PACIFIC PREMIER BANCORP INC
Form 10-Q
May 10, 2017


---

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q
(Mark One)
(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2017
OR
( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _______ to _______
Commission File Number 0-22193

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| DELAWARE | 33-0743196 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S Employer Identification No.) |

17901 VON KARMAN AVENUE, SUITE 1200, IRVINE, CALIFORNIA 92614
(Address of principal executive offices and zip code)

(949) 864-8000
(Registrant’s telephone number, including area code)

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 [_]

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

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

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Large accelerated filer | [ ] | Accelerated filer[X] | Non-accelerated filer (Do not check if a smaller reporting company) | [ ] | Smaller reporting company | [ ] | Emerging growth company | [ ] |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

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

The number of shares outstanding of the registrant’s common stock as of May 8, 2017 was 39,918,907.

PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES
FORM 10-Q
INDEX
FOR THE QUARTER ENDED MARCH 31, 2017

Table of Contents

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements
PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(dollars in thousands, except share data)
(unaudited)

| ASSETS | March 31, 2017 | December 31, 2016 |
|---|---|---|
| Cash and due from banks | $13,425 | $14,706 |
| Interest-bearing deposits with financial institutions | 87,088 | 142,151 |
| Cash and cash equivalents | 100,513 | 156,857 |
| Interest-bearing time deposits with financial institutions | 3,944 | 3,944 |
| Investments held-to-maturity, at amortized cost (fair value of $8,147 and $8,461 as of March 31, 2017 and December 31, 2016, respectively) | 8,272 | 8,565 |
| Investment securities available-for-sale, at fair value | 435,408 | 380,963 |
| FHLB, FRB and other stock, at cost | 37,811 | 37,304 |
| Loans held for sale, at lower of cost or fair value | 11,090 | 7,711 |
| Loans held for investment | 3,385,697 | 3,241,613 |
| Allowance for loan losses | (23,075) | (21,296) |
| Loans held for investment, net | 3,362,622 | 3,220,317 |
| Accrued interest receivable | 13,366 | 13,145 |
| Other real estate owned | 460 | 460 |
| Premises and equipment | 11,799 | 12,014 |
| Deferred income taxes, net | 12,744 | 16,807 |
| Bank owned life insurance | 40,696 | 40,409 |
| Intangible assets | 8,942 | 9,451 |
| Goodwill | 102,490 | 102,490 |
| Other assets | 24,271 | 25,874 |
| Total Assets | $4,174,428 | $4,036,311 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| LIABILITIES: | | |
| Deposit accounts: | | |
| Noninterest-bearing checking | $1,232,578 | $1,185,768 |
| Interest-bearing: | | |
| Checking | 191,399 | 182,893 |
| Money market/savings | 1,273,917 | 1,202,361 |
| Retail certificates of deposit | 381,738 | 375,203 |
| Wholesale/brokered certificates of deposit | 217,441 | 199,356 |
| Total interest-bearing | 2,064,495 | 1,959,813 |
| Total deposits | 3,297,073 | 3,145,581 |
| FHLB advances and other borrowings | 311,363 | 327,971 |
| Subordinated debentures | 69,413 | 69,383 |
| Accrued expenses and other liabilities | 25,554 | 33,636 |
| Total Liabilities | 3,703,403 | 3,576,571 |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock, $.01 par value; 1,000,000 authorized; none issued and outstanding | — | — |
| Common stock, $.01 par value; 100,000,000 shares authorized; 27,908,816 shares at March 31, 2017 and 27,798,283 shares at December 31, 2016 | 275 | 274 |

| | | |
|---|---|---|
| Additional paid-in capital | 345,888 | 345,138 |
| Retained earnings | 126,570 | 117,049 |
| Accumulated other comprehensive loss, net of tax | (1,708) | (2,721) |
| Total Stockholders' Equity | 471,025 | 459,740 |
| Total Liabilities and Stockholders' Equity | $4,174,428 | $4,036,311 |

Accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(dollars in thousands, except share data)
(unaudited)

| | Three Months Ended | | |
|---|---|---|---|
| | March 31, 2017 | December 31, 2016 | March 31, 2016 |
| INTEREST INCOME | | | |
| Loans | $42,436 | $ 43,006 | $ 35,407 |
| Investment securities and other interest-earning assets | 2,991 | 2,791 | 2,098 |
| Total interest income | 45,427 | 45,797 | 37,505 |
| INTEREST EXPENSE | | | |
| Deposits | 2,135 | 2,176 | 2,069 |
| FHLB advances and other borrowings | 604 | 332 | 325 |
| Subordinated debentures | 985 | 985 | 910 |
| Total interest expense | 3,724 | 3,493 | 3,304 |
| Net interest income before provision for loan losses | 41,703 | 42,304 | 34,201 |
| Provision for loan losses | 2,502 | 2,054 | 1,120 |
| Net interest income after provision for loan losses | 39,201 | 40,250 | 33,081 |
| NONINTEREST INCOME | | | |
| Loan servicing fees | 222 | 263 | 225 |
| Deposit fees | 847 | 934 | 828 |
| Net gain from sales of loans | 2,811 | 2,387 | 1,906 |
| Net gain from sales of investment securities | — | — | 753 |
| Other-than-temporary-impairment recovery/(loss) on securities | 1 | — | (207) |
| Other income | 802 | 734 | 1,343 |
| Total noninterest income | 4,683 | 4,318 | 4,848 |
| NONINTEREST EXPENSE | | | |
| Compensation and benefits | 14,887 | 13,815 | 11,739 |
| Premises and occupancy | 2,453 | 2,531 | 2,283 |
| Data processing and communications | 1,187 | 1,240 | 911 |
| Other real estate owned operations, net | 12 | 369 | 8 |
| FDIC insurance premiums | 455 | 320 | 382 |
| Legal, audit and professional expense | 857 | 830 | 865 |
| Marketing expense | 818 | 865 | 630 |
| Office and postage expense | 433 | 441 | 481 |
| Loan expense | 468 | 714 | 403 |
| Deposit expense | 1,444 | 1,388 | 1,005 |
| Merger-related expense | 4,946 | 772 | 3,119 |
| CDI amortization | 511 | 525 | 344 |
| Other expense | 1,276 | 1,567 | 1,463 |
| Total noninterest expense | 29,747 | 25,377 | 23,633 |
| Net income before income taxes | 14,137 | 19,191 | 14,296 |
| Income tax | 4,616 | 7,238 | 5,742 |
| Net Income | $9,521 | $ 11,953 | $ 8,554 |
| EARNINGS PER SHARE | | | |
| Basic | $0.35 | $ 0.44 | $ 0.33 |
| Diluted | 0.34 | 0.43 | 0.33 |
| WEIGHTED AVERAGE SHARES OUTSTANDING | | | |

| | | | |
|---|---|---|---|
| Basic | 27,528,940 | 27,394,737 | 25,555,654 |
| Diluted | 28,197,220 | 28,027,479 | 25,952,184 |

Accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(dollars in thousands)
(unaudited)

| | Three Months Ended | | |
|---|---|---|---|
| | March 31, 2017 | December 31, 2016 | March 31, 2016 |
| Net income | $9,521 | $11,953 | $8,554 |
| Other comprehensive income, net of tax: | | | |
| Unrealized holding gains on securities arising during the period, net of income taxes (1) | 1,013 | (4,084) | 1,565 |
| Reclassification adjustment for net gain on sale of securities included in net income, net of income taxes (2) | — | — | (436) |
| Net unrealized gain on securities, net of income taxes | 1,013 | (4,084) | 1,129 |
| Comprehensive income | $10,534 | $7,869 | $9,683 |

(1) Income tax (benefit) on the unrealized gains (losses) on securities was $714,000 for the three months ended March 31, 2017, $(2.9) million for the three months ended December 31, 2016 and $1.1 million for the three months ended March 31, 2016.

(2) Income tax (benefit) on the reclassification adjustment for net (gains) losses on sale of securities included in net income was $0 for the three months ended March 31, 2017, $0 for the three months ended December 31, 2016 and $317,000 for the three months ended March 31, 2016.

Accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED MARCH 31, 2017 AND 2016
(dollars in thousands)
(unaudited)

| | Common Stock Shares | Common Stock | Additional Paid-in Capital | Accumulated Retained Earnings | Accumulated Other Comprehensive Income | Total Stockholders' Equity |
|---|---|---|---|---|---|---|
| Balance at December 31, 2016 | 27,798,283 | $ 274 | $345,138 | $ 117,049 | $ (2,721) | $ 459,740 |
| Net income | — | — | — | 9,521 | — | 9,521 |
| Other comprehensive income | — | — | — | — | 1,013 | 1,013 |
| Share-based compensation expense | — | — | 1,154 | — | — | 1,154 |
| Issuance of restricted stock, net | 56,866 | — | — | — | — | — |
| Repurchase of common stock | — | — | (904) | — | — | (904) |
| Exercise of stock options | 53,667 | 1 | 500 | — | — | 501 |
| Balance at March 31, 2017 | 27,908,816 | $ 275 | $345,888 | $ 126,570 | $ (1,708) | $ 471,025 |
| | | | | | | |
| Balance at December 31, 2015 | 21,570,746 | $ 215 | $221,487 | $ 76,946 | $ 332 | $ 298,980 |
| Net income | — | — | — | 8,554 | — | 8,554 |
| Other comprehensive income | — | — | — | — | 1,129 | 1,129 |
| Share-based compensation expense | — | — | 461 | — | — | 461 |
| Issuance of restricted stock, net | 118,936 | — | — | — | — | — |
| Common stock issued | 5,815,051 | 58 | 119,325 | — | — | 119,383 |
| Exercise of stock options | 32,500 | — | 387 | — | — | 387 |
| Balance at March 31, 2016 | 27,537,233 | $ 273 | $341,660 | $ 85,500 | $ 1,461 | $ 428,894 |

Accompanying notes are an integral part of these consolidated financial statements.

PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(unaudited)

| | Three Months Ended March 31, 2017 | | 2016 | |
|---|---|---|---|---|
| Cash flows from operating activities: | | | | |
| Net income | $ 9,521 | | $ 8,554 | |
| Adjustments to net income: | | | | |
| Depreciation and amortization expense | 825 | | 670 | |
| Provision for loan losses | 2,502 | | 1,120 | |
| Share-based compensation expense | 1,154 | | 461 | |
| Loss on sale and disposal of premises and equipment | 45 | | — | |
| Net amortization on securities available-for-sale, net | 1,039 | | 1,057 | |
| Net accretion of discounts/premiums for loans acquired and deferred loan fees/costs | (249 | ) | (2,584 | ) |
| Gain on sale of investment securities available-for-sale | — | | (753 | ) |
| Other-than-temporary impairment recovery on investment securities, net | 1 | | — | |
| Originations of loans held for sale | (35,149 | ) | (18,899 | ) |
| Proceeds from the sales of and principal payments from loans held for sale | 33,037 | | 22,616 | |
| Gain on sale of loans | (2,811 | ) | (1,906 | ) |
| Deferred income tax expense (benefit) | 3,350 | | (325 | ) |
| Change in accrued expenses and other liabilities, net | (8,178 | ) | (5,499 | ) |
| Income from bank owned life insurance, net | (287 | ) | (290 | ) |
| Amortization of core deposit intangible | 511 | | 344 | |
| Change in accrued interest receivable and other assets, net | 2,713 | | 4,925 | |
| Net cash (used in) provided by operating activities | 8,024 | | 9,491 | |

| | | |
|---|---|---|
| Cash flows from investing activities: | | |
| Increase in loans, net | (144,347) | (138,358) |
| Principal payments on securities available-for-sale | 10,535 | 9,676 |
| Purchase of securities available-for-sale | (65,771) | — |
| Proceeds from sale or maturity of securities available-for-sale | 1,770 | 192,809 |
| Proceeds from the sale of premises and equipment | — | 3,294 |
| Purchases of premises and equipment | (655) | (2,177) |
| Change in FHLB, FRB, and other stock, at cost | (507) | (3,561) |
| Cash acquired in acquisitions | — | 40,156 |
| Net cash (used in) provided by investing activities | (198,975) | 101,839 |
| Cash flows from financing activities: | | |
| Net increase in deposit accounts | 151,588 | 74,549 |
| Change in FHLB advances and other borrowings, net | (16,578) | (71,169) |
| Proceeds from exercise of stock options and warrants | 501 | 387 |
| Repurchase of common stock | (904) | — |
| Net cash provided by financing activities | 134,607 | 3,767 |
| Net increase (decrease) in cash and cash equivalents | (56,344) | 115,097 |
| Cash and cash equivalents, beginning of period | 156,857 | 78,417 |
| Cash and cash equivalents, end of period | $ 100,513 | $ 193,514 |
| Supplemental cash flow disclosures: | | |
| Interest paid | $ 4,565 | $ 4,182 |
| Income taxes paid | 36 | 136 |
| Noncash investing activities during the period: | | |
| Assets acquired (liabilities assumed and capital created) in acquisitions (See Note 4): | | |

| | | |
|---|---|---|
| Investment securities | — | 190,254 |
| FHLB and Other Stock | — | 3,671 |
| Loans | — | 456,158 |
| Core deposit intangible | — | 4,319 |
| Deferred income tax | — | 7,069 |
| Goodwill | — | 51,252 |
| Fixed assets | — | 4,356 |
| Other assets | — | 5,610 |
| Deposits | — | (636,591) |
| Other liabilities | — | (8,843) |
| Common stock and additional paid-in capital | — | (119,383) |

Accompanying notes are an integral part of these consolidated financial statements.

PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2017
(UNAUDITED)
Note 1 - Basis of Presentation

The consolidated financial statements include the accounts of Pacific Premier Bancorp, Inc. (the “Corporation”) and its wholly owned subsidiaries, including Pacific Premier Bank (the “Bank”) (collectively, the “Company,” “we,” “our” or “us”). A significant intercompany accounts and transactions have been eliminated in consolidation.

In the opinion of management, the consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the Company’s financial position as of March 31, 2017 and December 31, 2016, the results of its operations and comprehensive income for the three months ended March 31, 2017, December 31, 2016 and March 31, 2016 and the changes in stockholders’ equity and cash flows for the three months ended March 31, 2017 and 2016. Operating results or comprehensive income for the three months ended March 31, 2017 are not necessarily indicative of the results or comprehensive income that may be expected for any other interim period or the full year ending December 31, 2017.

Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016 (the “2016 Annual Report”).

The Company accounts for its investments in its wholly owned special purpose entity, PPBI Trust I, under the equity method whereby the subsidiary’s net earnings are recognized in the Company’s statement of operations.

Note 2 – Recently Issued Accounting Pronouncements

Accounting Standards Adopted in 2017

In March 2016, the FASB issued ASU 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Accounting. The amendments simplify several aspects of the accounting for share-based payment award transactions, including accounting for excess tax benefits and tax deficiencies, classifying excess tax benefits on the statement of cash flows, accounting for forfeitures, classifying awards that permit share repurchases to satisfy statutory tax-withholding requirements and classifying tax payments on behalf of employees on the statement of cash flows. For public business entities, the amendment is effective for annual periods beginning after December 15, 2016 and interim period within those annual periods. Early adopt is permitted for any organization in any interim or annual period. As a result of the adoption of ASU 2016-09, the Company began recognizing the tax effects of exercised or vested awards as discrete items in the reporting period in which they occur, resulting in a $1.1 million tax benefit to the Company for the first quarter of 2017.

In March 2016, the FASB issued ASU 2016-05, Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships. The amendments clarify that a change in the counterparty to a derivative instrument designated as a hedging instrument does not, in and of itself, require designation of that hedging relationship provided that all other hedge accounting criteria remain the same. The Update is effective for public business entities for fiscal years beginning after December 31, 2016, including interim periods within those years. The adoption of this standard did not have a material effect on the Company's operating results or financial condition.

Table of Contents

Note 3 – Significant Accounting Policies

Except as discussed below, our accounting policies are described in Note 1. Description of Business and Summary of Significant Accounting Policies, of our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2016 as filed with the Securities and Exchange Commission ("Form 10-K").

Certain Acquired Loans–As part of business acquisitions, the Bank acquires certain loans that have shown evidence of credit deterioration since origination. These acquired loans are recorded at the allocated fair value, such that there is no carryover of the seller's allowance for loan losses. Such acquired loans are accounted for individually. The Bank estimates the amount and timing of expected cash flows for each purchased loan, and the expected cash flows in excess of the allocated fair value is recorded as interest income over the remaining life of the loan (accretable yield). The excess of the loan's contractual principal and interest over expected cash flows is not recorded (non-accretable difference). Over the life of the loan, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded through the allowance for loan losses. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Goodwill and Core Deposit Intangible–Goodwill is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually or more frequently if events and circumstances exist that indicate the necessity for such impairment tests to be performed. The Company has selected November 30 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on our balance sheet.

Core deposit intangible assets arising from whole bank acquisitions are amortized on a straight-line amortization method over their estimated useful lives, which range from 6 to 10 years.

Use of Estimates–The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

Note 4 – Acquisitions

The Company accounted for the following transaction under the acquisition method of accounting which requires purchased assets and liabilities assumed to be recorded at their respective fair values at the date of acquisition. The Company determined the fair value of the loans, core deposit intangible, securities and deposits with the assistance of third party valuations.

Security California Bancorp Acquisition

On January 31, 2016, the Company completed its acquisition of Security California Bancorp ("SCAF") whereby we acquired $714 million in total assets, $456 million in loans and $637 million in total deposits. Under the terms of the merger agreement, each share of SCAF common stock was converted into the right to receive 0.9629 shares of the Corporation's common stock. The value of the total deal consideration was $120 million, which includes $788,000 of aggregate cash consideration to the holders of SCAF stock options and the issuance of 5,815,051 shares of the Corporation's common stock, valued at $119 million based on a closing stock price of $20.53 per share on January 29, 2016.

Table of Contents

SCAF was the holding company of Security Bank of California, a Riverside, California, based state-chartered bank with six branches located in Riverside County, San Bernardino County and Orange County.

Goodwill in the amount of $51.7 million was recognized in the SCAF acquisition. Goodwill represents the future economic benefits arising from net assets acquired that are not individually identified and separately recognized and is attributable to synergies expected to be derived from the combination of the two entities. Goodwill recognized in this transaction is not deductible for income tax purposes.

The following table represents the assets acquired and liabilities assumed of SCAF as of January 31, 2016 and the fair value adjustments and amounts recorded by the Company in 2016 under the acquisition method of accounting:

| | SCAF Book Value | Fair Value Adjustments | Fair Value |
|---|---|---|---|
| ASSETS ACQUIRED | (dollars in thousands) | | |
| Cash and cash equivalents | $40,947 | $ — | $40,947 |
| Interest-bearing deposits with financial institutions | 1,972 | — | 1,972 |
| Investment securities | 191,881 | (1,627) | 190,254 |
| Loans, gross | 467,197 | (11,039) | 456,158 |
| Allowance for loan losses | (7,399) | 7,399 | — |
| Fixed assets | 5,335 | (1,145) | 4,190 |
| Core deposit intangible | 493 | 3,826 | 4,319 |
| Deferred tax assets | 5,618 | 1,130 | 6,748 |
| Other assets | 10,589 | (1,227) | 9,362 |
| Total assets acquired | $716,633 | $ (2,683) | $713,950 |
| LIABILITIES ASSUMED | | | |
| Deposits | $636,450 | $ 141 | $636,591 |
| Other Liabilities | 9,063 | (220) | 8,843 |
| Total liabilities assumed | 645,513 | (79) | 645,434 |
| Excess of assets acquired over liabilities assumed | $71,120 | $ (2,604) | 68,516 |
| Consideration paid | | | 120,174 |
| Goodwill recognized | | | $51,658 |

The fair values are preliminary estimates and are subject to adjustment for up to one year after the merger date or when additional information relative to the closing date fair values becomes available and such information is considered final, whichever is earlier. In the second quarter of 2016, the Company made a $146,000 adjustment to fixed assets and goodwill. As of March 31, 2017, the Company finalized its fair values with this acquisition.

Table of Contents

For loans acquired from SCAF, the contractual amounts due, expected cash flows to be collected, interest component and fair value as of the respective acquisition dates were as follows:

| | Acquired Loans SCAF (dollars in thousands) |
|---|---|
| Contractual amounts due | $ 539,806 |
| Cash flows not expected to be collected | 2,765 |
| Expected cash flows | 537,041 |
| Interest component of expected cash flows | 80,883 |
| Fair value of acquired loans | $ 456,158 |

In accordance with generally accepted accounting principles, there was no carryover of the allowance for loan losses that had been previously recorded by SCAF.

The operating results of the Company for the three months ending March 31, 2016 include the operating results of SCAF since its acquisition date. The following table presents the net interest and other income, net income and earnings per share as if the acquisition of SCAF were effective as of January 1, 2016. There were no material, nonrecurring adjustments to the pro forma net interest and other income, net income and earnings per share presented below:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2017 | 2016 |
| | (dollars in thousands) | |
| Net interest and other income | $43,884 | $40,090 |
| Net income | 9,521 | 6,583 |
| Basic earnings per share | 0.35 | 0.26 |
| Diluted earnings per share | 0.34 | 0.25 |

Table of Contents

Note 5 – Investment Securities

The amortized cost and estimated fair value of securities were as follows:

| | March 31, 2017 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gain | Unrealized Loss | Estimated Fair Value |
| | (dollars in thousands) | | | |
| Investment securities available-for-sale: | | | | |
| Corporate | $53,523 | $ 838 | $ (173 ) | $54,188 |
| Municipal bonds | 129,366 | 605 | (1,189 ) | 128,782 |
| Collateralized mortgage obligation: residential | 30,145 | 45 | (187 ) | 30,003 |
| Mortgage-backed securities: residential | 225,346 | 126 | (3,037 ) | 222,435 |
| Total investment securities available-for-sale | 438,380 | 1,614 | (4,586 ) | 435,408 |
| Investment securities held-to-maturity: | | | | |
| Mortgage-backed securities: residential | 7,095 | — | (125 ) | 6,970 |
| Other | 1,177 | — | — | 1,177 |
| Total investment securities held-to-maturity | 8,272 | — | (125 ) | 8,147 |
| Total investment securities | $446,652 | $ 1,614 | $ (4,711 ) | $443,555 |

| | December 31, 2016 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gain | Unrealized Loss | Estimated Fair Value |
| | (dollars in thousands) | | | |
| Investment securities available-for-sale: | | | | |
| Corporate | $37,475 | $ 372 | $ (205 ) | $37,642 |
| Municipal bonds | 120,155 | 338 | (1,690 ) | 118,803 |
| Collateralized mortgage obligation: residential | 31,536 | 25 | (173 ) | 31,388 |
| Mortgage-backed securities: residential | 196,496 | 69 | (3,435 ) | 193,130 |
| Total investment securities available-for-sale | 385,662 | 804 | (5,503 ) | 380,963 |
| Investment securities held-to-maturity: | | | | |
| Mortgage-backed securities: residential | 7,375 | — | (104 ) | 7,271 |
| Other | 1,190 | — | — | 1,190 |
| Total investment securities held-to-maturity | 8,565 | — | (104 ) | 8,461 |
| Total investment securities | $394,227 | $ 804 | $ (5,607 ) | $389,424 |

At March 31, 2017, mortgage-backed securities (“MBS”) with an estimated par value of $66 million and a fair value of $67.8 million were pledged as collateral for the Bank’s three repurchase agreements which totaled $28.5 million and homeowner’s association (“HOA”) reverse repurchase agreements which totaled $22.9 million.

At December 31, 2016, mortgage-backed securities (“MBS”) with an estimated par value of $63.6 million and a fair value of $65.3 million were pledged as collateral for the Bank’s three repurchase agreements which totaled $28.5 million and Homeowner's Association ("HOA") reverse repurchase agreements which totaled $21.5 million.

At March 31, 2017 and December 31, 2016, there were not holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

Table of Contents

The Company reviews individual securities classified as available-for-sale to determine whether a decline in fair value below the amortized cost basis is temporary because (i) those declines were due to interest rate changes and not to a deterioration in the creditworthiness of the issuers of those investment securities, and (ii) we have the ability to hold those securities until there is a recovery in their values or until their maturity.

If it is probable that the Company will be unable to collect all amounts due according to contractual terms of the debt security not impaired at acquisition, an other-than-temporary impairment ("OTTI") shall be considered to have occurred. If an OTTI occurs, the cost basis of the security will be written down to its fair value as the new cost basis and the write down accounted for as a realized loss.

The Company realized OTTI recovery of $1,000 for the three months ended March 31, 2017, which relates to investment income from previously charged-off investments. The Company did not realize any OTTI recoveries or losses for the three months ended December 31, 2016. A $207,000 OTTI was taken in the first quarter of 2016, related to a CRA investment purchased in June of 2014 with a par value of $50, and a book value of $500,000. In March of 2016, the shareholders of the investment voted to approve a sale of the institution at a per share acquisition price less the Bank's book value, and the sale closed in July 2016. The Company is currently waiting to receive the proceeds for its outstanding shares. As a result, the Bank's current holdings were written down and the loss recognized.

The table below shows the number, fair value and gross unrealized holding losses of the Company’s investment securities by investment category and length of time that the securities have been in a continuous loss position.

| | March 31, 2017 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Less than 12 months | | | 12 months or Longer | | | Total | | |
| | Number | Fair Value | Gross Unrealized Holding Losses | Number | Fair Value | Gross Unrealized Holding Losses | Number | Fair Value | Gross Unrealized Holding Losses |
| | (dollars in thousands) | | | | | | | | |
| Investment securities available-for-sale: | | | | | | | | | |
| Corporate | 3 | $7,629 | $(173) | — | $— | $— | 3 | $7,629 | $(173) |
| Municipal bonds | 90 | 53,419 | (1,189) | — | — | — | 90 | 53,419 | (1,189) |
| Collateralized mortgage obligation: residential | 5 | 17,032 | (187) | — | — | — | 5 | 17,032 | (187) |
| Mortgage-backed securities: residential | 57 | 168,484 | (2,648) | 6 | 20,105 | (389) | 63 | 188,589 | (3,037) |
| Total investment securities available-for-sale | 155 | 246,564 | (4,197) | 6 | 20,105 | (389) | 161 | 266,669 | (4,586) |
| Investment securities held-to-maturity: | | | | | | | | | |
| Mortgage-backed securities: residential | 1 | 6,970 | (125) | — | — | — | 1 | 6,970 | (125) |
| Total investment securities held-to-maturity | 1 | 6,970 | (125) | — | — | — | 1 | 6,970 | (125) |
| Total investment securities | 156 | $253,534 | $(4,322) | 6 | $20,105 | $(389) | 162 | $273,639 | $(4,711) |

Table of Contents

| | December 31, 2016 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Less than 12 months | | | 12 months or Longer | | | Total | | |
| | Number | Fair Value | Gross Unrealized Holding Losses | Number | Fair Value | Gross Unrealized Holding Losses | Number | Fair Value | Gross Unrealized Holding Losses |
| | (dollars in thousands) | | | | | | | | |
| Investment securities available-for-sale: | | | | | | | | | |
| Corporate | 3 | $7,609 | $ (205 ) | — | $— | $ — | 3 | $7,609 | $ (205 ) |
| Municipal bonds | 152 | 85,750 | (1,690 ) | — | — | — | 152 | 85,750 | (1,690 ) |
| Collateralized mortgage obligation: residential | 5 | 19,092 | (173 ) | — | — | — | 5 | 19,092 | (173 ) |
| Mortgage-backed securities: residential | 55 | 149,740 | (2,916 ) | 4 | 16,039 | (519 ) | 59 | 165,779 | (3,435 ) |
| Total investment securities available-for-sale | 215 | 262,191 | (4,984 ) | 4 | 16,039 | (519 ) | 219 | 278,230 | (5,503 ) |
| Investment securities held-to-maturity: | | | | | | | | | |
| Mortgage-backed securities: residential | 1 | 7,271 | (104 ) | — | — | — | 1 | 7,271 | (104 ) |
| Total investment securities held-to-maturity | 1 | 7,271 | (104 ) | — | — | — | 1 | 7,271 | (104 ) |
| Total investment securities | 216 | $269,462 | $ (5,088 ) | 4 | $16,039 | $ (519 ) | 220 | $285,501 | $ (5,607 ) |

Table of Contents

The amortized cost and estimated fair value of investment securities at March 31, 2017, by contractual maturity are shown in the table below.

| | One Year or Less | | More than One Year to Five Years | | More than Five Years to Ten Years | | More than Ten Years | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value | Amortized Cost | Fair Value | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| | (dollars in thousands) | | | | | | | | | |
| Investment securities available-for-sale: | | | | | | | | | | |
| Corporate | $— | $— | $— | $— | $45,523 | $46,188 | $8,000 | $8,000 | $53,523 | $54,188 |
| Municipal bonds | 1,841 | 1,841 | 26,585 | 26,672 | 48,823 | 48,411 | 52,117 | 51,858 | 129,366 | 128,782 |
| Collateralized mortgage obligation: residential | — | — | — | — | 1,308 | 1,310 | 28,837 | 28,693 | 30,145 | 30,003 |
| Mortgage-backed securities: residential | — | — | 2,400 | 2,385 | 32,117 | 31,998 | 190,829 | 188,052 | 225,346 | 222,435 |
| Total investment securities available-for-sale | 1,841 | 1,841 | 28,985 | 29,057 | 127,771 | 127,907 | 279,783 | 276,603 | 438,380 | 435,408 |
| Investment securities held-to-maturity: | | | | | | | | | | |
| Mortgage-backed securities: residential | — | — | — | — | — | — | 7,095 | 6,970 | 7,095 | 6,970 |
| Other | — | — | — | — | — | — | 1,177 | 1,177 | 1,177 | 1,177 |
| Total investment securities held-to-maturity | — | — | — | — | — | — | 8,272 | 8,147 | 8,272 | 8,147 |
| Total investment securities | $1,841 | $1,841 | $28,985 | $29,057 | $127,771 | $127,907 | $288,055 | $284,750 | $446,652 | $443,555 |

Unrealized gains and losses on investment securities available-for-sale are recognized in stockholders' equity as accumulated other comprehensive income or loss. At March 31, 2017, the Company had an accumulated other comprehensive loss of $3.0 million, or $1.7 million net of tax, compared to an accumulated other comprehensive loss of $4.7 million, or $2.7 million net of tax, at December 31, 2016.

Table of Contents

During the three months ended March 31, 2017 and December 31, 2016, the Company did not recognize any gross gains on sales of available-for-sale securities. For the three months ended March 31, 2016, the Company recognized gross gain on sales of available-for-sale securities in the amount of $762,000. During the three months ended March 31, 2017 and December 31, 2016, the Company did not recognize any gross losses on the sales of available-for sale securities. During the three months ended March 31, 2016, the Company recognized gross losses on sales of available-for-sale securities in the amount of $9,000. The Company had zero net proceeds from the sale of available-for-sale securities during the three months ended March 31, 2017 and December 31, 2016, and $186 million during the three months ended March 31, 2016, respectively.

FHLB, FRB and other stock

At March 31, 2017, the Company had $14.4 million in Federal Home Loan Bank ("FHLB") stock, $10.9 million in Federal Reserve Bank of San Francisco ("FRB") stock, and $12.5 million in other stock, all carried at cost. During the three months ended March 31, 2017 and December 31, 2016, FHLB did not repurchase any of the Company's excess FHLB stock through their stock repurchase program. The Company evaluates its investments in FHLB, FRB and other stock for impairment periodically, including their capital adequacy and overall financial condition. No impairment losses have been recorded through March 31, 2017.

Table of Contents

Note 6 – Loans Held for Investment

The following table sets forth the composition of our loan portfolio in dollar amounts at the dates indicated:

| | March 31, 2017 | December 31, 2016 |
|---|---|---|
| | (dollars in thousands) | |
| Business loans: | | |
| Commercial and industrial | $593,457 | $563,169 |
| Franchise | 493,158 | 459,421 |
| Commercial owner occupied (1) | 482,295 | 454,918 |
| SBA | 107,233 | 96,705 |
| Real estate loans: | | |
| Commercial non-owner occupied | 612,787 | 586,975 |
| Multi-family | 682,237 | 690,955 |
| One-to-four family (2) | 100,423 | 100,451 |
| Construction | 298,279 | 269,159 |
| Land | 19,738 | 19,829 |
| Other loans | 3,930 | 4,112 |
| Total gross loans (3) | 3,393,537 | 3,245,694 |
| Plus: Deferred loan origination costs/(fees) and premiums/(discounts), net | 3,250 | 3,630 |
| Total loans | 3,396,787 | 3,249,324 |
| Less: loans held for sale, at lower of cost or fair value | 11,090 | 7,711 |
| Loans held for investment | 3,385,697 | 3,241,613 |
| Allowance for loan losses | (23,075) | (21,296) |
| Loans held for investment, net | $3,362,622 | $3,220,317 |

(1) Secured by real estate.
(2) Includes second trust deeds.
(3) Total gross loans for March 31, 2017 are net of the unaccreted fair value purchase discounts of $6.4 million.

From time to time, we may purchase or sell loans in order to manage concentrations, maximize interest income, change risk profiles, improve returns and generate liquidity.

The Company makes residential and commercial loans held for investment to customers located primarily in California. Consequently, the underlying collateral for our loans and a borrower's ability to repay may be impacted unfavorably by adverse changes in the economy and real estate market in the region.

Under applicable laws and regulations, the Bank may not make secured loans to one borrower in excess of 25% of the Bank's unimpaired capital plus surplus and likewise in excess of 15% for unsecured loans. These loans-to-one borrower limitations result in a dollar limitation of $137.6 million for secured loans and $82.6 million for unsecured loans at March 31, 2017. At March 31, 2017, the Bank's largest aggregate outstanding balance of loans to one borrower was $33.0 million of secured credit.

Table of Contents

Purchased Credit Impaired

The Company has purchased loans as part of its acquisitions of Canyon National Bank in 2011, Palm Desert National Bank in 2012, Independence Bank in 2015 and Security Bank of California in 2016, for which there was, at acquisition, evidence of deterioration of credit quality since origination and for which it was probable, at acquisition, that all contractually required payments would not be collected. The carrying amount of those loans is as follows:

| | March 31, 2017 | December 31, 2016 |
|---|---|---|
| | (dollars in thousands) | |
| Business loans: | | |
| Commercial and industrial | $2,536 | $ 2,586 |
| Commercial owner occupied | 481 | 491 |
| Real estate loans: | | |
| Commercial non-owner occupied | 1,036 | 1,088 |
| One-to-four family | — | 1 |
| Other loans | 318 | 393 |
| Total purchase credit impaired | $4,371 | $ 4,559 |

On the acquisition date, the amount by which the undiscounted expected cash flows of the purchased credit impaired loans exceed the estimated fair value of the loan is the "accretable yield." The accretable yield is measured at each financial reporting date and represents the difference between the remaining undiscounted expected cash flows and the current carrying value of the purchased credit impaired loan. At March 31, 2017, the Company had $4.4 million of purchased credit impaired loans, of which none were placed on nonaccrual status.

The following table summarizes the accretable yield on the purchased credit impaired loans for the three months ended March 31, 2017, December 31, 2016 and March 31, 2016:

| | Three Months Ended | | |
|---|---|---|---|
| | March 31, 2017 | December 31, 2016 | March 31, 2016 |
| | (dollars in thousands) | | |
| Balance at the beginning of period | $3,747 | $ 3,254 | $2,726 |
| Additions | — | — | 788 |
| Accretion | (629 ) | (432 ) | (129 ) |
| Payoffs | — | (113 ) | (323 ) |
| Reclassification from (to) nonaccretable difference | 483 | 1,038 | 192 |
| Balance at the end of period | $3,601 | $ 3,747 | $3,254 |

Table of Contents

Impaired Loans

The following tables provide a summary of the Company’s investment in impaired loans as of the period indicated:

| | Impaired Loans | | | | |
|---|---|---|---|---|---|
| | Contractual Unpaid Principal Balance | Recorded Investment | With Specific Allowance | Without Specific Allowance | Specific Allowance for Impaired Loans |
| | (dollars in thousands) | | | | |
| March 31, 2017 | | | | | |
| Business loans: | | | | | |
| Commercial owner occupied | $118 | $ 86 | $ — | $ 86 | $ — |
| SBA | 2,442 | 298 | — | 298 | — |
| Real estate loans: | | | | | |
| One-to-four family | 286 | 115 | — | 115 | — |
| Land | 36 | 14 | — | 14 | — |
| Totals | $2,882 | $ 513 | $ — | $ 513 | $ — |

| | Impaired Loans | | | | |
|---|---|---|---|---|---|
| | Contractual Unpaid Principal Balance | Recorded Investment | With Specific Allowance | Without Specific Allowance | Specific Allowance for Impaired Loans |
| | (dollars in thousands) | | | | |
| December 31, 2016 | | | | | |
| Business loans: | | | | | |
| Commercial and industrial | $1,990 | $ 250 | $ 250 | $ — | $ 250 |
| Commercial owner occupied | 847 | 436 | — | 436 | — |
| SBA | 3,865 | 316 | — | 316 | — |
| Real estate loans: | | | | | |
| One-to-four family | 291 | 124 | — | 124 | — |
| Land | 36 | 15 | — | 15 | — |
| Totals | $7,029 | $ 1,141 | $ 250 | $ 891 | $ 250 |

Table of Contents

| | Impaired Loans Three Months Ended March 31, 2017 | | December 31, 2016 | | March 31, 2016 | |
|---|---|---|---|---|---|---|
| | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| | (in thousands) | | | | | |
| Business loans: | | | | | | |
| Commercial and industrial | $200 | $ 5 | $1,410 | $ 47 | $308 | $ 5 |
| Franchise | — | — | — | — | 1,629 | 27 |
| Commercial owner occupied | 192 | 3 | 493 | 10 | 518 | 9 |
| SBA | 307 | 5 | 672 | 13 | 23 | — |
| Real estate loans: | | | | | | |
| Commercial non-owner occupied | — | — | 1,658 | 49 | 143 | 2 |
| One-to-four family | 116 | 3 | 128 | 4 | 251 | 5 |
| Land | 14 | 1 | 16 | 1 | 20 | 1 |
| Totals | $829 | $ 17 | $4,377 | $ 124 | $2,892 | $ 49 |

The Company considers a loan to be impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement or it is determined that the likelihood of the Company receiving all scheduled payments, including interest, when due is remote. The Company has no commitments to lend additional funds to debtors whose loans have been impaired.

The Company reviews loans for impairment when the loan is classified as substandard or worse, delinquent 90 days, or determined by management to be collateral dependent, or when the borrower files bankruptcy or is granted a troubled debt restructuring ("TDR"). Measurement of impairment is based on the loan's expected future cash flows discounted at the loan's effective interest rate, measured by reference to an observable market value, if one exists, or the fair value of the collateral if the loan is deemed collateral dependent. All loans are generally charged-off at such time the loan is classified as a loss. Valuation allowances are determined on a loan-by-loan basis or by aggregating loans with similar risk characteristics.

The following table provides additional detail on the components of impaired loans at the period end indicated:

| | March 31, 2017 | December 31, 2016 |
|---|---|---|
| | (dollars in thousands) | |
| Nonaccruing loans | $513 | $ 1,141 |
| Accruing loans | — | — |
| Total impaired loans | $513 | $ 1,141 |

When loans are placed on nonaccrual status all accrued interest is reversed from earnings. Payments received on nonaccrual loans are generally applied as a reduction to the loan principal balance. If the likelihood of further loss is remote, the Company will recognize interest on a cash basis only. Loans may be returned to accruing status if the Company believes that all remaining principal and interest is fully collectible and there has been at least three months of sustained repayment performance since the loan was placed on nonaccrual.

Table of Contents

The Company does not accrue interest on loans 90 days or more past due or when, in the opinion of management, there is reasonable doubt as to the collection of interest. The Company had impaired loans on nonaccrual status of $0.5 million at March 31, 2017 and $1.1 million at December 31, 2016. The Company had no loans 90 days or more past due and still accruing at March 31, 2017 and December 31, 2016.

The Company had no TDRs at March 31, 2017 and December 31, 2016. In addition, the Company had $41,000 in consumer mortgage loans collateralized by residential real estate property for which formal foreclosure proceedings were in process as of March 31, 2017 and December 31, 2016.

Concentration of Credit Risk

As of March 31, 2017, the Company’s loan portfolio was primarily collateralized by various forms of real estate and business assets located predominately in California. The Company’s loan portfolio contains concentrations of credit in multi-family real estate, commercial non-owner occupied real estate and commercial owner occupied real estate and business loans. The Bank maintains policies approved by the Bank’s Board of Directors (the “Bank Board”) that address these concentrations and continues to diversify its loan portfolio through loan originations, purchases and sales to meet approved concentration levels. While management believes that the collateral presently securing these loans is adequate, there can be no assurances that a significant deterioration in the California real estate market or economy would not expose the Company to significantly greater credit risk.

Credit Quality and Credit Risk Management

The Company’s credit quality is maintained and credit risk managed in two distinct areas.  The first is the loan origination process, wherein the Bank underwrites credit quality and chooses which risks it is willing to accept. The second is in the ongoing oversight of the loan portfolio, where existing credit risk is measured and monitored, and where performance issues are dealt with in a timely and comprehensive fashion.

The Company maintains a comprehensive credit policy which sets forth minimum and maximum tolerances for key elements of loan risk. The policy identifies and sets forth specific guidelines for analyzing each of the loan products the Company offers from both an individual and portfolio wide basis. The credit policy is reviewed annually by the Bank Board. The Bank’s seasoned underwriters ensure key risk factors are analyzed with nearly all underwriting including a comprehensive global cash flow analysis of the prospective borrowers.

Credit risk is managed within the loan portfolio by the Company’s portfolio managers based on a comprehensive credit and portfolio review policy. This policy requires a program of financial data collection and analysis, comprehensive loan reviews, property and/or business inspections and monitoring of portfolio concentrations and trends. The portfolio managers also monitor asset-based lines of credit, loan covenants and other conditions associated with the Company’s business loans as a means to help identify potential credit risk. Individual loans, excluding the homogeneous loan portfolio, are reviewed at least every two years and in most cases, more often, including the assignment of a risk grade.

Risk grades are based on a six-grade Pass scale; along with Special Mention, Substandard, Doubtful and Loss classifications as such classifications are defined by the regulatory agencies. The assignment of risk grades allows the Company to, among other things; identify the risk associated with each credit in the portfolio, and to provide a basis for estimating credit losses inherent in the portfolio. Risk grades are reviewed regularly by the Company’s Credit and Portfolio Review committee, and are reviewed annually by an independent third-party, as well as by regulatory agencies during scheduled examinations.

21

Table of Contents

The following provides brief definitions for risk grades assigned to loans in the portfolio:

- Pass classifications represent assets with a level of credit quality which contain no well-defined deficiency or weakness.
- Special Mention assets do not currently expose the Bank to a sufficient risk to warrant classification in one of the adverse categories, but possess correctable deficiencies or potential weaknesses deserving management's close attention.
- Substandard assets are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. These assets are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. OREO acquired from foreclosure is also classified as substandard.
- Doubtful credits have all the weaknesses inherent in substandard credits, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.
- Loss assets are those that are considered uncollectible and of such little value that their continuance as assets is not warranted. Amounts classified as loss are promptly charged off.

The portfolio managers also manage loan performance risks, collections, workouts, bankruptcies and foreclosures. Loan performance risks are mitigated by our portfolio managers acting promptly and assertively to address problem credits when they are identified. Collection efforts are commenced immediately upon non-payment, and the portfolio managers seek to promptly determine the appropriate steps to minimize the Company's risk of loss. When foreclosure will maximize the Company's recovery for a non-performing loan, the portfolio managers will take appropriate action to initiate the foreclosure process.

When a loan is graded as special mention or substandard or doubtful, the Company obtains an updated valuation of the underlying collateral. If the credit in question is also identified as impaired, a valuation allowance, if necessary, is established against such loan or a loss is recognized by a charge to the allowance for loan losses ("ALLL") if management believes that the full amount of the Company's recorded investment in the loan is no longer collectable. The Company typically continues to obtain or confirm updated valuations of underlying collateral for special mention and classified loans on an annual basis in order to have the most current indication of fair value. Once a loan is identified as impaired, an analysis of the underlying collateral is performed at least quarterly, and corresponding changes in any related valuation allowance are made or balances deemed to be fully uncollectable are charged-off.

Table of Contents

The following tables stratify the loan portfolio by the Company’s internal risk grading as of the periods indicated:

| | Credit Risk Grades | | | | |
|---|---|---|---|---|---|
| | Pass | Special Mention | Substandard | Doubtful | Total Gross Loans |
| March 31, 2017 | (dollars in thousands) | | | | |
| Business loans: | | | | | |
| Commercial and industrial | $579,569 | $9,365 | $ 4,523 | $ — | $593,457 |
| Franchise | 493,158 | — | — | — | 493,158 |
| Commercial owner occupied | 477,109 | 997 | 4,189 | — | 482,295 |
| SBA | 106,644 | 18 | 571 | — | 107,233 |
| Real estate loans: | | | | | |
| Commercial non-owner occupied | 611,357 | 806 | 624 | — | 612,787 |
| Multi-family | 681,690 | — | 547 | — | 682,237 |
| One-to-four family | 99,992 | — | 431 | — | 100,423 |
| Construction | 298,279 | — | — | — | 298,279 |
| Land | 19,724 | — | 14 | — | 19,738 |
| Other loans | 3,607 | — | 323 | — | 3,930 |
| Totals | $3,371,129 | $11,186 | $ 11,222 | $ — | $3,393,537 |

| | Credit Risk Grades | | | | |
|---|---|---|---|---|---|
| | Pass | Special Mention | Substandard | Doubtful | Total Gross Loans |
| December 31, 2016 | (dollars in thousands) | | | | |
| Business loans: | | | | | |
| Commercial and industrial | $550,919 | $8,216 | $ 3,784 | $ 250 | $563,169 |
| Franchise | 459,421 | — | — | — | 459,421 |
| Commercial owner occupied | 450,416 | 281 | 4,221 | — | 454,918 |
| SBA | 96,190 | 53 | 462 | — | 96,705 |
| Real estate loans: | | | | | |
| Commercial non-owner occupied | 585,093 | 810 | 1,072 | — | 586,975 |
| Multi-family | 681,942 | 6,610 | 2,403 | — | 690,955 |
| One-to-four family | 100,010 | — | 441 | — | 100,451 |
| Construction | 269,159 | — | — | — | 269,159 |
| Land | 19,814 | — | 15 | — | 19,829 |
| Other loans | 3,719 | — | 393 | — | 4,112 |
| Totals | $3,216,683 | $15,970 | $ 12,791 | $ 250 | $3,245,694 |

Table of Contents

The following tables set forth delinquencies in the Company's loan portfolio at the dates indicated:

| | | Days Past Due | | | | Non- |
|---|---|---|---|---|---|---|
| | Current | 30-59 | 60-89 | 90+ | Total | Accruing |
| March 31, 2017 | (dollars in thousands) | | | | | |
| Business loans: | | | | | | |
| Commercial and industrial | $593,375 | $82 | $ — | $ — | $593,457 | $ — |
| Franchise | 493,158 | — | — | — | 493,158 | — |
| Commercial owner occupied | 482,260 | 35 | — | — | 482,295 | 86 |
| SBA | 106,936 | — | — | 297 | 107,233 | 298 |
| Real estate loans: | | | | | | |
| Commercial non-owner occupied | 612,787 | — | — | — | 612,787 | — |
| Multi-family | 682,237 | — | — | — | 682,237 | — |
| One-to-four family | 100,374 | — | — | 49 | 100,423 | 115 |
| Construction | 298,279 | — | — | — | 298,279 | — |
| Land | 19,724 | — | — | 14 | 19,738 | 14 |
| Other loans | 3,930 | — | — | — | 3,930 | — |
| Totals | $3,393,060 | $117 | $ — | $360 | $3,393,537 | $ 513 |

| | | Days Past Due | | | | Non- |
|---|---|---|---|---|---|---|
| | Current | 30-59 | 60-89 | 90+ | Total | Accruing |
| December 31, 2016 | (dollars in thousands) | | | | | |
| Business loans: | | | | | | |
| Commercial and industrial | $562,805 | $104 | $ — | $260 | $563,169 | $ 250 |
| Franchise | 459,421 | — | — | — | 459,421 | — |
| Commercial owner occupied | 454,918 | — | — | — | 454,918 | 436 |
| SBA | 96,389 | — | — | 316 | 96,705 | 316 |
| Real estate loans: | | | | | | |
| Commercial non-owner occupied | 586,975 | — | — | — | 586,975 | — |
| Multi-family | 690,955 | — | — | — | 690,955 | — |
| One-to-four family | 100,314 | 18 | 71 | 48 | 100,451 | 124 |
| Construction | 269,159 | — | — | — | 269,159 | — |
| Land | 19,814 | — | — | 15 | 19,829 | 15 |
| Other loans | 4,112 | — | — | — | 4,112 | — |
| Totals | $3,244,862 | $122 | $ 71 | $639 | $3,245,694 | $ 1,141 |

Note 7 – Allowance for Loan Losses

The Company's ALLL covers estimated credit losses on individually evaluated loans that are determined to be impaired as well as estimated credit losses inherent in the remainder of the loan portfolio. The ALLL is prepared using the information provided by the Company's credit review process together with data from peer institutions and economic information gathered from published sources.

The loan portfolio is segmented into groups of loans with similar risk characteristics. Each segment possesses varying degrees of risk based on, among other things, the type of loan, the type of collateral, and the sensitivity of the borrower or industry to changes in external factors such as economic conditions. An estimated loss

Table of Contents

rate calculated using the Company's actual historical loss rates adjusted for current portfolio trends, economic conditions, and other relevant internal and external factors, is applied to each group's aggregate loan balances.

The Company's base ALLL factors are determined by management using the Bank's annualized actual trailing charge-off data over intervals ranging from 6 to 87 months to encompass a full credit cycle. Adjustments to those base factors are made for relevant internal and external factors. Those factors may include:

- Changes in national, regional and local economic conditions, including trends in real estate values and the interest rate environment,
- Changes in the nature and volume of the loan portfolio, including new types of lending,
- Changes in volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified or graded loans, and
- The existence and effect of concentrations of credit, and changes in the level of such concentrations.

The resulting total ALLL factor is compared for reasonableness against the 10-year average, 15-year average, and trailing 12 month total charge-off data for all Federal Deposit Insurance Corporation ("FDIC") insured commercial banks and savings institutions based in California. This factor is applied to balances graded pass-1through pass-5. For loans risk graded as watch or worse, progressively higher potential loss factors are applied based on management's judgment, taking into consideration the specific characteristics of the Bank's portfolio and analysis of results from a select group of the Company's peers.

Table of Contents

The following tables summarize the allocation of the ALLL, as well as the activity in the ALLL attributed to various segments in the loan portfolio as of and for the three months ended for the periods indicated:

| | Three Months Ended March 31, 2017 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Commercial and industrial | Franchise | Commercial owner occupied | SBA | Warehouse Facilities | Commercial non-owner occupied | Multi-family | One-to-four family | Construction | Land | Other loans | Total |
| | (dollars in thousands) | | | | | | | | | | | |
| Balance, December 31, 2016 | $6,362 | $3,845 | $1,193 | $1,039 | $— | $1,715 | $2,927 | $365 | $3,632 | $198 | $20 | $21,296 |
| Charge-offs | (752) | — | — | (8) | — | — | — | — | — | — | — | (760) |
| Recoveries | 22 | — | 12 | 2 | — | — | — | 1 | — | — | — | 37 |
| Provisions for (reduction in) loan losses | 1,317 | 629 | 27 | 112 | — | 132 | (124) | 7 | 395 | 6 | | |