FIRST PACTRUST BANCORP INC
Form 10-Q
May 10, 2013

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2013

or

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

For the transition period from ______ to ______

Commission file number 001-35522

FIRST PACTRUST BANCORP, INC.

(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of

incorporation or organization)

04-3639825

(IRS Employer Identification No.)

18500 Von Karman Ave, Suite 1100, Irvine, California

(Address of principal executive offices)

92612

(Zip Code)

(949) 236-5211

(Registrant s telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	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 ¨ No x

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

As of April 30, 2013 the registrant had outstanding 10,879,726 shares of voting common stock and 1,124,258 shares of Class B non-voting common stock.

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FIRST PACTRUST BANCORP, INC.

Form 10-Q Quarterly Report

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Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

When used in this report and in public shareholder communications, in other documents of First PacTrust Bancorp, Inc. (the Company, we, us and our) filed with or furnished to the Securities and Exchange Commission (the SEC), or in oral statements made with the approval of an authorized executive officer, the words or phrases believe, will, should, will likely result, are expected to, will continue, is anticipated, project, plans, guidance or similar expressions are intended to identify forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. You are cautioned not to place undue reliance on any forward-looking statements, which speak only as of the date made. These statements may relate to our future financial performance, strategic plans or objectives, revenue, expense or earnings projections, or other financial items. By their nature, these statements are subject to numerous uncertainties that could cause actual results to differ materially from those anticipated in the statements.

Factors that could cause actual results to differ materially from the results anticipated or projected include, but are not limited to, the following: (i) the occurrence of any event, change or other circumstances that could give rise to the termination of the merger agreement for the Company s pending acquisition of the Private Bank of California (PBOC); (ii) the outcome of any legal proceedings that may be instituted against the Company or PBOC; (iii) the inability to complete the PBOC transaction due to the failure to satisfy such transaction s conditions to completion, including the receipt of regulatory approvals and the approval of the merger agreement by PBOC s shareholders; (iv) risks that the proposed PBOC transaction, or the Company s recently completed acquisitions of Beach Business Bank and Gateway Bancorp, may disrupt current plans and operations, the potential difficulties in customer and employee retention as a result of the transactions and the amount of the costs, fees, expenses and charges related to the transactions; (v) continuation or worsening of current recessionary conditions, as well as continued turmoil in the financial markets; (vi) the credit risks of lending activities, which may be affected by further deterioration in real estate markets and the financial condition of borrowers, may lead to increased loan and lease delinquencies, losses and nonperforming assets in our loan portfolio, and may result in our allowance for loan and lease losses not being adequate to cover actual losses and require us to materially increase our loan and lease loss reserves; (vii) the quality and composition of our securities portfolio; (viii) changes in general economic conditions, either nationally or in our market areas; (ix) continuation of the historically low short-term interest rate environment, changes in the levels of general interest rates, and the relative differences between short- and long-term interest rates, deposit interest rates, our net interest margin and funding sources; (x) fluctuations in the demand for loans and leases, the number of unsold homes and other properties and fluctuations in commercial and residential real estate values in our market area; (xi) results of examinations of us by regulatory authorities and the possibility that any such regulatory authority may, among other things, require us to increase our allowance for loan and lease losses, write-down asset values, increase our capital levels, or affect our ability to borrow funds or maintain or increase deposits, which could adversely affect our liquidity and earnings; (xii) legislative or regulatory changes that adversely affect our business, including changes in regulatory capital or other rules; (xiii) our ability to control operating costs and expenses; (xiv) staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our work force and potential associated charges; (xv) errors in our estimates in determining fair value of certain of our assets, which may result in significant declines in valuation; (xvi) the network and computer systems on which we depend could fail or experience a security breach; (xvii) our ability to attract and retain key members of our senior management team; (xviii) costs and effects of litigation, including settlements and judgments; (xix) increased competitive pressures among financial services companies; (xx) changes in consumer spending, borrowing and saving habits; (xxi) adverse changes in the securities markets; (xxii) earthquake, fire or other natural disasters affecting the condition of real estate collateral; (xxiii) the availability of resources to address changes in laws, rules or regulations or to respond to regulatory actions; (xxiv) inability of key third-party providers to perform their obligations to us; (xxv) changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board or their application to our business or final audit adjustments, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; (xxvi) war or terrorist activities; and (xxvii) other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services and the other risks described in this report and from time to time in other documents that we file with or furnish to the SEC, including, without limitation, the risks described under Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2012. You should not place undue reliance on forward-looking statements, and we undertake no obligation to update any such statements to reflect circumstances or events that occur after the date on which the forward-looking statement is made.

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PART I FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

First PacTrust Bancorp, Inc.

Consolidated Statements of Financial Condition

(In thousands of dollars except share and per share data)

(Unaudited)

	March 31, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$ 8,420	$ 8,254
Interest-bearing deposits	114,776	100,389
Total cash and cash equivalents	123,196	108,643
Time deposits in financial institutions	3,635	5,027
Securities available for sale, at fair value	99,658	121,419
Loans and leases receivable, net of allowance of $16,015 at March 31, 2013 and $14,448 at December 31, 2012	1,611,257	1,234,023
Loans held for sale, carried at fair value	114,582	113,158
Federal Home Loan Bank and other bank stock, at cost	8,844	8,842
Servicing rights, net ($2,579 measured at fair value at March 31, 2013 and $1,739 at December 31, 2012)	3,077	2,278
Accrued interest receivable	5,051	5,002
Other real estate owned (OREO), net	1,764	4,527
Premises, equipment, and capital leases, net	17,695	16,147
Bank-owned life insurance	18,742	18,704
Deferred income tax, net	7,572	7,572
Goodwill	7,048	7,048
Affordable housing fund investment	6,038	6,197
Income tax receivable	2,624	5,545
Other intangible assets, net	5,107	5,474
Other assets	15,165	13,096
Total assets	$ 2,051,055	$ 1,682,702
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Noninterest-bearing deposits	142,735	194,662
Interest-bearing deposits	1,556,063	1,111,680
Total deposits	1,698,798	1,306,342
Advances from Federal Home Loan Bank	50,000	75,000
Notes payable, net	82,031	81,935
Reserve for loss on repurchased loans	3,498	3,485
Accrued expenses and other liabilities	28,430	27,183
Total liabilities	1,862,757	1,493,945
Commitments and contingent liabilities		
SHAREHOLDERS EQUITY		
	31,934	31,934

Preferred stock, $.01 par value per share, $1,000 per share liquidation preference for a total of $32,000; 50,000,000 shares authorized, 32,000 shares issued and outstanding at March 31, 2013 and December 31, 2012		
Common stock, $.01 par value per share, 196,863,844 shares authorized; 12,024,303 shares issued and 10,853,290 shares outstanding at March 31, 2013; 12,013,717 shares issued and 10,780,427 shares outstanding at December 31, 2012	120	120
Class B non-voting non-convertible Common stock, $.01 par value per share, 3,136,156 shares authorized; 1,112,188 shares issued and outstanding at March 31, 2013 and December 31, 2012	11	11
Additional paid-in capital	155,139	154,563
Retained earnings	25,755	26,550
Treasury stock, at cost (1,171,013 shares at March 31, 2013 and 1,233,290 shares at December 31, 2012)	(25,850)	(25,818)
Accumulated other comprehensive income, net	1,189	1,397
Total shareholders equity	188,298	188,757
Total liabilities and shareholders equity	$ 2,051,055	$ 1,682,702

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First PacTrust Bancorp, Inc.

Consolidated Statements of Income and Comprehensive Income/(Loss)

(In thousands of dollars except share and per share data)

(Unaudited)

	Three months ended March 31,	
	2013	**2012**
Interest and dividend income		
Loans, including fees	$ 18,537	$ 9,528
Securities	498	737
Dividends and other interest-earning assets	133	60
Total interest and dividend income	19,168	10,325
Interest expense		
Deposits	1,999	1,349
Federal Home Loan Bank advances	63	100
Capital leases	12	
Notes payable	1,735	
Total interest expense	3,809	1,449
Net interest income	15,359	8,876
Provision for loan and lease losses	2,168	691
Net interest income after provision for loan and lease losses	13,191	8,185
Noninterest income		
Customer service fees	546	361
Loan servicing income	188	16
Income from bank owned life insurance	38	69
Net gain (loss) on sales of securities available for sale	308	(39)
Net gain on sale of loans	312	
Net gain on mortgage banking activities	16,370	
Other income	166	96
Total noninterest income	17,928	503
Noninterest expense		
Salaries and employee benefits	19,080	4,867
Occupancy and equipment	3,193	999
Professional fees	2,297	543
Data processing	910	407
Advertising	522	239
Regulatory assessments	381	318
Loan servicing and foreclosure expense	204	338
Operating loss on equity investment	159	76
Valuation allowance for OREO	79	14
Net gain on sales of other real estate owned	(114)	(316)
Provision for loan repurchases	256	
Amortization of intangible assets	367	
Other expense	2,224	733

Total noninterest expense		29,558		8,218
Income before income taxes		1,561		470
Income tax expense		632		93
Net income	$	929	$	377
Preferred stock dividends and discount accretion		288		400
Net income (loss) available to common shareholders	$	641	$	(23)
Basic earnings (loss) per common share	$	0.05	$	
Diluted earnings (loss) per common share	$	0.05	$	
Basic earnings (loss) per class B common share	$	0.05	$	
Diluted earnings (loss) per class B common share	$	0.05	$	

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First PacTrust Bancorp, Inc.

Consolidated Statements of Comprehensive Income

(In thousands of dollars, except share and per share data)

(Unaudited)

	Three months ended March 31, 2013	Three months ended March 31, 2012
Net income	$ 929	$ 377
Other comprehensive income, before tax:		
Change in net unrealized gains on securities:		
Unrealized holding gains arising during the period, net of tax (expense) benefit of $0 and $341, respectively	100	488
Less: reclassification adjustment for (gains) losses included in net income net of tax (expense) benefit of $0 and $16, respectively	(308)	23
Total other comprehensive income (loss), net of tax	$ (208)	$ 511
Comprehensive income	$ 721	$ 888

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First PacTrust Bancorp, Inc.

Consolidated Statements of Shareholder s Equity

(In thousands of dollars, except share and per share data)

(Unaudited)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balance at January 1, 2012	$ 31,934	$ 128	$ 150,786	$ 27,623	$ (25,037)	$ (939)	$ 184,495
Comprehensive income (loss):							
Net income				377			377
Other comprehensive income, net						511	511
Stock option compensation expense			214				214
Stock awards earned			70				70
Purchase of 6,864 shares of treasury stock					(73)		(73)
Tax loss of restricted share awards vesting			(1)				(1)
Dividends declared ($0.12 per common share)			214	(1,399)			(1,185)
Preferred stock dividends				(400)			(400)
Capital raising expenses			(6)				(6)
Balance at March 31, 2012	$ 31,934	$ 128	$ 151,277	$ 26,201	$ (25,110)	$ (428)	$ 184,002
Balance at January 1, 2013	$ 31,934	$ 131	$ 154,563	$ 26,550	$ (25,818)	$ 1,397	$ 188,757
Net income				929			929
Other comprehensive income, net						(208)	(208)
Purchase of 5,973 shares of treasury stocks					(32)		(32)
Stock option compensation expense			93				93
Restricted stock compensation expense			428				428
Issuance of stock awards			55				55
Dividends declared ($0.12 per common share)				(1,436)			(1,436)
Preferred stock dividends				(288)			(288)
Balance at March 31, 2013	$ 31,934	$ 131	$ 155,139	$ 25,755	$ (25,850)	$ 1,189	$ 188,298

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First PacTrust Bancorp, Inc.

Consolidated Statements of Cash Flows

(In thousands of dollars)

(Unaudited)

	Three months ended March 31,	
	2013	2012
Cash flows from operating activities:		
Net income (loss)	$ 929	$ 377
Adjustments to reconcile net income (loss) to net cash from operating activities		
Provision for loan losses	2,168	691
Provision for loan repurchases	256	
Net gain on mortgage banking activities	(16,370)	
Gain on sale of loans	(312)	
Net amortization (accretion) of securities	572	180
Depreciation	723	220
Amortization of intangibles	367	
Amortization of debt	96	
Stock option compensation expense	93	214
Restricted stock compensation expense	428	
Stock award compensation expense		70
Bank owned life insurance income	(38)	(69)
Operating loss on equity investment	159	76
Net (gain) loss on sale of securities available for sale	(308)	39
(Gain) loss on sale of other real estate owned	(114)	(316)
Gain on sale of property and equipment	(2)	
Deferred income tax (benefit) expense		326
Increase in valuation allowances on other real estate owned	79	14
Originations of loans held for sale	(332,808)	
Proceeds from loans held for sale	341,863	
Deferred loan costs	(207)	60
Premiums and discounts on purchased loans	(2,573)	(177)
Accrued interest receivable	(49)	(223)
Other assets	478	3,702
Accrued interest payable and other liabilities	1,047	1,499
Net cash from operating activities	(3,523)	6,683
Cash flows from investing activities:		
Proceeds from sales of securities available-for-sale	8,064	2,938
Proceeds from maturities, calls, principal repayments of securities available-for-sale	23,124	8,624
Purchases of securities available-for-sale	(9,881)	(10,782)
Loan originations and principal collections, net	(59,049)	(43,454)
Purchase of loans	(332,343)	(19,546)
Redemption of Federal Home Loan Bank stock		333
Purchase of Federal Home Loan Bank and Other Bank Stocks	(2)	
Net change in other interest-bearing deposits	1,392	
Proceeds from sale of loans	20,045	
Proceeds from sale of other real estate owned	3,283	5,765
Additions to premises and equipment	(2,269)	(2,045)
Payments of capital lease obligations	(43)	(2)

Net cash from investing activities	(347,679)	(58,169)

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Cash flows from financing activities:		
Net increase (decrease) in deposits	392,456	67,509
Repayments of Federal Home Loan Bank advances	(50,000)	(20,000)
Proceeds from Federal Home Loan Bank advances	25,000	35,000
Capital raising expenses		(6)
Purchase of treasury stock	(32)	(73)
Iissuance of stock awards	55	
Tax benefit (loss) from RRP shares vesting		(1)
Dividends paid on preferred stock	(288)	(400)
Dividends paid on common stock	(1,436)	(1,185)
Net cash from financing activities	365,755	80,844
Net change in cash and cash equivalents	14,553	29,358
Cash and cash equivalents at beginning of year	108,643	44,475
Cash and cash equivalents at end of year	$ 123,196	$ 73,833
Supplemental cash flow information		
Interest paid on deposits and borrowed funds	$ 15,359	$ 1,425
Income taxes paid		
Supplemental disclosure of noncash activities		
Transfer from other real estate owned to contracts receivable		
Transfer from loans to other real estate owned, net		3,614
Equipment acquired under capital leases	714	128

See accompanying notes to consolidated financial statements

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FIRST PACTRUST BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2013

(Amounts in thousands of dollars, except share and per share data)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The accompanying unaudited consolidated financial statements include the accounts of First PacTrust Bancorp, Inc (First PacTrust or the Company) and its wholly owned subsidiaries, Pacific Trust Bank (PacTrust Bank), Beach Business Bank (Beach, and together with PacTrust Bank, the Banks) and PTB Property Holdings, LLC, as of March 31, 2013 and December 31, 2012 and for the three month periods ended March 31, 2013 and March 31, 2012, except that the accounts of Beach Business Bank were not included for amounts prior to July 1, 2012. Significant intercompany accounts and transactions have been eliminated in consolidation. Unless the context requires otherwise, all references to the Company include its wholly owned subsidiaries.

Nature of Operations: The principal business of the Company is the ownership of the Banks. Pacific Trust Bank is a federally chartered stock savings bank and Beach is a California state chartered commercial bank. The Banks are members of the Federal Home Loan Bank (FHLB) system, and maintain insurance on deposit accounts with the Federal Deposit Insurance Corporation (FDIC). PTB Property Holdings, LLC manages and disposes of other real estate owned properties.

The Banks are engaged in the business of retail banking, with operations conducted through 19 banking offices serving San Diego, Los Angeles, Orange and Riverside counties, California and thirty-one loan production offices in California, Arizona, Oregon and Washington. As of March 31, 2013, single family residential (SFR) loans and Green loans, SFR mortgage lines of credit, accounted for approximately 50.5 percent and 11.9 percent, respectively, of the Company s loan and lease portfolio, with a high percentage of such loans concentrated in Southern California. However, the customer s ability to repay their loans or leases is dependent on the real estate market and general economic conditions in the area.

The accounting and reporting polices of the Company are based upon U.S. generally accepted accounting principles (GAAP) and conform to predominant practices within the banking industry. The Company has not made any significant changes in its critical accounting policies or in its estimates and assumptions from those disclosed in its 2012 Annual Report on Form 10-K other than the adoption of new accounting pronouncements and other authoritative guidance that became effective for the Company on or after January 1, 2013. Refer to *Accounting Pronouncements* for discussion of accounting pronouncements adopted in 2013.

Basis of Presentation: The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations for reporting on Form 10-Q. Accordingly, certain disclosures required by GAAP are not included herein. These interim statements should be read in conjunction with the consolidated financial statements and notes included in the Annual Report on Form 10-K for the year ended December 31, 2012 filed by the Company with the Securities and Exchange Commission. The December 31, 2012 balance sheet presented herein has been derived from the audited financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2012 filed with the Securities and Exchange Commission, but does not include all of the disclosures required by GAAP.

In the opinion of management of the Company, the accompanying unaudited interim consolidated financial statements reflect all of the adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the consolidated financial position and consolidated results of operations for the periods presented. Certain reclassifications have been made in the prior period financial statements to conform to the current period presentation.

The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the results to be expected for the full year.

Use of Estimates in the Preparation of Financial Statements: The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and disclosures provided, and actual results could differ. The allowance for loan and lease losses, reserve for loss reimbursements on sold loans, servicing rights, other real estate owned, realization of deferred tax assets, goodwill, other intangible assets, mortgage banking derivatives, fair value of assets and liabilities acquired in business combinations, fair value estimate of private label residential mortgage-backed securities, and the fair value of financial instruments are particularly subject to change and such change could have a material effect on the consolidated financial statements.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized. The Company had $7.8 million and $8.4 million of valuation allowance related to its deferred tax assets at March 31, 2013 and December 31, 2012 (See further discussion in Note 11, Income Taxes).

Accounting Pronouncements: During the three months ended March 31, 2013, the following pronouncements applicable to the company were issued or became effective:

In January 2013, the FASB issued ASU 2013-01, *Balance Sheet (Topic 210), Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities* (ASU 2013-01). ASU 2013-01 clarifies that ordinary trade receivables and other receivables are not in the scope of ASU 2011-11, Balance Sheet (Topic 210), Disclosures about Offsetting Assets and Liabilities (2011- 11). Specifically, ASU 2011-11 applies only to derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with specific criteria contained in the ASC or subject to a master netting arrangement or similar agreement. The amendments in ASU 2013-01 are effective for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. Adoption of the new guidance is not expected to have a significant impact on the Company s consolidated financial statements.

In February 2013, the FASB issued ASU 2013-02, *Other Comprehensive Income (Topic 220), Reporting of Amounts Reclassified out of Other Comprehensive Income* (ASU 2013-02). The provisions in the ASU supersede and replace the presentation requirements for reclassifications out of accumulated other comprehensive income (AOCI) in ASUs 2011-05 and 2011-12. ASU 2013-02 requires entities to disclose additional information about reclassification adjustments, including (1) changes in AOCI balances by component and (2) significant items reclassified out of AOCI. The new disclosure requirements are effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. The Company has adopted ASU 2013-02 for the three months ended March 31, 2013. Adoption of the new guidance did not have a significant impact on the Company s consolidated financial statements.

NOTE 2 BUSINESS COMBINATIONS

Beach Business Bank Merger

Effective July 1, 2012, the Company acquired Beach Business Bank (Beach) pursuant to the terms of the Agreement and Plan of Merger (the Merger Agreement) dated August 30, 2011, as amended October 31, 2011. At the effective time of the transaction, a newly formed and wholly owned subsidiary of the Company (Merger Sub) merged with and into Beach (the Merger), with Beach continuing as the surviving entity in the Merger and a wholly owned subsidiary of the Company. Pursuant and subject to the terms of the Merger Agreement, each outstanding share of Beach common stock (other than specified shares owned by the Company, Merger Sub or Beach, and other than in the case of shares in respect of, or underlying, certain Beach options and other equity awards, which were treated as set forth in the Merger Agreement) was converted into the right to receive $9.21415 in cash and one warrant. Each warrant entitles the holder to purchase 0.33 of a share of Company common stock at an exercise price of $14.00 per share of Company Common Stock for a period of one year. The aggregate cash consideration paid to Beach shareholders in the Merger was approximately $39.1 million. In addition, Beach shareholders received in aggregate warrants to purchase the equivalent of 1,401,959 shares of the Company s common stock with an estimated fair value of $1.0 million.

Beach operates branches in Manhattan Beach, Long Beach, and Costa Mesa, California. Beach also has a division named The Doctors Bank®, which serves physicians and dentists nationwide. Additionally, Beach provides loans to small businesses based on Small Business Administration (SBA) lending programs. Beach s consolidated assets and equity (unaudited) as of June 30, 2012 totaled $311.9 million and $33.3 million, respectively. The acquired assets and liabilities were recorded at fair value at the date of acquisition and were reflected in the Company s consolidated December 31, 2012 and March 31, 2013 financial statements as such.

In accordance with GAAP guidance for business combinations, the Company recorded $7.0 million of goodwill and $4.5 million of other intangible assets during the year ended December 31, 2012. The other intangible assets are primarily related to core deposits and are being amortized on an accelerated basis over 2 7 years. For tax purposes purchase accounting adjustments, including goodwill are all non-taxable and/or non-deductible.

The unique market opportunity that was created with the acquisition is that it creates for our Company the opportunity to leverage Beach s branch network, SBA lending platform, the Doctors Bank product offerings and other programs that can be deployed throughout our market which we expect will help augment our customer base. This acquisition was consistent with the Company s strategy to build a regional presence in Southern California. The acquisition offers the Company the opportunity to increase profitability by introducing existing products and services to the acquired customer base as well as acquire new customers in the expanded region.

Gateway Bancorp Acquisition

Effective August 18, 2012, the Company acquired Gateway Bancorp, the holding company of Gateway Business Bank (Gateway) pursuant to the terms of the Stock Purchase Agreement (the Purchase Agreement) dated June 3, 2011, as amended on November 28, 2011, February 24, 2012, June 30, 2012, and July 31, 2012. The acquisition was accomplished by the Company s purchase of all of the outstanding stock of Gateway

Bancorp, followed by the merger of Gateway into PacTrust Bank. Under the terms of the Purchase Agreement, the Company purchased all of the issued and outstanding shares of Gateway Bancorp for $15.4 million in cash.

Gateway operated branches in Lakewood and Laguna Hills, California. As part of the acquisition, Mission Hills Mortgage Bankers (MHMB , a division of Gateway), including its 22 loan production offices in California, Arizona, Oregon and Washington, became a division of PacTrust Bank. Gateway s consolidated assets and equity (unaudited) as of August 17, 2012 totaled $175.5 million and $25.8 million, respectively. The acquired assets and liabilities were recorded at fair value at the date of acquisition and were reflected in the December 31, 2012 and March 31, 2013 consolidated financial statements as such.

In accordance with GAAP guidance for business combinations, the Company recorded $11.6 million of bargain purchase gain and $1.7 million of other intangible assets during the year ended December 31, 2012. The other intangible assets are related to $720 thousand of core deposits, which are being amortized on an accelerated basis over 4 6 years, and $955 thousand of trade name intangible which is being amortized over 20 years. For tax purposes the purchase accounting adjustments and bargain purchase gain are non-taxable and/or non-deductible. Due to circumstances that Gateway faced at the time the acquisition was negotiated, which include regulatory orders and operating losses, the terms negotiated included a purchase price that was $5 million lower than Gateway Bancorp s equity book value. The discount was further increased to $6.5 million in exchange for the elimination of any contingent liability to the shareholder of Gateway Bancorp related to mortgage repurchase risk. Due to delays in obtaining regulatory approval, the deal closed nine months later than originally planned. This passage of time allowed Gateway to eliminate all regulatory orders, return to profitability, improve asset quality, and increase the book value of equity by reducing the expected discount on assets. As a result, a bargain purchase gain of $11.6 million resulted at the time of purchase.

This acquisition was consistent with the Company s strategy to build a regional presence in Southern California. The acquisition offers the Company the opportunity to increase profitability by introducing existing products and services to the acquired customer base as well as add new customers in the expanded region.

Pro Forma Information

The following table presents unaudited pro forma information as if the acquisitions had occurred on January 1, 2012 after giving effect to certain adjustments. The unaudited pro forma information for the three months ended March 31, 2013 and 2012 includes adjustments for interest income on loans and securities acquired, amortization of intangibles arising from the transaction, interest expense on deposits and borrowings acquired, and the related income tax effects. The unaudited pro forma financial information is not necessarily indicative of the results of operations that would have occurred had the transaction been effected on the assumed date.

	Pro Forma Three Months Ended	
	March 31, 2013	**March 31, 2012**
SUMMARIZED INCOME STATEMENT DATA (unaudited):		
Net interest income	$ 15,359	$ 13,830
Provision for loan and lease losses	2,168	891
Non-interest income	17,928	9,860
Non-interest expense	29,558	21,563
Income (loss) before income taxes	1,561	1,236
Income tax expense (benefit)	632	414
Net income (loss)	929	822
Basic earning (loss) per share	$ 0.05	$ 0.07
Diluted earnings (loss) per share	$ 0.05	$ 0.07

Excluded from the above pro forma financials is a gain of $11.6 million related to the bargain purchase gain for the Gateway acquisition.

Pending Acquisition

Private Bank of California

On August 21, 2012, First PacTrust and Beach entered into a definitive agreement to acquire all the outstanding stock of The Private Bank of California, a California-chartered bank (PBOC). Pursuant to the agreement, if the PBOC merger is completed, PBOC will merge with and into Beach (or at the option of First PacTrust, PacTrust Bank). At March 31, 2013, PBOC had total assets of $674.3 million, total loans, net of allowance for loan losses, of $376.3 million and total deposits of $580.7 million. PBOC provides

a range of financial services, including credit and deposit products as well as cash management services, from its headquarters located in the Century City area of Los Angeles, California as well as a full-service branch in Hollywood and loan production offices in downtown Los Angeles and Irvine. PBOC s target clients include high-net worth and high income individuals, business professionals and their professional service firms, business owners, entertainment service businesses and non-profit organizations.

If the PBOC merger is completed, each holder of PBOC common stock will receive a proportional share of 2,083,333 shares of First PacTrust common stock and $24,887,513 in cash, in each case subject to certain adjustments. If the total value of the merger consideration, calculated for this purpose using $12.00 as the value of one share of First PacTrust common stock, would otherwise exceed an amount equal to 1.30 times PBOC s tangible common equity as of the last business day of the month immediately prior to the closing of the merger (after subtracting from tangible common equity certain unaccrued one-time PBOC merger-related costs and expenses) then the cash portion of the merger consideration will be adjusted downward until the total value of the merger consideration is equal to such amount. We plan to finance the cash portion of the merger consideration with cash on hand.

In addition, if the PBOC merger is completed, each share of preferred stock issued by PBOC as part of the Small Business Lending Fund (SBLF) program of the United States Department of Treasury (10,000 shares in the aggregate with a liquidation preference amount of $1,000 per share) will be converted automatically into one substantially identical share of First PacTrust preferred stock. The terms of the preferred stock to be issued by First PacTrust in exchange for the PBOC preferred stock are substantially identical to the preferred stock previously issued by First PacTrust (and currently outstanding) as part of its own participation in the SBLF program (32,000 shares in the aggregate with a liquidation preference amount of $1,000 per share).

Completion of the PBOC merger is subject to certain conditions, including receipt of approval of the shareholders of PBOC. The Company s merger application for Beach and PBOC was approved by the DFI on March 21, 2013 and the FDIC on March 27, 2013. The acquisition will be accounted for under the acquisition method of accounting. We expect to complete the transaction on or before July 5, 2013, although we cannot assure you that the transaction will close on that timetable or at all.

NOTE 3 FAIR VALUES OF FINANCIAL INSTRUMENTS

Fair Value Hierarchy. ASC 820-10 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The topic describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Securities Available for Sale. The fair values of securities available for sale are generally determined by quoted market prices, if available (Level 1), or by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities relationship to other benchmark quoted securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). The fair values of the Company s Level 3 securities are determined by the Company and an independent third-party provider using a discounted cash flow methodology. The methodology uses discount rates that are based upon observed market yields for similar securities. Prepayment speeds are estimated based upon the prepayment history of each bond and a detailed analysis of the underlying collateral. Gross weighted average coupon, geographic concentrations, loan to value, FICO and seasoning are among the different loan attributes that are factored into our prepayment curve. Default rates and severity are estimated based upon geography of the collateral, delinquency, modifications, loan to value ratios, FICO scores, and past performance.

Impaired Loans and Leases. The fair value of impaired loans and leases with specific allocations of the allowance for loan and lease losses based on collateral values is generally based on recent real estate appraisals (Level 2). These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

Loans Held for Sale. The fair value of loans held for sale is based on commitments outstanding from investors as well as what secondary markets are currently offering for portfolios with similar characteristics. Therefore, loans held for sale subjected to recurring fair value adjustments are classified as Level 2.

Derivative Assets and Liabilities. The Company s derivative assets and liabilities are carried at fair value as required by GAAP and are accounted for as freestanding derivatives. The derivative assets are interest rate lock commitments (IRLCs) with prospective residential mortgage borrowers whereby the interest rate on the loan is determined prior to funding and the borrowers have locked in that interest rate. These commitments are determined to be derivative instruments in accordance with GAAP. The derivative liabilities are hedging instruments (typically to be announced, or TBA securities) used to hedge the risk of fair value changes associated with changes in interest rates relating to the Company s mortgage loan origination operations. The Company hedges the period from the interest rate lock (assuming a fall-out factor) to the date of the loan sale. The estimated fair value is based on current market prices for similar instruments. Given the meaningful level of secondary market activity for derivative contracts, active pricing is available for similar assets and accordingly, the Company classifies its derivative assets and liabilities as Level 2.

Servicing Rights Mortgage. The Company retains servicing on some of its mortgage loans sold and elected the fair value option for valuation of these mortgage servicing rights. The value is based on a third party model that calculates the present value of the expected net servicing income from the portfolio based on key factors that include interest rates, prepayment assumptions, discount rate and estimated cash flows. Because of the significance of unobservable inputs, these servicing rights are classified as Level 3.

I/O Strips Receivable. The fair value is determined by discounting future cash flows using discount rates and prepayment assumptions that market participants would use for similar financial instruments. Because of the significance of unobservable inputs, the I/O strips receivable are classified as Level 3.

Other Real Estate Owned Assets (OREO). OREO are recorded at the fair value less estimated costs to sell at the time of foreclosure. The fair value of other real estate owned assets is generally based on recent real estate appraisals adjusted for estimated selling costs. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value. Only OREO with a valuation allowance are considered to be carried at fair value. For the three months ended March 31, 2013 and March 31, 2012, the Company experienced $79 thousand and $14 thousand in valuation allowance expense for those assets, respectively.

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Assets and Liabilities Measured on a Recurring and Non Recurring Basis

Available-for-sale securities, loans held for sale, derivative assets and liabilities, and servicing rights mortgage are measured at fair value on a recurring basis, whereas impaired loans and leases and other real estate owned are measured at fair value on a non-recurring basis.

The following table sets forth the Company s financial assets and liabilities measured at fair value on a recurring basis as of the dates indicated:

		Fair Value Measurements Level		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level One)	Significant Other Observable Inputs (Level Two)	Significant Unobservable Inputs (Level Three)
		(In thousands)		
At March 31, 2013:				
Assets				
Available-for-sale securities:				
U.S. government-sponsored entities and agency securities	$ 2,002	$	$ 2,002	$
Private label residential mortgage-backed securities	37,492		35,573	1,919
Agency mortgage-backed securities	60,164		60,164	
Loans held for sale	114,582		114,582	
Derivative assets [(1)]	4,637		4,637	
Mortgage servicing rights [(2)]	2,579			2,579
Liabilities				
Derivative liabilities [(3)]	902		902	
At December 31, 2012:				
Assets				
Available-for-sale securities:				
U.S. government-sponsored entities and agency securities	$ 2,710	$	$ 2,710	$
State and Municipal securities	9,944		9,944	
Private label residential mortgage-backed securities	41,846		39,632	2,214
Agency mortgage-backed securities	66,919		66,919	
Loans held for sale	113,158		113,158	
Derivative assets [(1)]	2,890		2,890	
Mortgage servicing rights [(2)]	1,739			1,739
Liabilities				
Derivative liabilities [(3)]	988		988	

[(1)] *Included in other assets on the consolidated statements of financial condition*
[(2)] *Included in servicing rights, net on the consolidated statements of financial condition*
[(3)] *Included in accrued expenses and other liabilities on the consolidated statements of financial condition*

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The following table sets forth the Company s financial assets and liabilities measured at fair value on a non recurring basis as of the dates indicated:

	Carrying Value	Fair Value Measurements Level Quoted Prices in Active Markets for Identical Assets (Level One)	Significant Other Observable Inputs (Level Two)	Significant Unobservable Inputs (Level Three)
		(In thousands)		
At March 31, 2013:				
Assets				
Impaired loans:				
Real estate 1-4 family first mortgage	$ 17,063	$	$ 6,635	$ 10,428
Multi-family	2,336			2,336
Real estate mortgage	2,510		819	1,691
Other real estate owned assets:				
Real estate 1-4 family first mortgage	336			336
Land	1,428			1,428
At December 31, 2012:				
Assets				
Impaired loans:				
Real estate 1-4 family first mortgage	$ 21,778	$	$ 3,041	$ 18,737
Multi-family	5,442			5,442
Real estate mortgage	2,531		829	1,702
HELOC s, home equity loans, and other consumer installment credit	3			3
Other real estate owned assets:				
Real estate 1-4 family first mortgage	118			118
Land	3,889			3,889

There were $5.5 million and no impaired loans and leases with specific allowances tested for impairment using the fair value of the collateral for collateral dependent loans at March 31, 2013 and December 31, 2012, respectively.

Other real estate owned measured at fair value less costs to sell, had a net carrying value of $1.7 million, which was comprised of the outstanding balance of $1.8 million, net of a valuation allowance of $69 thousand at March 31, 2013. At December 31, 2012, real estate owned had a net carrying value of $4.5 million, which is made up of the outstanding balance of $6.6 million, net of a valuation allowance of $2.1 million.

The tables below present a reconciliation of assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2013.

	Private label residential mortgage-backed securities	Mortgage Servicing Rights	Total
		(In thousands)	
Balance of recurring Level 3 securities at January 1, 2013	$ 2,214	$ 1,739	$ 3,953
Transfers out of Level 3			
Total gains or losses (realized/unrealized):			
Included in earnings realized			
Included in earnings fair value adjustment		25	25
Included in other comprehensive income	(1)		(1)

Amortization of premium (discount)			
Additions		910	910
Sales, issuances and settlements	(294)	(95)	(389)
Balance of recurring Level 3 securities at March 31, 2013	$ 1,919	$ 2,579	$ 4,498

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The table below presents a reconciliation of assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2012:

	Private label residential mortgage-backed securities *(In thousands)*
Balance of recurring Level 3 securities at January 1, 2012	$ 91,862
Transfers out of Level 3	
Total gains or losses (realized/unrealized):	
Included in earnings realized	(39)
Included in earnings unrealized	
Included in other comprehensive income	860
Amortization of premium (discount)	(182)
Purchases	10,743
Sales, issuances and settlements	(11,556)
Balance of recurring Level 3 securities at March 31, 2012	$ 91,688

The following table presents quantitative information about Level 3 fair value measurements on a recurring basis at March 31, 2013:

	Fair Value *(in thousands)*	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Private label residential mortgage backed securities			Voluntary prepayment rate	5.38% to 5.62% (5.50%)
	$ 1,919	Discounted cash flow	Collateral default rate	7.54% to 8.48% (8.01%)
			Loss severity at default	55%
Servicing rights-mortgage	2,579	Discounted cash flow	Discount rate	10.5% to 11.5% (10.5%)
			Prepayment rate	5.9% to 36.4% (11.8%)

The following table presents quantitative information about Level 3 fair value measurements on a recurring basis at December 31, 2012:

	Fair Value *(in thousands)*	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Private label residential mortgage backed securities			Voluntary prepayment rate	3.15% to 8.00% (5.80%)
	$ 2,214	Discounted cash flow	Collateral default rate	8.46% to 8.56% (8.5%)
			Loss severity at default	55%
Servicing rights-mortgage	1,739	Discounted cash flow	Discount rate	10.5% to 11.5% (10.5%)
			Prepayment rate	4.3 to 35.3% (13.8%)

The significant unobservable inputs used in the fair value measurement of the Company s private label and agency residential mortgage backed securities are prepayment rates, collateral default rates, and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the collateral default rates is accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates.

The significant unobservable inputs used in the fair value measurement of the Company s servicing rights include the discount rate and estimated cash flows. There may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results.

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The carrying amounts and estimated fair values of financial instruments, at March 31, 2013 and December 31, 2012 were as follows:

	Carrying Amount	Fair Value Measurements Level			
		Level 1	Level 2	Level 3	Total
			(in thousands)		
At March 31, 2013:					
Financial assets					
Cash and cash equivalents	$ 123,196	$ 123,196	$	$	$ 123,196
Time deposits in financial institutions	3,635	3,635			3,635
Securities available-for-sale	99,658		97,739	1,919	99,658
FHLB stock	8,844		8,844		8,844
Loans and leases receivable, net, excluding loans held for sale	1,611,257			1,643,815	1,643,815
Loans held for sale	114,582		114,582		114,582
Accrued interest receivable	5,051	28	7	5,016	5,051
Derivative assets	4,637		4,637		4,637
Servicing rights	2,579			2,579	2,579
Financial liabilities					
Deposits	1,698,798		1,698,618		1,698,618
Advances from the FHLB	50,000		50,169		50,169
Notes payable	82,031	86,411			86,411
Derivative liabilities	902		902		902
Accrued interest payable	1,695	1,346	349		1,695
At December 31, 2012:					
Financial assets					
Cash and cash equivalents	$ 108,643	$ 108,643	$	$	$ 108,643
Time deposits in financial institutions	5,027	5,027			5,027
Securities available-for-sale	121,419		119,205	2,214	121,419
FHLB stock	8,842		8,842		8,842
Loans and leases receivable, net, excluding loans held for sale	1,234,023			1,267,292	1,267,292
Loans held for sale	113,158		113,158		113,158
Accrued interest receivable	5,002	7	50	4,945	5,002
Derivative assets	2,890		2,890		2,890
Servicing rights	2,278			2,278	2,278
Financial liabilities					
Deposits	1,306,342		1,305,884		1,305,884
Advances from the FHLB	75,000		75,166		75,166
Notes payable	81,935	86,106			86,106
Derivative liabilities	988		988		988
Accrued interest payable	1,639	1,335	304		1,639

The methods and assumptions used to estimate fair value are described as follows:

Carrying amount is the estimated fair value for cash and cash equivalents, FHLB stock, and accrued interest receivable and payable. The methods for determining the fair values for securities available for sale, derivatives assets and liabilities, and I/O strips are described above. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent re-pricing or re-pricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair value of long-term debt is based on current rates for similar financing. It was not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability. The fair value of off-balance-sheet items is not considered material (or is based on the current fees or costs that would be charged to enter into or terminate such arrangements) and is not presented.

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NOTE 4 SECURITIES AVAILABLE FOR SALE

The following tables summarize the amortized cost and fair value of the available-for-sale investment securities portfolio at March 31, 2013 and December 31, 2012, respectively, and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income (loss):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In thousands)		
March 31, 2013				
Available-for-sale				
U.S. government-sponsored entities and agency securities	$ 2,000	$ 2	$	$ 2,002
Private label residential mortgage-backed securities	37,182	401	(91)	37,492
Agency mortgage-backed securities	59,929	361	(126)	60,164
Total securities available for sale	99,111	764	(217)	99,658

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In thousands)		
December 31, 2012				
Available-for-sale				
U.S. government-sponsored entities and agency securities	$ 2,706	$ 4	$	$ 2,710
State and Municipal securities	9,660	284		9,944
Private label residential mortgage-backed securities	41,499	475	(128)	41,846
Agency mortgage-backed securities	66,818	335	(234)	66,919
Total securities available for sale	$ 120,683	$ 1,098	$ (362)	$ 121,419

The Company recorded no other-than-temporary impairment (OTTI) for securities available for sale at March 31, 2013 or December 31, 2012.

The amortized cost and fair value of the available-for-sale securities portfolio are shown below by expected maturity. In the case of residential mortgage-backed securities, expected maturities may differ from contractual maturities because borrowers generally have the right to call or prepay obligations with or without call or prepayment penalties. For that reason, mortgage-backed securities are not included in the maturity categories.

	March 31, 2013	
	Amortized Cost	Fair Value
	(In thousands)	
Maturity		
Available-for-sale		
Within one year	$	$
One to five years	2,000	2,002
Five to ten years		
Greater than ten years		
Private label residential mortgage backed and FNMA mortgage-backed securities	97,111	97,656
	$ 99,111	$ 99,658

At March 31, 2013 and December 31, 2012, there were no holdings of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10 percent of shareholders equity.

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The following table summarizes the investment securities with unrealized losses at March 31, 2013 by aggregated major security type and length of time in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(In thousands)			
Available-for-sale						
Private label residential mortgage-backed securities	$ 7,035	$ (39)	$ 5,247	$ (52)	$ 12,282	$ (91)
Agency residential mortgage-backed securities	14,518	(106)	1,095	(20)	15,613	(126)
Total available-for-sale	$ 21,553	$ (145)	$ 6,342	$ (72)	$ 27,895	$ (217)

The following table summarizes the investment securities with unrealized losses at December 31, 2012 by aggregated major security type and length of time in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(In thousands)			
Available-for-sale						
Private label residential mortgage-backed securities	$ 2,194	$ (13)	$ 10,061	$ (115)	$ 12,255	$ (128)
Agency residential mortgage-backed securities	37,388	(234)			37,388	(234)
Total available-for-sale	$ 39,582	$ (247)	$ 10,061	$ (115)	$ 49,643	$ (362)

As of March 31, 2013, the Company s securities available for sale portfolio consisted of 73 securities, 31 of which were in an unrealized loss position. The unrealized losses are related to an increase in prepayment speeds of the agency mortgage-backed securities as discussed below.

The Company s private label residential mortgage-backed securities that are in an unrealized loss position had a fair value of $12.3 million with unrealized losses of $91 thousand at March 31, 2013. The Company s agency residential mortgage-backed securities that are in an unrealized loss position had a fair value of $15.6 million with unrealized losses of $126 thousand at March 31, 2013. The Company monitors its securities portfolio to insure it has adequate credit support and as of March 31, 2013, the Company believes there is no OTTI and it does not have the intent to sell these securities and it is not likely that it will be required to sell the securities before their anticipated recovery. Of the Company s $99.7 million securities portfolio, $92.9 million were rated AAA, AA or A, $5.9 million were rated BBB, and $882 thousand were rated BB based on the most recent credit rating as of March 31, 2013. The Company considers the lowest credit rating for identification of potential OTTI. Subsequently, the Company sold the non-investment grade investment of $882 thousand during the month of April 2013, at a nominal gain, to be in compliance with the Company s investment policy.

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NOTE 5 LOANS AND LEASES AND ALLOWANCE FOR LOAN AND LEASE LOSSES

As of March 31, 2013 and December 31, 2012 the Company had the following balances in its loan and lease portfolio:

	March 31, 2013				
	Non-Traditional Mortgages (NTM)	**Traditional Loans**	**Total NTM and Traditional Loans**	**Purchased Credit Impaired**	**Total Loans and Leases Receivable**
			(In thousands)		
Commercial					
Commercial and industrial	$	$ 74,596	$ 74,596	$ 4,783	$ 79,379
Real estate mortgage		310,920	310,920	21,630	332,550
Multi-family		124,288	124,288	838	125,126
SBA		30,375	30,375	5,331	35,706
Construction		6,862	6,862		6,862
Lease financing		16,398	16,398		16,398
Consumer:					
Real estate 1-4 family first mortgage	203,026	431,622	634,648	185,833	820,481
Green Loans (HELOC) First Liens	186,791		186,791		186,791
Green Loans (HELOC) Second Liens	6,464		6,464		6,464
Other HELOC s, home equity loans, and other consumer installment credit		15,454	15,454	55	15,509
Total Gross Loans	$ 396,281	$ 1,010,515	$ 1,406,796	$ 218,470	$ 1,625,266
Percentage to total gross loans	24.4%	62.2%	86.6%	13.4%	100.0%
Net deferred loan costs					$ 636
Unamortized purchase premium					1,370
Allowance for loan losses					(16,015)
Loans and leases receivable, net					$ 1,611,257

	December 31, 2012				
	Non-Traditional Mortgages (NTM)	**Traditional Loans**	**Total NTM and Traditional Loans**	**Purchased Credit Impaired**	**Total Loans and Leases Receivable**
			(In thousands)		
Commercial					
Commercial and industrial	$	$ 73,585	$ 73,585	$ 6,808	$ 80,393
Real estate mortgage		318,051	318,051	21,837	339,888
Multi-family		112,829	112,829	845	113,674
SBA		30,512	30,512	5,608	36,120
Construction		6,648	6,648		6,648
Lease financing		11,203	11,203		11,203
Consumer:					
Real estate 1-4 family first mortgage	162,240	211,527	373,767	65,066	438,833
Green Loans (HELOC) First Liens	198,351		198,351		198,351
Green Loans (HELOC) Second Liens	7,653		7,653		7,653
Other HELOC s, home equity loans, and other consumer installment credit		13,740	13,740	56	13,796
Total Gross Loans	$ 368,244	$ 778,095	$ 1,146,339	$ 100,220	$ 1,246,559
Percentage to total gross loans	29.5%	62.5%	92.0%	8.0%	100.0%

Net deferred loan costs	$	447
Unamortized purchase premium		1,465
Allowance for loan losses		(14,448)
Loans and leases receivable, net	$	1,234,023

Non Traditional Mortgage Loans

The Company s non-traditional mortgage portfolio is comprised of three interest only products: the Green Account Loans (Green Loans), the hybrid interest only fixed or adjustable rate mortgage (Interest Only) and a small number of loans with the potential for negative amortization. As of March 31, 2013 and December 31, 2012, the non-traditional mortgages totaled $396.3 million or 24.4 percent of the total gross loan portfolio and $368.2 million or 29.5 percent of the total gross loan portfolio, respectively, which is an increase of $28.0 million or 7.6 percent.

	March 31, 2013			December 31, 2012		
	Count	Amount	Percent	Count	Amount	Percent
			($ in thousands)			
Green	224	$ 193,255	48.8%	239	$ 206,004	56.0%
Interest-only	272	183,924	46.4	191	142,978	38.8
Negative amortizaion	40	19,102	4.8	40	19,262	5.2
Total NTM loans	536	$ 396,281	100.0%	470	$ 368,244	100.0 %
Total gross loan portfolio		$ 1,625,266			$ 1,246,559	
% of NTM to total gross loan portfolio		24.4%			29.5%	

Green Loans

Green Loans are single family residence first and second mortgage lines of credit with a linked checking account that allows all types of deposits and withdrawals to be performed. The loans are generally interest only with a 15 year balloon payment due at maturity. At March 31, 2013, Green Loans totaled $193.3 million, a decrease of $12.7 million or 6.2 percent from $206.0 million at December 31, 2012, primarily due to reductions in principal balance and payoffs of $5.4 million and $12.8 million, respectively, partially offset by advances of $5.4 million. As of March 31, 2013 and December 31, 2012, $5.4 million and $5.7 million, respectively, of the Company s Green Loans were non-performing. As a result of their unique payment feature, Green Loans possess higher credit risk due to the potential of negative amortization.

Interest Only Loans

Interest only loans are primarily single family residence first mortgage loans with payment features that allow interest only payment in initial periods before converting to fully amortizing payments. As of March 31, 2013, our interest only loans increased by $40.9 million or 28.6 percent to $183.9 million from $143.0 million at December 31, 2012, primarily due to originations of $32.7 million and purchases of $29.3 million, partially offset by sales of $11.4 million, payoffs and principal reductions of $5.2 million and reclassification of $4,3 million from NTM interest only to traditional loans due to the expiration of the initial interest only period and conversion to a fully amortizing basis. The Company decreased its overall percent to total gross loans by 0.2 percent from 11.5 percent at December 31, 2012 to 11.3 percent at March 31, 2013 of the total gross loan portfolio. As of March 31, 2013 and December 31, 2012, $2.7 million and $0.9 million, respectively, of the Company s interest only loans were non-performing.

Loans with the Potential for Negative Amortization

The negative amortization loan balance decreased to $19.1 million as of March 31, 2013 from $19.3 million as of December 31, 2012. The Company discontinued origination of negative amortization loans in 2007. As of March 31, 2013 and December 31, 2012, none and $142 thousand, respectively, of the Company s loans that had the potential for negative amortization were non-performing. These loans pose a potentially higher credit risk because of the lack of principal amortization and potential for negative amortization; however, management believes the risk is mitigated through the Company s loan terms and underwriting standards, including its policies on loan-to-value ratios.

Risk Management of Non-Traditional Mortgages

The Company has assessed that the most significant performance indicators for non-traditional mortgages (NTMs) are loan-to-value (LTV) and FICO scores. Accordingly, we manage credit risk in the NTM portfolio through semi-annual review of the loan portfolio that includes refreshing FICO scores on the Green Loans and home equity lines of credit and ordering third party automated valuation models. The loan review is designed to provide an effective method of identifying borrowers who may be experiencing financial difficulty before they actually fail to make a loan payment. Upon receipt of the updated FICO scores, an exception report is run to identify loans with a decrease in FICO of 10 percent or more and a resulting FICO of 620 or less. The loans are then further analyzed to determine if the risk rating should be downgraded which will

increase the reserves the Company will establish for potential losses. A report of the semi-annual loan review is published and regularly monitored.

As these loans are revolving lines of credit, the Company, based on the loan agreement and loan covenants of the particular loan, as well as applicable rules and regulations, could suspend the borrowing privileges or reduce the credit limit at any time the Company reasonably believes that the borrower will be unable to fulfill their repayment obligations under the agreement or certain other conditions are met. In many cases, the decrease in FICO is the first red flag that the borrower may have difficulty in making their future payment obligations.

As a result, the Company proactively manages the portfolio by performing detailed analysis on its portfolio with emphasis on the non-traditional mortgage portfolio. The Company s Internal Asset Review Committee (IARC) conducts monthly meetings to review the loans classified as special mention, substandard, or doubtful and determines whether suspension or reduction in credit limit is warranted. If the line has been suspended and the borrower would like to have their credit privileges reinstated, they would need to provide updated financials showing their ability to meet their payment obligations.

On the interest only loans, the Company projects future payment changes to determine if there will be an increase in payment of 3.50 percent or greater and then monitor the loans for possible delinquency. The individual loans are monitored for possible downgrading of risk rating, and trends within the portfolio are identified that could affect other interest only loans scheduled for payment changes in the near future.

Non Traditional Mortgage Performance Indicators

In addition to monitoring of credit grades, for NTMs, the Company manages the loan portfolio with attention to borrower credit scores and LTV. The tables below represent the Company s non-traditional one-to-four SFR mortgage Green Loans first lien portfolio at March 31, 2013 by FICO score as of the dates indicated:

FICO Scores

	FICO score at March 31, 2013			FICO score at December 31, 2012			Changes in count and amounts		
($ in thousands)	Count	Amount	Percent	Count	Amount	Percent	Count change	Amount change	Percent change
800+	8	$ 6,993	3.7%	10	$ 8,133	4.1%	(2)	$ (1,140)	(14.0)%
700-799	114	95,793	51.4	120	101,188	51.0	(6)	(5,395)	(5.3)
600-699	52	56,652	30.3	55	60,052	30.3	(3)	(3,400)	(5.7)
<600	14	12,214	6.5	15	12,887	6.5	(1)	(673)	(5.2)
No FICO	10	15,139	8.1	12	16,091	8.1	(2)	(952)	(5.9)
Totals	198	$ 186,791	100.0%	212	$ 198,351	100.0%	$ (14)	$ (11,560)	(5.8)%

The Company updates FICO scores on a semi-annual basis, typically in November and April or as needed in conjunction with proactive portfolio management. As such, the FICO scores did not materially change from December 31, 2012 to March 31, 2013, but the change during the quarter reflects loans that were paid off during the quarter.

The table below represents the Company s one-to-four SFR non-traditional mortgage first lien portfolio by LTV as of the dates indicated:

Loan to Value

	March 31, 2013											
	Green			I/O			Neg Am			Total		
LTV s (1)	Count	Amount	Percentage	Count	Amount	Percentage	Count	Amount	Percentage	Count	Amount	Percentage
< 61	49	$ 57,398	30.8%	65	$ 62,019	33.7%	11	$ 2,417	12.7%	125	$ 121,834	31.2%
61-80	61	51,621	27.6	77	63,557	34.5	4	1,214	6.4	142	116,392	29.9
81-100	53	54,775	29.3	47	24,029	13.1	11	8,059	42.1	111	86,863	22.3
> 100	35	22,997	12.3	83	34,319	18.7	14	7,412	38.8	132	64,728	16.6
Totals	198	$ 186,791	100.0%	272	$ 183,924	100.0%	40	$ 19,102	100.0%	510	$ 389,817	100.0%

	December 31, 2012											
		Green			I/O			Neg Am			Total	
LTV s (1)	Count	Amount	Percentage	Count	Amount	Percentage	Count	Amount	Percentage	Count	Amount	Percentage
< 61	51	$ 59,546	30.0%	60	$ 47,295	33.1%	11	$ 2,442	12.6%	122	$ 109,283	30.3%
61-80	63	51,934	26.2	72	59,025	41.3	4	1,225	6.4	139	112,184	31.1
81-100	61	62,518	31.5	27	17,578	12.3	11	8,120	42.2	99	88,216	24.5
> 100	37	24,353	12.3	31	18,967	13.3	14	7,475	38.8	82	50,795	14.1
Totals	212	$ 198,351	100.0%	190	$ 142,865	100.0%	40	$ 19,262	100.0%	442	$ 360,478	100.0%

(1) LTV represents estimated current loan to value ratio, determined by dividing current unpaid principal balance by latest estimated property value received per the Company s policy

At March 31, 2013, the increase in interest only loans primarily related to purchases of 89 loans with a carrying value of $29.3 million and originations of $32.7 million, partially offset by sales, payoffs, principal reductions, and conversions to traditional loans of $21.1 million.

Allowance for Loan and Lease Losses

The Company has an established credit risk management process that includes regular management review of the loan and lease portfolio to identify any problem loans and leases. During the ordinary course of business, management becomes aware of borrowers that may not be able to meet the contractual requirements of the loan agreements. Such loans are subject to increased monitoring. Consideration is given to placing the loan on non-accrual status, assessing the need for additional allowance for loan and lease losses, and partial or full charge-off. The Company maintains the allowance for loan and lease losses at a level that is considered adequate to cover the estimated and known inherent risks in the loan portfolio and off-balance sheet unfunded credit commitments. The allowance for loan and lease losses includes allowances for loan, lease, and off-balance sheet unfunded credit commitment losses.

The credit risk monitoring system is designed to identify impaired and potential problem loans, and to permit periodic evaluation of impairment and the adequacy level of the allowance for credit losses in a timely manner. In addition, the Board of Directors of the Company has created a written credit policy that includes a credit review and control system which it believes should be effective in ensuring that the Company maintains an adequate allowance for credit losses. The Board of Directors provides oversight for the allowance evaluation process, including quarterly valuations, and determines whether the allowance is adequate to absorb losses in the loan and lease portfolio. The determination of the amount of the allowance for loan and lease losses and the provision for loan and lease losses is based on management s current judgment about the credit quality of the loan and lease portfolio and takes into consideration known relevant internal and external factors that affect collectability when determining the appropriate level for the allowance for loan and lease losses. The nature of the process by which the Company determines the appropriate allowance for loan and lease losses requires the exercise of considerable judgment. Additions to the allowance for loan and lease losses are made by charges to the provision for loan and lease losses. Identified credit exposures that are determined to be uncollectible are charged against the allowance for loan and lease losses. Recoveries of previously charged off amounts, if any, are credited to the allowance for loan and lease losses.

The following is a summary of activity in the allowance for loan and lease losses and ending balances of loans evaluated for impairment for the three months ended March 31, 2013 and 2012.

	2013	**2012**
Balance at beginning of year	$ 14,448	$ 12,780
Loans and leases charged off	(906)	(2,299)
Recoveries of loans and leases previously charged off	305	1
Provision for loan and lease losses	2,168	691
Balance at end of period	$ 16,015	$ 11,173

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The following table presents the activity and balance in the allowance for loan and lease losses and the recorded investment in loans and leases by portfolio segment and is based on the impairment method for the three months ended March 31, 2013.

	Commercial and Industrial	Commercial Real Estate Mortgage	Multi-Family	SBA	Construction	Lease Financing	Real Estate 1-4 family First Mortgage	HELOC s, Home Equity Loans, and Other Consumer Credit	Unallocated	TOTAL
Allowance for loan and lease losses:										
Balance as of December 31, 2012	$ 263	$ 3,178	$ 1,478	$ 118	$ 21	$ 261	$ 8,855	$ 274	$	$ 14,448
Charge-offs		(105)	(384)	(125)		(23)	(262)	(7)		(906)
Recoveries			88	125		2	90			305
Provision	218	625	362	15	273	23	529	(70)	193	2,168
Balance as of March 31, 2013	$ 481	$ 3,698	$ 1,544	$ 133	$ 294	$ 263	$ 9,212	$ 197	$ 193	$ 16,015
Individually evaluated for impairment	$	$ 38	$ 329	$	$	$	$ 1,095	$	$	$ 1,462
Collectively evaluated for impairment	481	3,636	1,215	133	294	263	7,902	197	193	14,314
Acquired with deteriorated credit quality		24					215			239
Total ending allowance balance	$ 481	$ 3,698	$ 1,544	$ 133	$ 294	$ 263	$ 9,212	$ 197	$ 193	$ 16,015
Loans:										
Individually evaluated for impairment	$	$ 2,511	$ 2,336	$	$	$	$ 17,062	$	$	$ 21,909
Collectively evaluated for impairment	74,564	307,338	123,329	30,329	6,831	16,418	806,197	21,901		1,386,907
Acquired with deteriorated credit quality	4,781	21,616	838	5,333			185,833	55		218,456
Total ending loan balances	$ 79,345	$ 331,465	$ 126,503	$ 35,662	$ 6,831	$ 16,418	$ 1,009,092	$ 21,956	$	$ 1,627,272

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The following table presents the activity and balance in the allowance for loan and lease losses and the recorded investment in loans and leases by portfolio segment and is based on the impairment method for the three months ended March 31, 2012.

	Commercial and Industrial	Commercial Real Estate Mortgage	Multi-Family	SBA	Construction	Lease Financing	Real Estate 1-4 family First Mortgage	HELOC s, Home Equity Loans, and Other Consumer Credit	Unallocated	TOTAL
Allowance for loan and lease losses:										
Balance as of December 31, 2011	$ 128	$ 2,234	$ 1,541	$	$	$	$ 8,635	$ 242	$	$ 12,780
Charge-offs		(236)					(2,060)	(3)		(2,299)
Recoveries								1		1
Provision	1	930	60				(258)	(42)		691
Balance as of March 31, 2012	$ 129	$ 2,928	$ 1,601	$	$	$	$ 6,317	$ 198	$	$ 11,173
Individually evaluated for impairment	$	$ 357	$ 732	$	$	$	$ 164	$	$	$ 1,253
Collectively evaluated for impairment	129	2,571	869				6,153	198		9,920
Acquired with deteriorated credit quality										
Total ending allowance balance	$ 129	$ 2,928	$ 1,601	$	$	$	$ 6,317	$ 198	$	$ 11,173
Loans:										
Individually evaluated for impairment	$	$ 3,558	$ 5,485	$	$	$	$ 15,704	$ 4	$	$ 24,751
Collectively evaluated for impairment	8,967	157,530	78,735				551,012	17,414		813,658
Acquired with deteriorated credit quality										
Total ending loan balances	$ 8,967	$ 161,088	$ 84,220	$	$	$	$ 566,716	$ 17,418	$	$ 838,409

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The following table presents loans and leases individually evaluated for impairment by class of loans and leases as of and for the three months ended March 31, 2013. The recorded investment represents customer balances net of any partial charge-offs recognized on the loans and leases, net of any deferred fees and costs. Recorded investment excludes accrued interest receivable, as it is not considered to be material.

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan and Lease Losses Allocated	Average Recorded Investment YTD	Interest Income Recognized YTD	Cash Basis Interest Recognized YTD
With no related allowance recorded:						
Commercial						
Commercial and industrial	$	$	$	$	$	$
Real estate mortgage	1,646	819		824		
Multi-family						
SBA						
Construction						
Lease financing						
Consumer:						
Real estate 1-4 family first mortgage	1,900	1,448		1,458		
HELOC s, home equity loans, and other consumer installment credit						
With an allowance recorded:						
Commercial						
Commercial and industrial						
Real estate mortgage	1,690	1,691	38	1,695	3	3
Multi-family	2,336	2,336	329	2,343		
SBA						
Construction						
Lease financing						
Consumer:						
Real estate 1-4 family first mortgage	15,560	15,615	1,098	15,567	106	96
HELOC s, home equity loans, and other consumer installment credit						
Total	$ 23,132	$ 21,909	$ 1,465	$ 21,887	$ 109	$ 99

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The following table presents loans and leases individually evaluated for impairment by class of loans and leases as of and for the three months ended March 31, 2012. The recorded investment represents customer balances net of any partial charge-offs recognized on the loans and leases, net of any deferred fees and costs. Recorded investment excludes accrued interest receivable, as it is not considered to be material

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan and Lease Losses Allocated	Average Recorded Investment YTD	Interest Income Recognized YTD	Cash Basis Interest Recognized YTD
With no related allowance recorded:						
Commercial						
Commercial and industrial	$	$	$	$	$	$
Real estate mortgage	776	780		781	11	11
Multi-family						
SBA						
Construction						
Lease financing						
Consumer:						
Real estate 1-4 family first mortgage	11,179	11,199		11,616	100	63
HELOC s, home equity loans, and other consumer installment credit	4	4		4		
With an allowance recorded:						
Commercial						
Commercial and industrial						
Real estate mortgage	2,782	2,792	357	2,792	12	12
Multi-family	5,485	5,495	732	5,499	77	58
SBA						
Construction						
Lease financing						
Consumer:						
Real estate 1-4 family first mortgage	4,525	4,517	164	4,518	55	20
HELOC s, home equity loans, and other consumer installment credit						
Total	$ 24,751	$ 24,787	$ 1,253	$ 25,210	$ 255	$ 164

The following table presents information for impaired loans and leases for the three months ended March 31, 2013 and 2012:

	2013	2012
Average of individually impaired loans during the period	$ 21,887	$ 25,210
Interest income recognized during impairment	109	255
Cash-basis interest income recognized	99	164

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Nonaccrual loans and leases and loans past due 90 days still on accrual were as follows as of the dates indicated:

	March 31, 2013			December 31, 2012		
	Traditional Loans	NTM Loans	Total	Traditional Loans	NTM Loans	Total
Loans past due over 90 days or more still on accrual	$	$	$	$	$	$
Nonaccrual loans						
The Company maintains specific allowance allocations for these loans of $1,415 in 2013 and $1,267 in 2012	$ 8,476	$ 8,045	$ 16,521	$ 11,166	$ 11,827	$ 22,993

Nonaccrual loans and leases consisted of the following as of the dates indicated:

	March 31, 2013			December 31, 2012		
	Traditional Loans	NTM Loans	Total	Traditional Loans	NTM Loans	Total
Commercial:						
Commercial and industrial	$ 203	$	$ 203	$	$	$
Real estate mortgage	3,110		3,110	2,906		2,906
Multi-Family	2,336		2,336	5,442		5,442
SBA	102		102	141		141
Construction						
Lease financing						
Consumer:						
Real estate 1-4 family first mortgage	2,725	2,678	5,403	2,676	6,169	8,845
Green Loan (HELOC) First Liens		5,367	5,367		5,658	5,658
Green Loan (HELOC) Second Liens						
HELOC s, home equity loans, and other consumer installment credit						