PACIFIC PREMIER BANCORP INC
Form 10-K
March 14, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2012

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 No.: 0-22193

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 33-0743196 |
| (State of Incorporation) | (I.R.S. Employer Identification No) |

17901 Von Karman Avenue. Suite 1200, Irvine, California 92614
(Address of Principal Executive Offices and Zip Code)
Registrant’s telephone number, including area code: (949) 864-8000

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Securities registered pursuant to Section 12(b) of the Act:

| Title of class | Name of each exchange on which registered |
|---|---|
| Common Stock, par value $0.01 per share | NASDAQ Global Market |

Securities registered pursuant to Section 12(g) of the Act:

None

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [__] No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes [__] No [X]

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

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

| | | | | |
|---|---|---|---|---|
| Large accelerated filer | [ ] | | Accelerated filer | [ 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 Act). Yes [__] No [X]

The aggregate market value of the voting stock held by non-affiliates of the registrant, i.e., persons other than directors and executive officers of the registrant, was approximately $83,637,616 and was based upon the last sales price as quoted on The NASDAQ Stock Market as of June 30, 2012, the last business day of the most recently completed second fiscal quarter.

As of March 14, 2013, the Registrant had 14,158,314 shares outstanding.

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PART I

ITEM 1. BUSINESS

Forward-Looking Statements

All references to “we”, “us”, “our”, “Pacific Premier” or the “Company” mean Pacific Premier Bancorp, Inc. and our consolidated subsidiaries, including Pacific Premier Bank, our primary operating subsidiary. All references to ‘‘Bank’’ refer to Pacific Premier Bank. All references to the “Corporation” refer to Pacific Premier Bancorp, Inc.

This Annual Report on Form 10-K contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). These forward-looking statements represent plans, estimates, objectives, goals, guidelines, expectations, intentions, projections and statements of our beliefs concerning future events, business plans, objectives, expected operating results and the assumptions upon which those statements are based. Forward-looking statements include without limitation, any statement that may predict, forecast, indicate or imply future results, performance or achievements, and are typically identified with words such as “may,” “could,” “should,” “will,” “would,” “believe,” “anticipate,” “estimate,” “expect,” “intend,” “plan,” or words or phases of similar meaning. We ca the forward-looking statements are based largely on our expectations and are subject to a number of known and unknown risks and uncertainties that are subject to change based on factors which are, in many instances, beyond our control. Actual results, performance or achievements could differ materially from those contemplated, expressed, or implied by the forward-looking statements.

The following factors, among others, could cause our financial performance to differ materially from that expressed in such forward-looking statements:

- The strength of the United States economy in general and the strength of the local economies in which we conduct operations;

- The effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System (the “Federal Reserve”);
- Inflation/deflation, interest rate, market and monetary fluctuations;
- The timely development of competitive new products and services and the acceptance of these products and services by new and existing customers;
- The willingness of users to substitute competitors’ products and services for our products and services;
- The impact of changes in financial services policies, laws and regulations, including those concerning taxes, banking, securities and insurance, and the application thereof by regulatory bodies;
- Technological changes;
- The effect of acquisitions we may make, if any, including, without limitation, the failure to achieve the expected revenue growth and/or expense savings from such acquisitions;
- Changes in the level of our nonperforming assets and charge-offs;
- Oversupply of inventory and continued deterioration in values of California real estate, both residential and commercial;
- The effect of changes in accounting policies and practices, as may be adopted from time-to-time by bank regulatory agencies, the U.S. Securities and Exchange Commission (“SEC”), the Public Company Accounting Oversight Board (“PCAOB”), the Financial Accounting Standards Board or other accounting standards setters;
- Possible other-than-temporary impairments (“OTTI”) of securities held by us;
- The impact of current governmental efforts to restructure the U.S. financial regulatory system, including enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”);
- Changes in consumer spending, borrowing and savings habits;
- The effects of our lack of a diversified loan portfolio, including the risks of geographic and industry concentrations;
- Ability to attract deposits and other sources of liquidity;
- Changes in the financial performance and/or condition of our borrowers;
- Changes in the competitive environment among financial and bank holding companies and other financial service providers;
- Geopolitical conditions, including acts or threats of terrorism, actions taken by the United States or other governments in response to acts or threats of terrorism and/or military conflicts, which could impact business and economic conditions in the United States and abroad;
- Unanticipated regulatory or judicial proceedings; and
- Our ability to manage the risks involved in the foregoing.

If one or more of the factors affecting our forward-looking information and statements proves incorrect, then our actual results, performance or achievements could differ materially from those expressed in, or implied by, forward-looking information and statements contained in this Annual Report on Form 10-K. Therefore, we caution you not to place undue reliance on our forward-looking information and statements. We will not update the forward-looking statements to reflect actual results or changes in the factors affecting the forward-looking statements.

Overview

We are a California-based bank holding company incorporated in 1997 in the State of Delaware and registered as a banking holding company under the Bank Holding Company Act of 1956, as amended (“BHCA”), for Pacific Premier Bank, a California state-chartered commercial bank. The Bank is subject to examination and regulation by the Federal Reserve, the California Department of Financial Institutions (the “DFI”), and by the Federal Deposit Insurance Corporation (the “FDIC”).

We conduct business throughout Southern California from our ten locations in the counties of Los Angeles, Orange, Riverside and San Bernardino. We operate depository branches in the cities of Huntington Beach, Irvine, Los Alamitos, Newport Beach, Palm Desert, Palm Springs, San Bernardino and Seal Beach, California. Our corporate headquarters are located in Irvine, California.

We provide banking services within our targeted markets in Southern California to businesses and consumers in the communities we serve. Through our branches and our Internet website at www.ppbi.com, we offer a broad array of deposit products and services for both business and consumer customers, including checking, money market and savings accounts, cash management services, electronic banking, and on-line bill payment. We also offer a wide array of loan products, such as commercial business loans, lines of credit, commercial real estate loans, U.S. Small Business Administration (“SBA”) loans, residential home loans, home equity lines of credit and consumer loans. At December 31, 2012, we had consolidated total assets of $1.2 billion, net loans of $977.9 million, total deposits of $904.8 million, and consolidated total stockholders’ equity of $134.5 million. At December 31, 2012, the Bank was considered a “well-capitalized” financial institution for regulatory capital purposes.

Recent Developments

Pacific Premier Bancorp, Inc. and San Diego Trust Bank

On March 6, 2013, the Company announced that it had entered into a definitive agreement to acquire San Diego Trust Bank (OTCBB: SDBK), a San Diego, California, based state-chartered bank with $242.0 million in total assets and $187.9 million in total deposits at December 31, 2012. This transaction will expand Pacific Premier’s banking footprint into San Diego County and is expected to further improve Pacific Premier’s deposit mix. At the time the definitive agreement was entered into, the acquisition of San Diego Trust Bank was valued at approximately $30.6 million. San Diego Trust Bank shareholders will have a choice between electing to receive $13.41 per share in cash or 1.114x shares of PPBI common stock for each share of San Diego Trust Bank or a combination thereof, subject to the overall requirement that 50% of the consideration will be in the form of cash and 50% will be in the form of PPBI stock. The number of shares of Pacific Premier common stock to be issued to San Diego Trust Bank shareholders is based on a fixed exchange ratio provided that Pacific Premier’s stock price remains between $10.83 and $13.24 as measured by the 10-day average closing price immediately prior to closing of the transaction. The value of the stock portion of consideration will fluctuate based on the value of PPBI common stock. The transaction is expected to close late in the second quarter of 2013 or in the third quarter of 2013, subject to satisfaction of customary closing conditions, including regulatory approvals and approval of San Diego Trust Bank shareholders.

Pacific Premier Bancorp, Inc. and First Associations Bank

On October 15, 2012, the Company announced that it had entered into an Agreement and Plan of Reorganization (the “Merger Agreement”) to acquire First Associations, a Texas-chartered bank (“FAB”). FAB is a specialized bank headquartered in Dallas, Texas, that focuses exclusively on serving homeowners associations (“HOAs”) and HOA management companies nationwide. At September 30, 2012, FAB had $356.2 million in total assets and $305.5 million in total deposits. If the acquisition of FAB is consummated, it will provide the Bank with a valuable source of low-cost core deposits that are expected to strengthen the Bank’s existing deposit base and lower its overall funding cost. On the date of the Merger Agreement, the transaction was valued at $53.7 million, which includes approximately $50.2 million in deal consideration for FAB shareholders and approximately $3.5 million in cash consideration for FAB option holders and FAB warrant holders. The $50.2 million of deal consideration for FAB shareholders includes $37.6 million in cash consideration, which is subject to adjustment, and 1,279,228 shares of Company common stock to be issued to FAB shareholders, which shares had a value of approximately $12.5 million based on the Company’s five-day average closing price immediately prior to announcement of the transaction. The transaction is expected to close late in the first quarter of 2013, subject to satisfaction of the closing conditions described in the Merger Agreement and other customary closing conditions.

Palm Desert National Bank

Effective April 27, 2012, the Bank acquired certain assets and assumed certain liabilities of Palm Desert National Bank (“Palm Desert National”) from the FDIC as receiver for Palm Desert National (the “Palm Desert National Acquisition”), pursuant to the terms of a purchase and assumption agreement entered into by the Bank and the FDIC on April 27, 2012. The Palm Desert National Acquisition included one branch of Palm Desert National that became a branch of the Bank upon consummation of the Palm Desert National Acquisition. The Bank did not enter into any loss sharing agreements with the FDIC in connection the Palm Desert national Acquisition. As a result of the Palm Desert National Acquisition, the Bank acquired and recorded at the acquisition date certain assets with a fair value of approximately $120.9 million and certain liabilities with a fair value of approximately $118.0 million. The fair values of the assets acquired and liabilities assumed were determined based on the requirements of FASB Accounting Standards Codification (“ASC”)Topic 820: Fair Value Measurements and Disclosures.

Canyon National Bank

Effective February 11, 2011, the Bank acquired certain assets and assumed certain liabilities of Canyon National Bank (“Canyon National”) from the FDIC as receiver for Canyon National (the “Canyon National Acquisition”), pursuant to the terms of a purchase and assumption agreement entered into by the Bank and the FDIC on February 11, 2011. The Canyon National Acquisition included the three branches of Canyon National, all of which became branches of the Bank upon consummation of the Canyon National Acquisition. The Bank did not enter into any loss sharing agreements with the FDIC in connection with the Canyon National Acquisition. As a result of the Canyon National Acquisition, the Bank acquired and received certain assets with a fair value of approximately $208.9 million, and liabilities with a fair value of approximately $206.6 million. The fair values of the assets acquired and liabilities assumed were determined based on the requirements of FASB ASC Topic 820: Fair Value Measurements and Disclosures.

Operating Strategy

The Bank was founded in 1983 as a state chartered savings and loan, became a federally chartered stock savings bank in 1991 and, in March 2007, converted to a California-chartered commercial bank. Our primary goal is to develop the Bank into one of Southern California’s top performing commercial banks as an alternative to the large regional and national banks for businesses, professionals, entrepreneurs and non-profit organizations for the long term benefit of our stockholders, customers and employees. The following are our operating strategies which we have adopted in order to achieve this goal:

Expansion through Acquisitions. Many banks have been negatively impacted by the economic environment, which we expect will lead to the continued consolidation and elimination of certain competitors. We intend to take advantage of this opportunity by pursuing additional acquisitions of open banks, FDIC-assisted transactions and the acquisition of non-depository asset generating and fee income producing businesses. Management has a proven track record of analyzing, executing upon, and integrating acquisitions, and we expect to continue to leverage this ability.

Expansion through Organic Growth. We believe that profitable businesses are not having their needs met either from a service level or credit availability basis from their current bank. Thus over the years we have developed a high performing sales culture resulting in effective cold calling by our business bankers. Management diligently monitors the quantity and quality of calls, while senior commercial bankers are utilized to train and assist with closing of new relationships. Our business bankers are focused on developing long term relationships with business owners, professionals, entrepreneurs, and non-profit organizations through consistent and frequent contact. Additionally, our bankers are actively involved in community organizations and events, thus building and capitalizing on the Bank’s reputation within the local communities we serve.

Diversifying our Deposit and Loan Portfolios. We believe franchise value is created through growth in low cost transaction accounts, principally business and consumer checking accounts. Customers that utilize checking accounts and the Banks other related products and services often become our most valuable relationships due to our ability to reduce interest costs associated with these customer accounts and in turn, generate greater fee income. We also believe it is important to diversify our loan portfolio in order to manage credit risks and to meet the financial services needs of our expanding client base. As part of our commercial banking platform, we have increased the amount of owner-occupied commercial real estate (“CRE”) loans, commercial and industrial (“C&I”) loans, Small Business Administration (“SBA”) loans and warehouse lending relationships within the portfolio. We will seek to add additional products to diversify the loan portfolio and add fee income while developing complementary product lines and services that further our primary goal.

Enterprise Risk Management. Management is committed to Enterprise Risk Management (“ERM”) program to help ensure Bank-wide risks are being well managed. As the Bank grows and introduces new business lines and product offerings, both its level of complexity and overall risk increases. Risk is the potential that events, expected or unanticipated, may have an adverse effect on the Bank’s earnings, capital, or franchise value. As such, the Bank will develop and maintain an enterprise-wide ERM program to help it manage the risks that are inherent to the Bank’s operations.

Proactive Asset Management and Sound Credit Quality. Our conservative credit and risk management culture has resulted in relatively low levels of nonperforming loans and an overall high credit quality within the loan portfolio as compared to our peer banks (California banks with between $1 billion and $3 billion in total assets.) Our portfolio management strategies involve the early identification of loan weakness, aggressive collection techniques, loss mitigation through loan sales and/or working with third parties to refinance the credit. We will continue to monitor economic trends and conditions that could positively or negatively impact our business. We seek to take advantage of these trends by entering or exiting certain lines of business or offering or eliminating various loan product types, as evidenced by our decision to curtail our multi-family and commercial non-owner occupied real estate lending. We will continue to monitor our risk management practices relative to changes in our local economy that impact our business.

Financial Management. We actively manage the Company’s liquidity and capital resources in order to achieve an optimal level of capital and a high quality, diversified loan portfolio that is funded through a stable, low cost core deposit base. Liquidity and interest rate risk are structured in conjunction with our capital, assets and liabilities with the goal of achieving optimal earnings throughout the business cycle.

Our executive offices are located at 17901 Von Karman Avenue, Suite 1200, Irvine, California 92614 and our telephone number is (949) 864-8000. Our Internet website address is www.ppbi.com. Our Annual Reports on

Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and all amendments thereto, from 1998 to present that have been filed with the SEC, are available free of charge on our Internet website. Also on our website are our Code of Ethics, Insider Trading and Beneficial Ownership forms, and Corporate Governance Guidelines. The information contained in our website, or in any websites linked by our website, is not a part of this Annual Report on Form 10-K.

Lending Activities

General. In 2012, we maintained our commitment to a high level of credit quality in our lending activities. We also diversified our loan portfolio during the prior fiscal year by, among other things, significantly increasing the origination of warehouse repurchase facilities to qualified mortgage bankers operating principally in California. We continue to focus our efforts on meeting the financial needs of qualified individuals and local businesses. To that end, the Company offers a full complement of flexible and structured loan products tailored to meet the diverse needs of our customers.

During 2012, we made or purchased loans to borrowers secured by real property and business assets located principally in Southern California, our market area. We also began to make loans, primarily U.S. Small Business Administration guaranteed loans, throughout the 12th Federal Reserve District and in the state of Texas. We emphasize relationship lending and focus on generating loans with customers who also maintain full depository relationships with us. These efforts assist us in establishing and expanding depository relationships consistent with the Company's strategic direction. We maintain an internal lending limit below our $35.4 million legal lending limit for secured loans and $21.2 million for unsecured loans as of December 31, 2012. During 2012, we originated or purchased $193.7 million of warehouse facilities, $117.9 million of commercial non-owner occupied real estate loans, $58.8 million of single family real estate loans, $47.2 million of C&I loans, $39.3 million of owner occupied commercial real estate loans, $28.5 million of multi-family real estate loans, $8.6 million of SBA loans, $5.4 million of land loans and $4.3 million of construction and other loans. At December 31, 2012, we had $986.2 million in total gross loans outstanding.

Commercial and Industrial Lending. We originate C&I loans secured by business assets including inventory, receivables, machinery and equipment to businesses located in our primary market area. In many instances, real estate holdings of the borrower, its principals or loan guarantors are also taken as collateral. Loan types include revolving lines of credit, term loans, seasonal loans and loans secured by liquid collateral such as cash deposits or marketable securities. We also issue letters of credit on behalf of our customers, backed by loans or deposits with the Company. At December 31, 2012, C&I loans totaled $115.4 million, constituting 11.7% of our gross loans, and we had additional commitments to extend credit on C&I loans of $37.9 million.

Commercial Owner Occupied Business Lending. We originate and purchase loans secured by commercial owner occupied real estate, such as retail buildings, small office and light industrial buildings, and mixed-use commercial properties located predominantly in Southern California. We also make loans secured by special purpose properties, such as gas stations. Pursuant to our underwriting policies, commercial owner occupied real estate loans may be made in amounts of up to 75% of the lesser of the appraised value or the purchase price of the collateral property. Loans are generally made for terms up to 30 years with amortization periods up to 30 years. At December 31, 2012, we had $150.9 million of commercial owner occupied real estate secured loans, constituting 15.3% of our gross loans.

SBA Lending. The Company is approved to originate loans under the SBA's Preferred Lenders Program ("PLP"). The PLP lending status affords the Company a higher level of delegated credit autonomy, translating to a significantly shorter turnaround time from application to funding, which is critical to our marketing efforts. We originate loans under the SBA's 7(a), Express, Patriot Express and 504 loan programs, in conformity with SBA underwriting and documentation standards. The guaranteed portion of the 7(a) loans is typically sold on the secondary market. At December 31, 2012, we had $6.9 million of SBA loans, constituting 0.7% of our gross loans.

Warehouse Repurchase Facilities. We originate warehouse repurchase facilities to qualified mortgage bankers operating principally in California. These facilities provide short-term funding for one-to-four family mortgage loans via a mechanism whereby the mortgage banker sells us closed loans on an interim basis, to be repurchased in conjunction with the sale of each loan on the secondary market. We carefully underwrite and monitor the financial strength and performance of all counterparties to the transactions, including the mortgage bankers, secondary market participants and closing agents. We generally purchase only conforming/conventional (Federal National Mortgage Association ("FNMA"), Federal Home Loan Mortgage Corporation ("FHLMC")) and government guaranteed (Federal Housing Administration ("FHA"), Veterans Administration ("VA") and U.S. Department of Agriculture ("USDA")) credits, and only after thorough due diligence including sophisticated fraud checks. At December 31, 2012, warehouse loans totaled $195.8 million constituting 19.9% of our gross loans, and had additional commitments to extend credit of $72.2 million.

Commercial Non-Owner Occupied Real Estate Lending. We originate and purchase loans that are secured by commercial real estate, such as retail centers, small office and light industrial buildings, and mixed-use commercial properties that are not occupied by the borrower and are located predominantly in Southern California. We also make loans secured by special purpose properties, such as hotels. Pursuant to our underwriting practices,, commercial non-owner occupied real estate loans may be made in amounts up to 75% of the lesser of the appraised value or the purchase price of the collateral property. We consider the net operating income of the property and typically require a stabilized debt service coverage ratio of at least 1.20:1, based on the qualifying interest rate. Loans are generally made for terms up to 30 years with amortization periods up to 30 years. At December 31, 2012, we had $253.4 million of commercial non-owner occupied real estate secured loans, constituting 25.6% of our gross loans.

Multi-family Real Estate Lending. Although we were not an active multi-family lender in 2012, on occasion, we originate and purchase loans secured by multi-family residential properties (five units and greater) located predominantly in Southern California. Pursuant to our underwriting practices, multi-family residential loans may be made in an amount up to 75% of the lesser of the appraised value or the purchase price of the collateral property. In addition, we generally require a stabilized minimum debt service coverage ratio of 1.15:1, based on the qualifying loan interest rate. Loans are made for terms of up to 30 years with amortization periods up to 30 years. As part of our desired strategy to diversify the loan portfolio, we substantially reduced the origination of multi-family real estate loans beginning in late 2007. Historically, we have managed our concentration in multi-family real estate loans by selling excess loan production. However, in recent periods, the level of loan sales has decreased significantly due to dislocations in the credit markets. Multi-family loan sales remain a strategic option for us. At December 31, 2012, we had $156.4 million of multi-family real estate secured loans, constituting 15.9% of our gross loans.

One-to-Four Family Real Estate Lending. We participate in single family lending on occasion, mainly through purchases, to diversify our portfolio; and, in keeping with the Company's strategy of offering a full complement of loan products to customers, we have occasionally funded home loans to banking customers. When we do originate or purchase loans we do not engage in Alt-A or subprime lending. The Company's portfolio of one-to-four family loans at December 31, 2012 totaled $97.4 million, constituting 9.9% of our gross loans, of which $88.3 million consists of loans secured by first liens on real estate and $9.1 million, consists of loans secured by second or junior liens on real estate.

Other Loans. We originate other consumer loan products, generally for banking customers only, which consist primarily of savings account loans and auto loans. Before we make a consumer loan, we assess the applicant's ability to repay the loan and, if applicable, the value of the collateral securing the loan. At December 31, 2012, we had $1.2 million in other loans that represented 0.1% of our gross loans.

Interest Rates on Our Loans. We employ a risk-based pricing strategy on all loans that we fund. The interest rates, fees and loan structure of our loans generally vary based on a number of factors, including the degree of credit risk, size, maturity of the loan, a borrower's business or property management expertise, and prevailing market rates for similar types of loans, as well as the deposit balances the borrower maintains with us. Adjustable rate C&I and SBA loans are typically priced based on a margin over the Prime rate, while warehouse repurchase facilities are priced over the London Inter-Bank Offered Rate (“LIBOR”). Commercial real estate loans are typically 3, 5, 7 or 10-year fixed rate hybrid adjustable-rate loans and are based on one of several interest rate indices. Many of the C&I loans and substantially all of the non-owner occupied real estate loans originated by the Company in 2012 had minimum interest rates, or floor rates, below which the rate charged may not be reduced regardless of further reductions in the underlying interest rate index. Substantially all of our non-owner occupied commercial real estate loans also include prepayment penalties.

Lending Risks on Our Loans. Lending risks vary by the type of loan extended. In our C&I and SBA lending activities, collectability of the loans may be adversely affected by risks generally related to small and middle market businesses, such as:

- Changes or continued weakness in general or local economic conditions;
- Changes or continued weakness in specific industry segments, including weakness affecting the business’ customer base;
- Changes in consumer behavior;
- Changes in a business’ personnel;
- Increases in supplier costs that cannot be passed along to customers;
- Increases in operating expenses (including energy costs);
- Changes in governmental rules, regulations and fiscal policies;
- Increases in interest rates, tax rates; and
- Other factors beyond the control of the borrower or the lender.

In our investor real estate loans, payment performance and the liquidation values of collateral properties may be adversely affected by risks generally incidental to interests in real property, such as:

- Changes or continued weakness in general or local economic conditions;
- Changes or continued weakness in specific industry segments;
- Declines in real estate values;
- Declines in rental rates;
- Declines in occupancy rates;
- Increases in other operating expenses (including energy costs);
- The availability of property financing;
- Changes in governmental rules, regulations and fiscal policies, including rent control ordinances, environmental legislation and taxation;
- Increases in interest rates, real estate and personal property tax rates; and
- Other factors beyond the control of the borrower or the lender.

In our warehouse repurchase facilities, performance is generally driven by the routine operation of the secondary market for one-to-four family mortgage loans. Primary risks include:

- The financial and operational health of the GSE agencies (FNMA and FHLMC);
- The ongoing commitment of U.S. Government agencies (FHA, VA and USDA) to the one-to-four family mortgage market;
- Major interest rate shocks; and
- Widespread loan fraud on the part of one of our counterparties.

We attempt to mitigate these risks through sound and prudent underwriting practices, as well as a proactive loan review process and our risk management practices. See “Lending Activities - Underwriting and Approval Authority for Our Loans” immediately below. We will not extend credit to any one borrower that is in excess of regulatory limits.

Underwriting and Approval Authority for Our Loans. Our board of directors establishes our lending policies. Each loan must meet minimum underwriting criteria established in our lending policies and must be consistent with our overall strategies for yield, interest rate risk, and portfolio concentrations. The underwriting and quality control functions are managed through our corporate office. Each loan application is evaluated from a number of underwriting perspectives. For C&I and SBA loans, underwriting considerations include historic business cash flows, debt service coverage, loan-to-value ratios of underlying collateral, if any, debt to equity ratios, credit history, business experience, history of business, forecasts of operations, economic conditions, business viability, net worth, and liquidity. For loans secured by real estate, underwriting considerations include property appraised value, loan-to-value ratios, level of debt service coverage utilizing both the actual net operating income and forecasted net operating income and use and condition of the property, as well as the borrower's liquidity, income, credit history, net worth, and operating experience. We do not offer loans on a limited- or no-documentation basis unless fully secured by cash collateral.

Business loans are generally originated as recourse or with full guarantees from key borrowers or borrower principals. Loans secured by real estate are likewise generally originated on a full recourse basis. On loans made to entities, such as partnerships, limited liability companies, corporations or trusts, we typically obtain personal guarantees from the appropriate managing members, major stockholders, trustees or other appropriate principals. In 2012, substantially all of our loans to entities were originated with full recourse and/or personal guarantees from the principals of the borrowers.

Prior to processing and underwriting any loan request, we issue a letter of interest based on a preliminary analysis by our bankers, which letter details the terms and conditions on which we will consider the loan request. Upon receipt of the signed letter of interest, a completed loan application and a deposit, a credit report and other required reports are ordered and, if necessary, additional information is requested. Upon receipt of all requested information, we process and underwrite each loan application and prepare all the loan documentation after the loan has been approved.

Our credit memorandums, which are prepared by our underwriters, include a description of the transaction and prospective borrower and guarantors, the collateral securing the loan, if any, the proposed uses of loan proceeds and source(s) of repayment, as well as an analysis of the borrower's business and personal financial statements and creditworthiness. The financial statements and creditworthiness of any guarantors are also analyzed. For loans secured by real property, the credit memorandum will include an analysis of the property. Loans for which real estate is the primary collateral require an independent appraisal conducted by a licensed appraiser. All appraisal reports are appropriately reviewed by our appraisal department. Our board of directors reviews and approves annually the independent list of acceptable appraisers. When appropriate, environmental reports are obtained and reviewed as well.

Following loan approval and prior to funding, our underwriting and processing departments ensure that all loan approval terms have been satisfied, that those terms conform with lending policies (or are properly documented as exceptions with required approvals), and that all the required documentation is present and in proper form.

Business loans are subject to the Company's guidelines regarding appropriate covenants and periodic monitoring requirements which may include, but are not limited to:

- Capital and lease expenditures;
- Capital levels;
- Salaries and other withdrawals;
- Working capital levels;
- Debt to net worth ratios;
- Sale of assets;
- Change of management;
- Change of ownership;

· Cash flow requirements;
· Profitability requirements;
· Debt service ratio;
· Collateral coverage ratio; and
· Current and quick ratios.

Subject to the above standards, our board of directors delegates authority and responsibility to management for loan approvals. The Management Loan Committee is comprised of our President/Chief Executive Officer, Chief Credit Officer, Chief Banking Officer, and 1st Vice President Senior Credit Manager. Our Vice President Senior Commercial Underwriters serve as secondary approval signers. Depending upon the loan amount and nature of collateral, loans require either two or three approval signatures, with at least one such signature coming from a Credit Committee member. Real-estate secured loans above $5 million and business loans not fully secured by real estate above $2 million require approval from the President/Chief Executive Officer.

Portfolio Management and Loan Servicing. Portfolio management and loan servicing activities are centralized at our corporate headquarters. Our loan servicing operations are designed to provide prompt customer service and accurate and timely information for account follow-up, financial reporting and loss mitigation. Following the funding of an approved loan, the data is entered into our data processing system, which provides monthly billing statements, tracks payment performance, and effects agreed upon interest rate adjustments. Loan servicing activities include (i) collecting and remitting loan payments, (ii) accounting for principal and interest and other collections and expenses, and (iii) holding and disbursing escrow or impounding funds for real estate taxes and insurance premiums.

Our portfolio management operations are designed to ensure that management and the board of directors has timely and comprehensive information regarding the performance of our loan portfolio. This information provides an essential leading indicator of potential performance issues prior to loan payment delinquency. For each of the Company's non-homogeneous loans, our Portfolio Managers collect financial information from borrowers and guarantors in order to conduct a detailed loan review in accordance with our policies, generally annually or more often as appropriate, but in no case less than biennially. The Portfolio Managers also visit properties and businesses on a periodic basis to perform inspections of our collateral and associated revenue-generating activities of borrowers. In conjunction with the loan review process, all loans in the portfolio are assigned a risk grade that, among other purposes, factors into the Company's allowance for loan and lease loss calculations.

When payments are not received by their contractual due date, collection efforts are initiated by our loss mitigation personnel. Accounts past-due by more than 10 days are assigned to our collector for comprehensive payment collection efforts. Our Portfolio Managers conduct an evaluation of all loans 90 days or more past due or otherwise identified as impaired by obtaining an estimate of value on the underlying collateral and an analysis of such collateral. The evaluation may result in our partial or complete charge off of the loan, but collection efforts still continue. Portfolio Managers also conduct discussions with borrowers in order to identify whether alternatives to foreclosure exist. When foreclosure will maximize the Company's recovery for a non-performing loan, the Portfolio Managers will carry out the foreclosure process, including any associated judicial legal actions.

Loan Portfolio Composition. At December 31, 2012, our net loans receivable held for investment totaled $974.2 million and our loans receivable held for sale totaled $3.7 million. The types of loans that the Company may originate are subject to federal and state law.

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

| At December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 2012 | | | 2011 | | | 2010 | | |
| Amount | % of Total | Weighted Average | Amount | % of Total | Weighted Average | Amount | % of Total | Weighted Average |

| | | | Interest Rate | | | Interest Rate | | | Interest Rate |
|---|---|---|---|---|---|---|---|---|---|
| | | | | (dollars in thousands) | | | | | |
| Real estate loans: | | | | | | | | | |
| Multi-family | $156,424 | 15.9% | 5.8% | $193,830 | 26.2% | 6.0% | $243,584 | 42.9% | 6.2% |
| Commercial non-owner occupied | 253,409 | 25.6% | 5.7% | 164,341 | 22.2% | 6.6% | 130,525 | 22.9% | 6.7% |
| One-to-four family (1) | 97,463 | 9.9% | 4.7% | 60,027 | 8.1% | 5.1% | 20,318 | 3.6% | 5.4% |
| Land | 8,774 | 0.9% | 4.9% | 6,438 | 0.9% | 5.8% | - | 0.0% | 0.0% |
| Business loans: | | | | | | | | | |
| Commercial owner occupied (2) | 150,934 | 15.3% | 6.1% | 152,299 | 20.6% | 6.6% | 113,025 | 20.0% | 6.6% |
| Commercial and industrial | 115,354 | 11.7% | 5.3% | 86,684 | 11.7% | 5.8% | 42,077 | 7.5% | 6.3% |
| Warehouse facilities | 195,761 | 19.9% | 4.8% | 67,518 | 9.1% | 5.4% | 12,610 | 2.2% | 6.1% |
| SBA | 6,882 | 0.7% | 6.0% | 4,727 | 0.7% | 6.0% | 4,088 | 0.7% | 5.9% |
| Other loans | 1,193 | 0.1% | 6.2% | 3,390 | 0.5% | 7.6% | 1,417 | 0.2% | 4.5% |
| Total gross loans | 986,194 | 100.0% | 5.4% | 739,254 | 100.0% | 6.1% | 567,644 | 100.0% | 6.4% |
| Less loans held for sale | 3,681 | | | - | | | - | | |
| Total gross loans held for investment | 982,513 | | | 739,254 | | | 567,644 | | |
| Plus (less) for: | | | | | | | | | |
| Deferred loan origination costs (fees) and premiums (discounts) | (306) | | | (665) | | | (3,227) | | |
| Allowance for loan losses | (7,994) | | | (8,522) | | | (8,879) | | |
| Loans held for investment, net | $974,213 | | | $730,067 | | | $555,538 | | |

2009 2008

| | Amount | % of Total | Weighted Average Interest Rate | Amount | % of Total | Weighted Average Interest Rate |
|---|---|---|---|---|---|---|
| | | | (dollars in thousands) | | | |
| Real estate loans: | | | | | | |
| Multi-family | $278,744 | 48.4% | 6.2 % | $287,592 | 45.7% | 6.3 % |
| Commercial non-owner occupied | 149,577 | 26.0% | 6.8 % | 163,428 | 26.0% | 7.0 % |
| One-to-four family (1) | 8,491 | 1.5 % | | | | |