside, San Bernardino, San Diego and San Luis Obispo Counties and most loans are secured by or dependent on real estate. Although the Company has no significant exposure to any individual customer, economic conditions, particularly the recent sustained decline in real estate values in Southern California, could adversely affect customers and their ability to satisfy their obligations under their loan agreements.

Changes in the allowance for non-covered loan losses were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Beginning balance	$18,344	$18,306	$17,747	$17,033
Provision for loan losses	500	1,550	1,500	4,550
Loans charged-off	(643)	(2,292)	(1,269)	(4,319)
Recoveries on loans charged-off	38	214	261	514
Ending balance	$18,239	$17,778	$18,239	$17,778

The following table details activity in the allowance for non-covered loan losses by portfolio segment for the three months ended September 30, 2012. Allocation of a portion of the allowance to one segment of the loan portfolio does not preclude its availability to absorb losses in other segments.

(in thousands)	Commercial Mortgage	Commercial	Multifamily	Construction and Land	Home Mortgage	Home Equity	Installment	Total
Allowance for credit losses:								
Beginning balance	$ 5,441	$ 7,116	$ 2,933	$ 458	$ 1,861	$ 418	$ 117	$ 18,344
Charge-offs	—	(253)	(160)	—	(71)	—	(159)	(643)
Recoveries	—	32	—	—	—	—	6	38
Provision	297	(263)	191	35	87	83	70	500
Ending balance	$ 5,738	$ 6,632	$ 2,964	$ 493	$ 1,877	$ 501	$ 34	$ 18,239
Ending balance; individually evaluated for impairment	$ 61	$ 4,945	$ 139	$ 10	$ 198	$—	$—	$5,353
Ending balance; collectively evaluated for impairment	5,677	1,687	2,825	483	1,679	501	34	12,886
Ending balance	$ 5,738	$ 6,632	$ 2,964	$ 493	$ 1,877	$ 501	$ 34	$ 18,239
Non-covered loan balances:								

Ending balance	$ 453,137	$ 168,513	$ 214,962	$ 33,021	$152,710	$42,483	$ 3,055	$1,067,881
Ending balance; individually evaluated for impairment	$ 671	$ 19,129	$ 2,014	$ 194	$1,526	$—	$ 29	$23,563
Ending balance; collectively evaluated for impairment	$ 452,466	$ 149,384	$ 212,948	$ 32,827	$151,184	$42,483	$ 3,026	$1,044,318

The following table details activity in the allowance for non-covered loan losses by portfolio segment for the three months ended September 30, 2011. Allocation of a portion of the allowance to one segment of the loan portfolio does not preclude its availability to absorb losses in other segments. At September 30, 2011, none of the allowance was associated with covered loans.

(in thousands)	Commercial Mortgage	Commercial	Multifamily	Construction and Land	Home Mortgage	Home Equity	Installment	Total
Allowance for credit losses:								
Beginning balance	$ 7,019	$ 5,469	$ 2,556	$ 874	$ 1,851	$ 426	$ 111	$ 18,306
Charge-offs	—	(2,237)	—	(7)	(3)	(37)	(8)	(2,292)
Recoveries	—	204	—	5	5	—	—	214
Provision	(878)	2,689	(70)	138	(276)	(31)	(22)	1,550
Ending balance	$ 6,141	$ 6,125	$ 2,486	$ 1,010	$ 1,577	$ 358	$ 81	$ 17,778
Ending balance; individually evaluated for impairment	$ —	$ 2,757	$ —	$ 45	$ —	$ —	$ 2	$ 2,804
Ending balance; collectively evaluated for impairment	1,141	3,368	2,486	965	1,577	358	79	14,974
Ending balance	$ 6,141	$ 6,125	$ 2,486	$ 1,010	$ 1,577	$ 358	$ 81	$ 17,778
Non-covered loan balances:								
Ending balance	$ 396,232	$ 189,119	$ 141,954	$ 47,931	$ 110,118	$ 29,489	$ 5,203	$ 920,046
Ending balance; individually evaluated for impairment	$ 1,413	$ 10,048	$ 1,532	$ 181	$ 1,105	$ —	$ 4	$ 14,283
Ending balance; collectively evaluated for impairment	$ 394,819	$ 179,071	$ 140,422	$ 47,750	$ 109,013	$ 29,489	$ 5,199	$ 905,763

The following table details activity in the allowance for non-covered loan losses by portfolio segment for the nine months ended September 30, 2012. Allocation of a portion of the allowance to one segment of the loan portfolio does not preclude its availability to absorb losses in other segments.

(in thousands)	Commercial Mortgage	Commercial	Multifamily	Construction and Land	Home Mortgage	Home Equity	Installment	Total
Allowance for credit losses:								

Beginning balance	$ 6,091	$ 6,221	$ 2,886	$ 814	$ 1,274	$ 390	$ 71	$ 17,747
Charge-offs	(10)	(739)	(160)	—	(169)	—	(191)	(1,269)
Recoveries	2	252	—	—	—	—	7	261
Provision	(345)	898	238	(321)	772	111	147	1,500
Ending balance	$ 5,738	$ 6,632	$ 2,964	$ 493	$ 1,877	$ 501	$ 34	$ 18,239

The following table details activity in the allowance for non-covered loan losses by portfolio segment for the nine months ended September 30, 2011. Allocation of a portion of the allowance to one segment of the loan portfolio does not preclude its availability to absorb losses in other segments.

(in thousands)	Commercial Mortgage	Commercial	Multifamily	Construction and Land	Home Mortgage	Home Equity	Installment	Total
Allowance for credit losses:								
Beginning balance	$ 6,134	$ 4,934	$ 2,273	$ 1,698	$ 1,496	$ 416	$ 82	$ 17,033
Charge-offs	(312)	(3,429)	(65)	(10)	(370)	(37)	(96)	(4,319)
Recoveries	—	495	—	9	5	—	5	514
Provision	319	4,125	278	(687)	446	(21)	90	4,550
Ending balance	$ 6,141	$ 6,125	$ 2,486	$ 1,010	$ 1,577	$ 358	$ 81	$ 17,778

Nonaccrual loans are those loans for which management has discontinued accrual of interest because reasonable doubt exists as to the full and timely collection of either principal or interest. Nonaccrual loans are also considered impaired loans. Total non-covered nonaccrual loans totaled $15.4 million at September 30, 2012 as compared to $13.9 million at December 31, 2011. The allowance for loan losses maintained for nonaccrual loans was $4.1 million and $3.1 million at September 30, 2012 and December 31, 2011, respectively. Had these loans performed according to their original terms, additional interest income of $0.5 million and $0.7 million would have been recognized in the nine months ended September 30, 2012 and 2011, respectively.

The following table sets forth the amounts and categories of our non-covered non-accrual loans at the dates indicated:

Non-accrual loans	At September 30, 2012	At December 31, 2011
	(Dollars in thousands)	
Aggregate loan amounts		
Multifamily	$ 1,295	$ 837
Commercial loans	13,032	11,594
Home mortgage	1,053	1,387
Installment	24	42
Total non-covered nonaccrual loans	$ 15,404	$ 13,860

Included in non-covered non-accrual loans at September 30, 2012 were thirteen restructured loans totaling $3.8 million. The thirteen loans consist of three home mortgage loans, nine commercial loans and one multifamily loan. Interest income recognized on these loans was $57,000 for the nine months ended September 30, 2012. We had no commitments to lend additional funds to these borrowers.

Included in non-covered non-accrual loans at December 31, 2011 were nine restructured loans totaling $2.8 million. The nine loans consist of one home mortgage loan and eight commercial loans. Interest income recognized on these loans was $34,000 for the twelve months ended December 31, 2011. We had no commitments to lend additional funds to these borrowers.

Credit Quality Indicators

Loans are risk rated based on analysis of the current state of the borrower's credit quality. This analysis of credit quality includes a review of all sources of repayment, the borrower's current financial and liquidity status and all other relevant information. The Company utilizes a ten grade risk rating system, where a higher grade represents a higher level of credit risk. The ten grade risk rating system can be generally classified by the following categories: Pass, Special Mention, Substandard, Doubtful and Loss. The risk ratings reflect the relative strength of the sources of repayment.

Pass loans are generally considered to have sufficient sources of repayment in order to repay the loan in full in accordance with all terms and conditions. These borrowers may have some credit risk that requires monitoring, but full repayment is expected. Special Mention loans are considered to have potential weaknesses that warrant close attention by management. Special Mention is considered a transitory grade and generally, the Company does not have a loan stay graded Special Mention for longer than six months. If any potential weaknesses are resolved, the loan is upgraded to a Pass grade. If negative trends in the borrower's financial status or other information is presented that indicates the repayment sources may become inadequate, the loan is downgraded to a Substandard grade. Substandard loans are considered to have well-defined weaknesses that jeopardize the full and timely repayment of the loan. Substandard loans have a distinct possibility of loss if the deficiencies are not corrected. Additionally, when management has assessed a potential for loss but a distinct possibility of loss is not recognizable, the loan is still classified as Substandard. Doubtful loans have insufficient sources of repayment and a high probability of loss. Loss loans are considered to be uncollectible and of such little value that they are no longer considered bankable assets. These internal risk ratings are reviewed continuously and adjusted due to changes in borrower status and likelihood of loan repayment.

The table below presents the non-covered loan portfolio by credit quality indicator as of September 30, 2012.

	Pass	Special Mention	Substandard	Doubtful	Loss	Total
			(in thousands)			
Home mortgage	$149,825	$967	$1,918	$—	$—	$152,710
Commercial mortgage	416,593	32,068	4,476	—	—	453,137
Construction and land	31,237	—	1,784	—	—	33,021
Multifamily	202,914	4,115	7,933	—	—	214,962
Commercial loans and lines	144,525	3,414	19,419	1,155	—	168,513
Home equity loans and lines	41,978	—	505	—	—	42,483
Installment	2,698	271	86	—	—	3,055
	$989,770	$40,835	$36,121	$1,155	$—	$1,067,881

The table below presents the non-covered loan portfolio by credit quality indicator as of December 31, 2011.

	Pass	Special Mention	Substandard	Doubtful	Loss	Total
			(in thousands)			
Home mortgage	$103,239	$1,326	$1,785	$—	$—	$106,350
Commercial mortgage	366,078	17,798	9,500	—	—	393,376
Construction and land	31,623	196	3,263	—	—	35,082
Multifamily	178,064	2,972	6,297	—	—	187,333
Commercial loans and lines	155,850	4,030	11,937	8,604	—	180,421
Home equity loans and lines	28,139	—	506	—	—	28,645
Installment	4,516	268	112	—	—	4,896
	$867,509	$26,590	$33,400	$8,604	$—	$936,103

Loans are tracked by the number of days borrower payments are past due. The tables below present an age analysis of nonaccrual and past due non-covered loans, segregated by class of loan, as of September 30, 2012 and December 31, 2011.

At September 30, 2012

Current loans Total

	Accruing loans 30-59 days past due	Accruing loans 60-89 days past due	Accruing loans 90+ days past due	Total Accruing past due loans	Nonaccrual past due loans		
				(in thousands)			
Commercial loans and lines	$ 96	$ —	$ —	$ 96	$ 13,032	$ 155,385	$ 168,513
Commercial mortgage	1,218	—	—	1,218	—	451,919	453,137
Multifamily	1,737	555	—	2,292	1,295	211,375	214,962
Construction and land	—	—	—	—	—	33,021	33,021
Home mortgage	707	—	—	707	1,053	150,950	152,710
Home equity loans and lines	—	—	—	—	—	42,483	42,483
Installment	7	—	—	7	24	3,024	3,055
Total	$ 3,765	$ 555	$ —	$ 4,320	$ 15,404	$ 1,048,157	$ 1,067,881

	At December 31, 2011						
	Accruing loans 30-59 days past due	Accruing loans 60-89 days past due	Accruing loans 90+ days past due	Total Accruing past due loans	Nonaccrual past due loans	Current loans	Total
				(in thousands)			
Commercial loans and lines	$ 41	$ 1,071	$ —	$ 1,112	$ 11,594	$ 167,715	$ 180,421
Commercial mortgage	648	—	—	648	—	392,728	393,376
Multifamily	1,010	—	—	1,010	837	185,486	187,333
Construction and land	—	—	—	—	—	35,082	35,082
Home mortgage	—	—	—	—	1,387	104,963	106,350
Home equity loans and lines	406	100	—	506	—	28,139	28,645

Installment	172	1	—	173	42	4,681	4,896
Total	$ 2,277	$ 1,172	$ —	$ 3,449	$ 13,860	$ 918,794	$ 936,103

The Company considers a loan to be impaired when, based on current information and events, the Company does not expect to be able to collect all amounts due according to the loan contract, including scheduled interest payments. Impaired loans are determined by periodic evaluation on an individual loan basis. The average investment in non-covered impaired loans was $19.3 million and $18.8 million for the nine months ended September 30, 2012 and 2011, respectively. Non-covered impaired loans were $23.6 million and $13.9 million at September 30, 2012 and December 31, 2011, respectively. Of the $23.6 million of non-covered impaired loans at September 30, 2012, $22.1 million had specific reserves totaling $5.4 million. Of the $13.9 million of non-covered impaired loans at December 31, 2011, $11.1 million had specific reserves totaling $3.1 million.

Impaired non-covered loans as of September 30, 2012 are set forth in the following table.

(in 000's)	Unpaid Principal Balance	Recorded Investment with no Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
Commercial loans and lines	$ 22,900	$ 347	$ 18,782	$ 19,129	$ 4,945	$ 15,370	$ 202
Commercial mortgage	671	—	671	671	61	675	28
Multifamily	2,166	513	1,501	2,014	139	1,654	30
Construction and land	194	—	194	194	10	151	2
Home mortgage	2,125	602	924	1,526	198	1,405	4
Installment	90	26	3	29	—	34	—
Total	$ 28,146	$ 1,488	$ 22,075	$ 23,563	$ 5,353	$ 19,289	$ 266

Impaired non-covered loans as of December 31, 2011 are set forth in the following table.

(in 000's)	Unpaid Principal Balance	Recorded Investment with no Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
Commercial loans and lines	$ 13,776	$ 471	$ 11,123	$ 11,594	$ 3,057	$ 9,374	$ —
Multifamily	837	837	—	837	—	140	—
Home mortgage	1,887	1,387	—	1,387	—	1,035	—
Installment	42	42	—	42	—	4	—
Total	$ 16,542	$ 2,737	$ 11,123	$ 13,860	$ 3,057	$ 10,553	$ —

The average recorded investment in impaired non-covered loans shown in the above tables represents the average investment for the period in the non-covered loans impaired at each respective period-end.

Troubled Debt Restructurings

The Company offers a variety of modifications to borrowers. The modification categories offered can generally be described in the following categories:

Rate modification – A modification in which the interest rate is changed.

Term modification – A modification in which the maturity date, timing of payments, or frequency of payments is changed.

Interest only modification – A modification in which the loan is converted to interest only payments for a period of time.

Payment modification – A modification in which the dollar amount of the payment is changed, other than an interest only modification described above.

Combination modification – Any other type of modification, including the use of multiple categories above.

The following tables present non-covered loan troubled debt restructurings as of September 30, 2012 and December 31, 2011.

	September 30, 2012					
	Accrual Status		Nonaccrual Status		Total Modifications	
	#	$	#	$	#	$
Commercial mortgage	2	$ 671	—	$ —	2	$ 671
Commercial loans & lines	15	6,097	9	3,248	24	9,345
Multifamily	1	719	1	212	2	931
Construction and land	1	194	—	—	1	194
Home Mortgage	1	472	3	352	4	824
Installment	2	5	—	—	2	5
Total	22	$ 8,158	13	$ 3,812	35	$ 11,970

	December 31, 2011					
	Accrual Status		Nonaccrual Status		Total Modifications	
	#	$	#	$	#	$
Commercial mortgage	6	$ 878	—	$ —	6	$ 878
Commercial loans & lines	—	—	8	2,665	8	2,665
Multifamily	1	725	—	—	1	725
Home mortgage	—	—	1	158	1	158
Total	7	$ 1,603	9	$ 2,823	16	$ 4,426

The Bank's policy is that loans placed on nonaccrual status will typically remain on nonaccrual status until all principal and interest payments are brought current and the prospect for future payment performance in accordance with the loan agreement appear relatively certain. The Bank's policy generally refers to six months of payment performance as sufficient to warrant a return to accrual status.

The following tables present newly restructured loans that occurred during the nine months ended September 30, 2012 and 2011, respectively.

	Nine months ended September 30, 2012							
	Term Modifications		Rate Modifications		Combo Modifications		Total Modifications	
	#	$	#	$	#	$	#	$
	(in thousands)							
Pre-modification outstanding recorded investment:								
Commercial loans & lines	4	$ 2,037	5	$ 6,242	4	$ 517	13	$ 8,796
Commercial mortgage	—	—	—	—	1	26	1	26
Multifamily	—	—	—	—	1	237	1	237
Construction and land	1	196	—	—	—	—	1	196
Home mortgage	—	—	—	—	3	747	3	747
Installment	—	—	—	—	1	4	1	4
Total	5	$ 2,233	5	$ 6,242	10	$ 1,531	20	$ 10,006

Nine months ended September 30, 2012

	Term Modifications		Rate Modifications		Combo Modifications		Total Modifications	
	#	$	#	$	#	$	#	$
				(in thousands)				
Post-modification outstanding recorded investment:								
Commercial loans & lines	4	$ 2,037	5	$ 6,288	4	$ 517	13	$ 8,842
Commercial mortgage	—	—	—	—	1	26	1	26
Multifamily	—	—	—	—	1	237	1	237
Construction and land	1	196	—	—	—	—	1	196
Home mortgage	—	—	—	—	3	686	3	686
Installment	—	—	—	—	1	4	1	4
Total	5	$ 2,233	5	$ 6,288	10	$ 1,470	20	$ 9,991

	Nine months ended September 30, 2011							
	Term Modifications		Payment Modifications		Combo Modifications		Total Modifications	
	#	$	#	$	#	$	#	$
	(in thousands)							
Pre-modification outstanding recorded investment:								
Commercial loans & lines	—	$ —	2	$ 83	2	$ 60	4	$ 143
Multifamily	—	—	—	—	1	626	1	626
Installment	—	—	—	—	1	5	1	5
Total	—	$ —	2	$ 83	4	$ 691	6	$ 774

	Nine months ended September 30, 2011							
	Term Modifications		Payment Modifications		Combo Modifications		Total Modifications	
	#	$	#	$	#	$	#	$
	(in thousands)							
Post-modification outstanding recorded investment:								
Commercial loans & lines	—	$ —	2	$ 83	2	$ 60	4	$ 143
Multifamily	—	—	—	—	1	614	1	614
Installment	—	—	—	—	1	5	1	5
Total	—	$ —	2	$ 83	4	$ 679	6	$ 762

During the nine months ended September 30, 2012 and 2011, no loans modified as a troubled debt restructuring had a payment default occurring within 12 months of the restructure date.

NOTE 6 – COVERED LOANS AND FDIC SHARED-LOSS ASSET

Covered assets consist of loans receivable and foreclosed property that we acquired in the FDIC-assisted SLTB and WCB acquisitions for which we entered into shared-loss agreements with the FDIC. The Bank will share in the losses with the FDIC, which begin with the first dollar of loss incurred on the loan pools (including single-family residential mortgage loans, commercial loans and foreclosed property) covered under our shared-loss agreements. We refer to all other loans not covered under our shared-loss agreements as non-covered loans.

Pursuant to the terms of the shared-loss agreements, the FDIC is obligated to reimburse the Bank for 80 percent of eligible losses with respect to covered assets. The Bank has a corresponding obligation to reimburse the FDIC for 80 percent of eligible recoveries with respect to covered loans. The shared-loss agreements for commercial and single-family residential mortgage loans are in effect for five years and ten years, respectively, from the acquisition date and the loss recovery provisions are in effect for eight years and ten years, respectively, from the acquisition date.

The following table reflects the estimated fair value of the acquired loans at the acquisition dates.

	Western	San Luis

	Commercial November 5, 2010	Trust Bank February 18, 2011	Total
Home mortgage	$ 2,484	$ 64,524	$ 67,008
Commercial mortgage	25,920	15,948	41,868
Construction and land loans	7,599	23,395	30,994
Multifamily	—	18,450	18,450
Commercial loans and lines of credit	19,486	2,353	21,839
Home equity loans and lines of credit	—	13,669	13,669
Installment and credit card	—	453	453
Total	$ 55,489	$ 138,792	$ 194,281

In estimating the fair value of the covered loans at the acquisition date, we (a) calculated the amount and timing of contractual undiscounted principal and interest payments and (b) estimated the amount and timing of undiscounted expected principal and interest payments. The difference between these two amounts represents the nonaccretable difference. On the acquisition date, the amount by which the undiscounted expected cash flows exceed the estimated fair value of the acquired loans is the "accretable yield." The accretable yield is then measured at each financial reporting date and represents the difference between the remaining undiscounted expected cash flows and the current carrying value of the loans.

The following tables present the changes in the accretable yield for the three months ended September 30, 2012 and 2011 for each respective acquired loan portfolio.

	Three months ended September 30, 2012		
	Western Commercial	San Luis Trust Bank	Total
Balance, beginning of period	$ 7,554	$ 33,648	$ 41,202
Accretion to interest income	(1,243)	(3,304)	(4,547)
Reclassifications (to)/from nonaccretable difference	(225)	2,673	2,448
Balance, end of period	$ 6,086	$ 33,017	$ 39,103

	Three months ended September 30, 2011		
	Western Commercial	San Luis Trust Bank	Total
Balance, beginning of period	$3,891	$24,891	$28,782
Accretion to interest income	(796)	(3,039)	(3,835)
Reclassifications (to)/from nonaccretable difference	6,582	2,977	9,559
Balance, end of period	$9,677	$24,829	$34,506

The following tables present the change in the accretable yield for the nine months ended September 30, 2012 and 2011 for each respective acquired portfolio.

	Nine months ended September 30, 2012		
	Western Commercial	San Luis Trust Bank	Total
Balance, beginning of period	$9,399	$55,318	$64,717
Accretion to interest income	(3,458)	(10,310)	(13,768)
Reclassifications (to)/from nonaccretable difference	145	(11,991)	(11,846)
Balance, end of period	$6,086	$33,017	$39,103

	Nine months ended September 30, 2011		
	Western Commercial	San Luis Trust Bank	Total
Balance, beginning of period	$5,457	$—	$5,457
Additions resulting from acquisition	—	31,885	31,885
Accretion to interest income	(2,588)	(7,761)	(10,349)
Reclassifications (to)/from nonaccretable difference	6,808	705	7,513
Balance, end of period	$9,677	$24,829	$34,506

The following table sets forth the composition of the covered loan portfolio by type.

Covered loans by property type (in thousands)	At September 30,	At December 31,

	2012	2011
Commercial mortgage	$31,346	$37,804
Home mortgage	31,338	36,736
Construction and land loans	17,611	22,875
Multifamily	10,120	15,944
Commercial loans and lines of credit	8,199	11,206
Home equity loans and lines of credit	7,530	10,841
Installment and credit card	—	6
Total covered loans	$106,144	$135,412

The FDIC shared-loss asset represents the present value of the amounts we expect to receive from the FDIC under our shared-loss agreements. We accrete into noninterest income over the life of the FDIC shared-loss asset the difference between the present value and the undiscounted cash flows we expect to collect from the FDIC. The FDIC shared-loss asset was $50.5 million at September 30, 2012 and $68.1 million at December 31, 2011.

The FDIC shared-loss asset was initially recorded at fair value, which represented the present value of the estimated cash payments from the FDIC for future losses on covered assets. The ultimate collectability of this asset is dependent upon the performance of the underlying covered assets, the passage of time and claims paid by the FDIC. The following table presents the changes in the FDIC shared-loss asset for the nine months ended September 30, 2012.

	Nine months ended September 30, 2012		
(in thousands)	WCB	SLTB	Total
Balance, beginning of period	$9,159	$58,924	$68,083
FDIC share of additional losses	580	1,157	1,737
Cash payments received from FDIC	(3,870)	(15,610)	(19,480)
Net (amortization)accretion	(121)	252	131
Balance, end of period	$5,748	$44,723	$50,471

Forty-five days following the tenth anniversary of the WCB and SLTB acquisition dates, the Company will be required to perform a calculation and determine if a payment to the FDIC is necessary. The payment amount will be 50 percent of the excess, if any, of (i) 20 percent of the intrinsic loss estimate minus (ii) the sum of (a) 20 percent of the net loss amount, plus (b) 25 percent of the asset discount bid, plus (c) 3.5 percent of total loss share assets at acquisition. The Company’s estimate for the present value of this liability was $3.8 million at both September 30, 2012 and December 31, 2011.

We evaluated each of the acquired loans under ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, or ASC 310-30, to determine loans for which 1) there was evidence of credit deterioration since origination and 2) it was probable that we would not collect all contractually required payments receivable. We determined the best indicator of such evidence was an individual loan’s accrual status. Therefore, an individual loan on nonaccrual at the acquisition date (generally 90 days or greater contractually past due) was deemed to be non-performing credit impaired and therefore within the scope of ASC 310-30. Acquired loans that were accruing at the acquisition date were separately identified and labeled performing credit impaired loans.

Pursuant to an AICPA letter dated December 18, 2009, the AICPA summarized the SEC Staff’s view regarding the accounting in subsequent periods for discount accretion associated with non-credit impaired loans acquired in a business combination or asset purchase. Regarding the accounting for such loans, in the absence of further standard setting, the AICPA understands that the SEC Staff would not object to an accounting policy based on contractual cash flows or an accounting policy based on expected cash flows. We believe analogizing to ASC 310-30 is an appropriate method to follow in accounting for the credit-related portion of the fair value discount on the performing credit impaired loans. By doing so, these loans, which are labeled performing credit impaired, are only being accreted up to the cash flows that we expected to receive at acquisition of the loan. Given the lending practices of the institution from which the loans were acquired, and in estimating the expected cash flows for each designated pool, all loans acquired were recognized to have some degree of credit impairment.

On the acquisition dates, the amounts by which the undiscounted expected cash flows exceeded the estimated fair value of the acquired loans is the accretable yield. The accretable yield is taken into interest income over the life of the loans using the effective yield method. The accretable yield changes over time due to both accretion and as actual and expected cash flows vary from the acquisition date estimated cash flows. The accretable yield is then measured at each financial reporting date and represents the difference between the remaining undiscounted expected cash flows and the current carrying value of the loans. The remaining undiscounted expected cash flows are calculated at each financial reporting date based on information then currently available. Increases in expected cash flows over those originally estimated increase the carrying value of the pool and are recognized as interest income prospectively. Decreases in expected cash flows compared to those originally estimated decrease the carrying value of the pool and are recognized by recording a provision for credit losses and establishing an allowance for credit losses. As the accretable yield increases due to cash flow expectations, the offset is a change to the nonaccretable difference.

The acquired covered loans are and will continue to be subject to the Bank's internal and external credit review and monitoring practices. The covered loans have the same credit quality indicators, such as risk grade and classification, as the non-covered loans, to enable the monitoring of the borrower's credit and the likelihood of repayment. If credit deteriorates beyond the respective acquisition date fair value amount of covered loans under ASC 310-30, such deterioration will be reserved for and a provision for credit losses will be charged to earnings with a partially offsetting noninterest income item reflected in the increase of the FDIC shared-loss asset.

At September 30, 2012 and December 31, 2011, there was no allowance for the covered loans accounted for under ASC 310-30 related to deterioration, as the credit quality deterioration was not beyond the acquisition date fair value amounts of the covered loans.

Loans are tracked by the number of days borrower payments are past due. The tables below present an age analysis of nonaccrual and past due covered loans, segregated by class of loan, as of September 30, 2012 and December 31, 2011.

	At September 30, 2012						
	Accruing loans 30-59 days past due	Accruing loans 60-89 days past due	Accruing loans 90+ days past due	Total Accruing past due loans	Nonaccrual past due loans	Current loans	Total
	(in thousands)						
Commercial loans and lines	$ —	$ —	$ —	$ —	$ 672	$ 7,527	$ 8,199
Commercial mortgage	—	—	—	—	1,260	30,086	31,346
Multifamily	157	—	—	157	934	9,029	10,120
Construction and land	—	—	—	—	1,473	16,138	17,611
Home mortgage	417	—	—	417	5,346	25,575	31,338
Home equity loans and lines	—	—	—	—	94	7,436	7,530
Total	$ 574	$ —	$ —	$ 574	$ 9,779	$ 95,791	$ 106,144

	At December 31, 2011						
	Accruing loans 30-59 days past due	Accruing loans 60-89 days past due	Accruing loans 90+ days past due	Total Accruing past due loans	Nonaccrual past due loans	Current loans	Total
	(in thousands)						
Commercial loans and lines	$109	$—	$—	$109	$1,338	$9,759	$11,206
Commercial mortgage	—	—	—	—	3,043	34,761	37,804
Multifamily	97	—	—	97	3,670	12,177	15,944
Construction and land	755	—	—	755	3,920	18,200	22,875
Home mortgage	793	909	511	2,213	6,389	28,134	36,736
Home equity loans and lines	243	—	—	243	187	10,411	10,841
Installment	—	—	—	—	—	6	6
Total	$1,997	$909	$511	$3,417	$18,547	$113,448	$135,412

The table below presents the covered loan portfolio by credit quality indicator as of September 30, 2012.

	Pass	Special Mention	Substandard	Doubtful	Loss	Total
			(in thousands)			
Home mortgage	$ 9,440	$ 3,869	$ 18,029	$ —	$ —	$ 31,338
Commercial mortgage	19,901	5,187	6,258	—	—	31,346
Construction and land	3,326	2,311	11,974	—	—	17,611
Multifamily	6,218	—	3,902	—	—	10,120
Commercial loans and lines of credit	4,053	1,306	2,787	53	—	8,199
Home equity loans and lines	5,822	944	764	—	—	7,530
	$ 48,760	$ 13,617	$ 43,714	$ 53	$ —	$ 106,144

The table below presents the covered loan portfolio by credit quality indicator as of December 31, 2011.

	Pass	Special Mention	Substandard	Doubtful	Loss	Total
			(in thousands)			
Home mortgage	$ 11,213	$ 5,953	$ 19,570	$ —	$ —	$ 36,736
Commercial mortgage	17,888	10,737	9,179	—	—	37,804
Construction and land	4,447	4,129	14,299	—	—	22,875
Multifamily	9,247	—	6,697	—	—	15,944
Commercial loans and lines of credit	3,076	2,057	5,952	121	—	11,206
Home equity loans and lines	8,513	1,327	1,001	—	—	10,841
Installment	2	—	4	—	—	6
	$ 54,386	$ 24,203	$ 56,702	$ 121	$ —	$ 135,412

NOTE 7 – FORECLOSED PROPERTY

Non-covered foreclosed property at September 30, 2012 consists of an $11.5 million completed office complex project consisting of 14 buildings in Ventura County and $2.8 million of unimproved property consisting of 161 acres located in an unincorporated section of western Los Angeles County known as Liberty Canyon. The remainder represents one multifamily property and one single-family residence.

The following table presents the activity of our non-covered foreclosed property for the periods indicated.

	Three months ended September 30,				Nine months ended September 30,			
	2012		2011		2012		2011	
(dollars in thousands)	# of Properties	$ Amount	# of Properties	$ Amount	# of Properties	$ Amount	# of Properties	$ Amount
Beginning balance	5	$16,124	7	$20,029	7	$20,349	8	$26,011
New properties added	—	—	1	99	—	—	2	328
Valuation allowances	—	(233)	—	—	—	(1,732)	—	(5,208)
Partial sale proceeds received	—	—	—	—	—	(1,076)	—	—
Sales of properties	(1)	(690)	(2)	(1,722)	(3)	(2,340)	(4)	(2,725)
Ending balance	4	$15,201	6	$18,406	4	$15,201	6	$18,406

Covered foreclosed property was $5.2 million at September 30, 2012 and $14.6 million at December 31, 2011. These are foreclosed properties from the Western Commercial Bank and San Luis Trust Bank covered loan portfolios.

The following table presents the activity of our covered foreclosed property for the periods indicated.

	Three months ended September 30,				Nine months ended September 30,			
	2012		2011		2012		2011	
(dollars in thousands)	# of Properties	$ Amount	# of Properties	$ Amount	# of Properties	$ Amount	# of Properties	$ Amount
Beginning balance	19	$9,530	21	$5,636	49	$14,616	2	$977
New properties acquired	—	—	—	—	—	—	22	11,052
New properties added	4	656	34	13,680	13	6,721	41	15,657
Valuation allowances	—	—	—	(739)	—	—	—	(2,141)
Sales of properties	(9)	(4,968)	(8)	(6,216)	(48)	(16,119)	(18)	(13,184)
Ending balance	14	$5,218	47	$12,361	14	$5,218	47	$12,361

NOTE 8 – GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill was $60.7 million at September 30, 2012 and at December 31, 2011. No impairment loss was recognized for the three-month or nine-month periods ended September 30, 2012 and September 30, 2011.

Core deposit intangibles, net of accumulated amortization, were $7.4 million at September 30, 2012 and $8.5 million at December 31, 2011. Amortization expense for the three months ended September 30, 2012 was $348,000 and for the three months ended September 30, 2011 was $434,000. Amortization expense for the nine months ended September 30, 2012 was $1.1 million and for the nine months ended September 30, 2011 was $1.2 million.

Trade name intangible, net of accumulated amortization, was $1.8 million at September 30, 2012 and $2.1 million at December 31, 2011. Amortization expense for the three months ended September 30, 2012 and 2011 was $100,000 in each period. Amortization expense for the nine months ended September 30, 2012 and 2011 was $300,000 in each period.

The contracts and customer relationship intangible related to the EPS division, net of accumulated amortization, was $3.1 million at September 30, 2012 and $3.3 million at December 31, 2011. Amortization expense for the three months ended September 30, 2012 and 2011 was $90,000. Amortization expense for the nine months ended September 30, 2012 was $270,000 and for the nine months ended September 30, 2011 was $180,000.

NOTE 9 – DERIVATIVES AND HEDGING ACTIVITY

Risk Management Objective of Using Derivatives

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk, primarily by managing the amount, sources, and duration of its assets and liabilities and through the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company's known or expected cash receipts and its known or expected cash payments principally related to certain variable-rate loan assets and borrowings. The Company does not use derivatives for trading or speculative purposes.

Fair Values of Derivative Instruments on the Balance Sheet

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the balance sheets as of September 30, 2012 and December 31, 2011.

Tabular Disclosure of Fair Values of Derivative Instruments

	Asset Derivatives				Liability Derivatives			
	As of September 30, 2012		As of December 31, 2011		As of September 30, 2012		As of December 31, 2011	
(in thousands)	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments								
Interest rate products	Other Assets	$ 35	Other Assets	$ 175	Other Liabilities	$ —	Other Liabilities	$ —
Total derivatives designated as hedging instruments		$ 35		$ 175		$ —		$ —
Derivatives not designated as hedging instruments								
Interest rate products	Other Assets	$ 105	Other Assets	$ 291	Other Liabilities	$ —	Other Liabilities	$ —
Total derivatives not designated as hedging instruments		$ 105		$ 291		$ —		$ —

Cash Flow Hedges of Interest Rate Risk

The Company's objectives in using interest rate derivatives are to add stability to interest income and expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate caps as part of its interest rate risk management strategy. For hedges of the Company’s variable-rate borrowings, interest rate caps designated as cash flow hedges involve the receipt of variable amounts from a counterparty if interest rates rise above the strike rate on the contract in exchange for an up-front premium. As of September 30, 2012, the Company had three interest rate caps with a notional amount of $37.1 million that were designated as cash flow hedges associated with the Company’s variable-rate borrowings. One of the caps is forward-starting and was not in effect during the three or nine months ended September 30, 2012.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in Other Comprehensive Income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. During 2012 and 2011, such derivatives were used to hedge the forecasted variable cash outflows associated with subordinated debt related to trust preferred securities. No hedge ineffectiveness was recognized during the three or nine months ended September 30, 2012 and 2011.

Amounts reported in Other Comprehensive Income related to derivatives will be reclassified to interest expense as interest payments are made on the Company’s variable-rate liabilities. During the next twelve months, the Company estimates that an additional $114,961 will be reclassified as an addition to interest expense.

Non-designated Hedges

Derivatives not designated as hedges are not speculative and are utilized as part of the Company’s overall interest rate risk management strategy. As of September 30, 2012, the Company had twelve interest rate caps with an aggregate notional amount of $240 million and hedge accounting does not apply; therefore, all changes in the fair value of the caps are recognized in earnings each period.

Effect of Derivative Instruments on the Statement of Operations

The tables below present the effect of the Company's derivative financial instruments on the statement of operations for the nine months ended September 30, 2012 and 2011.

Derivatives in Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) Nine Months Ended September 30, 2012	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) Nine Months Ended September 30, 2011	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) Nine Months Ended September 30, 2012 (in thousands)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) Nine Months Ended September 30, 2011 (in thousands)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) Nine Months Ended September 30, 2012 (in thousands)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) Nine Months Ended September 30, 2011 (in thousands)
Interest Rate Products	$ (32)	$ (159)	Interest income	$ (49)	$ (8)	Other non-interest income	$ —	$ —
Total	$ (32)	$ (159)		$ (49)	$ (8)		$ —	$ —

Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative Nine Months Ended September 30, 2012	Amount of Gain or (Loss) Recognized in Income on Derivative Nine Months Ended September 30, 2011
Interest Rate Products	Other non-interest income	$ (506)	$ (24)
Total		$ (506)	$ (24)

Credit-risk-related Contingent Features

The Company has agreements with certain of its derivative counterparties that contain a provision where if the Company defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations. Similarly, the Company could be required to settle its obligations under certain of its agreements if the Company fails to maintain its status as a well or adequately capitalized institution. As of September 30, 2012, the Company did not have any derivatives that were in a net liability position related to these agreements.

NOTE 10 – EARNINGS PER SHARE

Basic earnings per share, or EPS, excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if common shares were issued pursuant to the exercise of common stock options under the Company's stock option plans and if common shares were issued from the conversion of the convertible preferred stock. For the three months ended September 30, 2012 and 2011, common stock equivalents totaling approximately 350,397 and 285,426 shares, respectively, were excluded from the calculation of diluted earnings per share, as their impact would be anti-dilutive. For the nine months ended September 30, 2012 and 2011, common stock equivalents totaling approximately 373,975 and 289,735 shares, respectively, were excluded from the calculation of diluted earnings per share, as their impact would be anti-dilutive. The following table illustrates the computations of basic and diluted EPS for the periods indicated:

	Three months ended September 30,				Nine months ended September 30,			
(in thousands, except	2012		2011		2012		2011	
per share data)	Diluted	Basic	Diluted	Basic	Diluted	Basic	Diluted	Basic
Net income as reported	$3,464	$3,464	$2,516	$2,516	$9,234	$9,234	$20,521	$20,521
Less preferred stock dividend declared	(313)	(313)	(1,616)	(1,616)	(938)	(938)	(2,241)	(2,241)
Net income available to common shareholders	$3,151	$3,151	$900	$900	$8,296	$8,296	$18,280	$18,280
Weighted average common shares outstanding-Basic	29,222	29,222	29,077	29,077	29,230	29,230	28,545	28,545
Restricted stock	—	—	165	—	—	—	200	—
Stock options	47	—	—		25	—	—	—
Convertible preferred stock	335	—	320	—	332	—	31	—
Weighted average common shares outstanding-Diluted	29,604	29,222	29,562	29,077	29,587	29,230	28,776	28,545
Net income per common share – basic and diluted	$0.11	$0.11	$0.03	$0.03	$0.28	$0.28	$0.64	$0.64

NOTE 11 – FAIR VALUE MEASUREMENT

FASB accounting standards codification related to fair value measurements defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurement. This standard applies to all financial assets and liabilities that are being measured and reported at fair value on a recurring and non-recurring basis.

As defined in the FASB accounting standards codification, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following table presents information about the Company's assets and liabilities measured at fair value on a recurring and non-recurring basis as of September 30, 2012 and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) for identical instruments that are highly liquid, observable and actively traded in over-the-counter markets. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations whose inputs are observable and can be corroborated by market data. Level 3 inputs are unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

The Company uses fair value to measure certain assets and liabilities on a recurring basis when fair value is the primary measure for accounting. This is done primarily for available-for-sale securities and derivatives. Fair value is used on a nonrecurring basis to measure certain assets when applying lower of cost or market accounting or when adjusting carrying values, such as for loans held-for-sale, impaired loans, and foreclosed property. Fair value is also used when evaluating impairment on certain assets, including securities, goodwill, core deposit and other intangibles, for valuing assets and liabilities acquired in a business combination and for disclosures of financial instruments as required by the FASB accounting standards codification related to fair value disclosure reporting. The following tables present information on the assets measured and recorded at fair value on a recurring and nonrecurring basis at September 30, 2012.

		Financial Assets Measured at Fair Value on a Recurring Basis at September 30, 2012, Using		
	Fair value at Sept. 30, 2012	Quoted prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
		(in thousands)		
U.S. Treasury notes/bills	$ 19,039	$ —	$ 19,039	$ —
U.S. government agency notes	45,669	—	45,669	—
	231,836	—	231,836	—

U.S. government agency mortgage-backed securities								
U.S. government agency collateralized mortgage obligations		206,697		—		206,697		—
Private label collateralized mortgage obligations		5,125		—		5,125		—
Municipal securities		38,328		—		38,328		—
Other domestic debt securities		2,679		—		2,679		—
Interest rate caps		140		—		140		—
Total assets measured at fair value	$	549,513	$	—	$	549,513	$	—

	Financial Assets Measured at Fair Value on a Non-Recurring Basis at September 30, 2012, Using				
	Fair value at Sept. 30, 2012	Quoted prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total losses
			(in thousands)		
Non-covered impaired loans	$16,722	$—	$—	$16,722	$310
Non-covered foreclosed property	15,201	—	—	15,201	1,732
Covered foreclosed property	5,218	—	—	5,218	—
Total assets measured at fair value	$37,141	$—	$—	$37,141	$2,042

The following tables present information on the assets measured and recorded at fair value on a recurring and nonrecurring basis at and for the year ended December 31, 2011.

	Fair value at December 31, 2011	Financial Assets Measured at Fair Value on a Recurring Basis at December 31, 2011, Using		
		Quoted prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
		(in thousands)		
U.S. Treasury notes/bills	$45,161	$—	$45,161	$—
U.S. government agency notes	59,446	—	59,446	—
U.S. government agency mortgage-backed securities	133,675	—	133,675	—
U.S. government agency collateralized mortgage obligations	168,174	—	168,174	—
Private label collateralized mortgage obligations	13,042	—	13,042	—
Municipal securities	29,325	—	29,325	—
Other domestic debt securities	4,912	—	4,912	—
Interest rate caps	466	—	466	—
Total assets measured at fair value	$454,201	$—	$454,201	$—

	Fair value at December 31, 2011	Financial Assets Measured at Fair Value on a Non-Recurring Basis at December 31, 2011, Using			
		Quoted prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total losses
		(in thousands)			
Non-covered impaired loans	$8,066				