WESTAMERICA BANCORPORATION
Form 10-Q
October 30, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2009

or

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

For the transition period from _____ to _____.

Commission file number: 001-9383

WESTAMERICA BANCORPORATION

(Exact Name of Registrant as Specified in Its Charter)

CALIFORNIA	**94-2156203**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

1108 FIFTH AVENUE, SAN RAFAEL, CALIFORNIA 94901

(Address of Principal Executive Offices) (Zip Code)

Registrant s Telephone Number, Including Area Code (707) 863-6000

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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes o No o

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date:

Title of Class	Shares outstanding as of October 26, 2009
Common Stock, No Par Value	29,206,991

TABLE OF CONTENTS

	Page
Forward Looking Statements	3
PART I FINANCIAL INFORMATION	
Item 1 Financial Statements	4
Notes to Unaudited Condensed Consolidated Financial Statements	8
Financial Summary	24
Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations	25
Item 3 Quantitative and Qualitative Disclosures about Market Risk	49
Item 4 Controls and Procedures	49
PART II OTHER INFORMATION	
Item 1 Legal Proceedings	49
Item 1A Risk Factors	49
Item 2 Unregistered Sales of Equity Securities and Use of Proceeds	50
Item 3 Defaults upon Senior Securities	51
Item 4 Submission of Matters to a Vote of Security Holders	51
Item 5 Other Information	51
Item 6 Exhibits	51
Signatures	52
Exhibit Index	53

Exhibit 31.1 - Certification of Chief Executive Officer pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a)
Exhibit 31.2 - Certification of Chief Financial Officer pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a)
Exhibit 32.1 - Certification of Chief Executive Officer Required by 18 U.S.C. Section 1350
Exhibit 32.2 - Certification of Chief Financial Officer Required by 18 U.S.C. Section 1350

Table of Contents

FORWARD-LOOKING STATEMENTS

This report on Form 10-Q contains forward-looking statements about Westamerica Bancorporation for which it claims the protection of the safe harbor provisions contained in the Private Securities Litigation Reform Act of 1995. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, expenses, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans, objectives and expectations of the Company or its management or board of directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as believes , anticipates , expects , intends , targeted , pr continue , remain , will , should , may and other similar expressions are intended to identify forward-looking stat but are not the exclusive means of identifying such statements.

These forward-looking statements are based on Management s current knowledge and belief and include information concerning the Company s possible or assumed future financial condition and results of operations. A number of factors, some of which are beyond the Company s ability to predict or control, could cause future results to differ materially from those contemplated. These factors include but are not limited to (1) the length and severity of current difficulties in the national and California economies and the effects of federal and state government efforts to address those difficulties; (2) continued low liquidity levels in capital markets; (3) fluctuations in asset prices including, but not limited to, stocks, bonds, real estate, and commodities; (4) the effect of acquisitions and integration of acquired businesses including the recent acquisition of County Bank assets and assumption of County Bank liabilities from the Federal Deposit Insurance Corporation; (5) economic uncertainty created by terrorist threats and attacks on the United States, the actions taken in response, and the uncertain effect of these events on the national and regional economies; (6) changes in the interest rate environment; (7) changes in the regulatory environment; (8) significantly increasing competitive pressure in the banking industry; (9) operational risks including data processing system failures or fraud; (10) volatility of rate sensitive loans, deposits and investments; (11) asset/liability management risks and liquidity risks; and (12) changes in the securities markets. The Company undertakes no obligation to update any forward-looking statements in this report. The reader is directed to the Company s annual report on Form 10-K for the year ended December 31, 2008, for further discussion of factors which could affect the Company s business and cause actual results to differ materially from those expressed in any forward-looking statement made in this report. The Company undertakes no obligation to update any forward-looking statements in this report.

Table of Contents

PART I FINANCIAL INFORMATION
Item 1 Financial Statements

WESTAMERICA BANCORPORATION
CONSOLIDATED BALANCE SHEETS
(In thousands)
(unaudited)

	At September 30, **2009**	At December 31, **2008**
Assets:		
Cash and cash equivalents	$ 180,058	$ 138,883
Money market assets	463	341
Investment securities available for sale	391,644	288,454
Investment securities held to maturity, with market values of:		
$800,893 at September 30, 2009	780,846	
$950,210 at December 31, 2008		949,325
Non-covered loans	2,267,130	2,382,426
Allowance for loan losses	(42,683)	(44,470)
Non-covered loans, net of allowance for loan losses	2,224,447	2,337,956
Covered loans	932,656	
Total loans	3,157,103	2,337,956
Non-covered other real estate owned	4,319	3,505
Covered other real estate owned	18,740	
Premises and equipment, net	38,982	27,351
Identifiable intangibles	38,264	15,208
Goodwill	121,699	121,699
Interest receivable and other assets	239,041	150,212
Total Assets	$ 4,971,159	$ 4,032,934
Liabilities:		
Deposits:		
Noninterest bearing	$ 1,377,215	$ 1,158,632
Interest bearing:		
Transaction	660,001	525,153
Savings	962,823	745,496
Time	1,024,587	665,773
Total deposits	4,024,626	3,095,054
Short-term borrowed funds	222,030	457,275
Federal Home Loan Bank advances	85,904	
Debt financing and notes payable	26,531	26,631
Liability for interest, taxes and other expenses	76,350	44,122

Total Liabilities		4,435,441		3,623,082
Shareholders Equity:				
Preferred stock, authorized - 1,000 shares Issued and outstanding:				
42 at September 30, 2009		41,335		
Common stock, authorized - 150,000 shares Issued and outstanding:				
29,207 at September 30, 2009		365,547		
28,880 at December 31, 2008				352,265
Deferred compensation		2,485		2,409
Accumulated other comprehensive income		6,053		1,040
Retained earnings		120,298		54,138
Total Shareholders Equity		535,718		409,852
Total Liabilities and Shareholders Equity	$	4,971,159	$	4,032,934

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

WESTAMERICA BANCORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2009	**2008**	**2009**	**2008**
	(In thousands, except per share data)			
Interest Income:				
Loans	$ 48,530	$ 36,710	$ 143,148	$ 112,716
Money market assets and funds sold	1	1	3	3
Investment securities available for sale				
Taxable	2,352	1,858	6,775	7,281
Tax-exempt	1,920	2,183	5,775	7,503
Investment securities held to maturity				
Taxable	3,025	4,671	11,384	14,682
Tax-exempt	5,368	5,552	16,368	16,839
Total Interest Income	61,196	50,975	183,453	159,024
Interest Expense:				
Transaction deposits	263	346	761	1,145
Savings deposits	915	1,048	2,874	3,482
Time deposits	2,095	3,566	7,890	12,984
Short-term borrowed funds	509	1,954	1,572	9,360
Federal Home Loan Bank advances	295		714	
Notes payable	423	524	1,267	1,680
Total Interest Expense	4,500	7,438	15,078	28,651
Net Interest Income	56,696	43,537	168,375	130,373
Provision for Loan Losses	2,800	600	7,200	1,800
Net Interest Income After Provision For Loan Losses	53,896	42,937	161,175	128,573
Noninterest Income:				
Service charges on deposit accounts	9,479	7,555	27,017	22,379
Merchant credit card	2,163	2,611	6,818	7,903
Debit card	1,267	970	3,656	2,852
ATM fees and interchange	965	756	2,792	2,238
Trust fees	319	293	1,056	973
Financial services commissions	129	186	420	689
Other	1,639	1,336	5,712	4,689
FAS 141R gain			48,844	
Securities impairment		(41,206)		(59,384)
Gain on sale of Visa common stock				5,698
Total Noninterest Income (Loss)	15,961	(27,499)	96,315	(11,963)

Noninterest Expense:								
Salaries and related benefits		16,402		12,621		50,221		38,670
Occupancy		4,008		3,465		14,831		10,297
Outsourced data processing services		2,258		2,098		6,740		6,323
Amortization of identifiable intangibles		1,671		788		5,051		2,433
Furniture and equipment		1,789		903		4,618		2,825
Courier service		989		835		2,881		2,488
Professional fees		913		485		2,580		1,704
FDIC insurance assessments		1,442		131		4,820		359
Other		5,679		3,877		16,198		11,835
Visa litigation expense								(2,338)
Total Noninterest Expense		35,151		25,203		107,940		74,596
Income (Loss) Before Income Taxes		34,706		(9,765)		149,550		42,014
Income Tax Provision (Benefit)		9,449		(9,809)		48,285		2,989
Net Income		25,257		44		101,265		39,025
Preferred stock dividends and discount accretion		1,466				3,151		
Net Income Applicable to Common Equity	$	23,791	$	44	$	98,114	$	39,025
Average Common Shares Outstanding		29,210		28,908		29,072		28,895
Diluted Average Common Shares Outstanding		29,429		29,273		29,313		29,292
Per Common Share Data:								
Basic earnings	$	0.81	$	0.00	$	3.37	$	1.35
Diluted earnings		0.81		0.00		3.35		1.33
Dividends paid		0.35		0.35		1.06		1.04

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

WESTAMERICA BANCORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME
(unaudited)

	Common Shares Outstanding	Preferred Stock	Common Stock	Deferred Compensation	Accumulated Comprehensive (Loss) Income	Retained Earnings	Total
				(In thousands)			
Balance, December 31, 2007	29,018		$ 334,211	$ 2,990	$ (4,520)	$ 61,922	$ 394,603
Comprehensive income							
Net income for the period						39,025	39,025
Other comprehensive income, net of tax:							
Increase in net unrealized gains on securities available for sale					5,044		5,044
Post-retirement benefit transition obligation amortization					27		27
Total comprehensive income							44,096
Exercise of stock options	566		22,815				22,815
Stock option tax benefits			1,130				1,130
Restricted stock activity	11		1,261	(581)			680
Stock based compensation			893				893
Stock awarded to employees	3		157				157
Purchase and retirement of stock	(703)		(8,339)			(26,779)	(35,118)
Dividends						(30,128)	(30,128)
Balance, September 30, 2008	28,895		$ 352,128	$ 2,409	$ 551	$ 44,040	$ 399,128
Balance, December 31, 2008	28,880		$ 352,265	$ 2,409	$ 1,040	$ 54,138	$ 409,852
Comprehensive income							
Net income for the period						101,265	101,265
Other comprehensive income, net of tax:							
Increase in net unrealized gains on securities available for sale					4,986		4,986

Post-retirement benefit transition obligation amortization					27		27
Total comprehensive income							106,278
Issuance of preferred stock and related warrants		82,519	1,207				83,726
Redemption of preferred stock		(41,863)					(41,863)
Preferred stock dividends and discount accretion		679				(3,151)	(2,472)
Exercise of stock options	350		9,094				9,094
Stock option tax benefits			2,179				2,179
Restricted stock activity	7		251	76			327
Stock based compensation			847				847
Stock awarded to employees	2		78				78
Purchase and retirement of stock	(32)		(374)			(1,116)	(1,490)
Dividends						(30,838)	(30,838)
Balance, September 30, 2009	29,207	$ 41,335	$ 365,547	$ 2,485	$ 6,053	$ 120,298	$ 535,718

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

WESTAMERICA BANCORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	For the nine months ended September 30,	
	2009	**2008**
	(In thousands)	
Operating Activities:		
Net income	$ 101,265	$ 39,025
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,117	7,130
Loan loss provision	7,200	1,800
Net amortization of deferred loan cost (fees)	358	(72)
(Increase) decrease in interest income receivable	(3,637)	2,036
FAS 141R gain	(48,844)	
Decrease (increase) in other assets	48,191	(20,405)
Increase (decrease) in income taxes payable	3,811	(4,089)
Decrease in interest expense payable	(317)	(2,469)
Increase (decrease) in other liabilities	26,398	(13,373)
Stock option compensation expense	847	893
Stock option tax benefits	(2,179)	(1,130)
Impairment of investment securities		59,384
Gain on sale of Visa common stock		(5,698)
Writedown of property and equipment	37	9
Originations of loans for resale	(68)	(1,269)
Net proceeds from sale of loans originated for resale	70	1,283
Net gain on sale of property acquired in satisfaction of debt	(135)	
Writedown of property acquired in satisfaction of debt	83	195
Net Cash Provided by Operating Activities	134,197	63,250
Investing Activities:		
Net repayments of loans	330,616	89,415
Proceeds from FDIC loss-sharing indemnification	43,696	
Purchases of investment securities available for sale		(6,430)
Purchases of investment securities held to maturity	(522)	
Proceeds from maturity/calls of securities available for sale	76,185	183,616
Proceeds from sale of securities available for sale		480
Proceeds from maturity/calls of securities held to maturity	172,002	82,666
Purchases of FRB/FHLB* securities		(120)
Proceeds from sale of FRB/FHLB* stock	1,502	11,364
Proceeds from sale of Visa common stock		5,698
Proceeds from sale of property acquired in satisfaction of debt	10,009	311
Purchases of property, plant and equipment	(14,146)	(638)
Net cash acquired from acquisitions	44,397	

Net Cash Provided by Investing Activities	663,739	366,362
Financing Activities:		
Net decrease in deposits	(298,770)	(135,002)
Net decrease in short-term borrowings	(476,483)	(310,626)
Repayments of notes payable and debt financing	(101)	(10,109)
Exercise of stock options	9,094	22,815
Proceeds from issuance of preferred stock	83,726	
Redemption of preferred stock	(41,863)	
Stock option tax benefits	2,179	1,130
Repurchases/retirement of stock	(1,490)	(35,118)
Dividends paid	(30,838)	(30,128)
Preferred dividends	(2,215)	
Net Cash Used in Financing Activities	(756,761)	(497,038)
Net Increase (Decrease) In Cash and Cash Equivalents	41,175	(67,426)
Cash and Cash Equivalents at Beginning of Period	138,883	209,764
Cash and Cash Equivalents at End of Period	$ 180,058	$ 142,338
Supplemental Cash Flow Disclosures:		
Loan collateral transferred to other real estate owned	$ 23,804	$ 706
Unrealized gain on securities available for sale, net	4,986	5,044
Interest paid for the period	21,719	31,120
Income tax payments for the period	27,553	24,056
Acquisitions:		
Assets acquired	$ 1,624,464	
Liabilities assumed	1,575,620	
Net	48,844	

See accompanying notes to unaudited condensed consolidated financial statements.

* Federal Reserve Bank/Federal Home Loan Bank (FRB/FHLB)

Table of Contents

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. The results of operations reflect interim adjustments, all of which are of a normal recurring nature and which, in the opinion of Management, are necessary for a fair presentation of the results for the interim periods presented. The interim results for the nine months ended September 30, 2009 and 2008 are not necessarily indicative of the results expected for the full year. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes as well as other information included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

Note 2: Accounting Policies.

Certain accounting policies underlying the preparation of these financial statements require Management to make estimates and judgments. These estimates and judgments may significantly affect reported amounts of assets and liabilities, revenues and expenses, and disclosures of contingent assets and liabilities.

Management exercises judgment to estimate the appropriate level of the Allowance for Credit Losses, which is discussed in Note 1 to the audited consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

As described in Note 3 below, Westamerica Bank (Bank) acquired assets and assumed liabilities of the former County Bank on February 6, 2009 from the Federal Deposit Insurance Corporation (FDIC). The acquired assets and assumed liabilities of County Bank were measured at estimated fair values, as required by the acquisition method of accounting for business combinations (Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) 805, Business Combinations, formerly FASB Statement No. 141 (revised 2007)). Management made significant estimates and exercised significant judgment in accounting for the acquisition of County Bank. Management judgmentally assigned risk ratings to loans. The assigned risk ratings, appraised collateral values, expected cash flows, and current interest rates, and statistically derived loss factors were used to measure fair values for loans. Repossessed loan collateral was primarily valued based upon appraised collateral values. Due to the loss sharing agreements with the FDIC, the Bank recorded a receivable from the FDIC equal to 80 percent of the loss estimates embedded in the fair values of loans and repossessed loan collateral. The Bank also recorded an identifiable intangible asset representing the value of the core deposit customer base of County Bank based on an appraisal performed by an independent third party. In determining the value of the identifiable intangible asset, the third-party appraiser used significant estimates including average lives of depository accounts, future interest rate levels, the cost of servicing various depository products, and other significant estimates. Management used quoted market prices to determine the fair value of investment securities, FHLB advances and other borrowings.

Newly Adopted Accounting Policies

Purchased loans. Purchased loans acquired in a business combination, which include loans purchased in the County Bank acquisition, are recorded at estimated fair value on their purchase date but the purchaser cannot carryover the related allowance for loan losses. Purchased loans are accounted for under FASB ASC 310-30, Loans and Debt Securities with Deteriorated Credit Quality (formerly American Institute of Certified Public Accountants (AICPA) Statement of Position 03-3), when the loans have evidence of credit deterioration since origination and it is probable at the date of acquisition that the Company will not collect all contractually required principal and interest payments. Evidence of credit quality deterioration as of the purchase date may include statistics such as past due and nonaccural status. Generally, acquired loans that meet the Company s definition for nonaccrual status fall within the scope of FASB ASC 310-30. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference which is included in the carrying amount of the loans. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows result in a reversal of the provision for loan losses to the extent of prior charges, or a reclassification of the difference from nonaccretable to accretable with a positive impact on interest income. Further, any excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable yield and is recognized into interest income over the remaining life of the loan when there is a reasonable

expectation about the amount and timing of such cash flows.

Table of Contents

Covered loans. Loans covered under loss sharing or similar credit protection agreements with the FDIC are reported in loans exclusive of the expected reimbursement cash flows from the FDIC. Covered loans are initially recorded at fair value at the acquisition date. Subsequent decreases in the amount expected to be collected results in a provision for loan losses and a corresponding increase in the estimated FDIC reimbursement, with the estimated net loss impacting earnings. Interest is accrued daily on the outstanding principal balances. Covered loans which are more than 90 days delinquent with respect to interest or principal, unless they are well secured and in the process of collection, and other covered loans on which full recovery of principal or interest is in doubt, are placed on nonaccrual status. Interest previously accrued on covered loans placed on nonaccrual status is charged against interest income, net of estimated FDIC reimbursements of such accrued interest. In addition, some covered loans secured by real estate with temporarily impaired values and covered commercial loans to borrowers experiencing financial difficulties are placed on nonaccrual status even though the borrowers continue to repay the loans as scheduled (covered performing nonaccrual loans). When the ability to fully collect nonaccrual loan principal is in doubt, payments received are applied against the principal balance of the loans until such time as full collection of the remaining recorded balance is expected. Any additional interest payments received after that time are recorded as interest income on a cash basis. Covered performing nonaccrual loans are reinstated to accrual status when improvements in credit quality eliminate the doubt as to the full collectibility of both interest and principal.

Covered Other Real Estate Owned. Other real estate owned covered under loss sharing agreements with the FDIC is reported exclusive of expected reimbursement cash flows from the FDIC. Upon transferring covered loan collateral to covered other real estate owned status, acquisition date fair value discounts on the related loan is also transferred to covered other real estate owned. Fair value adjustments on covered other real estate owned result in a reduction of the covered other real estate carrying amount and a corresponding increase in the estimated FDIC reimbursement, with the estimated net loss charged against earnings.

Recently Adopted Accounting Pronouncements

In first quarter 2009, the Company adopted the following new accounting pronouncements:

FASB ASC 805, *Business Combinations* (formerly FAS 141R (revised 2007), *Business Combinations*);

FASB ASC 815-10, *Derivatives and Hedging* (formerly FAS 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133*); and

FASB ASC 820-10-55-23B, *Fair Value Measurements and Disclosures- Overall Implementation Guidance* (formerly, FASB Staff Position (FSP) FAS 157-2, *Effective Date of FASB Statement No. 15*).

In the second quarter 2009, the Company adopted the following new accounting pronouncements:

FASB ASC 320-10-65-1, *Investments Debt and Equity Securities Guidance related to Recognition and Presentation of Other-Than-Temporary Impairments* (formerly FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*);

FASB ASC 820-10-65-4, *Fair Value Measurements and Disclosures- Overall Transition Guidance related to Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (formerly FASB Staff Position (FSP) FAS 157-4 *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*);

FASB ASC 825-10-65-1, *Financial Instruments Overall Transition Guidance related to Interim Disclosures about Fair Value of Financial Instruments* (formerly FSP FAS 107-1 and APB Opinion 28-1, *Interim Disclosures about Fair Value of Financial Instruments*); and

FASB ASC 855, *Subsequent Events* (formerly FAS 165, *Subsequent Events*).

FASB ASC 805, *Business Combinations*, requires an acquirer in a business combination to recognize the assets acquired (including loan receivables), the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, at their fair values as of that date, with limited exceptions. The acquirer is not permitted to recognize a separate valuation allowance as of the acquisition date for loans and other assets acquired in a business combination. The revised statement requires acquisition-related costs to be expensed separately from the acquisition. It also requires restructuring costs that the acquirer expected but was not obligated to incur, to be expensed separately from the business combination. The Company applied these revised provisions in accounting for the acquisition of County

Bank.

FASB ASC 815-10, *Derivatives and Hedging,* changes the disclosure requirements for derivative instruments and hedging activities. It requires enhanced disclosures about how and why an entity uses derivatives, how derivatives and related hedged items are accounted for, and how derivatives and hedged items affect an entity s financial position, performance and cash flows. The Company had no derivative instruments designated as hedges as of September 30, 2009.

FASB ASC 820-10-55-23B, *Fair Value Measurements and Disclosures- Overall Implementation Guidance*, relates to the requirements that pertain to nonfinancial assets and nonfinancial liabilities covered by accounting guidance for Fair Value Measurements. The adoption of this guidance did not have any effect on the Company s financial statements at the date of adoption.

FASB ASC 320-10-65-1, *Investments Debt and Equity Securities Guidance related to Recognition and Presentation of Other-Than-Temporary Impairments* states that an other-than-temporary impairment (OTTI) write-down of debt securities, where fair value is below amortized cost, is triggered in circumstances where (1) an entity has the intent to sell a security, (2) it is more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis, or (3) the entity does not expect to recover the entire amortized cost basis of the security. If an entity intends to sell a security or if it is more likely than not the entity will be required to sell the security before recovery, an OTTI write-down is recognized in earnings equal to the entire difference between the security s amortized cost basis and its fair value. If an entity does not intend to sell the security or it is more likely than not that it will not be required to sell the security before recovery, the OTTI write-down is separated into an amount representing the credit loss, which is recognized in earnings, and the amount related to all other factors, which is recognized in other comprehensive income. The adoption of these provisions did not have any effect on the Company s financial statements at the date of adoption.

FASB ASC 820-10-65-4, *Fair Value Measurements and Disclosures- Overall Transition Guidance related to Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly,* addresses measuring fair value in situations where markets are inactive and transactions are not orderly. In these circumstances quoted prices may not be determinative of fair value. Even if there has been a significant decrease in the volume and level of activity for an asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement has not changed. Under these provisions price quotes for assets or liabilities in inactive markets may require adjustment due to uncertainty as to whether the underlying transactions are orderly. The adoption of these provisions did not have any effect on the Company s financial statements at the date of adoption.

FASB ASC 825-10-65-1, *Financial Instruments Overall Transition Guidance related to Interim Disclosures about Fair Value of Financial Instruments*, states that entities must disclose the fair value of financial instruments in interim reporting periods as well as in annual financial statements. The methods and assumptions used to estimate fair value as well as any changes in methods and assumptions that occurred during the reporting period must also be disclosed. The adoption of these provisions did not have any effect on the Company s financial statements at the date of adoption.

FASB ASC 855, *Subsequent Events,* establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The accounting guidance defines: (1) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, (2) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and (3) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. Management has reviewed events occurring through October 30, 2009, the date the financial statements were issued and no subsequent events occurred requiring accrual or disclosure.

Recently Issued Accounting Pronouncements

FASB Update 2009-05, *Measuring Liabilities at Fair Value.*

This Update provides amendments to Subtopic 820-10, Fair Value Measurements and Disclosures Overall, for the fair value measurement of liabilities.

This Update clarifies:

- In circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value by using one or more following: a) the quoted price for the identical liability when traded as an asset; b) the quoted prices for similar liabilities or similar liabilities when traded as assets; c) the income approach, such as present value technique; and/or d) the market

approach, such as a technique that is based on the amount at the measurement date that the reporting entity would pay to transfer the identical liability or would receive to enter into the identical liability.

When estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability.

Both a quoted price in an active market for the identical liability at the measurement date and the quoted price for the identical liability when traded as an asset in an active market when no adjustments to the quoted price of the asset are required are Level 1 fair value measurements.

Table of Contents

This Update is effective for the Company s December 31, 2009 year-end reporting period. The Company does not report liabilities at fair value on a recurring basis. Management does not expect the adoption of the Update to have a material effect on the Company s financial statements at the date of adoption.

In June 2009, the FASB issued FASB Statement No. 166 (FAS 166), Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140 and FASB Statement No. 167 (FAS 167), Amendments to FASB Interpretation No. 46(R).

FAS 166 was issued to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor s continuing involvement, if any, in transferred financial assets. Specifically to address: (1) practices that have developed since the issuance of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* that are not consistent with the original intent and key requirements of that Statement and (2) concerns of financial statement users that many of the financial assets (and related obligations) that have been derecognized should continue to be reported in the financial statements of transferors. This Statement must be applied to transfers occurring on or after the effective date. Additionally, on and after the effective date, the concept of a qualifying special-purpose entity is no longer relevant for accounting purposes.

FAS 167 was issued to improve financial reporting by enterprises involved with variable interest entities. Specifically to address: (1) the effects on certain provisions of FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* as a result of the elimination of the qualifying special-purpose entity concept in FASB Statement No. 166, *Accounting for Transfers of Financial Assets,* and (2) constituent concerns about the application of certain key provisions of Interpretation 46(R), including those in which the accounting and disclosures under the Interpretation do not always provide timely and useful information about an enterprise s involvement in a variable interest entity.

Both Statements must be applied as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter with early application prohibited. Management does not expect the adoption of these Statements to have a material effect on the Company s financial statement at the date of adoption, January 1, 2010.

Note 3: Federally Assisted Acquisition of County Bank

On February 6, 2009, Westamerica Bancorporation s bank subsidiary, Westamerica Bank (Bank), purchased substantially all the assets and assumed substantially all the liabilities of County Bank from the Federal Deposit Insurance Corporation (FDIC), as Receiver of County Bank. County Bank operated 39 commercial banking branches primarily within California s central valley region between Sacramento and Fresno. The FDIC took County Bank under receivership upon County Bank s closure by the California Department of Financial Institutions at the close of business February 6, 2009. Westamerica Bank submitted a bid for the acquisition of County Bank with the FDIC on February 3, 2009. The FDIC approved Westamerica Bank s bid upon reviewing three competing bids and determining Westamerica Bank s bid would be the least costly to the Deposit Insurance Fund. Westamerica Bank s bid included the purchase of substantially all County Bank assets at a cost of assuming all County Bank deposits and certain other liabilities. No cash or other consideration was paid by Westamerica Bank. Further, Westamerica Bank and the FDIC entered loss sharing agreements regarding future losses incurred on loans and foreclosed loan collateral existing at February 6, 2009. Under the terms of the loss sharing agreements, the FDIC will absorb 80 percent of losses and share in 80 percent of loss recoveries on the first $269 million of losses, and absorb 95 percent of losses and share in 95 percent of loss recoveries on losses exceeding $269 million. The term for loss sharing on residential real estate loans is ten years, while the term for loss sharing on non-residential real estate loans is five years in respect to losses and eight years in respect to loss recoveries. As a result of the loss sharing agreements with the FDIC, the Company recorded a receivable of $129 million at the time of acquisition.

Table of Contents

The County Bank acquisition was accounted for under the acquisition method of accounting in accordance with FASB ASC 805, Business Combinations. The statement of net assets acquired as of February 6, 2009 and the resulting bargain purchase gain are presented in the following table. The purchased assets and assumed liabilities were recorded at their respective acquisition date fair values, and identifiable intangible assets were recorded at fair value. Fair values are preliminary and subject to refinement for up to one year after the closing date of a merger as information relative to closing date fair values becomes available. A bargain purchase gain totaling $48.8 million resulted from the acquisition and is included as a component of noninterest income on the statement of income. The amount of the gain is equal to the amount by which the fair value of assets purchased exceeded the fair value of liabilities assumed. The acquisition resulted in a gain due to County Bank s impaired capital condition at the time of the acquisition. The operations of County Bank provided revenue of $46.0 million and net income of $7.7 million for the period of February 6, 2009 to September 30, 2009, and is included in the consolidated financial statements. County Bank s results of operations prior to the acquisition are not included in Westamerica s statement of income.

Statement of Net Assets Acquired (at fair value)

	At February 6, 2009 (In thousands)	
Assets		
Cash and cash equivalents	$	44,668
Federal funds sold		12,760
Securities		173,839
Loans		1,174,353
Core deposit intangible		28,107
Other real estate owned		9,332
Other assets		181,405
Total Assets	$	1,624,464
Liabilities		
Deposits		1,234,123
Federal funds purchased and securities sold under repurchase agreements		153,169
Other borrowed funds		187,252
Liabilities for interest and other expenses		1,076
Total Liabilities		1,575,620
Net assets acquired	$	48,844
County Bank tangible stockholder s equity	$	58,623
Adjustments to reflect assets acquired and liabilities assumed at fair value:		
Loans and leases, net		(150,326)
Other real estate owned		(5,470)
FDIC loss-sharing receivable (included in other assets)		128,962
Core deposit intangible		28,107
Deposits		(10,823)
Securities sold under repurchase agreements		(2,061)

Other borrowed funds		1,832
FAS 141R Gain	$	48,844

The pro forma consolidated condensed statements of income for Westamerica Bancorporation and County Bank for the nine months ended September 30, 2009 and 2008, and the year ended December 31, 2008 are presented below. The unaudited pro forma information presented does not necessarily reflect the results of operations that would have resulted had the acquisition been completed at the beginning of the applicable periods presented, nor does it indicate the results of operations in future periods.

The pro forma purchase accounting adjustments related to loans and leases, deposits, securities sold under repurchase agreements and other borrowed funds are being accreted or amortized into income using methods that approximate a level yield over their respective estimated lives. Purchase accounting adjustments related to identifiable intangibles are being amortized and recorded as noninterest expense over their respective estimated lives using accelerated methods. The pro forma consolidated condensed statements of income do not reflect any adjustments to County s historical provision for credit losses and goodwill impairment charges.

Table of Contents

	Nine months ended September 30, 2009 (In thousands except per share data)				Nine months ended September 30, 2008 (In thousands except per share data)			
	Westamerica	County Bank	Pro Forma Adjustments	Pro Forma Combined	Westamerica	County Bank	Proforma Adjustments	Pro Forma Combined
Interest Income	$ 152,357	$ 57,284	$ (3,603)	$ 206,038	$ 159,024	$ 91,110	$ (3,603)	$ 246,531
Interest Expense	8,191	15,483	(7,626)	16,048	28,651	32,249	(7,626)	53,274
Net Interest Income	144,166	41,801	4,023	189,990	130,373	58,861	4,023	193,257
Provision for Credit Losses	7,200	11,734		18,934	1,800	26,827		28,627
Net Interest Income after Provision for Credit Losses	136,966	30,067	4,023	171,056	128,573	32,034	4,023	164,630
Noninterest Income (Loss)	40,548	11,437	48,844	100,829	(11,963)	4,603	48,844	41,484
Noninterest Expense	75,875	34,267	4,956	115,098	74,596	89,896	4,956	169,448
Income (Loss) Before Taxes	101,639	7,237	47,911	156,787	42,014	(53,259)	47,911	36,666
Income Tax Provision (Benefit)	36,590	3,043	20,147	59,780	2,989	7,642	20,147	30,778
Net Income (Loss)	$ 65,049	$ 4,194	$ 27,764	$ 97,007	$ 39,025	$ (60,901)	$ 27,764	$ 5,888
Net Income (Loss) Applicable to Common Equity	$ 61,898	$ 4,194	$ 27,764	$ 93,856	$ 39,025	$ (60,901)	$ 27,764	$ 5,888
Earnings (Loss) Per Common Share	$ 2.13	$ 0.14	$ 0.96	$ 3.23	$ 1.35	$ (2.11)	$ 0.96	$ 0.20
Diluted Earnings (Loss) Per Common Share	2.11	0.14	0.95	3.20	1.33	(2.08)	0.95	0.20

Average Common Shares Outstanding	29,072	28,895
Diluted Average Common Shares Outstanding	29,313	29,292

	Year ended December 31, 2008 (In thousands except per share data)			
	Westamerica	**County Bank**	**Pro Forma Adjustments**	**Pro Forma Combined**
Interest Income	$ 208,469	$ 117,175	$ (4,477)	$ 321,167
Interest Expense	33,243	40,462	(9,717)	63,988
Net Interest Income	175,226	76,713	5,240	257,179
Provision for Credit Losses	2,700	55,370		58,070
Net Interest Income after Provision for Credit Losses	172,526	21,343	5,240	199,109
Noninterest (Loss) Income	(2,056)	5,775	48,844	52,563
Noninterest Expense	100,761	115,774	5,989	222,524
Income (Loss) Before Taxes	69,709	(88,656)	48,095	29,148
Income Tax Provision	9,874	7,381	20,224	37,479
Net Income (Loss)	$ 59,835	$ (96,037)	$ 27,871	$ (8,331)
Net Income (Loss) Applicable to Common Equity	$ 59,835	$ (96,037)	$ 27,871	$ (8,331)
Earnings (Loss) Per Common Share	$ 2.07	$ (3.32)	$ 0.96	$ (0.29)
Diluted Earnings (Loss) Per Common Share	2.04	(3.28)	0.95	(0.28)
Average Common Shares Outstanding	28,892			
Diluted Average Common Shares Outstanding	29,273			

Note 4: Investment Securities

The amortized cost, unrealized gains and losses, and estimated market value of the available for sale investment securities portfolio as of September 30, 2009 follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
		(In thousands)		
U.S. Treasury securities	$ 3,003	$ 20	$	$ 3,023
Securities of U.S. Government sponsored entities	1,015	68		1,083
Mortgage-backed securities	151,077	3,783	(2)	154,858

Obligations of States and political subdivisions	165,129	5,363	(424)	170,068
Collateralized mortgage obligations	46,864	802	(248)	47,418
Asset-backed securities	10,000	0	(2,135)	7,865
FHLMC and FNMA stock	824	1,910		2,734
Other securities	2,778	1,849	(32)	4,595
Total	$ 380,690	$ 13,795	$ (2,841)	$ 391,644

Table of Contents

The amortized cost, unrealized gains and losses, and estimated market value of the held to maturity investment securities portfolio as of September 30, 2009 follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
	(In thousands)			
Securities of U.S. Government sponsored entities	$ 25,000	$ 89	$	$ 25,089
Mortgage-backed securities	66,489	1,955		68,444
Obligations of States and political subdivisions	528,147	21,409	(794)	548,762
Collateralized mortgage obligations	161,210	3,767	(6,379)	158,598
Total	$ 780,846	$ 27,220	$ (7,173)	$ 800,893

The amortized cost, unrealized gains and losses, and estimated market value of the available for sale investment securities portfolio as of December 31, 2008 follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
	(In thousands)			
U.S. Treasury securities	$ 3,014	$ 68	$	$ 3,082
Securities of U.S. Government sponsored entities	11,019	71	(13)	11,077
Mortgage-backed securities	40,302	941	(3)	41,240
Obligations of States and political subdivisions	156,602	5,042	(598)	161,046
Collateralized mortgage obligations	61,565	143	(1,857)	59,851
Asset-backed securities	9,999		(3,552)	6,447
FHLMC and FNMA stock	824		(3)	821
Other securities	2,778	2,222	(110)	4,890
Total	$ 286,103	$ 8,487	$ (6,136)	$ 288,454

The amortized cost, unrealized gains and losses, and estimated market value of the held to maturity investment securities portfolio as of December 31, 2008 follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
	(In thousands)			
Securities of U.S. Government sponsored entities	$ 110,000	$ 1,731	$	$ 111,731
Mortgage-backed securities	85,676	867	(299)	86,244
Obligations of States and political subdivisions	545,237	12,983	(2,875)	555,345
Collateralized mortgage obligations	208,412	1,744	(13,266)	196,890
Total	$ 949,325	$ 17,325	$ (16,440)	$ 950,210

The amortized cost and estimated market value of securities as of September 30, 2009, by contractual maturity, are shown in the following table:

	Securities Available for Sale		Securities Held to Maturity	
	Amortized Cost	Estimated Market Value	Amortized Cost	Estimated Market Value
	(In thousands)			
Maturity in years:				
1 year or less	$ 10,873	$ 10,963	$ 32,386	$ 32,556
1 to 5 years	73,324	75,378	48,933	50,513
5 to 10 years	67,415	69,940	412,917	430,034
Over 10 years	27,535	25,758	58,912	60,748
Subtotal	179,147	182,039	553,148	573,851
Mortgage-backed	197,941	202,276	227,698	227,042
Other securities	3,602	7,329		
Total	$ 380,690	$ 391,644	$ 780,846	$ 800,893

Expected maturities of mortgage-backed securities can differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties. In addition, such factors as prepayments and interest rates may affect the yield on the carrying value of mortgage-backed securities. At September 30, 2009 and December 31, 2008, the Company had no high-risk collateralized mortgage obligations as defined by regulatory guidelines.
An analysis of gross unrealized losses of the available for sale investment securities portfolio as of September 30, 2009, follows:

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Mortgage-backed securities	$ 10	$	$ 233	$ (2)	$ 243	$ (2)
Obligations of States and political subdivisions	11,200	(342)	4,066	(82)	15,266	(424)
Collateralized mortgage obligations	3,438	(17)	12,652	(231)	16,090	(248)
Asset-backed securities			7,865	(2,135)	7,865	(2,135)
Other securities			1,968	(32)	1,968	(32)
Total	$ 14,648	$ (359)	$ 26,784	$ (2,482)	$ 41,432	$ (2,841)

An analysis of gross unrealized losses of the held to maturity investment securities portfolio as of September 30, 2009, follows:

	Less than 12 months		12 months or longer		Total	
		Unrealized		Unrealized		Unrealized

	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
			(In thousands)			
Obligations of States and political subdivisions	$ 6,621	$ (143)	$ 22,044	$ (651)	$ 28,665	$ (794)
Collateralized mortgage obligations	1,746	(10)	38,179	(6,369)	39,925	(6,379)
Total	$ 8,367	$ (153)	$ 60,223	$ (7,020)	$ 68,590	$ (7,173)

The unrealized losses on the Company s investments in collateralized mortgage obligations and asset backed securities were caused by market conditions for these types of investments. The Company evaluates these securities on a quarterly basis including changes in security ratings issued by ratings agencies, delinquency and loss information with respect to the underlying collateral, changes in the levels of subordination for the Company s particular position within the repayment structure, and remaining credit enhancement as compared to expected credit losses of the security. Substantially all of these securities continue to be AAA rated by one or more major rating agencies. Because the Company does not intend to sell or be required to sell these securities and we expect to recover the amortized cost basis of the securities, the Company does not consider those investments to be other-than temporarily impaired as of September 30, 2009.

The unrealized losses on the Company s investments in obligations of states and political subdivisions were caused by conditions in the municipal securities markets and certain securities being insured by one of the monoline insurance companies. The Company evaluates these securities quarterly to determine if a change in security rating has occurred or the municipality has experienced any financial difficulties. Substantially all of these securities continue to be investment grade rated. Because the Company believes that it will collect all principal and interest due and does not intend to sell or be required to sell the securities, the Company does not consider those investments to be other-than-temporarily impaired as of September 30, 2009.
The fair values of the investment securities could decline in the future if the general economy deteriorates and the liquidity for securities is low. As a result, other than temporary impairments may occur in the future.
An analysis of gross unrealized losses of the available for sale investment securities portfolio as of December 31, 2008, follows:

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Securities of U.S. Government sponsored entities	$ 9,988	$ (13)	$	$	$ 9,988	$ (13)
Mortgage-backed securities			1,680	(3)	1,680	(3)
Obligations of States and political subdivisions	8,817	(470)	2,171	(128)	10,988	(598)
Collateralized mortgage obligations	11,527	(595)	25,085	(1,262)	36,612	(1,857)
Asset-backed securities			6,447	(3,552)	6,447	(3,552)
FHLMC and FNMA stock	3	(3)			3	(3)
Other securities			1,890	(110)	1,890	(110)
Total	$ 30,335	$ (1,081)	$ 37,273	$ (5,055)	$ 67,608	$ (6,136)

An analysis of gross unrealized losses of the held to maturity investment securities portfolio as of December 31, 2008, follows:

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Mortgage backed securities	$ 22,401	$ (286)	$ 3,886	$ (13)	$ 26,287	$ (299)
Obligations of States and political subdivisions	73,205	(2,846)	4,713	(29)	77,918	(2,875)
Collateralized mortgage obligations	40,379	(10,925)	24,037	(2,341)	64,416	(13,266)
Total	$ 135,985	$ (14,057)	$ 32,636	$ (2,383)	$ 168,621	$ (16,440)

Table of Contents

Note 5: Loans

A summary of the major categories of non-covered and covered loans outstanding is shown in the following tables:

	At September 30, 2009	At December 31, 2008
	(In thousands)	
Non-covered loans:		
Commercial	$ 499,819	$ 524,786
Commercial real estate	809,717	817,423
Construction	41,124	52,664
Residential real estate	399,564	458,447
Consumer installment & other	516,906	529,106
	2,267,130	2,382,426
Allowance for loan losses	(42,683)	(44,470)
	$ 2,224,447	$ 2,337,956

The carrying amount of the covered loans at September 30, 2009, consisted of impaired and non impaired purchased loans in the following table.

	Impaired Purchased Loans	Non Impaired Purchased Loans	Total Covered Loans
		(In thousands)	
Covered loans:			
Commercial	$ 7,724	$ 286,561	$ 294,285
Commercial real estate	20,069	450,541	470,610
Construction	22,778	25,982	48,760
Residential real estate	138	19,120	19,258
Consumer installment & other	187	99,556	99,743
Total loans	$ 50,896	$ 881,760	$ 932,656

The following table represents the non impaired purchased loans receivable at the acquisition date of February 6, 2009. The amounts include principal only and do not reflect accrued interest as of the date of acquisition or beyond. (In thousands)

Gross contractual loan principal payment receivable	$ 1,151,844
Estimate of contractual principal not expected to be collected	(57,701)
Fair value of non impaired purchased loans receivable	$ 1,108,605

The Company applied the cost recovery method to impaired purchased loans at the acquisition date of February 6, 2009 due to the uncertainty as to the timing of expected cash flows as reflected in the following table. (In thousands)

Contractually required payments receivable (including interest)	$	210,561
Nonaccretable difference		(144,813)
Cash flows expected to be collected		65,748
Accretable difference		
Fair value of loans acquired	$	65,748

Changes in the carrying amount of impaired purchased loans were as follows for the quarter ended September 30, 2009. (In thousands)

Carrying amount at the beginning of the period	$	54,376
Reductions during the period		(3,480)
Carrying amount at the end of the period	$	50,896

Impaired purchased loans had an unpaid principal balance (less prior charge-offs) of $164 million and $82 million at February 6, 2009 and September 30, 2009, respectively.
There were no loans held for sale at September 30, 2009 and December 31, 2008.

Note 6: Intangible Assets

The Company has recorded goodwill and other identifiable intangibles associated with purchase business combinations. Goodwill is not amortized, but is periodically evaluated for impairment. The Company did not recognize impairment during the nine months ended September 30, 2009.
Identifiable intangibles are amortized to their estimated residual values over their expected useful lives. Such lives and residual values are also periodically reassessed to determine if any amortization period adjustments are indicated. During the nine months ended September 30, 2009, no such adjustments were recorded. The gross carrying amount of identifiable intangible assets and accumulated amortization was:

	At September 30, **2009**		At December 30, **2008**	
	(In thousands)			
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Core Deposit Intangibles	$ 52,490	$ (17,746)	$ 24,383	$ (13,426)
Merchant Draft Processing Intangible	10,300	(6,780)	10,300	(6,049)
Total Identifiable Intangible Assets	$ 62,790	$ (24,526)	$ 34,683	$ (19,475)

As of September 30, 2009, the current year and estimated future amortization expense for identifiable intangible assets was:

	Core Deposit Intangibles	Merchant Draft Processing Intangible	Total
		(In thousands)	
Nine months ended September 30, 2009 (actual)	$ 4,320	$ 731	$ 5,051
Estimate for year ended December 31,			
2009	5,734	962	6,696
2010	5,534	774	6,308
2011	4,954	624	5,578
2012	4,497	500	4,997
2013	3,957	400	4,357

2014	3,621	324	3,945

Note 7: Post Retirement Benefits

The Company offers a continuation of group insurance coverage to qualifying employees electing early retirement, for the period from the date of retirement until age 65. For eligible employees the Company pays a portion of these early retirees insurance premiums. The Company reimburses a portion of Medicare Part B premiums for all qualifying retirees over age 65 and their qualified spouses. Eligibility for post-retirement medical benefits is based on age and years of service, and restricted to employees hired prior to February 1, 2006. The Company uses an actuarial-based accrual method of accounting for post-retirement benefits.

The following table sets forth the net periodic post-retirement benefit costs:

	For the nine months ended At September 30,	
	2009	**2008**
	(In thousands)	
Service cost	$ (237)	$ (300)
Interest cost	165	198
Amortization of unrecognized transition obligation	45	45
Net periodic cost	$ (27)	$ (57)

The Company does not fund plan assets for any post-retirement benefit plans.

Note 8: Contingent Liabilities

Loan commitments are agreements to lend to a customer provided there is no violation of any condition established in the agreement. Commitments generally have fixed expiration dates or other termination clauses. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future funding requirements. Loan commitments are subject to the Company s normal credit policies and collateral requirements. Unfunded loan commitments were $507.9 million and $350.8 million at September 30, 2009 and December 31, 2008, respectively. Standby letters of credit commit the Company to make payments on behalf of customers when certain specified future events occur. Standby letters of credit are primarily issued to support customers short-term financing requirements and must meet the Company s normal credit policies and collateral requirements. Standby letters of credit outstanding totaled $27.6 million and $29.0 million at September 30, 2009 and December 31, 2008, respectively. The Company also had commitments for commercial and similar letters of credit of $184 thousand and $1.7 million at September 30, 2009 and December 31, 2008, respectively.

During 2007, the Visa Inc. (Visa) organization of affiliated entities announced that it completed restructuring transactions in preparation for an initial public offering planned for early 2008, and, as part of those transactions, the Bank s membership interest in Visa U.S.A. was exchanged for an equity interest in Visa Inc. In accordance with Visa s by-laws, the Bank and other Visa U.S.A. member banks were obligated to share in Visa s litigation obligations which existed at the time of the restructuring transactions. On November 7, 2007, Visa announced that it had reached a settlement with American Express related to an antitrust lawsuit. Visa has disclosed other antitrust lawsuits which existed at the time of the restructuring transactions. In consideration of the American Express settlement and other antitrust lawsuits filed against Visa, the Company recorded in the fourth quarter of 2007 a liability and corresponding expense of $2,338 thousand. In the first quarter 2008, Visa funded a litigation settlement escrow using proceeds from its initial public offering. Upon the escrow funding, the Company relieved its liability with a corresponding expense reversal in the amount of $2,338 thousand.

On October 27, 2008, Visa announced that it had reached a settlement with Discover Financial Services related to an antitrust lawsuit that existed at the time of Visa s restructuring requiring the payment of the settlement to be funded from the litigation settlement escrow. On December 22, 2008, Visa announced that it had funded its litigation settlement escrow in an amount sufficient to meet such litigation obligation pursuant to Visa s amended and restated Certificate of Incorporation approved by Visa s shareholders on December 16, 2008. As such, the Company did not

record a liability for this settlement. On July 16, 2009, Visa announced that it had deposited $700 million into the litigation escrow account previously established under Visa s retrospective responsibility plan. As a result, the Company s conversion rate applicable to the Company s Visa Class B common stock (stock) has decreased from 0.6296 to 0.5824. The Company had no previously recorded liabilities related to any outstanding lawsuits requiring reversal, and therefore the funding of the litigation escrow by decreasing the conversion rate of the Company s stock did not have any impact on the Company s income statement.

Table of Contents

Due to the nature of its business, the Company is subject to various threatened or filed legal cases. Based on the advice of legal counsel, the Company does not expect such cases will have a material, adverse effect on its financial position or results of operations.

Note 9: Fair Value Measurements

In accordance with FASB ASC 820, Fair Value Measurements and Disclosure, the Company groups its assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 Valuation is based upon quoted prices for identical instruments traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury and federal agency securities, which are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market. Level 2 includes mortgage-backed securities, municipal bonds and collateralized mortgage obligations as well as other real estate owned and impaired loans collateralized by real property where the fair value is generally based upon independent market prices or appraised values of the collateral.

Level 3 Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company s estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques. Level 3 includes those impaired loans collateralized by other business assets where the expected cash flow has been used in determining the fair value.

Assets Recorded at Fair Value on a Recurring Basis

The table below presents assets measured at fair value on a recurring basis.

	At September 30, 2009			
	Fair Value	Level 1	Level 2	Level 3
	(In thousands)			
U.S. Treasury securities	$ 3,023	$ 3,023	$	$
Securities of U.S. Government sponsored entities	1,083	1,083		
Mortgage-backed securities	154,858		154,858	
Obligations of states and political subdivisions	170,068		170,068	
Collateralized mortgage obligations	47,418		47,418	
Asset-backed securities	7,865		7,865	
FHLMC and FNMA stock	2,734	2,734		
Other securities	4,595	2,626	1,969	
Total securities available for sale	$ 391,644	$ 9,466	$ 382,178	$

Table of Contents

Assets Recorded at Fair Value on a Nonrecurring Basis

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets. For assets measured at fair value on a nonrecurring basis that were still held in the balance sheet at quarter end, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related assets at quarter end.

	At September 30, 2009			
	Fair Value	Level 1	Level 2	Level 3
	(In thousands)			
Non-covered other real estate owned (1)	$ 413	$	$ 413	$
Non-covered impaired loans (2)	3,928		3,928	
Total assets measured at fair value on a nonrecurring basis	$ 4,341	$	$ 4,341	$

(1) Represents the fair value of foreclosed real estate owned that was measured at fair value subsequent to their initial classification as foreclosed assets.

(2) Represents carrying value of loans for which adjustments are predominantly based on the appraised value of the collateral and loans considered impaired under FASB ASC 310-10-35, Subsequent Measurement of Receivables, where a specific reserve has been

established.

Disclosures about Fair Value of Financial Instruments

The fair values presented represent the Company s best estimate of fair value using the methodologies discussed below. The fair values of financial instruments which have a relatively short period of time between their origination and their expected realization were valued using historical cost. The values assigned do not necessarily represent amounts which ultimately may be realized. In addition, these values do not give effect to discounts to fair value which may occur when financial instruments are sold in larger quantities. Such financial instruments and their estimated fair values were:

	At September 30, 2009	
	Book Value	Fair Value
	(In thousands)	
Cash and cash equivalents	$ 180,058	$ 180,058
Money market assets	463	463
Interest and taxes receivable	61,173	61,173
Noninterest bearing and interest-bearing transaction and savings deposits	3,000,039	3,000,039
Sweep accounts	120,496	120,496
Interest payable	1,923	1,923

The fair values of investment securities were estimated using quoted prices as described above for Level 1 and Level 2 valuation:

	At September 30, 2009	
	Book Value	Fair Value
	(In thousands)	
Investment securities available for sale	$ 391,644	$ 391,644
Investment securities held to maturity	780,846	800,893

Table of Contents

The fair values of FHLB advances, term repurchase agreements, and notes payable were estimated by using interpolated yields for financial instruments with similar characteristics. Such financial instruments and their estimated fair values were:

	At September 30, 2009	
	Book Value	Fair Value
	(In thousands)	
Federal Home Loan Bank advances	$ 85,904	$ 86,278
Term repurchase agreements	101,533	103,892
Senior notes payable	15,000	13,862
Subordinated notes	11,531	10,865

Loans were separated into two groups for valuation. Variable rate loans, except for those described below, which reprice frequently with changes in market rates were valued using historical cost. Fixed rate loans and variable rate loans that have reached their minimum contractual interest rates were valued by discounting the future cash flows expected to be received from the loans using current interest rates charged on loans with similar characteristics. Additionally, the allowance for loan losses of $42.7 million and the fair market value discount due to credit default risk associated with the County acquisition of $98.7 million were applied against the estimated fair values to recognize estimated future defaults of contractual cash flows.

The book values and the estimated fair values of loans were:

	At September 30, 2009	
	Book Value	Fair Value
	(In thousands)	
Loans	$ 3,157,103	$ 3,192,020

The fair values of FDIC receivables and time deposits were estimated by discounting estimated future cash flows related to these financial instruments using current market rates for financial instruments with similar characteristics. The book values and the estimated fair values were:

	At September 30, 2009	
	Book Value	Fair Value
	(In thousands)	
FDIC receivables	$ 85,267	$ 84,812
Time deposits	1,024,587	1,016,149

The majority of the Company s standby letters of credit and other commitments to extend credit carry current market interest rates if converted to loans. No premium or discount was ascribed to these commitments because virtually all funding would be at current market rates.

Note 10: Shareholders Equity

On February 13, 2009, the Company issued to the United States Department of the Treasury (the Treasury) 83,726 shares of Series A Fixed Rate Cumulative Perpetual Preferred Stock (the Series A Preferred Stock), having a liquidation preference of $1,000 per share. The Series A Preferred Stock pays cumulative dividends at a rate of 5% per year for the first five years and thereafter at a rate of 9% per year. The Company may, at its option, subject to any necessary bank regulatory approval, redeem the Series A Preferred Stock at par value plus accrued and unpaid dividends. On September 2, 2009 the Company redeemed 41,863 shares of its Series A Preferred Stock at $1,000 per share. The Series A Preferred Stock is generally non-voting. Prior to February 13, 2012, unless the Company has redeemed the Series A Preferred Stock or the Treasury has transferred all of the Series A Preferred Stock to third parties, the consent of the Treasury will be required for the Company to declare or pay any dividends or make any distribution on its common stock, other than regular quarterly cash dividends not exceeding $0.35 or dividends payable only in shares of its common stock, or repurchase its common stock or other equity or capital securities, other than in connection with benefit plans consistent with past practice and certain other circumstances specified in the

Securities Purchase Agreement with the Treasury. The Treasury, as part of the preferred stock issuance, received a warrant to purchase 246,640 shares of the Company s common stock at an initial exercise price of $50.92. The proceeds from Treasury were allocated based on the relative fair value of the warrant as compared with the fair value of the preferred stock. The fair value of the warrant was determined using a valuation model which incorporates assumptions including the Company s common stock price, dividend yield, stock price volatility, the risk-free interest rate, and other assumptions. The Company allocated $1.2 million of the proceeds from the Series A Preferred Stock to the warrant. The discount on the preferred stock will be accreted to par value over a five-year term, which is the expected life of the preferred stock, and reported as a reduction to net income applicable to common equity over that period. The redemption of the preferred shares on September 2, 2009 triggered the acceleration of the discount accretion requiring a one-time charge of $538 thousand.

Table of Contents

Note 11: Earnings Per Common Share

The table below shows earnings per common share and diluted earnings per common share. Basic earnings per common share are computed by dividing net income applicable to common equity by the average number of common shares outstanding during the period. Diluted earnings per common share are computed by dividing net income applicable to common equity by the average number of common shares outstanding during the period plus the impact of common stock equivalents.

	For the three months ended September 30,		For the nine months ended September 30,	
	2009	**2008**	**2009**	**2008**
	(In thousands, except per share data)			
Weighted average number of common shares outstanding basic	29,210	28,908	29,072	28,895
Add exercise of options reduced by the number of shares that could have been purchased with the proceeds of such exercise	219	365	241	397
Weighted average number of common shares outstanding diluted	29,429	29,273	29,313	29,292
Net income applicable to common equity	$ 23,791	$ 44	$ 98,114	$ 39,025
Basic earnings per common share	$ 0.81	$ 0.00	$ 3.37	$ 1.35
Diluted earnings per common share	0.81	0.00	3.35	1.33

For the three months ended September 30, 2009, options to purchase 726 thousand shares of common stock were outstanding but not included in the computation of diluted net income per share because the exercise price exceeded the fair value of the stock such that their inclusion would have had an anti-dilutive effect. For the nine months ended September 30, 2009, options and warrants to purchase 889 thousand and 247 thousand shares of common stock, respectively, were outstanding but not included in the computation of diluted net income per share because they were anti-dilutive. For the three months and nine months ended September 30, 2008, options to purchase 582 thousand and 618 thousand shares of common stock, respectively, were outstanding but not included in the computation of diluted net income per share because they were anti-dilutive.

Table of Contents

WESTAMERICA BANCORPORATION
FINANCIAL SUMMARY

	Three months ended September 30,		Nine months ended September 30,	
	2009	**2008**	**2009**	**2008**
	(In thousands, except per share data)			
Net Interest Income (FTE)*	$ 61,593	$ 48,693	$ 183,270	$ 146,407
Provision for Loan Losses	(2,800)	(600)	(7,200)	(1,800)
Noninterest Income:				
Gain on sale of Visa common stock				5,698
Net loss from equity securities		(41,206)		(59,384)
FAS 141R gain			48,844	
Deposit service charges and other	15,961	13,707	47,471	41,723
Total Noninterest Income (Loss)	15,961	(27,499)	96,315	(11,963)
Noninterest Expense:				
Visa litigation				(2,338)
Other	35,151	25,203	107,940	76,934
Total Noninterest Expense	35,151	25,203	107,940	74,596
Income (Loss) Before Income Taxes (FTE)*	39,603	(4,609)	164,445	58,048
Income Tax Provision (Benefit) (FTE)*	14,346	(4,653)	63,180	19,023
Net Income	25,257	44	101,265	39,025
Preferred stock dividends and discount accretion	1,466		3,151	
Net Income Applicable to Common Equity	$ 23,791	$ 44	$ 98,114	$ 39,025
Average Common Shares Outstanding	29,210	28,908	29,072	28,895
Diluted Average Common Shares Outstanding	29,429	29,273	29,313	29,292
Common Shares Outstanding at Period End	29,207	28,895	29,207	28,895
As Reported:				
Basic Earnings Per Common Share	$ 0.81	$ 0.00	$ 3.37	$ 1.35
Diluted Earnings Per Common Share	0.81	0.00	3.35	1.33
Return On Assets	1.86%	0.00%	2.57%	1.22%
Return On Common Equity	19.68%	0.04%	28.38%	12.83%
Net Interest Margin (FTE)*	5.48%	5.19%	5.39%	5.04%
Net Loan Losses to Average Non-Covered Loans	0.56%	0.24%	0.51%	0.23%
Efficiency Ratio**	45.3%	118.9%	38.6%	55.5%
Average Balances:				
Total Assets	$ 5,072,866	$ 4,137,232	$ 5,113,359	$ 4,275,657

Earning Assets	4,470,851	3,745,058	4,541,596	3,878,972
Total Gross Loans	3,263,388	2,414,317	3,261,462	2,443,574
Total Deposits	4,131,388	3,154,340	4,066,462	3,183,393
Shareholders Equity	549,331	412,133	527,635	406,244
Balances at Period End:				
Total Assets	$ 4,971,159	$ 4,089,482		
Earning Assets	4,372,739	3,676,536		
Total Gross Loans	3,199,786	2,408,704		
Total Deposits	4,024,626	3,129,788		
Shareholders Equity	535,718	399,128		
Financial Ratios at Period End:				
Allowance for Loan Losses to Non-Covered Loans	1.88%	2.08%		
Book Value Per Common Share	$ 16.93	$ 13.81		
Equity to Assets	10.78%	9.76%		
Total Capital to Risk Adjusted Assets	15.07%	11.25%		
Dividends Paid Per Common Share	$ 0.35	$ 0.35	$ 1.06	$ 1.04
Common Dividend Payout Ratio	43%	n/m	32%	78%

The above financial summary has been derived from the Company s unaudited consolidated financial statements. This information should be read in conjunction with those statements, notes and the other information included elsewhere herein. Percentages under the heading As Reported are annualized with the exception of the efficiency ratio.

* Yields on securities and certain loans have been adjusted upward to a fully taxable equivalent (FTE) basis in

order to reflect the effect of income which is exempt from federal income taxation at the current statutory tax rate.

** The efficiency ratio is defined as noninterest expense divided by total revenue (net interest income on a tax-equivalent basis and noninterest income).

Table of Contents

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

Westamerica Bancorporation and subsidiaries (the Company) reported third quarter 2009 net income applicable to common equity of $23.8 million or $0.81 diluted earnings per common share compared with net income applicable to common equity of $44 thousand or $-0.00- diluted earnings per common share for the same period of 2008. In the third quarter 2009, the Company completed systems conversions and branch consolidations related to the purchase of assets and assumption of liabilities of the former County Bank (County), which resulted in reduced expense levels. During the third quarter 2009, the Company redeemed $42 million in preferred stock requiring accelerated discount accretion of $538 thousand, which reduced diluted earnings per common share EPS $0.02. Also, during the same quarter, the Company eliminated $587 thousand in tax reserves due to a lapse in the statute of limitations, which reduced tax provisions and increased EPS $0.02.

In the third quarter of 2008, the Company recognized a $24 million after-tax or $0.81 diluted earnings per common share charge for securities losses and other than temporary impairment of Federal Home Loan Mortgage Corporation (FHLMC) and Federal National Mortgage Association (FNMA) preferred stock held in its available for sale investment portfolio. Additionally, the Company reduced its tax provision by approximately $1 million primarily due to filing its 2007 federal tax return and adjusting 2007 tax estimates to actual amounts included in the filed tax return. The tax provision reduction represented $0.03 diluted earnings per common share. The adjustment primarily resulted from higher than anticipated tax credits earned on limited partnership investments providing low-income housing and housing for the elderly in Northern and Central California communities.

The Company reported net income applicable to common equity of $98.1 million or $3.35 diluted earnings per common share for the nine months ended September 30, 2009, compared with $39.0 million or $1.33 diluted earnings per common share for the same period of 2008. The first nine months of 2009 included a $48.8 million FAS 141R gain resulting from the acquisition of County Bank (County) which increased net income by $28.3 million and earnings per diluted common share by $0.97. The first nine months of 2008 included $34 million in after-tax losses on sale and impairment in the value of FHLMC and FNMA preferred stock, $4.7 million in after-tax benefits from Visa s initial public offering and $2.3 million in reduced expenses as known litigation contingencies were satisfied as a part of the VISA IPO, which combined to reduce net income by $27 million and earnings per diluted common share by $0.92. Results for this period also included the approximate $1.0 million reduction in the Company s tax provision primarily due to filing its 2007 federal tax return, which increased diluted earnings per common share by $0.03.

Acquisition

On February 6, 2009, Westamerica Bank (Bank) acquired the banking operations of County from the Federal Deposit Insurance Corporation (FDIC). The Bank acquired approximately $1.62 billion of assets and assumed $1.58 billion of liabilities. The Bank and the FDIC entered loss sharing agreements regarding future losses incurred on loans and foreclosed loan collateral existing at February 6, 2009. Under the terms of the loss sharing agreements, the FDIC will absorb 80 percent of losses and share in 80 percent of loss recoveries on the first $269 million of losses, and absorb 95 percent of losses and share in 95 percent of loss recoveries on losses exceeding $269 million. The term for loss sharing on residential real estate loans is ten years, while the term for loss sharing on non-residential real estate loans is five years in respect to losses and eight years in respect to loss recoveries. The County Bank acquisition was accounted for under the acquisition method of accounting in accordance with FASB ASC 805, Business Combinations. The Company recorded a bargain purchase gain totaling $48.8 million resulting from the acquisition, which is a component of noninterest income on the statement of income. The amount of the gain is equal to the amount by which the fair value of assets purchased exceeded the fair value of liabilities assumed. See Note 3 of the Notes to unaudited Consolidated Financial Statements for additional information regarding the acquisition.

Table of Contents

Net Income

Following is a summary of the components of net income for the periods indicated:

	Three months ended September 30,		Nine months ended September 30,	
	2009	**2008**	**2009**	**2008**
	(In thousands, except per share data)			
Net interest income (FTE)	$ 61,593	$ 48,693	$ 183,270	$ 146,407
Provision for loan losses	(2,800)	(600)	(7,200)	(1,800)
Noninterest income (loss)	15,961	(27,499)	96,315	(11,963)
Noninterest expense	(35,151)	(25,203)	(107,940)	(74,596)
Income tax (provision) benefit (FTE)	(14,346)	4,653	(63,180)	(19,023)
Net income	$ 25,257	$ 44	$ 101,265	$ 39,025
Net income applicable to common equity	$ 23,791	$ 44	$ 98,114	$ 39,025
Average diluted common shares	29,429	29,273	29,313	29,292
Diluted earnings per common share	$ 0.81	$ 0.00	$ 3.35	$ 1.33
Average total assets	$ 5,072,866	$ 4,137,232	$ 5,113,359	$ 4,275,657
Net income applicable to common equity to average total assets (annualized)	1.86%	0.00%	2.57%	1.22%
Net income applicable to common equity to average common stockholders equity (annualized)	19.68%	0.04%	28.38%	12.83%

County was acquired from the FDIC on February 6, 2009. Net income applicable to common equity for the third quarter of 2009 was $23.7 million more than the same quarter of 2008, largely attributable to a $24 million after-tax FHLMC and FNMA preferred stock loss on sale and impairment charge in the third quarter of 2008, higher net interest income (FTE) and higher service fee income on deposit accounts, partially offset by higher provision for loan losses, higher noninterest expense and an increase in income tax provision (FTE). A $12.9 million or 26.5% increase in net interest income (FTE) was mostly attributed to growth in average balances of loans due to the acquisition, lower rates paid on interest-bearing liabilities and lower average balances of borrowings, partially offset by lower yields on earning assets and higher average balances of interest-bearing deposits and lower average balances of investments. The provision for loan losses increased $2.2 million, reflecting Management s evaluation of losses inherent in the loan portfolio not covered by loss-sharing agreements with the FDIC. Noninterest income rose by $43.5 million mainly due to higher service charges on deposit accounts and because the third quarter of 2008 included securities losses and impairment charge of $41.2 million. Noninterest expense increased $9.9 million mostly due to acquisition-related increases in salaries and related benefits, occupancy and equipment expenses and higher FDIC insurance assessments and amortization of intangibles. The provision for income taxes (FTE) increased $19.0 million primarily due to higher profitability and because the third quarter of 2008 included the $17.3 million tax benefit on the investment security losses on sale and impairment charge.

Comparing the first nine months of 2009 to the first nine months of 2008, net income applicable to common equity increased $59.1 million, due to the FAS 141R gain, higher net interest income (FTE), higher service charges on

deposit accounts and the 2008 securities losses and impairment charges, partially offset by increases in the provision for loan losses, noninterest expense and income tax provision (FTE) and the 2008 gain on sale of Visa common stock and reversal of noninterest expense related to Visa litigation contingencies. The higher net interest income (FTE) was mainly caused by higher average loans, lower rates paid on interest-bearing deposits and lower average balances of borrowings, partially offset by lower yields on loans, lower average investments and higher average balances of interest-bearing deposits. The provision for loan losses increased $5.4 million to reflect Management s assessment of losses inherent in the loan portfolio not covered by loss-sharing agreements with the FDIC. Noninterest income increased $108.3 million largely due to the FAS 141R gain, higher service charges on deposit accounts due to assumed deposits and the securities losses in the first nine months of 2008, partially offset by the gain on Visa common stock in the first quarter of 2008. The income tax provision (FTE) increased $44.2 million primarily due to the FAS 141R gain, and higher profitability and securities losses in the first nine months of 2008, partially offset by an increase related to the gain on sale of Visa common stock in the first nine months of 2008.

Table of Contents

Net Interest Income

Following is a summary of the components of net interest income for the periods indicated:

	Three months ended September 30,		Nine months ended September 30,	
	2009	**2008**	**2009**	**2008**
	(In thousands)			
Interest and fee income	$ 61,196	$ 50,975	$ 183,453	$ 159,024
Interest expense	(4,500)	(7,438)	(15,078)	(28,651)
FTE adjustment	4,897	5,156	14,895	16,034
Net interest income (FTE)	$ 61,593	$ 48,693	$ 183,270	$ 146,407
Average earning assets	$ 4,470,851	$ 3,745,058	$ 4,541,596	$ 3,878,972
Net interest margin (FTE) (annualized)	5.48%	5.19%	5.39%	5.04%

At September 30, 2009, FDIC covered loans represented 29 percent of the Company s loan portfolio. Under the terms of the FDIC loss-sharing agreements, the FDIC is obligated to reimburse the Bank 80 percent of loan interest income foregone on covered loans. Such reimbursements are limited to the lesser of 90 days contractual interest or actual unpaid contractual interest at the time a principal loss is recognized in respect to the underlying loan. The Bank includes estimated FDIC reimbursable loan interest income in income in the period such loan interest would be recognized if the borrower were in compliance with the contractual terms of the loan.

Net interest income (FTE) increased during the third quarter of 2009 by $12.9 million or 26.5% from the same period in 2008 to $61.6 million, mainly due to higher average balances of loans (up $849.1 million), lower rates paid on interest-bearing liabilities (down 61 basis points (bp)) and lower average balances of borrowings (down $171.5 million), partially offset by lower yields on loans (down 21 bp) and higher average balances of interest-bearing deposits (up $778.9 million), and lower average balances of investments (down $123.3 million).

Comparing the first nine months of 2009 with the corresponding period of 2008, net interest income (FTE) increased $36.9 million or 25.2%, primarily due to a higher volume of average loans (up $817.9 million), lower rates paid on interest-bearing liabilities (down 83 bp) and lower average balances of borrowings (down $167.8 million), partially offset by lower yields on loans (down 35 bp), higher average balances of interest-bearing deposits (up $739.0 million) and lower average balances of investments (down $155.3 million).

Interest and Fee Income

Interest and fee income (FTE) for the third quarter of 2009 increased $10.0 million or 17.7% from the same period in 2008. The increase was caused primarily by higher average balances of loans (up $849.1 million), partially offset by lower yields on loans (down 21 bp) and lower average balances of investments (down $123.3 million).

The growth in the average earning assets in the third quarter of 2009 compared with the same period in 2008 was substantially attributable to the acquisition of County loans from the FDIC. The average balance of such loans for the third quarter of 2009 was $974.1 million. The growth in average balances of loans were mainly due to increases in the average balance of commercial real estate loans (up $483.5 million), taxable commercial loans (up $319.9 million), and other consumer loans (up $119.6 million), partially offset by a $21.5 million decline in average tax-exempt commercial loans, a $37.8 million decline in average residential real estate loans and a $20.3 million decline in indirect automobile loans. The acquired County loan portfolio did not contain significant volumes of tax-exempt commercial loans or residential real estate loans. The average investment portfolio decreased $123.3 million largely due to declines in average balances of U.S. government sponsored entity obligations (down $94.7 million), municipal securities (down $15.8 million) and a $42.9 million decline in average balances of FHLMC and FNMA stock resulting

from impairment charges in the second, third and fourth quarters of 2008, partially offset by a $21.7 million increase in the average balance of mortgage backed securities and collateralized mortgage obligations which were purchased from the FDIC as a part of the County acquisition. The Bank has not been actively purchasing investment securities in the current environment. The resulting liquidity has been applied to reduce high-cost and interest-sensitive funding sources.

Table of Contents

The average yield on the Company s earning assets decreased from 5.98% in the third quarter 2008 to 5.88% in the corresponding period of 2009. The composite yield on loans fell 21 bp to 6.03% due to decreases in yields on taxable commercial loans (down 104 bp), commercial real estate loans (down 33 bp), real estate construction loans (down 261 bp) and residential real estate loans (down 13 bp), partially offset by a 16 bp increase in yields on consumer loans. The investment portfolio yield decreased 2 bp to 5.47%, mainly due to a 363 bp decrease in the average yield on corporate and other securities which was affected primarily by suspended dividends on FHLMC and FNMA preferred stock.

Comparing the first nine months of 2009 with the comparable period of 2008, interest and fee income (FTE) was up $23.3 million or 13.3%. The increase largely resulted from a higher volume of average loans due to the County acquisition, partially offset by lower yields on loans and lower average balances of investments.

Average earning assets increased $662.6 million or 17.1% for the first nine months of 2009 compared with the same period of 2008 due to the County acquisition. A $817.9 million increase in the average balance of the loan portfolio was attributable to increases in average balances of commercial real estate loans (up $447.8 million), taxable commercial loans (up $328.1 million) and consumer loans (up $96.5 million), partially offset by a $29.0 million decrease in the average balance of residential real estate loans and a $22.7 million decrease in the average balance of tax-exempt commercial loans. The acquired County loan portfolio did not contain significant volumes of tax-exempt commercial loans or residential real estate loans. Average investments decreased by $155.3 million due to declines in the average balances of U.S. government sponsored entity obligations (down $112.6 million), municipal securities (down $17.5 million) and a $55.3 million decline in average balances of FHLMC and FNMA stock resulting from the impairment charge in the second, third and fourth quarters of 2008, partially offset by a $22.4 million increase in the average balance of mortgage backed securities and collateralized mortgage obligations. The Bank has not been actively purchasing investment securities in the current environment. The resulting liquidity has been applied to reduce high-cost and interest-sensitive funding sources.

The average yield on earning assets for the first nine months of 2009 was 5.83% compared with 6.02% in the corresponding period of 2008. The loan portfolio yield for the first nine months of 2009 compared with the previous quarter was lower by 35 bp, due to decreases in yields on taxable commercial loans (down 155 bp), commercial real estate loans (down 49 bp) and real estate construction loans (down 295 bp), partially offset by consumer loans (up 15 bp) and tax-exempt commercial loans (up 10 bp). The investment portfolio yield decreased by 5 bp. The decrease resulted from an 11 bp decline in yields on mortgage backed securities and collateralized mortgage obligations and a 494 bp decline in yields on corporate and other securities which was affected primarily by suspended dividends on FHLMC and FNMA preferred stock, partially offset by higher yields on U.S. government sponsored entity obligations (up 28 bp).

Interest Expense

Interest expense in the third quarter of 2009 decreased $2.9 million compared with the same period in 2008. The decrease was attributable to lower rates paid on the interest-bearing liabilities, lower balances of borrowings and higher levels of shareholders equity, partially offset by higher average interest-bearing deposits. The average rate paid on interest-bearing liabilities decreased from 1.19% in the third quarter of 2008 to 0.58% in the same quarter of 2009. Rates paid on most interest-bearing liabilities moved with general market conditions. Rates on interest-bearing deposits decreased 53 bp to 0.47% primarily due to decreases in rates paid on CDs over $100 thousand (down 108 bp) , CDs less than $100 thousand (down 180 bp) and preferred money market savings (down 87 bp). Rates on short-term borrowings also decreased 59 bp mostly due to lower rates on federal funds purchased (down 180 bp) and sweep accounts (down 35 bp). Average interest-bearing liabilities rose by $607.4 million or 24.4% for the third quarter of 2009 over the same period of 2008 primarily through acquisition. Interest-bearing deposits grew $778.9 million primarily due to increases in CDs less than $100 thousand (up $298.4 million), CDs over $100 thousand (up $97.3 million), money market checking accounts (up $169.1 million), money market savings (up $148.9 million) and regular savings (up $81.5 million). Offsetting the increase were decreases in average balances of short-term borrowings (down $162.8 million) and long-term debt (down $8.6 million). Average short-term borrowings decreased due to a $341.5 million decline in the average balance of federal funds purchased, partially offset by FHLB advances assumed through the County acquisition averaging $86.2 million and a $95.2 million increase in average balances of repurchase agreements due to the County acquisition.

Table of Contents

Comparing the first nine months of 2009 with the same period of 2008, interest expense decreased $13.6 million, due to lower rates paid, lower average balances of borrowing and higher levels of shareholders equity, offset in part by higher average balances of interest-bearing deposits. Average interest-bearing liabilities during the first nine months of 2009 rose by $571.2 million or 21.8% over the same period of 2008 mainly through the County acquisition. A $739.0 million growth in interest-bearing deposits was mostly attributable to increases in average balances of CDs less than $100 thousand (up $271.9 million), CDs over $100 thousand (up $129.4 million), money market checking accounts (up $161.4 million), money market savings (up $116.6 million) and regular savings (up $72.0 million). Short-term borrowings decreased $158.2 million, mainly the net result of lower average balances of federal funds purchased (down $296.4 million) and sweep accounts (down $15.8 million), partially offset by higher average balances of repurchase agreements (up $76.7 million) and FHLB advances (up $77.3 million). Average balances of long-term debt also declined $9.6 million. Rates paid on interest-bearing liabilities averaged 0.63% during the first nine months of 2009 compared with 1.46% for the first nine months of 2008. The average rate paid on interest-bearing deposits declined 62 bp to 0.56% in the first nine months of 2009 mainly due to lower rates on CDs less than $100 thousand (down 212 bp), CDs over $100 thousand (down 125 bp) and preferred money market savings (down 109 bp). Rates on short-term borrowings were also lower by 139 bp largely due to federal funds (down 236 bp) and repurchase agreements (down 118 bp).

Net Interest Margin (FTE)

The following summarizes the components of the Company s net interest margin for the periods indicated:

	Three months ended September 30,		Nine months ended September 30,	
	2009	**2008**	**2009**	**2008**
Yield on earning assets (FTE)	5.88%	5.98%	5.83%	6.02%
Rate paid on interest-bearing liabilities	0.58%	1.19%	0.63%	1.46%
Net interest spread (FTE)	5.30%	4.79%	5.20%	4.56%
Impact of all other net noninterest bearing funds	0.18%	0.40%	0.19%	0.48%
Net interest margin (FTE)	5.48%	5.19%	5.39%	5.04%

During the third quarter of 2009, the net interest margin (FTE) increased 29 bp compared with the same period in 2008. Rates paid on interest-bearing liabilities declined faster than yields on earning assets (FTE), resulting in a 51 bp increase in net interest spread. The margin contribution of noninterest bearing funds decreased 22 bp because of the lower market rates of interest at which they could be invested. The net interest margin (FTE) in the first nine months of 2009 rose by 35 bp compared with the comparable period of 2008. Earning asset yields decreased 19 bp while the cost of interest-bearing liabilities declined 83 bp, resulting in a 64 bp increase in the net interest spread. The margin contribution from noninterest bearing funding sources decreased 29 bp.

Summary of Average Balances, Yields/Rates and Interest Differential

The following tables present, for the periods indicated, information regarding the Company s consolidated average assets, liabilities and shareholders equity, the amount of interest income from average earning assets and the resulting yields, and the amount of interest expense paid on interest-bearing liabilities. Average loan balances include nonperforming loans. Interest income includes proceeds from loans on nonaccrual status only to the extent cash payments have been received and applied as interest income. Yields on securities and certain loans have been adjusted upward to reflect the effect of income which is exempt from federal income taxation at the current statutory tax rate (FTE).

	For the three months ended September 30, 2009		
	Average Balance	Interest Income/ Expense	Rates Earned/ Paid
	(In thousands)		
Assets:			
Money market assets and funds sold	$ 602	$ 1	0.66%
Investment securities:			
Available for sale			
Taxable	237,965	2,352	3.95%
Tax-exempt (1)	167,339	2,846	6.80%
Held to maturity			
Taxable	275,553	3,025	4.39%
Tax-exempt (1)	526,004	8,290	6.30%
Loans:			
Commercial:			
Taxable	642,366	9,391	5.80%
Tax-exempt (1)	184,054	3,032	6.54%
Commercial real estate	1,313,545	21,967	6.63%
Real estate construction	74,707	667	3.54%
Real estate residential	424,189	5,004	4.72%
Consumer	624,527	9,518	6.05%
Total loans (1)	3,263,388	49,579	6.03%
Total earning assets (1)	4,470,851	$ 66,093	5.88%
Other assets	602,015		
Total assets	$ 5,072,866		
Liabilities and shareholders equity			
Deposits:			
Noninterest bearing demand	$ 1,371,124	$	
Savings and interest-bearing transaction	1,687,028	1,178	0.28%
Time less than $100,000	491,555	829	0.67%
Time $100,000 or more	581,681	1,266	0.86%

Total interest-bearing deposits	2,760,264	3,273	0.47%
Short-term borrowed funds	307,266	804	1.04%
Debt financing and notes payable	26,551	423	6.36%
Total interest-bearing liabilities	3,094,081	$ 4,500	0.58%
Other liabilities	58,330		
Shareholders equity	549,331		
Total liabilities and shareholders equity	$ 5,072,866		
Net interest spread (1) (2)			5.30%
Net interest income and interest margin (1) (3)		$ 61,593	5.48%

(1) Interest and rates calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

(2) Net interest spread represents the average yield earned on earning assets minus the average rate paid on interest-bearing liabilities.

(3) Net interest margin is computed by calculating the difference between interest income and expense (annualized), divided by the average balance of earning assets.

	For the three months ended September 30, 2008		
	Average Balance	Interest Income/ Expense	Rates Earned/ Paid
	(In thousands)		
Assets:			
Money market assets and funds sold	$ 840	$ 1	0.47%
Investment securities:			
Available for sale			
Taxable	164,644	1,858	4.51%
Tax-exempt (1)	194,576	3,212	6.60%
Held to maturity			
Taxable	423,088	4,671	4.42%
Tax-exempt (1)	547,593	8,536	6.24%
Loans:			
Commercial:			
Taxable	322,455	5,547	6.84%
Tax-exempt (1)	205,505	3,347	6.48%
Commercial real estate	830,001	14,516	6.96%
Real estate construction	69,216	1,070	6.15%
Real estate residential	462,004	5,604	4.85%
Consumer	525,136	7,769	5.89%
Total loans (1)	2,414,317	37,853	6.24%
Total earning assets (1)	3,745,058	$ 56,131	5.98%
Other assets	392,174		
Total assets	$ 4,137,232		
Liabilities and shareholders equity			
Deposits:			
Noninterest bearing demand	$ 1,172,953	$	
Savings and interest-bearing transaction	1,303,821	1,394	0.43%
Time less than $100,000	193,170	1,201	2.47%
Time $100,000 or more	484,396	2,365	1.94%
Total interest-bearing deposits	1,981,387	4,960	1.00%
Short-term borrowed funds	470,109	1,954	1.63%
Debt financing and notes payable	35,163	524	5.96%
Total interest-bearing liabilities	2,486,659	$ 7,438	1.19%
Other liabilities	65,487		
Shareholders equity	412,133		

Total liabilities and shareholders equity	$ 4,137,232		
Net interest spread (1) (2)			4.79%
Net interest income and interest margin (1) (3)		$ 48,693	5.19%

(1) Interest and rates calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

(2) Net interest spread represents the average yield earned on earning assets minus the average rate paid on interest-bearing liabilities.

(3) Net interest margin is computed by calculating the difference between interest income and expense (annualized), divided by the average balance of earning assets.

Table of Contents

	For the nine months ended September 30, 2009		
	Average Balance	Interest Income/ Expense	Rates Earned/ Paid
	(In thousands)		
Assets:			
Money market assets and funds sold	$ 942	$ 3	0.43%
Investment securities:			
Available for sale			
Taxable	242,125	6,775	3.73%
Tax-exempt (1)	170,519	8,591	6.72%
Held to maturity			
Taxable	332,416	11,384	4.57%
Tax-exempt (1)	534,132	25,219	6.30%
Loans:			
Commercial:			
Taxable	644,107	27,565	5.72%
Tax-exempt (1)	188,479	9,351	6.63%
Commercial real estate	1,289,190	63,354	6.57%
Real estate construction	77,677	2,286	3.93%
Real estate residential	440,975	15,802	4.78%
Consumer	621,034	28,018	6.03%
Total loans (1)	3,261,462	146,376	6.00%
Total earning assets (1)	4,541,596	$ 198,348	5.83%
Other assets	571,763		
Total assets	$ 5,113,359		
Liabilities and shareholders equity			
Deposits:			
Noninterest bearing demand	$ 1,330,495	$	
Savings and interest-bearing transaction	1,647,624	3,635	0.29%
Time less than $100,000	466,175	2,550	0.73%
Time $100,000 or more	622,168	5,340	1.15%
Total interest-bearing deposits	2,735,967	11,525	0.56%
Short-term borrowed funds	424,362	2,286	0.72%
Debt financing and notes payable	26,584	1,267	6.35%
Total interest-bearing liabilities	3,186,913	$ 15,078	0.63%
Other liabilities	68,316		
Shareholders equity	527,635		

Total liabilities and shareholders equity	$ 5,113,359		
Net interest spread (1) (2)			5.20%
Net interest income and interest margin (1) (3)		$ 183,270	5.39%

(1) Interest and rates calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

(2) Net interest spread represents the average yield earned on earning assets minus the average rate paid on interest-bearing liabilities.

(3) Net interest margin is computed by calculating the difference between interest income and expense (annualized), divided by the average balance of earning assets.

Table of Contents

	For the nine months ended September 30, 2008		
	Average Balance	Interest Income/ Expense	Rates Earned/ Paid
	(In thousands)		
Assets:			
Money market assets and funds sold	$ 948	$ 3	0.42%
Investment securities:			
Available for sale			
Taxable	227,227	7,281	4.27%
Tax-exempt (1)	209,365	11,067	7.05%
Held to maturity			
Taxable	444,314	14,682	4.41%
Tax-exempt (1)	553,544	25,806	6.22%
Loans:			
Commercial:			
Taxable	316,018	17,194	7.27%
Tax-exempt (1)	211,221	10,319	6.53%
Commercial real estate	841,391	44,442	7.06%
Real estate construction	80,473	4,143	6.88%
Real estate residential	469,952	17,021	4.83%
Consumer	524,519	23,100	5.88%
Total loans (1)	2,443,574	116,219	6.35%
Total earning assets (1)	3,878,972	$ 175,058	6.02%
Other assets	396,685		
Total assets	$ 4,275,657		
Liabilities and shareholders equity			
Deposits:			
Noninterest bearing demand	$ 1,186,443	$	
Savings and interest-bearing transaction	1,309,921	4,627	0.47%
Time less than $100,000	194,305	4,144	2.85%
Time $100,000 or more	492,724	8,840	2.40%
Total interest-bearing deposits	1,996,950	17,611	1.18%
Short-term borrowed funds	582,564	9,360	2.11%
Debt financing and notes payable	36,210	1,680	6.19%
Total interest-bearing liabilities	2,615,724	$ 28,651	1.46%
Other liabilities	67,246		
Shareholders equity	406,244		

Total liabilities and shareholders equity	$ 4,275,657		
Net interest spread (1) (2)			4.56%
Net interest income and interest margin (1) (3)		$ 146,407	5.04%

(1) Interest and rates calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

(2) Net interest spread represents the average yield earned on earning assets minus the average rate paid on interest-bearing liabilities.

(3) Net interest margin is computed by calculating the difference between interest income and expense (annualized), divided by the average balance of earning assets.

Table of Contents

Summary of Changes in Interest Income and Expense due to Changes in Average Asset & Liability Balances and Yields Earned & Rates Paid

The following tables set forth a summary of the changes in interest income and interest expense due to changes in average asset and liability balances (volume) and changes in average interest rates for the periods indicated. Changes not solely attributable to volume or rates have been allocated in proportion to the respective volume and rate components.

	Three months ended September 30, 2009 compared with Three months ended September 30, 2008		
	Volume	**Rate**	**Total**
	(In thousands)		
Interest and fee income:			
Money market assets and funds sold	$ 0	$ 0	$ 0
Investment securities:			
Available for sale			
Taxable	750	(256)	494
Tax-exempt (1)	(462)	96	(366)
Held to maturity			
Taxable	(1,620)	(26)	(1,646)
Tax-exempt (1)	(340)	94	(246)
Loans:			
Commercial:			
Taxable	4,800	(956)	3,844
Tax-exempt (1)	(345)	30	(315)
Commercial real estate	8,151	(700)	7,451
Real estate construction	80	(483)	(403)
Real estate residential	(449)	(151)	(600)
Consumer	1,528	221	1,749
Total loans (1)	13,765	(2,039)	11,726
Total increase (decrease) in interest and fee income (1)	12,093	(2,131)	9,962
Interest expense:			
Deposits:			
Savings and interest-bearing transaction	347	(563)	(216)
Time less than $100,000	940	(1,312)	(372)
Time $100,000 or more	407	(1,506)	(1,099)
Total interest-bearing deposits	1,694	(3,381)	(1,687)
Short-term borrowed funds	(486)	(663)	(1,149)
Debt financing and notes payable	(134)	32	(102)
Total increase (decrease) in interest expense	1,074	(4,012)	(2,938)

Increase in Net Interest Income (1)	$	11,019	$	1,881	$	12,900

(1) Amounts calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

- 34 -

Table of Contents

	Nine months ended September 30, 2009 compared with Nine months ended September 30, 2008		
	Volume	**Rate**	**Total**
	(In thousands)		
Interest and fee income:			
Money market assets and funds sold	$ 0	$ 0	$ 0
Investment securities:			
Available for sale			
Taxable	439	(945)	(506)
Tax-exempt (1)	(1,983)	(493)	(2,476)
Held to maturity			
Taxable	(3,818)	520	(3,298)
Tax-exempt (1)	(935)	348	(587)
Loans:			
Commercial:			
Taxable	14,655	(4,284)	10,371
Tax-exempt (1)	(1,139)	171	(968)
Commercial real estate	22,130	(3,218)	18,912
Real estate construction	(147)	(1,710)	(1,857)
Real estate residential	(1,048)	(171)	(1,219)
Consumer	4,311	607	4,918
Total loans (1)	38,762	(8,605)	30,157
Total increase (decrease) in interest and fee income (1)	32,465	(9,175)	23,290
Interest expense:			
Deposits:			
Savings and interest-bearing transaction	646	(1,638)	(992)
Time less than $100,000	2,302	(3,896)	(1,594)
Time $100,000 or more	1,496	(4,996)	(3,500)
Total interest-bearing deposits	4,444	(10,530)	(6,086)
Short-term borrowed funds	(1,481)	(5,593)	(7,074)
Debt financing and notes payable	(325)	(88)	(413)
Total increase (decrease) in interest expense	2,638	(16,211)	(13,573)
Increase in Net Interest Income (1)	$ 29,827	$ 7,036	$ 36,863

(1)

Amounts calculated on a fully taxable equivalent basis using the current statutory federal tax rate.

Provision for Loan Lossess

The Company manages credit costs by consistently enforcing conservative underwriting and administration procedures and aggressively pursuing collection efforts with troubled debtors. County loans purchased from the FDIC are covered by loss-sharing agreements the Company entered with the FDIC. Further, the Company recorded the purchased County loans at estimated fair value upon acquisition as of February 6, 2009. Due to the loss-sharing agreements and February 6, 2009 fair value recognition, the Company did not record a provision for loan losses during the first nine months of 2009 related to covered loans. The Company provided $2.8 million for loan losses related to non-covered loans in the third quarter of 2009, compared with $600 thousand in the third quarter of 2008. For the first nine months of 2009 and 2008, $7.2 million and $1.8 million were provided in each respective period. The provision reflects Management s assessment of credit risk and the appropriate level of the allowance for loan losses for each of the periods presented. For further information regarding credit risk, the FDIC loss-sharing agreements, net credit losses and the allowance for loan losses, see the Classified Assets, Nonperforming Assets, and Allowance for Credit Losses section of this report.

Table of Contents

Noninterest Income

The following table summarizes the components of noninterest income (loss) for the periods indicated.

	Three months ended September 30,		Nine months ended September 30,	
	2009	**2008**	**2009**	**2008**
	(In thousands)			
Service charges on deposit accounts	$ 9,479	$ 7,555	$ 27,017	$ 22,379
Merchant credit card fees	2,163	2,611	6,818	7,903
Debit card fees	1,267	970	3,656	2,852
ATM fees and interchange	965	756	2,792	2,238
Other service fees	558			

Prohibited Transactions

As discussed above, we will be subject to a 100% U.S. federal income tax on any net income derived from "prohibited transactions." Net income derived from prohibited transactions arises from the sale or exchange of property held for sale to customers in the ordinary course of our business which is not foreclosure property. There is an exception to this rule for the sale of property that:

- is a real estate asset under the 75% Asset Test;
- generally has been held for at least two years;
- has aggregate expenditures which are includable in the basis of the property not in excess of 30% of the net selling price;
- in some cases, was held for production of rental income for at least two years;
- in some cases, substantially all of the marketing and development expenditures were made through an independent contractor; and
- when combined with other sales in the year, either does not cause the REIT to have made more than seven sales of property during the taxable year (excluding sales of foreclosure property or in connection with an involuntary conversion), occurs in a year when the REIT disposes of less than 10% of its assets (measured by U.S. federal income tax basis or fair market value, and ignoring involuntary dispositions and sales of foreclosure property), or occurs in a year when the REIT disposes of less than 20% of its assets as well as 10% or less of its assets based on a 3 year average (measured by U.S. federal income tax basis or fair market value, and ignoring involuntary dispositions and sales of foreclosure property).

Although we currently intend to sell each of the properties, our primary intention in acquiring and operating the properties is the production of rental income, and we do not expect to hold any property for sale to customers in the ordinary course of our business. The 100% tax will not apply to gains from the sale of property that is held through a TRS or other taxable corporation, although such income will be subject to tax in the hands of the corporation at regular corporate income tax rates. As a general matter, any condominium conversions we might undertake must satisfy these restrictions to avoid being "prohibited transactions," which will limit the annual number of transactions. See "— REIT Qualification Tests — Ownership of Interests in TRSs."

Excess Inclusion Income

Pursuant to IRS guidance, a REIT's excess inclusion income, including any excess inclusion income from a residual interest in a REMIC, must be allocated among its stockholders in proportion to dividends paid. The REIT is required to notify stockholders of the amount of "excess inclusion income" allocated to them. A stockholder's share of excess inclusion income:

- cannot be offset by any net operating losses otherwise available to the stockholder;
- is subject to tax as UBTI in the hands of most types of stockholders that are otherwise generally exempt from U.S. federal income tax; and
-

results in the application of U.S. federal income tax withholding at the maximum rate (30%), without reduction for any otherwise applicable income tax treaty or other exemption, to the extent allocable to most types of foreign stockholders.

Pursuant to IRS guidance, to the extent that excess inclusion income is allocated to a tax exempt stockholder of a REIT that is not subject to unrelated business taxable income (such as a government entity or charitable remainder trust), the REIT may be subject to tax on this income at the highest applicable corporate tax rate (currently 35%). In that case, the REIT could reduce distributions to such stockholders by the amount of such tax paid by the REIT attributable to such stockholder's ownership. Treasury Regulations provide that such a reduction in distributions does not give rise to a preferential dividend that could adversely affect the REIT's compliance with its distribution requirements. See "— Annual

68

Distribution Requirements." The manner in which excess inclusion income is calculated, or would be allocated to stockholders, including allocations among shares of different classes of stock, is not clear under current law. As required by IRS guidance, we intend to make such determinations using a reasonable method. Tax-exempt investors, foreign investors and taxpayers with net operating losses should carefully consider the tax consequences described above, and are urged to consult their tax advisors.

Characterization of Property Leases

We may purchase either new or existing properties and lease them to tenants. Our ability to claim certain tax benefits associated with ownership of these properties, such as depreciation, would depend on a determination that the lease transactions are true leases, under which we would be the owner of the leased property for U.S. federal income tax purposes, rather than a conditional sale of the property or a financing transaction. A determination by the IRS that we are not the owner of any properties for U.S. federal income tax purposes may have adverse consequences to us, such as the denial of depreciation deductions (which could affect the determination of our REIT taxable income subject to the distribution requirements) or the aggregate value of our assets invested in real estate (which could affect REIT asset testing).

Tax Aspects of Investments in Partnerships

General. We currently hold and anticipate holding direct or indirect interests in one or more partnerships, including our Operating Partnership. We operate as an Umbrella Partnership REIT, or UPREIT, which is a structure whereby we own a direct interest in our Operating Partnership and our Operating Partnership, in turn, owns the properties and may possibly own interests in other non-corporate entities that own properties. Such non-corporate entities would generally be organized as limited liability companies, partnerships or trusts and would either be disregarded for U.S. federal income tax purposes (if our Operating Partnership were the sole owner) or treated as partnerships for U.S. federal income tax purposes.

The following is a summary of the U.S. federal income tax consequences of our investment in our Operating Partnership if our Operating Partnership is treated as a partnership for U.S. federal income tax purposes. This discussion should also generally apply to any investment by us in a property partnership or other non-corporate entity.

A partnership (that is not a publicly traded partnership taxed as a corporation) is not subject to tax as an entity for U.S. federal income tax purposes. Rather, partners are allocated their allocable share of the items of income, gain, loss, deduction and credit of the partnership, and are potentially subject to tax thereon, without regard to whether the partners receive any distributions from the partnership. We are required to take into account our allocable share of the foregoing items for purposes of the various REIT gross income and asset tests, and in the computation of our REIT taxable income and U.S. federal income tax liability. Furthermore, there can be no assurance that distributions from our Operating Partnership will be sufficient to pay the tax liabilities resulting from an investment in our Operating Partnership.

Generally, an entity with two or more members formed as a partnership or limited liability company under state law will be taxed as a partnership for U.S. federal income tax purposes unless it specifically elects otherwise. Because our Operating Partnership was formed as a partnership under state law, for U.S. federal income tax purposes, our Operating Partnership will be treated as a partnership if it has two or more partners, or as a disregarded entity if it is treated as having one partner. We intend that interests in our Operating Partnership (and any partnership invested in by our Operating Partnership) will fall within one of the "safe harbors" for the partnership to avoid being classified as a publicly traded partnership. However, our ability to satisfy the requirements of some of these safe harbors depends on the results of actual operations and accordingly, no assurance can be given that any such partnership will at all times satisfy one of such safe harbors. We reserve the right to not satisfy any safe harbor. Even if a partnership is a publicly traded partnership, it generally will not be treated as a corporation if at least 90% of its gross income each taxable year is from certain sources, which generally include rents from real property and other types of passive income. We believe that our Operating Partnership has had, and will have, sufficient qualifying income so that it would be taxed as a partnership, even if it were treated as a publicly traded partnership.

If for any reason our Operating Partnership (or any partnership invested in by our Operating Partnership) is taxable as a corporation for U.S. federal income tax purposes, the character of our assets and items of gross income would change, and as a result, we would most likely be unable to satisfy the applicable REIT requirements under U.S. federal

69

income tax laws discussed above. In addition, any change in the status of any partnership may be treated as a taxable event, in which case we could incur a tax liability without a related cash distribution. Furthermore, if any partnership were treated as a corporation, items of income, gain, loss, deduction and credit of such partnership would be subject to corporate income tax, and the partners of any such partnership would be treated as stockholders, with distributions to such partners being treated as dividends.

Anti-abuse Treasury Regulations have been issued under the partnership provisions of the Code that authorize the IRS, in some abusive transactions involving partnerships, to disregard the form of a transaction and recast it as it deems appropriate. The anti-abuse regulations apply where a partnership is utilized in connection with a transaction (or series of related transactions) with a principal purpose of substantially reducing the present value of the partners' aggregate U.S. federal tax liability in a manner inconsistent with the intent of the partnership provisions. The anti-abuse regulations contain an example in which a REIT contributes the proceeds of a public offering to a partnership in exchange for a general partnership interest. The limited partners contribute real property assets to the partnership, subject to liabilities that exceed their respective aggregate bases in such property. The example concludes that the use of the partnership is not inconsistent with the intent of the partnership provisions, and thus, cannot be recast by the IRS. However, the anti-abuse regulations are extraordinarily broad in scope and are applied based on an analysis of all the facts and circumstances. As a result, we cannot assure you that the IRS will not attempt to apply the anti-abuse regulations to us. Any such action could potentially jeopardize our qualification as a REIT and materially affect the tax consequences and economic return resulting from an investment in the Company.

Income Taxation of Partnerships and their Partners. Although a partnership agreement generally will determine the allocation of a partnership's income and losses among the partners, such allocations may be disregarded for U.S. federal income tax purposes under Code Section 704(b) and the Treasury Regulations. If any allocation is not recognized for U.S. federal income tax purposes, the item subject to the allocation will be reallocated in accordance with the partners' economic interests in the partnership. We believe that the allocations of taxable income and loss in our Operating Partnership agreement comply with the requirements of Code Section 704(b) and the Treasury Regulations.

In some cases, special allocations of net profits or net losses will be required to comply with the U.S. federal income tax principles governing partnership tax allocations. Additionally, pursuant to Code Section 704(c), income, gain, loss and deduction attributable to property contributed to our Operating Partnership in exchange for units must be allocated in a manner so that the contributing partner is charged with, or benefits from, the unrealized gain or loss attributable to the property at the time of contribution. The amount of such unrealized gain or loss is generally equal to the difference between the fair market value and the adjusted basis of the property at the time of contribution. These allocations are designed to eliminate book-tax differences by allocating to contributing partners lower amounts of depreciation deductions and increased taxable income and gain attributable to the contributed property than would ordinarily be the case for economic or book purposes. With respect to any property purchased by our Operating Partnership, such property generally will have an initial tax basis equal to its fair market value, and accordingly, Code Section 704(c) will not apply, except as described further below in this paragraph. The application of the principles of Code Section 704(c) in tiered partnership arrangements is not entirely clear. Accordingly, the IRS may assert a different allocation method than the one selected by our Operating Partnership to cure any book-tax differences. In certain circumstances, we create book-tax differences by adjusting the values of properties for economic or book purposes, and generally the rules of Code Section 704(c) would apply to such differences as well.

For U.S. federal income tax purposes, depreciation deductions on residential rental buildings, structural components and improvements generally are computed using the straight line method over 27.5 years. Shorter depreciation periods apply to other properties. Some improvements to land are depreciated over 15 years. However, we have elected to have the alternative depreciation system apply to our properties with the result that residential rental buildings, structural components and improvements are depreciated using the straight-line method over 40 years and some improvements to land are depreciated using the straight-line method over 20 years. For properties contributed to our Operating Partnership, depreciation deductions are calculated based on the transferor's basis and depreciation method. Because depreciation deductions are based on the transferor's basis in the contributed property, our Operating Partnership generally would be entitled to less depreciation than if the properties were purchased in a taxable transaction. The burden of lower depreciation generally will fall first on the contributing partner, but also may reduce

the depreciation allocated to other partners.

Gain on the sale or other disposition of depreciable property is characterized as ordinary income (rather than capital gain) to the extent of any depreciation recapture. Buildings and improvements depreciated under the straight-line method of depreciation are generally not subject to depreciation recapture unless the property was held for less than one year. However, individuals, trusts and estates that hold shares either directly or through a pass-through entity may be subject to tax on the disposition on such assets at a rate of 25% rather than at the normal capital gains rate, to the extent that such assets have been depreciated.
Some expenses incurred in the conduct of our Operating Partnership's activities may not be deducted in the year they were paid. To the extent this occurs, the taxable income of our Operating Partnership may exceed its cash receipts for the year in which the expense is paid. As discussed above, the costs of acquiring properties must generally be recovered through depreciation deductions over a number of years. Prepaid interest and loan fees, and prepaid management fees, are other examples of expenses that may not be deducted in the year they were paid.
Taxation of U.S. Holders
The following section applies to you only if you are a U.S. Holder. Generally, for purposes of this discussion, a "U.S. Holder" is a person (other than a partnership or entity treated as a partnership for U.S. federal income tax purposes) that is, for U.S. federal income tax purposes:

- an individual citizen or resident of the United States for U.S. federal income tax purposes;
- a corporation, or other entity taxable as a corporation, created or organized in or under the laws of the United States, any state thereof or the District of Columbia;
- an estate the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust if (1) a court within the United States is able to exercise primary supervision over its administration and one or more U.S. persons have the authority to control all substantial decisions of the trust or (2) the trust has a valid election in effect under current Treasury Regulations to be treated as a U.S. person.

If a partnership or entity treated as a partnership for U.S. federal income tax purposes holds mShares, the U.S. federal income tax treatment of a partner generally will depend upon the status of the partner and the activities of the partnership. A partner of a partnership holding mShares or shares of our common stock should consult his, her or its own tax advisor regarding the U.S. federal income tax consequences to the partner of the acquisition, ownership and disposition of such mShares or shares of our common stock by the partnership.
mShares and Common Stock. As long as we continue to qualify as a REIT, distributions (including any deemed distributions) paid to our U.S. Holders out of current or accumulated earnings and profits (and not designated as capital gain dividends or qualified dividend income) will be ordinary income. Distributions in excess of current and accumulated earnings and profits are treated first as a tax-deferred return of capital to the U.S. Holder, reducing the U.S. Holder's tax basis in his, her or its stock by the amount of such distribution, but not below zero, and then as capital gain. Because our earnings and profits are reduced for depreciation and other non-cash items, it is possible that a portion of each distribution will constitute a tax-deferred return of capital. Additionally, because distributions in excess of earnings and profits reduce the U.S. Holder's basis in our stock, this will increase the U.S. Holder's gain, or reduce the U.S. Holder's loss, on any subsequent sale of the stock.
Distributions that are designated as capital gain dividends will be taxed as long-term capital gain to the extent they do not exceed our actual net capital gain for the taxable year, without regard to the period for which the U.S. Holder that receives such distribution has held its stock. However, corporate U.S. Holders may be required to treat up to 20% of some types of capital gain dividends as ordinary income. We also may decide to retain, rather than distribute, our net capital gain and pay any tax thereon. In such instances, U.S. Holders would include their proportionate shares of such gain in income as long-term capital gain, receive a credit on their returns for their proportionate share of our tax payments, and increase the tax basis of their shares of stock by the after-tax amount of such gain.
With respect to U.S. Holders who are taxed at the rates applicable to individuals, we may elect to designate a portion of our distributions (including any deemed distributions) paid to such U.S. Holders as "qualified dividend income." A portion of a distribution that is properly designated as qualified dividend income is taxable to non-corporate U.S. Holders as capital gain; provided, that the U.S. Holder has held the stock with respect to which the distribution is made for more than 60 days during the 121-day period beginning on the date that is 60 days before the date on which such stock became

71

ex-dividend with respect to the relevant distribution. The maximum amount of our distributions eligible to be designated as qualified dividend income for a taxable year is equal to the sum of:

(1) the qualified dividend income received by us during such taxable year from C corporations (including any TRSs);

(2) the excess of any "undistributed" REIT taxable income recognized during the immediately preceding year over the U.S. federal income tax paid by us with respect to such undistributed REIT taxable income; and

(3) the excess of any income recognized during the immediately preceding year attributable to the sale of a built-in gain asset that was acquired in a carry-over basis transaction from a non REIT corporation or had appreciated at the time our REIT election became effective over the U.S. federal income tax paid by us with respect to such built-in gain.

Generally, dividends that we receive will be treated as qualified dividend income for purposes of (1) above if the dividends are received from a regular domestic C corporation, such as any TRSs, and specified holding period and other requirements are met.

Dividend income is characterized as "portfolio" income under the passive loss rules and cannot be offset by a U.S. Holder’s current or suspended passive losses. Corporate U.S. Holders cannot claim the dividends received deduction for such dividends unless we lose our REIT qualification. Although U.S. Holders generally will recognize taxable income in the year that a distribution is received, any distribution that we declare in October, November or December of any year that is payable to a U.S. Holder of record on a specific date in any such month will be treated as both paid by us and received by the U.S. Holder on December 31st of the year it was declared even if paid by us during January of the following calendar year. Because we are not a pass-through entity for U.S. federal income tax purposes, U.S. Holders may not use any of our operating or capital losses to reduce their tax liabilities.

We have the ability to declare a large portion of a dividend in shares of our stock. As long as a portion of such dividend is paid in cash (which portion can be as low as 20%) and certain requirements are met, the entire distribution will be treated as a dividend for U.S. federal income tax purposes. As a result, U.S. Holders will be taxed on 100% of the dividend in the same manner as a cash dividend, even though most of the dividend was paid in shares of our stock. In general, any dividend on shares of our preferred stock will be taxable as a dividend, regardless of whether any portion is paid in stock.

In general, the sale of our stock held for more than 12 months will produce long-term capital gain or loss. All other sales will produce short-term gain or loss. In each case, the gain or loss is equal to the difference between the amount of cash and fair market value of any property received from the sale and the U.S. Holder’s basis in the stock sold. However, any loss from a sale or exchange of stock by a U.S. Holder who has held such stock for six months or less generally will be treated as a long-term capital loss, to the extent that the U.S. Holder treated our distributions as long-term capital gain. The use of capital losses is subject to limitations.

If excess inclusion income from a REMIC residual interest is allocated to any U.S. Holder, that income will be taxable in the hands of the Holder and would not be offset by any net operating losses of the U.S. Holder that would otherwise be available. As required by IRS guidance, we intend to notify our U.S. Holders if a portion of a dividend paid by us is attributable to excess inclusion income.

Currently, the maximum tax rate applicable to individuals and certain other noncorporate taxpayers on net capital gain recognized on the sale or other disposition of shares is 20%, and the maximum marginal tax rate applicable to them on dividends received from corporations that are subject to a corporate level of tax is reduced from the rate applicable on ordinary dividends to the rate applicable on net capital gain if certain holding period requirements are also satisfied. Except in limited circumstances, with respect to "qualified dividend income" as discussed above, this reduced tax rate will not apply to dividends paid by us.

Cost Basis Reporting. U.S. federal income tax information reporting rules may apply to certain transactions in our shares. Where such rules apply, the "cost basis" calculated for the shares involved will be reported to the IRS and to you. Generally these rules apply to all shares purchased. For "cost basis" reporting purposes, you may identify by lot the shares that you transfer or that are redeemed, but if you do not timely notify us of your election, we will identify the shares that are

transferred or redeemed on a "first in/first out" basis. The shares in the Distribution Reinvestment Plan are also eligible for the "average cost" basis method, should you so elect.

Information reporting (transfer statements) on other transactions may also be required under these rules. Generally, these reports are made for certain transactions. Transfer statements are issued between "brokers" and are not issued to the IRS or to you.

Stockholders should consult their tax advisors regarding the consequences of these rules.

Backup Withholding and Information Reporting. We will report to our U.S. Holders and the IRS the amount of dividends (including deemed dividends) paid during each calendar year and the amount (if any) of U.S. federal income tax we withhold. Under the backup withholding rules, a U.S. Holder may be subject to backup withholding at the current rate of 28% with respect to dividends (including any deemed dividends) paid unless the U.S. Holder (1) is a corporation or comes within other exempt categories and, when required, demonstrates this fact, or (2) provides us with a taxpayer identification number or social security number, certifies under penalties of perjury that such number is correct and that such U.S. Holder is not subject to backup withholding and otherwise complies with applicable requirements of the backup withholding rules. A U.S. Holder that does not provide his, her or its correct taxpayer identification number or social security number also may be subject to penalties imposed by the IRS. In addition, we may be required to withhold a portion of capital gain distribution to any U.S. Holder who fails to certify his, her or its non-foreign status. See the " — Taxation of Non-U.S. Holders" portion of this section.

Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules may be allowed as a refund or a credit against such U.S. Holder’s U.S. federal income tax liability, provided the required information is furnished to the IRS.

Taxation of Tax-Exempt Holders

U.S. tax-exempt entities, including qualified employee pension and profit sharing trusts and individual retirement accounts, generally are exempt from U.S. federal income taxation. However, they are subject to taxation on their unrelated business taxable income, or UBTI. While many investments in real estate may generate UBTI, the IRS has ruled that dividend distributions from a REIT to a tax-exempt entity do not constitute UBTI. Based on that ruling, our distributions to a U.S. Holder that is a domestic tax-exempt entity should not constitute UBTI unless such U.S. Holder borrows funds (or otherwise incurs acquisition indebtedness within the meaning of the Code) to acquire its shares of common stock, or the shares of common stock are otherwise used in an unrelated trade or business of the tax-exempt entity. Furthermore, even in the absence of acquisition debt, part or all of the income or gain recognized with respect to our stock held by certain domestic tax-exempt entities, including social clubs, voluntary employee benefit associations, supplemental unemployment benefit trusts and qualified group legal service plans (all of which are exempt from U.S. federal income taxation under Code Sections 501(c)(7), (9), (17) or (20)), may be treated as UBTI.

Special rules apply to the ownership of REIT shares by some tax-exempt pension trusts. If we would be "closely held" (discussed above with respect to the share ownership tests) because the stock held by tax-exempt pension trusts was viewed as being held by the trusts rather than by their respective beneficiaries, tax-exempt pension trusts owning more than 10% by value of our stock may be required to treat a percentage of our dividends as UBTI. This rule applies if: (i) at least one tax-exempt pension trust owns more than 25% by value of our shares, or (ii) one or more tax-exempt pension trusts (each owning more than 10% by value of our shares) hold in the aggregate more than 50% by value of our shares. The percentage treated as UBTI is our gross income (less direct expenses) derived from an unrelated trade or business (determined as if we were a tax-exempt pension trust) divided by our gross income from all sources (less direct expenses). If this percentage is less than 5%, however, none of the dividends will be treated as UBTI. Because of the restrictions in our charter regarding the ownership concentration of our stock, we believe that a tax-exempt pension trust should not become subject to these rules. However, because our shares of common stock are publicly traded, we can give no assurance of this.

Prospective tax-exempt purchasers should consult their own tax advisors and financial planners as to the applicability of these rules and consequences to their particular circumstances.

Taxation of Non-U.S. Holders

General. The rules governing the U.S. federal income taxation of Non-U.S. Holders are complex, and as such, only a summary of such rules is provided in this prospectus. Non-U.S. investors should consult with their own tax advisors and financial planners to determine the impact that U.S. federal, state and local income tax or similar laws will have on such investors as a result of an investment in our REIT. A Non-U.S. Holder means a person (other than a partnership or entity treated as a partnership for U.S. federal income tax purposes) that is not a U.S. Holder.
Distributions — In General. Distributions paid by us that are not attributable to gain from our sales or exchanges of "U.S. real property interests," or USRPIs, and not designated by us as capital gain dividends will be treated as dividends of ordinary income to the extent that they are made out of our current or accumulated earnings and profits. Such ordinary dividends to Non-U.S. Holders are subject to a 30% tax unless an applicable treaty reduces or eliminates that tax, which is collected through withholding at the time the distribution is made. Under some treaties, however, lower rates generally applicable to dividends do not apply to dividends from REITs. Any constructive dividends on the mShares also would be subject to U.S. federal withholding tax to the same extent as an actual distribution. Because constructive dividends would not give rise to any cash from which any applicable withholding tax could be satisfied, we may withhold the U.S. federal tax on such dividend from cash proceeds otherwise payable to a Non-U.S. Holder.
If income from the investment in our shares of common stock is treated as effectively connected with the Non-U.S. Holder’s conduct of a U.S. trade or business, the Non-U.S. Holder generally will be subject to a tax at the graduated rates applicable to ordinary income, in the same manner as U.S. Holders are taxed with respect to such dividends (and also may be subject to the 30% branch profits tax in the case of a Non-U.S. Holder that is a foreign corporation that is not entitled to any treaty exemption). In general, Non-U.S. Holders will not be considered to be engaged in a U.S. trade or business solely as a result of their ownership of our stock. Distributions in excess of our current and accumulated earnings and profits will not be taxable to a Non-U.S. Holder to the extent they do not exceed the adjusted basis of the Non-U.S. Holder’s shares. Instead, they will reduce the adjusted basis of such shares. To the extent that such distributions exceed the adjusted basis of a Non-U.S. Holder’s shares, they will give rise to tax liability if the Non-U.S. Holder would otherwise be subject to tax on any gain from the sale or disposition of his shares, as described in the "— Sales of Shares" portion of this Section below.
Distributions Attributable to Sale or Exchange of Real Property. Pursuant to the Foreign Investors in Real Property Tax Act of 1980, or FIRPTA, distributions that are attributable to gain from our sales or exchanges of USRPIs will be taxed to a Non-U.S. Holder as if such gain were effectively connected with a U.S. trade or business. Non-U.S. Holders would thus be taxed at the normal capital gain rates applicable to U.S. Holders, and would be subject to applicable alternative minimum tax and a special alternative minimum tax in the case of nonresident alien individuals. For these purposes, however, a distribution is not attributable to gain from sales or exchanges by us of a USRPI if we held the underlying asset solely as a creditor, although the holding of a shared appreciation mortgage loan, for example, would not be solely as a creditor. Also, such distributions may be subject to a 30% branch profits tax in the hands of a corporate Non-U.S. Holder not entitled to any treaty exemption. However, generally, pursuant to FIRPTA, a capital gain dividend from a REIT is not treated as effectively connected income for a Non-U.S. Holder if: (i) the distribution is received with respect to a class of stock that is regularly traded on an established securities market located in the U.S.; and (ii) the Non-U.S. Holder does not own more than 10% of the class of stock at any time during the one-year period ending on the date of such distribution. Distributions that qualify for this exception are subject to withholding tax in the manner described above as dividends of ordinary income. We anticipate that our shares of common stock will be "regularly traded" on an established securities market, although, no assurance can be given that this will be the case.
U.S. Federal Income Tax Withholding on Distributions. For U.S. federal income tax withholding purposes, we generally will withhold tax at the rate of 30% on the gross amount of any distribution (other than distributions designated as capital gain dividends) made to a Non-U.S. Holder, unless the Non-U.S. Holder provides us with appropriate documentation (i) evidencing that such Non-U.S. Holder is eligible for an exemption or reduced rate under an applicable income tax treaty, generally an IRS Form W-8BEN (in which case we will withhold at the lower treaty rate), or (ii) claiming that the dividend is effectively connected with the Non-U.S. Holder’s conduct of a trade or business within the U.S., generally an IRS Form W-8ECI (in which case we will not withhold tax). We are also generally required to withhold tax at the rate of 35% on the portion of any dividend to a Non-U.S. Holder that is or

could be designated by us as a capital gain dividend, to the extent attributable to gain on a sale or exchange of an interest in U.S. real property. Such withheld amounts of tax do not represent actual tax liabilities, but rather, represent payments in respect of those tax liabilities described above. Therefore, such withheld amounts are creditable by the Non-U.S. Holder against its actual U.S. federal income tax liabilities, including those described above. The Non-U.S. Holder would be entitled to a refund of any amounts

74

withheld in excess of such Non-U.S. Holder’s actual U.S. federal income tax liabilities, provided that the Non-U.S. Holder files applicable returns or refund claims with the IRS.

Sales of Shares. Gain recognized by a Non-U.S. Holder upon a sale of shares that is not otherwise subject to U.S. federal income taxation under FIRPTA, generally will not be subject to U.S. federal income taxation, provided that: (i) such gain is not effectively connected with the conduct by such Non-U.S. Holder of a trade or business within the U.S.; (ii) the Non-U.S. Holder is an individual and is not present in the U.S. for 183 days or more during the taxable year and certain other conditions apply; and (iii) (A) our REIT is "domestically controlled," which generally means that less than 50% in value of our shares continues to be held directly or indirectly by foreign persons during a continuous five-year period ending on the date of disposition or, if shorter, during the entire period of our existence, or (B) the class of shares being sold are "regularly traded" on an established securities market and the selling Non-U.S. Holder has not held more than 10% of our outstanding shares of such class at any time during the five-year period ending on the date of the sale.

We believe that we qualify as "domestically controlled." If we are not domestically controlled, a Non-U.S. Holder’s sale of shares would be subject to tax, unless the class of shares being sold were regularly traded on an established securities market and the selling Non-U.S. Holder has not directly, or indirectly, owned during the five-year period ending on the date of sale more than 10% in value of such class of our shares. We anticipate that our common shares will be "regularly traded" on an established market for the foreseeable future, although no assurance can be given that this will be the case.

If the proceeds of a disposition of our securities are paid by or through a U.S. office of a broker-dealer, the payment is generally subject to information reporting and to backup withholding unless the disposing Non-U.S. Holder certifies as to its name, address and non-U.S. status or otherwise establishes an exemption. Generally, U.S. information reporting and backup withholding will not apply to a payment of disposition proceeds if the payment is made outside the U.S. through a foreign office of a foreign broker-dealer. Under Treasury Regulations, if the proceeds from a disposition of our securities paid to or through a foreign office of a U.S. broker-dealer or a non-U.S. office of a foreign broker-dealer that is (i) a "controlled foreign corporation" for U.S. federal income tax purposes, (ii) a person 50% or more of whose gross income from all sources for a three-year period was effectively connected with a U.S. trade or business, (iii) a foreign partnership with one or more partners who are U.S. persons and who, in the aggregate, hold more than 50% of the income or capital interest in the partnership, or (iv) a foreign partnership engaged in the conduct of a trade or business in the U.S., then (A) backup withholding will not apply unless the broker-dealer has actual knowledge that the owner is not a Non-U.S. Holder, and (B) information reporting will not apply if the Non-U.S. Holder certifies its non-U.S. status and further certifies that it has not been, and at the time the certificate is furnished reasonably expects not to be, present in the U.S. for a period aggregating 183 days or more during each calendar year to which the certification pertains. Prospective foreign purchasers should consult their tax advisors and financial planners concerning these rules.

Medicare Tax

Certain net investment income earned by U.S. citizens and resident aliens and certain estates and trusts is subject to a 3.8% Medicare tax. Net investment income includes, among other things, dividends on and capital gains from the sale or other disposition of shares of stock. Holders of shares of our stock should consult their tax advisors regarding the effect, if any, of this tax on their ownership and disposition of such shares.

Foreign Accounts

Withholding taxes may apply to certain types of payments made to "foreign financial institutions" (as specially defined in the Code) and certain other non-U.S. entities. A withholding tax of 30% generally will be imposed on dividends on, and gross proceeds from the sale or other disposition of, our common stock paid to (a) a foreign financial institution (as the beneficial owner or as an intermediary for the beneficial owner) unless such foreign financial institution agrees to verify, report and disclose its U.S. accountholders and meets certain other specified requirements or (b) a non-financial foreign entity (as the beneficial owner or an intermediary for the beneficial owner) unless such entity certifies that it does not have any substantial U.S. owners or furnishes identifying information regarding each substantial U.S. owner and such entity meets certain other specified requirements. Applicable Treasury Regulations and other IRS guidance provide that these rules generally will apply to payments of dividends on our common stock and generally will apply to payments of gross proceeds from a sale or other disposition of our common

stock after December 31, 2018. We will not pay any

additional amounts in respect of any amounts withheld. U.S. Holders and Non-U.S. Holders are encouraged to consult their tax advisors regarding the particular consequences to them of this legislation and guidance.

Other Tax Considerations

State, Local and Foreign Taxes. We and you may be subject to state, local or foreign taxation in various jurisdictions, including those in which we transact business or you reside. Our and your state, local and foreign tax treatment may not conform to the U.S. federal income tax consequences discussed above. Any foreign taxes incurred by us would not pass through to U.S. Holders as a credit against their U.S. federal income tax liability. You should consult your own tax advisors and financial planners regarding the effect of state, local and foreign tax laws on an investment in our securities.

Legislative Proposals. You should recognize that our and your present U.S. federal income tax treatment may be modified by legislative, judicial or administrative actions at any time, which may be retroactive in effect. The rules dealing with U.S. federal income taxation are constantly under review by Congress, the IRS and the Treasury, and statutory changes as well as promulgation of new regulations, revisions to existing statutes, and revised interpretations of established concepts occur frequently. We are not currently aware of any pending legislation that would materially affect our or your taxation as described in this prospectus. You should, however, consult your advisors concerning the status of legislative proposals that may pertain to a purchase of our securities.

PLAN OF DISTRIBUTION

General

We are offering up to a maximum of 500,000 mShares through PCS, our affiliated dealer manager, on a "reasonable best efforts" basis, which means that the dealer manager is only required to use its good faith efforts and reasonable diligence to sell the mShares and has no firm commitment or obligation to purchase any specific number or dollar amount of the mShares. Each mShare will be sold at a public offering price of $1,000 per mShare.

This offering is scheduled to terminate by [ ], 2019. Under rules promulgated by the SEC, in some circumstances we could continue this offering until as late as [ ], 2020, in our sole discretion. If we decide to continue this offering beyond [ ], 2019 we will supplement this prospectus accordingly. We may terminate this offering at anytime.

We will sell mShares using two closing services provided by the DTC. The first service is DTC Settlement and the second service is DRS Settlement. Investors purchasing mShares through DTC Settlement will coordinate with their registered representatives to pay the full purchase price for their mShares by the settlement date, and such payments will not be held in escrow. Investors who are permitted to utilize the DRS Settlement method will complete and sign subscription agreements, which will be delivered to the escrow agent, UMB Bank N.A. In addition, such investors will pay the full purchase price for their mShares to the escrow agent (as set forth in the subscription agreement), to be held in trust for the investors’ benefit pending release to us as described herein. See "— Settlement Procedures" for a description of the closing procedures with respect to each of the closing methods.

PCS is a securities broker-dealer registered with the SEC and a member firm of FINRA. PCS is affiliated with us and our Manager. The principal business address of PCS is 3284 Northside Parkway, NW, Suite 150, Atlanta, GA 30327.

Compensation of Dealer Manager and Participating Broker-Dealers

We will pay to PCS up to and including 3% of the gross offering proceeds from this offering as compensation for acting as dealer manager. As dealer manager, PCS, will manage, direct and supervise its associated persons who will be wholesalers in connection with the offering. The combined dealer manager fee and properly documented expenses associated with the offer, sale or distribution of the mShares, which are paid by or reimbursed by the Company and are deemed components of underwriting compensation under this offering will not exceed FINRA's 10% cap under FINRA Rule 2310(b)(4)(B)(ii), which we refer to as FINRA's 10% cap. Our dealer manager will repay to the Company any excess payments made to our dealer manager over FINRA's 10% cap if this offering is abruptly terminated before reaching the maximum amount of offering proceeds. We will not pay referral or similar fees to any accountants, attorneys or other persons in connection with the distribution of the mShares.

We expect PCS to authorize other broker-dealers that are members of FINRA, which we refer to as participating broker-dealers, to sell our mShares. PCS may also reallow a portion of its dealer manager fee earned on the proceeds raised by a participating broker-dealer, to such participating broker-dealer as a marketing fee. We will not sell mShares to participating broker-dealers for their own account, their retirement plans, their representatives and family members, IRAs and the qualified plans of their representatives until 90 days after our registration statement is declared effective by the SEC. The amount of the marketing fee to be reallowed to any participating broker-dealer will be determined by the dealer manager in its sole discretion and include such factors as:

- the volume of sales estimated to be made by the participating broker-dealer; or

- the participating broker-dealer’s agreement to provide one or more of the following services:

- providing internal marketing support personnel and marketing communications vehicles to assist the dealer manager in our promotion;

- responding to investors' inquiries concerning monthly statements, valuations, distribution rates, tax information, annual reports, redemption rights and procedures, our financial status, and the markets in which we have invested;

- assisting investors with redemptions; or
- providing other services requested by investors from time to time and maintaining the technology necessary to adequately service investors.

PCS, as our dealer manager, provides services to us, which include conducting broker-dealer seminars, holding informational meetings and providing information and answering any questions concerning this offering. We pay PCS a dealer manager fee of up to and including 3.0% of the price per mShare. In addition to re-allowing a portion of the dealer manager fee to the participating broker-dealers as a marketing fee, the fee will also be used for certain costs that FINRA includes in the 10% underwriting compensation limit, such as the cost of the following activities:

- travel and entertainment expenses;
- compensation of PCS's employees in connection with wholesaling activities;
- expenses incurred in coordinating broker-dealer seminars and meetings;
- wholesaling expense reimbursements paid by PCS or its affiliates to other entities;
- the national and regional sales conferences of our selected dealers;
- training and education meetings for registered representatives of our participating broker-dealers; and
- permissible forms of non-cash compensation to registered representatives of our selected dealers, such as logo apparel items and gifts that do not exceed an aggregate value of $100 per annum per registered representative and that are not pre-conditioned on achievement of a sales target (including, but not limited to, seasonal gifts).

If these costs exceed the 3% dealer manager fee after the payout of any marketing fees, then these costs will be paid by either us or PCS. These additional payments will be considered underwriting compensation and applied to FINRA's 10% cap.

Neither our dealer manager nor its affiliates will directly or indirectly compensate any person engaged as an investment advisor or a bank trust department by a potential investor as an inducement for such investment advisor or bank trust department to advise favorably for an investment in mShares.

The dealer manager fee for purchases of more than $5.0 million are negotiable. The dealer manager fee paid will in all cases be the same for the same level of sales and once a price is negotiated with the initial purchaser this will be the price for all purchases at that volume. In the event of a sale of more than $5.0 million, we will file a Form 8-K, which will be incorporated by reference in the prospectus to include:

- the aggregate amount of the sale;
- the price per share paid by the purchaser; and
- a statement that other similar investors wishing to purchase at that volume of securities will pay the same price for that volume of securities.

Dealer Manager and Participating Broker-Dealer Compensation

The table below sets forth the nature and estimated amount of all items viewed as "underwriting compensation" by FINRA, assuming we sell all the mShares offered hereby.

78

Dealer manager fee (maximum)	$15,000,000
Total	$15,000,000

Subject to the cap on issuer expenses described below, we also will reimburse PCS for reimbursements it may make to broker-dealers for bona fide due diligence expenses presented on detailed and itemized invoices.
To the extent permitted by law and our charter, we will indemnify the participating broker-dealers and the dealer manager against certain civil liabilities, including certain liabilities arising under the Securities Act and liabilities arising from breaches of our representations and warranties contained in the dealer manager agreement. However, the SEC takes the position that indemnification against liabilities arising under the Securities Act is against public policy and is not enforceable.
We will reimburse our Manager up to 1.5% of the gross offering proceeds of this offering for actual expenses incurred in connection with this offering. Any remaining amounts will be paid by our Manager without reimbursement by us.
The total amount of underwriting compensation, including dealer manager fees paid or reimbursed by us, our Manager or any other source in connection with this offering, will not exceed FINRA’s 10% cap. The aggregate of all organization and offering expenses under this offering, excluding selling commissions and dealer manager fees, will be capped at 1.5% of the aggregate gross proceeds of this offering; however, upon approval by the conflicts committee of our Board of Directors, we may reimburse our Manager for any such expenses incurred above the 1.5% amount as permitted by FINRA.
We will be responsible for the expenses of issuance and distribution of the mShares in this offering, including registration fees, printing expenses and the Company’s legal and accounting fees, which we estimate will total approximately $7.5 million (excluding dealer manager fees).
The dealer manager agreement may be terminated upon 60 days written notice by either the Company or the dealer manager to the other party.
Settlement Procedures
If your broker-dealer uses DTC Settlement, then you can place an order for the purchase of mShares through your broker-dealer. A broker-dealer using this service will have an account with DTC in which your funds are placed to facilitate the anticipated monthly closing cycle. Orders will be executed by your broker-dealer electronically and you must coordinate with your registered representative to pay the full purchase price of the mShares by the settlement date, which depends on when you place the order during the monthly settlement cycle and can be anywhere from one to 20 days after the date of your order. This purchase price will not be held in escrow.
Under special circumstances, you have the option to elect to use DRS Settlement. If you elect to use DRS Settlement, you should complete and sign a subscription agreement similar to the one filed as an exhibit to the registration statement of which this prospectus is a part, which is available from your registered representative and which will be delivered to the escrow agent. In connection with a DRS Settlement subscription, you should pay the full purchase price of the mShares to the escrow agent as set forth in the subscription agreement. Subscribers may not withdraw funds from the escrow account. Subscriptions will be effective upon our acceptance, and we reserve the right to reject any subscription in whole or in part.
Irrespective of whether you purchase mShares using DTC Settlement or DRS Settlement, by accepting mShares you will be deemed to have accepted the terms of our charter.
Subject to compliance with Rule 15c2-4 of the Exchange Act, in connection with purchases using DRS Settlement, our dealer manager or the broker-dealers participating in this offering promptly will deposit any checks received from subscribers in an escrow account maintained by UMB Bank N.A. by the end of the next business day following receipt of the subscriber’s subscription documents and check. In certain circumstances where the subscription review procedures are more lengthy than customary or pursuant to a participating broker-dealer’s internal supervising review procedures, a subscriber’s check will be transmitted by the end of the next business day following receipt by the review office of the

dealer, which will then be promptly deposited by the end of the next business day following receipt by the review office. Any subscription payments received by the escrow agent will be deposited into a special non-interest bearing account in our name until such time as we have accepted or rejected the subscription and will be held in trust for your benefit, pending our acceptance of your subscription. Subscriptions will be accepted or rejected within 10 business days of receipt by us and, if rejected, all funds shall be returned to the rejected subscribers within 10 business days. If accepted, the funds will be transferred into our general account on our next closing date. You will receive a confirmation of your purchase subsequent to a closing. We generally will admit stockholders on a semimonthly basis. Investors purchasing mShares through DTC Settlement will coordinate with their registered representatives to pay the full purchase price for their mShares by the settlement date, and such payments will not be held in escrow.

In recommending to a potential investor the purchase of mShares, each participating broker-dealer must have reasonable grounds to believe, on the basis of information obtained from the potential investor concerning his investment objectives, other investments, financial situation and needs, and any other information known by the participating broker-dealer, that the potential investor is or will be in a financial position appropriate to enable him to realize to a significant extent the benefits described in the prospectus; the potential investor has a fair market net worth sufficient to sustain the risks inherent in the program, including loss of investment and lack of liquidity; and the program is otherwise suitable for the potential investors. In making this determination, the participating broker-dealer will rely on relevant information provided by the investor, including information as to the investor's age, investment objectives, investment experience, income, net worth, financial situation, other investments and other pertinent information. Each investor should be aware that the participating broker-dealer will be responsible for determining whether this investment is appropriate for your portfolio. However, you are required to represent and warrant in the subscription agreement or, if placing an order through your registered representative not through a subscription agreement in connection with a DTC Settlement, to the registered representative, that you have received a copy of this prospectus and have had sufficient time to review this prospectus. PCS and each participating broker-dealer shall maintain records of the information used to determine that an investment in the mShares is suitable and appropriate for an investor. These records are required to be maintained for a period of at least six years.

Minimum Purchase Requirements

For your initial investment in our mShares, you must invest at least $5,000, or such lesser amounts in the discretion of PCS, our dealer manager. In order to satisfy the minimum purchase requirement for retirement plans, unless otherwise prohibited by state law, a husband and wife may jointly contribute funds from their separate IRAs. You should note that an investment in the mShares will not, in itself, create a retirement plan and that, in order to create a retirement plan, you must comply with all applicable provisions of the Code.

LEGAL MATTERS

Certain legal matters regarding the validity of the securities offered hereby and certain matters of Maryland Law have been passed upon for us by Venable LLP. Certain U.S. federal income tax matters have been passed upon by Proskauer Rose LLP, which relies on the opinion of Venable LLP as to all matters of Maryland law. If the validity of any securities is also passed upon by counsel for the underwriters, dealers or agents of an offering of those securities, that counsel will be named in this prospectus or any applicable prospectus supplement.

EXPERTS

The financial statements and management's assessment of the effectiveness of internal control over financial reporting (which is included in Management's Report on Internal Control over Financial Reporting) incorporated in this prospectus by reference to the Annual Report on Form 10-K of Preferred Apartment Communities, Inc. for the year ended December 31, 2015 have been so incorporated in reliance on the reports of PricewaterhouseCoopers LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

The combined statement of revenue and certain expenses for the years ended December 31, 2012, 2011, and 2010 of Lake Cameron, McNeil Ranch and Ashford Park included on page F-2 of Preferred Apartment Communities, Inc.'s Current Report on Form 8-K/A dated January 17, 2013 and filed with the SEC on April 3, 2013 has been audited by PricewaterhouseCoopers LLP, independent auditors, as stated in their report (which report expresses an unqualified opinion and includes an explanatory paragraph referring to the purpose of the statement) incorporated herein by reference, and is incorporated in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

The combined statement of revenue and certain expenses for the period of March 12, 2012 to December 31, 2012 of Trail II included on page F-2 of Preferred Apartment Communities, Inc.'s Current Report on Form 8-K/A dated June 14, 2013 and filed with the SEC on July 12, 2013 has been audited by PricewaterhouseCoopers LLP, independent auditors, as stated in their report (which report expresses an unqualified opinion and includes an explanatory paragraph referring to the purpose of the statement) incorporated herein by reference, and is incorporated in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

The combined statement of revenue and certain expenses for the year ended December 31, 2015 of the Village at Baldwin Park included on page F-2 of Preferred Apartment Communities, Inc.'s Current Report on Form 8-K dated July 15, 2016 and filed with the SEC on July 15, 2016 has been audited by PricewaterhouseCoopers LLP, independent auditors, as stated in their report (which report expresses an unqualified opinion and includes an explanatory paragraph referring to the purpose of the statement) incorporated herein by reference, and is incorporated in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

The combined statements of revenues and certain expenses of the Estancia Dallas, LLC, Sandstone Overland Park, LLC, Stoneridge Nashville, LLC, and Vineyards Houston, LLC for the year ended December 31, 2013 incorporated in this prospectus by reference from Preferred Apartment Communities, Inc.'s Current Report on Form 8-K/A filed with the SEC on September 17, 2014 has been audited by CohnReznick LLP, independent auditors, as stated in their report (which report expresses an unqualified opinion and includes an explanatory paragraph referring to the purpose of the statement) incorporated herein by reference, and is incorporated in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

The combined statement of revenue and certain expenses of the Sunbelt Portfolio for the year ended December 31, 2013 incorporated in this prospectus by reference from Preferred Apartment Communities, Inc.'s Current Report on Form 8-K/A filed with the SEC on December 4, 2014 has been audited by Moore, Colson & Company, P.C., independent auditors, as stated in their report (which report expresses an unqualified opinion and includes an explanatory paragraph referring to the purpose of the statement) incorporated herein by reference, and is incorporated in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

The combined statement of revenue and certain operating expenses of Avenues at Cypress and Avenues at Northpointe for the year ended December 31, 2014 incorporated in this prospectus by reference from Preferred Apartment Communities, Inc.'s Current Report on Form 8-K/A filed with the SEC on March 30, 2015 has been audited by CohnReznick LLP, independent auditors, as stated in their report (which report expresses an unqualified opinion and

---

includes an explanatory paragraph referring to the purpose of the statement) incorporated herein by reference, and is incorporated in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.
The combined statement of revenue and certain expenses for the year ended December 31, 2014 of the Lenox Village Portfolio, which appears in the Current Report on Form 8-K/A of Preferred Apartment Communities, Inc. dated March 2, 2016 has been audited by Moore, Colson & Company, P.C., independent auditors, as stated in their report (which report expresses an unqualified opinion and includes an explanatory paragraph referring to the purpose of the statement) incorporated herein by reference, and is incorporated in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.
The combined statement of revenues and certain expenses for the year ended December 31, 2015 of the Southeast 6 Portfolio, which appears in the Current Report on Form 8-K of Preferred Apartment Communities, Inc. dated July 15, 2016 has been audited by KPMG LLP, independent auditors, as stated in their report (which report expresses an unqualified opinion and includes an explanatory paragraph referring to the purpose of the statements) incorporated herein by reference, and is incorporated in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

The combined statement of revenues and certain expenses for the year ended December 31, 2015 of Grandeville on Avalon Park, which appears in the Current Report on Form 8-K of Preferred Apartment Communities, Inc. dated July 15, 2016 has been audited by Insero & Co. CPAs, LLP, independent auditors, as stated in their report (which report expresses an unqualified opinion and includes an explanatory paragraph referring to the purpose of the statement) incorporated herein by reference, and is incorporated in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

The combined statement of revenues and certain expenses of the Southeastern 7 Portfolio, a portfolio of seven grocery-anchored shopping centers, for the year ended December 31, 2015 incorporated in this prospectus by reference from Preferred Apartment Communities, Inc.'s Current Report on Form 8-K/A filed on October 24, 2016 has been audited by Deloitte & Touche LLP, independent auditors, as stated in their report incorporated herein by reference (which report expresses an unmodified opinion and includes an emphasis-of-matter paragraph referring to the purpose of the statement), and is incorporated in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

WHERE YOU CAN FIND MORE INFORMATION ABOUT PREFERRED APARTMENT COMMUNITIES

We file annual, quarterly and current reports, proxy statements and other information with the SEC under the Exchange Act.
You may request and obtain a copy of these filings, at no cost to you, by writing or telephoning us at the following address or telephone number:
3284 Northside Parkway NW, Suite 150
Atlanta, Georgia 30327
(770) 818-4100
Attn: Leonard A. Silverstein
Our website at www.pacapts.com contains additional information about us. The contents of the site are not incorporated by reference in, or otherwise a part of, this prospectus.
This prospectus is part of the registration statement and does not contain all the information included in the registration statement and all its exhibits, certificates and schedules. Whenever a reference is made in this prospectus to any contract or other document of ours, the reference may not be complete and you should refer to the exhibits that are a part of the registration statement for a copy of the contract or document.

You may read and copy our registration statement and all its exhibits and schedules which we have filed with the SEC, at the Public Reference Room at 100 F. Street, N.E., Washington, D.C. 20549. This material, as well as copies of all other documents filed with the SEC, may be obtained from the Public Reference Section of the SEC, 100 F. Street, N.E., Washington D.C. 20549 upon payment of the fee prescribed by the SEC. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330 or e-mailing the SEC at publicinfo@sec.gov. The SEC maintains a web site that contains reports, proxy statements, information statements and other information regarding registrants that file electronically with the SEC, including us. The address of this website is http://www.sec.gov.

INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

We are incorporating certain information about us that we have filed with the SEC by reference in this prospectus, which means that we are disclosing important information to you by referring you to those documents. We are also incorporating by reference in this prospectus information that we file with the SEC after the date of the initial registration statement and prior to the effectiveness of the registration statement. The information we incorporate by reference is an important part of this prospectus, and later information that we file with the SEC automatically will update and supersede the information we have included in or incorporated into this prospectus.

We incorporate by reference the following documents we have filed, or may file, with the SEC:

- Our Annual Report on Form 10-K for the period ended December 31, 2015 filed with the SEC on March 14, 2016;
- Our Quarterly Report on Form 10-Q for the period ended March 31, 2016 filed with the SEC on May 9, 2016;
- Our Quarterly Report on Form 10-Q for the period ended June 30, 2016 filed with the SEC on August 9, 2016;
- Our Quarterly Report on Form 10-Q for the period ended September 30, 2016 filed with the SEC on November 7, 2016;
- Our Current Reports on Form 8-K and amendments thereto on Form 8-K/A, as applicable, filed with the SEC on April 3, 2013, April 4, 2013, July 12, 2013, September 17, 2014, December 4, 2014, January 2, 2015, March 30, 2015, March 2, 2016, May 5, 2016, May 25, 2016, June 6, 2016, July 15, 2016, July 15, 2016, July 18, 2016, August 9, 2016, August 10, 2016, October 5, 2016 and October 24, 2016;
- The description of capital stock contained in our Form 8-A, filed December 3, 2010, including any amendments or reports filed for the purpose of updating the description; and
- All documents filed by us with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act, after the date of this prospectus and before termination of this offering.

We are not, however, incorporating by reference any documents or portions thereof, whether specifically listed above or filed in the future, that are not deemed "filed" with the SEC, including our compensation committee report and performance graph (included in any proxy statement) or any information furnished pursuant to Items 2.02 or 7.01 of Form 8-K or certain exhibits furnished pursuant to Item 9.01 of Form 8-K.

The section entitled "Where You Can Find More Information About Preferred Apartment Communities" above describes how you can obtain or access any documents or information that we have incorporated by reference herein.

The information relating to us contained in this prospectus does not purport to be comprehensive and should be read together with the information contained in the documents incorporated or deemed to be incorporated by reference in this prospectus.

Upon written or oral request, we will provide, free of charge, to each person, including any beneficial owner, to whom a prospectus is delivered, a copy of any or all of the reports or documents that are incorporated by reference into this prospectus. Such written or oral requests should be made to:

Leonard A. Silverstein
3284 Northside Parkway NW, Suite 150
Atlanta, Georgia 30327
Telephone Number: (770) 818-4100

In addition, such reports and documents may be found on our website at www.pacapts.com.

Maximum of 500,000 mShares

(Liquidation Preference $1,000 per mShare
(subject to adjustment))

PROSPECTUS

PREFERRED CAPITAL SECURITIES, LLC
as Dealer Manager

, 2016

You should rely only on the information contained in this prospectus. No dealer, salesperson or other person is authorized to make any representations other than those contained in this prospectus, and, if given or made, such information and representations must not be relied upon. This prospectus is not an offer to sell nor is it seeking an offer to buy these securities in any jurisdiction where the offer or sale is not permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or any sale of these securities. You should not assume that the delivery of this prospectus or that any sale made pursuant to this prospectus implies that the information contained in this prospectus will remain fully accurate and correct as of any time subsequent to the date of this prospectus.

PART II INFORMATION NOT REQUIRED IN PROSPECTUS

Item 14. Other expenses of issuance and distribution

The following table sets forth the costs and expenses to be borne by the registrant in connection with the offering described in this registration statement.