First California Financial Group, Inc.
Form 10-Q
November 08, 2010

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, 2010

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 000-52498

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

Delaware	38-3737811
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

3027 Townsgate Road, Suite 300 Westlake Village, California	91361
(Address of Principal Executive Offices)	(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 ¨

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 ¨ No ¨

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

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

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

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

28,170,760 shares of Common Stock, $0.01 par value, as of November 5, 2010

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

For the Quarterly Period Ended September 30, 2010

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

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

(in thousands, except share and per share data)	September 30, 2010	December 31, 2009
Cash and due from banks	$ 73,028	$ 26,757
Interest bearing deposits with other banks	92,874	19,737
Securities available-for-sale, at fair value	272,381	349,645
Loans, net	902,208	922,741
Premises and equipment, net	19,973	20,286
Goodwill	60,720	60,720
Other intangibles, net	10,332	11,581
Deferred tax assets, net	3,520	6,046
Cash surrender value of life insurance	12,122	11,791
Foreclosed property	27,906	4,893
Accrued interest receivable and other assets	23,868	25,624
Total assets	$ 1,498,932	$ 1,459,821
Non-interest checking	$ 308,964	$ 317,610
Interest checking	71,224	82,806
Money market and savings	382,482	339,750
Certificates of deposit, under $100,000	72,596	116,012
Certificates of deposit, $100,000 and over	254,100	268,537
Total deposits	1,089,366	1,124,715
Securities sold under agreements to repurchase	45,000	45,000
Federal Home Loan Bank advances and other borrowings	133,000	98,500
Junior subordinated debentures	26,792	26,753
Accrued interest payable and other liabilities	6,490	7,627
Total liabilities	1,300,648	1,302,595
Perpetual preferred stock; authorized 2,500,000 shares		
Series A - $0.01 par value, 1,000 shares issued and outstanding as of September 30, 2010 and December 31, 2009	1,000	1,000
Series B - $0.01 par value, 25,000 shares issued and outstanding as of September 30, 2010 and December 31, 2009	23,514	23,170
Common stock, $0.01 par value; authorized 100,000,000 shares; 28,520,477 shares issued at September 30, 2010 and 11,969,294 shares issued at December 31, 2009; 28,174,076 and 11,622,893 shares outstanding at September 30, 2010 and December 31, 2009	283	118
Additional paid-in capital	175,027	136,635
	(3,061)	(3,061)

Treasury stock, 346,401 shares at cost at September 30, 2010 and at December 31, 2009				
Retained earnings		4,356		5,309
Accumulated other comprehensive loss		(2,835)		(5,945)
Total shareholders' equity		198,284		157,226
Total liabilities and shareholders' equity	$	1,498,932	$	1,459,821

See accompanying notes to consolidated financial statements.

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

	Three months ended Sept. 30,		Nine months ended Sept. 30,	
(in thousands, except per share data)	2010	2009	2010	2009
Interest and fees on loans	$ 13,075	$ 13,331	$ 38,881	$ 39,144
Interest on securities	1,529	2,819	4,626	9,847
Interest on federal funds sold and interest bearing deposits	70	78	149	368
Total interest income	14,674	16,228	43,656	49,359
Interest on deposits	1,897	2,938	5,953	9,519
Interest on borrowings	1,231	1,455	3,801	4,512
Interest on junior subordinated debentures	439	439	1,316	1,365
Total interest expense	3,567	4,832	11,070	15,396
Net interest income before provision for loan losses	11,107	11,396	32,586	33,963
Provision for loan losses	3,618	4,117	7,138	10,296
Net interest income after provision for loan losses	7,489	7,279	25,448	23,667
Service charges on deposit accounts and other banking-related fees	932	1,111	2,835	3,199
Loan sales and commissions	10	22	26	76
Net gain on sale of securities	1,204	1,639	1,466	4,310
Impairment loss on securities	(23)	—	(41)	(565)
Gain on transfer of foreclosed property	—	—	691	—
Earnings on cash surrender value of life insurance	111	110	331	327
Other income	63	48	136	238
Total noninterest income	2,297	2,930	5,444	7,585
Salaries and employee benefits	4,420	5,011	14,279	16,032
Premises and equipment	1,576	1,558	4,630	4,871
Data processing	607	862	1,800	1,812
Legal, audit and other professional services	445	541	1,216	1,758
Printing, stationery and supplies	69	197	194	600
Telephone	193	237	630	764
Directors' expense	101	142	335	398
Advertising, marketing and business development	194	245	706	1,144
Postage	55	39	158	190

Insurance and regulatory assessments	797	849	2,377	2,504
Loss on and expense of foreclosed property	185	193	731	442
Amortization of intangible assets	416	417	1,249	1,210
Market loss on loans held-for-sale	—	—	—	709
Other expenses	626	1,003	2,046	2,513
Total noninterest expense	9,684	11,294	30,351	34,947
Income (loss) before provision for income taxes	102	(1,085)	541	(3,695)
Provision (benefit) for income taxes	38	(949)	213	(1,898)
Net income (loss)	64	(136)	328	(1,797)
Preferred stock dividends	(313)	(313)	(938)	(819)
Net loss available to common shareholders	$ (249)	$ (449)	$ (610)	$ (2,616)
Loss per common share:				
Basic	$ (0.01)	$ (0.04)	$ (0.03)	$ (0.23)
Diluted	$ (0.01)	$ (0.04)	$ (0.03)	$ (0.23)

See accompanying notes to consolidated financial statements.

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

(in thousands)	Nine Months Ended Sept. 30, 2010	2009
Net income (loss)	$ 328	$ (1,797)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Provision for loan losses	7,138	10,296
Stock-based compensation costs	467	774
Gain on sales of securities	(1,466)	(4,310)
Loss (gain) on sale and transfer of foreclosed property	(695)	72
Market loss on loans held-for-sale	—	709
Impairment loss on securities	41	565
Amortization of net premiums on securities available-for-sale	2,569	578
Depreciation and amortization of premises and equipment	1,421	1,194
Amortization of core deposit and trade name intangibles	1,249	1,210
Loss on disposal of premises and equipment	50	—
Proceeds from sale of, and payments received from, loans held-for-sale	—	181
Increase in cash surrender value of life insurance	(331)	(327)
Decrease in deferred tax assets	2,526	2,058
(Increase) decrease in accrued interest receivable and other assets, net of effects of acquisition	1,145	(446)
Decrease in accrued interest payable and other liabilities, net of effects of acquisition	(1,137)	(427)
Net cash provided by operating activities	13,305	10,330
Purchases of securities available-for-sale, net of effects of acquisition	(222,933)	(171,273)
Proceeds from repayments and maturities of securities available-for-sale	118,437	48,567
Proceeds from sales of securities available-for-sale	184,892	120,483
Purchases of Federal Home Loan Bank and other stock	(55)	(54)
Redemption of Federal Home Loan Bank stock	624	—
Net change in federal funds sold and interest bearing deposits, net of effects from acquisition	(73,137)	87,110
Loan originations, purchases and principal collections, net of effects of acquisition	(12,994)	(35,082)
Purchases of premises and equipment, net of effects of acquisition	(1,206)	(1,039)
Proceeds from sale of foreclosed property	2,170	949
Net cash paid in acquisition	—	(48,790)
Net cash (used) provided by investing activities	(4,202)	871
Net increase (decrease) in noninterest-bearing deposits, net of effects of acquisition	(8,645)	14,737
Net increase (decrease) in interest-bearing deposits, net of effects of acquisition	(26,704)	21,885
Net increase (decrease) in FHLB advances and other borrowings	34,539	(17,961)
Dividends paid on preferred stock	(938)	(819)
Purchases of treasury stock	—	(11)
Proceeds from issuance of common stock	38,916	—
Proceeds from exercise of stock options	—	9

Net cash provided by financing activities		37,168		17,840
Change in cash and due from banks		46,271		29,041
Cash and due from banks, beginning of period		26,757		13,712
Cash and due from banks, end of period	$	73,028	$	42,753
Supplemental cash flow information:				
Cash paid for interest	$	10,803	$	13,953
Cash paid for income taxes	$	1,000	$	950
Supplemental disclosure of noncash items:				
Net change in fair value of securities available-for-sale, net of tax	$	3,233	$	5,520
Net change in fair value of cash flow hedges, net of tax	$	(123)	$	—
Loans transferred to foreclosed property	$	25,414	$	6,893
Transfer of loans held-for-sale to loans	$	—	$	31,221

See accompanying notes to consolidated financial statements.

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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 January 23, 2009, the Bank assumed the insured, non-brokered deposits of 1st Centennial Bank, totaling approximately $270 million from the FDIC. The Bank also purchased from the FDIC approximately $178 million in cash and cash equivalents, $89 million in securities and $101 million in loans related to 1st Centennial Bank. The assumption of deposits and purchase of assets from the FDIC, or the FDIC-assisted 1st Centennial Bank transaction, was an all-cash transaction with an aggregate transaction value of $48.8 million. The Bank recorded $10.6 million in goodwill in connection with this transaction. All six of the former 1st Centennial Bank branches have been fully integrated into the Bank's full-service branch network.

The Bank serves the comprehensive financial needs of businesses and consumers in Los Angeles, Orange, Riverside, San Diego, San Bernardino and Ventura counties through 17 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 nine months ended September 30, 2009 include the effects of the FDIC-assisted 1st Centennial Bank transaction from the date of the acquisition. 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 and Article 8-03 of Regulation S-X 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, 2010 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, 2010. We have evaluated events that have occurred subsequent to September 30, 2010 and have concluded there are no subsequent events that would require recognition in the accompanying condensed consolidated financial statements, except as disclosed in footnote 11. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's 2009 Annual Report on Form 10-K.

Reclassifications – Certain reclassifications have been made to the 2009 consolidated financial statements to conform to the current year presentation.

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 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 uncollectible, 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 sixteen 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 $16.5 million at both September 30, 2010 and December 31, 2009.

Deferred income taxes – Deferred income tax assets and liabilities represent the tax effects of the differences between the book and tax basis of the various balance sheet assets and liabilities. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. An estimate of probable income tax benefits that will not be realized in future years is required in determining the necessity for a valuation allowance for deferred tax assets. There was no valuation allowance at September 30, 2010 or December 31, 2009. There were net deferred tax assets of $3.5 million at September 30, 2010 and $6.0 million at December 31, 2009.

Derivative instruments and hedging – In December 2009, the Company purchased a $10.3 million notional forward-starting interest rate cap to limit the variable interest rate payments on the Company's $10.3 million junior subordinated debentures. In September 2010, the Company purchased a $16.5 million notional forward-setting interest rate cap to limit the variable interest rate payments on the Company's $16.5 million junior subordinated debentures. The Company assesses the effectiveness of derivative instruments designated in cash flow hedging relationships in off-setting changes in the overall cash flows of designated hedged transactions on a quarterly basis. To the extent these instruments are not effective, the unrealized gains or losses on these instruments are reflected directly in current period earnings. Management determined that the financial instruments are highly effective since inception and for each period and including the quarter ended September 30, 2010.

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, 2009, the annual assessment resulted in the conclusion that goodwill was not impaired. At September 30, 2010, an interim assessment was not performed as 2010 year-to-date results were not materially different than the estimates used in the year-end assessment.

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 2009, other-than-temporary impairment related to the credit loss on three debt securities and recognized in earnings was $1.1 million. In addition, an impairment of $0.4 million on a $1.0 million community development-related equity investment was recognized in earnings in 2009. There was an additional impairment of $41,000 recognized in the nine months ended September 30, 2010 related to the community development-related equity investment.

NOTE 2 – RECENTLY ISSUED AND ADOPTED ACCOUNTING PRONOUNCEMENTS

Improving Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. In July 2010, the FASB issued guidance requiring more robust and disaggregated disclosures about the credit quality of an entity's financing receivables and its allowance for credit losses. As a result of this guidance, an entity is required to disaggregate, by portfolio segment or class of financing receivable, certain existing disclosures and provide certain new disclosures about its financing receivables and related allowance for credit losses. The objective of enhancing these disclosures is to improve financial statement users' understanding of (1) the nature of an entity's credit risk associated with its financing receivables and (2) the entity's assessment of that risk in estimating its allowance for credit losses as well as changes in the allowance and the reasons for those changes. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. This guidance will only result in increased financial statement disclosures and will not have an impact on the Company's results of operations, financial condition, or cash flows.

Effect of a Loan Modification When the Loan is part of a Pool that is Accounted for as a Single Asset. In April 2010, the FASB issued guidance to account for the modification of a loan which is part of an acquired pool that is accounted for as a single asset. This new guidance clarifies that modifications of acquired loans do not result in the removal of those loans from the pool even if the modification would otherwise be considered a troubled debt restructuring. An entity will continue to be required to consider whether the pool of assets in which the loan is included is impaired if expected cash flows for the pool change. The guidance also allows an entity to make a one-time election to prospectively terminate accounting for loans as a pool. An entity shall apply this election on a pool-by-pool basis. In addition, this election does not preclude an entity from accounting for future loan acquisitions as a pooled unit. The new guidance is to be applied prospectively for any modification of a loan (or loans) accounted for within a pool occurring in the first interim or annual period ending on or after July 15, 2010. The Company does not expect the adoption of this guidance to have a material impact on the Company's results of operations, financial condition, or cash flows.

Fair Value Measurements and Disclosures – Improving Disclosures about Fair Value Measurements. In January 2010, the FASB issued amended guidance for fair value measurement disclosures. The update requires a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. Furthermore, this update requires a reporting entity to present separately information about purchases, sales, issuances, and settlements in the reconciliation for fair value measurements using significant unobservable inputs; clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value; and amends guidance on employers' disclosures about postretirement benefit plan assets to require that disclosures be provided by classes of assets instead of by major categories of assets. The new guidance is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. In the period of initial adoption, entities will not be required to provide the amended disclosures for any previous periods presented for comparative purposes. The Company adopted this guidance effective January 1, 2010, which resulted in increased financial statement disclosures and did not have any impact on the Company's financial condition, results of operations, or cash flows.

NOTE 3 – ACQUISITION

On January 23, 2009, or the Transaction Date, the Bank assumed the insured, non-brokered deposits of 1st Centennial Bank from the FDIC, acting in its capacity as receiver of 1st Centennial Bank. Under the terms of the purchase and assumption agreement between the Bank and the FDIC, the Bank also purchased certain assets from the FDIC at the close of the transaction. The Bank paid cash consideration of $48.8 million to the FDIC for the assets acquired and liabilities assumed. The Bank continues to operate the former 1st Centennial Bank's six branch locations as part of the Bank's seventeen branch locations. The Company desired this transaction to enter into new markets and to assume a diversified deposit portfolio with a large percentage of stable core deposits.

Under the acquisition method of accounting, the Bank recorded the assets acquired and liabilities assumed based on their estimated fair values as of the Transaction Date. Results of operations for the nine months ended September 30, 2009 include the effects of the assumption of deposits and purchase of assets from the FDIC from the Transaction Date. The excess of the purchase price over the estimated fair values of the underlying assets acquired, the identified intangible assets, and liabilities assumed was allocated to goodwill. Goodwill represents intangible assets that do not qualify for separate recognition.

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

(Dollars in thousands)	
Assets Acquired:	
Federal Funds sold	$113,090
Securities	88,969
Loans	101,217
Goodwill	10,606
Core deposit intangible	4,755
Other assets	1,365
Total assets acquired	320,002
Liabilities Assumed:	
Deposits	269,688
Other liabilities	1,524
Total liabilities assumed	271,212
Total cash consideration paid to FDIC	$48,790

The Bank based the allocation of the purchase price above on the fair values of the assets acquired and the liabilities assumed. All of the resulting goodwill is expected to be deductible for tax purposes.

The following information presents the pro forma results of operations for the nine months ended September 30, 2009, as though the transaction had occurred on January 1, 2009. The pro forma data was derived by combining the historical consolidated financial information of First California and the results of operations from the assets purchased and liabilities assumed from the FDIC using the acquisition method of accounting for business combinations. The pro forma results do not necessarily indicate results that would have been obtained had the transaction actually occurred on January 1, 2009 or the results that may be achieved in the future.

(in thousands, except per share data)	Pro forma Nine months ended Sept. 30, 2009
Net interest income	$ 34,569
Noninterest income	7,672
Noninterest expense	35,169
Provision for loan losses	10,296
Loss before provision for income taxes	(3,224)
Income tax benefit	(1,656)
Net loss	$ (1,568)
Pro forma loss per common share:	
Basic	$ (0.14)
Diluted	$ (0.14)
Pro forma weighted average shares:	
Basic	11,598
Diluted	11,598

NOTE 4 – SECURITIES

The amortized cost, gross unrealized gains, gross unrealized losses and estimated fair values of securities available-for-sale at September 30, 2010 and December 31, 2009 are summarized as follows:

	September 30, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. Treasury notes/bills	$ 43,178	$ 68	$ —	$ 43,246
U.S. government agency notes	37,557	46	(15)	37,588
U.S. government agency mortgage-backed securities	58,086	1,179	(64)	59,201
U.S. government agency collateralized mortgage obligations	98,764	573	(255)	99,082
Private label collateralized mortgage obligations	28,446	74	(4,153)	24,367

Municipal securities		3,448		50		(2)		3,496
Other domestic debt securities		7,272		—		(1,871)		5,401
Securities available-for-sale	$	276,751	$	1,990	$	(6,360)	$	272,381

	December 31, 2009							
		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Estimated Fair Value
	(in thousands)							
U.S. Treasury notes/bills	$	142,617	$	114	$	(71)	$	142,660
U.S. government agency notes		77,097		170		(102)		77,165
U.S. government agency mortgage-backed securities		47,034		280		(467)		46,847
U.S. government agency collateralized mortgage obligations		47,028		68		(156)		46,940
Private label collateralized mortgage obligations		32,984		17		(7,456)		25,545
Municipal securities		7,985		98		(55)		8,028
Other domestic debt securities		4,848		—		(2,388)		2,460
Securities available-for-sale	$	359,593	$	747	$	(10,695)	$	349,645

As of September 30, 2010, securities available-for-sale with a fair value of $70.9 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 with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2010 and December 31, 2009. This table excludes the three securities with other-than-temporary impairments at September 30, 2010 and December 31, 2009.

	At September 30, 2010					
	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	$ —	$ —	$ —	$ —	$ —	$ —
U.S. government agency notes	5,000	(15)	—	—	5,000	(15)
U.S. government agency mortgage-backed securities	20,678	(64)	—	—	20,678	(64)
U.S. government agency collateralized mortgage obligations	43,409	(255)	—	—	43,409	(255)
Private-label collateralized mortgage obligations	—	—	13,440	(2,072)	13,440	(2,072)
Municipal securities	1,167	(2)	—	—	1,167	(2)
Other domestic debt securities	2,500	(19)	4,772	(1,852)	7,272	(1,871)
	$ 72,754	$ (355)	$ 18,212	$ (3,924)	$ 90,966	$ (4,279)

	At December 31, 2009					
	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	$ 55,962	$ (71)	$ —	$ —	$ 55,962	$ (71)
U.S. government agency notes	17,613	(102)	—	—	17,613	(102)
U.S. government agency mortgage-backed securities	38,349	(467)	—	—	38,349	(467)
U.S. government agency collateralized mortgage obligations	19,113	(156)	—	—	19,113	(156)
Private-label collateralized mortgage obligations	—	—	17,424	(4,147)	17,424	(4,147)
Municipal securities	4,399	(53)	172	(2)	4,571	(55)
Other domestic debt securities	—	—	4,848	(2,388)	4,848	(2,388)
	$ 135,436	$ (849)	$ 22,444	$ (6,537)	$ 157,880	$ (7,386)

An impairment analysis on our debt and equity securities is performed each quarter by the Company. When 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, the Company separates other-than-temporary impairment into (a) the amount representing credit loss and (b) the amount related to other factors. The Company recognizes in earnings the amount of other-than-temporary impairment related to credit loss. The Company recognizes in other comprehensive income the amount of other-than-temporary impairment related to other factors. The Company’s assessment of other-than-temporary declines in fair value considers the duration the debt security has been in a continuous unrealized loss position, the severity of the decline in value, the rating of the debt security, and the long-term financial outlook of the issuer. In addition, the Company considers the expected future cash flows of the debt security and our ability and intent on holding the debt security until the fair values recover. For 2009, other-than-temporary impairment related to the credit loss on three debt securities with an amortized cost basis totaling $15.1 million and recognized in earnings was $1.1 million. In addition, the Company recognized an impairment of $0.4 million on a $1.0 million community development-related equity investment. There was an additional impairment of $41,000 recognized in the nine months ended September 30, 2010 related to the community development-related equity investment.

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.

(in thousands)	Nine Months Ended September 30, 2010 Impairment Related to Credit Loss	Impairment Related to Other Factors	Total Impairment
Recognized as of beginning of period	$ 1,115	$ —	$ 1,115
Charges on securities for which OTTI was previously recognized	—	—	—
Recognized as of end of period	$ 1,115	$ —	$ 1,115

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, 2010 Amortized Cost	Fair Value
	(in thousands)	
Due in one year or less	$ 51,484	$ 51,545
Due after one year through five years	30,827	30,841
Due after five years through ten years	9,709	9,762
Due after ten years	184,731	180,233
Total	$ 276,751	$ 272,381

NOTE 5 – LOANS AND ALLOWANCE FOR LOAN LOSSES

The loan portfolio by type consists of the following:

(in thousands)	At September 30, 2010	At December 31, 2009
Commercial mortgage	$ 388,786	$ 381,334
Commercial loans and lines of credit	218,108	235,849
Multifamily mortgage	135,544	138,548
Home mortgage	76,190	51,036
Construction and land development	58,055	86,609
Home equity loans and lines of credit	36,806	40,122
Installment and credit card	5,219	5,748

Total loans		918,708		939,246
Allowance for loan losses		(16,500)		(16,505)
Loans, net	$	902,208	$	922,741

At September 30, 2010, loans with a balance of $516.8 million were pledged as security for Federal Home Loan Bank, or FHLB, advances. Loan balances include net deferred fees of $0.1 million and $1.5 million at September 30, 2010 and December 31, 2009, respectively.

Most of the Company's lending activity is with customers located in the six Southern California counties where our branches are located. The Company has no significant credit exposure to any individual customer; however, the economic condition in Southern California could adversely affect customers. A significant portion of our loans are collateralized by real estate. Changes in the economic condition in Southern California could adversely affect the value of real estate.

Changes in the allowance for loan losses were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in thousands)			
Beginning balance	$16,452	$11,955	$16,505	$8,048
Provision for loan losses	3,618	4,117	7,138	10,296
Loans charged-off	(3,891)	(4,079)	(7,735)	(6,590)
Recoveries on loans charged-off	321	144	592	383
Ending balance	$16,500	$12,137	$16,500	$12,137
Allowance to gross loans	1.80%	1.29%	1.80%	1.29%

Past due loans and foreclosed assets consist of the following:

(dollars in thousands)	At September 30, 2010	At December 31, 2009
Accruing loans past due 30 - 89 days	$ 2,003	$ 14,592
Accruing loans past due 90 days or more	$ —	$ 200
Nonaccrual loans	$ 22,398	$ 39,958
Foreclosed assets	$ 27,906	$ 4,893

There were $22.4 million and $39.3 million of nonaccrual loans at September 30, 2010 and September 30, 2009, respectively. Had these loans performed according to their original terms, additional interest income of approximately $124,000 and $676,000 would have been recognized in the three months ended September 30, 2010 and 2009, respectively. Had these loans performed according to their original terms, additional interest income of approximately $1,230,000 and $1,317,000 would have been recognized in the nine months ended September 30, 2010 and 2009, respectively.

We had twelve restructured loans for $4.3 million at September 30, 2010; four loans for $2.0 million were current at September 30, 2010. Eight loans for $2.3 million are reported as nonaccrual loans at September 30, 2010. We had one $0.6 million restructured loan which was reported as a nonaccrual loan at December 31, 2009.

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. Due to the size and nature of the loan portfolio, impaired loans are determined by periodic evaluation on an individual loan basis. The average balance of impaired loans was $27.9 million for the nine months ended September 30, 2010 and

$32.7 million for the nine months ended September 30, 2009. Impaired loans were $21.1 million at September 30, 2010 and $40.0 million at December 31, 2009. Loan loss allowances for individually impaired loans are computed in accordance with FASB accounting standards related to accounting by creditors for impairment of a loan and are based on either the estimated collateral value less estimated selling costs (if the loan is a collateral-dependent loan), or the present value of expected future cash flows discounted at the loan's effective interest rate. Of the $21.1 million of impaired loans at September 30, 2010, $10.7 million had specific allowances of $1.9 million. Of the $40.0 million of impaired loans at December 31, 2009, $3.5 million had specific allowances of $2.7 million.

NOTE 6 – GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill was $60.7 million at September 30, 2010 and at December 31, 2009. No impairment loss was recognized for the three and nine month periods ended September 30, 2010 and September 30, 2009.

Core deposit intangibles, net of accumulated amortization, were $7.8 million at September 30, 2010 and $8.7 million at December 31, 2009. Amortization expense for the three months ended September 30, 2010 and 2009 was $316,000 in each period. Amortization expense for the nine months ended September 30, 2010 and 2009 was $949,000 and $910,000, respectively.

Trade name intangible, net of accumulated amortization, was $2.6 million at September 30, 2010 and $2.9 million at December 31, 2009. Amortization expense for the three months ended September 30, 2010 and 2009 was $100,000 in each period. Amortization expense for the nine months ended September 30, 2010 and 2009 was $300,000 in each period.

NOTE 7 — 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 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 and currently does not have any derivatives that are not designated in qualifying hedging relationships.

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, 2010 and December 31, 2009.

Tabular Disclosure of Fair Values of Derivative Instruments

	Asset Derivatives				Liability Derivatives			
	As of September 30, 2010		As of December 31, 2009		As of September 30, 2010		As of December 31, 2009	
	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	$ 403,980	Other Assets	$ 194,680	Other Liabilities	$ —	Other Liabilities	$ —
Total derivatives designated as hedging instruments		$ 403,980		$ 194,680		$ —		$ —

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 swaps and caps as part of its interest rate risk management strategy. For hedges of the Company's variable-rate loan assets, interest rate swaps designated as cash flow hedges involve the receipt of fixed amounts from a

counterparty in exchange for the Company making variable payments over the life of the agreements without exchange of the underlying notional amount. 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, 2010, the Company had two interest rate caps with notional amounts of $10.3 million and $16.5 million that were designated as cash flow hedges associated with the Company's variable-rate borrowings. The $10.3 million notional amount cap is forward-starting and will become effective December 15, 2010. The $16.5 million notional amount cap is forward-starting and will become effective March 15, 2012. At December 31, 2009, the Company had one interest rate cap with a notional amount of $10.3 million.

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 the three and nine months ended September 30, 2010, 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 and nine months ended September 30, 2010. The Company did not have any outstanding derivatives during the three and nine months ended September 30, 2009.

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 $15,140 will be reclassified as an addition to interest expense.

Effect of Derivative Instruments on the Income Statement

The tables below present the effect of the Company's derivative financial instruments on the statements of operations for the three and nine months ended September 30, 2010.

Derivatives in Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)		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)		Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	
	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010		Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010		Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010
Interest Rate Products	$(37,214)	$(122,764)	Interest income	$-	$-	Other non-interest income	$-	$-
Total	$(37,214)	$(122,764)		$-	$-		$-	$-

Credit-risk-related Contingent Features

The terms of the outstanding interest rate caps at September 30, 2010 do not contain any credit-risk-related contingent features. Therefore, consideration of the counterparty's credit risk is not applicable.

The Company has no derivatives payable, so consideration of the Company's own credit risk is not applicable.

NOTE 8 – EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share, or EPS, excludes dilution and is computed by dividing income (loss) 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.

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,			
	2010		2009		2010		2009	
	Diluted	Basic	Diluted	Basic	Diluted	Basic	Diluted	Basic

(in thousands, except per share data)								
Net income (loss) as reported	$64	$64	$(136)	$(136)	$328	$328	$(1,797)	$(1,797)
Less preferred stock dividend declared	(313)	(313)	(313)	(313)	(938)	(938)	(819)	(819)
Loss available to common shareholders	$(249)	$(249)	$(449)	$(449)	$(610)	$(610)	$(2,616)	$(2,616)
Weighted average common shares outstanding (1)	28,174	28,174	11,631	11,631	23,144	23,144	11,598	11,598
Earnings (loss) per common share	$(0.01)	$(0.01)	$(0.04)	$(0.04)	$(0.03)	$(0.03)	$(0.23)	$(0.23)

(1) In accordance with FASB accounting codification standards related to earnings per share, due to the net loss for the periods presented, the impact of securities convertible to common stock is not included as its effect would be anti-dilutive. These securities include convertible preferred stock, restricted stock and warrants to acquire common stock. The dilutive calculation excludes 304,870 and 348,922 weighted average shares for the three months ended September 30, 2010 and 2009, respectively. The dilutive calculation excludes 301,214 and 349,373 weighted average shares for the nine months ended September 30, 2010 and 2009, respectively.

The increase in weighted average common shares outstanding for the 2010 periods compared to prior periods was the result of the Company's consummation of an underwritten public offering of common stock at a price of $2.50 per share in March 2010. The Company sold 16,560,000 common shares, which include the exercise by the underwriter of its over-allotment option, for gross proceeds of $41.4 million. The Company contributed $36.0 million to our bank subsidiary. The Company intends to use the net proceeds of this public offering for general corporate purposes, including funding working capital requirements, supporting the growth of our business from internal efforts and from whole bank or failed bank acquisitions, and regulatory capital needs related to any such growth and acquisitions.

NOTE 9 – COMPREHENSIVE INCOME

Other comprehensive income is the change in equity during a period from transactions and other events and circumstances from non-owner sources. Total comprehensive income was as follows:

(dollars in thousands)	Three months ended Sept. 30, 2010	Three months ended Sept. 30, 2009	Nine months ended Sept. 30, 2010	Nine months ended Sept. 30, 2009
Other comprehensive income:				
Unrealized loss on interest rate cap	$ (64)	$ —	$ (212)	$ —
Unrealized gain on securities available-for-sale	1,320	5,271	7,044	9,830
Reclassification adjustment for gains included in net income (loss)	(1,204)	(1,639)	(1,466)	(4,310)
Other comprehensive income, before tax	52	3,632	5,366	5,520
Income tax expense related to items of other comprehensive income	(22)	(1,479)	(2,256)	(1,544)
Other comprehensive income	30	2,153	3,110	3,976
Net income (loss)	64	(136)	328	(1,797)
Comprehensive income	$ 94	$ 2,017	$ 3,438	$ 2,179

NOTE 10 – FAIR VALUE MEASUREMENT

The FASB accounting standards codification related to fair value measurements defines fair value, establishes a framework for measuring fair value including a three-level valuation hierarchy, 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 exchange 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 reflecting assumptions that a market participant would use when pricing an asset or liability. 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, 2010.The hierarchy uses three levels of inputs to measure the fair value of assets and liabilities as follows:

- Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2: Observable inputs other than Level 1, including quoted prices for similar assets and liabilities in active markets; quoted prices in less active markets, or other observable inputs that can be corroborated by observable

market data, either directly or indirectly, for substantially the full term of the financial instrument. This category generally includes available-for-sale securities which are regularly priced in an active market.

- Level 3: Inputs to a valuation methodology that are unobservable, supported by little or no market activity, and significant to the fair value measurement. These valuation methodologies generally include pricing models, discounted cash flow models, or a determination of fair value that requires significant management judgment or estimation. This category also includes observable inputs from a pricing service not corroborated by observable market data.

The Company uses fair value to measure certain assets, primarily securities available-for-sale, on a recurring basis when fair value is the primary measure for accounting. 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, collateral dependent 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, 2010.

	Fair value at September 30, 2010	Financial Assets Measured at Fair Value on a Recurring Basis at September 30, 2010, Using		
		Quoted prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	(in thousands)			
Available-for-sale securities	$ 272,381	$ —	$ 272,381	$ —
Total assets measured at fair value	$ 272,381	$ —	$ 272,381	$ —

	Fair value at September 30, 2010	Financial Assets Measured at Fair Value on a Non-Recurring Basis at September 30, 2010, Using			
		Quoted prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total gains (losses)
	(in thousands)				
Impaired loans	$ 8,874	$ —	$ —	$ 8,874	$ (4,456)
Foreclosed property	27,906	—	—	27,906	869
Total assets measured at fair value	$ 36,780	$ —	$ —	$ 36,780	$ (3,587)

There were no significant transfers of assets into or out of Level 1, Level 2 or Level 3 of the fair value hierarchy during the quarter ended September 30, 2010. There have been no changes in valuation techniques for the quarter ended September 30, 2010 and such techniques are consistent with techniques used in prior periods.

The following methods were used to estimate the fair value of each class of financial instrument above:

Available-for-sale securities – Fair values for securities are based on quoted market prices of identical securities, where available (Level 1). When quoted prices of identical securities are not available, the fair value estimate is based on quoted market prices of similar securities, adjusted for differences between the securities (Level 2). Adjustments may include amounts to reflect differences in underlying collateral, interest rates, estimated prepayment speeds, and counterparty credit quality. In determining the fair value of the securities categorized as Level 2, the Company obtains a report from a nationally recognized broker-dealer detailing the fairvalue of each security in our portfolio as of each

reporting date. The broker-dealer uses observable market information to value our securities, with the primary source being a nationally recognized pricing service. The Company reviews the market prices provided by the broker-dealer for our securities for reasonableness based upon our understanding of the marketplace and we consider any credit issues related to the bonds. As the Company has not made any adjustments to the market quotes provided to us and they are based on observable market data, they have been categorized as Level 2 within the fair value hierarchy.

Impaired loans – Impaired loans are measured and recorded at the fair value of the loan's collateral on a nonrecurring basis as the impaired loans shown are collateral dependent. The fair value of each loan's collateral is generally based on estimated market prices from an independently prepared appraisal, which is then adjusted for the estimated cost related to liquidating such collateral; such valuation inputs result in a nonrecurring fair value measurement that is categorized as a Level 3 measurement.

Foreclosed property – Foreclosed property is initially measured at fair value at acquisition and carried at the lower of this new cost or fair value on a nonrecurring basis. The foreclosed property shown is collateral dependent and, accordingly, is measured based on the fair value of such collateral. The fair value of collateral is generally based on estimated market prices from an independently prepared appraisal, which is then adjusted for the estimated cost related to liquidating such collateral; such valuation inputs result in a nonrecurring fair value measurement that is categorized as a Level 3 measurement.

The FASB accounting standards codification requires that the Company disclose estimated fair values for its financial instruments during annual and interim reporting periods. Fair value estimates, methods and assumptions, set forth below for our financial instruments, are made solely to comply with the requirements of the disclosures regarding fair value of financial instruments. The following describes the methods and assumptions used in estimating the fair values of financial instruments, excluding financial instruments already recorded at fair value as described above.

Cash and cash equivalents – The carrying amounts of cash and interest bearing deposits at other banks is assumed to be the fair value given the liquidity and short-term nature of these deposits.

Loans – Loans are not measured at fair value on a recurring basis. Therefore, the following valuation discussion relates to estimating the fair value to be disclosed under fair value disclosure requirements. Loans were divided into three major groups. The loan groups included (1) loans that mature or re-price in three months or less, (2) loans that amortize or mature in more than three months, and (3) impaired loans. We estimated the fair value of impaired loans and loans that mature or re-price within three months at their carrying value. We used discounted cash flow methodology to estimate the fair value of loans that amortize or mature in more than three months. We developed pools of these loans based on similar characteristics such as underlying type of collateral, fixed or adjustable rate of interest, payment or amortization method, credit risk categories and other factors. We projected monthly principal and interest cash flows based on the contractual terms of the loan, adjusted for assumed prepayments and defaults, and discounted these at a rate that considered funding costs, a market participant’s required rate of return and adjusted for servicing costs and a liquidity discount. Loans are not normally purchased and sold by the Company, and there are no active trading markets for much of this portfolio.

Deposits – The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate money market accounts and fixed-term certificates of deposit (CDs) approximate their fair values at the reporting date. Fair values for fixed-rate CDs are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Federal Home Loan Bank advances and other borrowings – The fair value of the FHLB advances and other borrowings is estimated using a discounted cash flow analysis based on the Company’s current incremental borrowing rates for similar types of borrowing arrangements.

Junior subordinated debentures – The fair value of the debentures is estimated using a discounted cash flow analysis based on current incremental borrowing rates for similar types of borrowing arrangements.

Off-balance sheet instruments – Off-balance sheet instruments include unfunded commitments to extend credit and standby letters of credit. The fair value of these instruments is not considered practicable to estimate because of the lack of quoted market prices and the inability to estimate fair value without incurring excessive costs.

The following table estimates fair values and the related carrying amounts of the Company’s financial instruments:

	At September 30, 2010	
(in thousands)	Carrying Amount	Estimated Fair Value
Financial assets:		
Cash, due from banks and interest bearing deposits with other banks	$ 165,902	$ 165,902
Securities available-for-sale	272,381	272,381
FHLB and other stock	8,892	8,892

Loans	918,708	776,667
Interest rate cap	404	404
Financial liabilities:		
Demand deposits, money market and savings	$ 762,670	$ 762,670
Time certificates of deposit	326,696	327,278
FHLB advances and other borrowings	178,000	182,242
Junior subordinated debentures	26,792	16,493

These fair value disclosures represent the Company's best estimates based on relevant market information and information about the financial instruments. Fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of the various instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in the above methodologies and assumptions could significantly affect the estimates.

NOTE 11 – SUBSEQUENT EVENT

On November 5, 2010, the Bank assumed all of the deposits and purchased substantially all of the assets of Western Commercial Bank from the FDIC acting in its capacity as receiver of Western Commercial Bank. The Bank purchased approximately $102 million of total assets and assumed approximately $101 million of deposits. The addition of Western Commercial Bank's one branch expanded First California Bank's operations to 18 full-service branches throughout Southern California and increased total assets to greater than $1.5 billion.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This discussion contains certain forward-looking statements about us; we intend these statements to fall under the safe harbor for "forward-looking statements" provided by the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact are forward-looking statements. Such statements involve inherent risks and uncertainties, many of which are difficult to predict and are generally beyond our control. We caution readers that a number of important factors could cause actual results to differ materially from those expressed in, implied or projected by, such forward-looking statements. Risks and uncertainties include, but are not limited to:

- revenues are lower than expected;
- credit quality deterioration, which could cause an increase in the provision for loan losses;
- competitive pressure among depository institutions increases significantly;
- changes in consumer spending, borrowings and savings habits;
- our ability to successfully integrate acquired entities or to achieve expected synergies and operating efficiencies within expected time-frames or at all;
- technological changes;
- the cost of additional capital is more than expected;
- a change in the interest rate environment reduces interest margins;
- asset/liability repricing risks and liquidity risks;
- general economic conditions, particularly those affecting real estate values, either nationally or in the market areas in which we do or anticipate doing business are less favorable than expected;
- legislative, accounting or regulatory requirements or changes adversely affecting our business;
- the effects of and changes in monetary and fiscal policies and laws, including the interest rate policies of the Board of Governors of the Federal Reserve, or the Federal Reserve Board;
- recent volatility in the credit or equity markets and its effect on the general economy;
- regulatory approvals for acquisitions cannot be obtained on the terms expected or on the anticipated schedule; and
- demand for the products or services of First California and the Bank, as well as their ability to attract and retain qualified people.

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If any of these risks or uncertainties materializes, or if any of the assumptions underlying such forward-looking statements proves to be incorrect, our results could differ materially from those expressed in, implied or projected by, such forward-looking statements. For information with respect to factors that could cause actual results to differ from the expectations stated in the forward-looking statements, see "Risk Factors" under Part I, Item 1A in our 2009 Annual Report on Form 10-K and under Part II, Item 1A of this Quarterly Report on Form 10-Q. We urge investors to consider all of these factors carefully in evaluating the forward-looking statements contained in this Quarterly Report on Form 10-Q. We make these forward-looking statements as of the date of this document and we do not intend, and assume no obligation, to update the forward-looking statements or to update the reasons why actual results could differ from those expressed in, or implied or projected by, the forward-looking statements. All forward-looking statements contained in this document and all subsequent written and oral forward-looking statements attributable to us or any other person acting on our behalf, are expressly qualified by these cautionary statements.

Overview

First California Financial Group, Inc., or First California, or the Company, is a bank holding company which serves the comprehensive banking needs of businesses and consumers in Los Angeles, Orange, Riverside, San Bernardino, San Diego and Ventura counties through our wholly-owned subsidiary, First California Bank, or the Bank. The Bank is a state chartered commercial bank that provides traditional business and consumer banking products through 17 full-service branch locations. The Company also has two unconsolidated statutory business trust subsidiaries, First California Capital Trust I and FCB Statutory Trust I, which raised capital through the issuance of trust preferred securities.

At September 30, 2010, we had consolidated total assets of $1.5 billion, total loans of $918.7 million, deposits of $1.1 billion and shareholders' equity of $198.3 million. At December 31, 2009, we had consolidated total assets of $1.5 billion, total loans of $939.2 million, deposits of $1.1 billion and shareholders' equity of $157.2 million.

For the third quarter of 2010, we had net income of $64,000, compared with a net loss of $136,000 for the third quarter of 2009. Our net income for the first nine months of 2010 was $328,000, compared with a loss of $1.8 million for the first nine months of 2009. The net loss for the first nine months of 2009 was due largely to the $10.3 million provision for loan losses.

After dividend payments on our Series B preferred shares of $312,500 in the third quarter of 2010 and 2009, we incurred a loss per diluted common share of $0.01 for the 2010 third quarter and $0.04 for the 2009 third quarter. Our net loss for the first nine months of 2010, after Series B preferred share dividends of $937,500, was $0.03 per diluted common share. Our net loss for the first nine months of 2009, after Series B preferred dividends of $819,500, was $0.23 per diluted common share.

On November 5, 2010, the Bank assumed all of the deposits and purchased substantially all of the assets of Western Commercial Bank from the FDIC acting in its capacity as receiver of Western Commercial Bank. The Bank purchased approximately $102 million of total assets and assumed approximately $101 million of deposits. The addition of Western Commercial Bank's one branch expanded First California Bank's operations to 18 full-service branches throughout Southern California and increased total assets to greater than $1.5 billion.

Critical accounting policies

We base our discussion and analysis of our consolidated results of operations and financial condition on our unaudited consolidated interim financial statements and our audited consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these

consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, income and expense, and the related disclosures of contingent assets and liabilities at the date of these consolidated financial statements. We believe these estimates and assumptions to be reasonably accurate; however, actual results may differ from these estimates under different assumptions or circumstances. The following are our critical accounting policies and estimates.

Allowance for loan losses

We establish the allowance for loan losses through a provision charged to expense. We charge-off loan losses against the allowance when we believe that the collectability of the loan is unlikely. We perform periodic and systematic detailed reviews of the loan portfolio to identify trends and to assess the overall collectability of the loan portfolio. The allowance is an amount that we believe will be adequate to absorb estimated probable losses on existing loans that may become uncollectible, based on evaluations of the collectability of loans and prior loan loss experience. We believe the accounting estimate related to the allowance for loan losses is a “critical accounting estimate” because: changes in it can materially affect the provision for loan losses and net income, it requires management to predict borrowers’ likelihood or capacity to repay, and it requires management to distinguish between losses incurred as of a balance sheet date and losses expected to be incurred in the future. Accordingly, this is a highly subjective process and requires significant judgment since it is often difficult to determine when specific loss events may actually occur. Our 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 sixteen quarters. We also evaluate individual loans for impairment and if a portion of a loan is impaired, we charge-off the impaired amount or allocate a specific reserve for that loan. Various regulatory agencies, as a regular part of their examination process, periodically review our allowance for loan losses. Such agencies may require us 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 $16.5 million at both September 30, 2010 and December 31, 2009.

Deferred income taxes

We recognize deferred tax assets subject to our judgment that realization of the assets are more-likely-than-not. We establish a valuation allowance when we determine that realization of income tax benefits may not occur in future years. There were net deferred tax assets of $3.5 million at September 30, 2010 and $6.0 million at December 31, 2009. There was no valuation allowance at either period end.

Derivative instruments and hedging

We record all derivatives on the balance sheet at fair value. In December 2009, we purchased a $10.3 million notional forward-starting interest rate cap to limit the variable interest rate payments on our $10.3 million junior subordinated debentures. In September 2010, we purchased a $16.5 million notional forward-stating interest rate cap to limit the variable interest rate payments on our $16.5 million junior subordinated debentures. The Company assesses the effectiveness of derivative instruments designated in cash flow hedging relationships in off-setting changes in the overall cash flows of designated hedged transactions on a quarterly basis. To the extent these instruments are not effective, the unrealized gains or losses on these instruments are reflected directly in current period earnings. Management determined that the financial instruments are highly effective since inception and for each period and including the quarter ended September 30, 2010.

Assessments of impairment

We assess goodwill for impairment on an annual basis as of December 31, or at interim periods if an event occurs or circumstances change which may indicate a change in the implied fair value of the goodwill. We estimate the implied fair value of goodwill 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. Based on the results of our assessment, we concluded that the fair value of goodwill was greater than our carrying value and that no goodwill impairment existed at December 31, 2009. At September 30, 2010, we did not perform an interim assessment because results for the first three quarters of 2010 were not materially different from the estimates used in our year-end assessment.

We also undertake an impairment analysis on our debt and equity securities each quarter. When we do not intend to sell, and it is more likely than not that we are not required to sell, a debt security before recovery of its cost basis, we separate other-than-temporary impairment into (a) the amount representing credit loss and (b) the amount related to other factors. We recognize in earnings the amount of the other-than-temporary impairment related to credit loss. We recognize in other comprehensive income the amount of other-than-temporary impairment related to other factors. Our assessment of other-than-temporary declines in fair value considers the duration the security has been in a continuous unrealized loss position, the severity of the decline in value, the rating of the security, and the long-term financial outlook of the issuer. In addition, we consider the expected future cash flows from the security and our ability and intent to hold the security until the fair value recovers.

For 2009, other-than-temporary impairment related to the credit loss on three debt securities and recognized in earnings was $1.1 million. In addition, we recognized an impairment loss of $0.4 million on a $1.0 million community development-related equity investment in our 2009 earnings. We recognized an additional impairment loss of $18,000 on this community development-related equity investment in the first quarter of 2010 and an additional impairment loss of $23,000 in the third quarter of 2010.

Results of operations – for the three and nine months ended September 30, 2010 and 2009

Net interest income

Our earnings are derived predominantly from net interest income, which is the difference between interest and fees earned on loans, securities and federal funds sold (these asset classes are commonly referred to as interest-earning assets) and the interest paid on deposits, borrowings and debentures (these liability classes are commonly referred to as interest-bearing funds). The net interest margin is net interest income divided by average interest-earning assets.

Our net interest income for the three months ended September 30, 2010 declined to $11.1 million from $11.4 million for the same period last year. For the first nine months of 2010, our net interest income declined to $32.6 million from $34.0 million for the same period a year ago. The decline in net interest income for both periods principally reflects the decline in interest income from securities. Interest income for the 2010 third quarter was $14.7 million, down $1.6 million from the 2009 third quarter. The decline in interest income was due to lower yielding securities. Interest expense for the 2010 third quarter was $3.6 million, down $1.3 million from the 2009 third quarter. The decrease in interest expense was due to lower rates paid on interest-bearing deposits. For the first nine months of 2010, interest income was $43.7 million, down $5.7 million from the same period last year. The decline in interest income was again due to lower yielding securities. Interest expense for the first nine months of 2010 was $11.1 million, down $4.3 million from the same period a year ago. The decline in interest expense was again due to lower rates paid on interest-bearing deposits.

Our net interest margin (tax equivalent) for the third quarter of 2010 was 3.46 percent compared with 3.50 percent for the same quarter last year. For the first nine months of 2010, our net interest margin was 3.42 percent compared with 3.60 percent for the first nine months of 2009. The decline in our net interest margin was primarily due to lower yields on our securities and reflects the shift in the composition of our securities to lower yielding, shorter-term securities. The yield on interest-earning assets for the third quarter of 2010 was 4.57 percent, down 40 basis points from 4.97 percent for the third quarter a year ago. The reduction in the cost of our interest-bearing liabilities, which equaled 1.54 percent for the 2010 third quarter, down 39 basis points from 1.93 percent for the third quarter a year ago, partially offset that decline. The yield on interest-earning assets for the nine months ended September 30, 2010 was 4.57 percent compared with 5.21 percent for the same period last year. Partially offsetting that decline was the decline in the cost of our interest-bearing liabilities. The rate paid on interest-bearing liabilities fell to 1.58 percent for the first nine months of 2010 compared with 2.10 percent for the same period last year.

The following table presents the distribution of our average assets, liabilities and shareholders' equity in combination with the total dollar amounts of interest income from average interest earning assets and the resultant yields, and the dollar amounts of interest expense and average interest bearing liabilities, expressed in both dollars and rates for the three and nine months ended September 30, 2010 and 2009.

Average Balance Sheet and Analysis of Net Interest Income

	Three months ended September 30,					
	2010			2009		
(dollars in thousands)	Average Balance	Interest Income/ Expense	Weighted Average Yield/Rate	Average Balance	Interest Income/ Expense	Weighted Average Yield/Rate
Loans(1)	$ 890,221	$ 13,075	5.83 %	$ 935,848	$ 13,331	5.65%
Securities	287,370	1,529	2.15%	262,664	2,819	4.49%
Federal funds sold and deposits with banks	97,405	70	0.28%	108,165	78	0.29%
Total earning assets	1,274,996	$ 14,674	4.57%	1,306,677	$ 16,228	4.97%
Non-earning assets	174,941			152,404		
Total average assets	$ 1,449,937			$ 1,459,081		
Interest bearing checking	$ 82,656	$ 71	0.34%	$ 80,514	$ 65	0.32%
Savings and money market	374,842	895	0.95%	290,894	839	1.14%
Certificates of deposit	303,606	931	1.22%	441,737	2,034	1.83%
Total interest bearing deposits	761,104	1,897	0.99%	813,145	2,938	1.43%
Borrowings	131,492	1,231	3.72%	151,930	1,455	3.80%
Junior subordinated debentures	26,785	439	6.55%	26,733	439	6.57%
Total borrowed funds	158,277	1,670	4.19%	178,663	1,894	4.21%
Total interest bearing funds	919,381	$ 3,567	1.54%	991,808	$ 4,832	1.93%

Noninterest checking	323,886			295,444		
Other liabilities	7,967			11,554		
Shareholders’ equity	198,703			160,275		
Total liabilities and shareholders’ equity	$ 1,449,937			$ 1,459,081		
Net interest income		$ 11,107			$ 11,396	
Net interest margin (tax equivalent)(2)			3.46%			3.50%

	Nine months ended September 30,					
	2010			2009		
(dollars in thousands)	Average Balance	Interest Income/ Expense	Weighted Average Yield/Rate	Average Balance	Interest Income/ Expense	Weighted Average Yield/Rate
Loans(1)	$ 910,898	$ 38,881	5.71%	$ 913,256	$ 39,144	5.73%
Securities	302,352	4,626	2.08%	272,706	9,847	5.08%
Federal funds sold and deposits with banks	65,296	149	0.30%	90,467	368	0.54%
Total earning assets	1,278,546	$ 43,656	4.57%	1,276,429	$ 49,359	5.21%
Non-earning assets	161,463			155,190		
Total average assets	$ 1,440,009			$ 1,431,619		
Interest bearing checking	$ 81,465	$ 201	0.33%	$ 77,096	$ 168	0.29%
Savings and money market	361,205	2,678	0.99%	256,122	2,077	1.08%
Certificates of deposit	327,453	3,074	1.26%	460,044	7,274	2.11%
Total interest bearing deposits	770,123	5,953	1.03%	793,262	9,519	1.60%
Borrowings	135,131	3,801	3.76%	158,466	4,512	3.81%
Junior subordinated debentures	26,772	1,316	6.56%	26,720	1,365	6.81%
Total borrowed funds	161,903	5,117	4.21%	185,186	5,877	4.24%
Total interest bearing funds	932,026	$ 11,070	1.58%	978,448	$ 15,396	2.10%
Noninterest checking	313,363			280,036		
Other liabilities	8,429			12,808		
Shareholders' equity	186,191			160,327		
Total liabilities and shareholders' equity	$ 1,440,009			$ 1,431,619		
Net interest income		$ 32,586			$ 33,963	
Net interest margin (tax equivalent)(2)			3.42%			3.60%

(1) Yields and amounts earned on loans include loan fees of -$0.2 million and -$0.1 million for the three months ended September 30, 2010 and 2009, respectively, and -$0.6 million and zero for the nine months ended September 30, 2010 and 2009, respectively. The average loan balance includes loans held-for-sale and nonaccrual loans; however, there is no interest income related to nonaccrual loans in the amount earned on loans.

(2) Includes tax equivalent adjustments primarily related to tax-exempt income on securities.

Our net interest income changes with the level and mix of average interest-earning assets and average interest-bearing funds. We call the changes between periods in interest-earning assets and interest-bearing funds balance changes. We measure the effect on our net interest income from balance changes by multiplying the change in the average balance between the current period and the prior period by the prior period average rate.

Our net interest income also changes with the average rate earned or paid on interest-earning assets and interest-bearing funds. We call the changes between periods in average rates earned and paid rate changes. We measure the effect on our net interest income from rate changes by multiplying the change in average rates earned or paid between the current period and the prior period by the prior period average balance.

We allocate the change in our net interest income attributable to both balance and rate on a pro rata basis to the change in average balance and the change in average rate. The following table presents the change in our interest income and interest expense.

Increase (Decrease) in Net Interest Income/Expense Due to Change in Average Volume and Average Rate (1)

	Three months ended September 30, 2010 to 2009 due to:		
(in thousands)	Rate	Volume	Total
Interest income			
Interest on loans	$394	$(650)	$(256)
Interest on securities	(1,555)	265	(1,290)
Interest on Federal funds sold and deposits with banks	(1)	(7)	(8)
Total interest income	(1,162)	(392)	(1,554)
Interest expense			
Interest on deposits	853	188	1,041
Interest on borrowings	62	161	223
Interest on junior subordinated debentures	2	(1)	1
Total interest expense	917	348	1,265
Net interest income	$(245)	$(44)	$(289)

	Nine months ended September 30, 2010 to 2009 due to:		
(in thousands)	Rate	Volume	Total
Interest income			
Interest on loans	$(162)	$(101)	$(263)
Interest on securities	(6,291)	1,070	(5,221)
Interest on Federal funds sold and deposits with banks	(117)	(102)	(219)
Total interest income	(6,570)	867	(5,703)
Interest expense			
Interest on deposits	3,288	278	3,566
Interest on borrowings	47	664	711
Interest on junior subordinated debentures	52	(3)	49
Total interest expense	3,387	939	4,326
Net interest income	$(3,183)	$1,806	$(1,377)

(1) The change in interest income or interest expense that is attributable to both changes in average balance and average rate has been allocated to the changes due to (i) average balance and (ii) average rate in proportion to the relationship of the absolute amounts of changes in each.

(2) Tables do not include interest income that would have been earned on nonaccrual loans.

Provision for loan losses

The provision for loan losses was $3.6 million for the three months ended September 30, 2010 compared with $4.1 million for the three months ended September 30, 2009. For the first nine months of 2010, the provision for loan losses was $7.1 million compared with $10.3 million for the same period last year. We revised upward in the second quarter of 2010 and in the first quarter of 2009, our estimated loss factors for the qualitative considerations used in the determination of the adequacy of our allowance for loan losses. The change in our estimated loss factors for the 2010 period was less than the change for the 2009 period; however, the changes resulted in a higher ratio of the allowance for loan losses to loans. At September 30, 2010, the ratio of the allowance for loan losses to loans was 1.80 percent compared with 1.76 percent at December 31, 2009. The ratio of the allowance for loan losses to loans was 1.29 percent at September 30, 2009 compared with 1.02 percent at December 31, 2008.

Noninterest income

Noninterest income was $2.3 million for the 2010 third quarter compared with $2.9 million for the same period a year ago. Noninterest income was $5.4 million for the first nine months of 2010 compared with $7.6 million for the same period last year. The decline in each instance reflects principally a smaller amount of securities gains period to period.

The following table presents a summary of noninterest income:

	Three months ended Sept. 30,		Nine months ended Sept. 30,	
	2010	2009	2010	2009
	(in thousands)			
Service charges on deposit accounts and other banking-related fees	$932	$1,111	$2,835	$3,199
Earnings on cash surrender value of life insurance	111	110	331	327
Commissions on brokered loans	10	22	26	76
Net gain on sale of securities	1,204	1,639	1,466	4,310
Impairment loss on securities	(23)	—	(41)	(565)
Gain on transfer of foreclosed assets	—	—	691	—
Other income	63	48	136	238
Total noninterest income	$2,297	$2,930	$5,444	$7,585

Our service charges on deposit accounts for the three months ended September 30, 2010 and 2009 were $0.9 million and $1.1 million, respectively. Service charges on deposit accounts for the nine months ended September 30, 2010 were $2.8 million, down from the $3.2 million in the nine months ended September 30, 2009. The decrease reflects a lower incidence of customers drawing checks against their deposit account when insufficient funds are on deposit.

During the first nine months of 2010 and 2009, we did not sell any loans. However, we brokered loans for commissions of $26,000 for the first nine months of 2010 compared with $76,000 for the first nine months of 2009.

We also recognized in noninterest income an impairment loss of $41,000 on a $1.0 million community development-related equity investment in the first nine months of 2010. A year ago, we recognized other-than-temporary impairment losses on securities of $565,000 in the first nine months of 2009. We will continue to evaluate our securities portfolio for other-than-temporary impairment at each reporting date and we can provide no assurance there will not be other impairment losses in future periods.

In the 2010 second quarter we completed the foreclosure on a $21.0 million completed office construction project. This project consisted of 20 completed units ranging from approximately 1,650 square feet to 14,600 square feet in size. We obtained a current appraisal, evaluated the estimated retail sales prices as well as the estimated costs to sell and determined the fair value of this project to be $21.7 million. Accordingly, for the 2010 second quarter, we recognized a market value gain of $691,000. Subsequent to June 30, 2010, we sold one unit of approximately 4,100 square feet resulting in net proceeds of approximately $1.0 million.

In the third quarter of 2010, we sold $105.0 million of securities and realized net gains of $1.2 million. For the third quarter of 2009 we sold $47.8 million of securities and realized net gains of $1.6 million. In the first nine months of 2010, we sold $184.9 million of securities and realized net gains of $1.5 million. For the first nine months of 2009, we sold $116.2 million of securities and realized net gains of $4.3 million.

Noninterest expense

Our noninterest expense for the three months ended September 30, 2010 was $9.7 million, down 14 percent from $11.3 million for the three months ended September 30, 2009. For the first nine months of 2010, noninterest expense was $30.4 million, down 13 percent from $34.9 million for the same period last year. The decline in noninterest expense reflects the workforce reductions effected in the 2009 and 2010 third quarters. In addition, in the first nine months of 2009, we incurred costs associated with the FDIC-assisted 1st Centennial Bank transaction. Noninterest expense for the three and nine months ended September 30, 2009 included integration and conversion expenses related to the FDIC-assisted 1st Centennial Bank transaction of approximately $51,000 and $774,000, respectively.

The following table presents a summary of noninterest expense:

	Three months ended Sept. 30,		Nine months ended Sept. 30,	
	2010	2009	2010	2009
	(in thousands)			
Salaries and employee benefits	$4,420	$5,011	$14,279	$16,032
Premises and equipment	1,576	1,558	4,630	4,871
Data processing	607	862	1,800	1,812
Legal, audit, and other professional services	445	541	1,216	1,758
Printing, stationery, and supplies	69	197	194	600
Telephone	193	237	630	764
Directors' expense	101	142	335	398
Advertising, marketing and business development	194	245	706	1,144
Postage	55	39	158	190
Insurance and regulatory assessments	797	849	2,377	2,504
Loss on and expense of foreclosed property	185	193	731	442
Amortization of intangible assets	416	417	1,249	1,210
Market loss on loans held-for-sale	—	—	—	709
Other expenses	626	1,003	2,046	2,513
Total noninterest expense	$9,684	$11,294	$30,351	$34,947

Salaries and benefits fell 12 percent to $4.4 million for the 2010 third quarter from $5.0 million for the same period last year. For the first nine months of 2010, salaries and benefits declined 11 percent to $14.3 million from $16.0 million. The decline reflects the 2009 and 2010 third quarter workforce reductions and the completion of the integration and conversion effort related to the FDIC-assisted 1st Centennial Bank transaction. Our workforce declined approximately 5 percent to 235 full-time equivalent employees at September 30, 2010 from 248 a year ago.

The FDIC assesses all financial institutions for deposit insurance. The 2009 second quarter included a $675,000 special assessment the FDIC charged all institutions. In addition, the FDIC increased the regular insurance assessments. With the increased assessment, our regular FDIC insurance expense for the first nine months of 2010 was $1.9 million compared with $1.5 million for the same period last year.

In the second quarter of 2009, we determined not to pursue the sale of $31.2 million of loans previously classified held-for-sale and returned these performing, multi-family loans to our regular portfolio. As such, we recognized a market loss of $709,000 to write down these loans to the lower of cost or market value.

We acquired through foreclosure eight real estate properties and sold two previously foreclosed upon real estate properties in the nine months ended September 30, 2010. The expenses of and the loss on sale of foreclosed properties was $731,000 for the first nine months of 2010 compared with $442,000 for the same period last year.

Our efficiency ratio was 76 percent for the third quarter of 2010 compared with 86 percent for the third quarter of 2009. Our efficiency ratio for the first nine months of 2010 was 80 percent compared with 91 percent for the same period last year. The efficiency ratio is the percentage relationship of noninterest expense, excluding amortization of intangibles, to the sum of net interest income and noninterest income, excluding gains or losses on security sales. The improvement in the efficiency ratio for the third quarter of 2010 as compared to the third quarter of 2009 was due primarily to lower noninterest expense.

Income taxes

The income tax provision was $0.2 million for the nine months ended September 30, 2010 compared with an income tax benefit of $1.9 million for the same period in 2009. The combined federal and state effective tax rate for the nine months ended September 30, 2010 was 39.4 percent compared with 51.4 percent for the same period in 2009.

Financial position – September 30, 2010 compared with December 31, 2009

Lending and credit risk

We provide a variety of loan and credit-related products and services to meet the needs of borrowers primarily located in the six Southern California counties where our branches are located. Business loans, represented by commercial real estate loans, commercial loans and construction loans comprise the largest portion of the loan portfolio. Consumer or personal loans, represented by home mortgage, home equity and installment loans, comprise a smaller portion of the loan portfolio. We attempt to avoid the risk of an undue concentration of credits in a particular property type or with an individual customer.

Credit risk is the risk to earnings or capital arising from an obligor's failure to meet the terms of any contract with us or otherwise to perform as agreed. All activities in which success depends on counterparty, issuer, or borrower performance have credit risk. Credit risk is present any time we extend, commit or invest funds; whenever we enter into actual or implied contractual agreements for funds, whether on or off the balance sheet, credit risk is present.

All categories of loans present credit risk. Major risk factors applicable to all loan categories include changes in international, national and local economic conditions such as interest rates, inflation, unemployment levels, consumer and business confidence and the supply and demand for goods and services.

Commercial real estate loans rely upon the cash flow originating from the underlying real property. Commercial real estate is a cyclical industry; general economic conditions and local supply and demand affect the commercial real estate industry. In the office sector, the demand for office space is highly dependent on employment levels. Consumer spending and confidence affect the demand for retail space and the levels of retail rents in the retail sector. The industrial sector has exposure to the level of exports, defense spending and inventory levels. Vacancy rates, location and other factors affect the amount of rental income for commercial property. Tenants may relocate, fail to honor their lease or go out of business. In the multifamily residential sector, the affordability of ownership housing, employment conditions and the vacancy of existing inventory heavily influences the demand for apartments. Population growth or decline and changing demographics, such as increases in the level of immigrants or retirees, are also factors influencing the multifamily residential sector.

Construction loans provide developers or owners with funds to build or improve properties; developers ultimately sell or lease these properties. Generally, construction loans involve a higher degree of risk than other loan categories because they rely upon the developer's or owner's ability to complete the project within specified cost and time limits. Cost overruns can cause the project cost to exceed the project sales price or exceed the amount of the committed permanent funding. Any number of reasons, such as poor weather, material or labor shortages, labor difficulties, or redoing substandard work to pass inspection, can delay construction projects. Furthermore, changes in market conditions or credit markets may affect a project's viability once completed.

Commercial loans rely upon the cash flow originating from the underlying business activity of the enterprise. The manufacture, distribution or sale of goods or sale of services are not only affected by general economic conditions but also by the ability of the enterprise's management to adjust to local supply and demand conditions, maintain good labor, vendor and customer relationships, as well as market, price and sell their goods or services for a profit. Customer demand for goods and services of the enterprise may change because of competition or obsolescence.

Home mortgages and home equity loans and lines of credit use first or second trust deeds on a borrower's real estate property, typically their principal residence, as collateral. These loans depend on a person's ability to regularly pay the principal and interest due on the loan and, secondarily, on the value of real estate property that serves as collateral for the loan. Generally, home mortgages involve a lower degree of risk than other loan categories because of the relationship of the loan amount to the value of the residential real estate and a person's reluctance to forego their principal place of residence. General economic conditions and local supply and demand, however, affect home real estate values. Installment loans and credit card lines also depend on a person's ability to pay principal and interest on a loan; however, generally these are unsecured loans or, if secured, the collateral value can rapidly decline, as is the case for automobiles. A person's ability to service debt is highly dependent upon their continued employment or financial stability. Job loss, divorce, illness and bankruptcy are just a few of the risks that may affect a person's ability to service their debt.

We obtain appraisals when extending credit for real estate secured loans as follows:

1. All business loans in excess of $1,000,000 where real estate was taken as collateral but where the sale or rental of the real estate is not the primary source of repayment;

2. All business loans in excess of $250,000 where real estate was taken as collateral and where the sale or rental of the real estate is the primary source of repayment; and

3. All other real estate secured loans in excess of $250,000.

All real estate secured loans, at the time of origination, renewal or extension, require a current appraisal. A current appraisal is an appraisal with an “as of” date not more than six months before the date of funding or renewal or extension. We also obtain updated appraisals when the useful life of the appraisal ceases. Under the Uniform Standards of Professional Appraisal Practice guidelines, the useful life of an appraisal, regardless of the dollar amount, is the life of the loan. However, useful life ends when (a) there has been a deterioration in the borrower’s performance and there is an increasing likelihood of a forced liquidation of the property and the existing appraisal is older than two years old, or (b) there has been deterioration in the property’s value due to a significant depreciation in local real estate values, lack of maintenance, change in zoning, environmental contamination or other circumstances.

Since the risks in each category of loan changes based on a number of factors, it is not possible to state whether a particular type of lending carries with it a greater or lesser degree of risk at any specific time in the economic cycle. Generally, in a stabilized economic environment, home mortgage loans have the least risk, followed by home equity loans, multifamily property loans, commercial property loans, commercial loans and lines and finally construction loans. However, this ordering may vary from time to time and the degree of risk from the credits with the least risk to those with the highest risk profile may expand or contract with the general economy.

We manage credit risk through Board-approved policies and procedures. At least annually, the Board of Directors reviews and approves these policies. Lending policies provide us with a framework for consistent loan underwriting and a basis for sound credit decisions. Lending policies specify, among other things, the parameters for the type or purpose of the loan, the required debt service coverage and the required collateral requirements. Credit limits are also established and certain loans require approval by the Directors' Loan Committee. In addition, we have a well-defined set of standards for evaluating the loan portfolio, and management utilizes a comprehensive loan grading system to determine the risk potential in the portfolio. The Directors' Audit Committee also engages a